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**FINANCIAL SYSTEM IN ECONOMIC DEVELOPMENT:
THE NATURE AND ROLE OF A ROBUST FINANCIAL SYSTEM IN
THE ECONOMIC TRANSFORMATION OF UGANDA**

A Thesis

Submitted to

John F. Donahue Graduate School of Business

Duquesne University

By

Frederick Leo Nkwasiwe, A.J

Summer 2005

THESIS TOPIC AND COMMITTEE APPROVAL SHEET

DUQUESNE UNIVERSITY
JOHN F. DONAHUE GRADUATE SCHOOL OF BUSINESS

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ABSTRACT

Financial System in Economic Development: The Nature and Role of Robust Financial System in the Economic Transformation of Uganda is a thesis that treats the nature and role of the massive network of efficient as opposed to dysfunctional financial institutions and functions in the mobilization and allocation of financial resources for creative investment and economic transformation of Uganda.

The thesis suggests that a market-focused robust financial system utilizing a *Rural Reach Refocus Financial Model* (the 3-R Financial Model), spurs the entrepreneurial revolution, offers debt and equity financing, and enhances economic transformation. It also highlights the basic conditions for the success of the 3-R Financial Model, which are awareness and attitude change, information efficacy, competition candor and government friendly intervention.

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DEDICATION

I dedicate this academic work to those who have had greater impact on my vocation and profession and those who have supported and encouraged me, principally

1. My Family Members , Relatives , and Friends,
2. The Religious and Missionary Institute of the Apostles of Jesus,
3. St. Bede Parish Community, Point Breeze, Pittsburgh, PA, USA, and
4. Members of Kyerero-Italia Solidale, Uganda, East Africa.

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CHAPTER ONE

1 GENERAL INTRODUCTION

1.1 Prologue

The subject of low income and high poverty levels in Uganda, interrelated with dependency on donors, is a growing economic concern. Hence, searching for a sustainable solution to this quandary has become inevitable in the academics and policymakers' loop. Lessening reliance on donors and increasing domestic productivity through efficient mobilization of national and international financial resources and appropriate allocation of these assets stand out as the best way forward.

But of all eight principal economic systems, which include the (i) supply and value chain system, (ii) market system (market / managed economy), (iii) price system, (iv) trading system, (v) financial system, (vi) national accounting system ($Y=C+I+G+X-M$), (vii) monetary system, and (viii) taxation system, a robust financial system shines as an outstanding system capable of spearheading the lessening of reliance on donors and increasing domestic productivity, thereby transforming a country from mass poverty to richness and improved living standards.

As a consequence of this discernment, it further follows that a two-fold goal is critical and significant for us: (1) to become aware of the nature and role of a robust financial system as an outstanding economic system and (2) to make it today's priority to construct a robust financial system to enhance Uganda's economic transformation. Exploration and discussion of this two-fold economic goal is the focus of this thesis.

This chapter elucidates subject matter, provides definition of basic terms and a glossary, describes the purpose of the thesis, reviews the existing literature, provides

statements of the problem and delimitations, describes the hypothesis, research methods, the structure of the thesis, and gives chapter-by-chapter outline and a justification for the study.

1.2 Topic

Rooted in the discipline of economics and approached from a financial economics perspective, this topic is comprehensive, interesting, enterprising and challenging. As its name implies, **Financial System in Economic Development: The Nature and Role of Robust Financial System in the Economic Transformation of Uganda** is a thesis that treats the nature and role of the massive network of financial institutions and functions in the economy which mobilize and allocate resources, coordinate saving and investment and make lenders and borrowers correspond. Savings and investment are ingredients of long term economic growth and transformation.

Just as a country needs communication and transport systems to supply its needs and the body has a circulatory system for its transportation needs, so an economy requires its own circulatory system to service its multiple needs. In the economy, this is the financial system, a massive network of financial institutions and functions that nurtures and carries capital everywhere.

Because saving and investment are basic ingredients to long-term economic growth and development, it is imperative that we comprehend how a robust financial system in Uganda through a saving and investment multiplier effect helps to pair and steer one person's domestic and global saving with another person's domestic and global investment to promote sustained economic growth and development.

1.3 Basic Concepts / Definitions

1.3.1 Thesis

Quoting Rummel and Ballaine, the Duquesne University Thesis Program states that a *“thesis should have a problem as its topic. It should not be solely the tabulation of answers to a questionnaire sent out to members of a trade association or a summation of answers to identical questions obtained by interviews. Neither should it be a mere recitation of facts, even though the facts may be historical and not previously available. A thesis must include an analysis or more conclusions based on this analysis.”*¹

Thus, a thesis is a position or proposition that a person (as a candidate for scholastic honors) advances and offers to maintain by argument. It is an analysis embodying results of original research and especially substantiating a specific view; especially one written by a candidate for an academic degree.² A completed thesis must be a construction of the author’s own thoughts and judgment held up by the ideas or information of others in the field. Moreover, the topic of a thesis submitted to the John F. Donahue Graduate School of Business of Duquesne University must be in the area of business and/or economics.

1.3.2 Role

The dictionary defines the term *role* as a function, position, responsibility, task, job, part or character. Throughout this work, we shall use the term *role* chiefly to signify a function or part performed by a robust financial system in the economic transformation of Uganda.

¹ The Thesis Program Pamphlet for Duquesne University Graduate School of Business Administration, Revised 9/99:4

² Merriam-Webster’s Collegiate Dictionary. 10ed. Springfield, Massachusetts: Merriam-Webster, Incorporated < An Encyclopedia Britannica Company > 1993:1220

1.3.3 Robust

The term *robust* means being healthy, vigorous, hearty, full-bodied, strong, tough, stout and forceful. Throughout this work, the term *robust* shall be used to signify a financial system that is well-functioning, efficient and effective as demonstrated by the following characteristics:

- 1) Strongly formed and not frail and feeble or easily shaken or prone to a number of internal and external vulnerabilities;
- 2) Transparently conducted: a system is transparent when accurate information is available to all intermediary and market participants;
- 3) Informationally efficient: security prices adjust rapidly to the arrival of new information ;
- 4) Healthy in depth, value and volume in operation and performance;
- 5) Efficiently developed in units, level, structure and sector; not underdeveloped;
- 6) Integrated and connected virtually, vertically and horizontally;
- 7) Composed of a variety of financial market instruments;
- 8) Diversified to reduce or balance risks; diversification opportunities across assets, classes, capitalization sizes, sectors, industries, and countries;
- 9) Considerable penetration and dispersion in locations; outreach and output; and
- 10) Exhibiting structural, functional and technical strengths enhanced by information and competition competencies.

In brief, a robust financial system – financial intermediaries and markets – must possess all or almost all of the following efficiencies: informational, pricing, allocative, operational, diversification, depth, and integration or connectedness. Consequently, a financial system is robust and efficient enough if and/or when the market price or actual

price of the financial assets or securities traded in and by the financial intermediaries and markets is equal to their intrinsic value.

1.3.4 Financial System

A concept of financial system is constructed from two words: finance and system. Before defining the concept of financial system, it is important that we understand the meaning of each word separately.

1.3.4.1 Finance

Finance, whose principal hub is the workings of the financial institutions and the supply, demand and pricing of financial assets, is a subfield of economics that examines how individuals and organizations make decisions concerning the allocation of resources over time and the management of risks. It is an art and science of managing risks, monetary assets and returns. For example, individuals, households, organizations, and governments raise money and decide how to spend and invest it. Finance is concerned with the whole process of acquiring the money that individuals, organizations and governments require, and spending and investing that money in the most proficient and effectual manner.

1.3.4.2 System

System stems from a Greek word: *systemat or systema* – meaning to *combine*.³ A system is a combination or a massive network of organs or institutions that enable coordinated functioning of an entity. For example, biologically, a system is a collection of organs that work together to carry out a particular function. For instance, a human

³ Merriam-Webster's Collegiate Dictionary. 10ed. Springfield, Massachusetts: Merriam-Webster, Incorporated < An Encyclopedia Britannica Company > 1993:1194

body has the following systems: (i) skeletal, (ii) muscular, (iii) nervous, (iv) circulatory, (v) respiratory, (vi) digestive, (vii) lymphatic, (viii) urinary, (ix) hormonal, and (x) reproductive. These major systems “support the body, move it, control its activities, transport materials around it, remove waste from it, supply it with oxygen and food, and enable it to reproduce itself.”⁴

On the other hand, a financial system, which is one of the major systems of economic life, functions to mobilize resources and allocate assets, make borrowers and lenders correspond and enable savings and investments to match.

1.3.4.3 Robust versus inefficient financial system

Robustness and efficiency imply that the market price or actual price and intrinsic value of financial assets traded in the loanable funds market are equal. Although all financial systems are supposed to be robust and efficient, not all financial institutions are robust, efficient and effective. For example, financial markets in developed or industrialized countries are almost efficient, that is, new information is promptly mirrored in financial asset prices but those in low-income developing countries are distantly efficient. Some are more efficient than others and some others are totally inefficient and ineffective. Inefficient financial systems lack market transparency and are dysfunctional, informationally imperfect, undeveloped, disintegrated, shallow, and fragile.

A robust financial system is like a healthy circulatory system in a human body, because it is essential to the allocation of resources in an economy, just as the circulatory system, a massive network of blood vessels, carries blood everywhere. At the core of the body system is the heart. A healthy heart pumps blood to the lungs where it is

⁴ Walker, Richard. The Children’s Atlas of the Human Body: Actual size Bones, Muscles, and Organs in full color. Brookfield, CT: Quarto Children’s Books Ltd; The Millbrook Press, 1994.

oxygenated, and then sends the blood to the rest of the body, nurturing the body's cells on its way.⁵ At the core of the financial system are the financial intermediaries and markets. A financial system's blood is capital. If capital stops flowing, then economic life dies.

1.3.5 Financial intermediaries

Financial intermediaries are go-between ("middle-man") financial institutions or mediators between savers and investors and lenders and borrowers. Because they fill a role of an intermediary, they are medium institutions in a financial system through which savers can indirectly provide funds to borrowers. They operate on a financial intermediation⁶ principle – a lender lends to the institution such as a bank which, in turn, lends to the borrower. Examples include commercial banks, credit unions and credit cooperative societies, insurance companies, mutual funds and brokerage firms, microfinance institutions, and savings and loans associations and many more financial service associations.

1.3.6 Financial markets

Financial markets are financial institutions through which savers and/or lenders can directly provide funds to investors or borrowers or they are direct means of transmitting savings from persons and companies able to supply them to persons and companies demanding them for creative investment. They operate on a financial disintermediation

⁵ Walker, Richard. The Children's Atlas of the Human Body: Actual size Bones, Muscles, and Organs in full color. Brookfield, CT: Quarto Children's Books Ltd; The Millbrook Press, 1994.

⁶ Financial intermediation is an act of borrowing, acquiring and pooling plentiful funds from the public with savings and then making loans and providing them to units or geographical levels (borrowers) that require them. The variety of units include: (1) the individual person, (2) household, (3) firm, (4) industry, (5) sector (either public or private; agriculture or manufacturing or service). Meanwhile, the geographical levels include: (1) Local, (2) District (3) Province (4) National, (5) Region (multiple countries, cross-border initiatives, world region, blocs, continental regions) and (6) global (all countries).

principle – a lender lends directly to the borrower such as a household to a firm. Examples include bond markets, capital markets, money markets, stock markets, derivative markets (futures or options) mortgage markets and foreign exchanges.

1.3.7 Loanable Funds Market

This concept combines two words: *market* and *loanable* funds. Loanable funds are funds borrowed and/or lent. It is a source of capital for managers' and entrepreneurs' external and/or internal funding. The borrower disburses the principal and an interest rate to the lender.

A market is generally understood as a cluster of individuals and businesses that are connected to each other in the buying or selling activity of products. A market is also any arrangement established to facilitate the encounter between sellers and buyers in getting information and doing business with each other. Therefore, a loanable funds market is a market that coordinates lenders and borrowers (savers and investors) or a market in which persons who want to save provide funds and those who want to borrow to invest or spend require funds.

In the loanable funds market, savings present the supply curve because saving is the source of the supply of loanable funds and investments present the demand curve because investment is the source of demand for loanable funds.⁷

1.3.8 Income

Income, which usually connotes individual income, is defined by the formulae:
individual income = occupation earnings + property income + gift and donations - taxes,

⁷Mankiw, Gregory. Essentials of Economics. United Kingdom and United States: Thomson, South – Western, 2004 :395.

fees and licenses. Property income refers to income from real, financial and intellectual ownership.

Income is well understood when it is categorized. Thus, aggregate income, which has a unit of time such as per hour, per day, per week, per month or per year attached to it and consists of the total amount of money that households and business firms receive before consumption expenses and taxes are deducted, is categorized into disposable income and discretionary income.

1.3.8.1 Disposable income

Disposable income is the amount of money that remains after households or business firms have budgeted for and met their taxes and consumption payment obligations.

1.3.8.2 Discretionary income

Discretionary income is the amount of money that consumers (households) have budgeted for and *hold to pay* for products they need and want. Notably, households spend most of their discretionary income on consumption of durable and/or non-durable goods and of all types of services.

1.3.9 Saving

Saving simply refers to having purchasing power, an intention and a decision to abstain from consumption in view of future economic commitment. Saving is equal to purchasing power in the form of disposable income less consumption. Savings increase, when consumption decreases. The greater the consumption implies the lower the savings.

The relationship between and among income, savings, consumption and investments is aptly explained by leakages and injections. These typify the generation and flow of income and locate savings. For example, production generates income. However, this income is subject to *three leakages* before it returns to generate more production. These are: (1) taxes, (2) savings, and (3) consumption (domestic and imports). On the other hand, *three injections* into the flow of spending boost income. These are: (1) investment spending, (2) government spending, and (3) exports. Overall demand of a thriving or stressed economy is assessed by looking at the relationship between the leakages and injections.

1.3.10 Money

Defining money is rather difficult. However, most economists agree that money is better understood from the context of its functions and characteristics. Thus, money is what money performs. Money as a medium of exchange, a store of value, and a unit of account is the standard item used in economic transactions. Money is categorized by liquidity. Liquidity is the ability to convert an asset into cash. This conversion ability has two characteristics: (i) facility and speed and (ii) without incurring a loss.

1.3.11 Economic Transformation

Economic transformation, synonymous with economic development, refers to a progressive shift from one economic state of development to another. It is a process of economic advancement in meeting the society's economic tasks of production, distribution, consumption and sustenance. It completes the supply and value chains.

Economic transformation is typified by factors that facilitate the society to stimulate economic growth and development and improve living standards. These include high output, efficient economic institutions, highly dispersed technology, advances in agriculture, industry, information and entrepreneurship, resource availability and utilization, innovation in the form of invention, extension and synthesis and other improved methods and techniques of doing things. It involves changing ways in which people think, act, perform and live. The end result of economic transformation is a high standard of living for every one. It goes beyond achieving sustainable development⁸ to having a better life for every being.

Economic transformation embraces both economic and financial planning. Good economic planning (the planning of production, distribution, and consumption) is done by one or several units, and is a major factor in enhancing economic development of any country. But good economic planning without a robust financial system achieves little. Similarly, good financial planning, which includes planning for the new venture, risk management, insurance, taxation, retirement, and estate among others, require a robust financial system.

1.3.12 GNP, GDP and Per Capita GDP

Gross National Product (GNP) , Gross Domestic Product (GDP) and Productivity per person or income per person (Per-Capita GDP) all function as stethoscopes for

⁸ The World Commission on Environment and Development (1987) defines sustainability or sustainable development as development that meets the needs of the present without compromising the ability of future generations to meet their own needs. Stiglitz Joseph and Carl Walsh (2002) hold that sustainable development requires growth strategies that use resources and the environment in ways that do not jeopardize future potential growth (p 239).

measuring the economic and financial health and wealth of a nation. They measure the productivity or economic growth of any country.

However, they differ in meaning and functional approach. To distinguish GNP and GDP, two words play a role: (i) ownership and (ii) location.

1.3.12.1 Gross National Product (GNP)

GNP is the market value of final goods and services produced *by* the citizens of a country or the country's own firms during a given period (usually a year) regardless of geographical *location*.

1.3.12.2 Gross Domestic Product (GDP)

GDP is the market value of final goods and services produced *within* a country or by firms located in the country during a given time period (usually a year) regardless of *ownership*.

1.3.12.3 Approaches of Measuring GDP

Because in an economy production is equal to consumption, either a production (income) approach or consumption (expenditure) approach is used to get the GDP of a country.

1.3.12.4 Per Capita GDP or Per Capita Income

Per Capita GDP or Per Capita Income is productivity per person or income per person. GDP divided by the total population gives us Per-Capita GDP or Per Capita Income.

1.3.13 Market Economy

Because trade is organized by two social institutions (a) property rights and (b) markets,⁹ the market economy as distinguished from the economy planned or controlled by a central authority, is an economy that allocates resources through the decentralized decisions of many firms and households as they interact in markets for goods and services. There exist *two* types of markets in a circular flow in the market economy: (i) commodity markets (involving the trade in goods and services) and (ii) factor markets (involving the trade in factors of production – land, labor, capital and entrepreneurship).¹⁰

1.3.14 Mass Poverty

In economics, poverty is defined in absolute and relative terms but both denoting physiological and social deprivation. Since poverty is a state of lacking a usual basic necessity such as food, shelter, clothing, medicine, etc., or lack of a socially acceptable amount of money or material possessions, mass poverty is a capital or monetary or social wanting situation participated in by or affecting a large number of individuals. For example, 38% of the population of Uganda lived below the internationally recognized poverty line in the fiscal year 2002/2003.

1.3.15 Property Rights

Property rights are social and cultural stipulations put down to oversee the tenure, utilization and clearance of resources or factors of production and products and are enforceable in regulatory frameworks such as tribunals. The promotion of privatization

⁹ Parkin, Michael. Macroeconomics. (6ed) Boston, New York, London, Paris: Addison Wesley, Pearson Education Inc., 2003: 40

¹⁰ Parkin, Michael. Macroeconomics. (6ed) Boston, New York, London, Paris: Addison Wesley, Pearson Education Inc., 2003: 40

and deregulation to steer investment is urged by a need for property rights in business and economics.

1.4 Purpose of this Thesis

Intended for academics, businesspeople and public policymakers through whom economic and civil stability can be achieved, the main goal of this thesis is to make these groups become more aware of the nature and role of a robust financial system in economic development. Thus, it serves **seven** main functions which include:

1. It aptly and comprehensively examines and illustrates the topic and contributes ideas to the process of economic development through building more efficient and robust financial systems; it leads to breaking the cycle of poverty and improving quality of life;
2. It provides background information and suggestions to overcome the perils of a dysfunctional financial system; it is a guidepost and wake-up call of economic transformation through a robust financial system;
3. It provides data, knowledge and insights thereby becoming a useful tool for correcting inefficiencies of financial and economic planners; it sharpens their minds and facilitates the development of their skills required to build and operate an effective and robust financial system;
4. It deepens knowledge, leads to a greater understanding of the importance of well-functioning financial systems in stimulating productivity, economic growth and living standards;

5. It is an outstanding primer and guide for savers and investors as well as lenders and borrowers; it provides sufficient knowledge about investment and financial system milieu, especially in Uganda;
6. It is an educational tool and reference for anyone interested in learning about the relationship between financial system and economic development and related issues; and
7. It enriches not only readership but also the authorship; it leads to an academic award for the author since it is written and submitted in partial fulfillment for the requirements for the award of an MBA degree.

1.5 Review of Existing Knowledge

1.5.1 Thesis's Focus

Basically, this thesis's focus is the role of a robust financial system in increasing and determining domestic productivity, economic growth and development in Uganda in view of lessening dependence on donors. The study examines and illustrates the nature, role and value of a robust financial system in mobilizing resources and allocating assets from surplus units to deficient units for creative investment thereby improving domestic productivity, economic growth and development.

1.5.2 Others' writings on the topic

Works of some great economists and authors, which have been accessed and read, provide important and related information and knowledge about saving and investment, productivity and economic growth, and the basic components of a financial system, namely, the financial intermediaries and markets. However, this knowledge is

merely broad, limited and not systematically presented. For example, we accessed works of Parkin, Gwarteny and companions, Stiglitz and Walsh, Mankiw and Butt among others and professors like Davies, Burnham, Baird and Bhaskar among others. Their valuable works and lectures on macro-economics, global economy, financial management and the investment environment are being applied to the Ugandan context.

Updated knowledge about the topic directly focusing on Uganda has been reviewed from the research and country reports of the IMF/World Bank on Uganda, the Daily Newspapers especially the New Vision-Uganda and the Monitor-Uganda [on line], and the Official Websites of Uganda Securities Exchange (USE) and Central Bank of Uganda (BOU) among others.

However, all accessed sources agree on a principal idea, which is: the financial system incorporates all financial institutions concerned with moving savings from units and levels whose income surpasses their expenditures and transferring them to other units and levels that would like to spend more than their current income allows.

1.5.3 Review of Terminologies and Concepts

We reviewed the usage of selected terminologies on the subject matter. It is in the usage of some terminologies that differences have been observed. For example, some economists and authors have generally used the term *financial markets* synonymously with *capital markets*. We think these terms are inseparable but distinguishable.

Though in stating their function(s) no big difference has been noticed among different authors since there is agreement that each of them refers to a collective term for various types of markets where money can be used from savers to investors, distinguishing these concepts is important. Capital markets are better understood when

they are compared with money markets because they are distinguished by duration or maturity of investments [long-term versus short term] but both are components of the financial market, which is broader.

Of those who prefer to use the term capital markets instead of financial markets as connoting the broader market, we have great economic writers like Parkin, Gwartney and companions and Stiglitz and Walsh among others. For example, Parkin (2003), while analyzing factor markets with emphasis on demand and supply, in *Macroeconomics*, describes capital markets as channels through which firms obtain financial resources to buy capital resources. He points out that financial resources come from saving.¹¹

Gwartney, Stroup, Studenmund and Sobel (1997) in *Economics: Private and Public Choice* describe the capital market as a highly diverse market that includes markets for stocks, real estate, and business, as well as the loanable funds market. According to them, if a nation is going to realize its potential, the capital market ought to attract savings and channel them into investment projects that create wealth.¹²

Stiglitz and Walsh (2002) in *Principles of Macroeconomics* (3ed) acknowledge the “confusion” in the usage of terms: ‘financial’ and ‘capital’ markets, and write, “the capital market is the market where the supply of funds is allocated to those who wish to borrow...in everyday language, we often refer to this as the country’s financial market.”¹³

¹¹ Parkin, Michael. Microeconomics.6ed. Boston, Paris and Hong Kong: Addison Wesley, Pearson Education, Inc., 2003:321.

¹² Gwartney, James and Stroup, Richard. Economics: Private and Public Choice. (8ed.) New York, London, and Tokyo: The Dryden Press, Harcourt Brace College Publishers, 1997: 674-676

¹³ Stiglitz, Joseph E. and Walsh, Carl, E. Principles of Macroeconomics. (3ed). New York and London: W.W. Norton & Company, Inc., 2002:164

In Uganda, the term *capital markets* rather than *financial markets* are familiar. Moreover, the Capital Markets Authority Statute was enacted in 1996, leading to the establishment of the Capital Markets Authority (CMA), a government body mandated by Parliament to regulate and develop the financial (capital) markets industry in Uganda.¹⁴ And, though the term: *capital market* is commonly used in Uganda, in our analysis; we have observed that financial markets are broader than capital markets. Thus, we have preferred to use the term *financial markets* in our work.

Two economists, with whom we strongly concur, convey a dissimilar approach to understanding the mechanism of the financial system in economic development. First, Professor Burnham (February 2004) in his lecture notes in the course *The Global Economy*, points out that the financial system is better understood from the perspective of its functions and institutions.

By *institution*, a financial system is grouped into two categories: (1) financial intermediaries such as banks, insurance companies, credit unions, savings and loan associations or “thrifts”, mutual funds, etc. and (2) financial markets such as equity markets, money and capital markets, derivative markets, mortgage markets and foreign exchanges.

On the other hand, by *function*, the financial system performs the following duties: (1) facilitating payments, (2) transferring financial resources to those who need funds, loans, equity, etc. for creative investment, and (3) redistributing and discounting

¹⁴ The Capital Markets Authority Digest. Volume 1: The Rationale for Capital Markets in Uganda. [On Line] Accessed in May 2004 < <http://www.ugandacapitalmarkets.co.ug> >

various types of risk such as in cases of futures, options, pension funds and insurance companies.¹⁵

Second, Mankiw (2004) in *Essentials of Economics*, (3ed), describes the financial system as a group of institutions in the economy that help to match one person's savings with another person's investments. He groups them into two categories: (1) financial markets and (2) financial intermediaries. According to him, financial markets include the bond and stock markets while the financial intermediaries consist of banks and mutual funds. However, he also explains that the financial system also includes pension funds, credit unions, insurance companies, and even the local loan bilker.¹⁶

1.5.4 Review of the significance of a robust financial system

Existing literature reveals the role of a robust financial system may be challenged and made more significant and critical by the limitations of capital deepening through machinery and human capital investments. Great economists corroborate this. For example, having analyzed the effects of capital accumulation and deepening in both the short-run and long-run, Stiglitz and Walsh give us compelling evidence to believe that the law of diminishing returns has impact on the long-run effects of capital deepening.¹⁷

The two argue that beyond investment in machinery and human capital, there exist other sources of productivity growth which must be considered. These include a

¹⁵ Burnham, James is a Professor of Global Economy at Duquesne University's Graduate School of Business. He was the U.S. executive director at the World Bank (1982-85) and staff director of the President's Council of Economic Advisors (1981-82). Burnham has served in a variety of capacities with Mellon Bank, including as senior Vice-President and Manager of Global Treasury.

¹⁶ Mankiw, Gregory, N. Essential of Economics. 3ed. United Kingdom and United States: Thomson Southwestern, 2004: 386-391.

¹⁷ Stiglitz, Joseph E and Carl, Walsh, E. Principles of Macroeconomics (3ed): 226

higher quality of labor force prepared by the strengths of the educational system, moral character formation systems, and competence in reallocating resources from low-to-high productivity.¹⁸ Reallocating resources from low-to-high productivity is demonstrated by industry or sectoral shifts in employment such as from peasant agriculture to commercial agriculture; from commercial agriculture to manufacturing and from manufacturing to services. Further, it includes technological changes demonstrated by research and development and/or innovation in the form of extension and invention or “thinking up new ways to do old things and new ways to do entirely new things.”¹⁹

Lessons drawn from the aforementioned observation include the insight that the success of a robust financial system in transforming Uganda’s economy depends also on other factors including awareness and attitude change, information efficacy, competition candor and government friendly intervention. Just as capital deepening through machinery and human capital investment has limitations, so there are limitations of capital deepening through the financial system. The aforementioned concerns should not be ignored or underrated.

Besides, the power of incentives to work, save and invest in enhancing economic development cannot be overlooked. Professor Burnham states: “economic development can occur where incentives to work, save and invest productively are present.”²⁰

Butt’s work has also been accessed and reviewed as resourceful literature on the significance of the role of a robust financial system in economic transformation of East

¹⁸ Stiglitz, Joseph E and Carl, Walsh, E. Principles of Macroeconomics (3ed): 229

¹⁹ Ibid, 229

²⁰ Professor Burnham, James. “Lecture Notes in the Course: Global Economy,” John F. Donahue Graduate School of Business, Duquesne University, PA, USA. Spring 2004.

African communities in which Uganda is a member. Butts's *Essentials of Commerce in East Africa* (5ed) (2000), provides basic knowledge about functions of the financial institutions in East Africa. For example, he writes about the functioning and structure of the banking system, the joint stock companies or corporations from which shares and stocks are issued, and the membership, functions and securities traded on the stock exchange.

In his analysis of aids to trade, he implicitly treats a financial system as one of the aids to trade and writes: "*it is indeed true that a business is provided with the main investment by the owner in the form of capital...but often capital at the disposal of the owner (or owners) may be insufficient to meet either the short term or long term financial needs of the concern.*"²¹ In such a situation the role of a financial system is prized because a business of integrity and credibility²² becomes accessible to bank loans, bank overdrafts, bills of exchange and promissory notes, credit buying and hire purchase for short-term finance. Moreover, even for long-term finance, business is helped with loans from commercial banks, loans from special lending institutions, mortgage loans, hire purchase, debentures or bonds, sale and lease-backs, and stocks or shares.

1.5.5 Literature Review on Uganda's Underdevelopment: causes, course and effect

In addition to reviewing existing knowledge about a role of a robust financial system, we also reviewed some literature on why Africa, Uganda in particular, has lagged

²¹ Butt, A. S. *Essentials of Commerce in East Africa*. (5ed). Nairobi and London: Cassell Publishers Limited, 2000: 164-169.

²² Butt, A.S. *Essentials of Commerce in East Africa*: 169.

behind in economic development. Some of the sources and works we have been able to refer to are the writings of Munro and Whitaker.

Whitaker (1988), having analyzed Africa's weak socio-economic condition especially from colonial to post colonial Africa, writes with a challenging question in mind: *How can Africa [Uganda] survive?*²³ Whitaker observes that because of many stumbling factors African low income countries, Uganda in particular, have an uphill task to develop and industrialize.

Munro, Forbes's *Britain in Tropical Africa 1880-1960: Economic Relationships and Impact*, challenges us with a milestone question about Sub-Saharan Africa's, in particular Uganda's, low income and high poverty levels. It is: *what explains the slow and restricted industrial growth in colonial and post-colonial Africa?*²⁴ To put the question the other way around we ask: *why has Uganda remained poor?*

Answers to this question represent three economic developmental schools of thought. While one school puts the principal factor on deliberate obstruction by colonial governments, the other school places it on the metropolitan policy-makers. Nevertheless, interventionists with whom we concur prefer to avoid placing blame on a single factor but to look at a multiplicity of factors. Chapter three of this thesis thoroughly explains these other factors.

²³ Whitaker, Jennifer Seymour. How can Africa survive? New York & Sydney: Harper & Row, Publishers, 1988: title page.

²⁴ Munro, Forbes, J. Britain in Tropical Africa 1880-1960. Economic Relationships and Impact. London: McMillan Press, 1984: 64.

1.6 Statements of the Problem

Uganda, which is a member of the East African Community (EAC), is one of the world's low-income developing countries. The country, with a population of 26.8 million 80% of whom are living on less than US \$1 per day, is in dire need of transforming its economy from a predominantly peasantry and informal economy to an industrial and formal economy.

Despite the espousal of a liberal economy and the laissez-faire model of economic transformation since the late 1980s, the real cry of the poor and needy is loud enough but the capacity to reduce it is still wanting. Of its households totaling 5.14 million in 57 districts consisting of 961 sub-counties and conceivably 5,000 parishes,²⁵ 3.8 million households, which constitute about 74% of all households, presently rely on agriculture for a living. However, their living standards remain the lowest in the world.

Further, the government continues to rely on donors to finance its budget deficit. For example, about 46% of the country's budget for the fiscal year 2004/2005 was financed by donors. Moreover, donors have supported the country during previous years. This is creditable. How long shall the Uganda government depend on foreign mercy and generosity to provide for its citizens?

It is thus palpable and compelling that a halt and reverse of this risky practice and trend is significant and critical. The best way to come out of this predicament is for Uganda to use a financial system to mobilize savings and increase domestic productivity. There is a need to act decisively and innovatively to construct a robust financial system utilizing the *Rural Reach Refocus Financial Model* (3-R Financial Model) to overturn the

²⁵ Sunday Vision Special Report. "The Suruma Strategy," in the Sunday Vision, Uganda of February 20, 2005. Available: <http://www.Sundayvision.co.ug/detail.php?mainNewsCategoryId>

situation. A *Rural Reach Refocus Financial Model* (3-R Financial Model) refers to the expansion, adoption and adaptation of a market-oriented robust financial system to Rural Uganda to spur and broaden the entrepreneurial revolution that promotes, stimulates, and sustains economic development.

In the face of the changing structure of the global trading and financial systems characterized by widespread globalization, liberalization and economic integration, Uganda must change its traditional ways lest it perish economically. It must construct a robust financial system to mobilize both national and international resources and allocate and re-allocate them in creative investment. High rates of savings and investment are key ingredients of long-run economic growth and development.

Why does a robust financial system matter in the economic transformation of Uganda? Elsewhere, robust financial systems spearhead economic transformation. Uganda could emulate these and prosper as well. For example, most Asian countries have advanced economically and industrially as a result of constructing robust financial systems. For instance, for almost 20 years, countries including Hong Kong, Singapore, Thailand, Taiwan, Malaysia, South Korea and many more have strengthened their financial systems with an incessant investment spending in the financial system of more than 30% of their GDP.²⁶ Consequently, these Asian countries now enjoy higher economic growth rates.

Uganda's financial system is not yet robust enough to spearhead and achieve economic development. It contains many inefficiencies and imperfections. For example, despite some improvements, Uganda's financial system has weak and small capital

²⁶ Gwartney, James, D. and Richard Stroup. *Economics: Private and Public Choice*. (8ed). San Diego & New York: The Dryden Press, Harcourt Brace College Publishers, 1997: 675

capacity. It is governed under a weak legal and institutional framework. Its financial market is still nascent and its banking sector is prone to money laundering.²⁷ Uganda's financial system is vulnerable to both economic and political shocks; externally and internally.

1.7 Hypothesis

I do think that with a market-oriented robust financial system utilizing the *Rural Reach Refocus Financial Model*, more resources and assets will be mobilized and allocated efficiently and, sooner than later, domestic productivity will increase and dependence on donors will decrease. Both domestic and international resources will be mobilized and allocated in profusion and this will increase household income. Raised income increases both private and public saving and investment levels. Consequently, the circle of poverty will break and standards of living will improve.

1.8 Research methods

1.8.1 Different Forms of Research

Researching takes different forms that include: (i) action research (ii) creative research, (iii) expository research, (iv) historical research, (v) experimental research, (vi)

²⁷ The U.S. Department of State on “ Money Laundering and Financial Crimes,” [On-Line] describes money laundering as a disguised activity that generally involves a series of multiple transactions used to disguise the source of financial assets so that these assets may be used without compromising the criminals who are seeking to use the funds. Available: <http://www.state.gov/g/inl/rls/nrcrpt> . Research reveals that money laundering is necessitated by the requirement for criminals, be they drug traffickers, organized criminals, terrorists, arms traffickers, blackmailers, or credit card swindlers, to disguise the origin of their criminal money so that they can use it more easily.

descriptive research, and (vii) ex-post facto research.²⁸ Other research types include: (a) empirical research, (b) analytical or critical research, and (c) argumentative research.

Regardless of the type, a research follows a certain methodology. A methodology consists of research design, research delimitation, the target population, research instruments and data analysis.²⁹

1.8.2 Design of this Research

This research comprises both expository and descriptive designs. It is an expository research because new insights have been developed after reading widely on the fields of economic development and financial systems. These insights were then compared, contrasted, analyzed and synthesized on all points of view of the topic. It is also a descriptive research because the role of a robust financial system as our focus has been studied to see if it gives rise to economic transformation in Uganda.

The conclusion is that the role of a robust financial system in determining growth and transforming the economy of Uganda is critical and significant. However, it does require the support of other factors including a level of government friendly intervention in good political and administrative governance; peace, stability and security; appropriate national economic policies; increased production and mass market demand creation; institutional changes such as land systems, cooperatives, funds, and boards, and kingship systems; perseverance in moments of shock deriving from the international economy; altruistic investors, aid donors, and trading partners; and the leaders' and citizenry's

²⁸ Types of Research as adapted from Goddard and Melville, 2001 [On Line ; Accessed on April 14, 2004] < <http://imem01.tripod.com/rmguidetypesofresearch.htm> >

²⁹ Awongo, Vincent, A.J (Rev.Fr). "Factors leading to poor management and financial performance of income generating projects in Church organizations in Kenya: case study: Apostles of Jesus Youth Technical Institute, Langata, Nairobi-Kenya." A research paper submitted to St. Augustine University in requirements for the Award of Advanced Diploma in accountancy, Mwanza, Tanzania, May 2001:16-17.

altruistic economic will reflected in dedication, respectful responsibility, sacrificial service and devoted teamwork.

1.8.3 Limitation of this research

The research limitation is that, in spite of using both sources, it has depended more on secondary data source than primary data source. There are no surveys and case studies. We are limited by accidents of and by inaccuracy and remote prevalence of data due to inefficient data processing and recording systems. Absent or slow dispersion of information and communications technology (ICT) in Uganda, which has become globally central for processing and accessing data, is a strong limitation. However, absolutely proving to follow a faithful path and orientation, one finds this thesis the best asset we have on this topic.

1.8.4 The targeted population of this research

The targeted population consists of academic, business and public policymakers' groups.

1.8.5 The research or study instruments

Our instruments include two sources of data collection: (1) primary data source and (2) secondary data source. The primary data source is composed of gathering first-hand information from representatives of targeted groups using the following methods of data collection (i) interview using physical, telephone and e-mail channels of communication, and (ii) documentary or publication review. The secondary data source consists mainly of external or second hand information which includes literature review

of text books, books, government publications, newsletters, professional journals, news periodicals, articles, research papers, reports, and on-line information.

1.8.6 Data analysis

After collecting both qualitative and quantitative data from different literature reviews and respondents, it had to be sorted out and edited to eliminate possible errors. The purpose of data analysis is to find solutions to the problems or challenges discovered so as to make recommendations for action.

1.9 Structure of the Thesis

The thesis is divided into three main parts: the preliminary comprising the title, approval data sheet, blank page, intellectual rights, dedication, acknowledgement, etc., the text comprising seven chapters including the general introduction and conclusion and plan of action and information about the sources, that is, references and/or bibliography, appendices, data sheet, and reader approval sheet.

The text presents both the conceptual and practical understanding of the nature and role of the financial system in economic transformation.

1.10 Chapter-by-chapter outline

1.10.1 Chapter One: General Introduction

Chapter one, which is a general introduction of the thesis, focuses on the design and rationale of the work and aspects that elucidate what the thesis is all about.

1.10.2 Chapter Two: Conceptual Understanding of the Nature and Role of a Financial System in Economic Transformation

Chapter two examines the conceptual understanding of the nature and role of well-functioning financial systems in economic transformation as they exist in the global economy irrespective of high income or low income countries.

1.10.3 Chapter Three: Practical Understanding: Situation Analysis of Uganda's Economy

Chapter three is a situation analysis of Uganda's economy with emphasis on low-income and poverty trends as a consequence of historical and contemporary economic factors that stifled capital inflow and intra-flow and affected capital formation. Uganda's low-income levels and mass poverty are a result of several factors that affected the flow of capital to all units, sectors, regions and industries. Further, the chapter highlights the current economic situation and environment prompting the intervention of a robust financial system to enhance capital formation, capital inflow and intra-flow.

1.10.4 Chapter Four: The Investment and Financial System Milieu in Uganda's Economy

In chapter four, the thesis covers the investment environment and financial system milieu in Uganda's economy with emphasis on the meaning of saving and investments as key ingredients of economic growth and development, on the loanable funds market participants and on the various components of Uganda's financial system: financial intermediaries and markets.

1.10.5 Chapter Five: Theory and Practice: Transforming Uganda's Economy with an Emerging Robust Financial System

Chapter five looks at the nature and role of a financial system in Uganda in theory and practice with emphasis on resource mobilization and asset allocation and its auxiliary functions. The chapter highlights several key functions performed by Uganda's financial system in economic transformation of Uganda from predominantly peasantry and informal to industrial and formal.

1.10.6 Chapter Six: The SWOT Analysis: Assessing the Robustness of the Financial System in Uganda

Chapter six, using the SWOT Analysis, makes an assessment of the robustness of Uganda's financial system. It looks at the financial system's strengths, weaknesses, opportunities and threats.

1.10.7 Chapter Seven: Conclusion and Plan of Action: Constructing a Robust Financial System with Emphasis on the Rural Reach Refocus Financial Model (The 3 R Financial Model)

Chapter seven presents a conclusion with key recommendation: to construct a market-oriented robust financial system with emphasis on a rural reach refocus financial model to achieve economic transformation, high economic growth and improvement of living standards. A market oriented robust financial system utilizing the rural reach financial model and involving government friendly intervention is considered as the best way forward.

1.10.8 Appendices: Tables

1.10.9 Bibliography and Reference

1.10.10 Author Data Sheet and Reader(s) Approval Sheet.

1.11 Justification for the Study

Searching for a solution to reduce today's biting poverty to the majority of Ugandans is the noblest study and action one can undertake. This study and action is such an undertaking. Grounded on this premise, there are basically four main reasons that justify this study. These are:

1. The author's interest stimulated by his missionary, religious and priestly vocation, Ugandan nationality and professional goals justify the study of this topic in particular. I am touched by the poor quality of life of people, especially in Rural Uganda. Economic liberation should occur.
2. Uganda's low-income and high poverty levels must be urgently and appropriately addressed through raising capital for investment to break the cycle of poverty. Moreover, since the economic and financial reforms of the early 1990s, Uganda's annual GDP growth rate for the past consecutive seven years [1997-2004] has been about or greater than 5%. This enhanced economic growth and enlarging productive sectors compel sufficient availability of investment capital. However, the weak, small, young, ineffective and underdeveloped nature and structure of the financial system in Uganda, deprives creative and productive units and levels of many opportunities and options for raising capital. A robust one is required.
3. The fast changing face of global trading and financial systems in response to globalization, economic integration and alliances and liberalization requires an

urgent national response to these compelling events and trends. For example, Cross-Border Initiatives (CBIs) in Eastern and Southern Africa continue to gain momentum. Uganda is a prominent and strategic partner in most of these initiatives. For instance, Uganda is now a member of COMESA, PTA, The Nile River Basin and EAC among others.

CBIs encompass a shared policy structure and aspire to aid cross-border economic and financial activity by removing obstacles to the flow of goods, services, labor, and capital, and facilitate the integration of markets by synchronizing reform programs in many basic structural sections backed by suitable macroeconomic policies. CBIs require a robust financial system to achieve their goals of poverty reduction.

The economic global environment today is characterized by (i) cross-border and regional trading alliances and (ii) a variety of types and sizes of global organizations. Trading blocs require a robust financial system to access global markets and compete favorably, mobilize and allocate resources and maximize profits. For instance, the on-going formation and consolidation of regional trading and cooperation agreements like ASEAN, COMESA, EAC, ECOWAS, EU, FTAA, MERCOSUR, and NAFTA among others, require robust financial systems.

4. The international community's increased concern with poverty reduction in a globalized economy can only be achieved beginning with national levels. For instance, drawing on the research done within UNCTAD on economic development in Africa, the international community, in its Millennium declaration

of the Millennium development goals, resolved to reduce poverty by half by 2015.³⁰

³⁰ UNCTAD/United Nations (UN) Conference on Trade and Development (UNCTAD), 2001 on “Economic development in Africa: performances, prospects and policy issues.” On Line. Accessed on February 24, 2004. < <http://www.eldis.org/static/DOC9371.htm> >

CHAPTER TWO

2 CONCEPTUAL UNDERSTANDING: THE NATURE AND ROLE OF FINANCIAL SYSTEM IN ECONOMIC DEVELOPMENT

2.1 Introduction

The chapter focuses on explaining and understanding the general concepts of the nature and role of a financial system in economic transformation. It explores the mechanism of financial institutions in mobilizing and allocating financial resources and determining productivity and economic growth. In particular, the chapter delves into the three critical and significant segments and notions, which explicate the financial system's functions and activities. They are the (1) meaning, components, and functions of a financial system, (2) vitality of the "II-Rates", an acronym for incentives and influential rates, interest rates and foreign exchange rates, as boosters of economic transformation, and (3) characteristics of a robust or efficient financial system.

2.2 Meaning, Components, and Functions of a Financial System

2.2.1 Meaning: What is a financial system?

A financial system is a massive network of interdependent financial institutions, functions and activities that muster and allocate resources and synchronize saving and investment or coordinate lenders and borrowers. It is a set of interdependent rather than independent financial institutions and functions. A financial system is one of the major systems of economic life, a cornerstone and aid to legitimate national and global commerce, an ardent participant in both formal and informal financial sectors, and a catalyst of the market economy.

Whether motivated by profit or non-profit, a financial system is a source and strength of economic transformation and economic growth which ultimately increases the living standards around the world, *ceteris paribus*.

2.2.2 A Financial System as a Constituent of Economic Life

There is an interrelationship between a financial system and the rest of the economy. A financial system is one of the eight principal constituents of economic life. Other constituents are: (i) the supply and value chain system, (ii) the market system (market/managed economy), (iii) the price system, (iv) trading system, (v) the monetary system, (vi) the national accounting system ($Y=C+I+G+X-M$), and (vii) the taxation system.

As a constituent of economic life, a financial system has an impact on the financial health of the entire economy just as the entire economy has effect on the financial system's economic health. Moreover, events that happen within a financial system, especially the operation of financial intermediaries and markets in the capital formation process, are vital for comprehending developments in the entire economy.³¹

For example, there is an interaction between economic activity and security markets. Changes in securities markets are interrelated to changes in the aggregate economy. Reilly and Brown put it, "*the price of most bonds is determined by the level of interest rates, which are influenced by overall economic activity and central bank policy...and individual stock prices reflect investor expectations about an issuing firm's performances in terms of earnings, cash flow, and the investor's required rate of return;*

³¹ Mankiw, Gregory, N. Essentials of Economics. (3ed). United States of America: Thomson South-Western, 2004:292.

moreover, this performance is likewise affected by the overall performance of the economy.”³²

Further, within the financial system, we observe how the effects of monetary policy impact economic activity and how real, fiscal, financial and external sectors and activities of the economy correlate to determine ROE or ROI, productivity and employment. Interest rates and growth in income are two important economic variables used to determine the growth of financial intermediaries, markets and assets.

For instance, the price of a financial security would be determined by the growth of the economy as shown by the basic formula for savings and investment: $P = [D] / [K - G]$; whereas P (price of security) = $[D]$ (Dividend <usually D_1 >) divided by $[K$ (Required rate of Return: (i) Risk Free Rate + (ii) Risk Premium) – G (growth in economy)].³³ To illustrate this outstanding interrelationship we take one example: if expected dividend = \$ 4.20, economic growth = 3%, Risk free rate = 2%, Risk premium = 7%, then the price would be $P = D (\$4.20) / [K (2\% + 7\%) - G (3\%)] = P = \$4.20 / [0.09 - 0.03] = 4.20 / 0.06 = \70.00 . If there was an *increase of interest rate* by 1%, K would be 10% and price would become \$ 60.00, that is, $P = D (\$ 4.20) / [K (10\%) - G (3\%)] = P = \$ 4.20 / [0.10 - 0.03] = \$4.20 / 0.07 = \$ 60.00$. On the other hand, if there was a *decrease or reduction* in economic growth from 3% to 2% the price would similarly change. It would become \$ 52.50, that is, $P = D (\$4.20) / [K (10\%) - G (2\%)] = P = \$4.20 / 0.10 - 0.02 = \$ 4.20 / 0.08 = \$ 52.50$.

³² Reilly, Frank K. and Brown, Keith, C. Investment Analysis and Portfolio Management. (7ed). US and Spain: Thomson: South-Western, 2003:247.

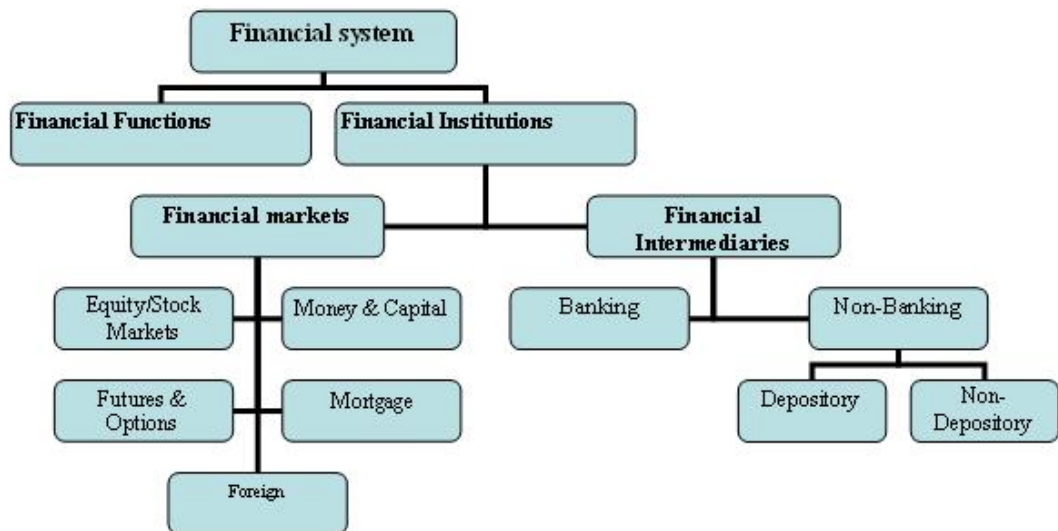
³³ Vashishta, Bhaskar, (Assistant Professor of Finance), “Lecture Notes, May 18, 2004: Introduction to the course: Overview of Investment Environment. Duquesne University, John F. Donahue Graduate School of Business, Summer Semester 2004.

Therefore, when seeking to conceptually understand the role of a robust financial system in economic transformation, this interrelationship cannot be ignored. It must be mastered.

2.2.3 Components and Economic Functions of a Financial System

A financial system is composed of financial institutions and functions. The financial institutions are categorized into (i) financial markets and (ii) financial intermediaries. These financial institutions are linked together by their respective functions. The financial functions are many but are summed up into one main economic function: mobilization and allocation of resources and assets and support of the growth of the private and public sectors through credit allocation.

Figure 2-(1) illustrates the components and structure of a typical financial system in a global economy.



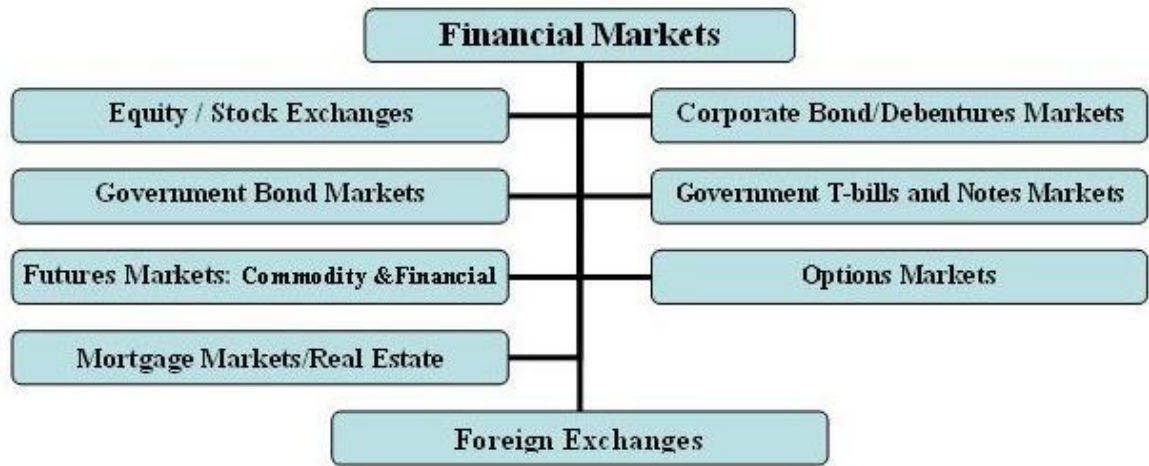
2.2.3.1 *Financial Markets: What are Financial Markets?*

Financial markets, which are markets where financial assets, commonly called securities, are traded, are a result of publicly traded³⁴ versus privately held firms. They are financial institutions that operate on a disintermediation principle; that is, savers or lenders directly provide funds to investors or borrowers for creative investment. They are direct means of transmitting savings from persons and organizations able to supply them to persons and organizations demanding them for creative investment.

A financial market may be a physical place such as the Uganda Securities Exchange in Uganda or the Nairobi Stock Exchange in Kenya or the New York Stock Exchange or the American Stock Exchange in the USA or the London Stock exchange in the UK or the Bombay Stock Exchange and Delhi Stock Exchange in India or the Italian Stock Exchange in Italy or the Moscow Exchange in Russia or the Bourse de Paris and MATIF in France or the Deutsche Boerse in Germany or the Muscat Securities Market in Oman or the Shanghai Stock Exchange in China or the Tokyo Stock Exchange and Osaka Securities Exchange in Japan. It could also be a network of linked computers, such as the National Association of Securities Dealers Automated Quotation (NASDAQ) in the USA.

³⁴ A clear understanding of financial markets is derived from making a distinction between publicly traded firms and privately held firms. While for the privately held firm the main source of external capital is typically the bank or micro-finance or cooperative society loan and their access to the public debts is limited, publicly traded firms have extensive accessibility to the public debt markets. Going public means converting a private company into a public company and thus having the right to have the company quoted on the stock exchange with an approval of the stock exchange council and the opportunity to sell its shares to the public and to raise more capital for development. A quoted company is one whose shares are bought and sold on a stock exchange; only public corporations can have the prices of their shares quoted and shares listed on the stock exchange list because these shares are freely transferable.

Figure 2-(2) highlights the principal examples and classification of financial markets in a typical economy.



Because trading markets are classified by security type or by their organizational form,³⁵ financial markets are understood from the following contexts: (i) securities markets, (ii) debt or equity markets, and (iii) primary or secondary markets.

2.2.3.1.1 Financial Markets as Securities Markets

Excluding markets such as the foreign exchange, financial markets are also known as securities markets. The name derives from security, a financial term, which refers to “any document that gives its holder a right to money or other property not actually in possession.”³⁶

Examples of financial securities include:(a) a share certificate (common or preferred stock), which entitles its owner to share in the assets and/or liabilities of the

³⁵ Logue, Dennis E. *The WG &L Handbook of Financial markets*. Cincinnati, Ohio: WG, Warren, Gorham and Lamont; College Division South-Western Publishing Co., 1995:288.

³⁶ Butt, S.A. *Essentials of Commerce in East Africa*. 5th Edition. London: Cassell Publishers Limited, 2000:228.

issuing company, (b) a government treasury bond or bill certificate, which warrants that the holder named on it will be paid back at the maturity date of the bond or bill and bears a fixed rate of interest, (c) a bill of exchange, which entitles its owner to the amount of money specified therein, and (d) corporate/company bonds also called debentures, which are a loan security (unit of a loan) issued by a publicly held company promising to pay principal and interest at a stated percentage of return and making the debenture holder a creditor of the company.³⁷

2.2.3.1.2 *Financial Markets as Debt or Equity Securities Markets*

Securities markets are divided into either debt or equity markets. *Debt Securities Markets* comprise debt instruments such as money market securities, capital market securities, debt derivatives such as futures contracts and option contracts and mortgage markets. Maturity is what distinguishes money from capital markets. While money markets offer secondary services to debt trade of short-term, highly liquid debt instruments such as Treasury bills (T-bills) and Banker's acceptances, capital markets offer secondary services to debt trade of longer-term securities such as government bonds, municipal or local government bonds, and corporate bonds.³⁸ *Equity Securities Markets*, on the other hand, consist of common and preferred stock markets.

³⁷ Butt, S.A. Essentials of Commerce in East Africa. 5th Edition. London: Cassell Publishers Limited, 2000:228

³⁸ Logue, Dennis E (Editor). The WG&L Handbook of Financial Markets. Cincinnati, Ohio: Warren, Gorham & Lamont; College Division South Western Publishing Co., 1995:304

2.2.3.1.3 *Financial Markets as Primary and/or Secondary Markets*

According to their organizational form financial markets are divided into two markets: primary financial markets and secondary securities markets. *Primary Financial (Securities) Markets* exist and operate where and when original and new securities are put up for sale. Professor Burnham calls them “the markets for newly-issued securities (government, municipal and corporate bonds, equities, etc.).”³⁹ In a primary market transaction, the firm issuing securities receives funds directly.

On the other hand, *Secondary Financial (Securities) Markets* exist and function where and when already issued (outstanding) securities such as stocks, bonds, options and futures are purchased and sold. They trade in existing securities and Professor Burnham calls them “markets for trading in previously-issued securities (bonds, equities, options and futures, etc.).”⁴⁰ In a secondary market transaction, there is no impact on the firm’s balance sheet. For example, the New Vision Printing and Publishing Company Limited (NVPPCL) in Uganda could open the Initial Public Offer (IPO) of 20% shares (up to 10,200,000 shares) and even issue more equity to the public. This would be a primary market transaction because NVPPCL receives the funds. However, one could buy 100 shares of NVPPCL at UGSHS 200/= (US \$ 0.12) from another party (an investor who possesses NVPPCL shares) and one would pay the other party UGSHS 20, 000/= (US \$ 11.59); in return, he would receive and own the shares. In this latter transaction, NVPPCL is unaffected and so it is a secondary market transaction.

³⁹ Professor Burnham, James, Ph D, “Selected Financial Market Terminology,” in the course of Global Economy at Duquesne University, John F. Donahue Graduate School of Business, Spring 2004.

⁴⁰ Professor Burnham, James, Ph D, “Selected Financial market Terminology,” in the course of Global Economy, Spring 2004.

There are many secondary securities markets in the global financial market. Examples include: (a) international, national and domestic securities exchanges such as the (i) New York Stock Exchange (NYSE) and NASDAQ in the USA, (ii) Bolsa Mexicana de Valores in Mexico, (iii) Johannesburg Stock Exchange in South Africa (iv) Dar es Salaam Stock Exchange (DSE) in Tanzania, (v) Geneva Stock Exchange in Switzerland and (vi) Uganda Securities Exchange (USE) in Uganda; (b) Regional securities exchange; and (c) Over-the-counter (OTC) markets.

Secondary financial markets are very common and securities traded on them are calculated, summarized and published in what is known as *stock price indexes or all share indexes*. Securities or stock price indexes or all share indexes summarize numerous adverse securities or stock prices traded each business day on the global secondary securities or stock markets. Stock price indexes or all share indexes help savers and investors to know how their own securities or stocks have performed and how they have fared relative to other securities or stocks on the average. Parkin (2003) highlights that index numbers of the average stock prices are calculated and published “to make comparisons and to indicate movements in the market.”⁴¹

Just as there are numerous secondary financial markets, so there are several securities or stock prices or all share indexes. For example, in the USA three are prominent: (i) S&P Composite Index, (ii) Dow Jones Industrial Average (DJIA) Index and (iii) NASDAQ Composite Index. Other popular indexes that trail the condition of the world’s major securities or stock markets include: (a) FTSE 100 owned by the Financial Times (FT) and the London Stock Exchange (SE) in the UK, (b) DAX index,

⁴¹ Parkin, Michael. Microeconomics. (Sixth Edition). Boston, London, New York and Paris: Addison Wesley, Pearson Education Inc., 2003: 459.

which is the average prices on the Frankfurt stock exchange in Germany, (c) Nikkei index, which is the average of prices on the Tokyo stock exchange in Japan, and (d) Hang Seng index, which is an average of prices on the Hong Kong stock exchange in Hong Kong.⁴² The USE All Share Index, which was launched in August 2003, trails the activities and condition of the securities market in Uganda.

2.2.3.2 Financial Intermediaries: What are Financial Intermediaries?

Financial intermediaries are financial institutions that follow the intermediation or go-between (“middle-man”) principle, that is, savers or lenders indirectly provide funds to investors or borrowers for creative investment. Savers or lenders put money into the financial institution and the financial institution extends credit to the borrowers or investors.

There are two dimensions of understanding financial intermediaries; (i) the nature of their financial intermediation activities including banking intermediation or non-banking intermediation, and (ii) the status of their prudential regulation and supervision including the practice and observance of principal standards and codes such as payment systems, accounting, auditing and information disclosures.

2.2.3.2.1 Nature of Financial Intermediation Activities

According to the nature of their financial intermediation activities and services, financial intermediaries fall into three main categories: (i) banking, (ii) non banking, and (iii) assorted financial services.

⁴² Parkin, Michael. *Microeconomics*. (Sixth Edition). Boston, London, New York and Paris: Addison Wesley, Pearson Education Inc., 2003: 459-460.

All banking financial intermediaries are also depository but not all depository financial institutions are banking institutions. Non-banking financial intermediaries are both depository and non-depository.

A. Banking and Non-Banking

(i) *Depository* financial intermediaries.

Depository institutions are divided into two: *banking depository* and *non-banking depository*. For example, commercial banks are banking depository institutions because they incur liabilities in the form of deposits payable on demand and transferable by cheque (check) or otherwise in making payments.⁴³

Non-banking depository financial institutions are deposit taking but incur liabilities in forms other than demand deposits such as time and saving deposits. Examples include (i) Savings and Loan Associations (S&L), which are depository institutions that obtain checking and savings deposits and make personal commercial and home-purchase loans, (ii) Saving banks, which are depository institutions that accept savings deposits and offer mostly mortgage refinancing loans, (iii) Credit unions, which are depository institutions owned by a social or economic group, accept saving deposits and offer mostly consumer loans, and (iv) others including mortgage banks, post office savings banks, merchant banks and financial service associations.

(ii) *Non-Banking and Non-Depository* financial intermediaries.

These are financial institutions including contractual institutions such as insurance companies and pension or provident funds. For example, the insurance policies and products are always offered and purchased but never resold.

⁴³ Official Website of Tanzania High Commission –London Government of United Republic of Tanzania Finance and Banking –General Information. Accessed January 6, 2005. Available: http://www.tanzania-online.gov.uk/Business/financialinstit_/Finance-Banking.htm .

B. Assorted Financial Services

These are financial institutions which are non-banking institutions but have a special operation arrangement and include institutions such as development banks, housing finance, investment banks and other institutions lending on a priority projects basis. For example, investment banks invest funds on behalf of investors.

2.2.3.2.2 Status of Prudential Regulation and Supervision: Observance of Standards

According to the status of their prudential regulation and supervision including Observance of Standards and Codes (OSC), financial intermediaries are classified as (i) informal, (ii) semi-formal, and (iii) formal financial institutions.

(i) Informal financial intermediaries

These financial institutions, which use particular schemes to deliver financial services to large segments of people who lack access to formal financial services, refer to financial providers whose financial programs and activities are not regulated by central bank's supervisory authorities.⁴⁴

They operate within the informal financial sector environment that consists of a large number of small, non-registered financial service and non-formal collateralized micro-loan providers, including (i) loans to relatives and friends, (ii) rotating savings and credit associations (ROSCAs) which involve supplying households with basics on a rotational basis, (iii) accumulating savings and credit associations (ACRA) in which members pool money, which is used as a fund for loans, (iv) clan or kinship based

⁴⁴ Ernest Aryeetey, Hemamala Hettige, Machiko Nissanke and William Steel, "A study of both informal and formal financial markets in Ghana, Malawi, Nigeria and Tanzania: Financial Market Fragmentation and Reform in Sub-Saharan Africa," World Bank, Washington D.C., 1996. Accessed on October 31, 2004

savings and credit groups to support the credit or savings needs of the clan or kinship, (v) funeral financial groups in which members save regularly and create a fund to meet emergencies such as death (burial and funeral) expenses, (vi) rotational digging financial groups in which members cultivate on each others' land or garden in turn in order to save expenses of hired labor⁴⁵ or to earn money which is saved to create a fund for loans, (vii) individual moneylenders or village/local loan sharks, and (viii) a network of savings and credit cooperatives.⁴⁶ They usually conduct their activities utilizing familiar, personal and mutual relationships, social and cultural institutions and a variety of security (collateral) substitutes to serve market segments that are not covered by formal intermediaries especially banks.⁴⁷

Formal banks and credit institutions prefer to deal with larger business customers or macro-entrepreneurs (big clients) than micro-entrepreneurs. This is because of high financial intermediation costs, small loan sizes, lack of strict financial discipline to manage cash flow and lack of formal collateral in the informal financial sector. The micro-level lending situation makes it more risky to deal with micro-entrepreneurs.

Informal financial intermediaries conduct their activities through three main concentrations: (a) specializing in either the credit or the savings services of the market,

⁴⁵ Bejjuka, John, "Microfinance in Post-Conflict Countries: The Case Study of Uganda." Joint ILO/UNHCR Workshop: Microfinance in Post-Conflict Countries 15-17 September 1999 ILO Geneva. Accessed August 3, 2004. Available: <http://www.ilo.org/public/english/employment/finance/papers/uganda>

⁴⁶ *ibid.*

⁴⁷ Ernest Aryeetey, Hemamala Hettige, Machiko Nissanke and William Steel, "A study of both informal and formal financial markets in Ghana, Malawi, Nigeria and Tanzania: Financial Market Fragmentation and Reform in Sub-Saharan Africa," *World Bank*, Washington D.C., 1996. Accessed on October 31, 2004.

(b) basing their financial activities on personal or business relationship, and (c) providing partial or full financial intermediation between savers and borrowers.⁴⁸

Informal financial intermediaries, especially those involved in small-holder and micro-finance credit products and services comprising the transactional credit suppliers, the mutual credit suppliers and personal credit suppliers, are very common in low-income developing countries especially Sub-Saharan Africa.

(ii) *Semi-formal financial intermediaries*

Between informal and formal financial intermediaries are the semi-formal financial intermediaries. These are financial institutions that are registered entities under non-financial legislation and include financial intermediaries established by civil society organizations (CSOs)⁴⁹ such as Faith-Based Organizations (FBOs), Non-Governmental Organizations (NGOs), Private Volunteer Organizations (PVOs) and Community Based Organizations (CBOs). Beijuka refers to semi-formal financial intermediaries as “those financial providers –NGOs⁵⁰ and private companies – which operate under an official registration, but not under any financial or cooperative law and often give loans to community groups or to individuals through groups.”⁵¹

⁴⁸ *ibid*

⁴⁹ Makokha Akoyi Kevin Theopista, (Country Representative Vredeseilanden-Coopibo Uganda), “Working with Community Organizations and Civil Society: The Case of Uganda,” a presentation at the European Forum on Rural Development Cooperation, Montpellier, France, 4th to 6th September, 2002 explains that CSOs include students’ associations, farmer groups and other producer groups, intellectuals, peasant associations, informal networks, Non-Governmental Organizations (NGOs), Faith Based Organizations (FBOs) and Community Based Organizations (CBOs).

⁵⁰ The 1989 Non-Government Organizations Registration Statute of Uganda, defines a non-government organization as one “established to provide voluntary services including religious, educational, literary, scientific, social or charitable services to the community,” (Section 13, NGO Registration Statute, 1989).

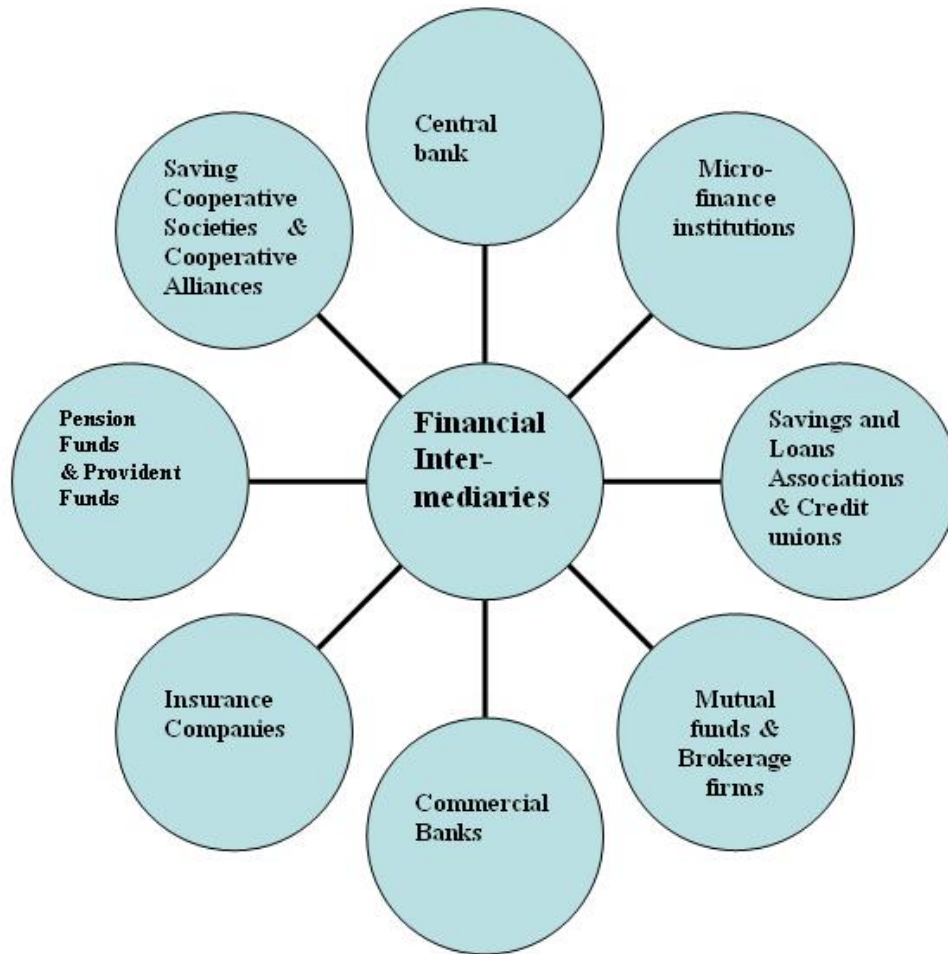
⁵¹ Beijuka, John, “Microfinance in Post-Conflict Countries: The Case Study of Uganda.” Joint ILO/UNHCR Workshop: Microfinance in Post-Conflict Countries 15-17 September 1999 ILO Geneva. Available: <http://www.ilo.org/public/english/employment/finance/papers/uganda.htm>.

(iii) Formal financial intermediaries

These are financial intermediaries that are subject to general and specific laws of regulation and supervision. Their programs, activities and transactions are regulated and overseen by the Central bank's supervisory authorities. These include commercial and government banks, savings and post banks and also the cooperatives and private financial institutions, which are officially registered under formal financial legislation.

Because they operate nationally and internationally, to some degree they observe the nationally and internationally accepted standards and codes especially in the areas of data dissemination and transparency in monetary and financial policies. For instance, they use legal documentation or the legal system to enforce contracts. Worldwide, especially in low-income developing countries, there is a continual and stable appearance of formal non-bank financial intermediaries including discount houses, leasing companies, finance companies, etc.

Figure 3-(2) highlights the major constituents of financial intermediaries.



2.2.3.3 The Economic Functions of a Financial System

Just as there are several financial institutions, so there are many financial functions. Because a financial system comprises financial activities carried out in both formal and informal financial sectors, its functions encompass the ownership structures, focus and services of numerous financial institutions. For example, micro-finance institutions provide financial services mainly to the poor groups and small and medium

enterprises (SMEs) with differing ownership structures. For instance, credit cooperatives in China are mainly government-owned. Credit unions in East and West Africa are mainly member-owned. In Europe, microfinance banks are dominated by profit-maximizing shareholders. In South America, small-holder financial institutions are mainly run by socially minded shareholders and usually transformed from NGOs.⁵² This important variation in functions and focus causes us to consider the focal economic function of a financial system.

Thus, the focal economic function of financial institutions is to mobilize resources and allocate capital or financial assets to sectors of the economy where it is needed most.⁵³ Money from individual or institutional savers and lenders flows to individual or institutional investors and/or borrowers. This main role is performed through assembling, organizing and coordinating savers and investors and helping lenders and borrowers to correspond.

From this central function springs auxiliary financial and economic functions, which include (i) bridging the gap between domestic investment and national saving; (ii) creation and provision of liquidity at balanced prices; (iii) summation of right information for investors' needs; (iv) monetary control: stimulation and stabilization; (v) economy watch: business cycles and fluctuation monitor; (vi) risks balance, reduction and mitigation; (vii) credit extension and promotion of entrepreneurship; (viii) funds transfer and payment facilitation; (ix) property ownership extension and wealth distribution; (x)

⁵² Consultative Group to Assist the Poor (CGAP): About Microfinance (2003). Accessed May 21, 2004. Available: <http://www.cgap.org/about/faq05.html>.

⁵³ Professor McCue, Thomas, "The Role of Financial Markets," in the Course of Financial Management GRBUS 514. John F Donahue Graduate School of Business Administration, Duquesne University, Fall 2003. Lecture V.

trade aid: help and support services and activities; (xi) economic development catalyst: corporate social responsibility; and (xii) fighting ingrained corruption and inefficiency.

Mankiw (2004) summarizes the functions of all financial institutions into one: “to help to match one person’s saving with another person’s investment...moreover; saving and investment are important determinants of long-run growth in GDP and living standards.”⁵⁴ It is apt to keenly note that a financial system significantly helps to pair and steer one person’s domestic and global saving with another person’s domestic and global investment thereby making lenders and borrowers correspond.

For example, individuals or organizations in need of funds to develop and enlarge or finance budget deficits find financial institutions as right and fervent economic avenues and sources as well as financial fortresses, strongholds and rocks. For instance, there exist four main sources of funds for corporate firms: (i) borrowing (borrowed capital) from commercial banks and special lending institutions, (ii) raising capital (share capital) through going public and selling shares, (iii) getting capital from earnings (retained earnings capital), reserves or firm/corporate savings, and (iv) issuing firm/corporate bonds (debentures).⁵⁵ Almost all of these functions are exclusively provided by a financial system in the form of either debt or equity financing. Thus, a financial system is a help, refuge and hope of both savers and investors; lenders and borrowers. It makes possible the coordination and collaboration of savings and

⁵⁴ Mankiw, Gregory N. Essentials of Economics. (Third Edition). United States of America: Thomson South-Western, 2004:386, 392.

⁵⁵ McCue, Thomas E. (Professor of Finance), “The Role of Financial Markets: Assessing the Financial Health of a Firm,” Lecture Notes. John F. Donahue Graduate School of Business, Duquesne University, PA, Fall Semester 2003.

investment and of supply of and demand for money in domestic loanable funds markets and foreign currency exchanges.

However, this possibility occurs because there is a trade-off between present consumption and future consumption. The rate of exchange between future consumption (future income) and present consumption is the price, known as the interest rate. In addition to the interest rate, there exists another price that is important for the stimulation of the financial system, especially the international division of the financial system. It is the foreign currency exchange rate. Because of their indispensable role in matching savings and investments, we refer to them as the “II-Rates” of a financial system.

2.3 The Vitality of the “II-Rates” as Incentives: Interest Rate and Foreign Exchange Rate in the Economic Transformation

There is no way any study of a robust financial system’s role in the economic transformation of any economy or country can make sense and show justice if it excludes having rich knowledge of the “II-Rates”. Economic development can occur where incentives to work, save and invest productively are present.⁵⁶ A properly designed reward system comprising monetary and non-monetary incentives is the management’s most powerful tool for mobilizing organizational commitment to successful strategy execution.⁵⁷ A financial system can also function well where incentives and influences⁵⁸

⁵⁶ Burnham, James, Professor of Global Economy. John F. Donahue School of Graduate School of Business, Duquesne University. The Global Economy. Lecture Notes, Spring Semester, April 21, 2004.

⁵⁷ Lance B. Kurke , Professor of the Strategic Management Process at John F. Donahue Graduate School of Business, Duquesne University’s Graduate School of Business. Business Problems II; the Strategic Management Process. Lecture Notes, Fall Semester November 4, 2004.

⁵⁸ While for-profit financial institutions are motivated by expected rates of return [ROE & ROI] in form of economic and accounting profits, non-for-profit financial institutions are influenced by the achievements of a shared vision and value (ASVV).

to save and invest and lend and borrow industriously and productively can happen. People invest for high returns.

The role of incentives in the functioning of a robust financial system in economic transformation cannot be overlooked. Incentives speedily and conveniently move businesses and match savings with investment. For example, Gwartney and Stroup (1997) observe that “*interest and profit perform important allocative functions...interest induces people to give up current consumption, a sacrifice that is a necessary ingredient for capital formation...economic profit provides both human and physical capital decision makers and investors with the incentive to (i) undertake investments yielding an uncertain return and (ii) discover and develop beneficial and productive investment opportunities.*”⁵⁹

Interest rates and foreign currency exchange rates are the two vital “II-Rates” that effect the dynamic and productive functioning of the financial system in any economy. This is because alterations in the real interest rates as well as changes in foreign exchange rates do rework the incentives envisioned by households and firms in these markets. Moreover, a financial system is directly concerned with two of the four key macroeconomic markets⁶⁰: the loanable funds market and the foreign exchange. Let us now proceed to a description of interest rates and foreign exchange rates.

⁵⁹ Gwartney, James and Richard Stroup. Economics: Private and Public Choice. (8ed).Tokyo, San Diego & London: The Dryden Press, Harcourt Brace College Publishers, 1997:673.

⁶⁰ There are four key macroeconomic markets: (1) Labor/resource market (market for inputs used to produce domestic goods); (2) Loanable funds market (market coordinating borrowers and lenders); (3) Foreign Exchange (market coordinating exchange of currency with foreigners: savings and investments; imports and exports coordination); and (4) Goods and Services market (product market for all domestic goods and/or services).

2.3.1 Interest Rate

Interest rate is the price of exchange of funds at each time that links the present supply of funds by lenders and savers and demand for funds by borrowers and investors. Interest rates balance the readiness of sellers, who consume less today in the hope of improved future consumption with buyers who desire to move some of their anticipated future consumption to the present.⁶¹ When interest rates increase, it is an indication that people prefer to move relatively more future consumption to the present and so savers preferring to move more present consumption to the future must be compensated more generously.

Reilly and Brown (2003) aptly explain that “*the trade-off of present consumption for a higher level of future consumption is the reason for saving...and the interest rate is established in the financial market [loanable funds market] by a comparison of the supply of excess income available (savings) to be invested and the demand for excess consumption available (borrowing) at a given time.*”⁶² Interest rates are therefore a return for saving and a cost of borrowing.

By preferring savings and investments to present consumption or by postponing present consumption to future consumption, individuals and institutions manifest enthusiasm to earn a return (ROE or ROIC). Investment decision, for example, is based on interest rate and expected rate of return. As a general principle and practice, investors would take on the investment venture if the real interest rate is less than the expected rate

⁶¹ FRB Cleveland, “The Economy in Perspective,” Economic Trends, February 2000. Accessed January 21, 2004. Available: <http://www.clev.frb.org/research/Et2000/0200/html/eip.htm>.

⁶² Reilly, Frank K and Keith C Brown. Investment Analysis and Portfolio Management. (7ed). US and Spain. Thomson: South –Western, 2003: 5.

of return or if the expected rate of return exceeded the cost of capital. Evidently, as real interest rates rise investors become reluctant and less investment ventures are taken on as future consumption is not preferred.

While in managed or non liberalized economies, interest rates are determined through administrative controls such as government controls by fixing interest rates and credit allocation. In market economies, interest rates are determined by the forces of supply and demand. Market factors that determine the supply of and demand for funds include (i) inflationary expectations, (ii) the real rate of interest differential, (iii) excess liquidity, (iv) domestic and foreign interest rate differential, and (v) government policy.

Interest rates are a key issue in economics and finance and influence Government and the Central bank policy makers, lenders and borrowers and savers and investors. Interest rates, especially the key policy rates such as the discount bank rate, T-Bills rate, bond rate, floating rate note (FRN) linked to the London Inter-Bank Offered Rate (LIBOR),⁶³ and the Federal Funds rate⁶⁴, play an important part in loanable funds markets and in determining productivity, economic growth and living standards.

High inflation means reduced rate of return, especially on assets with a fixed rate of return because real interest rate or interest rate in terms of purchasing power is nominal interest rate minus inflation. As real interest rate becomes smaller, rates of return on investment reduce and aggregate investment declines. The Central bank checks

⁶³ Professor Burnham, James, Ph D Lecture Notes. Selected Financial Market Terminology. Spring 2004. He explains that LIBOR means “ The London Interbank Offered Rate; the reference rate at which international banks lend to top-rated borrowers on the Eurocurrency market; and LIBOR rates are published for all major currencies but are determined by the British Bankers Association based on a daily poll of selected banks.”

⁶⁴ The Federal Funds rate or target is the price of overnight US Federal Reserve credit that depository institutions charge one another.

inflation by either encouraging the increase in the supply of output or the decrease in the demand for money.

Central banks use the key rates to maintain the stringent monetary policy since these send signals to the market especially about inflationary expectations and excess liquidity. For example, when the bank rediscount rates are raised, the message is “tightening”; when they are lowered or maintained, the message is “loosening”. This is because the economic environment and conditions are tolerable for economic and financial activities.

Because there is a close relationship between interest rates and inflation rates, Central banks endeavor to monitor many economic indicators linked to them. According to Kozicki (2001), globally, “Central banks conduct monetary policies to promote selected long-run goals defined in terms of an inflation target: price stability and sustainable economic growth yet monitoring a wide range of economic indicators.”⁶⁵

Earnings and interest rate differentials also affect a country’s currency. For example, a higher yield on Japanese securities compared to American securities would make Japanese securities more attractive. An increase in Japanese yields would raise the flow of US dollar into Japanese securities, and decrease the outflow of Japanese Yen to American securities. This increased flow of funds into Japan would lower the value of the US dollar and increase the value of the Japanese Yen.

For example, interest rates in Africa as compared to other continents are high. Financial segmentation, fiscal position and financing costs lead the list of reasons accounting for high interest rates. Financial segmentation refers to the situation where the

⁶⁵ Kozicki, Sharon . Economic Review (Kansas City); 6/22/2001

market is partitioned into sections that are almost independent of each other and thus prevent these market partitions from affecting each other either through integration or competition.

The fiscal position accounts for this phenomenon. For instance, fiscal reasons including financing national budget deficits and debts drive financial institutions and the Central banks' monetary policies become the result of fiscal pressure. Moreover, Sub-Saharan African countries have poor or weak fiscal position, which has an impact on interest rates, and fiscal adjustment impacts domestic borrowing through Treasury bills.⁶⁶

Financing costs are high in Africa because the continent's financial systems are shallow, undiversified, inefficient, and often financially fragile. Also the transactions costs of financial intermediation are very high. This reflects core risks, which suppliers of finance face as a result of risks arising from political and economic instability, high incidence of default, intensity of fraud, weak legal systems in which contract enforcement is poor, and often acute informational problems.⁶⁷

Overall assessment comprising security risk, political stability risk, government effectiveness risk, legal and regulatory risk, macroeconomic risk, foreign trade and payment risk, tax policy risk, labor market risk, financial risk, policy uncertainty and

⁶⁶ Njuguna Ndung'u, Ph. D. "Determinants of Interest Rates in Kenya: An Economist's View," An IPAR/CPAK Seminar, 1997.

⁶⁷ Office of the Governor, Central Bank of Uganda, "Country Risk Analysis, Its Implications and the Need for an Insurance Facility for Africa," a Presentation during the Africa Trade Insurance Agency (ATI) High Level Seminar on Political Risks and Financing Trade Transactions in Africa held on August 21, 2001 at the Uganda International Conference Centre, Kampala.

infrastructural risk presents a more risky saving and investment climate in most African countries.⁶⁸

2.3.2 Foreign Exchange Rate

Foreign exchange rate is the price of one country's currency in terms of another. For example, US \$/ EU Euro implies Dollars needed to purchase one Euro; UGSHS/K SH signifies Ugandan Shillings needed to buy one Kenyan Shilling and Japanese Yen / UGSHS indicates Japanese Yens required to purchase one UGSH. The foreign exchange rate plainly explains how many domestic units it will cost to purchase a unit of foreign currency. Exporters, importers, tourists, international students and governments constitute the major participants in the foreign exchange market.

Countries or economies choose between foreign exchange rate regimes. There are two basic foreign exchange rate regimes: (i) fixed and (ii) floating or flexible. Though no foreign exchange rate regime can absolutely prevent macroeconomic instability, Mishkin and Calvo (2003) aptly observe that “the choice of foreign exchange rate regime can be better-or worse-suited to the economic institutions and characteristics of an economy.”⁶⁹

Open or market economies, which are economies of our interest, are under flexible or floating foreign exchange rate regimes, which are determined by the market forces. Thus, because of the market forces, the flexible or floating foreign exchange rate changes frequently with the international supply of and demand for currency. Volatility

⁶⁸ The International Bank for Reconstruction and Development/the World Bank, World Development Report 2005: A Better Investment Climate for Everyone. A copublication of the World Bank and Oxford University Press, 2004: 46

⁶⁹ Mishkin, Frederic S. and Guillermo A Calvo. “The Mirage of Exchange Rate Regimes for Emerging Market Countries.” The Journal of Economic Perspectives. A Journal of the American Economic Association, Volume 17, Number 4, Fall 2003:106.

is inevitable. Parkin (2003) backs this position with an explanation that “the foreign exchange rate fluctuates because in the foreign exchange changes in demand and supply are not independent of each other...every one is a potential buyer and seller in the foreign exchange.”⁷⁰

2.3.2.1 The Supply of and Demand for Money

Several factors can increase the supply of and demand for a foreign currency. Stiglitz and Walsh observe that foreigners’ demand for a country’s local currency and the nationals’ supply of the country’s local currency are determined by (i) underlying trade factors, (ii) underlying investment forces, and (iii) speculation.⁷¹

In addition, Dr. DeMaskey, EconEdLink [National Council on Economic Education the USA] and many other economists observe that several factors are potential foreign spot exchange rate determinants. They include: (i) parity conditions (relative inflation rates, relative interest rates, forward exchange rates, exchange rate regimes, and official monetary reserves); (ii) infrastructure (strength of banking system, strength of securities markets, and outlook for growth and profitability); (iii) cross-border investment (foreign direct investment and portfolio investment); (iv) political risk (capital controls, black market in currencies, exchange rate spreads, and risk premium on securities and FDI); and (v) speculation (currencies, securities, uncovered interest arbitrage, real estate and commodities).⁷²

⁷⁰ Parkin, Michael. *Macroeconomics*. Sixth Edition. Boston, San Francisco & Paris: Addison Wesley, Pearson Education, Inc., 2003:449.

⁷¹ Stiglitz, Joseph, E. and Carl E. Walsh. *Principles of Macro-economics*. 3ed. New York & London: W.W. Norton & Company, 2002: 411.

⁷² Dr. DeMaskey & EconEdlink/ “Exchange Rates and Exchange: How Money Affects Trade,” October 8, 2002. Accessed January 21, 2004. Available: <http://www.econedlink.org/lessons>.

For example, if the inflation disparity relative to other countries is large, domestic consumers demand for foreign goods and foreign currency. If the interest rate differential is favorable abroad, domestic investors will demand foreign securities thus demanding foreign currency.

Domestic currency supply factors are also worth noting. Like for demand for currency, the interaction of trade-related factors and financial factors as well as speculation or expectations affect the quantity of money supplied to the foreign exchange. Because consumers spend domestic currency to purchase the foreign currency, when the demand for foreign currency increases, the foreign supply of domestic currency increases proportionately.⁷³

2.3.2.2 The Appreciation and Depreciation of Currencies

A nation's currency value either appreciates or depreciates over a period. These changes in value not only affect international trade by affecting the demand for the products the country creates and the prices of the products it purchases, but also the entire financial system. While currency depreciation refers to the decrease in value of one currency in terms of another currency, currency appreciation implies the increase in value of one currency in terms of another one.⁷⁴

The increase in demand pushes the price of the currency higher, so that particular currency appreciates (increases in value). As the supply of domestic currency increases, the price of the country's currency falls, causing the local currency to depreciate

⁷³ EconEdLink [National Control on Economic Education], "Exchange Rates and Exchange: How Money Affects Trade." Accessed January 21, 2004. Available: <http://www.econedlink.org/lessons>.

⁷⁴ Parkin, Michael. *Macroeconomics*. Sixth Edition. Boston, San Francisco & Paris: Addison Wesley, Pearson Education, Inc., 2003: G-2 Glossary.

(decrease in value). There are several factors that are responsible for the appreciation and depreciation of currencies and these include (i) trade balance, income and demand gap, (ii) inflation rate gap, (iii) interest rate and earnings gap, (iv) government monetary policy, (vi) speculation or expectation, and (vii) volume/ value of capital inflow.

For example, the flow of funds to purchase stocks, bonds and/or other financial instruments impacts the currency exchange rate and the value of currency. Increased inflow of funds as a result of foreign trade, aid, donations and remittances lead to appreciation of the domestic currency relative to the flowing currency that is falling in value from increased supply. On the other hand, decreased inflow of funds will lead to currency depreciation of the domestic currency relative to the undersupplied foreign currency that is scarce and has retained its intrinsic value.

2.3.2.3 Importers and Exporters' Interests: Mixed Reaction to Currency Fluctuations

The differences in currency values affect the ability to buy imports or sell exports, affecting not only the financial system but also economic growth and the standard of living. In the scenario of foreign currency exchange fluctuations, it is important to observe that reactions to it from importers and exporters are mixed toward a weak domestic currency versus a strong domestic currency.

A stronger domestic currency is very valuable compared to other currencies and the other currencies become cheaper to obtain. By obtaining the foreign currency more cheaply, the country's consumers or investors also become advantaged with purchasing the products of another country at lower prices. Moreover, at lower prices, there is an

increase in quantity demanded of those commodities and thus an increase in the purchase of imports from abroad.

Importers prefer a stronger local unit of currency because it makes imports relatively cheaper for them and exports become less competitive. How? When more imports are purchased because they are cheaper, importers could sell those commodities to their customers at rational prices. At rational prices the quantity demanded increases for the commodities and eventually profits increase. Thus, when the domestic currency appreciates, importers make atypical profits because currency gains favor imports not exports.

Exporters prefer a weaker local unit of currency because a stronger local currency decreases the volume of exports as they become more expensive to foreign consumers and more competitive with imports. With a stronger local unit of currency, foreign buyers withdraw from an expensive currency since they would not prefer trade off with more of their currency to buy the local currency. This has a negative effect on prices and quantity demanded of domestic products (exports) because they appear very costly to foreign buyers and consequentially the quantity demanded of these exports declines. In attempt to attract demand for their products, exporters have to lower their prices. This harms the exporters as their exports become uncompetitive or less competitive.

2.4 Characteristics of a Robust or an Efficient Financial System

When we talk of a robust or an efficient financial system, we refer to the financial system in which the market price or actual price is equal to the intrinsic value of the

financial asset. To gain or generate abnormal returns from the financial asset investment, the investor has to search for inefficient markets and/or anomalies.

Four conditions are necessary for the financial system – intermediaries and markets – to function efficiently. They are awareness and attitude change, information efficacy, competition candor, and government friendly intervention. Thus, the financial asset market price or actual price can manage to achieve equality to its intrinsic value when there is quick and accurate information available to a large number of competing lenders and borrowers and savers and investors. Competition among lenders or borrowers or savers or investors assures that financial assets are correctly priced. Healthy competition that brings about correct pricing is anti-collusion or conspiracy.⁷⁵

An efficient/robust financial system is typified by the following characteristics: (1) information, (2) pricing, (3) allocation, (4) operation, (5) diversification, (6) size, depth, development and maturity, and (7) integration and connectedness. To gain or generate abnormal returns from the financial asset investment, one has to look for inefficient markets.

2.4.1 Informational Efficiency

When we talk of an informationally efficient financial system, we refer to one in which “security prices adjust rapidly to the arrival of new information and, therefore, the current prices of the securities reflect all information about the security.”⁷⁶ Informational imperfections usually cause market failure or inefficiency. The asset price of a robust

⁷⁵ Professor Baird Philip, “The Efficient Market,” in the Course of Intermediate Financial Management. John F. Donahue Graduate School of Business, Duquesne University, Pittsburgh, PA, USA, Spring 2005.

⁷⁶ Reilly, Frank, K and Keith C. Brown,. Investment Analysis and Portfolio Management. (7ed). US and Spain. Thomson: South –Western, 2003: 176.

financial system should reflect all relevant historical, public and private information about the financial asset. Also, information efficiency should instill confidence. For example, lenders should know if the borrowers will pay loans back and savers should know if their money is secure in their esteemed financial institutions.

2.4.2 Pricing Efficiency

Pricing efficiency as a characteristic of a financial system refers to the speedy reaction of financial traders and swift price adjustment to new information thereby causing it to be reflected correctly in financial instruments or security prices. It implies that all available information is included in the market and results into appropriate returns so much so that financial assets are neither undervalued nor overvalued. It is believed that if there are inefficiencies in the market, then prices or costs would fail to reflect the real information relevant for financial decision-making, what is known as price discovery efficiency.⁷⁷ Slow price adjustment to new information causes price unfairness because it fails to reflect all available information regarding the asset. Further, pricing efficiency implies that there is no financial institution participant that is so large to be able to affect prices in the absence of new information.⁷⁸ Moreover, pricing efficiency also signifies that there is price continuity and depth.⁷⁹

⁷⁷ USAID Policy Papers, "Financial Markets Development, August 1988." Accessed November 4, 2004 Available : <http://www.usaid.gov/policy/ads/200/finmkts/fm>.

⁷⁸ Lougue, Dennis, E. The WG & L Handbook of Financial Markets. Cincinnati, Ohio: WG, Warren, Gorham and Lamont; College Division South-Western Publishing Co., 1995:286

⁷⁹ Vashishta, Bhaskar, (Assistant Professor of Finance). "Lecture Notes of the course: Overview of Investment Environment. Duquesne University, John F. Donahue Graduate School of Business, Summer Semester 2004.

2.4.3 Allocative Efficiency

Allocative efficiency is a characteristic that refers to the financial system that is right in giving the correct signals for allocation of resources. Further, a financial system is said to be allocatively efficient if investing in its market or intermediary is said to be a fair game. In other words, a financial system displays allocative efficiency if the funds of savers flow to the most creative investment opportunities. Allocative efficiency is a way of determining if the amount of funds supplied in the loanable funds market by a financial institution is fair or not. Allocative efficiency is achieved when consumers in the loanable funds market are willing to spend what almost equals the cost of supplying the product.

USAID points out that the two basic features of allocational efficiency include (i) mobilizing funds from savings with, at the margin, the lowest opportunity cost and (ii) distributing these funds to investments that offer, at the margin, the highest potential returns.⁸⁰

2.4.4 Operational Efficiency

Operational efficiency as characteristic of a financial system refers to the situation whereby operational costs, that is, cost of running the financial institution in its mobilization and allocation functions including capital/financial costs, flotation costs, administrative costs, staff costs, technology costs, etcetera and the base interest cost-make up of matching and intermediation services rendered are very low or at minimal cost. Low transaction costs including the cost of reaching the market, the actual

⁸⁰ USAID Policy Papers, "Financial Markets Development, August 1988." Accessed on November 4, 2004. Available : <http://www.usaid.gov/policy/ads/200/finmkt/fm>.

brokerage costs, and the costs of transferring the asset⁸¹ are the main features of operational efficiency. In other words, a robust financial system should demonstrate that the cost of trading a financial asset is reasonably low especially when considered in terms of the bid-ask spread⁸². For example, if the commissions of brokers and the bid-ask spreads of dealers are low, a financial system is said to be operationally efficient.

For instance, financial markets provide three categories of service: (i) communication and execution, (ii) clearing, settlement, and record keeping, and (iii) market making.⁸³ Meanwhile, financial intermediaries charge the final interest rate to the customer in consideration of the base rate as computed comprising the funding cost plus the operation cost.⁸⁴ The funding cost includes (i) deposit interest cost, (ii) cost of liquidity, which is cash ratio and minimum cash reserve to cater for unexpected customer demands and (iii) cost of cash holding, that is, cash held in liquid form to take care of day-to-day customer needs.

2.4.5 Diversification Efficiency

Diversification efficiency as a characteristic of the financial system refers to the condition where financial securities, assets and/or instruments are diversified to mitigate unsystematic or unique/specific risks. For example, a well diversified stock portfolio is a

⁸¹ Vashishta, Bhaskar, (Assistant Professor of Finance). "Lecture Notes of the course: Overview of Investment Environment. Duquesne University, John F. Donahue Graduate School of Business, Summer Semester 2004.

⁸² "Why Financial Markets Exist." Available: <http://members.aol.com/finboy3> .Accessed November 4, 2004.

⁸³ Lougue, Dennis, E. The WG & L Handbook of Financial Markets. Cincinnati, Ohio. WG, Warren, Gorham and Lamont; College Division South-Western Publishing Co., 1995:286

⁸⁴ Awuondo , Isaac (Executive Director , Commercial Bank of Africa Ltd). "Determinants of Interest Rates: A Banker's View," An IPAR/ICPAK Seminar, 1997

portfolio that contains a large number of stocks spread across different industries, classes, sectors, and countries. It confirms a traditional adage that says thus: *it is risky to carry all your eggs in one basket*. Diversification efficiency also refers to the incidence of financial institutions in different geographical locations to provide opportunities for majority.

Professor Bhaskar, like O'Shaughnessy, believes that with diversification when "one door closes, another opens"⁸⁵ and so it is important to diversify. Diversification efficiency implies that: (i) there should be high penetration of branches per population served; (ii) the branch penetration should be spread in urban, semi-urban and rural areas; (iii) financial intermediaries and markets should offer a variety of financial instruments and securities; and (iv) asset allocation should have several diversification opportunities to meet the risk and return analysis expectations.

For example, a robust financial system should permit opportunities for a conservative or moderate or aggressive investor to make a good investment plan, which is a plan that diversifies investment portfolios through choosing a variety of investment options and allocating resources appropriately. An investment portfolio is a collection of various financial assets and securities possessed by an individual or corporate or institutional investor.

Not only does diversification efficiency provide options in the ranking strategies through observation of returns but also consideration of sizes of stocks and market capitalization (micro-cap, small-cap, mid-cap, and large-cap). It also implies opportunity for asset allocation for equity, bond, commodity and options portfolios.

⁸⁵ Professor Bhaskar. "Asset Allocation and Ranking the Strategies," in the Lecture Notes and Handouts of the course of Overview of Investment Environment. John F. Donahue Graduate School of Business, Duquesne University, PA, Summer Semester 2004.

2.4.6 Size, Depth, Development and Maturity Efficiency

A financial system is said to be efficient in size, depth, development and maturity if it is large as opposed to small in total assets, developed as opposed to underdeveloped in terms of indicators of financial depth being high in absolute terms and relative to other global comparators, deep as opposed to shallow, and mature as opposed to young in terms of institutional and legal framework and performance. This may be seen, if the selected indicators of financial depth including M2 /GDP and private sector credit/GDP are higher than the immediate country comparators.⁸⁶

The depth of a financial system is a gauge of its strength. Shallow financial institutions do not regulate well to external shocks without breaking up or exhibiting undue changes.⁸⁷ Over-reliance on friends, relatives, small money lenders and other financial institutions in the informal sector as primary sources of external finance is an example of a very shallow system because these groups tend to place their savings in real assets such as cash, land, minerals, crops and/or animals as a store of value. Few risk engaging in venture capital financing.

Deep financial institutions are known to be intrinsically less fragile than shallow financial institutions and therefore, a robust financial system should be deep. USAID advances that the ratio of broadly defined money to gross domestic product is a commonly used indicator of formal sector financier with a low ratio signifying that the formal financial system is poor at mobilizing funds. Moreover, when this is combined

⁸⁶ IMF Country Report No.03/97. “Uganda: Financial System Stability Assessment , including Reports on the Observance of Standards and Codes on the following topics: Monetary and Financial Policy Transparency, Banking Supervision, Securities Regulation, Insurance Regulation, Corporate Governance, and Payment Systems,” International Monetary Fund, April 2003.

⁸⁷ USAID Policy Papers, “Financial Markets Development, August 1988.” Accessed November 4, 2004 Available : <http://www.usaid.gov/policy/ads/200/finmkt/fm>

with increased demand for funds by the public sector, a low ratio makes credit to the private sector very scarce.⁸⁸

Moreover, a robust financial system should be developed because “as the financial system develops, prospective investors increasingly can turn to local financial institutions, national organizations, and ultimately, international banks and securities markets for additional funds.”⁸⁹

2.4.7 Integration and connectedness efficiency

This characteristic implies that a robust financial system should be integrated and connected in all forms. First, the financial markets should be linked with the financial intermediaries, the informal financial sector with the formal financial sector, the banking sector with non-banking sector, and the domestic financial institutions with the international institutions. For example, the banking sector’s equity investments in non-banking financial institutions and lending to them should be significant; not negligible.

In fact, this integration should encompass the two dimensions of integration, which are (i) vertical and (ii) horizontal integration. A vertically integrated financial system refers to the system that efficiently and effectively links and connects the informal, semi-formal and formal financial institutions.⁹⁰ It also connects the domestic and national financial institutions with the international financial institutions thereby

⁸⁸ USAID Policy Papers, “Financial Markets Development, August 1988.” Accessed November 4, 2004 Available : <http://www.usaid.gov/policy/ads/200/finmkts/fm>.

⁸⁹ *ibid*

⁹⁰ USAID Policy Papers, “Financial Markets Development, August 1988.” Accessed November 4, 2004 Available : <http://www.usaid.gov/policy/ads/200/finmkts/fm>.

increasing opportunities for mobilizing and transferring funds from abroad and thus increasing the foreign currency denominated inflows.

On the other hand, a financial system is said to be horizontally integrated when there is a basic reference rate such as the inter-bank rate, which is the market rate of a short term against which the market interest rates for financial institutions typically group themselves around.⁹¹ In doing so, the formal financial system is provided with the basic liquidity and the Central bank is provided with a measure for gauging the tightness of monetary policies.

Horizontal integration also implies appropriate standards of coordination, regulation and supervision. For example, in the USA, the federal funds rate, which is a rate at which banks borrow money from each other overnight and serves as a benchmark for consumer loans is a basic reference rate. For instance, in June 2004, several USA banks raised their prime rates, the borrowing rates they charge their best customers and which serve as benchmark for consumer loans, by a quarter of a percentage point to 4.25%. The rate increase trailed a move by the USA Federal Reserve to increase the Federal Funds Rates by a quarter of percentage point to 1.25%.⁹² In Uganda, the treasury bills rate is useful because it serves as a base rate since treasury bills are free-risk assets as the possibility of default is extremely low. Integration and connectedness efficiencies stand against sector, market and institutional fragmentation and segmentation.

⁹¹ USAID Policy Papers, "Financial Markets Development, August 1988." Accessed November 4, 2004 Available : <http://www.usaid.gov/policy/ads/200/finmks/fm>.

⁹² Rozens, Aleksandrs, "Banks Raise Price Rates," in the Yahoo! News! Reuters, New York. Accessed after June 30, 2004. Available: <http://story.news.yahoo.com/news?>

2.5 Conclusion

In a well-functioning financial system, all relevant information about the financial security's future prospects is reflected in the current price⁹³ and the market price or actual price should be equal to the intrinsic value with no chance of undervaluation or overvaluation. For example, if a financial system is robust, its financial markets are also efficient thereby denying market participants the possibility of earning abnormal returns consistently. Further, a robust financial system should be characterized by efficiency and financial depth, which support the growth of private sector through improved credit allocation, that is, extending loans to borrowers with higher expected rates of return irrespective of levels of business, financial, liquidity, exchange rate and country risks and through increased competition resulting from liberalized entry.⁹⁴ Further, it should provide higher quality financial services for a given level of inputs including technology, infrastructure, legal system, policy certainty, professionalism, experience and succession of financial staff.

Moreover, in terms of a robust or efficient financial market these features should make it possible to attain financial goals, which, in the financial stock markets are summed up into: "maximizing the current value per share of the existing stock."⁹⁵

⁹³ Professor Baird, Phillip, Ph.D, "Basic Stock Valuation... The Efficient Market," Lecture Notes in Intermediate Financial Management at John F. Donahue Graduate School of Business at Duquesne University, Spring 2005.

⁹⁴ Gayi, Samuel K and Brownbridge Martin, "Progress, Constraints and Limitations of Financial Sector Reforms in the Least Developed Countries." Available: <http://www.devinit.org/findev/working%20Paper7.htm>.

⁹⁵ Ross, Stephen, et. al. Fundamentals of Corporate Finance. Homewood, IL and Boston, MA: Richard D Irwin, Inc., 1991:14.

CHAPTER THREE

3 PRACTICAL UNDERSTANDING: SITUATION ANALYSIS OF UGANDA'S ECONOMY

3.1 Introduction

The conceptual understanding of a financial system applies to Uganda in a variety of ways. Uganda is one of the world's lowest-income countries and manifests a disrupted process of capital inflow and intra-flow and formation due to historical and contemporary factors. These complex factors plunged the country into economic and social affliction and continue to serve as indelible marks.

This chapter analyzes Uganda's economy and answers the fundamental question: What causes the lethargic and limited commercial, industrial, and investment growth and low income and high poverty levels in pre-Imperial, Imperial and post-Imperial Uganda? It explains the factors that generated this situation chronologically. It incorporates fundamental economic indicators that signal Uganda's ardent need for economic transformation through the construction of a market-oriented robust financial system with an emphasis on the *Rural Reach Refocus Financial Model*.

It also presents areas of economic difficulty that may hinder the development of a robust financial system in Uganda resulting in the country's economic transformation.

3.2 Location and Area of Uganda

Uganda is an East African nation and a member of the East African Community. It is one of the 53 countries of Africa, one of the 236 world entities, and one of the 191

independent countries that comprise the international community.⁹⁶ It is a landlocked country on the equator in East Africa. Uganda has a total area of 241,139 sq. km (93, 104 sq miles) of which 42,383 sq km (16,364 sq miles or 18%) is inland water or swamp and 30, 000 sq km (12%) is made of forest reserves and game parks, leaving 168,756 sq km (70%) as cultivable land.⁹⁷

Uganda is situated between the two arms of the Great Rift Valley in East Africa. Uganda is surrounded by Sudan in the North, Kenya in the East, Tanzania and Rwanda in the South, and the Democratic Republic of Congo in the West.

3.3 Population of Uganda

As of July 2003, Uganda was the 8th most populous country in Africa and the 42nd in the world. Uganda's population growth rate stood at 3.35% per annum⁹⁸ or about one million people born every year as of September 2004. The average household size is 4.7 persons. The total fertility rate was 6.64 children born/woman⁹⁹ and was projected to 7.1 children born/woman by mid-2005. This ranks Uganda with having the second highest fertility rate in Africa and the third highest rate in the world after the Gaza Strip and Niger.

⁹⁶ The total number of countries comprising the international communities varies according to different sources because the sovereignty of certain countries is disputed. However, independent countries range from 189 to 194.

⁹⁷ The Republic of Uganda: "The Pearl of Africa." Available on line: <http://webpages.cusus.edu/~sac19508> Cf. The World Factbook on Uganda (2004 Updates).

⁹⁸ Wossita, Samuel, "Uganda's population at 26 million," in the Monitor, Uganda, September 14, 2004. <http://www.monitor.co.ug/news> Accessed on September 14, 2004.

⁹⁹ "Why Population Matters," August 25, 2004. Available on: <http://www.overpopulation.org> quoting Xinhua General News Service of July 11, 2004 and The World Fact-book: Uganda, (2004 estimates).

According to the United Nations Population Division Report released in February 2005, the world population is projected to increase from the present 6.5 billion to 9 billion in 2050. Uganda is amongst the 9 countries whose population growth is estimated to make one half of the world's population between 2005 and 2050. Its companions are Bangladesh, China, Congo, Ethiopia, India, Nigeria, Pakistan and the United States.¹⁰⁰ As of the year 2005, the population for developing countries was 5.3 billion and was projected to increase to 7.8 billion by 2050. Richer countries constituted 1.2 billion people. Uganda also falls under the category of the world's poorest countries whose population is expected to triple by 2050. Others include Afghanistan, Burkina Faso, Burundi, Chad, Congo, the Democratic Republic of Congo, East Timor, Guinea Bissau, Liberia, Mali and Niger.¹⁰¹

The population in Uganda is sharply growing despite poverty, civil wars, diseases such as Malaria and HIV/AIDs, hunger, illiteracy, and traffic accidents. In 1960 the population of Uganda was at 6.5 million people. By 1990, Uganda had a total population of 17.6 million people; 24.7 million by 2002; and 26.8 million people in April 2005.

Quoting the 2002 Population Census by the Uganda National Demographic and Household Census, the September 2004 Uganda Population Secretariat projections observed that "the number of people would increase to 36.8 million in 2015 and to 53.7

¹⁰⁰ Lederer, Edith M. (Associated Press Writer), "U.N.: World Population to Hit 9B in 2050," Yahoo! News of February 25, 2005. Available: <http://story.news.yahoo.com/news?tmpl=story&acid=514&e> .

¹⁰¹ Mugisa Anne and Agencies (quoting the United Nations), "Uganda Population to triple," in the New Vision, Uganda [on line] February 26, 2005. Available: <http://www.newvision.co.ug/D/8/12/420180> .

million people by 2025 despite 88 children out of 100,000 dying per year before celebrating their first birthday.”¹⁰²

The UN Population Division Report of February 2005 projected Uganda’s population would triple from the current 26.8 million to around 75 million people in less than 50 years.¹⁰³ In 2004, Uganda’s estimated birth rate stood at 46.31 births/1,000 population and the death rate stood at 16.61 death/1,000 population.¹⁰⁴ According to the last Uganda National Demographics and Household Census conducted in 2000/02, the population distribution showed that 12.3% comprised the urban population while 87.7% lived in a rural setting. Uganda’s labor force was estimated at 12.09 million people in March 2005. The Uganda Bureau of Statistics Report in 2001/2002 recorded that only 3.6% of the economically active population was employed by the private sector, which was defined as “formal or informal business operating from fixed business.”¹⁰⁵

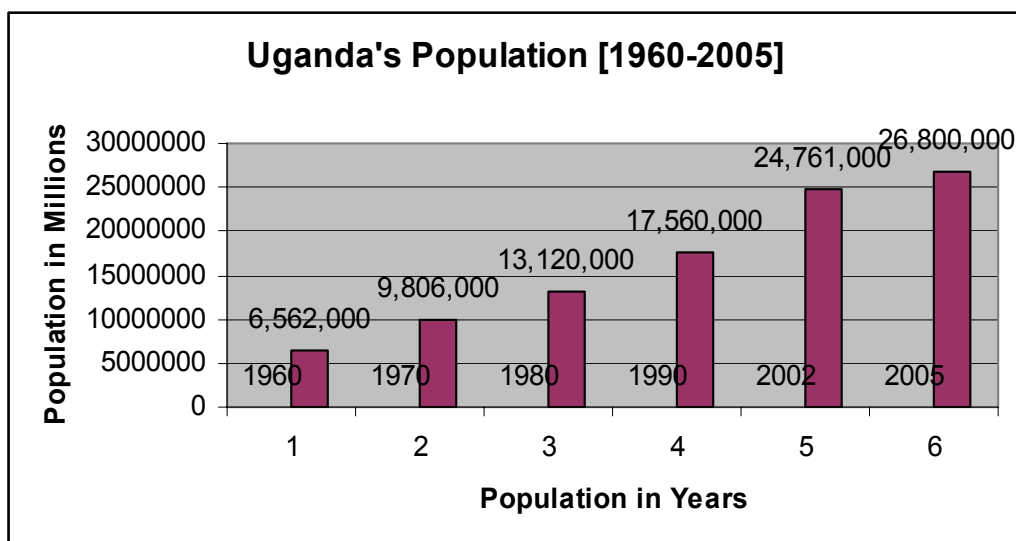
Figure 1-(3) below highlights Uganda’s population growth from 1960-2005.

¹⁰² Wossita, Samuel, “Uganda’s population at 26 million,” in the Monitor, Uganda, September 14, 2004. <http://www.monitor.co.ug/news> Accessed on September 14, 2004.

¹⁰³ Mugisa Anne and Agencies (quoting the United Nations), “Uganda Population to triple,” in the New Vision, Uganda [on line] February 26, 2005. Available: <http://www.newvision.co.ug/D/8/12/420180>.

¹⁰⁴ The World Fact-book (Uganda) Revised 2004.

¹⁰⁵ The Monitor , Uganda [Business and Finance Report] of April 5-11, 2005. Accessed on April 5, 2005.



Data Source: Uganda Population Secretariat (2004) quoted by different New Vision Newspapers of Uganda [2002-2004] and the Monitor Newspaper September 15, 2004 [On line versions].

3.4 Uganda's Economic Growth and Development

3.4.1 Uganda's Economic Growth Rate and Ranking

According to the 1994 United Nations and the World Bank economic classifications, Uganda is one of the world's low-income developing countries. The United Nations and World Bank categorizes the international community into three economic classes: (i) low-income developing countries with GDP per capita of \$725 or less; (ii) middle-income developing countries with GDP per capita above \$725 but below \$8,955; and (iii) high-income developing countries with GDP per capita above \$ 8,955.¹⁰⁶

Uganda's GDP was UGSHS 10.9 trillion (US \$5.8 billion) in 2002/03 and was expected to amount to UGSHS 12.1 trillion (US \$ 7.1 billion) for 2004/05. In 2003/2004, per capita GDP was estimated to stand at UGSHS 468, 661 (US \$250).¹⁰⁷ Moreover, as

¹⁰⁶ Stiglitz, Joseph, E. and Carl E Walsh. Principles of Macroeconomics. 3ed. New York, N.Y: W.W. Norton & Company, Inc., 2002: 479.

¹⁰⁷ Republic of Uganda Background to the Budget for Financial Year 2004/05: 4.

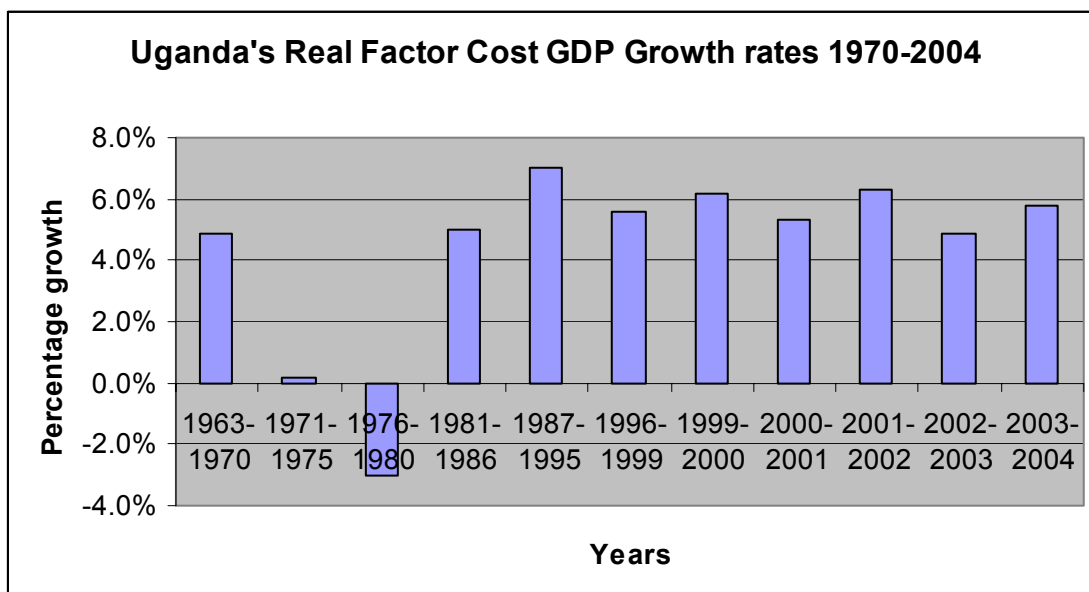
one of the African low-income developing countries, Uganda has been urged by the United Nations Economic Commission for Africa to increase productivity and economic growth to meet the Millennium Development Goals (MDGs) by 2015. To meet the MDGs by 2015, GDP growth of each Sub-Saharan Africa country ought to grow at an annual average rate of 7%, the level required to achieve the international community's target for reducing poverty.¹⁰⁸

Although Uganda's economic growth has been encouraging relative to its previous standing, it has not yet stabilized at a target of more than 7%. Rising from the troubled past during the era of President Amin (1971-1979) and of Obote II (1981-1985), Uganda's economic growth has steadily continued until 2002. Since that time, the economy has failed to grow by the targeted 7%. It has stalled due to several factors including powerful drought, rebellions, sinking commodity and export prices and rising oil prices.¹⁰⁹ Inefficiency in mobilizing and allocating financial capital has been another contributing factor.

Figure 2-(3) below shows Uganda's GDP growth rates from 1963-September 2004

¹⁰⁸ Sylvia Juuko, "Africa may need 100 years to beat poverty," quotes Mr. Trevor Manuel during the meeting of African Finance ministers and Bank Governors, in the New Vision Uganda [online division], May 24, 2004.

¹⁰⁹ Busharizi, Paul, "Uganda's Economy is stalling, says IMF," in the New Vision Uganda [on line] of February 24, 2005. Available: <http://www.newvision.co.ug/D/9/32/419825>.



Data Sources: Adapted from WTO Trade and Development Country Case Studies (1997), CIA –The World Fact Book (2000-2003), the East African Newspaper on the Web (May 31, 2004), and Background to the Uganda Budget for Financial Year 2004/2005.

During the financial year 2003/04, Uganda’s economy registered a growth rate of 5.9%, which was an improvement over the growth rate of 5.2% in 2002/2003. However, a preliminary report review released in February 2005 by the IMF saw Uganda’s economy stalling and/or slowing to 5.5% in 2004/05 ¹¹⁰ thereby energizing or reinforcing the critics of the Structural Adjustment Programs and Policies (SAPs) imposed on it together with 35 other African countries by the World Bank and the IMF institutions since 1981.

Critics of the Structural Adjustment Programs (SAPs) in Africa contend that “ *the SAPs imposed by the World Bank and the IMF on 36 African countries since 1980 have devastated the continent, decimating national economies and health and education systems...the SAPs offer loans on condition that governments drastically reduce public*

¹¹⁰ Busharizi, Paul, “Uganda’s Economy is stalling, says IMF,” in the New Vision Uganda [on line] of February 24, 2005. Available: <http://www.newvision.co.ug/D/9/32/419825>.

spending (especially on health, defense, education and food subsidies) in favor of repayment of debt owed to Western Banks, increase export of raw materials to the West, encourage foreign investment and privatize state enterprises ...steps that mean selling whatever national assets a poor country may have to Western multinational and transnational corporations.”¹¹¹

3.4.2 GDP Contribution by Industry/Sector

A financial system principally functions to match savings and investments or to help borrowers and lenders correspond, especially pursuing economic activity. Economic activity in Uganda is categorized into three sectors: (a) agriculture, (b) industry or manufacturing, and (c) services. These sectors provide investment opportunities in Uganda, which include (i) floriculture, (ii) fish and fish farming industry, (iii) cotton and textile industry, (iv) building and construction industry, (v) foods and beverages sector, (vi) education sector, (vii) health sector, (viii) financial services, (ix) fruits and vegetables, (x) electronics sector, (xi) dairy sector , (xii) tourism sector, (xiii) transport and communication industry, and (xiv) mining and quarrying industry, among others.

For the fiscal year ending June 30, 2004, agriculture contributed 38.5% to the GDP while industry (manufacturing) contributed 19.4% and services 42.0%.

Figure 3-(3) below summarizes the GDP Contribution by Sector, 1999/2000 - 2003/2004 [Fiscal Financial Years]

	1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
Agriculture	40.9%	40.7%	39.7%	38.7%	38.5%

¹¹¹ Asadi Ismi, “The Ravaging of Africa: Western Neo-Colonialism Fuels Wars, Plundering of Resources,” in the Canadian Centre for Policy Alternatives Monitor (October 2002). Accessed on April 5, 2004. Available: <http://www.minesandcommunities.org/Country/Africa 1.htm> .

Industry	18.6%	18.7%	19.0%	19.5%	19.4%
Services	40.5%	40.6%	41.2%	41.8%	42.0%

Source: Background to the Budget for Financial Year 2004/05 quoting Uganda Bureau of Statistics 2004.

3.4.3 Poverty Reigns as Uganda’s main Economic Problem

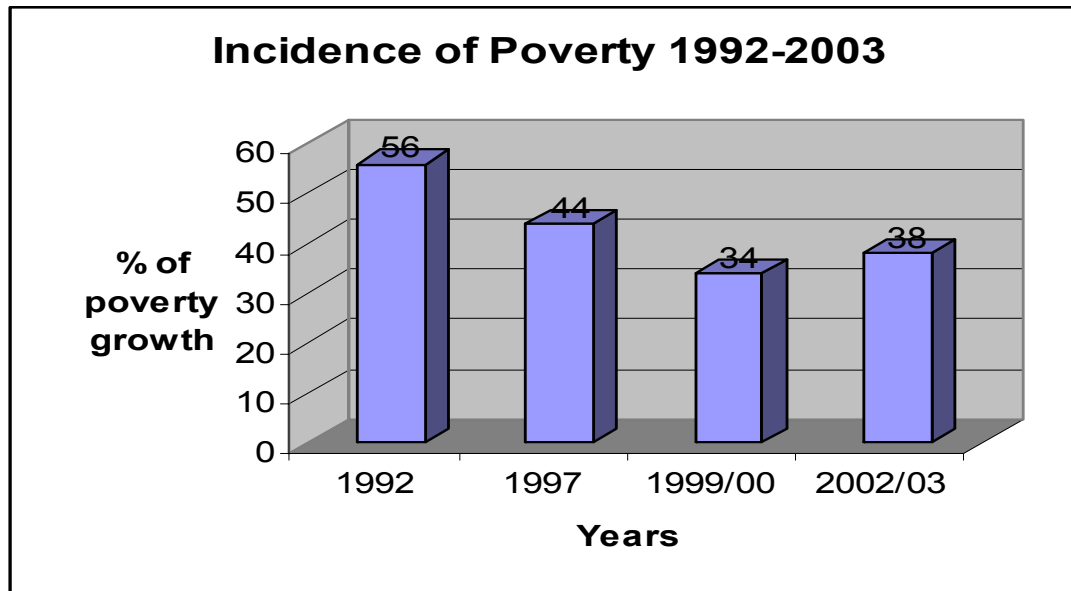
3.4.3.1 Meaning of Poverty and its Trends in Uganda

Poverty, which the *World Bank’s 2000 Development Report* defines as “an unacceptable deprivation in human well-being that comprises both physiological and social deprivation,”¹¹² has persisted in Uganda throughout the pre-Imperial, Imperial and post-Imperial periods. For example, the year 2002/03 witnessed a steady increase in poverty to 38% of the population, corresponding to 9.1 million Ugandans. It was 34% of the population, corresponding to about 7.2 million Ugandans as of 1999/2000.¹¹³

¹¹² World Bank’s 2000 Development Report’s Definition of Poverty.

¹¹³ The Republic of Uganda Background to the Budget For Financial Year 2004/05, June 2004 and IMF Country Report No.04/289, Uganda: Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver Performance Criteria –Staff Report, September 2004:9.

Figure 4-(3) below shows poverty and income trends in Uganda for the years 1992-2003



Source: International Monetary Fund Country Report No. 04/289 Approved by Michael Nowark and Mark Plant July 16, 2004. Published in September 2004.

3.4.3.2 Causes of Low Income and High Poverty Levels in Uganda

Devoting time and space to the causes of poverty in Uganda may appear to be a divergent topic. Because we cannot annul the contribution of past and contemporary factors to Uganda's income and poverty trends, we find it significant and critical to explore some of these factors. Only then will we appreciate the role of a financial system and need to construct a more robust financial system to enhance the economic transformation of Uganda. Moreover, to have an ahistorical viewpoint is to ignore or underrate or undervalue a multifaceted picture of the fundamental causes of Uganda's underdevelopment, low income and high poverty levels.

3.4.3.2.1 PRECEDING HINDRANCE FACTORS AND THEIR IMPACT

1. The Earliest Inhabitants and Settlement Economy

Uganda's present economic situation is also shaped by its history. As early as 400 B.C., Uganda was occupied by herders, gatherers and hunters. Uganda's mass poverty dates back to these early inhabitants, who are reported to have lived more than 50,000 years ago.¹¹⁴ And between 2500 and 3000 years ago, the Bantu speaking farmers are recorded to have moved into the forested areas and cleared the land for crops around Lake Victoria in Uganda, thereby joining the herders, hunters and gatherers. The Bantu agriculturalists met a migrating group of Nilotic pastoralists with both groups eventually settling in Uganda. The Nilotic settled in the northern part and the Bantu established in the central, southern and western parts of present Uganda.

Personified by powerful kingdoms such as Buganda, Bunyoro-Kitara, Toro, Busoga, and Ankole as well as by tribal chiefdoms, Uganda's socio-economic life became characterized by a settlement of an agrarian society, hunters, gatherers, iron-ore smelting workers, pastoralists and intra-traders.

2. Long-Distance Trade opened Uganda to Outsiders

Foreign trade, investment and economic development as practiced at the time did not boost Uganda's economic development although it benefited its trading partners. About A.D 1100, the Swahili City States including the ports and market places of Kilwa, Mombasa, Malindi, and Zanzibar along the Eastern Coast of Africa developed trade with Arabia, China and India. This trade, which gradually led to the penetration of the interior of Africa as a long-distance and ivory trade, eventually opened Uganda to the foreigners or outsiders from the East African Coast. The Arab traders were the first foreigners in

¹¹⁴ The Republic of Uganda: "Early History of Uganda." Webpages. On line. Accessed April 27, 2004. Available on <http://webpages.csus.edu/~sac19508/page2.htm> .

Uganda. Ivory was a popular trade product. Several herds of elephants were killed as the demand for ivory increased in the 19th century. Records have it that leading caravans sponsored by Indian money-lenders and coastal Arab traders based in Zanzibar had reached Uganda around Lake Victoria in 1844.¹¹⁵ Other trade items besides ivory tusks that were traded in by the 1860s included imported American or Indian or European cloth and guns and gunpowder.

3. Foreign Exploration, “Colonization” and Imperialism

Foreign exploration entered into the annals of Uganda’s economic history as a curtain raiser for “colonization” and imperialism. Though foreign exploration per se is not to blame for Uganda’s economic troubles, imperialism that it speedily spearheaded did not help Ugandans as much as it did the imperial masters. Exploration and foreign invasion culminated in slave trade and “colonialism” and imperialism, ills that contributed to the exploitation and plunder of Uganda’s resources.

Between the late 1400s and early 1500s, European exploration of African coasts was an activity of choice. The exploration eventually extended into the interior. In 1844, the Arab traders had become the first foreigners to enter into Uganda. They were soon followed by the British in the early 1860s.

Between 1860 and 1875, the British explorers Samuel Baker, J.H. Speke and Stanley explored Uganda. Their reports to England accelerated European-British occupation of Uganda. The British gained control of Uganda through military force and aided by the Bible and Koran following an imperialistic process that began around 1860.

¹¹⁵ US Congress Library U.S Country Studies on Uganda, US Congress Library, 1999. Accessed on August, 27, 2003. Available on Line: <http://countrystudies.us/uganda/5.htm> .

Protectorates and colonies were of great economic and political value for European colonizers and imperialists. Between the mid 1800s and 1914, popularly known as the Age of Imperialism, European nations split and divided much of the globe, including Uganda, into a hodgepodge of colonies and protectorates. By World War 1 almost all of Africa was under wrongful European occupation. For example, about 25% of the world's land and people, including Ugandans, lived under unlawful British rule. Even islands in the South and North Pacific Ocean, Arctic Ocean, Indian Ocean and Atlantic Ocean had become colonized and occupied.¹¹⁶

Imperialism, if looked at from one perspective, yielded some economic returns to Uganda including provision of infrastructure (schools and learning centers, hospitals and health centers, transport and communication systems, etc.). Although these promoted the conditions for operational and allocative efficiencies of the financial system and enhanced mass poverty reduction, the manifold economic liabilities and ills far outweighed the gains. These include failure to create (i) real agents of change in agriculture or manufacturing sectors, (ii) natural process of market forces for sustainable economic growth, (iii) markets for lengthened production, (iv) trade in value-added products, and (v) feasible sources of capital for industrialization.¹¹⁷ Surprisingly, like for many African colonies and protectorates, Uganda's economy was patterned into what is known as the *classical colonial export-economy*. Ugandans were to provide cheap raw-

¹¹⁶ Beyer, Barry, Craven, Jean, McFarland, Mary, and Parker, Walter. The World Past and Present. The World around Us. New York and Chicago: McMillan/McGraw Hill School Publishing Company, 1991.

¹¹⁷ Mahmood, Mamdani, "Uganda: Contradictions in the IMF Program and Perspective," in the IMF and the South: The Social Impact of Crisis and Adjustment. Edited by Dharam Ghai. London and New Jersey: Zed Books Ltd. United Nations Research Institute for Social Development, 1991: 210.

materials (with no or little value added) and receive pricey imports (value added products).

Territorial expansion and economic gain seem to have been the rationale for “colonialism” and imperialism of Uganda. For example, in 1888, by royal charter, Britain appointed the Imperial British East Africa Company (I.B.E.A) and gave it both political and economic authority over Uganda. Uganda became not only politically significant to Britain, but also economically critical. Uganda became a British protectorate in 1894 and its present borders were fashioned in 1926. Like many other African countries, Uganda functioned as (i) land for European settlement, (ii) source of cheap raw materials and outlets to sell products spurred by the Industrial Revolution, and (iii) place for the experimentation of administrative policies. Uganda gained its political independence on October 9, 1962.

4. *Slave Trading*

Slave trading and slavery is another factor that inescapably bears responsibility for Uganda’s economic affliction. It not only diverted human capital but also retarded economic growth and disorganized the social structure. Leinward (1991) calls slavery and slave trading “the worst evil of Imperialism in Africa.”¹¹⁸ Slave trading and slavery accompanied imperialism.

In Sub Saharan Africa including Uganda, until about A.D 1500, gold, ivory, salt, spices, and rhinoceros horns were the principal and desirable products for trade. Human trafficking, on a small scale, had also been carried on by Arab Merchants for a hundred years in Africa. But soon after the Portuguese arrived in Africa in the late 1400s, trade in

¹¹⁸ Leinward, Gerald. The Pageant of World History. Needham, Massachusetts and Englewood Cliffs, New Jersey: Prentice Hall, Inc., 1991: 765.

slaves intensified, diversified and dominated the economic activity of most Sub-Saharan Africa. Many Portuguese captured African men, women and children and shipped them to Europe as slaves. This awful, but lucrative, business attracted many more European countries into the market. Slaves from Africa and Uganda in particular were being shipped to Europe, North America and South/Latin America to do menial domestic jobs, public construction jobs, and to work on sugar or cotton plantations, thereby depriving Africa and Uganda in particular of their economic and social strengths and strangling their productivity and economic growth.

In Uganda, though this abhorrent human trade had started earlier, it was not until the early 1860s that slave trading intensified. It was spearheaded by Khedive Ishmael of Egypt, under the British influence. By the 1870s, his assorted band of ivory traders and slave raiders had raided most parts of northern Uganda including Bunyoro. Many slaves were taken from Uganda.

For over 350 years, the slave trade was the leading and most gainful type of trade between Europe and Africa. Portugal, Spain, France, the Netherlands, Germany and Italy—all actively participated in the dreadful but profitable trade. The Portuguese, English, Spanish, French, Dutch, Italians and Americans swelled up their wealth at the expense of cheap slave trade labor leaving Africa's, including Uganda's, economy devastated.

Slave trade was outlawed and abolished in most countries by about A.D. 1870, although cases of human trafficking are alleged to exist today in Uganda as well as in other countries. Human trafficking affects productivity and the labor market as well as the loanable funds market because it affects savings and investment. It is rife globally. For example, the US Justice Department reported to the US Congress in mid May 2004

that as many as 17, 500 people each year were being brought to the USA by human traffickers who trap them in slavery-like conditions for forced sex, sweatshop labor and domestic servitude.¹¹⁹ A total of US \$7 billion is annually gained world wide in the illegal exploitation of human trafficking.¹²⁰

5. *Timely Missed Benefits of Industrial Revolution and Dispersion of Technology*

The timely missed benefits of the industrial revolution also account for Uganda's underdevelopment. These delayed the dispersion of technology to Uganda, thereby keeping the pace of economic development sluggish.

Between the years A.D 1750 and 1900, Europe experienced the Industrial Revolution. Beginning in England in the middle of the 1700s, the Industrial Revolution quickly spread to other European and American countries but, unfortunately, bypassed Africa including Uganda. Beyer and group (1991) note that in Europe, *“by 1800 new technology had totally transformed the textile industry...the growth of industry had changed the ways people lived...towns with factories grew into cities...families in villages moved into industrial centers for work...the middle class made of business people some of these owning factories, mines, railroads and banks emerged... and a working class living in crowded conditions near the factories grew.”*¹²¹

First emerging in the textile industry, the use of the steam engine was quickly adopted for uses in other industries. Here was a new technology that converted heat energy into power that was not reliant on wind or water. Industrialization increased productivity. For

¹¹⁹ News Brief, “Human trafficking in the US,” in the Pittsburgh Post Gazette, Wednesday, May 19, 2004, A-24.

¹²⁰ The Forbes Investment Guide , June 1-7, 2004

¹²¹ Beyer, Barry, Craven, Jean, McFarland, Mary, and Parker, Walter. The World Past and Present. The World Around Us. New York and Chicago: McMillan/McGraw Hill School Publishing Company, 1991.

example, before industrialization, one shoe maker, working without machinery, made one pair of shoes per day and after industrialization, seven factory workers with machinery made 49 pairs of shoes a day. This increased output and economic growth.¹²² The Industrial Revolution also generated new forms of business organizations including incorporated firms, which resulted into competition and emergence of shareholding of companies with provision of dividends.¹²³

While Europe benefited enormously, the industrial revolution became an avenue for out-flowing Uganda's capital that would have created investment and accumulated and deepened wealth. Sub-Saharan Africa was targeted as the source of cheap raw-materials and profitable market for the industrialization products. Nevertheless, like many Sub-Saharan Africa countries, Uganda has eventually started to profit from the benefits of technology

Revolutions in agriculture, industry, information and entrepreneurship have played an enormous role in boosting the spread of technology in many countries. The rapid spread of technology, especially information technology (computer, internet and mobile devices) has accelerated economic transformation elsewhere. However, the late arrival and unhurried spread of this technology has impacted economic transformation in Uganda. Changes in technology and education can immensely increase labor productivity.

6. Internal Economic and Financial Policy Errors

¹²² Beyer, Barry, Craven, Jean, McFarland, Mary, and Parker, Walter. The World Past and Present. The World Around Us. New York and Chicago: McMillan/McGraw Hill School Publishing Company, 1991.

¹²³ Leinward, Gerald. The Pageant of World History. Needham, Massachusetts and Englewood Cliffs, New Jersey: Prentice Hall, Inc., 1991: 519.

Low income levels, high poverty trends, and underdevelopment in Uganda also relate to the internal economic and financial policy errors that both imperial and post-imperial government leaders made.

First, the imperialists' production control, land tenure, agricultural produce and subsidization policies weren't appropriate and were thus opposed by most Ugandans. This created strained relations between and among Ugandan peasants, imperial growers and local chiefs. For example, World War 1 (1914-1918) significantly affected the global commodity markets with fluctuations in world prices. This pushed the colonial powers in many countries to consolidate subsidies for agricultural plantations. However, rather than subsidize plantations, the Ugandan imperialists refused to do so.¹²⁴ They opted for a low-cost productivity strategy that relied on small scale peasant cultivators for provision of export commodities. Refusal to subsidize resulted in decreasing cash-crop production while increasing subsistence agriculture that still dominates Uganda's economy today. In addition to war effects, the 1916 upsurge of cotton exports rising from baled cotton export valued at 200 Sterling Pounds in 1905 to 369,000 Sterling Pounds in 1915, made Britain end its subsidy of imperial administration in Uganda.¹²⁵ This affected productivity and development.

Second, following its political independence in 1962, Uganda's embrace of a socialist economic strategy of *Common Man's Charter* affected economic transformation. It denied economic freedom and property rights and disregarded the economic

¹²⁴ Mahmood, Mamdani, "Uganda: Contradictions in the IMF Program and Perspective," in the IMF and the South: The Social Impact of Crisis and Adjustment, Edited by Dharam Ghai. London and New Jersey: Zed Books Ltd. United Nations Research Institute for Social Development, 1991.

¹²⁵ The Country Studies by U.S Congress Library on Uganda, "Uganda: Colonial Era." Accessed August 27, 2003 Available on <http://countrystudies.us/uganda>

importance of the market economy in steering economic transformation. Following liberation from the foreign occupation, most post-colonial era African heads pursued some economic strategies aligned to either Capitalism or Socialism, Communism or Marxist economic systems. The majority avoided capitalism and embraced economic strategies and systems that had one common economic error: neglect of economic freedom demonstrated by the muzzling of the market economy and property rights.

For example, Tanzania, under Mwalimu Julius Nyerere, followed a *Socialist Ujamaa* system. Ghana's Nkwame Nkrumah promoted *African Conscientism*. Zambia's Kenneth Kaunda advocated for *African humanism*. Jomo Kenyatta of Kenya advocated for a *Socialist Harambee* system. Mozambique's Frelimo's Third National Congress (1977) embraced a *Marxism-Leninism* system. South Africa thrived under *Apartheid*. Meanwhile, Milton Obote of Uganda, having suspended the constitution of Uganda in 1966, published and embraced a *Socialist Common Man's Charter* program.

Uganda's Socialist Common Man's Charter of 1969 had a maxim that read, "One country, one people, one party (UPC), one Parliament, and one destiny."¹²⁶ It was adapted from Tanzania's Arusha Declaration of 1967 by Mwalimu Julius Nyerere. While it slightly avoided Nyerere's socialism under the Arusha Declaration by which many Asian properties and businesses were nationalized at 100% state-ownership, Obote's Common Man's Charter, was essentially the nationalization of over 60% of all businesses.

Considered as a spirit of nationalization that would enhance industrialization, it achieved less than the expectations. Moreover, it created state-owned corporations and

¹²⁶ World History at KMLA (January 2002). KMLA stands for Korean Minjok Leadership Academy. Accessed in May 2004.

monopolies including the banking industry in the financial sector. This, eventually, had a harmful impact not only on national fiscal funding but also on capital accumulation, market creation, and economic growth. In fact, even before the Amin era's errors occurred, Uganda's annual average economic growth rate had started declining.

Third, President Amin's 'Economic War' and the Asian-Indian forced exodus was an internal economic policy error that contributed to Uganda's underdevelopment and high rate of poverty because it disrupted economic activity, productivity and development. The year 1896 had brought the construction of the Uganda Railway and the largest influx of Indians into East Africa. Construction of the railroad had started in Mombasa in 1895 and reached Kampala in 1931. As the Uganda Railway was being constructed, Indian traders followed the route and opened up stores along the way. The British government of East Africa relied on Indian clerks, administrators, judiciary, postal service, currency system, and police force already familiar with British bureaucracy secondary to British colonization of India.

Eventually, the Ugandan population providing both the labor force and local market was composed of (i) local Ugandans (Africans), (ii) Europeans (White Settlers), and (iii) Indian-Asians (Indian Entrepreneurs). At the time of political independence in 1962, Uganda had a total Asian population of 77,400 rising from 5,200 in 1921, 14,150 in 1931 to 17,300 in 1939 while the total Asian population of East Africa was 366,013. It had been 6,345 in East Africa in 1887.¹²⁷

Ugandan economic historians note that *“by 1919 and in the period between World War I and II enterprising Indians, especially the Mehta Group and Madhvani Group, laid*

¹²⁷ The Indian-Asian establishment in Uganda. Available <http://www.asiansfromuganda.org> Accessed May 13, 2004.

*the foundations of the 20th Century industrial empires starting with the agricultural processing of sugar, tea, coffee, and cotton ginning and expanding into the manufacturing.”*¹²⁸ By 1919, Indians were trading and exporting almost 50% of Uganda’s cotton crop to Bombay Mills, India. Mamdani (1991) pertinently recounts that “an immigrant trading and processing minority from India controlled the processing of export agriculture and the marketing of major agricultural exports and consumer imports, while agricultural production was the preserve of local peasant producers.”¹²⁹

Following his take over of power through a military coup de tat in 1971, Amin, swiftly and myopically, waged the economic war that quickly placed the economy into a fragile situation. The 1972 expulsion of the Asian-Indian minority – residents and non-residents, trading and non-trading – from Uganda not only spectacularly altered the composition of the urban population but also affected the production and marketing micro-and macro-economic environment consisting of the demographic, cultural, economic, and technological factors. In particular, their forced exodus affected the supply and demand curves in all sectors of the economy. For instance, the structure of demand for both imported and locally produced consumer goods including food stuffs and the supply of entrepreneurial and technical skills suffered a setback.

Mamdani aptly refers to Amin’s economic war of 1972 as the “starting point of a period of sharp economic destabilization and ‘mismanagement’.”¹³⁰ With the forced

¹²⁸ Anonymous Author quoting the Country Studies by US Congress Library on Uganda, “Uganda: The Colonial Era.” Accessed August 27, 2003. Available: <http://countrystudies.us/uganda>.

¹²⁹ Mahmood, Mamdani, “Uganda: Contradictions in the IMF Program and Perspective,” in the IMF and the South: The Social Impact of Crisis and Adjustment. Edited by Dharam Ghai. London and New Jersey: Zed Books Ltd. United Nations Research Institute for Social Development, 1991: 202.

¹³⁰ *ibid*, 187.

exodus of Asian-Indians (immigrant bourgeoisie) and the take-over of their assets and enterprises, the growth and efficient management of the private sector, which is the focal sector in economic transformation, was disrupted. Majority private enterprises were taken over by a blend of inept middle-class hopefuls and military or civilian bureaucrats.

The managerial vacuum created by the forced exodus was to be filled by the corrupt state management. Amin's policies produced a state-created and state-protected echelon of powerful proprietors, commonly known as the *mafutamingi*.¹³¹ This wealthy minority of local propertied individuals was characterized by lack of managerial skills and sponsorship of smuggling and tax evasion. This led to the decrease in state revenue collection that eventually generated a significant division between the working class and wealthy property owners leading to a fiscal crisis. As the government failed to tax the *mafutamingi* group, it resorted to dependence entirely on the taxation of peasants' and workers' incomes.¹³²

Obote II's regime of 1981-1985 did not disrupt the *mafutamingi* stratum. Rather, it perpetuated it. Despite the *mafutamingi* proprietors having more money in their hands, they did not promote investment and productive activities. They preferred consumption of imported luxury products. During this period export taxes and sales taxes were the principal sources of state revenue. With this, the size of state revenue dwindled and failed to finance the national budget leading to a biting state budget deficit. The budgetary shortfall was made up over the years through deficit financing including printing of more

¹³¹ The word *mafutamingi* was popular during the Amin era (1971-1979) and in the early 1980s during the Obote II regime. It referred to those rich people with government direct or indirect connections and with ill-gotten property or quick yielding speculative investments.

¹³² Mahmood, Mamdani, "Uganda: Contradictions in the IMF Program and Perspective," in the IMF and the South: The Social Impact of Crisis and Adjustment. Edited by Dharam Ghai. London and New Jersey: Zed Books Ltd. United Nations Research Institute for Social Development, 1991:188.

money, nourishing inflation.¹³³ Subsequent governments have continued to inherit the financial troubles of this economic and financial situation.

7. Bad governance, Conflicts and Civil and National Wars in Uganda

Although foreign stratagem is one of the causes of civil and national wars in most African countries, sectarianism, bad governance and mismanagement have contributed more to civil and national wars in Uganda. Numerous civil wars and coup d'états in Uganda contribute greatly to Uganda's low income levels and high poverty trends. These wars destroyed life and property and disrupted economic development in several ways. The 1971 coup d'état caused significant economic instability and chaos. In 1979, President Amin was ousted after a prolonged and costly liberation war that destroyed not only property but thousands of lives. It slowed down economic development and was followed in 1985 by a military coup d'état removing Obote II from power. Opposition to Obote II had started in 1981 by the National Resistance Army (NRA) rebellion against election fraud, culminating in the disruptive armed conflict.

In 1986, the NRA took over the government by force after a bloody five year guerrilla bush war. Although there was relative peace following this take over, portions of the country, especially the northern region, have yet to experience political stability. Each of these armed conflicts disrupted economic development programs.

Political unrest in Uganda affects business by upsetting contracts such as payments, destroying assets such as buildings, factories and equipment and people through the civil unrest of terrorism, kidnappings and violent accidents. These have had huge impact on

¹³³ Mahmood, Mamdani, "Uganda: Contradictions in the IMF Program and Perspective," in the IMF and the South: The Social Impact of Crisis and Adjustment. Edited by Dharam Ghai. London and New Jersey: Zed Books Ltd. United Nations Research Institute for Social Development, 1991:192.

investment, trade and economic development. Lack of confidence in the Ugandan economy discouraged foreign and domestic investors. Consequently, the financial system, especially the banking sector and other lending financial institutions were underutilized leading to their underperformance, under capitalization and huge losses.

Conflict in Uganda also contributed to high inflation and loss of confidence in the local currency (Uganda Shilling) compared to neighboring countries like Tanzania and Kenya. Smuggling or *Magendo* (illegal cross-border trade) of tea, coffee, animal trophies, petroleum products, and gold to the neighboring countries of Rwanda and Kenya, became common.

3.4.3.2.2 CONTEMPORARY HINDRANCE FACTORS AND THEIR IMPACT

Historical events are not the only contributing factors to Uganda's high rate of poverty, low incomes and low standard of living. Contemporary factors contribute to the high rate of poverty in Uganda. Despite promising growth, poverty and inequality trends are still high and alarming. We have, just as the September 2004 IMF Country Report No.04/289 on Uganda, observed that factors contributing to the increase in poverty in Uganda include:

- High financing costs: Financial capital –credit and cost of capital – in form of commercial lending interest rates ranging from 11% to 25% and micro-finance industry lending and borrowing interest rates, have remained high for a long time and become disincentives to entrepreneurship;
- The slow down in real GDP growth in recent years ranging around 5.4%-5.9% for three consecutive years;

- Decline in the terms of trade, especially in agriculture which is the backbone of the economy;
- Failure to achieve sustained growth due to internal factors such as insecurity in the northern parts of the country and corruption, especially in public offices;
- Artificial barriers including cumbersome laws and physical barriers including inadequate highway systems enabling national and intra-African trade;
- Poor infrastructure and lacking socio-economic amenities;
- Being landlocked with very high transport costs to access the coast ;
- Limited access or total inaccessibility to bigger markets of industrialized countries as well as trade in raw materials rather than value-added products; and
- High population growth despite the prevalence of HIV/AIDS and Malaria with a very high disease load. ¹³⁴ It was reported in January 2005 that between 70,000 and 80,000 workers died of HIV/AIDS annually. Of these, about 19% accounted for the workers in the informal sector while between 10% and 14% were in the formal sector.¹³⁵

3.4.3.2.3 *RESULTANT CONTEMPORARY ECONOMIC CONDITIONS*

3.4.3.2.3.1 *Low Labor Productivity*

Labor productivity is a contemporary economic factor of great importance. Where productivity is high we find more motivated investors. Conversely, where there is low labor productivity we notice reluctance by the majority of investors. Uganda's labor

¹³⁴ IMF Country Report No.04/289, Uganda: Third Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver Performance Criteria –Staff Report, September 2004 :9

¹³⁵ Writer of the [New Vision Newspaper, Uganda](#) [on-line], January 14, 2005.

productivity, which is measured in terms of value added per worker, is low especially in small and medium enterprises (SMEs).

Many reasons account for this scenario but the most important include low levels of education and skills in Uganda as well as limited incentives. Uganda's level of investment in human capital, that is, investment in the social sectors of education, vocational training and public health remains negligible. Small and medium enterprises constitute the largest percentage of the country's informal sector and most entrepreneurs lack sufficient education and skills to foster successful entrepreneurship. This keeps output low. Amacher aptly puts it, "labor that is healthy and well educated is more productive."¹³⁶ Uganda's limited technology and wanting educational system contribute to the country's low labor productivity.

Low productivity places Uganda in a weak position in terms of attracting foreign investments. Generally, while labor availability is an important consideration for direct investments in low income developing countries, labor productivity counts more.

3.4.3.2.3.2 Reliance on Primary Commodity Trade

- *Meaning:* Primary commodity markets refer to trade dealing with primary products before they are processed.¹³⁷ Uganda's export sector is still dominated by primary commodity markets and products. It heavily depends on primary commodities for its wealth creation and economic growth. They are either consumer or producer commodity products. The Natural Resource Institute of the University of Greenwich,

¹³⁶ Amacher, Ryan C. Principles of Economics. 2d edition. Cincinnati, Ohio: South -Western Publishing Co. ,1983: 641.

¹³⁷ Commodity Markets, "Definition and Examples." Accessed on May 26, 2004. Available: http://www.trail.eunits.co.uk/html/commodity_markets.html.

UK observes that “*commodity trade in world markets is the economic backbone of most of the world’s developing countries, particularly in Sub-Saharan Africa; and production and export is centered in the developing countries of the ‘South’, and import and consumption is in the industrialized countries of the ‘North’.*”¹³⁸

- *Examples of primary commodities traded:* Ugandans participate in domestic or foreign (regional or international) commodity markets and trade for: industrial raw materials such as non-metallic chemicals; ferrous metals such as iron, steel, and aluminum; non-ferrous metals such as tin, diamonds, gold, uranium, cobalt and copper; energy and power such as coal, crude oil, charcoal, geo-thermal, etc.; fishery food and agricultural products such as food crops (coffee-beans, tea leaves, bananas, fruits, vegetables, vanilla, simsim, palm oil, grains, etc.), livestock (beef, bacon, chicken, etc.) and fish; and agricultural non-food products such as cash crops like cotton, rubber, sisal, tobacco, timber, and animal products like hides and skins.¹³⁹
- *Impediment to Economic Growth:* The main impediment of primary commodity trade to economic development is not only lower prices but also frequent price fluctuations in the world primary commodity market. Dependency on this exchange is filled with economic risk for Uganda. Agricultural or cash crop products are the most vulnerable in the global primary commodity markets. Uganda’s chief exports are dominated by these products, thereby exposing the country to greater market risks.

¹³⁸ Coote, Claire and Dr. Peter Greenhalgh, “Commodity Trade in World Markets,” Natural Resources Institute –NRI Project Codes: C1487. Accessed May 26, 2004. Available: <http://www.nri.org/work/etf-commoditytrade.html>.

¹³⁹ Coote, Claire and Dr. Peter Greenhalgh, “Commodity Trade in World Markets,” Natural Resources Institute –NRI Project Codes: C1487. Accessed May 26, 2004. Available: <http://www.nri.org/work/etf-commoditytrade.html>.

As of the first quarter of the fiscal year 2005, Uganda was losing about UGSHS 2.4 billion (US \$139 million) export revenue due to exporting unprocessed leather in the form of hides and skins. Uganda produced 1.1 million bovine hides and skins and more than 95% was exported in its raw form, generating formally recorded exports of US \$11 million per annum instead of US \$150 million that would have been earned had the exportation been of finished products. Moreover, it spent UGSHS 7.5 billion on the importation of about 15 million pairs of leather shoes alone.¹⁴⁰

In an era of privatization and liberalization, marketing boards are no longer protected by their mother countries in the bargaining or fixing of prices and Ugandan agricultural exporters are disadvantaged. Moreover, industrialized countries such as the USA and EU offer substantial subsidies to their farmers, something that is lacking in Uganda.

3.4.3.2.3.3 External Debt Burden

Following cancellation of the debt on June 11, 2005 of the 18 world's poorest countries by the G8, the economic landscape of the 18 world' poorest nations looked forward to changing for the better. However, before the G8 or the world's 8 richest countries cancelled US \$40 billion owed by the 18 world poorest countries including Uganda, Uganda's external debt was standing at US \$ 4.3 billion, a tremendous economic burden and one that slowed the process of economic development. It greatly impacted the efficiency of the financial system in Uganda because it directly affected savings and investments, which are ingredients of long-term economic growth and a key source of the financial system's robustness.

¹⁴⁰ Nakaweesi, Dorothy, "Uganda loses Shs2.4bn in hides and skins trade," in *the Monitor, Uganda* [online] March 25, 2005. Available: <http://www.monitor.co.ug/business/bus03251.php> .

Uganda's debt burden dated back to the early 1960s when the country adopted a *nationalist strategy* to industrialize the nation and finance major developmental projects by borrowing from key international banks and lenders including the World Bank. There exist two main sources of finances for any country's economic activities: (i) internal funding and (ii) external funding. While the *internal source* pertains to revenues obtained through taxation and fees of all forms, export/import trade, donations and domestic borrowing, the *external source* relates to revenues obtained through foreign aid in the form of grants, loans, debt relief, foreign donations, and borrowing from foreign funds.

Foreign loans and borrowing, in particular, were responsible for Uganda's debt burden. It became the genesis of the debt predicament with its effect of debt servicing that continues to cripple economic development programs. Taking advantage of the international expansionary era, foreign aid flowed into Sub-Saharan Africa and Uganda in particular in the early 1960s. As years progressed, the international financial environment escalated with unfavorable high interest rates, making disbursement more difficult. By 1996, foreign aid represented 10-13% of GDP of many African countries with costly debt servicing impact.¹⁴¹

Between 1986 and 1994, Uganda's external debt is noted to have increased by 128%, that is, from US \$1.4 billion to US \$3.2 billion. The highest rises occurred in 1987, 1989 and 1990 due to new expenditure arising from the pressure of the structural adjustment

¹⁴¹ Dr. Opio, Peter (Dean of Business School at Uganda Martyrs University, Nkozi, Uganda), "Economic Development and Nation Building in Africa: In search of a New Paradigm," at African Nation Builders Workshop, Minnesota, 2000.

reform policies. Debt as percentage of GDP increased from 11.8% in 1971 to 66.1% in 1995.¹⁴²

Although Uganda's powerlessness to fulfill its debt servicing duty dates back to the late 1970s, with total debt stock increasing by 16% to 17% annually towards the end of 1980s, it was not until 1992, when the country intensified its campaign of debt-reduction, that its external debt burden became glaringly evident.

Resulting from its status as a harshly indebted low-income country (HILIC) and from its impressive economic discipline demonstrated by its dedication to the implementation of structural adjustment programs (SPAs) since 1987, Uganda started to benefit from debt relief initiatives from several of its creditors. For example, in addition to obtaining debt relief from the Paris Club five times between 1981 and 1999, under the Toronto terms in 1989, London terms in 1992, Naples terms in 1995, Lyon terms in 1998, and Cologne terms in 1999, Uganda received debt relief from the International Development Association (IDA) in 1992, and the Multilateral Debt Fund (Uganda) in 1995.¹⁴³

Although, in 2000, Uganda qualified for enhanced Highly Indebted Poor Countries (HIPC) debt relief worth US \$1.3 billion and Paris Club debt relief worth US \$145 million, its debt burden remains daunting. The HIPC Initiative had as its principal purpose: reducing to sustainable levels the debt burden of low-income developing countries that had demonstrated sound economic and social policy reforms. To reduce to sustainable levels the debt burden of poor countries would eliminate the debt overshadow

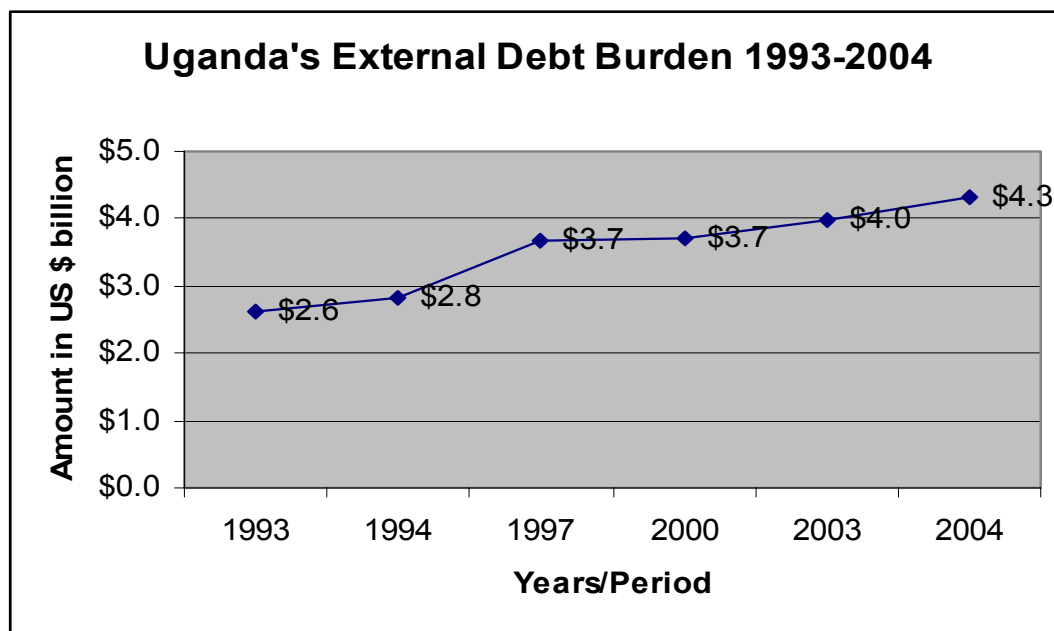
¹⁴² Mahmood, Mamdani, "Uganda: Contradictions in the IMF Program and Perspective," in the IMF and the South: The Social Impact of Crisis and Adjustment. Edited by Dharam Ghai. London and New Jersey: Zed Books Ltd. United Nations Research Institute for Social Development, 1991: 202.

¹⁴³ Ibid, 1991: 202

and apportion expenditure to economic and social infrastructure, utilities and amenities needed for enhancing economic development.

As of March 2005, Uganda’s external debt stood at over US \$4.3 billion. It stood at US \$4.3 billion in 2004 when it had risen from US \$3.9 billion in 2003, US \$3.7 billion in 2000, US \$3.7 billion in 1997, US \$2.8 billion in 1994 and US \$2.6 billion in 1993.

Figure 5-(3) highlights Uganda’s external debt burden for the years 1993-2004



Data Source: Background to Uganda’s Budget Speech 2004/2005, Mijumbi Peter’s Document 2001 and the New Vision and Monitor [on-line] 2004-2005

Despite government’s commitment to reduce the debt burden even with the support of the HIPC debt relief, Uganda’s external debt was rising. Uganda’s external debt had been rising by an average of US \$108 million per year.¹⁴⁴

Five factors account for this scenario. They are: (i) large sums of borrowed money between 1981 and 1985 and after 1987 for economic recovery and stabilization programs,

¹⁴⁴ A.Mutumba-Lule, “Politics Sinking Uganda into Debt,” in the East African Standard, July 19, 2004, Regional News. Available : <http://nationmedia.com/estafrican/current/Regional/Regional2007200465>.

(ii) economic corruption in form of embezzlement of public funds and mismanagement of borrowed funds,¹⁴⁵ (iii) decline in export earnings, especially earnings from the strategic exports such as coffee, cotton and tea, which affect the country's capability to meet its debt service duty, (iv) general insecurity, instability and armed conflict in some parts of the country, especially the northern region, and (v) total belief in the SAPs and Debt Relief doctrine despite the pitfalls.

Debt service payments were increasing too. For example, while the debt service was US \$133 billion in 1999/2000, it rose to US \$172 million in the financial year 2000/2003, and in 2004 it was at about US \$ 180 million.¹⁴⁶ Mijumbi aptly observes that *“large annual debt payments limit foreign exchange reserve buildup and contribute to the balance-of-payments financing gap while placing significant pressure on the budget... reduces funding that would go to priority sectors (primary education, primary health care, water and sanitation, agricultural extension and rural roads) outlined by Uganda's Poverty Eradication Action Plan (PEAP).”*¹⁴⁷

Re-servicing debts in tandem providing social services was a tough task for developing countries like Uganda. This is why when on March 15, 2004 the Japanese government cancelled a UGSHS 110 billion (US \$57.2 million) debt, enlightened and patriotic Ugandans rejoiced because Uganda would be saving UGSHS 6 billion (US \$3

¹⁴⁵ Mijumbi, Peter, A (Visiting Senior Research Fellow , Economic Policy Research Center, Kampala, Uganda), “ Uganda's External Debt and The HIPC Initiative,” a paper prepared for the North-South Institute 2001.

¹⁴⁶ A.Mutumba-Lule, “Politics Sinking Uganda into Debt,” in the East African Standard, July 19, 2004, Regional News. Available : <http://nationmedia.com/estafrican/current/Regional/Regional2007200465>.

¹⁴⁷ Mijumbi, Peter, A (Visiting Senior Research Fellow , Economic Policy Research Center, Kampala, Uganda), “ Uganda's External Debt and The HIPC Initiative,” a paper prepared for the North-South Institute 2001.

million) annually for the next 20 years. The cancellation of the debt would henceforth buttress poverty alleviation and the provision of social services in the education, health and roads sectors.¹⁴⁸

Serious actions have to be put in place to restore the sustainability of the external debt burden and to reduce external borrowing lest poverty escalates. Placing a ceiling on government's annual new borrowing leads to debt sustainability. Practically, the benefits announced by donors in 1998 as to accrue from the debt relief initiative are not forthcoming. They are minimal. With increased debt service payments, Uganda's government finds itself handicapped when it comes to implementing its noble Poverty Eradication Action Plan (PEAP) aimed at improving quality of life, and reducing poverty and ultimately enhancing the standard of living.

3.4.3.2.3.4 An Enlarged Informal Sector

o What is the informal economy or sector?

According to the Uganda Bureau of Statistics report published in March 2005, Uganda's informal trade greatly contributed to GDP by fetching US \$23.7 million in 4 months. Between October 2003 and January 2004, Uganda's informal exports amounted to about US \$23.7 million and US \$4.6 million for informal imports. Recorded or formal trade figures were at US \$ 47.8 million of exports and US \$ 107.5 million of imports.

The informal economy concept, which is synonymous with informal sector, is multifaceted and amorphous, so much so that it is difficult to give its precise meaning. The informal sector is defined and understood by the international community based on the System of National Accounts (SNA) of 1993 and Fifteenth International Conference

¹⁴⁸ Eremu, John, "\$ 6b Saved Annually," in the New Vision, Uganda [on-line] of March 16, 2004.

of Labor Statisticians (ICLS) of 1993 definition that incorporates both work and enterprise approaches.

Unni,¹⁴⁹ referring to the *System of National Accounts (SNA)*¹⁵⁰ of 1993, characterizes the informal sector “*as consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned...forming part of household sector as unincorporated enterprises owned by household...and distinguished from corporations and quasi-corporations on the basis of their legal status and the type of accounts held.*”¹⁵¹ Units in the household sector in the informal economy lack and do not follow full accounting standards and codes.

Further, the *Fifteenth International Conference of Labor Statisticians (ICLS) of 1993* adapted an operational definition of the informal sector. It places the informal sector within the household sector of the economy and explains that it “*consists of (i) informal own-account enterprises that are single member or partnership household units that do not hire workers on a continuous basis and (ii) enterprises of informal employers as*

¹⁴⁹ Unni, Jeemol’s work: [Informal Sector: Definition and Survey Methods](http://www.mospi.nic.in/informal_paper_04.htm) at Gujarat Institute of Development Research, Gota, Ahmedabad 380 060. Accessed on November 11, 2004. Available: http://www.mospi.nic.in/informal_paper_04.htm .

¹⁵⁰ System of National Accounts (SNA) comprises a logical and incorporated set of macroeconomic and finance accounts, balance sheets and tables based on a set of internationally agreed concepts, definitions, classifications and accounting rules. It provides a comprehensive accounting framework within which economic data can be compiled and presented in a format that is designed for purposes of economic analysis, decision-taking and policy-making. It also serves as a point of reference in establishing standards for related statistics.

¹⁵¹ Unni, Jeemol’s work: [Informal Sector: Definition and Survey Methods](http://www.mospi.nic.in/informal_paper_04.htm) at Gujarat Institute of Development Research, Gota, Ahmedabad 380 060. Accessed on November 11, 2004. Available: http://www.mospi.nic.in/informal_paper_04.htm .

*household units owned and operated by employers, singly or in partnership and employ one or more employees on a more or less continuous basis.”*¹⁵²

The World Bank Group advances that there are two sub-categories of the informal sector units incorporated in its concept at the international level. These are the (a) family enterprises, which consist of independent or own-account owners, family workers, trainees and casual workers with no permanent employees and (b) the micro-enterprises, which comprise unregistered units with between 2 to 10 unregistered employees.¹⁵³

○ *Difference between the informal sector and formal sector*

Although there are several differences between the informal and formal sector, the major difference between them is based on the economic units and activities including production, distribution and consumption. While the formal sector's related sequence of supply and value chain activities are regulated and tracked by the official record-keeping system of a governing organ,¹⁵⁴ in the informal sector the official tracking system may be absent, deficient or highly inaccurate. For example, the elimination of child labor (ECL) in Uganda remains difficult because most children work in the informal sector and their numbers, ages, grades and conditions are formally and methodically unknown. That is why the *World Bank Online Discussions* on June 11, 2003 describe the informal economy as the economy where most income is unreported

¹⁵² Unni, Jeemol's work: [Informal Sector: Definition and Survey Methods](http://www.mospi.nic.in/informal_paper_04.htm) at Gujarat Institute of Development Research, Gota, Ahmedabad 380 060. Accessed on November 11, 2004. Available: http://www.mospi.nic.in/informal_paper_04.htm.

¹⁵³ The World Bank Group, "Urban Development –Program and Project Options, The Informal Economy and LED: What is the Informal Economy?" Accessed November 11, 2004. Available: http://www.Worldbank.org/urban/led/informal_economy.html.

¹⁵⁴ Noury, Alex, J., "The Informal Sector and Its Divisions," in *Exploring the Economy's Informal Sector*, the Progress Report. Accessed November 11, 2004. Available: <http://www.progress.org/2003/noury03.htm>.

and illegal activities such as smuggling, gambling, and tax and local tribunal fees evasion or misappropriation go undetected.¹⁵⁵

On contrary, in the formal system, businesses or enterprises are registered, books of accounts and records are maintained and audited, tax returns are filed, bank accounts and statements are maintained, and government dues and employee benefits are paid.¹⁵⁶

o *Economic Unit Segments and Activities of Uganda's Informal sector*

Quoting the Commission of Labor of Uganda, the editorial commentary of the *New Vision, Uganda* Newspaper [on-line] of May 12, 2005 observed that an estimated 65% of Uganda's labor force is unemployed and the country was creating only 8,120 of 390,000 new jobs required annually.¹⁵⁷ Quoting the Global Entrepreneurial Monitor (GEM) report published in early May 2005, the editorial commentary highlighted that Uganda had 3.3 million entrepreneurs in a population of 26.8 million and was one of the highest ratios in the world. However, only 14% of the entrepreneurs were in the formal sector.¹⁵⁸

Uganda's informal sector contributes to income and savings and investment. The informal sector in Uganda is better understood when observed from distinct economic unit segments and activities, which include the following:

1. *Self-Employed Family or Micro Entrepreneurs*: This segment includes those individuals who use informal financial institutions to start new micro-enterprises in the villages. Such enterprises include small shops, kiosks, restaurants or bars or

¹⁵⁵ World Bank Hot Topics for a global community, "The Informal Economy: large and growing in most developing countries," Online Discussions; Discussion closed on June 13, 2003. Available: <http://www.rru.worldbank.org.Discussions> .

¹⁵⁶ Editorial of the *New Vision, Uganda* [on line] of May 12, 2005

¹⁵⁷ *Ibid*, May 12, 2005

¹⁵⁸ Editorial of the *New Vision, Uganda* [on-line] May 12, 2005.

agricultural business including rearing of animals such as poultry, cattle, pigs, etc. or trade in handcrafts and crops such as grains.

2. *Self-Employed Street Vendors*: This unit and activity comprise legal and illegal self-employed street workers or vendors selling second hand clothes *ntunda* or *mitumba* or *mivumba*, food vendors selling roasted or cooked chicken , beef, *nyama choma*, *gonja*, fruits and vegetables, and individuals selling salvage value electrical, household and/or scholastic goods.
3. *Self-Employed or Non-Self Employed Workshop Workers*: These are engaged in the production of either furniture including coffins for burial, shutters (doors and windows), household chairs and tables among others or metal or scrap products including frames for windows and doors, gates, *kalayas*, garbage cans, utensils, and many more.
4. *Self-Employed or Non-Self Employed Miscellaneous Workers*: This segment of informal sector workers includes regular charcoal burners, firewood-fuel collectors, brick bakers, water porters, local brew sellers, bee-keepers using traditional bee-hives, fishers using traditional methods such as baskets and hooks, and many more.
5. *Non-Self Employed Odd-Job Workers*: Odd job workers, also known as *Nkuba Kyeyo* include night guards or watchmen, shoe shiners, unlicensed parking attendants, waste collectors, public toilet and/or urinal cleaners, wheel barrow or wooden cart pushers, prostitutes, bar maids, motor vehicle and cycle cleaners, etc.

6. *Resident or Non-Resident Domestic Service Workers*¹⁵⁹: Resident or non resident (immigrant) domestic service workers such as gardeners, housekeepers, baby sitters, house boys or girls and many more also constitute the informal sector.
 7. *Seasonal/Casual Workers*: Another unit and activity found in Uganda's informal sector includes itinerant or seasonal or temporary or casual job workers. Many of these work on building sites or road constructions.
 8. *Mutual Self-help Workers*: Mutual self-help workers such as women cultivating or digging each other's gardens on rotational basis also constitute the unit and activity in Uganda's informal sector.
 9. *Rural Bicycle or Motor Cycle Transporters or Boda Boda*: A recent unit and activity in rural areas inaccessible to cars is the *boda boda* industry or rural bicycle or motor cycle transporters. Young people are engaged in this activity that transports people and baggage from one place to another.
 10. *Self-Employed Livestock Traders*: These move from village to village or from produce market to produce market looking for and trading in livestock especially goats and cows. These are sold wholesale or slaughtered and sold as fresh meat.
- *Characteristics of Uganda's informal sector*

The informal economy absorbs several legal and illegal economic activities and is characterized by the following: (i) non-payment of income tax and contribution to the National Social Security Fund (NSSF) to enhance the formal social security system, (ii) status, living and working conditions of the workers are predominantly of lower quality, (iii) social protection of workers is negligible, (iv) high incidence of unregistered

¹⁵⁹ Noury, Alex, J., "The Informal Sector and Its Divisions," in Exploring the Economy's Informal Sector, the Progress Report. Accessed November 11, 2004. Available: <http://www.progress.org/2003/noury03.htm>

enterprises and employees with exchange outside of government controlled economic activities, (v) labor market is dominated by the unskilled, semi-skilled, and vulnerable groups of workers especially women and young people, (vi) enterprises operate on a small scale, are mainly family owned, depend on local resources, employ labor intensive and adaptive technology, and are in unregulated markets, (vii) industrial, occupational, and activity status is poorly organized,¹⁶⁰ (viii) large percentage of participants live in informal settlements including villages, slums and suburbs of major cities or towns with limited utilities, etc. (ix) witch craft and magic are rife, and (x) the majority of labor workers struggle to conquer diseases without medical care.

3.4.3.2.3.5 *Economic Corruption*

○ *What is Economic corruption?*

Economic corruption is broad in its meaning. Just as it is intricate to define the concept of the informal economy, so it is challenging to define corruption in precise terms. Economic corruption still remains one of the bedrocks of underdevelopment of Uganda. It hinders poverty eradication, slows economic transformation and increases or upholds low income levels in households. Moreover, it negatively impacts on government's performance and effectiveness.

Although many people tend to define economic corruption from a white-collar job perspective as “the abuse of public office for private gain,”¹⁶¹ this definition merely

¹⁶⁰ Unni, Jeemol's work: [Informal Sector: Definition and Survey Methods](http://www.mospi.nic.in/informal_paper_04.htm) at Gujarat Institute of Development Research, Gota, Ahmedabad 380 060. Accessed on November 11, 2004. Available: http://www.mospi.nic.in/informal_paper_04.htm

¹⁶¹ Emery, Quinones (Financial, Fiscal and Enterprise Affairs Directorate), “What is corruption?” in [Observer OECD](http://www.oecdobserver.org/news/fullstory.php/aid/233), Accessed on January 3, 2005. Available: <http://www.oecdobserver.org/news/fullstory.php/aid/233>.

addresses economic corruption in the public sector or corrupt *public* practices. Economic corruption also exists in the private sector including the financial intermediaries and markets.

Corruption can exist at family, local, national, regional, and international levels. As Enery (May 2000) notes, “Corruption respects no borders, knows no economic distinctions and infects all forms of government.”¹⁶² Economic corruption, which exists universally though at varying degrees, is a two-way transaction with well drawn supply and demand curves. While the supply curve describes the “donor” or briber, the demand curve depicts the receiver or bribed.

In order to capture the real concept of corruption, it is important that we maintain it in broad terms as defined in the *Merriam-Webster’s Collegiate Dictionary* (10ed). Here, corruption refers to inducement to wrongful conduct by improper or unlawful means thereby impairing integrity, virtue, or moral principle.¹⁶³ Whether the amount of economic corruption is trivial or impressive, whether it involves a handful of fraudulent individuals or entire institutions, economic corruption remains a pervasive and crippling economic issue for all of the African low-income nations, especially Uganda. It slows the pace of the poverty war by retarding economic transformation. If the fight to combat it lacks effective means, the consequences become tragic to productivity, economic growth, and standards of living.

- *Shades, Causes, and Consequences of corruption*

¹⁶² Enery, Quinones (Financial, Fiscal and Enterprise Affairs Directorate), “What is corruption?” in *Observer OECD*, Accessed on January 3, 2005. Available: <http://www.oecdobserver.org/news/fullstory.php/aid/233>.

¹⁶³ *Merriam-Webster’s Collegiate Dictionary*. 10ed. Springfield, Massachusetts: Merriam-Webster, Incorporated < An Encyclopedia Britannica Company > 1993: 260.

- *Shades*

Economic corruption presents itself with many shades in many sectors, especially where service delivery is most competitive and where moral degeneration is high. These include bribery, extortion, fraud, trafficking, embezzlement, nepotism, sectarianism, and favoritism in the form of offering gifts or benefits including sex or scholarships for children, friends, and relatives among others. It is many-sided. Between 1998 and 2004, Ugandan economic corruption took the form of outright fraud and embezzlement, illegal payments, payment of ghost employees, false declaration of customs entries, evasion of taxes, poor contracting systems and fraudulent procurement.¹⁶⁴

Although a recent ranking shows that anti-corruption efforts to address the issue include commissions of inquiry and the publishing, broadcasting and posting of information in newspapers regarding transfers of public funds to local governments, hospitals and schools being effective, economic corruption still exists. Uganda’s corruption rating by Transparency International (TI) Corruption Perceptions Index (CPI) of 2004 shows that Uganda’s anti-corruption measures from 1998 to 2004 are somehow addressing the issue with considerable success.

Figure 6-(3) below highlights Uganda’s corruption rankings at the international level (1998-2004)

Year	From the Top	From the Bottom (most corrupt)	CPI Score
1998	73 out of 87	8 th	2.6
1999	87 out of 99	12 th	2.2
2000	80 out of 90	10 th	2.3
2001	88 out of 91	3 rd	1.9
2002	93 out of 102	9 th	2.1

¹⁶⁴ Nalugo, Mercy and Walulya, Gerald, “Uganda loses Shs350b to graft,” in the *Monitor, Uganda*, October 19, 2004 online. Available: <http://www.monitor.co.ug> .

2003	113 out of 143	17 th	2.2
2004	105 out of 146	42 nd	2.6

Source: The Monitor, Uganda, October 29, 2004 and March 19, 2005

The Transparency International (TI) Corruption observes that “a total of 106 out of 146 countries score less than 5 against a clean score of 10; 60 countries score less than 3 out of 10.”¹⁶⁵

- *Causes*

Economic corruption, which can be minimized through moral conduct and well-established macro-economic and financial policies including liberalization, stabilization, deregulation, and privatization,¹⁶⁶ thrives well with excessive and direct government intervention in the economy, in a culturally and morally degraded socio-economic environment, and where anti-economic corruption fishers use fishing nets, which lack appropriate size-holes to net the “big fish”, and economic corruption butchers, lack the courage to approach the “cowsheds of sacred cows.”

Government tends to nurture corruption if it encourages (i) un-audited classified accounts or expenditures, (ii) restrictions of home and foreign trade, (iii) subsidization to selected groups or sectors, (iv) buffer system and price ceilings, (iv) compound and dissimilar exchange rate applications and foreign exchange allotment designs, (v) low wages and/or overdue arrears or delayed salaries and benefits, (vi) abetting of division within the country’s sociological stratum exemplified by linguistic, ethnic, tribal and

¹⁶⁵ Muyita Solomon and Mwanguhya Charles, “ Uganda drops to 41st most corrupt,” in the Monitor, Uganda [on line] March 19, 2005 Available: <http://www.monitor.co.ug/news/news03192.php>.

¹⁶⁶ Paolo Mauro, “Why Worry About Corruption?” in Economic Issues No.6 of International Monetary Fund, February 1997. Accessed January 3, 2005, Available: <http://www.imf.org/external/pubs/ft/issues6/>

kinship lines, and (vii) poor and inappropriate policies on natural resource endowments such as timber, minerals, rare species of animals like gorillas, parrots and many more.¹⁶⁷

In Uganda, the causes of economic corruption are many. Commissions of inquiry, like the *Ssebutinde commission*, that were established to examine and combat corruption in army procurement, revenue collection and the electoral process, revealed several. A judicial corruption probe report, also known as the *Ssebutinde Commission* probe of 2002- 2004 into Uganda's tax body, the Uganda Revenue Authority (URA), revealed factors that fostered both public and private economic corruption in Uganda. These included (i) mismanagement and poor leadership, (ii) unstable structures, (iii) weak administrative and procedural controls, and (iv) inadequate logistical support.¹⁶⁸ Others included poor recruitment policies, terms and conditions of service, staff indiscipline, external or political interference and patronage.¹⁶⁹

This confirmed what the Second National Consultative Workshop on Coalition Building for Fighting Corruption and Building Ethics and Integrity, held in May 2001 in Uganda, had labeled as a primary task of government if corruption was to be combated. They included financial management, procurement management, tax collection and revenue handling, public service management and the strengthening of law enforcement agencies.¹⁷⁰

¹⁶⁷ Paolo Mauro, "Why Worry About Corruption?" in Economic Issues No.6 of International Monetary Fund, February 1997. Accessed January 3, 2005, Available: <http://www.imf.org/external/pubs/ft/issues6/>

¹⁶⁸ Mpagi, Mwanguhya and Mulumba, Badru, "Ssebutinde report exposes 500 cases," in the Monitor, Uganda, February 18, 2004, on line. Available: <http://www.monitor.co.ug/news> .

¹⁶⁹ *ibid*

¹⁷⁰ The Directorate for Ethics and Integrity in Uganda, "Uganda's anti-corruption fortunes improve," in the Monitor-Uganda Oct.29, 2004 Available: <http://www.monitor.co.ug/specialincludes/mplsups/crr10311.php>

According to the Uganda Capital Markets Authority (CMA), entrepreneurs in Uganda lack financial reporting and disclosure, which nurture and ingrain corruption. The controversial Ssebutinde probe into Uganda's tax body uncovered the magnitude of this economic cancer by exposing and documenting 500 cases of firms and persons in illegal activities.¹⁷¹

Foreigners from the anti-corruption vocal countries are also variables of the supply curve. They provide kick-backs with big envelopes to influence profitable contracts. Moral degradation encouraged by the quick spreading ideology of materialism, secularism, individualism, greed, egoism, and relativism is also a causative factor.

- *Consequences*

Economic corruption impacts the economy negatively in many ways but the most damaging are inefficiency and deterring investment. Corruption scares investors. During the judicial probe into the URA, Justice Julie Ssebutinde of the Uganda High Court related corruption with inefficiency and called them "cousins".

Economic corruption results in many anti-economic transformation scenarios. It impacts economic transformation in the following ways: (i) shoddy construction of public works and infrastructure such as poor roads, schools, hospitals, health centers, and stadiums, etc. by the contracting companies, thereby keeping the quality of life and services poor, (ii) reduces local savings and investment and impedes economic growth, (iii) encourages incompetence through misplacement of talents and resources, (iv) maintains the status quo of low income and high poverty levels for the majority, (v) impacts customers' confidence in the financial system, especially the banking sector, and

¹⁷¹ Mpagi, Mwanguhya and Mulumba, Badru, "Ssebutinde report exposes 500 cases," in the Monitor, Uganda, February 18, 2004, on line. Available: <http://www.monitor.co.ug/news> .

(vi) slows economic transformation including creation of jobs, collection of revenue for government and adding value to the raw-materials.

It also affects the performance of corporations and institutions. According to Mr. Gariyo, Zie, the Executive Director of *Uganda Debt Network*, basing on the research commissioned in 2000 and whose findings came out in a report titled: *A Dossier to Corruption*, Uganda was losing between UGSHS 200 billion (US \$100 million) to UGSHS 350 billion (US \$175 million) per year in corruption.

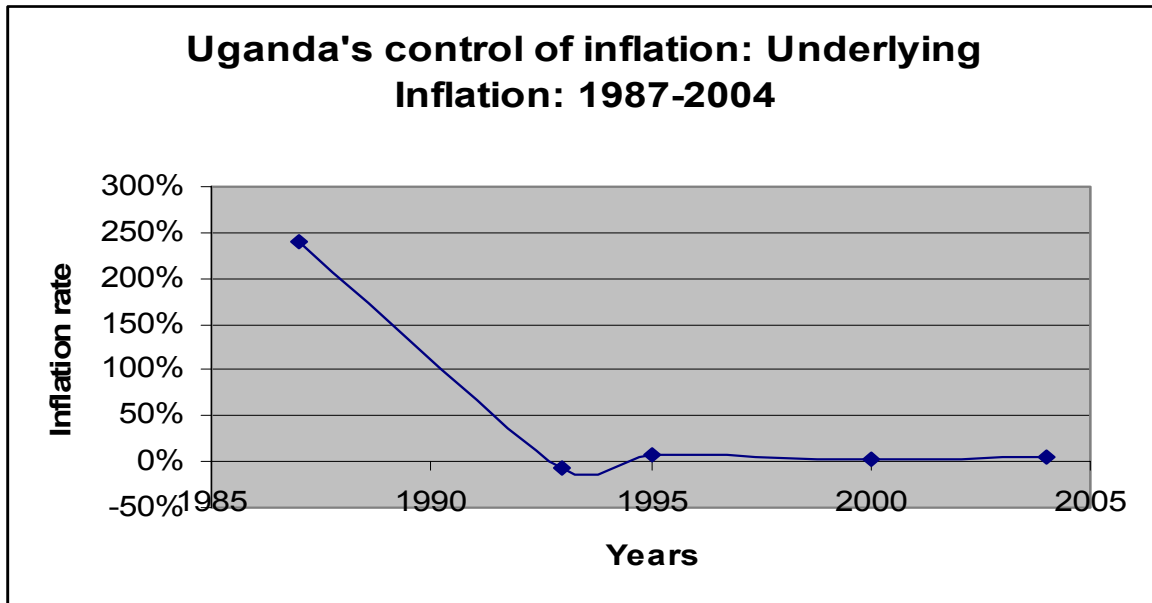
3.4.4 Inflation Control

Inflation rate, which is the general rise in the prices of products or growth rate of average prices, is mainly measured by the consumer price index (CPI), producer price index (PPI) and implicit price deflator (IPD). Inflation impacts the domestic value and is a factor observed from three dimensions: (i) headline inflation (monthly and annual), (ii) underlying inflation (monthly and annual), and (iii) food crops annual inflation (monthly and annual). Inflation affects the value of money in the domestic market.

Inflation is a concern of savers and investors because high inflation reduces real rates of return. Increases in all the sub-groups of the consumer price index including food prices, beverages and tobacco prices, rent, fuel and utilities prices, household and personal goods prices, transport and communication prices, and health, education and entertainment prices have impact on both consumers' and investors' confidence.

Although inflation in Uganda is still a problem, efforts to subdue it are succeeding because inflation in Uganda has been contained to low single digits. It was 240% in 1987, -6% in 1993, 7% in 1995, 3.8% in 2000 and 5% in October 2004.

Figure 8-(3) below shows changes in the annual inflation rates in Uganda from 1987 to October 2004.



Data Source: Adapted from Siddhartha Prakash, WTO Consultant on Trade and Development Country Case Studies: Uganda [1997 World Trade Organization, Geneva, Switzerland and the Uganda Government's Background to the Budget for the Financial Year 2004/05 read on June 10, 2004 and the 2000/01 Uganda Budget in Brief.

3.4.5 Uganda's Taxation Regime

Uganda's revenue base as a percentage of GDP is very low. As of 2004, the revenue collection was 12% of GDP. Though a substantial increase from the rate of 6% in the early 1990s, it was not satisfactory. Government's expenditure doubled it.¹⁷² This revenue is collected mainly from taxation. A small percentage comes from Non Tax Revenue (NTR) collections. There is need to improve tax administration to achieve a gradual reduction in fiscal deficit.

¹⁷² Juuko, Sylvia (quoting New Finance Minister, Dr. Ezra Suruma during interview), "Suruma wants people to be more productive," in the New Vision, Uganda [on line] of January 19, 2005. Accessed January 19, 2005. Available: <http://www.newvision.co.u/D/9/32/412928>.

3.4.5.1 *Uganda's Principal Taxes*

Before describing Uganda's principal taxes, it is important that we understand the meaning of a tax. Generally, a tax is a charge against a citizen's person, property or activity for the support of government or public expenditure and /or spending.¹⁷³ Tax revenue and non-tax revenue, such as judiciary bail fees and court fines support national development budgets.

Taxes as levied on individuals are described in different forms, that include income taxes such as personal tax levied on annual income, capital gains taxes such as tax on capital gains in a business, gift taxes such as taxes imposed on transfers of property by gift during the life time of a giver, direct taxes such as taxes paid directly by the person or firm on whom it is imposed, indirect tax such as taxes levied on products rather than on a person or firm, hidden taxes including *ad valorem* taxes paid without knowing by consumers, progressive taxes such as taxes whose rate adjustment increases with the rise of the amount subject to taxation, and regressive taxes such as taxes whose rate adjustment decreases with the addition of the amount subject to taxation.¹⁷⁴

Uganda's principal taxes are (i) income tax both on individuals and on companies, (ii) value-added tax (VAT), (iii) customs tax, (iv) excise duty, (v) graduated or poll tax, and (vi) land rates. While the first four are levied by the Central Government through the Uganda Revenue Authority (URA), the last two are levied by the local authorities.

¹⁷³ The Free Dictionary.Com, "Definition of Tax." Accessed on October 21, 2004. Available: <http://www.thefreedictionary.com/Tax>

¹⁷⁴ The Free Dictionary.Com, "Definition of Tax." Accessed on October 21, 2004. Available: <http://www.thefreedictionary.com/Tax>.

3.4.5.2 *Income Tax in Uganda*

Figure 9-(3) shows *Income Tax Guide as of 2002/2003 (for Individuals in Uganda)*

Taxable Income per annum (In UGSHS & US \$)	Rate (%) of Taxation for Residents	Rate (%) of Taxation for non-residents
UGSHS 0 – 1,560,000 (US \$ 0-902)	0%	10%
UGSHS 1,560,001 - 2,820,000 (US \$ 902-1,630)	10%	10%
UGSHS 2,820,001 - 4,920,000 (US \$1,630-2,844)	20%	20%
Over UGSHS 4,920,001 (US \$ 2,844)	30%	30%

Note: Exchange Rate is at UGSHS 1, 730 per US \$ 1.

3.4.5.3 *PAYE (Pay-As-You-Earn)*

P-A-Y-E, which is an acronym for **Pay As You Earn**, is a withholding tax system whereby income tax is withheld from employees' wages and paid directly to the government's tax body by the employer. PAYE is a popular British system but also practiced in Uganda. In Uganda, every licensed company must register with the Uganda Revenue Authority (URA) as the employer. PAYE (pay-as-you-earn) begins at UGSHS 1,560,000 /=(US \$ 902) for residents per annum.

3.4.5.4 *Other forms of Taxes*

Corporate Income Tax Residents Companies	30%
Corporate Income Tax Non-Residents Companies	30%
VAT (General Standard Rate or Sales Tax)	17%
Customs Duty	0-15%
Exemptions	0 %
Withholding Taxes on Dividends, Interest, Royalties, etc. for Residents	4-15%
Withholding Taxes on Dividends, Interest, Royalties, etc. for Non-Residents	15-20%

Items	Tax rate of EACU -CET	Tax Rate within EACU Region
Raw-Materials	0%	0%
Intermediate	10%	0%
Finished goods	25%	0%

3.5 Economic Planning: Poverty Eradication Action Plan (PEAP)

Government's mission for poverty reduction is reflected in the implementation of the national development plan known as the Poverty Eradication Action Plan (PEAP). Launched in 1997, PEAP articulates a national vision for poverty eradication by 2017.¹⁷⁵

The plan consists of *four pillars*, which include:

- Creating a framework for economic growth and structural transformation,
- Strengthening good governance and security,
- Increasing the ability of the poor to earn higher incomes, and
- Improving the quality of life of the poor.¹⁷⁶

To produce desired results, the PEAP program involves government's multiple agencies and their development partners. Together, they allocate resources among all sectors of the economy to facilitate the implementation of this development plan.

The plan involves *five priority areas*: (1) economic management (the maintenance of macroeconomic stability, fiscal consolidation, boosting private investment and debt sustainability), (2) production, competitiveness and incomes (modernization of agriculture, preservation of the natural resource base, particularly soil and forests, infrastructure including roads, electricity and railways; better maintenance, cost-reduction and private sector participation, and enhancing private sector skills and business development), (3)

¹⁷⁵ The Third Uganda Poverty Status Report (PSR) published in 2003:ix

¹⁷⁶ The Third Uganda Poverty Status Report (PSR) published in 2003: xiii-xv.

security, conflict-resolution and disaster-management (promoting peace and dealing with internal displacement), (4) governance (human rights and democratization, development of a better legal system, and transparency, accountability and the elimination of corruption), and (5) human development (primary and secondary education, adult literacy, increasing people's ability to plan the size of their families and improving health outcomes).¹⁷⁷

Through the Poverty Status Report (PSR), which is a periodical publication on Uganda's status, the government methodically scrutinizes progress and outcomes of the execution of the Poverty Eradication Action Plan (PEAP) policies and programs.¹⁷⁸

3.6 Conclusion

A completed comprehensive situation analysis of Uganda's economy reveals that Uganda's economy has not performed well in capital formation. Without capital formation and capital flow, economic life becomes emaciated and weak. Historical and contemporary factors have contributed to the situation. These factors have perpetuated other hindering conditions including low labor productivity, high reliance on primary commodity trade, an enlarged informal sector, economic corruption and inefficiency. As such, poverty has reigned unbothered and economic transformation has taken a snail's pace.

The next chapter, which highlights the evolution of Uganda's financial system, looks at the financial institutions, constituents and instruments required to accelerate the pace of economic transformation.

¹⁷⁷ Background to the Budget for the Financial Year 2004/05 for the Republic of Uganda, June 2004: 2-5.

¹⁷⁸ The Third Uganda Poverty Status Report (PSR) published in 2003: xiii.

CHAPTER FOUR

4 THE INVESTMENT AND FINANCIAL SYSTEM MILIEU IN UGANDA'S ECONOMY

4.1 Introduction

The preceding chapter has presented the dark period characterized by capital malformation and economic affliction. But things have not remained static. The structural adjustment reforms, especially of the financial sector in the early 1990s, have created a different outlook for the financial system, and the pace of economic transformation has improved.

In order to appreciate the nature and role of a robust financial system in Uganda's economic transformation, it is important that we examine the investment and financial system milieu in Uganda's economy. It is with this that this chapter deals. Savings and investments design the supply and demand curves in the loanable funds market.

According to the foreign private capital survey jointly carried out in 2004 by the Central Bank of Uganda (BOU), Uganda Investment Authority (CIA) and Uganda Bureau of Statistics, the financial sector in Uganda grew by 95% in 2003. Signaling the role a robust financial system plays in the economic transformation of Uganda, it posted more profits in comparison to other sectors with US \$43 million realized in 2003 from US \$22 million in 2002. The wholesale and retail sector came second with US \$18 million realized in 2003 down from US \$29 million in 2002.¹⁷⁹

¹⁷⁹ Juuko, Sylvia, "Financial Sector Grows by 95%," in the New Vision, Uganda [on line] of December 6, 2004. Posted to the Web December 7, 2004.

The report also recorded significant portfolio inflows in the form of government securities, following the widening interest rate differential between the country and the rest of the world in 2002. Portfolio inflows, as measured by investments of offshore investors in the Uganda government securities market, increased from US \$1.23 million in 2002/3 to US \$10.2 million in 2003/2004.¹⁸⁰

4.2 Savings and Investment in Uganda's Economy

4.2.1 Savings

4.2.1.1 Meaning of Saving

Saving simply refers to having purchasing power, an intention and a decision to abstain from consumption in view of future economic commitment. Future commitment includes, but is not limited to, the following: purchasing a house through mortgage, refinancing loans, purchasing a transportation vehicle, taking a trip or a vacation, preparing for a wedding or having a baby, planning for major surgery, planning for a large donation to a private non-profit volunteer organization, planning for tuition for further studies, and lending to get more income. Saving is equal to purchasing power in the form of disposable income less consumption. Savings increase when consumption decreases.

Mankiw (2004) facilitates our understanding of saving by distinguishing three dimensions of saving: (i) *national saving* or total saving, which is the total income in the economy that remains after paying for consumption and government purchases, (ii) *private* or personal saving, which is part of total saving and is the income that households

¹⁸⁰ Juuko, Sylvia, "Financial Sector Grows by 95%," in the New Vision, Uganda [on line] of December 6, 2004. Posted to the Web December 7, 2004.

have left after paying for taxes and consumption, and (iii) *public* or government saving, which is a portion of national saving and is the tax revenue that the government has left after paying for its spending¹⁸¹ or tax revenues less government spending. Parkin (2003) also observes that there is *business* or corporate saving, which is “the retained profits of firms plus pension funds that result from payroll deductions.”¹⁸²

4.2.1.2 *Sources of and Options for Saving*

4.2.1.2.1 *Sources*

Saving is obtained from income and is related to consumption. Though income might come from several origins, the main sources of income are the rewards of the factors of production, which include the following: (i) profits from entrepreneurship, (ii) wages from labor, (iii) rent from land, and (iv) interest from capital. Other sources include gifts, donations, lottery wins, gambling, and talent investment awards and rewards. Income gives rise to savings. Saving results when current income exceeds current consumption or spending.

4.2.1.2.2 *Options*

There exist two options for individuals and institutions regarding their savings. These include (i) the unprofitable option pursued by unprofitable “servants” and (ii) the profitable option pursued by profitable and innovative “servants”.

¹⁸¹ Mankiw, Gregory, N. Essentials of Economics. (Third Edition). United States of America. Thomson South-Western, 2004:393.

¹⁸² Parkin, Michael. Macroeconomics. (6ed). Boston, New York, Madrid, Paris, and Cape Town: Addison Wesley, Pearson Education, Inc., 2003: 181.

The unprofitable option pursuers are like one of the ten servants told of in the Bible who were given ten gold pieces to trade till their master returns.¹⁸³ While the rest made profits proportionate to their savings and investments and were rewarded, one kept the gold piece tied up in a napkin. In today's milieu, those who fall under this category include (i) those that possess cash money kept under one's mattress or wallet or in the granary, a briefcase, or open pot without getting future returns, (ii) those that hold savings in the form of animals, timber/furniture, or land assets, and (iii) those that deposit the money in banking or micro-financing institutions on savings or primary chequeing (checking) accounts.

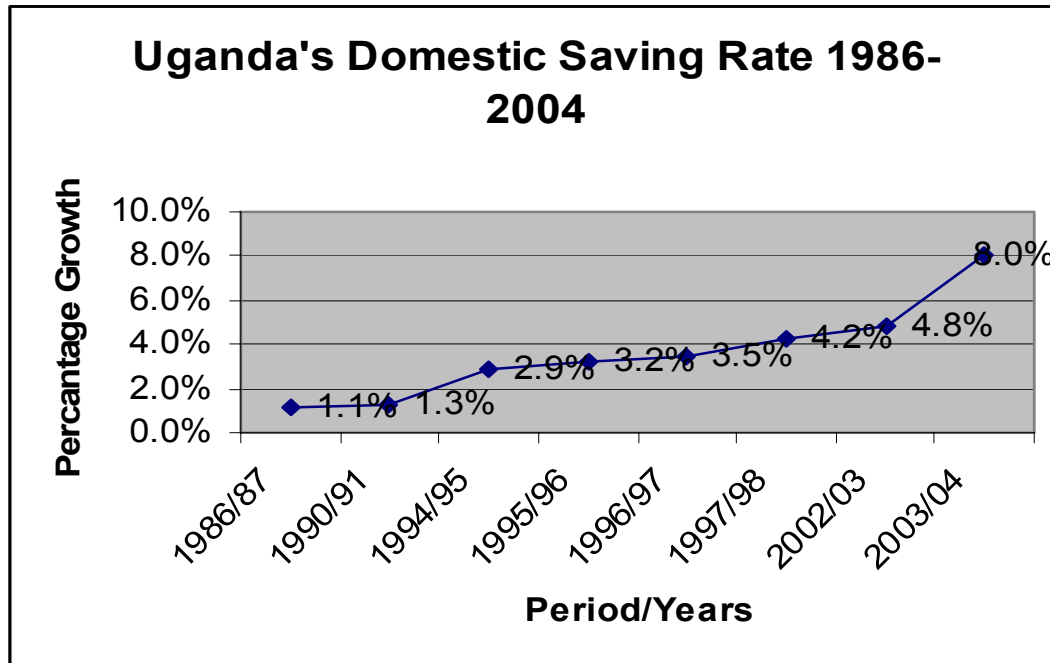
The profitable option pursuers sow to reap and reap to sow. Gainful pursuers give up immediate possession of their savings and invest them for higher levels of future consumption (creative investment) just as the first and second servants mentioned in the Bible obtained rewards for making more gold pieces. The first servant had the gold piece earn 10 gold pieces while the second servant had the gold piece make 5 gold pieces.¹⁸⁴

4.2.1.3 Uganda's Saving Rate to GDP

In 1986/87 Uganda's domestic saving rate to GDP was 1.1% , was about 2.9% in 1994/95, and grew to about 7%-9% of GDP in 2004. *Figure 1-(4) below highlights the rate of domestic savings to GDP from 1986 to 2004*

¹⁸³ Luke 19:23, "The Parable of the Gold Pieces," in the Holy Bible edited by O'Connell, John. Chicago: The Catholic Press, Inc. 1954.

¹⁸⁴ Luke 19:11-27, "The Parable of the Gold Pieces," in the Holy Bible edited by O'Connell, John. Chicago: The Catholic Press, Inc. 1954.



Data Source: ILO Social Finance Unit: The Case Study of Uganda [1999] and The New Vision Newsletter June 2004

Although the graph might not be very detailed, it nevertheless represents Uganda's saving spirit and position. Compared to Kenya, whose savings to GDP ratio stood at 30% in the same period, Uganda experiences low savings rate. When compared to a country like Singapore, where workers save up to 40% of their income, and savings cover housing, health care, and retirement plans,¹⁸⁵ Uganda's savings to GDP ratio remains wanting.

One major cause of this is that the majority of the population is generally poor. They earn and live from hand to mouth. They earn the equivalent of US \$1 per day, and most are in agriculture at subsistence levels in the informal sector. Further, the government lacks strong policies for savings and has no voluntary, regulated saving

¹⁸⁵ The New Vision Newspaper Uganda. Online. 4th June, 2004. <http://www.newvision.co.ug>

plans. Perhaps there are vast stores of money under mattresses or unproductively kept! Low saving culture is also a causative factor.

As of mid 2004, Africa's continental average saving rate was 15%, an indication that Uganda was performing below the continental average. USA, Europe and some East Asian and South American governments set strong policies to attract citizenry to save. Their savings are high, and their living standards are impressive. Sub-Saharan Africa's saving culture in general and Uganda's in particular, is miserably low.

4.2.2 Investment

4.2.2.1 Meaning of investment

Although macro-economists refer to investment as the purchase of new capital, financial economists refer to investment as a social and an economic activity carried out to implement the plans, intentions, and decisions for savings increase over time. Reilly and Norton (2003) appositely define investment as *“the current commitment of resources for a period of time in the expectation of receiving future resources that will compensate the investor for (i) the time the resources are committed, (ii) the expected rate of inflation, and (3) the risk—that is, the uncertainty of the future payments.”*¹⁸⁶

4.2.2.2 Dimensions of Investment in Uganda

To meet their future goals including income and capital growth needs, investors in Uganda choose from three basic types of investments: (a) real assets, (b) financial assets, and (c) social bond investments (intangible investments in social or communal ties and links for commercial purposes). Investors in Uganda comprise both domestic and

¹⁸⁶ Reilly, Frank, K. and Norton, Edgar. Investments. Sixth edition. USA & UK: Thomson South-Western, 2003: 3.

foreigners. Foreigners participate in two forms: foreign *direct* investment and foreign *portfolio* investment.

The overall business and investment environment in Uganda is promising and enterprising. Uganda's investment rate to GDP has been growing. Rising from 10.4% in 1990/91, it reached 15.3% in 1996/97. According to the Uganda Investment Authority (UIA), in 2004, Uganda recorded US \$417 million in new investments up from US \$353 million in 2003.¹⁸⁷ Investments in 2004 created 17,047 planned jobs although the figure fell from 19,368 jobs created in 2003.¹⁸⁸

4.2.2.2.1 Real Assets

Real assets investments cover tangible assets such as purchasing property, buildings, machinery, equipment, land, and livestock among others and intangible assets such as growth opportunities, brand images, technological superiority, human capital, conducting research and development and having patents and copyrights. In real assets investments, two categories are distinguished: (i) intended investment, which involves the purchase of capital for future income, and (ii) unintended investment, which involves the change of inventories.¹⁸⁹ This implies that acquisitions such as the household purchase of a new washing machine are not included in the investment component of GDP.

¹⁸⁷ Nakawesi Dorothy, "Museveni's PR campaign boosts investments," in the Monitor, Uganda [on line] January 17, 2005. Accessed January 17, 2005.

¹⁸⁸ *ibid*

¹⁸⁹ Professor Anthony Davies, "GDP: Size of Components of GDP," in Principles of Macroeconomics, Lecture Notes. Duquesne University, School of Business Spring Semester 2003.

On the other hand, the purchase of new equipment by a business, a warehouse built by a firm, and a business failing to sell all of its output and therefore experiencing an increase in inventories are included in the investment component of GDP.¹⁹⁰

Positive net investment creates growth in capital equipment thereby increasing worker productivity. Net investment, which is gross investment minus depreciation¹⁹¹ during a year, equals the change of capital stock over the year.¹⁹²

4.2.2.2 *Financial Assets*

Financial assets investments represent claims on real assets. In Uganda, as of February 5, 2005, these claims were categorized into three: (i) ownership claims such as equity or shares of common stock, (ii) debt claims such as mortgage, fixed income deposits or certificate of deposits (CDs), bank loans, corporate and government bonds, government treasury bills and commercial papers, and (iii) claims based on the value of other financial assets such as the value of a convertible bond which could be affected by the share price of the stock into which the bond might be converted.¹⁹³ Although the business of some financial institutions includes “engaging in foreign exchange business, in particular, the buying and selling foreign currencies including forward and option type

¹⁹⁰ Professor Anthony Davies, “GDP: Size of Components of GDP,” in Principles of Macroeconomics, Lecture Notes. Duquesne University, School of Business Spring Semester 2003

¹⁹¹ Depreciation is economically defined as the decrease in the stock of capital goods from physical wear and tear or as capital consumption or gross investment minus net investment.

¹⁹² Professor Anthony Davies, “GDP: Size of Components of GDP,” in Principles of Macroeconomics, A.J. Palumbo School of Business Administration, Duquesne University. Lecture Notes. Spring Semester 2003

¹⁹³ Reilly, Frank, K. and Norton, Edgar. Investments. Sixth edition. USA & UK: Thomson South-Western, 2003: 12

contracts for future sales of foreign currencies,”¹⁹⁴ futures and options contracts are not yet popular investments.

4.2.2.2.3 Social Bond Investments

Social bond investments, which are intangible investments and usually ignored or neglected in most literature, refer to investments in social or communal ties and links for commercial purposes. They are considered investments if they are carried out with the aim of increasing expected returns in a real asset. Social bond investments include investments in relationships and sacrifice of time and energy to commit oneself to community gatherings, parties, meetings, seminars, workshops, public affairs, funerals and burials for both personal and community achievement and commercial purposes. Because of many factors, including poverty and the nature of the communities affiliated with clans and tribes, most Ugandans invest in social bond investments for community support.

4.2.2.3 Investment Methods

All types of investments bring expected returns and include risks. Our focus is the financial assets or securities investments. There are three methods of investing in financial assets or securities. In developed countries investors invest in financial assets or securities through either disintermediation or intermediation or derivative ways. In Uganda only the disintermediation and intermediation investment methods are common. They are explained as:

¹⁹⁴ Financial Institutions Act, 2004: 13

(i) *Disintermediation investment method in financial assets*

Investment in financial assets through disintermediation methods involves buying shares of stock through primary or secondary financial markets.

(ii) *Intermediation investment method in financial assets*

Investment in financial assets or securities through intermediation investment is accomplished by buying securities that represent claims on other securities.¹⁹⁵ Examples include depositing funds in a bank or micro-finance or collective investment scheme (unit trusts) where the selected institutional investors pool the money to make loans and to buy stocks and/or bonds for the shareholders. Other examples of intermediation investment in financial assets or securities comprise insurance companies and provident or pension funds. Insurance companies invest policyholders' premiums in financial assets or securities. Pension funds such as the National Social Security Fund (NSSF) invest employee's PAYE money in financial assets or securities to create and bolster a repayment package.

4.3 Loanable Funds Market Participants in Uganda

Like in many other countries, Uganda's investment and financial system milieu is nurtured by the loanable funds market. The loanable funds market is one of the macro-economic markets directly served by the financial system. The other is the foreign exchange. The financial system directly serves these macro-economic markets. The loanable funds market facilitates the coordination of domestic and foreign savers and investors and/or lenders and borrowers. In domestic finance businesses, the participants

¹⁹⁵ Reilly, Frank, K. and Norton, Edgar. *Investments*. Sixth edition. USA & UK: Thomson South-Western, 2003: 12.

in the loanable funds market are grouped into four parties, which are (i) savers/investors, (ii) users/borrowers, (iii) banks/agents (brokers/dealers), and (iv) government authorities.

Figure 2-(4) below highlights the four major parties involved in a financial system in domestic transaction.

Savers/Investors look for:	Users /Borrowers look for:	Banks/Agents/ Dealers look for:	Authorities/Government look for:
1. High return	1. Low cost	1.High volume	1. Tax revenue (Big base)
2. Low risk	2. Floating but stable exchange rates	2. High profit	2. Protection of small customers and fair and ethical business
3.Liquidity, fair and stable prices	3. Long term tenure of funds	3. Low taxes	3. Creation of jobs and reduction of poverty
4. Low taxes (Incentives)	4. Swift and reliable service	4.Stable political environment	4. Reduction of hardships for monetary policy
5.Diversification opportunities (more investment vehicles)	5.Sufficient market information and transparency	5. Low operation and allocation costs	5. Achievement of micro- and macro-economic goals: Favorable foreign exchange rates for exports.
6.Confidentiality	6.Flexible Security/Collateral	6.Valuable Security/Collateral	6. Price stability: foreign exchange and interest rates
7. Variety/ Competition	7.Variety/ Competition	7. Limited entry/ Market Dominance	7. Strong private sector

Source: Adapted from Burnham James, Global Economy Course Lectures at Duquesne University, Spring 2004

In international finance business, two countries, plus these parties, as well as the market for the foreign currency exchange, are involved. When examining the role of a robust financial system in the economic transformation of Uganda, these four parties become a point of reference because they serve as sources and uses of resources. For each party to benefit from the game, the investment and financial system milieu must be

horizontal and even. It must be transparent; that is, reliable and immediate information – whether weak or semi-strong or strong – must be available to all market participants. This leads to a need for an overview of the pre-reform and post-reform situation of Uganda’s financial system thereby strengthening our assertion that a well functioning financial system is very important for economic transformation.

4.4 Pre-reforms Situation of Uganda’s Financial System [1787-1987]

4.4.1 Background Information

Pre-reform policies, as examined in this work, date from 1787 to 1987. This long period is usually divided into three historical and economic periods: (i) ancient or pre-imperial economic Uganda up to 1860, (ii) imperial economic Uganda up to 1962, and (iii) post-political independence economic Uganda before the 1987 reforms. It is not a subject matter of this work to examine these periods in detail. Moreover, in our previous chapter, we examined the causes of poverty and low income levels.

Until the first phase of economic and financial reforms was initiated by the IMF and World Bank in Uganda in 1981 and a formidable second phase of these reforms was renewed in 1987, the economic and financial environment was characterized by unfavorable pre-reform policies. The pre-reform policies discouraged the emergence of a market-oriented financial system.

It should come to mind that pre-reform economic and financial policies were characterized by aggressive and direct government involvement in commercial and financial sectors through (1) state-owned corporations, commercial banks, cooperative movements, and commodity marketing boards, (2) official price controls, interest rate controls and buffer systems, (3) commercial bank credit ceilings, and (4) administrative

credit allocations¹⁹⁶ including lending directives, rediscount facilities, or special lending schemes designed to increase the volume of bank credit extended to priority sectors such as agriculture and often at preferential interest rates.¹⁹⁷

The financial sector, especially the financial intermediaries dominated by the banking system, operated under financial distress, weak prudential regulation and supervision, and with regulations that restricted entry and thus limited competition. Without competition, effectiveness and efficiency in terms of quality, cost, flexibility, and response to customer needs become limited.

4.4.2 The Evolution of Uganda's Banking Industry: Money and Banking

Uganda's financial system, which recorded Standard Chartered Bank as Uganda's first commercial bank established in 1912 and the Cooperative Movement established in 1913, has undergone a tremendous evolution with the following highlights:

4.4.2.1 Barter System in Pre-Imperial Uganda

It is historically known that as early as 400 B.C. Uganda was occupied by cultivators and herders. The early Bantu people used iron-ore age technology to clear the land and live on their agricultural produce. Later on, the Bantu agriculturalists met a group of Nilotic pastoralists moving into northern Uganda. The agriculturalists and pastoralists formed a relationship based on a barter system whereby manure from animals was used to improve the fertility of fields and was exchanged for crops.

¹⁹⁶ IMF Report on Observance of Standards and Codes: Uganda, August 1999. Available: <http://www.imf.org/external/np/roscu/uga> Accessed April 1, 2004.

¹⁹⁷ GAYI Samuel and BrownBridge Martin, "Progress, Constraints and Limitations of Financial Sector Reforms in the Least Developed countries." Available: <http://www.devinit.org/findev/> Accessed March 1, 2004.

Before money came into usage for exchange, a bartering system was the means of exchange in ancient Uganda. Goods were exchanged for goods, and services were exchanged for services. Further, before currency notes and coins issued by a Central Bank came into existence, various items like shells, stones, metals, and skins, etc. were used as money. In our examination of the history of money and financial institutions in Uganda, the use of the Cowries Shells is our starting point.

4.4.2.2 *The Cowries Shells*

The Cowry or Cowries Shells, which were brought from the coast of Zanzibar and introduced into Uganda at the end of the 18th Century, were the first form of medium of exchange we know to have supplemented barter trade. History records it that the years between 1800 and 1860 witnessed the depreciation of the Cowries (Cowry Shells) in Uganda.

While Uganda used this medium of transaction, in 1864, during the international monetary conference, 20 international countries debated the introduction of a global currency and decided to adopt the *gold standard* which was already used by Britain and the USA. This was a form of commodity money whereby using gold as money also meant using paper money that was convertible into gold on demand. Mankiw (2004) refers to commodity money as “money that takes the form of a commodity with intrinsic value”¹⁹⁸ such as gold, oil, diamond, and cigarettes used as the medium of exchange, store of value, and unit of account.

¹⁹⁸ Mankiw, Gregory, N. Essentials of Economics (Third Edition). United States : Thomson South-Western, 2004:453.

4.4.2.3 *The Indian Silver Rupee (1895)*

When Uganda fell under British rule in 1890 through “colonization”, beginning in 1895, the Imperial British East African Company (IBEAC) started minting a new currency, which were coins denominated in the *Indian Silver Rupee*. They were introduced and used as Uganda currency. India and some parts of East Africa under British occupation were already using this type of money. Tanganyika under the Germans was using the *German Silver Rupee*.

4.4.2.4 *The East African Currency Board (1905) and East African Currency*

- *East African Florin (1920)*

Because Britain had formed Uganda, Kenya, and Tanganyika (after the First World War) as the East African Currency Area, in 1919 the British government set up the East African Currency Board to issue currency notes and coins in its East African protectorates and colony. The first currency to be issued was the East African Florin, which equaled to two British pounds.

- *East African Shilling (1922)*

In 1922, Uganda, Kenya, and Tanzania comprising East Africa, which was still ruled by the British and constituting the East African Currency Area, adopted a single common currency known as the East African Shilling. It replaced the East African Florin. By 1936 and during the Second World War (1939-1945), the East African Shilling was in circulation in a number of African countries, including Zanzibar, Ethiopia, and Somali.¹⁹⁹

¹⁹⁹ Butt, S. A. Essentials of Commerce in East Africa (5ed) London: Cassell Publishers Ltd., 2000:117

It was, however, withdrawn from circulation before the end of World War II. By then, the US Dollar had dethroned the British pound as the world's major currency.

4.4.2.5 *Alignment to a Gold-Exchange Standard (1944)*

The impact of the global events on the development and growth of a financial system in Uganda must also be considered. In 1944, the Bretton Woods Conference not only set up the IMF to maintain a stable system of fixed exchange rates and to minimize balance of payment deficits in a postwar period (1939-1945), but also developed a *gold-exchange standard*, as opposed to the gold standard.²⁰⁰ Under this system, the dollar currency was convertible into gold at a fixed price, thus dictating that other currencies could be converted into dollars at fixed exchange rates and convertible indirectly into gold at a fixed price.²⁰¹

4.4.2.6 *Fixed versus Flexible Exchange Rates (March 1973)*

The depreciation and devaluation of the US Dollar in 1971 and in February 1973 resulted in abandoning the Bretton Woods System of fixed exchange rates and replacing it with a flexible or fluctuating exchange rates system in March 1973. Exchange rates of most major industrialized nations have been, since then, flexible with minimum government intervention aimed at achieving favorable balance of payments or what

²⁰⁰ Mansfield, Edwin and Behraves. Economics USA. (2ed). New York and London: W.W. Norton & Company, 1989: 601.

²⁰¹ *ibid*

Mansfield and Behravesh (1989) call, “to keep the movement of exchange rates between broad bounds.”²⁰²

Adopting and adapting to a flexible / floating foreign exchange regime did not spill over into Africa’s economies until the early 1990s. The pre-reform financial system of Uganda was characterized by economic and financial repression or financial sector inefficiency and pre-reform policies that included government controls over interest rates, nationalization of banks, and allocation of financial resources according to administrative directives.²⁰³ For example, domestic price controls remained in Uganda until 1993.

4.4.2.7 *Political Independence and the East African Currency Board as a Joint Central Bank*

Tanganyika attained its independence in 1961; Uganda gained it in 1962 and Kenya in 1963. When the three East African countries achieved political independence, the East African Currency Board played the role of a joint Central bank until different Central banks were established in each country. The newly independent countries remained part of the British Sterling Area with the local currency being fully convertible into British Sterling Pounds. Economic transformation was not independent of the volume and value of money especially through trade (export of raw materials) and foreign aid.

²⁰² Mansfield, Edwin and Behravesh, Nariman. Economics USA. (2ed). New York and London: W.W. Norton and Company, 1989: 604.

²⁰³ GAYI Samuel K and BROWNBIDGE Martin, “Progress, Constraints and Limitations of Financial Sector Reforms in the Least Developed Countries.” Available: <http://www.devinit.org/findev/>.

4.4.2.8 *Dissolution of the East African Currency Board and Formation of the National Central Banks*

In 1966, the East African Currency Board as a joint Central Bank was dissolved. The National Central Banks were established. Each country had to have its own Central Bank and new currency with a legal tender. This implied each nation taking full management and responsibility of its macro-economic policies and in the areas of data dissemination, fiscal transparency, and monetary and fiscal policy.

When examining Uganda's economic and financial history in the context of the socio-economic integration of the East African countries, we observe that the formal economic and social integration in the East African Region commenced with the construction of the Kenya Uganda Railway between 1897 and 1901. It advanced with the establishment of the Customs Collection Centre in 1900, the East African Currency Board in 1905, the Postal Union in 1905, the Court of Appeal for Eastern Africa in 1909, the Customs Union in 1919, the East African Governors Conference in 1926, the East African Income Tax Board in 1940, and the Joint Economic Council in 1940.²⁰⁴

4.4.2.9 *Bank of Uganda Act (1966)*

Bank of Uganda, which is Uganda's Central Bank, was established under the Bank of Uganda Act of 1966. The Bank of Uganda Act, 1966, defined the powers, status and functions of Bank of Uganda as a Central Bank of Uganda. A Central Bank is the main and most important government financial institution established to supervise the

²⁰⁴ The Preamble of The East African Community Treaty signed by the three East African heads of state on 15 January 2001 in Arusha , northern Tanzania to form the East African Community (EAC). Kenya's President Daniel arap Moi, Uganda's Yoweri Museveni and Tanzania's Benjamin Mkapa, formalized the EAC treaty set to pave way for an economic and, ultimately, political union of the three countries.

banking system and regulate the quantity of money in the economy. It is the major conduit through which a government implements its monetary policies.

The Central bank of Uganda is the Bank of Uganda. The major functions of the Central bank include (a) issuing currency, (b) being the banker to the government, (c) lending to the government, (d) offering advice to the government, (e) regulating supervising, and intervening with the key policy II-rates to maintain a healthy balance of payments, (f) being the banker to international agencies and financial bodies, (g) being a banker to commercial banks and controlling commercial banks, and (h) serving as a lender of last resort to the government, commercial banks and other financial institutions.²⁰⁵

4.4.2.10 Uganda’s Unit of Currency: The Uganda Shilling

Uganda adopted a Uganda Shillings currency. The Uganda Shilling (UGSHS) has since then remained Uganda’s unit of currency. *Figure 3-(4) below shows the Uganda currency as of December 2004*

Denominations NOTES	Denominations COINS
UGSHS 50,000	UGSHS 500
UGSHS 20,000	UGSHS 100
UGSHS 10,000	UGSHS 50
UGSHS 5,000	UGSHS 10*
UGSHS 1,000	UGSHS 5*
UGSHS 0,000	UGSHS 2*
UGSHS 0,000	UGSH 1*

Source: Adapted from David Muwanga, “ BOU to upgrade 5,000,10,000 currency notes with security features effective September 2004,” in the New Vision, Uganda [On-Line] of Thursday August 26, 2004, quoting Walusimbi, Juma, the Bank of Uganda’s spokesman. *Majority was not aware of the existence of

²⁰⁵ Butt, S.A. Essentials of Commerce in East Africa. (5ed). London: Cassell Publishers Limited, 2000:109-113.

coins in these denominations though they were being used in prominent shopping centers like Shoprite and Game, in Kampala, Uganda.

Today, the major foreign currencies traded with the Uganda Shilling include (i) US Dollar, (ii) European EURO, (iii) British Sterling Pound, (iv) Japanese Yen, (v) South African Rand, (vi) Kenyan Shilling, and (vii) Tanzania Shilling. These are the currencies of Uganda's main trading partners. The supply and demand for other currencies in the Uganda foreign exchange is significantly low.

4.4.2.11 The Banking Act in Uganda (1969)

In 1969, the Banking Act, broadening and empowering the Bank of Uganda through its supervision department to control, regulate, and supervise commercial banks and financial institutions in Uganda, was enacted. It required all international bank branches to incorporate locally and operate under the Bank of Uganda. The Ministry of Finance retained the authority to license banks and credit institutions.

For many years, financial intermediaries other than financial markets have dominated the growth and development of Uganda's financial system. This is why when the financial markets were introduced in Uganda beginning in 1997, the securities markets language puzzled the majority, and knowledge about them is still limited.

Many Ugandans erroneously think that the entire financial system mechanism consists of a bank and credit institutions. A bank is understood in clear terms as a financial institution that (i) receives deposits, (ii) safeguards the deposits, (iii) avails the money to genuine owners on demand, (iv) lends to borrowers, and (v) offers both individual and institutional banking services. Butt (2000) broadly classifies banks into (a) saving banks, (b) commercial banks, (c) central banks, (d) merchant banks, and (d)

specialized banks (cooperative banks, agricultural and sectoral development banks, the Housing Finance Company, etc.).²⁰⁶

4.4.2.12 The Disintegration of the Sterling Area (1972) and the Formal End of the East African Currency Area (1977)

Following the take over of President Idi Amin of the Republic of Uganda in 1971, the East African countries suddenly witnessed the disintegration of the Sterling Area in 1972. In 1977 the East African Currency Area was formally ended following the collapse of the East African Community.²⁰⁷ How had the East African community integration including participation in the monetary control come about, and how had it enhanced economic transformation?

Following the provision made by the East Africa (High Commission) Orders in Council 1947 – 1961 and the East African Common Services Organization Agreements 1961 – 1966 for establishing the East African Community (EAC), the Treaty for East African Co-operation for the establishment of the East African Community was formally made in 1967.²⁰⁸ This 1967 treaty also established the East Africa High Commission and the East African Common Services Organization.

Beginning in 1967, the Republic of Uganda, the Republic of Kenya, and the United Republic of Tanzania started enjoying more formal and close historical, fiscal, commercial, industrial, and cultural ties under the East African community cooperation.

²⁰⁶ Butt, S.A. *Essentials of Commerce in East Africa*. (5ed). London: Cassell Publishers Ltd., 2000: 89.

²⁰⁷ The Preamble of The East African Community Treaty signed by the three East African heads of state on 15 January 2001 in Arusha , northern Tanzania to form the East African Community (EAC). Kenya's President Daniel arap Moi, Uganda's Yoweri Museveni and Tanzania's Benjamin Mkapa, formalized the EAC treaty set to pave way for an economic and, ultimately, political union of the three countries.

²⁰⁸ The Preamble of the East African Community Treaty - 15 January 2001.

However, lack of strong political will, lack of strong participation of the private sector and civil society in the co-operation activities, the persistent uneven sharing of benefits of the Community among the Partner States due to their differences in their levels of development, and lack of adequate policies to address this situation led to tepid involvement that resulted in the official dissolution of the 1967 Treaty for East African Co-operation in 1977.²⁰⁹ However, it was revived on January 15, 2001.

4.4.2.13 Toward East African Community Monetary Union

Members of the East African Community still used separate currencies as of May 2005. However, a strong push from the East African Business Council (EABC) to establish a monetary union within five years after the implementation of the customs union emerged and continued to gain popular support. Under the East African Economic and Monetary Union (EA-EMU), a formal name for the system in which member countries share the same currency, the Uganda Shilling will no longer be used.

Resolute to strengthen their economic, social, cultural, political, technological, and other ties for their fast balanced and sustainable development by the establishment of an East African Community, the leaders had deliberated on instituting the East African Customs Union by January 2005. A Customs Union creates a tariff regime that is accepted by the member countries thereby encouraging trade and investment. It also dismantles smuggling rings. A Customs Union leads to a Common Market. Under a single or common market, there would be no national barriers to travel, employment,

²⁰⁹ The Preamble of The East African Community Treaty –January 15,2001.

investment, and trade.²¹⁰ A common market invigorates economic life and the financial system in particular because it permits the free movement of labor and other resources for enhanced production.

The Customs Union serves as the transitional stage to and integral part of the formation of Common Markets and/or Monetary Union and, ultimately, a Political Federation. As a positive move towards establishing a monetary union, the East African Customs Union was officially launched on December 31, 2004, simultaneously by the East African Countries (Kenya, Uganda and Tanzania). It became effective January 1, 2005.

4.5 Other Highlights of Major Financial Institutions

4.5.1 Insurance Industry

Insurance companies in Uganda started around 1953 with Hogg Robinson and Collin-Hood, a British based insurance company as one of the first companies to operate in Uganda. The company provided insurance services especially during the construction of Owen Falls Dam, Jinja. Subsequently, as industrialization and commerce progressed, other companies (mostly based in Britain and India) emerged. These were acting as brokers for the parent companies based overseas.²¹¹

4.5.2 Cooperative Societies Movement

The Uganda Cooperative Movement, which was founded to mobilize and allocate resources especially to support agricultural activities in Uganda dates back to 1913 during

²¹⁰ Robbins, Stephen and Coulter, Mary. Management. 7ed. Upper Saddle River, New Jersey: Prentice Hall, Pearson Education, Inc., 2002.

²¹¹ Musoke, Badru, Kazibwe, R.O., Kaye, P and Lubega-Kadunabbi, “ A presentation for the Strategic Insurance Management course for Senior Managers,” Country Report for Uganda, 2000.

the imperial era. But it gained more government support and recognition in the 1960s. In 1961, Cooperative Unions in Uganda formed the Uganda Cooperative Alliance (UCA) as the Apex body of the Uganda Cooperative Movement. And in 1972, the Uganda Cooperative Savings and Credit Union (UCSCU), the national Union of Savings and Credit Associations, was founded to coordinate Savings and Credit Associations. Primary cooperative societies belonged to the Cooperative Bank. But the start of their underperformance is traced from the 1970s and 1980s when internal failings in the form of poor management and government interference affected their operations.

4.6 Striving for Robustness: Economic and Financial Reforms in Uganda

4.6.1 The IMF/World Bank Structural Adjustment Programs and Policies (SAPs)

When the fullness of the economy's productivity crisis and financial distress had been diagnosed by the IMF and World Bank, the main creditors of Uganda, these international financial institutions sought means of treatment and cure. Establishing a robust financial system through structural adjustment programs and policies (SAP) became the prescription of choice.

The first phase or program of the IMF/World Bank's structural adjustment program in Uganda was between 1981 and 1984. This phase failed. However, in 1987, the second phase of IMF/World Bank was introduced and ran up to the early 1990s. It is marked as a most amazing, constructive program because it initiated several economic and financial reforms, resulting in Uganda's economic turnaround. As part of the overall structural adjustment program, the financial sector reforms in Uganda started in 1991.

Writing about the economic crisis, structural adjustment and the state in Sub-Saharan Africa and in Uganda in particular, Sandbrook (1991) describes the “structural adjustment” concept to involve *“a set of policy reforms to maximize reliance upon markets in domestic and external trade and capital flows, minimize the government’s interventionist role by reducing public ownership, subsidies and regulation, and improve the state’s efficiency in allocating and using resources.”*²¹² He also recounts that including Uganda, *“by 1989, 35 Sub-Saharan African countries had adopted structural adjustment programs designed to relieve external and internal imbalances and facilitate the resumption of growth.”*²¹³

4.6.2 The Economic and Financial Reform Package

While strong and broad economic reforms started in 1987 in Uganda, it was not until the early 1990s that the financial sector embraced them. The Uganda Financial Institutions Statute of 1993 contains what reforms were implemented and continue to be implemented. In it we read a variety of reasons explaining why the financial reforms were inevitable. Prior to reforms, Uganda had experienced financial repression and the financial system had recorded high levels of inefficiencies and ineffectiveness.

The main components of the financial sector reforms in Uganda included (i) privatization, (ii) liberalization, (iii) institutional restructuring and (iv) prudential

²¹² Sandbrook, Richard (1991), “Economic Crisis, Structural Adjustment and the State in Sub-Saharan Africa,” in the *IMF and the South: The Social Impact of Crisis and Adjustment*. Edited by Dharam Ghai. London and New Jersey: Zed Books Ltd., 1991: 95.

²¹³ *ibid.*

regulation and supervision of financial institutions.²¹⁴ These reforms were intended to address the problem of an inefficient financial system, especially caused by the adverse pre-reform financial policies including the following:

- Nationalization or government ownership of most financial intermediaries and operating them on non-business oriented strategy such as expanding or establishing branches in rural areas because of the government's political concerns rather than under market efficiency considerations;
- Government control over interest rates and foreign exchange rates through the central bank, which became not only a constraint to competition but also created "black markets" especially in the foreign exchange and encouraged the practice of preferential interest rates in the loanable funds market; and
- Private sector commercial banks operating on government directives including directives to give credit or lend to particular sectors and to participate in other special lending schemes or rediscount practices instead of corporate business principles and goals.

The reform impact on the financial sector was great. Since 1993, the financial system in Uganda has been humming with significant improvements; and its soundness and efficiency have been enhanced and stimulated.

Five important benefits have been achieved as a consequence of reforms, and these include (i) financial intensification has been boosted, (ii) competition due to removal of administrative constraints such as interest rate controls and direct restrictive entry has been promoted, (iii) prudential regulatory and supervisory frameworks have been

²¹⁴ GAYI, Samuel K. and BROWNBIDGE Martin, "Progress, Constraints and Limitations of Financial Sector Reforms in the Least Developed Countries." Accessed March 1, 2004. Available: <http://www.devinit.org/findev/Working%20Paper7.htm>.

promoted through a toughened Central Bank and Capital Markets Authority as bodies that regulate and supervise the functioning of the financial system, (iv) diversification of financial institutions and functions including establishment of the Uganda Securities Exchange (USE) as the first financial market institution in Uganda and the licensing of the operation of Investment Collective Schemes (Unit Trust Funds or Money Market Funds) to pool individual investments into portfolios managed by professional financial managers.

4.7 Reform's Progress: Nature and Constituents of Uganda's Financial System

4.7.1 Profile and Categorization of Uganda's Financial System

4.7.1.1 Formal Financial Institutions

At the beginning of the year 2005, Uganda's financial system consisted of 12 types of formal financial institutions. These were as follows: (i) commercial banks, (ii) cooperative societies (iii) credit institutions, (iv) development banks, (v) leasing houses, (vi) micro-finance institutions, (vii) insurances, (viii) operational foreign exchange bureaus, (ix) post banks , (x) Uganda Securities Exchange (USE),²¹⁵ (xi) provident or pension funds, and (xii) real estate mortgage financing institutions.

4.7.1.2 Informal and Semi-Informal Financial Institutions

As of March 2005, Uganda's financial system consisted of several informal and semi-informal financial institutions including a large number of small, non-registered financial service and non-formal collateralized micro-loans providers. Examples include financial intermediaries such as (i) loans to relatives and friends, (ii) rotating savings and credit

²¹⁵ Bank of Uganda: Financial Institutions, December 20, 2004. Accessed January 13, 2005. Available: <http://www.bou.or.ug/Financial.htm>.

associations (ROSCAs), (iii) accumulating savings and credit associations (ACRA), (iv) a network of village savings and credit cooperatives, (iv) individual money lenders or village/local loan sharks, (v) rotational digging financial groups, (vi) burial and funeral financial groups, (vii) financial services by private, volunteer, non-profit organizations (PVOs) and Non-Government Organizations (NGOs), and (vii) Financial Services Associations (FSAs).

4.8 Classification of Uganda's Financial Institutions

The constituents of Uganda's financial system are in two broad classifications. They include (1) financial intermediaries and (2) financial markets.

4.8.1 FINANCIAL INTERMEDIARIES

4.8.1.1 Meaning and Dimensions

Financial intermediaries in Uganda are categorized according to two dimensions: (a) the nature of their financial intermediation and activities including banking and non-banking financial intermediaries and (b) the status of their prudential regulation and supervision including compliance to the practice and observance of principal standards and codes such as licensing, payment systems, accounting, auditing and disclosures.

4.8.1.2 Explication of Common Financial Intermediaries

1) Commercial Banks

Commercial banks refer to banks that provide or conduct the following financial services: (i) accept call, demand, savings, and time deposits, which can be withdrawn by cheque or otherwise, (ii) provide overdrafts and short-to medium-term loans; (iii) provide foreign exchange facilities; (iv) give guarantees, bonds, or other forms of collateral; (iv)

place third party drafts and promissory notes connected with operations in which they take part; (v) provide investment and financial advice; and (vi) participate in inter-bank clearing systems.²¹⁶

2) *Cooperative Societies*

Cooperative societies consisting of savings and credit associations and unions and financial cooperative societies constitute the oldest forms of financial institutions in Uganda and are credited to have operated in rural areas for many years. The Uganda Cooperative Movement dates back to 1913, gaining government support in the 1960s. And in 1972, UCSCU, the national union of Savings and Credit Associations (S & Cs), was founded to coordinate S & Cs. Other primary cooperative societies belonged to the Cooperative Bank. However, the start of their underperformance is traced from the 1970s and 1980s when poor management and government interference undermined their operations.

The Cooperative Act of 1991 separated cooperatives from the government. Uganda Cooperative Alliance emerged as the apex body of the cooperative movement. By the end of 1996, under the apex Uganda Cooperative Alliance, there were five National Cooperative Organizations including (i) UCSCU, the apex for credit unions, (ii) Cooperative Bank (closed in 1998), (iii) a Cooperative Insurance Company, (iv) district unions and (v) primary cooperative societies. Of 5062 primary cooperative societies

²¹⁶ Financial Institutions Act of 2004; Second Schedule : Section 3, 10(3) and 12(7) : Types of Financial Institutions: 144.

registered in 1995 only 28.2% were equipped and operational, and of the total 475 registered savings & credit societies only 247 belonged to UCSCU.²¹⁷

As of February 2004, under the umbrella Uganda Cooperative Alliance (UCA-Village Banks) Ltd., there were at least 64 cooperative financial institutions in Uganda. Cooperative Societies in Uganda are licensed under the Cooperative Societies Act.

3) *Credit Institutions*

Credit institutions refer to those financial institutions that are characterized by acceptance of call and time deposits repayable after a fixed period or after notice and employment of such deposits wholly and partly by lending or any other means for account and at the risk of the person accepting such deposits.

There are 6 credit financial institutions in Uganda. These include (1) Capital Finance Corporation Ltd., (2) Housing Finance Company of Uganda Ltd., (3) Imperial Investment Finance Ltd., (4) Mercantile Credit Bank Ltd., (5) Stanhope Finance Company Ltd., and (6) Commercial Micro-Finance Ltd.

4) *Development Banks*

Development banks mobilize external funds from international, government, and non-government agencies and lend them out for long-term projects in different sectors including agriculture, manufacturing, and services as well as development of infrastructure. They mobilize resources in the form of commercial and concessionary aid (loans and grants) and export credit from aid organizations and international financial institutions. Sources of funds for Development Banks in Uganda include (i) World Bank, (ii) ADB, (iii) The OPEC Fund, (iv) EU, and (v) the governments of Sweden, Norway

²¹⁷ Ditcher, Tom (International Consultant) and Kamuntu Ephraim (National Consultant), “UNDP Micro-Finance Assessment Report for Uganda,” prepared as component of the MicroStart Feasibility Mission March 1997 http://www.undp.org/sum/sum_reports/Country_Reports/Ugandaadb2.html.

and Switzerland. Development Banks provide medium and long-term loans ranging from US \$ 200,000 to US\$ 5,000,000.

5) *Mortgage Banks*

Mortgage banks in Uganda are banks that provide the following financial services: (i) receive deposits of participation in mortgage loans and in special accounts; (ii) grant loans for the acquisition, construction, enlargement, repair, improvement and maintenance of urban or rural real estate, and for the substitution of mortgages taken out for that purpose; (iii) give guarantees, bonds, or other forms of collateral connected with the operations in which they take part; and (iv) obtain foreign loans and act as intermediary in loans extended in local and foreign currency, having the previous authorization of the Central Bank for such loans exceeding a specified limit as prescribed by the Central Bank.

The popularity and importance of mortgage lending in Uganda is that a borrower gets a long-term loan on real property, which he/she secures in order to buy that property. A mortgage transfers the rights to that segment of property from the borrower to lender until the loan is equally reimbursed.

6) *Leasing Houses*

Leasing refers to an economic and business pact involving two parties: the lessor and the lessee. It is a commercial pact by which a financial institution, especially a financial intermediary (lessor) grants funds to another party (lessee) to obtain a real asset, which remains the property of the financial institution until the agreed conditions are fulfilled. The lessee repays the lease (principal and the interest) according to the expected and accepted installment schedule and terms. The lessor usually requires a collateral or the

very property may be used as a collateral. The main advantage of leasing is that a lessee acquires an expensive and valued property which he/she would not have obtained on his own.

There are three leasing houses or companies in Uganda. These are the (i) Uganda Leasing House, (ii) K.T.U leasing company (with one branch in Kenya and one in Uganda), and (iii) East African Development Bank (E.A.D.B) leasing company (operating in Uganda, Kenya, and Tanzania with one branch in each country). Other financial institutions that offer leasing in Uganda include Dfcu Leasing Company and Stanbic Bank Uganda Ltd.

7) *Insurance Industry and Market*

Out of the 18 insurance companies in Uganda, only four are large companies that engage in serious competition in the insurance industry.

8) *Micro-Finance Institutions*

Micro-finance institutions are categorized into two: deposit taking and non-deposit taking. Formal deposit-taking institutions refer to companies licensed to carry on, conduct, engage in, or transact micro-finance business in Uganda. By micro-finance business, we mean businesses that accept deposits from and provide short-term loans to small micro-enterprises and low income households, usually characterized by the use of collateral substitutes such as group guarantees.²¹⁸

As of April 2005, the micro-finance industry comprised two commercial banks involved in the micro-financing sector (CBI-MFS) and several emerging micro-finance institutions (MFIs), savings and credit cooperative organizations (SACCOs), community based organizations (CBOs), and Financial Services Associations (FSAs). However, only

²¹⁸ The Financial Institutions Act 2004 : 17.

less than twelve were Micro Deposit Taking Institutions (MDIs) as regulated by the Central Bank of Uganda. The rest delivered credits without accepting deposits.

Many people refer to a micro-finance as an organization that provides financial services to the poor and needy with the broad goal of increasing household income and alleviating poverty. Since the early 1990s, micro-finance institutions of all sizes and types have become very common in Uganda with one stated goal: to fight poverty. However, some have become financial predators, exploiting the poor.

9) *Operational Forex Bureaux*

These are financial institutions that provide financial services in the form of exchange for foreign currency in the foreign exchange. A foreign exchange market is a financial market that deals with foreign currencies. Gwartney and Stroup (1997) define the foreign exchange market as “a widely dispersed, highly organized market in which currencies of different countries are bought and sold.”²¹⁹ Stiglitz and Walsh (2002) refer to the foreign exchange market as “the starting point for understanding the international financial system.”²²⁰ As of April 2005, there were seventy-nine foreign exchange bureaus operating in Uganda in addition to commercial banks, which do a substantial foreign exchange business.

10) *Post Office Bank(s)*

A Post-Office Savings Bank is characterized by provision of the following financial services or businesses: (i) acceptance of savings and fixed deposits and investment in

²¹⁹ Gwartney, James, Stroup, Richard, Studenmund, A.H., and Sobel, Russell. Economic: Private and Public Choice. 8ed. New York and London: The Dryden Press, Harcourt Brace College Publishers, 1997:874.

²²⁰ Stiglitz, Joseph, E and Walsh, Carl, E. Principles of Macroeconomics. Third Edition. New York & London: W.W. Norton & Company, 2002:405.

government securities. As of April 2005, there was only one Post-Office Savings Bank, but it was operating in ninety-one post offices in Uganda.

11) *Non-Government Organizations (NGOs)*

There are several NGOs that operate informal financial institutions in Uganda. Whether Ugandan or foreign as distinguished by the Non-Government Organizations Regulations of 1990, a non-government organization is one “ established to provide voluntary services including religious, educational, literary, scientific, social or charitable services to the community,” according to section 13 of the 1989 Non-Government Organizations Registration Statute.²²¹

Examples include the Uganda Women to Save Orphans (UWESO), which runs the UWESO Credit and Savings Scheme (USCS), and Agency for Cooperation and Research in Development (ACORD), which runs Pakwach Rural Development and Micro Finance Agency (PRDPMA). The American Government (USA) through USAID supports several non-government organizations in Uganda. In January 2005, the USA donated UGSHS 9 billion to help NGOs in Uganda. The money was dispatched through the Uganda Program for Human and Holistic Development –UPHOLD. According to UPHOLD’s Chief Executive, Nosa Orobato, nineteen community service organizations had received up to UGSHS 180 million, which is used to fight HIV/AIDS and improve primary education.²²²

²²¹ ILO Social Finance Unit: Micro-Finance in Post-Conflict Countries: The Case Study for Uganda. Accessed June 15, 2004 Available: <http://www-ilo-mirror.cornell.edu/public/english/employment/finance> .

²²² Matekha, Samuel, “US government donates,” in Simba, Uganda of Wednesday 26 January 2005. Accessed January 27, 2005. Available: Simba.fm Website powered by ONE2NET [www.one2net.co.ug].

12) *Financial Service Associations (FSAs)*

Financial Service Associations (FSAs), which form the Micro-Finance Industry, are financial service providers to low income individuals in rural, semi-urban, and urban Uganda. Licensed by FSA International Uganda Limited (FSAIU), they operate under a franchise arrangement. FSAs are spread throughout the country and are self-managed branches that operate locally raised share capital applying a FSAIU methodology. However, FSAIU is not a shareholder in the FSAs. As of June 30, 2003, there were thirty-one FSA branches overseen by FSAIU and located in Kampala area and Masaka region as well as in Bushenyi, Ntungamo, Rukungiri, Kabale and Kisoro districts in Uganda.²²³

The Financial Services Associations (FSAs) operate by selling shares, extending credit to, and accepting deposits from customers. As of June 2003, the entire network comprised about 12,000 shareholders.

13) *Private Volunteer Organizations (PVOs)*

The financial system, especially the informal and semi-formal intermediaries, is composed of financial private, volunteer organizations (PVOs) that provide financial services to local communities. They realize financial requests unmet by the government and the formal private sector. Most private volunteer organizations in Uganda are nonprofit organizations established by religious/faith groups or spiritual movements.

They serve as social and economic safety nets especially for the poorest. In addition to providing a range of critical services, time, and expertise that improve the quality of life in a community, they also run local or rural settings to provide financial services to the most needy in the community.

²²³ Combined Financial Statements of 31 FSAs in Uganda. DRAFT 30 June 2003.

They do their significant job on lean budgets and struggle to make ends meet while making daily decisions about how to allocate their resources. They contribute to economic development through the provision of financial services. They commit themselves to helping community projects.

4.8.2 FINANCIAL MARKETS

4.8.2.1 Background

Financial markets in Uganda form the Securities Markets Industry and are still nascent, minimal, and fragile. They are a fruit of the financial sector reforms that were started in the early 1990s as part of the 1987 general economic reforms in Uganda. The Financial Market in Uganda currently trades in stocks of seven listed companies, one corporate bond, seven government bonds, and short-term securities especially treasury bills. It has no trading activities in commodities and derivatives: futures and options contracts.

4.8.2.2 Structure and Components of Uganda's Financial Market

The financial market in Uganda is constituted by the following organs: (i) the Capital Markets Authority (CMA) Uganda, which is the regulator and enforcement agency for all laws, rules, and regulations of the securities markets, (ii) the Uganda Securities Exchange (USE), which is the market operating as the only Stock Exchange and Secondary Market in Uganda, and (iii) the Market Actors consisting of the brokers/dealers who are licensed to trade on the Uganda Securities Exchange floor, investment advisors who play the advisory role to the clients, money market funds or collective investment schemes (unit trust funds) whose managers pool the funds of their

clients and invest them, the registrars, and the investing public comprising foreign and domestic investors.

To encourage foreign investment in the financial markets in Uganda, the government promotes and provides a competitive incentive regime for private sectors and investors characterized by (a) a fully liberalized foreign exchange rate with no restrictions on the movement of capital in and out of Uganda, (b) a trading environment which removed restrictions on foreign participation in the sector, (c) a freely convertible , and (d) the acceptance of multiple and cross border listings on foreign financial markets. For example, companies like Kenya Airways Ltd. and East African Breweries Ltd. are listed both in Kenya and Uganda. Foreign brokers can also enlist as dealers on the Uganda Stock Exchange (USE), and investors of any nationality are allowed to invest.

4.8.2.3 The Uganda Securities Exchange (USE) as the Market

4.8.2.3.1 Establishment and Profile

The Uganda Securities Exchange (USE) is one of the many secondary markets in the global financial market. Licensed by the CMA of Uganda to operate as an approved stock exchange, the Uganda Securities Exchange was established in June 1997. By December 31, 2004, it was the only securities market in Uganda characterizing both the security type and organizational form classifications.

By May 2005, it had seven listed companies. Of these, two companies had cross-border listing. All listings were included in only one index, the Uganda Stock Exchange All Shares Index, which was launched in August 2003.

Figure 4-(4) shows the companies listed on the Uganda Securities Exchange as of May 2005

	Listed Company	Year of listing and Notes	Ticker	Sector
1.	Uganda Clays Ltd.	1998	UCL	Building Materials
2.	British American Tobacco (U) Ltd.	1999	BATU	Tobacco
3.	Bank of Baroda (U) Ltd.	2000	BOBU	Banking
4.	East African Breweries Limited	Cross –listing (U , K & T), 2001	EABL	Beverages
5.	Kenya Airways Ltd.	Cross-listing (U & K)	KA	Transportation
6.	Development Finance Company of Uganda Ltd.	2004	DFCU	Holding/Leasing
7.	The New Vision Printing & Publishing Company Ltd.	2004	UCL	Media /Printing

Data Source: USE Website and the New Vision, Uganda April 2005

4.8.2.3.2 *Categorization of Financial Markets in Uganda*

The Uganda Securities Exchange is classified according to *organizational form* perspective (organizational-form classification) and according to *securities* traded (security- type classification).

4.8.2.3.2.1 *Organizational Perspective*

From the organizational perspective, the Uganda Securities Exchange (USE) currently represents two distinguishable but inseparable markets in their character and functions. These are (i) *the primary* and (ii) *the secondary* markets.

1) *Primary Financial Markets*

Primary financial markets exist and operate where and when original and new securities are put up for sale. They are markets for newly-issued securities. When securities are issued and sold in the primary market through the initial public offer (IPO), they are bought by individual or institutional investors wanting to sell them to other

investors at a future point of time. The transaction directly affects the balance sheet of the issuer of the security.

The Uganda Securities Exchange (USE) characterizes and functions as the primary financial market when the trading activity it carries out involves initial public offers (IPOs) or newly-issued securities. Companies on the Uganda Securities Exchange (USE) make new issues which are subscribed to by any and all investors without any form of discrimination.

Beginning with the year 2005, Bank of Uganda appointed five banks to deal in the primary market. These are the following: (i) Bank of Baroda, (ii) Barclays Bank, (iii) DFCU Bank, (iv) Stanbic Bank and (v) Standard Chartered Bank. The primary dealers have to meet criteria set out in the licensing requirements, rules, privileges, and obligations.

2) *Secondary Financial Markets*

Secondary financial markets exist and function where and when already issued (outstanding) securities such as stocks and bonds are purchased and sold. They trade in previously-issued securities. When individual or institutional investors trade among themselves, they carry out the trading activity in the secondary market.

The Uganda Securities/Stock Exchange is an example of secondary financial markets in Uganda. The Uganda Securities Exchange (USE) characterizes and functions as the secondary financial market when already issued (outstanding) securities including equity and non-equity instruments are purchased and sold. Secondary financial markets are usually facilitated by a broker and a dealer. While brokers coordinate buyers and sellers,

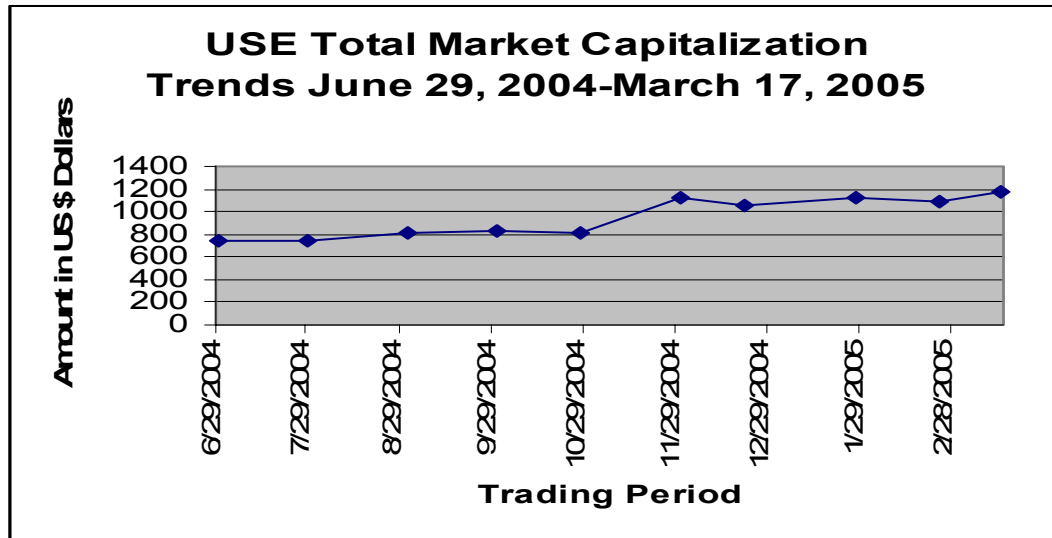
dealers trade securities from their own account.²²⁴ There is hope for establishing an electronic order-matching service to assist the transaction. Dealing members buy and sell quoted securities in respect of the rules and regulations of the Uganda Securities Exchange (USE) and of the Capital Markets Authority (CMA) of Uganda.

These transactions that take place involve transfer forms since the securities move from one hand to another. Investors are made to know that share certificates of companies quoted on the Uganda Securities Exchange (USE) are negotiable instruments and registrars do not seek the approval of the vendors before completing transfers.

The total market capitalization of every quoted company is listed on the Uganda Securities Exchange. Each sale of shares is achieved on the trading floors through brokers or agents licensed by the Uganda Securities Exchange under the Capital Markets Authority. For example, total market capitalization was UGSHS 1,342.2 billion (US \$741.5 million) as June 29, 2004 before jumping to UGSHS 1,968.5 billion (US \$1,118.5 million) on November 29, 2004. On February 28, 2005 it amounted to UGSHS 1,870.5 billion (US \$1,093.9 million). It was over UGSHS 2,100.1 billion as of mid 2005.

²²⁴ Reilly, Frank and Norton, Edgar. Investments. Sixth edition. USA & UK: Thomson South-Western, 2003: 14

Figure 5-(4) below gives the Market Report of the USE between June 2004 and March 17, 2005



Data Source: USE Website Market Information Report March 2005

The trading system used in the Uganda Securities Exchange (USE) market floor is a *continuous open outcry* system whereby representatives of broker members converge on the trading floor and trade by shouting their orders to a board writer who records the data on the board. Commenced by the ringing of a bell, a trade is completed when a *bid* and an *offer* are matched, and trading is ended by the ringing of a bell. Interested members of the public view and listen to trading as it takes place through the public gallery.²²⁵

²²⁵ Official Website of Uganda Securities Exchange (USE) Ltd., Market Information and Listed Securities , 2003 Copyright: 137

Figure 6-(4) presents the Uganda Securities Exchange (USE) Particulars and Operations

USE –Particulars and Operations	
1) Tradable Securities on USE	Corporate Bonds, Ordinary Shares, Preference Shares, Treasury Bills, Commercial Paper, Government Bonds, Asset Backed Securities
2) Types of Securities Currently Traded	Corporate Bonds, Ordinary Shares and Government Bonds
3) Forms of Securities Instruments	Equities and Debts Instruments
4) Trading System	Continuous Open Outcry System
5) Over-The-Counter-Trading (OTC)	OTC Trading-Not yet permitted
6) Official Working Days & Hours	Monday to Friday save for public holidays; 8.30a.m-5.30p.m
7) Trading Days and Hours of Equities	Tuesdays & Thursdays; 10.00a.m to 12.00noon
8) Trading Days and Hours of Fixed Income Securities (debt instruments)	Anytime of working days through licensed broker/dealers
9) Regulatory & Supervisory Body	Capital Markets Authority (CMA)
10) USE Trading, Clearing & Settlement	Central Securities Clearing House (CSCS)
11) Settlement Cycle (Partial settlement or delivery is not allowed in the market)	T+5 Rolling Settlement Cycle [Trading-T; Delivery-T+3; Settlement-T+5]
12) Depository System	Manual to Central Depositing System (CDS)
13) Stamp Duty or Transaction Taxes	0%
14) Capital Gains Tax	0%
15) Withholding Taxes on Dividends & Interest	15% (taxed at source)
16) Corporate Tax	30%
17) Joint Investor Compensation Fund	Funded by the Broker Guarantee
18) Total Trading Costs to the investor	2%, 1.8%, and 1%
19) Corporate actions for Listed Companies	Must make prompt and full public disclosure of Company Actions

Data Source: Uganda Securities Exchange (USE): USE -Trading Costs and USE – Operations, 2004.

(i) *Trading Costs/Commission rates*

Determinant Figure	Broker Commission	USE Transaction Tax	CMA Transaction Tax	Joint USE & CMA Compensation Fund Fee	Total Cost to Investor
On the First UGSHS 200 million	1.7%	0.14%	0.14%	0.02%	2%
On the Next UGSHS 800 million	1.5%	0.28%	0.14%	0.02%	1.8%
Above UGSHS 1 billion	0.8%	0.28%	0.14%	0.02%	1%

Source: Uganda Securities Exchange (USE): USE -Trading Costs and USE – Operations, 2004

(ii) *Membership of Licensed Securities Firms*

The Uganda Securities Exchange (USE) membership comprises broker/dealers and investment advisory firms. These perform distinguishable but inseparable roles. The brokers/dealers are licensed to carry out trade transactions on the exchange floor. Meanwhile, the investment advisors are licensed to only offer investment advisory services to their clients.

Some firms perform both roles in tandem, which include trading and advising. Examples include (i) Baroda Capital Markets (U) Ltd., (ii) Crane Financial Services (U) Ltd., (iii) Equity Stock Brokers (U) Ltd., (iv) MBEA Brokerage Services (U) Ltd., and (v) Dyer & Blair (U) Ltd. At the present time, with one exception, licensed broker/dealers and investment dealers essentially include the same group. As of mid 2004, only G. Geoffrey Onegi-Obel & Co. Ltd. held a license to act as investment advisor only.

The Exchange has an *Automated Trading System*. Selling and buying activities listed on each company's performance are computed and published daily, weekly, monthly, quarterly and annually.

4.8.2.3.2.2 Securities Traded (Security-Type Perspective)

Securities markets are either equity or debt market securities.

1. Equity Market Securities: Corporate Stocks/Shares

The equity market securities and the exchange turnover reflected the share price of these companies.

Figure 7-(4) highlights the performance and market capitalization of individual stock companies as of March 17, 2005

Session No.	Firm	Current Price (UGSHS)	3 Month High (UGSHS)	3 Month Low (UGSHS)	Market Capitalization (UGSHS)
434	BATU	1,145	1,145	1,145	56.2bn (US\$ 32.6m)
224	BOBU	800	800	800	32bn (US \$ 18.6m)
40	DFCU	300	315	300	59.7bn (US \$34.6m)
388	EABL	2,433	2,486	2,241	1,603.2bn (US \$ 929.4m)
290	KA	523	484	378	246bn (US \$142.6m)
22	NVL	250	250	245	12.8bn (US \$7.39m)
455	UCL	8,000	8,010	8,000	4bn (US \$ 2.32m)

Source: USE Equity Market –Market Report March 17, 2005

2. Debt Market Securities: Money markets and Capital markets in Uganda

In Uganda, households and individuals are the net savers while the government and companies are the net borrowers. Governments and companies access both the money market and capital markets. For example, since the 1990s, the government has been borrowing from individuals, households and companies through the money market and capital markets by issuing treasury bills and bonds.

- *Money Market Securities in Uganda*

- *Meaning of Money Markets*

Money market securities refer to markets for short-term finance. Logue (1995) calls the money market “a collection of markets involving various money market instruments: short term obligations of the central government treasury and central government agencies, commercial banks’ and other major money center banks’ certificates of deposit (CDs), banker’s acceptances (BAs), and commercial paper (CP) or public short-term loans from various corporations.”²²⁶

- *Financial Instrument, Maturity and Purpose of Money Markets*

Money markets trade short-term, more liquid debt instruments such as Treasury bills and notes. The main financial instruments of money market securities traded on the Uganda Securities Exchange (USE) are the Government T-Bills. As of December 2004, only the Uganda government had been the issuer/borrower of the bills to/from the public through the primary dealers.

Short-term loans, which are the financial instruments of the money markets, mature in less than one year. Although money market borrowing is intended to finance short-term needs such as inventory, the Uganda government has used it to finance its debit deficit and to facilitate loanable and foreign exchanges through the Central bank.

- *Capital Market Securities in Uganda*

Capital market securities refer to debt markets for long-term loans usually ranging from one year onwards. A capital market qualifies to be categorized as a financial market

²²⁶ Logue, Dennis, E. *The WG &L Handbook of Financial markets*. Cincinnati, Ohio. WG, Warren, Gorham and Lamont; College Division South-Western Publishing Co., 1995:76.

when the long-term loan(s) in the trading market is of security type. Examples of capital markets trading in longer-term securities include the government bonds and corporate bonds. The Uganda government treasury bonds dominate the capital market securities in Uganda. Only one corporate bond was traded, which is the UTL Bond with a coupon rate of 182 days TB interest rate +1.65% a maturity in 2008.

Figure 8-(4) demonstrates the Government Bonds in the Uganda Securities Exchange (USE) as of April 1, 2005

Issue No	Issue Size (UGHS)	Issue Date	Maturity Date	Coupon Determination	Current Coupon	Mid Price at YTM
FXD 1/2004/2	80bn	14/01/2004	17/01/2006 (306 Days)	Fixed	10%	14.13%
FXD 5/2004/2	60bn	30/06/2004	39/06/2006 (469 Days)	Fixed	10%	14.38%
FXD 2/2004/3	80bn	25/02/2004	22/02/2007 (707 Days)	Fixed	10.25%	15.63%
FXD 3/2004/5	40bn	24/03/2004	19/03/2009 (1,463 Days)	Fixed	10.75%	15.83%
FXD 4/2004/10	15bn	19/05/2004	08/05/2014 (3,339 Days)	Fixed	11.00%	15.50%
FXD 6/2004/3	90bn	07/10/2004	04/10/2007 (931 Days)	Fixed	10.25%	16.25%
FXD 1/2005/2	65bn	28/01/2005	25/01/2007 (679 Days)	Fixed	10%	14.43%

Source: Uganda Securities Exchange (USE) Website on Debt Securities Market: Government Bonds Market Report –March 2005

4.8.2.3.3 Money Market Funds (Collective Investment Schemes or Unit Trust Funds)

4.8.2.3.3.1 Meaning of a Money Market Fund

A money market fund is a type of mutual fund that refers to a unit trust fund or collective investment scheme in which both individual and institutional investors pool their funds and entrust them to a competent investment manager who manages and

invests these funds into financial assets that earn higher investment returns. The funds are invested in debt securities markets.

A Mutual Fund is an investment firm that pools funds from a variety of investors who become shareholders and invests these funds on their behalf in different securities such as equity/stocks, debt/bonds, and money market securities. The different types of mutual funds based on portfolio objectives include (i) common stock funds, (ii) taxable bond funds, (iii) municipal or local government authority bond funds, (iv) stock-and-bond funds, (v) money market funds, (vi) life-stage funds/life-cycle funds or date-definite funds, and (vii) supermarkets funds²²⁷

However, the first money market fund to operate in Uganda in January 2005 traded in debt markets only. The African Alliance (U) Ltd. Money Market Fund's Trustee Deed specifies that fund managers may only invest in debt securities markets such as high-quality bank fixed deposits, government treasury bills and bonds with a maximum term to maturity of thirteen months.²²⁸

4.8.2.3.3.2 Operation of Money Market Funds in Uganda

African Alliance (U) Ltd was licensed in October 2004, by the Uganda Capital Markets Authority (UCMA) as the first firm to operate as the money market funds also known as the Unit Trust Funds. African Alliance (U) Ltd. is a subsidiary of African Alliance Group International, which specializes in corporate finance stock broking, assets and pension fund management, and debt origination across the continent. In Uganda,

²²⁷ Reilly Frank K. and Norton Edgar. *Investments*. 6edition. UK and USA: Thomson South –Western, 2003: 99-102 .

²²⁸ Oketch Martin Luther, "Collective investment scheme to realize US \$ 60," in the *Monitor, Uganda* [online] of February 11, 2005. Available: <http://www.monitor.co.ug/business/bus02121.php>.

however, African Alliance (U) Ltd started operating as a fund manager of short-term securities in early February 2005, thereby becoming another form of a financial market in Uganda. By February 11, 2005, it had 20 clients and 20 enquiries.²²⁹

4.8.2.3.3.3 Regulatory and Supervisory Framework set by UCMA

To safeguard investors' money and uphold confidence in the financial market, the investment or fund manager operates under the guidance and directive of a strict set of rules issued by the Uganda Capital Markets Authority (UCMA). For example, as of March 2, 2005, UCMA required a firm desiring to operate as a Fund Manager or Unit Trust Fund to have a minimum capital of UGSHS 200 million (US \$114,286).

4.8.2.3.3.4 Significance to Investors

Money market funds provide five important advantages to investors: expertise in or professional management and record keeping of funds and risks, economies of scale as investors pool their resources, option and agility to meet the miscellaneous investment aims of individuals, indexing that is helpful in tracking markets prices, and diversification of funds.

Many resources pooled under a competent investment manager are able to benefit individual and/or institutional investors in the following ways: (i) bargaining leverage for attractive incentives in form of interest rates, (ii) opportunities for accessibility to hitherto remote investment markets, (iii) capacity to allocate, spread, and diversify investments

²²⁹ Ibid.

and lower risks, (iv) ability to lower operational costs and costs of doing business, and (v) preservation of investors' capital.²³⁰

When Bank of Uganda (BOU) re-opened the three year government bond worth UGSHS 30 billion in mid June 2004, it was over-subscribed by 1½ times in an auction dominated by institutional investors leaving individuals with a minimal share. Commercial banks accounted for 94.63%. Other institutional investors took 3.33%, and insurance companies accounted for 2%, leaving individuals with just 0.04% of the bid offer.²³¹

4.8.2.3.3.5 *Resource Mobilization and Allocation Role and Advantages*

By the time African Alliance Group International constituted Uganda's financial market, it had investment banking and advisory operations in Kenya, Botswana, Swaziland, and South Africa.

As of May 2005, African Alliance (U) Ltd. as the first Fund Manager in Uganda encouraged the public to participate in the buying of units which cost UGSHS 10,000 and earned 8.06% interest. The range of the required minimum investment was UGSHS 50,000 to UGSHS 250,000 (US \$29 to US \$143). The Unit Trust holder or the collective investment scheme holder is given 10 to 12% for the amount invested.

The advantage of this institution is that it becomes cheaper and easier to mobilize and allocate resources by pooling small amounts from a diversity of people. It raises both saving and investment rates. Moreover, collective investment schemes (CIS) are

²³⁰ Writer of The Monitor Newspaper, "A Guide to money market funds," in the Monitor, Uganda [on-line] February 16, 2005. Available: <http://www.monitor.co.ug/bizfin/bf021510.php>.

²³¹ Kaujju, Peter, "Three-year bond over-subscribed," in the New Vision, Uganda [on-line] June 30, 2004. Available: <http://www.newvision.co.ug/D/32/367930>.

considered the best investment vehicles for financial markets in low-income and developing economies because they aid small investments and allow investors to indirectly own a variety of shares.

By the end of January 2005, African Alliance (U) Ltd. had started plans to establish nationwide networks as receiving points for small savings and investments collected from rural or village communities. The establishment of Unit trust funds and mutual funds or unit trust funds is one of the safest and cheapest means to mobilize savings for creative investment. It also provides opportunity for immediate needs since an investor is free to withdraw money at any time.²³²

4.8.2.3.3.6 African Alliance (U) Ltd. Products

As of March 2005, African Alliance (U) Ltd. operating as a fund manager offered three products and services: (i) *the balanced investment fund*, (ii) *the high yield income fund* and (iii) *the money fund*.²³³ Figure 9-(4) presents the products services and prices of African Alliance (U) Ltd.

Products	Fund	Price (UGSHS)
Product -1	Balanced Investment Fund	102.6261
Product -2	High Income Fund	102.1762
Product -3	Money Fund	8.38%

Thus, the collective investment scheme offers options from which to choose. Financial experts predicted that investments could realize about US \$ 60 million in a year.

²³² Oketch Martin Luther, “Collective investment scheme to realize US \$ 60,” in the Monitor, Uganda [online] of February 11, 2005. Available: <http://www.monitor.co.ug/business/bus02121.php>.

²³³ Kauju, Peter, “Unit Trust Trading Starts,” in the New vision, Uganda [On line] February 3, 2005.

4.8.3 Categories of Formal, Semi-formal and Informal Financial Institutions in Uganda as of April 2005

Figure 10 - (4) illustrates the categories of financial institutions in Uganda as of May 2005

Category	Sub-Category	Field	Examples
Banking			
Depository Banks	Central Bank	Regulation & Monetary Policy	Bank of Uganda
	Commercial Banks	Banking & Finance	CERUDEB Ltd.
Non-Banking			
Depository	Thrift & Cooperative Institutions	Micro-Finance Institutions	UMU Ltd. , U-Trust, & Pride
		Savings & Credit Associations	UCSCU
		Savings & Credit Cooperative Societies (SACCOS)	UCA
	Financial Service Associations (FSAs)	Financial Service Providers	FSAIU -FSA / Muhanga
	Merchant Banks		
	Mortgage Banks		
	Post office Savings Bank	Assorted Institutions/Acceptance of Savings	Posta Uganda Ltd
Non-Depository	Credit Institutions	Leasing & Hire Purchase	ULH Ltd
		Development Banks	UDB & EADB
		Housing Finance Companies	UHFCU Ltd
		Finance & Capital Companies	STANHOPE
	Contractual Companies	Pension & Provident Fund(s)	NSSF
		Insurance Companies & Brokers	NIC & SWICO Ltd
		Insurance Fund for Political Risks for Foreign Investors	ATI Agency
	Other Payment Providers	Foreign Exchange Bureaus	CFC & Stanhope
		Transfer/Payment Agents	WESTERN UNION

	NGOs , PVOs , CBOs & FBOs	Non-Government Organizations	WORLD VISION
		Private Volunteer Organizations (PVOs)	Uganda – Italia Solidale (UIS)
		Community & Faith Based Organizations (CBOs & FBOs)	NAWOU
		ACRAs & ROSCAs	
	Government Schemes	<i>Entandikwa</i> Credit Scheme	BOU-Dep't Finance
		Poverty Alleviation Program (PAP)	BOU-Dep't Finance
Financial Markets	Uganda Securities Exchange (USE)	Money & Capital Markets	USE
		Uganda Stock Exchange	USE
Other Financial Intermediaries	Collective Investment Schemes (Unit Trust Funds)	Fund Manager / Money Market Fund	African Alliance Ltd.
	Real Estate & Property Mortgage	Real Estate Mortgage	Mowin Properties
		Real Estate/Jobs Mortgage	JP & PM Ltd.

4.8.4 Facts and Figures: Summary Table

Figure 11-(4) shows numerical data of Uganda's Financial Institutions as April, 2005

Type of Institution	Dec. 1997	Dec. 1998	Dec. 1999	Dec. 2000	Dec. 2001	Dec. 2002	Dec. 2003	Dec 2004	Mar. 2005
Central Bank	1	1	1	1	1	1	1	1	1
Commercial Banks	20	19	17	17	17	15	15	15	15
Development Banks	2	2	2	2	2	3	3	3	3
Credit Institutions	7	5	5	6	6	7	7	6	6
Cooperative Institutions	--	--	--	--	18	25	25	64	64
Micro-finance Institutions	80	--	---	102	102	101	96	105	105
Insurance Companies	--	--	--	--	--	--	13	17	18
Foreign Exchange Bureaus	-	-	-	-	-	70	62	79	79
Leasing Companies	1	1	1	1	1	1	3	3	5
Pension Funds	1	1	1	1	1	1	1	1	1
Securities Exchange	1	1	1	1	1	1	1	1	1
Mutual Fund/Unit Trust	--	--	--	--	--	--	---	---	1
Real Estate Institutions	--	--	--	--	--	6	9	9	9
Financial Service Associations (FSAs)	---	---	---	--	---	26	31	31	31

Data Source: IMF Country Report No.03/97 (Uganda) –Financial system Stability Assessment (April 2003) and Uganda’s Financial Sector Profile (as of February 2003) and the *New Vision, Uganda* October 25, 2004, BOU Website updated December 2004, The *New Vision, Uganda* January 2005

Meanwhile, as of June 30, 2002, the Uganda financial assets comprising the commercial banks, non-bank financial institutions (NBFI), pension, insurance and micro-finance institutions totaled UGSHS 2,994 billion and 29.5 % of GDP.²³⁴

4.8.5 Assets and Contribution of Uganda Financial System to GDP

Figure 12-(4) shows Uganda’s Financial System assets as of June 30, 2002

Type of Institution	Assets (UG SHS Billions)	% of Assets	% of GDP
Banking (Commercial Banks)	2,450	81.8	24.1
Non-Banking Financial Institutions	200	6.7	2.1
Pension & Provident	254	8.5	2.5
Insurance Industry	60	2.0	0.6
Microfinance Institutions	30	1.0	0.3
Total of Assets of financial system	2,994	100.00	29.5

Source: 2003 International Monetary Fund Country (Uganda) Report No 03/97 published April 2003

4.9 Conclusion

Uganda’s savings and investment milieu is promising. The financial system is emerging from inefficiency and ineffectiveness to efficiency and robustness. The banking sector has evolved. Many non-banking financial institutions, especially the micro-finance institutions have been established. The financial market has also emerged and is promising. This chapter introduces us to the next one, which examines the economic functions of Uganda’s financial system.

²³⁴ 2003 International Monetary Fund Country (Uganda) Report No 03/97 published April 2003. Available: <http://www.imf.org>

CHAPTER FIVE

5 THEORY AND PRACTICE: TRANSFORMING UGANDA'S ECONOMY WITH AN EMERGING ROBUST FINANCIAL SYSTEM

5.1 Introduction

This chapter highlights the indispensable roles of a robust financial system, which are topped by resource mobilization and asset allocation from surplus units to deficient units for creative investment leading to economic transformation.

Transformation of Uganda's economy, which involves changing the way people think, act and live, increasing income levels and reducing poverty levels, managing and using technology, enhancing managerial and technical skills, providing loans and financing for more of private enterprises, creating internal demand, increasing production and export of value-added products, among others, is challenging but not insurmountable.

Industrialization is one way of transforming Uganda's economy. Roasting and grinding Uganda's coffee into finished forms, turning iron ore into steel, converting phosphates into fertilizers, turning fruits into fruit juices, beef into beef products, milk into milk products, and fish into processed and preserved fillets, and processing skins and hides into leather goods are some of the examples of industrialization and transformation.

Despite being merely an emerging robust financial system, there is an abundance of evidence that a robust financial system plays a role in transforming the economy as demonstrated in this chapter.

5.2 Resource Mobilization and Asset Allocation

Resource mobilization and asset allocation is the primary function of financial institutions in Uganda. Be it financial intermediaries or markets, their key role is to mobilize financial resources – especially savings – and allocate them for creative investment. Financial resources and wealth are unequally distributed among individuals, households, sectors, industries, countries, regions, and continents. There exists economic and geographical gap in national, regional, and global endowments of financial resources. Some resources are mobilized locally through local and national financial institutions while others are mobilized internationally through international financial institutions such as the IMF and World Bank. In doing so, the financial system synchronizes savings with investments.

Even in Uganda, not all regions are equally wealthy. The central and western regions of the country are relatively rich. Yet, national economic development programs are expected to be evenhanded for each village, parish, sub-county, county, district, province, and region. Thus, unless there is a mechanism of mobilizing financial resources – especially savings – from rich units and regions and allocating them to poor units and regions, both poverty and economic imbalance will become character traits of Uganda. The financial system is presently doing the mobilization and allocation of savings into creative investments.

Both financial intermediaries and financial markets function to provide funds from surplus units to deficit units. Surplus units, which include individuals, households, organizations and companies with savings, provide funds to financial intermediaries and markets. Deficit units, which consist of individuals, households, firms, and government

agencies that borrow funds, obtain these funds from financial intermediaries and markets. Consequently, there is a bridge between savings and investments and lenders and borrowers.

In December 2004, Uganda Telecom received a loan of up to US \$38 million from mainly East African Development Bank (EADB). The loan was used to expand the company's GSM network so as to enhance value-added services to the landline and internet connectivity thereby expanding their capacity to compete.

Longer term borrowing in the international bond market is another alternative through which resources are mobilized and allocated for creative investment. Burnham (2003) correctly notes that international bond market borrowing amounted to US \$2.1 trillion in 2002 with individual corporations finding it feasible to raise as much as four billion dollars in a single bond issue. Further, of US \$2.1 trillion raised in a 2002 issue, US \$35 billion characterized net borrowings by low-income developing countries.²³⁵ Indirectly, Uganda has benefited from this transaction through its economic integration and borrowing from institutions and governments that borrow through bonds in the global market.

The Uganda Securities Exchange (USE) performs several functions beginning with the mobilization of resources (savings) for creative investment. It provides more options for savings in addition to savings in bank deposits, purchase of real assets including real estate, and putting the money under mattresses or open pots.

Uganda's insurance industry also contributes to economic development through mobilization of savings and allocation of financial assets. It is recorded that in 2003, a

²³⁵ Burnham, James, Ph D (Murrin Professor of Global Competitiveness), "A Note on International Financial Markets," Issued in Pittsburgh, November 21, 2003. Lecture Reference Notes. John F. Donahue Graduate School of Business, Duquesne University, Spring Semester 2004

gross premium of UGSHS 64.7 billion (US \$37.84 million) was mustered. These savings, which are deposited in or borrowed by banks and other financial institutions, are accessed by investors or entrepreneurs.

Other funds are invested in real estate or in government treasury bonds or bills and/or corporate stocks and bonds. Accessed funds by entrepreneurs or investors are channeled into creative investments in agriculture, manufacturing, and service industries thereby increasing productivity and economic growth. Not only does the industry create employment, provide taxes, and increase production and consumption but also exports earn foreign exchange.

Further, insurers offer services of being guarantors to credit/loan seekers thereby facilitating the allocation of financial assets for creative investments. They offer guarantees on various types of credit to facilitate performance of contract.²³⁶

5.2.1 Bridging the Gap between Domestic Investment and National Saving

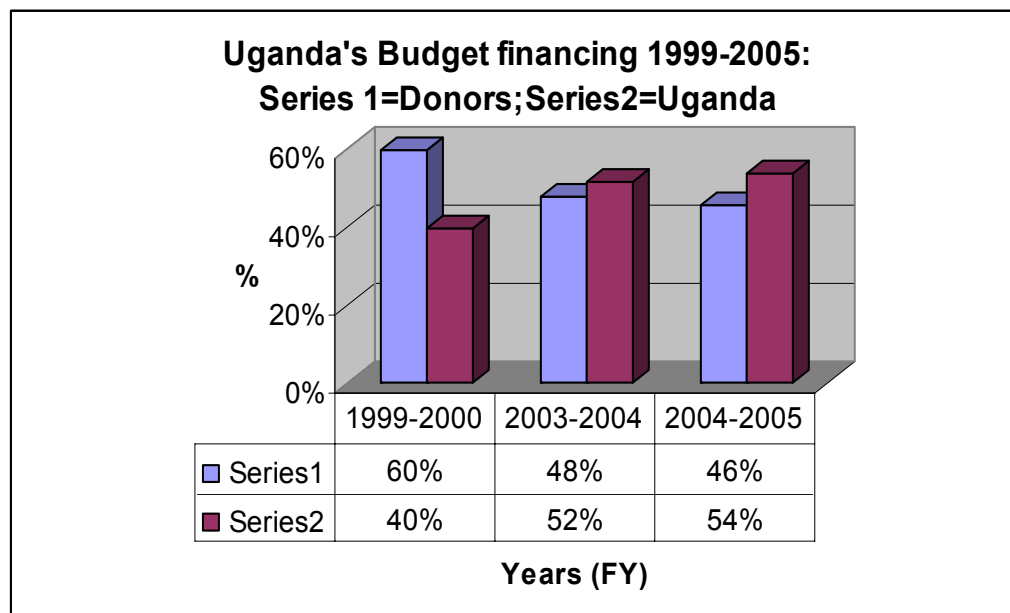
Just as it is in many Sub-Sahara African countries, national saving in Uganda is insufficient and modestly low. Consequently, there exists an economic gap between domestic investments and national savings. Without capital inflow to finance this gap, Uganda's economic prosperity hits a snag. When Uganda's financial system links to the global financial system, it channels savings from the rest of the world into investments in Uganda.

The low level of national savings in Uganda limits Uganda's ability to finance its entire national budget and invest, for example, in novel technologies and in research and

²³⁶ Bwogi, Charles (interview with Magezi, the Commissioner of Uganda Insurance Commission), "Life assurance an uphill task'," in the New Vision, Uganda [on-line] of February 17, 2005.

development. That is why Uganda still depends on donors' support for most of its finances. Though Uganda is continuously lowering dependence on donors for its national budget financing, it still has a long way to go. For the fiscal year 1999/2000, donors contributed 60% while Uganda contributed 40%; in 2002/2004, donors' percentage was 48%, and Uganda's percentage amounted to 52%; and in 2004/2005, the donors contributed 46% while Uganda contributed 54%.

Figure 1-(5) below highlights the gap-bridging scenario



Source Data: Background to the Budget Speech 2004/2005

5.3 Creation and Provision of Liquidity at Balanced Prices

Financial markets, especially secondary securities markets, which are markets for trading in previously-issued securities (bonds, equities, etc.), play an important role in providing liquidity at balanced prices to investors. Liquidity is the ability of securities to be converted into cash at a fair price. Because liquidity is realized when investors trade abundant securities without affecting price, investors prefer liquidity at reasonable prices.

Prices are considered reasonable or fair if they properly mirror the core value of the security.²³⁷ The Uganda Securities Exchange (USE), for example, provides a ready market for share buyers and sellers who are confident and assured of prompt conversion of their savings and investments into cash. This trading in stocks is relatively simple, quick, and cheap for someone wanting liquid money.

One of the characteristics of a good financial market is that it is liquid; meaning an asset can be bought or sold quickly at a price close to the prices for previous transactions (price continuity). Logue (1995) observes that globally, investors seek liquidity for three reasons: first, because of availability of new information about a particular security; second, because of a preference to buy or sell securities; and third, because of change of attitude toward risk that necessitates an adjustment of composition of portfolios.²³⁸ Uganda's financial system provides the opportunity for the investors' needs.

Financial markets such as the USE also proffer a system for price discovery through open market operations. Because trading takes place at the Securities Market under consideration of price factors, the exchange looks at both the value of a particular stock and the value the market is paying for the stock. Also, financial intermediaries such as banks create liquidity by taking idle money and funneling it to borrowers who, in turn, spend the money.

²³⁷ Logue, Dennis, E. The WG &L Handbook of Financial markets. Cincinnati, Ohio. WG, Warren, Gorham and Lamont; College Division South-Western Publishing Co., 1995:286

²³⁸ *ibid*, 286.

5.4 Summation of Right Information for Investors' Needs

Another notable function of a robust financial system in economic transformation is that it summarizes correct information for investors' and society's needs. Without right information, many investors in financial markets would find it difficult to make correct investment decisions regarding low and high performing public companies as well as high and low profitable public companies. There exist divergent choice problems for many investors and the timely availability of public and private information helps in making investment decisions.

All shares index of the activities of the Stock Exchange, for example, plays several roles in the economic transformation of Uganda including publishing useful information, in statistical and summary form, about various companies for the guidance of both investors and relevant companies. Correct information is important for setting prices so as to allocate resources – especially savings – to proper and competing uses.²³⁹ The ability of firms to sell additional shares or to make decisions to pay out dividends, for example, depends on the correct information about stock price in the stock exchange.

Further, because proper information – public and/or private – is an essential factor in facilitating financial intermediation, all financial institutions are urged by the Central Bank (BOU) to provide proper information to facilitate financial intermediation. This serves two main purposes. First, it prevents relying on misleading information which may cause financial imbalances and safeguards the collapse of banks as is evidenced by what happened in the late 1990s. Collected right information by banking institutions and

²³⁹ *ibid*, 286

venture capitalists is significant in addressing the problem of possible costs that could arise from moral hazard behavior and divergent option problems.

Second, the summation of correct information serves the investors' needs. Investors are interested in knowing not only the stability of the financial sector and the individual financial institutions but also the stability and growth of companies listed on the Uganda Securities Exchange (USE).

A stable financial sector consists of well-managed and sound financial institutions with good and transparent corporate governance and robust market discipline operating in an environment of efficient payments and clearing and settlement systems.

Through the Early Warning System (EWS) project, Bank of Uganda analyses data obtained from commercial banks as well as credit institutions and assesses trends in key macro-prudential variables. It focuses on risk and crisis prevention and management.

Also, all commercial banks and registered financial institutions and listed companies are required to submit annual financial statements, most importantly the income statement and balance sheet. Bank of Uganda produces annual financial statements. These serve as useful sources of information for investors, business people and policy makers.

Availability of summed up right information is necessary to minimize the supremacy of intermediation or indirect finance over disintermediation or direct finance. Divergent selection problems for investors usually reduce capacity of disintermediation financing making intermediation financing a major source of corporate financing in Uganda.

5.5 Monetary Control: Stimulation and Stabilization

One of the most important roles of a robust financial system is monetary control. Bank of Uganda is in charge of two macro-economic policies: monetary policy and supervision policy. The monetary policy pertains to monitoring policy decisions, which are made by the Bank's monetary and credit policy committee whose members include (1) the governor, (2) the deputy governor and (3) executive directors of the research, finance, supervision, and operations departments.

Central Bank of Uganda's principal function is to formulate and implement monetary policy geared to economic targets of realizing and maintaining price stability.²⁴⁰ This function includes monetary control, which is essential for the stimulation and stabilization of the economy. Founded on August 15, 1966, under the Bank of Uganda Act 1966, amended in 1969 and 1993, Uganda's Central Bank (BOU) is the strait through which the government implements its monetary policies and promotes its priorities. These roles it plays, place Bank of Uganda in a position of leadership in the economy. One of the duties of a good leader is to monitor the developments in and movements of the economy.

Together with two other institutions (i) the Uganda Bureau of Statistics (UBOS), which coordinates the development and maintenance of a National Statistical System and (ii) the Uganda Investment Authority (UIA), which markets Uganda's investment opportunities and provides quick and quality facilitation to investors, Bank of Uganda, monitors and tracks both resident and foreign private capital for each year. This helps in monitoring economic development and planning for better policies. Moreover, because of

²⁴⁰ Bank of Uganda: Directors' Report for the year ended 30 June 2003: 25.

its key position in Uganda's economic life, Bank of Uganda is required by the Bank of Uganda Statute 1993 to make a performance report on its activities and operations thereby guaranteeing continued monitoring of the economy's status.

Another important contribution to economic development especially delivered by the banking and non-banking sectors, is the role the Central Bank plays with regard to foreign exchange and interest rates. Although the exchange rate is a floating one – that is, the currency freely floats on the foreign exchange – Bank of Uganda often intervenes in the market under sterilization and intervention strategies.

In the domestic loanable funds market, Bank of Uganda's verdict on interest rates is crucial and influential on the supply of money, credit control, and aggregate demand which in turn influences economic growth, unemployment, and inflation. Two policy rates; the rediscount rate and the bank rate that Bank of Uganda issues, affect commercial banks' and micro-finance's prime lending rates. Let us now see how this works practically in Uganda's economy.

In its monetary control task –that is, the control of the supply of money –Bank of Uganda, employs three principal tools. These are as follows:

5.5.1 Open-Market Operations

Open-market operation is the purchase and sale of the Uganda government securities – Treasury bills and bonds by Bank of Uganda. Bank of Uganda's involvement in selling or buying government securities and stock to or from the general public manages inflation. The purchase of government securities (bonds and T-bills) adds to the money supply; the sale of government securities (bonds and T-bills) reduces the money supply. The Central Bank of Uganda controls inflation by the sale of government treasury

bills and bonds and by selling foreign currency exchange. When the Central Bank of Uganda shifts away from the use of T-bills to the use of US Dollar sales, the Ugandan shilling tends to appreciate highly.

Appreciation favors consumption over investment because individuals will prefer to import products rather than invest in production, which eventually gravely affects job creation and the export sector. This is why in mid-August 2004, for example, it took an intervention of the Bank of Uganda (BOU) to halt the appreciation of a Uganda shilling, which had peaked at 1,695/1700 against the US dollar in 2½ years, a trend that would boost consumption but had started giving manufacturers and exporters much worry. In June 2004, Bank of Uganda reduced T-bills sales to UGSHS 90 billion from UGSHS 120 billion in December 2003. Net dollar sales to the market increased to US \$28 million from net purchases of US \$ 1.7 million during the same period.

5.5.2 Reserve Ratio Requirements

Reserve ratio requirements are regulations on the minimum percentages or amount of reserves or deposits that banks must hold in the form of cash at the Central Bank. When reserve ratio requirements are reduced, Bank of Uganda enlarges the money supply and when they are increased, Bank of Uganda minimizes the money supply.

5.5.3 Discount Bank Rate

Discount bank rate is the interest rate on the loans that Bank of Uganda makes to banks which borrow from the Central Bank when they have too few reserves to meet reserve requirements. By lowering discount rates, Bank of Uganda increases the money supply, and by increasing discount rates, it shrinks the money supply. By raising a

discount bank rate, the Central Bank causes an increase in the rate of interest charged by commercial banks. A higher interest rate discourages borrowing by businessmen.

When on June 30, 2003, the rediscount rate was raised from 18.58% to 20.58%, and the bank rate rose from 19.58% to 21.58%, commercial banks followed suit. This led to an outcry against high interest rates in the country.

5.6 Economy Watch: Business Cycles and Fluctuation Monitor

One of the functions of Uganda's financial system in the economic transformation is to watch the economy trends through observing business cycles and monitoring fluctuations of prices, interest rates, and foreign exchange rates. Under its supervision policy, the Bank of Uganda oversees the operations of other financial institutions and watches the movement of the economy.

Through its alert or early warning system, a robust financial system guards the economy and keeps it safe from the plague of economic and financial disaster. Not only does a robust financial system monitor the economy's direction, but it also is the first economic system that gives early warning about any impending economic disaster. It is an alert system.

Financial markets such as the Uganda Securities Stock Exchange also monitor the financial affairs of each listed company thereby ensuring that there is proper corporate governance, conduct, and performance. This contributes to economic transformation because the public is confident that financial assets in the form of stocks/shares are safe in a quoted company.

A robust financial system keenly and punctually observes, monitors, and signals the periodic but erratic movement of productivity in Uganda. Parkin (2003) defines the

economic cycles (business cycles) as “the periodic but irregular up-and-down movement in production and jobs.”²⁴¹ Professor Davies (2003) calls them “a sequence of expansions and recessions in which actual GDP rises above and then falls below potential GDP.”²⁴²

Stiglitz and Walsh (2002) emphasize that “while potential GDP measures how much the economy could produce if it used all its resources at normal level of overtime and capacity utilization, real GDP shows what the economy actually produces.”²⁴³ They also pertinently point out that output (productivity) does not grow gracefully. Its growth fluctuates – sometimes developing an upward real growth, sometimes a slow down in real growth, and sometimes an actual decline in real growth.²⁴⁴ When real growth (real GDP) is rising more than usual up to the peak, the economy is in a business cycle expansion (boom). When real growth (real GDP) is declining more than usual for at least two consecutive quarters (6 months) down to the trough, the economy is in a business cycle recession. A recession is characterized by decreased production and increased unemployment, and a harshly prolonged recession becomes a depression.

Because in a market economy the market forces of supply and demand determine and drive trade-offs, reading the shifts and movements of the supply of and demand for capital and financial assets is a full time preoccupation with savers, investors, lenders, borrowers, speculators, and arbitragers. These followers and observers keep an hourly,

²⁴¹ Parkin, Michael. Macroeconomics. (6ed). Boston, New York, Madrid, Paris, and Cape Town: Addison Wesley, Pearson Education, Inc., 2003: 8.

²⁴² Davies, Anthony, Ph D, “Full Employment, Real GDP and Business Cycles,” in the course of Principles of Macroeconomics. Lecture Notes on January 13, 2003 at Duquesne University, Spring Semester, 2003.

²⁴³ Stiglitz, Joseph, E and Walsh, Carl, E. Principles of Macroeconomics. (Third Edition). New York and London: W. W. Norton & Company, Inc., 2002: 109.

²⁴⁴ Stiglitz, Joseph, E and Walsh, Carl, E. Principles of Macroeconomics. (Third Edition) New York and London: W. W. Norton & Company, Inc., 2002:108-109.

daily, monthly, quarterly, semi-annual and annual vigilance of the trade and market trends.

Amazingly, the global East-West and North-South geography separated by a number of time zones makes trading in global bonds and stocks a continuous activity. Tokyo is almost 15 hours ahead of New York, and New York is about 6 hours behind London. When it is 6:00 p.m. in New York, it is 9:00 a.m. in Tokyo, 8:00 a.m. in Hong Kong, and 12:00 midnight in London. By this time, it is about 1:00 a.m. in Kampala, Uganda.

Although there are yet no Ugandan companies listed on international financial markets like the New York Stock Exchange, London Stock Exchange, Hong Kong Securities Exchange, etc., trading activities taking place in these financial markets have an impact on Uganda's foreign exchange. Traders are always attentive to financial transactions taking place in locations with time differences.

Foreign investors keep monitoring the transparency and predictability of the issuance of instruments in the global financial markets. Uganda Securities Exchange (USE), especially its trade in government T-bonds and bills, has been attracting foreign investors and Ugandans living abroad. Bank of Uganda (BOU) spokesman Mr. Juma Walusimbi revealed in November, 2004, that Uganda T-bonds and bills or the government securities market was the most attractive in East Africa, and many foreign investors had become interested in it. Its interest rates were the highest, and it offered four T-bills – the 91-day, 182-day, 273-day, and 364-day instruments compared to Kenya with two instruments – the 91-day and the 182-day. Although Tanzania also had four instruments – the 35-day, 91-day, 182-day, and 364-day, Uganda's 182-day T-bills

offered a 10.77% return, followed by Tanzania's with 9.96% and Kenya's at a low 5.57%.²⁴⁵

5.7 Risks Balance, Reduction, and Mitigation

5.7.1 Individual versus Portfolio Assets and Risks

Both financial intermediaries and markets reduce, discount and balance risks viewed from the *individual* basis and on a *collective* basis.²⁴⁶ A risk refers to “the chance that some unfavorable event will occur.”²⁴⁷ It entails insecurity of results or events. An investor in equity markets, for example, is confronted with two sources of risks: (i) market risk, which is uncertainty in equity price due to factors affecting the overall equity market and which is measured by beta but cannot be diversified and (ii) company-specific or unique risk that can be eliminated through diversification.²⁴⁸ Investors are always worrying about, measuring and managing risks.

A combination of market risk and specific risk equals total risk and is measured by standard deviation. A linear exchange of risk and return is a propelling factor. Expected return = risk free rate (Treasury bill rate or Base rate) + (market risk premium) x Beta (measure of the asset's sensitivity to market-wide factors).²⁴⁹ Moreover, “no investment

²⁴⁵ Settumba, Samuel, “Uganda's market most attractive in the region,” in the Monitor, Uganda [on-line] November 9, 2004. Available: <http://www.monitor.co.ug/bizfin/bf11091.php> .

²⁴⁶ Professor Baird Phillip, “ Risk and Return,” in Financial Management 522, Lecture Notes , John F. Donahue Graduate School of Business, Duquesne University, Spring 2005.

²⁴⁷ Brigham, F. Eugene and Daves Phillip R. Intermediate Financial Management. 8th edition. United States and United Kingdom: Thomson Southwestern, 2004:29.

²⁴⁸ Professor Baird Phillip, “ Risk and Return,” in Financial Management 522, Lecture Notes , John F. Donahue Graduate School of Business, Duquesne University, Spring 2005.

²⁴⁹ Professor Baird Phillip, “ Risk and Return,” in Financial Management 522, Lecture Notes , John F. Donahue Graduate School of Business, Duquesne University, Spring 2005.

should be undertaken unless the expected rate of return is high enough to compensate the investor for the perceived risk of the investment.”²⁵⁰ Ross, Westerfield, and Jordan (1991) emphasize that risk balance is a concern of every investor and financial manager because “risky assets, on average, earn a risk premium and there is a reward for bearing risk, yet, the greater the potential reward from a risky investment, the greater is the risk.”²⁵¹

5.7.2 Consideration of a Variety of Risks in Uganda

Investments in Uganda encounter market risks in the form of political and economic risks. A country’s economic risk ratings is based on a range of key macro-economic factors including the level of the country’s foreign exchange reserves, its public debts and its current account and fiscal deficits. On the other hand, a country’s political risk is assessed by the rating agencies based on the type of government, flexibility of political institutions, extent of popular participation, neatness of leadership succession, degree of consensus on economic policy objectives, integration of the country in the global trade and financial systems, and internal and external security risks.²⁵²

Constraints to investment in Africa and in Uganda in particular consist of unstable foreign exchange rates, inflation, high interest rates, poor tax policies, economic corruption, bureaucratic delays, forgery of cheques (checks), smuggling and financial

²⁵⁰ Brigham, F. Eugene and Daves Phillip R. Intermediate Financial Management. 8th edition. United States and United Kingdom: Thomson Southwestern, 2004:29.

²⁵¹ Ross, Stephen, Westerfield, Randolph and Jordan Bradford. Fundamental of Corporate Finance. United States of America: Richard D Irwin, Inc., 1991:327.

²⁵² Bank of Uganda’s Office of Governor, “Country Risk Analysis, Its Implications and the Need for an Insurance Facility for Africa,” presented for Africa Trade Insurance Agency High Level Seminar on Political Risks and Financing Trade Transactions in Africa. Uganda International Conference, Kampala, August 21, 2004.

instability among others. These constitute a package of risks that investors in Uganda must meet.

Risk rating models assess country risks under the consideration of the following 10 factors: (i) security risk, (ii) political stability risk, (iii) government effectiveness risk, (iv) legal and regulatory risk, (v) macroeconomic risk, (vi) foreign trade and payment risk, (vii) tax policy risk, (viii) labor market risk, (ix) financial risk and (x) infrastructural risk. Meanwhile, essentials of risk management in companies include pure, speculative, demand, input, financial, property, personnel, insurance, environmental, and liability risks.²⁵³

5.7.3 Diversification of Assets and Risks

One important role that a financial system plays in economic development in Uganda is that it provides possibilities of diversification to eliminate company-specific risks. Diversification reduces risks because financial assets in the same risk class offer the same expected return. Individual assets such as stocks have a higher standard deviation than a diversified portfolio invested in a large number of assets. Additional assets (stocks) in a portfolio reduce risks significantly.

Financial markets through provision of different financial instruments including equity and debt securities markets help investors to meet financial goals and minimize financial risks and liabilities. They have opportunities to choose between government bonds and treasury bills, between corporate bonds and government bonds, between debt securities and equity securities, etc. Through diversified portfolios of assets in debt and

²⁵³Brigham, Eugen F. and Daves, Phillip, R. Intermediate Financial Management. 8Edition. Australia and United States: Thomson : South-Western, 2004: 822.

equity markets as well as through derivative markets and insurance companies, risks are reduced, discounted, and balanced.

Even to the low-level of robustness, the financial system in Uganda now shows that knowledgeable investors and fund managers are utilizing it to balance and reduce risks to earn high returns. Commercial Banks, for example, keep a small fraction of their funds in reserves (cash and deposits at the Central Bank) and lend the remainder. They keep their assets in three parts: liquid assets, investment securities, and loans.

In April 2005, greater competition and diversification among financial institutions and investors saw pension funds dominate a 3-year government bond worth UGSHS 25 billion issued at a 10.25% coupon rate. Pension funds accounted for 63.8%, while commercial banks that until April 2005 had always been the leading force in the issue of government securities took 21.1%. Other financial institutions accounted for 8% and insurance companies accounted for 4%.²⁵⁴

5.7.4 National, Regional and International Programs that Mitigate Risks

Uganda's financial system reduces and balances risks for investors through its linkage to international and regional investment programs. For example, Uganda is a signatory to the Multilateral Investment Guarantee Agency (MIGA) of the World Bank and a member of the International Center for the Settlement of Investment Disputes (ICSID). It is also a signatory to the Overseas Private Investment Corporation (OPIC). All these are investment insurance programs that reduce and balance risks.

Also, there is multilateral insurance for political risks in Uganda. Uganda is a member of the African Trade Insurance (ATI), which is Africa's only multilateral import

²⁵⁴ Odeu, Steven, "Pension Funds dominate 3-year bond," in the new vision Uganda [on line] of April 23, 2005. Available: <http://www.newvision.co.ug/D/8/220/430705>

and export credit and investment insurance agency. This plays the role of risk balance and reduction through insurance of political risks. Formed by the members of the Common Market for Eastern and Southern Africa (COMESA) including Burundi, Djibouti, Eritrea, Kenya, Madagascar, Malawi, Rwanda, Tanzania, Uganda, and Zambia, ATI was created in response to a lack of finances for investment especially caused by a volatile political environment.

Because political risks affect business by affecting contracts such as payments, assets such as buildings and other valuables destroyed by war or terrorism or confiscated by government and people such as civil unrest through kidnappings, terrorism attacks, or accidents, it was realized that coverage against expropriation and political risks was critical and significant not only to trade but also to saving, investment and economic growth.

Since 1994, if there has been a loss due to action or inaction by the member governments, ATI has underwritten the claim with its global partners and make the government pay its share of the claim from the ATI Fund. Member countries pay US \$100,000 for subscription, which is followed by the underwriting capital of Kenya (US \$ 25 million), Uganda (US \$ 0 million), and Tanzania (US \$5 million).²⁵⁵

5.7.5 Insurance Companies

Both local and foreign-based insurers pool risks by compensating the unlucky ones amongst those who contributed premiums to the pool of the insurance company. Insurance firms discount, balance, or mitigate risks that befall to institutions,

²⁵⁵ Odeu, Steven, “ Insurance for Political Risks,” in the New Vision , Uganda, Thursday August 26 , 2004 Available; <http://www.newvision.co.ug>.

entrepreneurs, investors, or households that are policy holders. Through the principle of indemnity, the insured is restored to the identical monetary or economic standing prior to the incidence of the event.

5.8 Credit Extension and Promotion of Entrepreneurship

A robust financial system promotes economic transformation through debt and equity financing and/or internal or external borrowing. Consequently, credit is accessed by the public and private sectors. In the private sector, businesses are able to finance their investment projects ranging from small and medium enterprises to large corporations. The private sector is a catalyst and fortress of economic growth and expanding it with competent and industrious entrepreneurs is creditable.

Financial institutions have heightened rural financial services especially for agriculture, retail trade, small and medium enterprises, and rural development. Rural financial services are today needed for three key purposes: (i) to supply rural credit for creative investment, (ii) to offer a savings service for the rural community, and (iii) to provide a payments machinery to reposition purchasing power between economic agents within the rural sector and between the rural sector and the rest of the economy.²⁵⁶

The impact of credit facilitation has been the emergence of the entrepreneurship revolution in Uganda. Rather than technology, a financial system is spearheading entrepreneurial revolution. According to the 2003 survey carried out by Enterprise Uganda and published in 2004, many entrepreneurs in Uganda have emerged with private

²⁵⁶ Ssemogerere, Germina, "Financial Sector Restructuring Under the SAPs and Economic Development, With Special Reference to Agriculture and Rural Development: A Case Study of Uganda -2002." Accessed January 23, 2005.

enterprises mainly due to some accessibility to credit.²⁵⁷ The survey also showed that many Ugandans have declined from looking to the government for employment but started income generating enterprises for a living. This is corroborated by the entrepreneurial index. While the world's average was 8.8%, Uganda's entrepreneurial index stood at 29.2%.²⁵⁸

According to the Global Entrepreneurship Monitor (GEM) report for the year 2004 released in April 2005, "after Uganda had the highest Total Entrepreneurial Activity (TEA) of all participating countries in 2003, it ranked second after Peru in 2004."²⁵⁹ The report showed that Uganda's Total Entrepreneurial Activity (TEA) had risen from 29.2% in 2003 to 31.6% in 2004, signifying that approximately every third adult Ugandan is an entrepreneur.²⁶⁰

Also, the research by the *Fifth Annual Global Entrepreneurial Report 2003* funded by the Kauffman Foundation ranked Uganda as the foremost enterprising country in the world, with 30% of its population self-employed. Uganda was followed by Chile, South Korea, New Zealand, and Venezuela. The study ranks countries based on two basic criteria: the number of new start-ups and young firms, and the number of entrepreneurial firms; that is, those creating innovative products and anticipating growth. The report found that 2 out of 3 entrepreneurs are aged between 25 and 44 years and that less than

²⁵⁷ Kauju, Peter (quoting Ocici Charles, the CEO of Enterprise Uganda), "Low acumen threatens firms," in the New Vision, Uganda [on line] January 19, 2005. Accessed January 19, 2005. Available: <http://www.newvision.co.ug/D/9/32/412930>.

²⁵⁸ Kauju, Peter (quoting Ocici Charles, the CEO of Enterprise Uganda), "Low acumen threatens firms," in the New Vision, Uganda [on line] January 19, 2005. Accessed January 19, 2005. Available: <http://www.newvision.co.ug/D/9/32/412930>.

²⁵⁹ Juuko Sylvia, "Local entrepreneurship spirit tops nations but..." in the New Vision Uganda [on line] 25th April 2005.

²⁶⁰ Ibid, 25th April, 2005.

37 out of every 1000 entrepreneurs receive venture capital. The study also found that there are five times more individuals starting new firms than there are owners of existing companies.²⁶¹

Credit accessibility is an incentive that encourages both formal and informal investment. In Uganda, informal investors were found to hold the key for start-ups and new ventures. This is a sign of the start of the process of breaking the cycle of poverty. According to the report, informal investors funded 99.96% of all businesses and supplied 90% of total investment.²⁶² According to the Global Entrepreneurship Monitor (GEM) report for the year 2004, eastern Uganda ranked top entrepreneurial region accounting for 46% while central region followed with 30%, the western region with 23%, and the northern region was last at 20%.²⁶³

The global financial magazine *Fortunate* called Uganda's leadership of the queue a 'bolt from the blue' or 'surprise' coming ahead of countries with better-known status for enterprise, including the USA, Japan, China, South Africa, and a multitude of industrialized countries around the world.²⁶⁴ This is not surprising. One possible explanation for this scenario is the presence of many financial institutions that have sprung up to provide credit in rural villages. Although the level of credit is still low, it is noticeably better than a decade ago and exemplifies the advantages of a rural reach

²⁶¹ Nannozi, Tereza, "Ugandans on top in business innovation," in the Monitor, Uganda [on line] February 17-23. Accessed February 18, 2004. Available <http://www.monitor.co.ug/mm/mm0217.php> .

²⁶² Nannozi, Tereza, "Ugandans on top in business innovation," in the Monitor, Uganda [on line] February 17-23. Accessed February 18, 2004. Available <http://www.monitor.co.ug/mm/mm0217.php> .

²⁶³ Juuko Sylvia, "Local entrepreneurship spirit tops nations but..." in the New Vision Uganda [on line] 25th April 2005.

²⁶⁴ Nannozi, Tereza, "Ugandans on top in business innovation," in the Monitor, Uganda [on line] February 17-23. Accessed February 18, 2004. Available <http://www.monitor.co.ug/mm/mm0217.php> .

refocus financial model, which is considered as best for rural transformation. Despite high lending interest rates, many Ugandans have not become discouraged about utilizing financial services.

Credit extension results are reflected in the overall performance of the economy. According to the key highlights of the 2004/2005 budget, the performance of the export sector for the year 2003/2004 was better than the year 2002/2003. Total export earnings for goods and services increased by 19.9% to UGSHS 1,605.4 billion (US \$ 928 million) in the 2003/04 fiscal year from UGSHS 1,339.0 billion (US\$ 774 million) in 2002/03. Next, are highlights of the participation and performance of some lending financial institutions in Uganda's economy.

5.8.1 Commercial Banks in Credit Facilitation

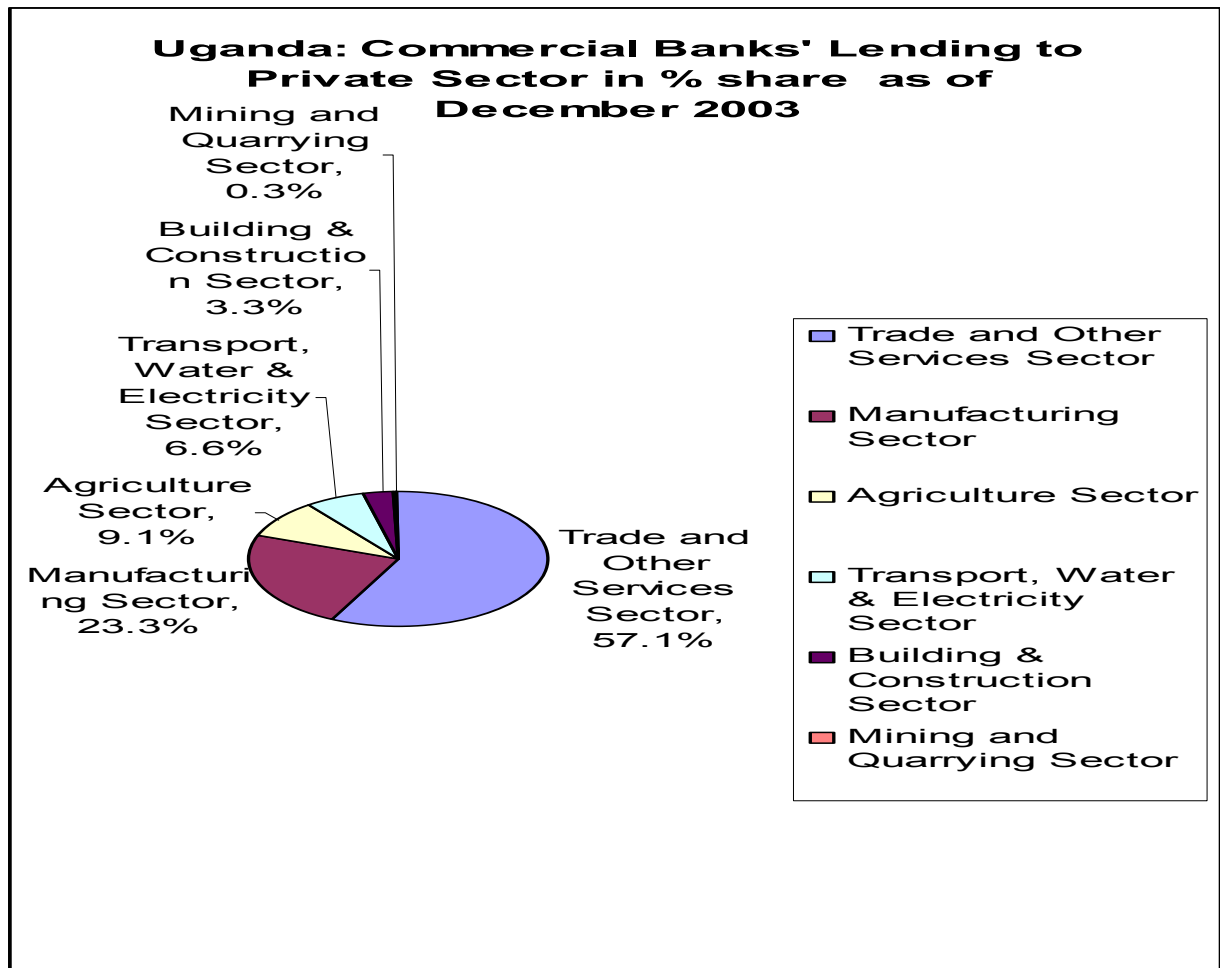
Commercial banks dominate lending in Uganda. Although commercial banks' credit to the private sector declined by an average of 1.3% from UGSHS 1,002 billion to UGSHS 996 billion in July/August 2004 relative to the 2nd quarter of the year, due to preference to invest in short term government bills, commercial banks still dominate service to the private sector in Uganda and contribute to economic development. However, investments in T-bills and bonds have been preferred by commercial banks so much that in the year 2004, for example, the government paid UGSHS 253 billion in interest on T-bill maturities to commercial banks that invested in T-bills.²⁶⁵

Of the total banks' lending in 2004, agriculture's share was 11.1%, manufacturing amounted to 20.3%, trade and other services stood at 57.4%, and transport, electricity and

²⁶⁵ Juuko, Sylvia, "Treasury Bills Interest hits UGSHS 253bn," in the *New Vision, Uganda* [On-line] January 26, 2005. Accessed January 26, 2005. Available: <http://www.newvision.co.ug/D/8/220/414304>.

water accounted for 7.2%²⁶⁶ In 2003, the manufacturing sector obtained 23.3%; the agriculture sector , 9.1%; the transport, water, and electricity sectors, 6.6%; building and construction, 3.3%; and mining and quarrying, 0.3%. Meanwhile, the trade and other services sector obtained 57.1%.

Figure 2-(5) shows Commercial Banks' lending to various private sectors in 2003.



Data Source: The New Vision, Uganda [on-line] of March 12, 2004

²⁶⁶ Juuko Sylvia, "Private Sector credit dips," in the New Vision Uganda [On Line] of November 8, 2004. Accessed November 8, 2004. Available: <http://www.newvision.co.ug/D/8/220>

At the international level, under the government agreement, Uganda Commercial Banks acquire loans from the European Investment Bank (EIB), also known as APEX loans, which they lend to small and medium enterprises (SMEs). Commercial banks like DFCU rely on the European Investment Bank as their main source of funds for long-term loans for investment. All other things being equal, DFCU has always put UGSHS 5 billion (US \$2.8 million) as the capital investment for loans to small and medium scale enterprises. Its long term loans borrowing amounted to UGSHS 35 billion (US \$20.2 million) for the last few years ending December 2004.

For example, in March 2005 DFCU and Allied Commercial Banks had expressed a serious interest in handling the UGSHS 17.2 billion (US \$10 million) line of credit advanced by the Iranian government to the private sector in Uganda. The line of credit had been offered about 9 years ago but could not be utilized due to what was termed a “lack of seriousness from Uganda’s business community.”²⁶⁷

5.8.2 Development Banks

Development banks also extend medium and long-term credits to borrowers. In August 2004, East African Development Bank made loans totaling US \$8.5 million to Kakira Sugar Works (KSW). This augmented Kakira’s co-generation facilities and helped acquire new power generation equipment and distribution lines to interconnect to the national grid.²⁶⁸ In February 2005, the East African Development Bank (EADB) promised to make more loans to the education sector.²⁶⁹

²⁶⁷ Bwogi, Charles, “Dfcu, Allied Banks to get \$10m Iranian Credit,” in the New Vision, Uganda [on-line] 5th March 2005.

²⁶⁸ Juuko Sylvia, “EADB gives Kakira \$8m loans,” in the New Vision Uganda [on line] of August 9, 2004. Available: <http://www.newvision.co.ug/D/8/220/378030> .

5.8.3 Joint Lending Services: Commercial Banks and Micro-Finances

Some commercial banks lend through their established micro-finance institutions. For example, CERUDEB is the leading micro-finance commercial bank in Uganda and it provides loans to rural farmers and small businessmen and women.

5.8.4 Micro-Finance Industry

Micro-finance loans are popular in Uganda, and they have proved to be the main way through which poor and needy Ugandans in rural areas can access money, fight poverty, and become self-reliant. Despite high interest rates which, nevertheless, are being reviewed, the role of micro-credit in poverty reduction is great because micro-finance provides finances to start income-generating projects thereby enabling the common rural population to access money to make more money. Microfinance Support Centre Ltd. (MSCL) is one such institution that facilitates the operations of micro-finance and deserves special mention.

Micro Finance Support Centre Ltd. was created in 2001 as a follow up of the Poverty Alleviation Project which operated in 12 districts and ended in 1998. It is financed by the African Development Bank (ADB) and the government of Uganda to deliver credit to individuals and institutions on their behalf. By the end of 2003, the Micro-Finance Industry in Uganda recorded UGSHS 86 billion (US \$49.7 million) as outstanding loan portfolio. This amounted to about 0.5% of the GDP and 6.2% of the National Domestic Credit.²⁷⁰

²⁶⁹ Musamali, Geresom, "EADB bank to give more loans to education," in the *New Vision, Uganda* [online] 28th February 2005. Available: <http://www.newvision.co.ug> .

²⁷⁰ Ministry of Finance, Planning and Economic Development of The Republic of Uganda :Background to the Budget For the Financial Year 2004/2005 , June 2004: 34.

As of July 2004, it operated in 45 districts out of 57 and supported 96 partner organizations, which include savings and credit cooperative societies, non-governmental organizations, and micro-credit finance institutions.

As of July 2004, and since 2002 MSCL has disbursed UGSHS 5.8 billion (US \$3.35 million) and looked forward to disbursing about UGSHS 11 billion (US \$6.36 million) during the fiscal year 2004/2005. Through its partner organizations, the center has reached 35,000 direct beneficiaries and has noticed an impact on savings amounting to UGSHS 2.1 billion since 2002.²⁷¹

5.8.5 Equity Financing through Uganda Securities Exchange

Equity financing is another form of credit creation, an alternative to debt financing. Although with common stock equity financing control is lost, it is the safest means of financing in corporate finance. There are two sources of common equity: (i) common stock and paid up capital (external) and (ii) retained earnings (internal). When financing new investments with common equity, firms use retained earnings first. If retained earnings are not sufficient, new common stock is issued. Due to flotation costs, new common stock equity is more costly than the retained earnings.²⁷²

Financial markets such as the Uganda Securities Exchange (USE) aid equity financing, which is flexible as opposed to debt financing, which is fixed.²⁷³ While in equity financing the firm compensates possessors on the performance basis, debt

²⁷¹ Kayizzi Ricks (quoting Charles Byanyima, CEO of Microfinance Support Centre Ltd), “ Micro-finance leander reaches 45 districts,” in the New Vision, Uganda [on line] of July 13, 2004. Available: <http://www.newvision.co.ug/D/9/32/371105>.

²⁷² Professor Baird Philip, “ The Cost of Capital” Lecture Notes and Handouts for the course of Intermediate Financial Management, Duquesne University, Pittsburgh, PA, Spring Semester 2005.

²⁷³ About USE/ Functions. Available: <http://www.use.or.ug/content.asp?contentid=38&category=About> .

financing demands that the possessor of the security obtain a fixed sum in interest irrespective of the performance of the company. Equity financing is strengthening listed companies.

5.9 Funds Transfer and Payment Facilitation

Funds transfer and payment facilitation is one more important role that a robust financial system plays in Uganda. It performs this internationally and nationally.

5.9.1 International Fund Transfers and Payments

To Uganda, funds are transferred from multilateral and/or bilateral donors and/or creditors in the form of aid (grants or loans); trading corporations in the form of settling trade transactions; international financial institutions such as the World Bank and IMF in the form of loans or debt relief initiatives; Non-Governmental Organizations (NGOs) in the form of supporting community development projects; private volunteer non-profit organizations (PVNPO) in the form of supporting community based projects for the benefit of the poor; and from Ugandans living abroad sending funds home for family and private business support.

Many Ugandan banks have correspondent USA banking arrangements. These include (i) Nile Bank with Citibank, New York, (ii) Standard Chartered Bank with Standard Chartered Bank, New York, (iii) Bank of Baroda with Chase Manhattan Bank, New York, (iv) Stanbic with Bankers Trust, New York, and (v) Barclays with Barclays Bank PLC, New York.

Quoting the recent data of the Organization for Economic Cooperation and Development (OECD) countries, Mr. David Nii Addy, the ILO Program Officer for

Africa Region, revealed on May 26, 2005 that “Uganda has over 35% of its graduates living in an OECD country...in 2002, the UN Population Division estimated that in Uganda, the migrant stock represented about 2.3% of its total population (some 530,000)”.²⁷⁴ Some of the Ugandans in abroad send money back home, which support the private sector and the entire economy. Such remittances from migrant workers serve as the source of foreign exchange.

Remittances or transfers from Ugandans working abroad, commonly referred to as *nkuba kyeyo*,²⁷⁵ and facilitated by the financial system, more than tripled from US \$ 102.2 million in 2000/2001 to US \$320.6 million in 2001/2002.²⁷⁶ Although East African migrant workers including Ugandans working in Britain pay as much as 35 Sterling pounds in the form of transfer charges excluding bank charges on the recipient’s end and exchange rate costs to money transfer companies and banks to send 100 sterling pounds (US \$ 188) back home, the financial system continues to play a major role in cash transfer deals.²⁷⁷ For the year 2002/2003, private transfers were at US \$ 236.1 million but then increased by 68% to US \$ 395.1 million in 2003/2004.

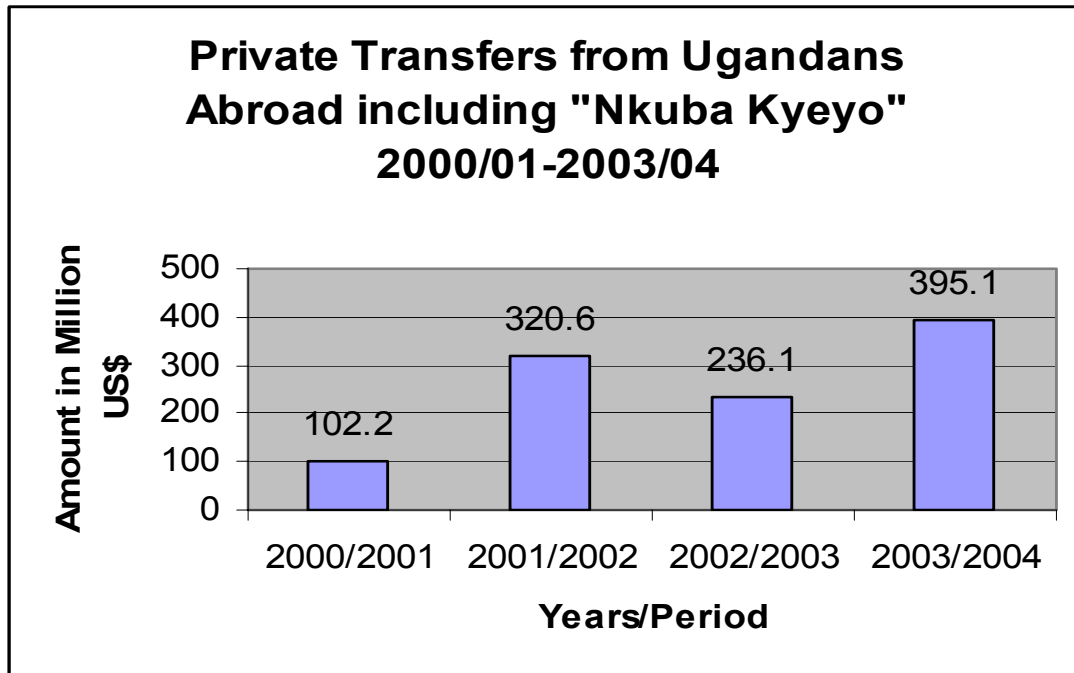
²⁷⁴ Oketch Martin Luther, “ 35% Ugandan graduates in OECD” in the Monitor, Uganda [on line] June 1, 2005.

²⁷⁵ *Nkuba Kyeyo* is a rather loose and demeaning concept in Luganda Language of Uganda used to refer to Ugandans – skilled or semi-skilled –living abroad , especially emigrant workers who leave their home country to the USA, EU, Japan and many more developed countries. Their motive is to earn a better wage or salary irrespective of the type of work they do including odd or demeaning jobs such as serving as guards in private security firms, sweeping or cleaning streets and public places including rest rooms, being waitresses in hotels or restaurants, and working in nursing homes to attend to the elderly and the sick.

²⁷⁶ Kiwawulo C., “Kyeyo brings home US \$320m,” in the New Vision, Uganda [on line] February 13, 2004 Accessed February 13, 2004. Available: <http://www.newvision.co.ug/D/8/12/339947>

²⁷⁷ Kimani, Dagi, “ EA migrant workers losing 65pc of home remittances in cash transfer deals,” in the East African on the Web quoting a study by Britain’s Department for International Development. Accessed May 9, 2005. Available: <http://www.nationmedia.com/eastafrican/current/Regional 1.html>.

Figure 3-(5) shows Private Remittances for the years 2000-2004 from Ugandans Living and/or Working abroad



Data Source: The New Vision, Uganda [On-Line] February 14, 2004, quoting Bank of Uganda (Report)

Remittances of foreign direct equity investment (FDEI) and foreign portfolio equity investment (FPEI) are also executed through financial institutions²⁷⁸ thereby attesting the funds transfer and payment facilitation of a financial system.

5.9.2 Domestic Funds Transfers and Payments

In Uganda, the financial system participates in both commercial and non-commercial transactions. The financial system executes funds transfer and payment through settling obligations of commercial and non-commercial transactions including (i) among traders or business people, (ii) disbursement of dividends to shareholders, (iii) remittance of

²⁷⁸ FDEI imply that there is a holding of 10% or more of ordinary shares for a non-resident in the local entity or a national holding 10% or more ordinary shares in a non-resident entity. FPEI imply that there is a holding of less than 10% of the ordinary shares for a non-resident in a local entity or a national holding less than 10% of the ordinary shares in a non-resident entity.

branch profits, (iv) inter-company borrowing and lending, (v) bills, wages, and/or salaries of civil servants including teachers, and dividends of shareholders paid by the companies, among others. Commercial banks have become the main payment channels for education tuition and fees of university, college, technical institution, high school, senior secondary school and primary school students.

Banks through partnership with the revenue collection body also serve as funds transfer and payment facilitators in the collection of Non-Tax Revenues (NTR). For the year 2001/02 Uganda's tax body, the Uganda Revenue Authority (URA) used Orient Bank to collect fees for passports issued by the Immigration Department. This pilot project with a target of UGSHS 700 million became successful with an achievement rate of 289%, having surpassed the target to UGSHS 1.3 billion. Consequently, the URA was assigned more non-tax revenue items, and the revenue output collected through Orient Bank became tremendous. According to Orient Bank's CEO, over 350 customers benefited from this service every day, and the bank collected an average of UGSHS 2 billion per week.

5.9.3 Means of Payment

All commercial transactions end with a payment. To demonstrate how a financial system plays a vital role in a commercial transaction, we need to observe that there are two components that complete a commercial transaction in the supply chain management and value chain creation process. They are the (1) transfer of a product and (2) payment for the product. Occasionally both components are performed concurrently, thereby

rendering a transaction to be called a cash transaction. At other times, the payment is completed some time after the transfer of a product thus making it a credit transaction.²⁷⁹

The means of payment available in Uganda's financial system include the following:

5.9.3.1 Cash

Uganda's formal economy is a predominantly cash economy. Money supply, which is the stock of money (M1, M2 and M3)²⁸⁰ in an economy, is dominated by cash transactions. Cash made available by the central bank (BOU) in the form of currency notes and coins is the most common form of payment. However, cash is mainly used in home trade only.

5.9.3.2 Cheques, drafts, orders, and cards

Cheques (checks), drafts, standing orders, credit transfers, travelers' cheques (checks), and credit and debit cards (plastic money) made available by commercial banks are other means of payments. While checks, standing orders, and credit transfers are used in home trade only, bank drafts, credit and debit cards, and travelers cheques (checks) have been used mainly in foreign trade. It is of recent that they have expanded in home trade.

²⁷⁹ Butt, S.A. Essentials of Commerce in East Africa. 5th Edition. London: Cassell Publishers Limited, 2000:38

²⁸⁰ M1 consists of discretionary currency and funds such as cash and cheques (checking accounts); M2 comprises M1 and all savings accounts and/or short-term deposits; and M3 is composed of the total aggregate of M1 and M2 and assets and liabilities of banks. It is the measure of money supply.

5.9.3.3 Post Office means

Cash in registered postal, postal orders, money orders, telegraphic money orders, and international money orders made available by the Post Office and Post Bank are an alternative means of payment in Uganda.

5.9.3.4 Bills and Notes

Bills of exchange and promissory notes, which are means of payment or settling debts between or among traders themselves, are also available in Uganda.

5.9.4 The Main Agents of Funds Transfer and Payment in and outside Uganda

Commercial Banks, Post Office, Western Union, and Money Gram are the main agents of funds transfer to and in Uganda. As of April 2005, there were 90 outlets of Western Union Uganda operating throughout the country.

Western Union is a subsidiary of First Data Corporation, which has its headquarters in Denver, USA. The company carries out electronic financial transactions world wide. With Orlandi Valuata Money Transfer, its partner, Western Union has more than 220,000 agents in more than 195 countries and territories connecting to Uganda. In Uganda, in February 2005, Western Union opened the 70th Nile Bank Branch. Out of about 90 outlets in Uganda, 70 were for Nile bank, 45 of which are upcountry.²⁸¹

5.9.5 Contribution to Economic Transformation and Living Standards

Money transfers contribute to investment and economic growth of the economy. In Uganda in 2004, for example, it was recorded that the supply and transfer of capital

²⁸¹ Monsengo, Kayima Adrien, "Western Union spreads its wings," in the New Vision, Uganda [on line] of 3rd March 2005.

from Ugandans living abroad through financial institutions had vibrated economic growth in the recent past. Money transfers with ease and speed not only solve the recipients' human and economic needs, but also accelerate and contribute to investment and growth. It assists government in the fight against poverty and underdevelopment. Because of improved financial services in financial international wiring and transfer of funds, private money transfers more than doubled in Uganda from an estimated US \$270 million in 1995/1996 to over US \$500 million in the 2003/2004 financial year.²⁸²

According to figures supplied by *Celent's 2002 Global Money Transfer Report*, due to relatively robust financial institutions such as Western Union, Money Gram, and commercial banks transferring money domestically and internationally, the market share of non-official money transmitters had declined from 50% in 1996 to 45% in 2001.²⁸³

International financial institutions like the IMF and World Bank (WB) use the Uganda financial system to transfer funds destined for the poverty war and economic development in Uganda. In May 2004, the World Bank approved loans and grants totaling over US \$320 million for poverty alleviation and rural roads. The banking industry serves as the channel of transferring such provided money for the government's poverty reduction initiatives in education, health, and sanitation. Therefore, we cannot underrate the role of financial institutions in Uganda's economy since these funds support

²⁸² Kayizzi, Ricks, quoting the Uganda Finance Minister of State, "Rukutana Hails Western Union," in the *New Vision Uganda* [on line] September 15, 2004. Accessed September 15, 2004. Available: <http://www.newvision.co.ug/D/8/220/386200>.

²⁸³ Kayizzi, Ricks, quoting the Uganda Finance Minister of State, "Rukutana Hails Western Union," in the *New Vision Uganda* [on line] September 15, 2004. Accessed September 15, 2004. Available: <http://www.newvision.co.ug/D/8/220/386200>.

the economic and institutional environment for sustainable implementation of the Poverty Eradication Action Plan (PEAP).

Also, the transferred funds make the country more competitive since this can be achieved through provision of infrastructure including the upgrading of roads in rural and economically viable areas and other facilities to support economic growth, investment in skills, and increasing productivity, quality, and reliability of small and medium enterprises.²⁸⁴

5.10 Property Ownership Extension and Wealth Distribution

Property ownership extension and wealth distribution is one of the roles a robust financial system assumes in economic transformation. Both financial intermediaries and markets help to mobilize and allocate resources from surplus to deficient sectors. In doing so, though at a cost, they not only extend sharing property rights but also distributing wealth. This is achieved in many ways.

5.10.1 Privatization Extends Property Ownership and Richness

Privatization of companies as a lead to going public and listing on the Uganda Securities Exchange has enabled many Ugandans to own property. Since the privatization exercise heated up beginning in the early 1990s with over 2000 previously state-owned companies having become privately owned as of today, many Ugandans now own

²⁸⁴ Kirembeka, Richard, “\$ 320m set for poverty war,” in the New Vision, Uganda, October 5, 2004, on line. Available: <http://www.newvision.co.ug/D/8/220>

property, which had been hitherto distant to them. Ugandans have, for example, bought more than 60% of divested companies.²⁸⁵

5.10.2 Purchase of Shares Creates Wealth and Can Narrow the Economic Gap

It is not privatization alone that empowers more Ugandans to get ownership of companies. The Uganda Securities Exchange (USE) also empowers people to become co-owners of corporations. The purchase of shares creates wealth and can narrow the economic gap. People buying shares of listed companies in the stock exchange become co-owners and co-heirs of these assets. As such, financial markets provide an opportunity for many people to participate in the supply and value chain management of the economy and to own property.

Public companies whose shares are freely transferable especially in financial markets – particularly the stock or equities exchanges – enable extension of property ownership to new shareholders. As of July 2004, the six-year old Uganda Securities Exchange (USE) had about 5,000 investors. Large sums of capital supplied to companies through share/stock trading in financial markets facilitate large-scale production, which result in economies of scale with lesser cost of production and higher profits.

Employees in many public companies are usually allowed and encouraged to buy shares in the company. This not only serves as added incentive to work harder but also promises them dividends. To buy a share is to buy part of a company, which entitles one to enjoy part of the profits of the company or to carry the company's liabilities.

In September 2004, when Ugandans at home and abroad requested the two-week extension of the sale of the Development Finance Company of Uganda's shares in order

²⁸⁵ Olaki, Emmy, "Locals buy 60% of divested firms," in the New Vision, Uganda, October 20, 2004 on line. Available: <http://www.newvision.co.ug> .

for them to have time to decide and/or apply to the central bank before remitting the funds, the director of the Privatization Unit (PU) in Uganda gladly welcomed the idea. He agreed to the extension because it would enable more Ugandans to own a slice of one of the fastest growing financial institutions. This was consistent with the government's policy of broad-based ownership of companies by Ugandans.²⁸⁶

On October 27, 2004, during the official launch of the sale of 10.2 million shares offered to the public by the New Vision Printing and Publishing Company under the Initial Public Offer (IPO), President Yoweri Museveni of Uganda urged Ugandans to own big companies and factories in small parts and collectively through buying shares. Showing an example, the President in his individual capacity not only bought 50,000 shares –worth at UGSHS 10 million (US \$5,882) – in the New Vision Printing and Publishing Company, but also urged Ugandans to contribute towards the development of the country by investing through buying shares to raise money to construct and establish bigger factories. In turn, shareholders would themselves receive investment returns in the form of dividends on each share every financial year if the company paid issued them annually.²⁸⁷

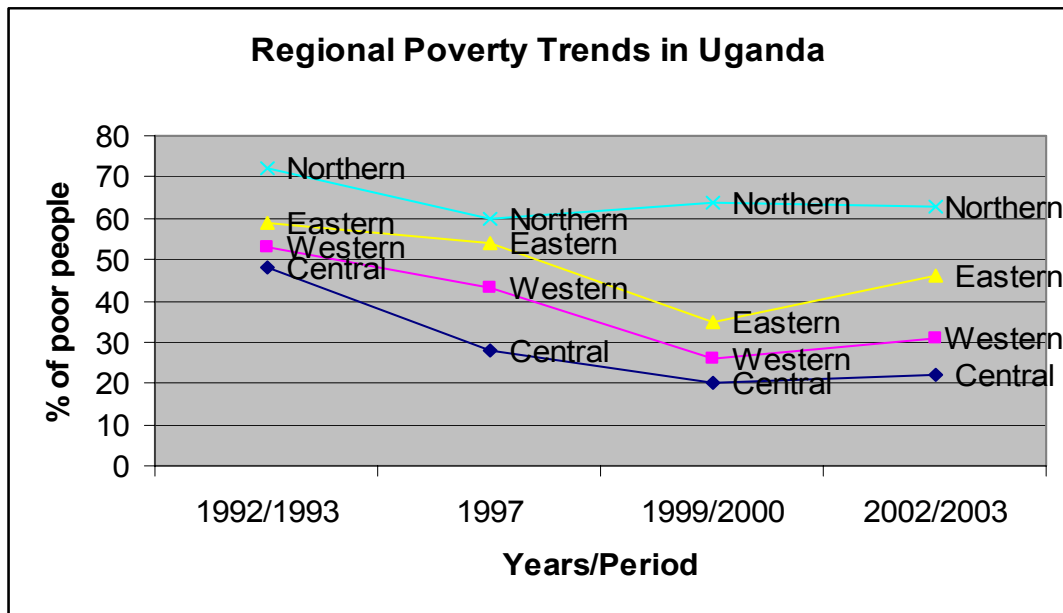
Receiving returns in the form of dividends not only distributes wealth and reduces economic inequality but also promotes economic transformation. Uganda Clays Limited (UCL) was listed on the Uganda Securities Exchange in 2000. As of December 2004, it had registered a total of about 960 shareholders and had paid a total of UGSHS 500

²⁸⁶ Juuko, Sylvia, "PU hails dfcu share extension," in the New Vision, Uganda, September 8, 2004 on line. Available: <http://www.newvision.co.ug>.

²⁸⁷ Etengu, Nathan, "Museveni buys Vision Shares," in the New Vision, Uganda, October 28, 2004 on line. Available : <http://www.newvision.co.ug/>.

million dividends to its shareholders for the year 2003. In December 2004, the company had started paying UGSHS 250 million in interim dividends to shareholders.²⁸⁸

Through wealth distribution and property ownership, the financial system becomes a channel through which the geographical poverty gap in Uganda can be bridged. Wealth distribution in Uganda is imbalanced. In terms of regions, the northern region is the poorest of the four. It registered 63% of the poor in 2002/2003 compared to the central with 22%, the western with 31%, and the eastern with 46%.



Data Source: Background to the Budget for Financial Year 2004/2005 for Uganda.

A robust financial system is capable of reducing this geographical poverty gap through property ownership extension and wealth distribution.

5.10.3 Institutional Investors' Wealth Creation

Financial institutions, especially institutional investors, initiate large-scale projects that affect the economy positively. NSSF, which is the pension fund, extends

²⁸⁸ Kauju, Peter, "Uganda Clays pays Sh250m dividends to shareholders," in the New Vision, Uganda, December 30, 2004 on line. Available: <http://www.newvision.co.ug>

property ownership through its economic activity as an institutional investor. This institution invests savings for its members thereby extending the sharing of property rights and the ownership of national and global assets. In 2004, for instance, the Uganda National Social Security Fund (NSSF) planned to construct 10,000 housing units in and around Kampala City in Uganda within the next five years beginning in 2005. This would not only solve the problem of inadequate housing and high rent costs for the existing substandard housing but also affect the economy positively.²⁸⁹

The construction of three housing estates by NSSF would come with a multiple of benefits including boosting employment opportunities, gaining billions of shillings in tax, especially Value Added Tax (VAT) and Income Tax, and addressing the public's housing needs. Large-scale housing projects create economies of scale in the housing sector and push down prices of building materials and finished houses in the long run. There is no doubt that increasing the housing estates results in downward pressure on house prices, rent, and more people owning houses.²⁹⁰

5.11 Trade Aid: Help and Support Services and Activities

Financial institutions perform commercial activities in getting products within the access of a consumer. Commercial activities are broadly categorized into two groups: (1) trade and (2) aids to trade. While trade are those activities related to the actual buying and

²⁸⁹ Odeu, Steven, "NSSF housing project to come with multiple benefits," in the New Vision, Uganda, September 27, 2004 on line. Available: <http://www.newvision.co.ug>

²⁹⁰ Odeu, Steven, "NSSF housing project to come with multiple benefits," in the New Vision, Uganda, September 27, 2004 on line. Available: <http://www.newvision.co.ug>

selling of products , aids to trade are those activities that assist in the buying and selling of products.²⁹¹

In Uganda, almost all financial institutions provide enormous help and support services and activities to trade. Whether it is home (retail and wholesale) or foreign (import and export) trade, financial institutions aid it. Aids or services to trade, which include (a) advertising and sales promotion, (b) banking and finance, (c) insurance and pension, (d) market research and customer services, (e) transport and communication, and (f) warehousing and inventory control, are auxiliary to trade and without them trade would be dysfunctional.

In particular, aids to trade like banking and finance and insurance services in Uganda highly represent a financial system not only in trade but also in the economic transformation of Uganda. In Uganda, the banking industry performs the following functions: (a) accepting surplus money as deposits, (b) safeguarding the deposited money, (c) making deposited money available to true owners on demand or at notice, (d) advancing loans to creditworthy customers, and (e) performing other banking services including personal banking services, investments, and business banking services.²⁹²

Therefore, by providing services such as home equity loans, current accounts, savings accounts, fixed deposit accounts, credit and/or debit cards, cash management, education financing, etc. and providing excellent means of payments in the form of cheques (checks), credit transfers, standing orders , drafts, etc., the banking industry aids trade and plays an important role in economic transformation.

²⁹¹ Butt, S.A. Essentials of Commerce in East Africa. 5th Edition. London: Cassell Publishers Limited, 2000:12.

²⁹² Butt, Ibid.

5.12 Economic Development Catalyst: Corporate Social Responsibility

Another notable role of the financial system in Uganda is being a catalyst of economic development and social change through derived economic benefits and corporate social responsibility. For example, the banking industry has continued to register and enjoy high profits due to growth marked by expansion in customer base, profitability margins, jobs absorption and infrastructure network. Financial institutions promote and support communities to achieve transformational benefits through corporate social responsibility. Both financial intermediaries and markets serve as catalysts of economic development in many ways.

5.12.1 Specialized Financial Services Providers

Micro-finance institutions in Uganda serve as specialized providers of financial services to small and medium enterprises. They provide credit to rural areas and supplement informal financial institutions.

5.12.2 Contribution to GDP

The banking sector, insurance industry, micro-finance industry, Uganda Securities Exchange, and real estate mortgage refinancing sectors not only contribute to GDP but also reduce poverty in many ways including employment opportunities, increasing tax base, increasing household income levels, and promoting community development projects among others. By the end of 2003 the micro-finance industry recorded a savings portfolio of over UGSHS 129 billion (US \$74.6 million), which was about 15% of the National Financial Savings and 0.5% of GDP. The financial system also offers employment opportunities to local people.

5.12.3 Development of Infrastructure

Financial intermediaries and markets require a vast infrastructure to support the clearing and settlement of transactions. A robust financial system sows the seeds of economic transformation and social change through provision of infrastructure.

5.12.4 Entrepreneurship Knowledge and Skills

Many small and medium entrepreneurs continue to get training in entrepreneurial skills, savings mobilization, and credit management especially under the Enterprise Development Program implemented by the Private Sector Promotion Center and under Micro-Finance Institutions Programs. In December 2004, Barclays Bank signed an agreement with Enterprise Uganda to improve financial and business skills of the bank's clients. This was aimed at providing the bank's clients with necessary skills including enabling the clients to share business information. In doing this, the banking sector demonstrated interest not only in taking deposits but also in business development.²⁹³

Some financial institutions such as micro-finances, financial services associations, and cooperative societies target rural areas and local people and because of their services at the local level, the community not only benefits with financial services but also obtains other advantages including education and learning life and job skills. They also provide basics in household management and opportunities for empowerment. Women in particular have been empowered through micro-credits and micro-enterprises.

Because most of the financial institutions operating in rural communities follow the *solidarity lending methodology* or group based lending practice, they also teach, train and

²⁹³ The New Vision reporter, the New Vision, Uganda, Tuesday 28th December 2004, on line. Available: <http://www.newvision.co.ug> .

educate their clients and furnish them with knowledge and skills about the essentials in reading, writing, arithmetic, accounting, and book-keeping. The culture of saving, banking, borrowing, and loan servicing is beginning to germinate.

For example, by requiring business plans for credits or loans, banks encourage small and medium entrepreneurs to develop entrepreneurial knowledge and skills. For instance, in February 2005, Allied Bank advocated that small and medium enterprises should have business plans submitted when applying for loans from banks.²⁹⁴ This is a boon not only to banks that get to know how much the firm produces, the demand and supply in relation to the competitors, cost of production, and sources of capital, but also to the firm owners.

5.12.5 Community and Public Projects Support

Most financial institutions also offer charity donations to demonstrate corporate social responsibility, and this has also increased economic development. In January 2005, Centenary Rural Development Bank (CERUDEB) donated UGSHS 2million to St. Francis Hospital Nsambya for plastic surgery for children with lip deformities.²⁹⁵ In February 2005, under the bank's community partnership initiative, Standard Chartered Bank (StanChart) mobilized UGSHS 600,000 for the Heart Institute in Mulago Hospital. In 2004, the same bank had donated a Cardiac Auto humalyser machine worth US \$30,000 to the same institute.²⁹⁶ In February 2005, United Assurance Company, an insurance firm, donated UGSHS 1 million (US \$580) to the police to facilitate mentally

²⁹⁴ Muwanga David, "Allied advocates business plans," in the New Vision, Uganda [on-line] 28th February 2005.

²⁹⁵ Odemel, James, " CERUDEB donates to Nsambya Hospital," in the New Vision, Uganda [on line] January 11, 2005.

²⁹⁶ Asiimwe Victor, " StanChart mobilizes shs600,000 for Mulago," in the New vision Uganda [on line] February 1, 2005.

handicapped children as they prepared for Special Olympics to take place in Japan in March 2005.²⁹⁷

Supporting the needy who are part of the community where financial institutions do business has become a common corporate social responsibility. In February 2005, Iki-ki Agricultural Development Centre of Pallisa Branch and Crane Pharmacy Ltd. of Mityana Branch won themselves computers in a Stanbic promotional mini-draw.²⁹⁸ In February 2005, in participation with the Community Partnership for Africa Fund, StanChart in a joint venture with Water-Aid, finalized a UGSHS 115 million (US \$ 66,470) water project in which boreholes were drilled in four districts.²⁹⁹ In February 2005, Stanbic Bank renovated Nakasero Primary School. The bank also donated 10 computers to kick-start an information, communication, and technology (ICT) laboratory for the school.³⁰⁰ This is part of the bank's corporate social responsibility

5.13 Fighting Ingrained Economic Corruption and Inefficiency

Fighting ingrained economic corruption is another role Uganda's financial system plays in economic transformation. Fighting economic corruption demands commitment, time, will, skill, money, and efficient facilities. Although Uganda's financial system is not directly included among the key official organizations mandated to fight corruption in Uganda, its anti-corruption campaigns are contributing immensely.

²⁹⁷ New Vision Reporter, "Insurance firm aids Police," in the New Vision, Uganda [on line] February 7, 2005.

²⁹⁸ New Vision Reporter, "Two Win Stanbic Bank Computers," in the New Vision, Uganda [on-line] of February 12, 2005.

²⁹⁹ Kauju Peter, "Sh115m project," in the New Vision Uganda [on-line] February 24, 2005. Available: <http://www.newvision.co.ug/D/9/32/419829>

³⁰⁰ Wadri, Peter, " Stanbic renovates Nakasero Primary School," in the Monitor, Uganda [on-line] February 18, 2005 Available: <http://www.monitor.co.ug/business/bus02183>

Organizations directly mandated to fight corruption in Uganda include (i) the Public Accounts Committee of Parliament, (ii) Local Government Public Accounts Committees, (iii) Directorate of Ethics and Integrity (DEI), (iv) Office of the Inspectorate General of Government (IGG), (v) Judiciary, (vi) Directorate of Public Prosecutions (DPP), (vii) the Fraud Squad of the Criminal Investigation Department (CID) and (viii) the internal audit and inspection units of the Ministries, Departments, and Agencies (MDAs).

Within, almost all structures and legislations pertaining to the financial institutions have provisions stipulated to fight economic corruption of any form. Through continued appropriate legislative and supervisory actions, the Central Bank of Uganda, the Uganda Capital Markets Authority (UCMA), and the Uganda Securities Exchange (USE) endeavor to combat economic corruption in the financial sector and loanable funds market.

As previously stated, economic corruption in Uganda is entrenched mostly in the public sector, but it's also menacing private companies including financial institutions, especially financial intermediaries. In mid-October 2004, Mr. Nick Mbuvu, the Barclays Bank (U) Ltd. Managing Director, observed that fraud had become rife in the country's banks. He estimated that banks were losing about US \$1 million annually.³⁰¹

Bank cheque (check) fraud is the commonest form of banking fraud by individuals who defraud banks and international businesses. This intensifies the impact of enormous possible loss for financial institutions in the local and international market thereby eroding confidence in the business community. Cheque (check) tampering and forging of

³⁰¹ Kyamutetera, Muhereza, "Banks lose \$1m annually," in the Monitor, Uganda [on-line] of October 2004. Accessed October 24, 2004. Available: <http://www.monitor.co.ug/business/bus10201.php>.

signatures had become the common form of bank fraud. Other forms of fraud include high level collusion mainly within financial institutions and money laundering.

According to the International Narcotics Control Strategy Report for 2003, released by the US Bureau for International Narcotics and Law Enforcement Affairs, Uganda had been placed on the list of countries closely monitored globally for money laundering and other financial crimes.³⁰²

To protect its international reputation or credibility and to prevent ruining the economy as a consequence of fraud, the Central Bank of Uganda has continued to amend inappropriate laws and monitoring mechanisms and legislate new tougher rules. As an example of war against economic corruption and inefficiency in the financial sector, especially in the banking industry, the Central Bank of Uganda (BOU) closed two banks: Cooperative Bank in 1998 and Greenland Bank in 1999. This was due to insolvency and failure to meet the minimum capital requirement as set out in the Financial Institutions Statute (FIS) and Act of 1993. At the time of closure, Cooperative Bank, which had 26 branches operating countrywide and 6 micro-finance agencies, was insolvent by UGSHS 15 billion and had lost UGSHS 10 billion in fraudulent transactions.³⁰³ Today, the commercial bank sub-sector has become relatively stronger.

Fighting economic corruption in Uganda through the financial system is gaining strength. The regulatory and supervisory financial institutions, particularly the Bank of Uganda and Capital Markets Authority have continued to fight economic corruption in the following ways:

³⁰² Kyamutetera, Muhereza, “‘Banks lose \$1m annually’,” in the Monitor, Uganda [on-line] of October 2004. Accessed October 24, 2004. Available: <http://www.monitor.co.ug/business/bus10201.php>.

³⁰³ Karugaba, Mary, “Government to pay shs91b to defunct banks’ debtors,” in the New Vision, Uganda [on-line] July 23, 2004. Accessed July 23, 2004. Available: <http://www.newvision.co.ug/D/8/220/3740300>

5.13.1 The Listing and Registration Policy

Economic corruption has been confronted by the Central Bank of Uganda through its licensing and registration policy. For example, the legislative clause on ownership and management of banks prevents one individual or family from owning and controlling a bank.

5.13.2 Effectual Regulation and Supervision

Effectual regulation and supervision carried out by the Central Bank of Uganda pins financial institutions on operating under general and particular financial intermediation and transaction laws. Both on-site and off-site regular inspections and monitoring activities of financial institutions control economic corruption, which is usually nurtured by off-site reporting characterized by data that is doctored, irrelevant, and misleading. Effectual regulation and supervision assures that minimum capital requirements in line with inflation rates are in place. This policy automatically eliminates incompetent banks. It also upholds restrictions on imprudent economic activities including insider loaning and overstating of the value of assets, profits, and capital.³⁰⁴

5.13.3 External Pressure, Vigilance, and Surveillance Impact

The International Monetary Fund (IMF), Multilateral Development Banks (MDBs) and Donors acting in their capacity as creditors or aid givers keep pressure on governments and their financial institutions to avoid or eliminate corruption. Some financial institutions in Uganda's financial system are some of the projects donors and multilateral development banks finance.

³⁰⁴ GAYI, K Samuel and BROWNBIDGE, Martin, "Progress, Constraints and Limitations of Financial Sector Reforms in the Least Developed Countries." Accessed March 4, 2004.

Although economic corruption in project lending is infrequent because it is easier to detect and control, especially in projects that the MDBs directly fund and oversee than non-project lending,³⁰⁵ it isn't all gone. Cases of some corrupt government officials conniving with corrupt investors, bankers, and other actors to misappropriate project or non-project loaned funds continue to be overheard in Uganda. However, Uganda's Central Bank, the IMF, MDBs and Donors have controlled the trend by persistently putting monitor performance of institutions in both public and private sectors including financial institutions. In doing so, they continue to make Uganda more transparent and accountable thereby reducing levels of corruption and leading to economic development.

Under external – particularly donor and creditor – pressure, vigilance and surveillance, economic corruption is under check in both public and private sectors including financial institutions. Also, financial institutions in Uganda struggle to prevent and eliminate corrupt conduct in the form of fraud that erodes both customer and creditor confidence. Image and credibility are very important in the financial industry. Combating economic corruption is critical to enhancing economic transformation, especially in low-income developing countries.

5.13.4 Tighter Financial Disciplinary Regime

Just as high discipline leads to academic excellence in schools and colleges and high performance in sports and games, so there is better performance in fighting corruption in financial institutions through a tighter financial disciplinary regime. As a direct result of a tighter disciplinary regime enforced by the Central Bank of Uganda (BOU) demonstrated

³⁰⁵ Kimberly Ann Elliott, (Research Fellow Center for Global Development and Institute for International Economics), "Combating Corruption in the Multilateral Development Banks." Testimony before the US Senate Foreign Relations Committee, July 21, 2004.

through effective supervision, enforcement of prudent regulations and increased frequency of on- and off-site surveillance, the financial sector in Uganda not only started registering robust growth but also a decline in institutional corruption.

There are different financial regulations and policies that have lifted the rod on many significant aspects of efficiency and effectiveness. These include supervision of management, performance, and standards and codes. They have instituted financial reforms, which cover financial reporting, management, shareholding, and strengthening the regulatory powers of the Bank of Uganda. For example, all commercial banks are required to file daily, weekly, monthly, quarterly, semi-annual and annual statistical reports on foreign currency trading, liquidity levels, cash reserves, balance sheets, income statements, non-performing loans, insider loaning, and credit concentration.³⁰⁶

Also, following the embrace and implementation of macro-economic adjustment and structural reforms, the IMF has continuously assessed the government's practices against a set of internationally accepted standards and codes. In the area of data dissemination, Ugandan practices are assessed against the IMF's General Data Dissemination Standard (GDDS). In the field of fiscal transparency, the practices are assessed against the requirements of the IMF's Code of Good Practices on Fiscal Transparency –Declaration Principles. Meanwhile, in the area of banking supervision, Uganda's practices are appraised against the requirements of transparency aspects of the Basle Committees' Core Principles for Effective Banking Supervision.

³⁰⁶ Biryabareema, Elias, "Bankers swim in profits," in the Monitor, Uganda [on-line] of August 31, 2004. Available: <http://www.monitor.co.ug/businesswk/bwk08313>

5.13.5 Full Disclosure as a Listing Condition in the Stock Exchange

The Uganda Capital Markets Authority (CMA) and Uganda Securities Exchange (USE) require full disclosure as a listing condition in the stock exchange. This has made companies wanting and hoping to go public and become listed to distance themselves from engaging in shady business deals, evading taxes, and being non-compliant with Bank of Uganda Statutory provisions. They become honest in business dealings.

5.14 Conclusion

Uganda's financial system isn't robust yet. However, there are signs of progress in efficiency. In spite of its institutional and functional limitations, Uganda's financial system has contributed and continues to be the driver of economic transformation. Its principal function is to mobilize financial resources from surplus units and allocate them to deficient units for creative investment. Through its many more roles, the financial system has spearheaded increased productivity and economic growth.

CHAPTER SIX

6 THE SWOT ANALYSIS: ASSESSING THE ROBUSTNESS OF THE FINANCIAL SYSTEM IN UGANDA

6.1 Introduction

This chapter makes an assessment of the robustness of Uganda's financial system. Though considered the most appropriate economic system to transform Uganda's economy, the system comprises strengths and weaknesses and opportunities and threats that should be looked at and eventually addressed.

6.2 Strengths

6.2.1 What are the strengths of a financial system and which strengths do we observe in Uganda's financial system?

The strengths of the system are the current features specific to the financial system that embody efficiencies and competencies in its functioning. The Uganda system has several of them. They include the following:

6.2.2 Prudent Regulatory and Supervisory Framework through the Central Bank of Uganda (BOU) and the Capital Markets Authority (CMA)

The foremost strength of Uganda's financial system is the presence of prudential regulation and supervision through the Central Bank of Uganda and the Capital Markets Authority. These two institutional structures, which by law and function exist to regulate and supervise financial intermediaries and markets respectively, have managed to maintain tough discipline in the financial sector and loanable funds market thereby creating efficiency, credibility and confidence.

In the fiscal year 2001/2002, the strict regulations of the Central Bank of Uganda, forced the Non-Government Organizations Board (NGO Board) to deregister two NGOs namely Care for Orphans, Widows and Elderly (C.O.W.E) and Kawaala Children's Home for breach of rules. C.O.W.E was operating as a micro-finance institution, an activity which they were not licensed to perform.³⁰⁷ Also, between 1998 and 1999, Bank of Uganda exercised its prudential regulatory and supervisory roles by suspending and closing the operations of inefficient banks. Trust Bank and Trans Africa Bank were suspended while Cooperative Bank, Greenland Bank, International Credit Bank and Teefe Bank were definitively closed.

The standards applicable to the Uganda financial market are contained in the regulations issued under the Capital Markets Authority Statute (1996) of Uganda and conform to the disclosure and reporting standards applicable to Kenya and Tanzania. The financial reporting and accounting standards for companies listed on the Uganda Securities Exchange (USE) also are based on the International Accounting Standards.³⁰⁸

Since 1993, many laws and regulations have been put in place to guard and guide the operations of the financial system in Uganda. All formal financial institutions in Uganda operate under strict laws. They include the following: (i) the Financial Institution Statute of 1993, (ii) Bank of Uganda Statute of 1993, (iii) Insurance Statute of 1996, (iv) Capital Markets Authority (CMA) Statute of Uganda, 1996, (v) Uganda Securities Exchange (USE), 1997, (v) Micro Finance and Deposit Taking Institutions Act of 2003,

³⁰⁷ Parliament Uganda –Members of Parliament Report of the Defense and Internal Affairs Committee on The Budgetary Proposals on the Ministries of Defense and Internal Affairs for the Financial Year 2002/2003 Accessed March 8, 2004. Available: <http://www.parliament.go.ug/defence%20rpt7>.

³⁰⁸ 1999 IMF Report on Observance of Standards and Codes: Uganda. Accessed January 1, 2004. Available: <http://www.imf.org/external/np/rosc/uga/>.

(vi) Revised Financial Institution Bill and Act of 2004, and (vi) the Foreign Exchange Bill of 2004 among others. Although these legislations might have imperfections and limitations, they have nevertheless improved the status of Uganda's financial system. Some of these legislations are emphasized below:

6.2.2.1 The Bank of Uganda Statute (1993)

The Bank of Uganda Statute of 1993 establishes powers and capacities to the Central Bank of Uganda to exercise tougher regulation and supervision of all financial institutions in Uganda. It also emphasizes the function of the Central of Bank of Uganda, which is to formulate and implement monetary policy directed toward achieving and maintaining economic stability; and act as financial advisor to government and as the manager of public debt. This Statute, in particular, identifies and utilizes the five main departments of the Central bank of Uganda, which include (i) trade and external debt department, (ii) banking department, (iii) foreign operations department, (iv) legal counsel, and (v) financial markets department.

6.2.2.2 The Insurance Statute of 1996 and the Insurance Commission (1997)

The Insurance Statute of 1996 is the basic statutory tool that guides and regulates the insurance industry. Though this is the main legislative tool, there exist other valid and licit statutory tools that guide, guard and regulate the undertakings of the insurance industry. They include (i) the Insurance Companies Act CAP-92 of 1964, (ii) the Road Safety Act of 1970, (iii) the Insurance Decree of 1978, and (iv) the Motor Vehicle Insurance Third Party Risks Statute of 1988. The Insurance Statute of 1996 categorizes

the insurance industry into three main constituents: (i) life insurance, (ii) non-life insurance, and (iii) re-insurance.

This legislative and institutional framework of the insurance industry stipulates grounds for cancellation, suspension or revocation of license. A company failing to maintain relevant minimum capital and security deposit requirements or to conduct insurance business on sound insurance principles as stipulated in the Insurers Association with the Commission is liable to punishment. Minimum paid up capital for local companies is UGSHS 200 million for life or non-life insurance business and UGSHS 500 million for reinsurance business. For foreign companies minimum paid up capital is UGSHS 1 billion for life or non-life insurance and UGSHS 2.5 billion for reinsurance.³⁰⁹

6.2.2.3 The Capital Markets Authority Statute (1996)

The institutional structure of financial markets in Uganda is relatively strong. Financial markets in Uganda are regulated and supervised by the Capital Markets Authority (CMA) established by the Capital Markets Authority Statute (1996). In its routine undertakings, it operates autonomously. There exist strong rules and regulations under the statute that govern Uganda's financial market. These cover licensing, prospectus requirements, formation, establishment of stock exchanges, conduct of business, advertisement, and accounting and financial reporting requirements.

Further, in joint venture with the Uganda Securities Exchange (USE), the Capital Markets Authority (CMA) runs a Compensation Fund, which safeguards and protects investors in the event of loss. The Compensation Fund provides compensation to

³⁰⁹ Badru Musoke, Kazibwe O, Kay P, Kadunabbi Lubega , “ Country Report for Uganda: A presentation for the Strategic Insurance management Course for Senior Managers,” 2000 Accessed May 13, 2003 Available: <http://bicon.org/en/sidor/uganda.htm> .

investors who lose money in case of a failed transaction conducted by a licensed broker or dealer. Moreover, the Capital Markets Authority is accountable to the Parliament of the Republic of Uganda through the Minister of Finance, Planning and Economic Development after the Auditor General has audited the accounts.

Also, through a memorandum of understanding, the CMA is a member of the regional body, the East African Community Securities Regulatory Authority (EACSRA), which harmonizes the securities laws and standards in order to develop a regional market, a regional exchange, cross-border investment, and cross-border listings.³¹⁰

6.2.2.4 *The Financial Institutions Bill of 2002 and Financial Institutions Act of 2004*

The Financial Institutions Act of 2004, which was enacted by Parliament of Uganda in March 2004, is the most recent, comprehensive and imperative regulatory and supervisory law that “*revises and consolidates the law relating to financial institutions; provides for the regulation, control and discipline of financial institutions by the Central Bank of Uganda; repeals the previous Financial Institutions Bills and Acts; and provides for other related matters.*”³¹¹ While many of the regulations and supervision provisions are prescribed in the Financial Institutions Statute (FIS) of 1993, new provisions have been formulated in the amended Financial Institutions regulations. The new Financial Institutions Bill that was approved in 2002 and became an Act in 2004 provides for

³¹⁰ Accessed January 4, 2004 Available: <http://www.imf.org/external/np/rosc/uga/>.

³¹¹ Introductory Remark and Purpose of The Financial Institutions Act, 2004: 7.

mandatory prompt corrective action for problem banks and penalties for noncompliance with prudential norms and regulations.³¹²

6.2.2.5 The Foreign Exchange Bill of 2004

To reduce the risk of money laundering, the Foreign Exchange Bill of 2004 prohibits Foreign Exchange Bureaus from transferring funds. The Bill, which was instigated by Bank of Uganda (BOU), affirms the role of foreign exchange bureaus as to engage in only spot transactions. It assigns the role of transferring money or foreign currency to financial institutions other than the foreign exchange bureaus. Financial Institutions such as commercial banks can be easily monitored in case of money laundering and fraud.

6.2.3 Competition in the Financial Industry in a Liberalized Environment

Competition is another critical strength of Uganda's financial system. The financial system in Uganda operates in a rather competitive and liberalized environment. Financial institutions –intermediaries and markets– work at different levels of competitiveness. There is competitiveness in the loanable funds market in Uganda.

Competitive markets have many buyers and many sellers and ultimately benefit the customer. Among the financial intermediaries, there is competition between commercial banks and non-banking institutions. Even within the commercial banks, foreign banks are competing with local banks. Commercial banks compete against each other. Micro-finance institutions compete with cooperative societies. In the financial market, stocks are competing with bonds and treasury bills.

³¹² International Monetary Fund: UGANDA – Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, Kampala, Uganda, August 27, 2002. Accessed March 8, 2004. Available: <http://www.imf.org/External/NP/LOI/2002/Uga/01/>.

Entry into the financial services industry or sector has not only reduced monopoly and cartel sellers' base characterized by high degrees of imperfections and inefficiencies in the financial system but also pressured each institution to operate efficiently. Most financial institutions now struggle to offer quality products in bid to be competitively priced in the market. The net result of competition is quality service, moderate cost and affordability, flexibility in services and timely response to customer needs.³¹³ Services have improved because of competition.

Under retail banking, some banks such as Stanbic now provide a variety of products including executive lending, a service that wholly targets corporate customers, salary earners scheme, commercial loans and overdrafts, customer access terminal system and Automated Teller Machines (ATMs). Other financial products provided competitively include mortgage financing, personal loans, vehicle schemes, points of sale services, credit and debit cards and asset-based finance product for customers to secure credit for capital expenditure among others. Bank of Baroda, for example, announced that it would start offering mortgage services by the end of the first quarter of the year 2005. In February, 2005 Nile Bank unveiled a car loan product branded "Wheel Source" to enable individuals and corporate bodies to purchase the vehicles of their dreams. The person would pay 10% of the total value of the car and the bank finances 90%.³¹⁴

In March, 2005 Orient Bank made a car deal with Spear Motors in the form of car loan scheme with interest rates between 11.25% and 35%. Individuals, small

³¹³ Professor Presutti, Bill, Jr., Ph D, C.P.M. "Understanding the Value Chain," Course Number GRBUS 510", Duquesne University, John F. Donahue Graduate School of Business, Fall 2004.

³¹⁴ Odemel, James, "Nile Bank launches car loans," in the New Vision, Uganda [on-line] 19th February 2005.

enterprises and corporations would acquire new passenger and truck vehicles from Spear Motors and pay in installments. Spear Motors' products include Mercedes Benz, Jeep and Chrysler with prices ranging between UGSHS 45 million and 1.6 billion.³¹⁵

Many commercial banks are now installing ATMs for deposits and withdrawals. Although more than 8,500 Ugandans, especially the business and elite community, had experienced usage of plastic money that came in the form of Smart Money Cards introduced in late 1990s by the defunct International Credit Bank,³¹⁶ Standard Chartered Bank, for example, became the first bank to be associated with the Visa through enabling ATMs to accept transactions from International cardholders since 2001. In November 2003, StanChart launched the VISA Electronic Debt Card (VED) enabling Ugandans to access what is a rapidly growing means of payment in the world.³¹⁷

Meanwhile, Barclays Bank was the first bank to issue and launch the first credit card in Uganda. Barclays' *Prestige Barclaycard* offers a convenient, flexible and safe way to spend with credit limits allocated to suit individual circumstances. Card holders are able to buy products up to a predetermined credit limit at select outlets whether they have cash in their accounts or not. Candidates must have a monthly salary of at least UGSHS 1.2 million (US \$ 694).³¹⁸

³¹⁵ Lillian Keno, "Spear Motors and Orient Bank in Car Deal," in Radio Simba, Uganda [on-line] of Friday 11th March 2005.

³¹⁶ Juuko Sylvia, "Plastic Money comes to town," in the Monitor, Uganda [on-line] of March 23, 2004. Available: <http://www.monitor.co.ug/business/bizw03231.php>.

³¹⁷ Francis Mills-Robertson [Head of Consumer Banking for the Standard Chartered Bank] , Interview on March 15, 2004 Monitor's Business Week <http://www.monitor.co.ug/business/bizw03231.php> .

³¹⁸ New Vision Reporter, " Maiden Credit Card in offing," in the New Vision, Uganda [On line] of 9th August, 2004. Accessed August 9, 2004. Available: <http://www.newvision.co.ug/D/8/220/378032>.

By July 2004 Stanbic Bank had invested over US \$15 million (UGSHS 26 billion) in the renovation of over 66 branches throughout the country to match international standards.³¹⁹ By mid-January 2005, ten Commercial banks had installed ATM machines and services. These are: Stanbic, Barclays, Standard Chartered, Nile, Crane, Centenary, Orient, Baroda, Allied and Cairo International Bank. Tropical Africa Bank looked forward to introducing Automated Teller Machines (ATMs) in March 2005. Other banks are introducing Visa, MasterCard, Discover and Express debit and/or credit cards etc. as a convenient service to their customers.

Stanbic competes not only by installing automated teller machines (ATMs), but also by increasing the number of tellers in branches country-wide to shorten the common long queues. This is particularly important at the start of every school term or end of month for salary payments or big public holidays like Christmas and Independence Day.

Orient Bank, since March 2004, has been updating its technology to provide better services including establishing about 500 points of sale of Orient Express cards. In 2004, Orient Bank became the pioneer of wide scale plastic money transactions. Plastic money enables holder customers to spend wherever there is a point of sale (POS) machine such as in hotels, restaurants, supermarkets or stores, theatres, fuel or gas stations, saloons, bars, bookstores, clinics or drug shops and many more areas. With OrientXpress Blue, Gold and Platinum cards, the holder customer does not need to worry about not having enough cash or a cheque (check) or access to an ATM to satisfy financial obligations. While the Blue card is an ATM and debit card, the Gold and Platinum cards can be used as debit or credit cards. The Gold card offers a credit of up to

³¹⁹ Juuko, Sylvia, "Stanbic puts \$15m in refurbishment," in the New Vision, Uganda [on Line] of July 24, 2004. Available: <http://www.newvision.co.ug/D/8/220/374404>.

UGSHS 1 million (US \$570), while the Platinum offers credit of up to UGSHS 5 million (US \$2,857).³²⁰

In addition, commercial banks no longer charge customers overwhelmingly high interest rates nor offer terrible inefficient services. Competition is leading to efficiency. Even though interest rates in the form of banks' prime lending rates are still high, individual banks charge within the range of the entire industry.

The *Monthly Economic Review* by Bank of Uganda, quoting the *Weekly Report of Interest rates by Commercial Banks* for the months of July and August showed that the prime lending rates were between 16-21%.

Figure 1-(6) below highlights the interest rates by commercial banks: 2001-2004

Lending rates %	Dec.- 2001	May 02	16-Jul- 04	30-Aug- 04	17-Sept- 04	10-Oct- 04
<i>No. of Banks charging rates within range</i>						
0.0-10.9	0	0	0	0	0	0
11.0-13.9	0	5	0	0	0	0
14.0-15.9	0	1	0	0	0	0
16.0-18.0	11	11	5	5	5	5
18.1-20.0	3	0	6	7	6	7
20.1-22.0	3	0	4	3	4	3
22.1->>	0	0	0	0	0	0
Range (Min-Max)	16-22%	16-22%	16-21%	16-21%	16-21%	16-21%

Source: Monthly Economic Review of Bank of Uganda- December 2001, May 2002, September 2004 and October 2004

Because government liberalized all trade in Uganda, the market forces determine the prices of financial assets or instruments. That is why the Bank of Uganda only intervenes cautiously in the loanable funds markets and in foreign exchanges making sure

³²⁰ Ilungole Stephen (quoting Njuki Samwiri, Orient Bank's Managing Director), "Orient targets regional market," in the *New Vision, Uganda* [on line] January 10, 2005. Accessed on January 10, 2005 Available : <http://www.newvision.co.ug/D/9/32/410127>.

that its monetary operations do not determine prices and exacerbate instability in both the domestic money and foreign exchanges.³²¹

Under competitiveness insurance companies are also struggling to become market leaders in the industry. In the market worth about UGSHS 60 billion, the Ugandan market comprises many insurance companies totaling over 18 insurance firms thereby creating stiff competition, which lowers premiums to the advantage of low-income earners. Having written premiums exceeding UGSHS 18 billion in the previous three years (2002, 2003, and 2004) and being conscious of competition in the industry, the Managing Director of AIG (U) Ltd, stated that their insurance company considered itself leader in premiums written, claims efficiency and product innovation.³²² AIG Uganda is a subsidiary of American International Group, the world's leading international insurance and financial services organization, with operations in more than 130 countries.

6.2.4 Effectiveness of Central Bank of Uganda's Interventionist Role in the Foreign Exchange

Another notable strength of Uganda's financial system is the effectiveness of the Central Bank's interventionist role in the foreign exchange. Bank of Uganda has demonstrated that it can successfully give or withdraw implicit or tacit support to either strengthen or weaken the currency in accordance with the interests of the country. Inflation has been kept in single digits for more than 10 years.

Necessitated by the events of the market, Bank of Uganda enters the foreign exchange using the strategy geared at mopping up excess liquidity injected by poverty

³²¹ Bank of Uganda - Monthly Economic Review September 2004.

³²² Odomel James, (quoting Alex Wanjohi , Managing Director of AIG Uganda) , “ AIG writes sh18b premiums,” in the New Vision , Uganda [on line] Saturday, 22nd January, 2005

reduction, government expenditures, international NGO remittances, international PVO transfers, and Ugandans living abroad, and also under the intervention strategy to restore stability in the market.

6.2.5 Heartening Developments in the Banking Industry

The recent, encouraging developments in the banking industry, as a consequence of the implementation of the financial sector reforms initiated in Uganda in the early 1990s, indicate strength in the financial system. The current banks' improved performance indicates a strengthened financial system. It also points to the effectiveness of the regulatory and supervisory actions by the Central Bank of Uganda.

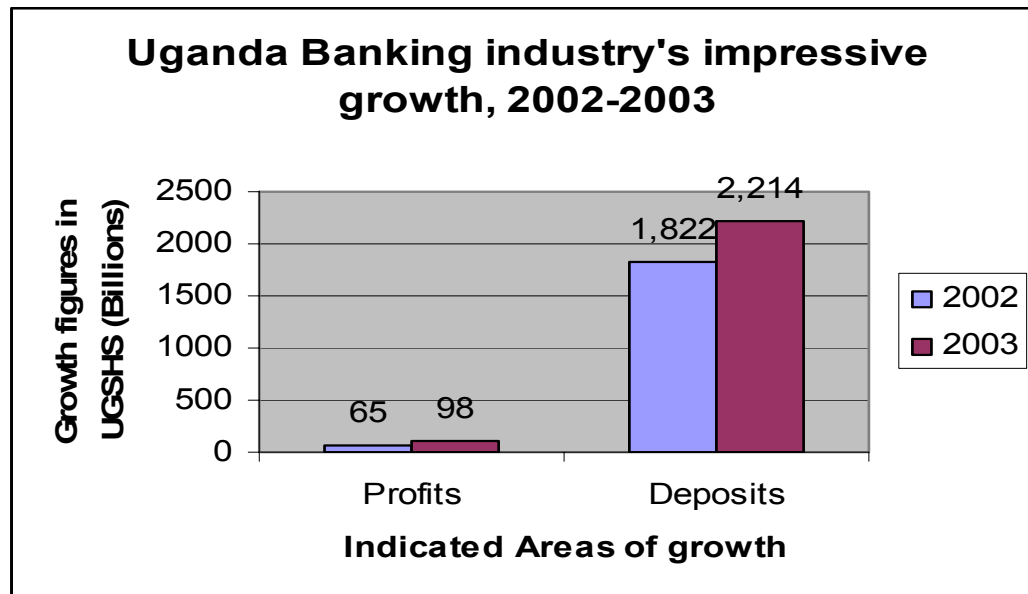
For example, as of March 2002, the banks' ratio of non-performing assets to total advances stood at 5.1 % compared with 9.5% in 2001. Further, the ratio of core capital to risk-weighted assets rose from 18.3% to 22.9% during the same period.³²³ Reflecting the soundness of the industry as a corollary to tough discipline on commercial banks, as of the first quarter of 2005, the ratio of non-performing assets to total assets was recorded at its chronological lowest point of below 3%.

An analysis of the commercial sub-sector of the banking industry reveals that since 1999, after the closure of four insolvent banks, a consolidation of balance sheets of banks and the improvement in the supervisory capacity at Bank of Uganda, the sub-sector is stable and strong. For example, total deposits (demand, savings and time deposits) increased by 50% from UGSHS 669.9 billion at the end of 1998 to UGSHS 1,004 billion at the end of the first quarter of 2000. Financial savings defined as "total time and

³²³ International Monetary Fund: UGANDA – Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding, Kampala, Uganda, August 27, 2002. Accessed March 8, 2004. Available: <http://www.imf.org/External/NP/LOI/2002/Uga/01/> .

savings deposits in the banking system,³²⁴ moved from UGSHS 128.6 billion during 1994/95 to UGSHS 306.9 billion during 1999/2000.³²⁵ In 2002 total deposits stood at UGSHS 1,822 billion and in 2003 the amount rose to UGSHS 2,214 billion (US \$ 1,294.74 million).

Figure 3-(6) highlights the Impressiveness of Uganda's Banking Industry



6.2.6 Sturdy Capital Base through Phased Increase of the Minimum Paid-Up Capital

To strengthen the capital base of the banking industry, the Central Bank continues to increase over time the minimum paid up capital. As of 2000, the required minimum paid up capital was UGSHS 4 billion (US \$2.33 million). Such a requirement not only guarantees financial depth of the industry but also ensures efficiency. Even the six smaller commercial banks in Uganda are required to have minimum paid-up capital to the required UGSHS 4 billion. The Central Bank of Uganda directs that weak banks that fail

³²⁴ The Uganda Financial Sector Profile, 2003: 4.

³²⁵ The Uganda Financial Sector Profile, 2003: 4

to meet the requirement develop a contingency plan for an arranged exit or where suitable, seek mergers and consolidations as a way to meet the requirement. And the Central Bank of Uganda continues to closely monitor all the banks, especially the six smaller banks, to ensure sound policies and safeguard the depositors' interests.³²⁶

The Commission of the insurance industry also obliges insurance companies to adhere to the phased increase of the minimum paid up capital. With effect from August 2002, the minimum paid-up capital by insurance firms rose from UGSHS 200 million (US \$116,959) to UGSHS 1 billion. August 2006 became the deadline for each insurance firm to raise this amount.³²⁷

In spite of high interest rates, the stock of commercial banks lending to the private sector has been increasing. For example, bank loans to private sector increased from UGSHS 937.9 billion by the end of 2003 to UGSHS 1,001.4 billion (US \$ 585.6 million) by April 2004.

6.2.7 Booming Business of the Financial System

Generally, business in the financial sector is booming. According to the foreign private capital survey jointly carried out in 2004 by the Central Bank of Uganda (BOU), Uganda Investment Authority (UIA) and Uganda Bureau of Statistics (UBOS), the financial sector in Uganda grew by 95% in 2003. It led by positing more profits in comparison to other sectors. US \$43 million was realized in 2003 up from US \$22

³²⁶ Accessed March 8, 2004 Available: <http://www.imf.org/External/NP/LOI/2002/uga/01/> .

³²⁷ Bwogi, Charles (interview with Magezi, the Commissioner of Uganda Insurance Commission), “Life assurance an uphill task’,” in the New Vision, Uganda [on-line] of February 17, 2005.

million attained in 2003, down from US \$29 million in 2002.³²⁸ The wholesale and retail sector came second with US \$18 million.

The Banking Sector dominates Uganda's financial system. Moreover, the Micro-Finance Industry in Uganda has expanded tremendously despite difficulty in determining its reach and depth of resources.

According to the accounts approved by the Central Bank of Uganda in mid-January 2005, Orient Bank registered a pre-tax profit of UGSHS 3.5 billion and maintained non-performing assets ratio of less than 1% of the facilities extended by the bank. It also registered an increase of 16% in deposits. The deposits stood at UGSHS 71 billion by December 31, 2004. The bank recorded a 25% increase in advances, which stands at UGSHS 35 million and the asset base went up from UGSHS 85 billion in 2003 to UGSHS 95 billion in 2004. Crane Bank recorded a 97% increase in profits before taxation (EBIT) in 2004 to UGSHS 6.5 billion, due to increased lending and controlled costs. In the financial year 2003, net profit was at UGSHS 3.13 billion.³²⁹

Stanbic Commercial Bank recorded profit before taxes (EBIT) of UGSHS 55 billion (US \$32.16 million), for the year ending December 31, 2004 up from UGSHS 42 billion (US \$24.46 million) realized in 2003. Standard Chartered Bank's pre-tax profit for the year 2004 was UGSHS 9.2 billion (US \$5,369 million) indicating a 39% increase from the previous year.

³²⁸ Juuko, Sylvia, "Financial Sector Grows by 95%," in the New Vision, Uganda [on line] of December 6, 2004. Posted to the Web December 7, 2004.

³²⁹ Odeu, Steven, "Crane Bank profits soar," in the New Vision, Uganda [on line] of February 10, 2005. Available: <http://www.newvision.co.ug/D/9/32/417121>.

The Uganda mortgage industry has also performed well. The Housing Finance Company Uganda Limited (HFCU) recorded net profits totaling UGSHS 1.75 billion in 2003. The DFCU mortgages amounted to UGSHS 25 billion in 2004.³³⁰

There are also significant portfolio inflows mainly in the form of government securities because of the widening interest rate differential between the country and the rest of the world. Portfolio inflows as measured by investments of offshore investors in Ugandan government securities market increased from US \$1.23 million in 2002/3 to US \$10.2 million in 2003/2004.³³¹

Other financial institutions are also expanding and operating relatively soundly. For example, loans by the Foundation for International Community Assistance (FINCA), which is one of the micro-finance institutions that acquired a Micro-Finance Deposit-Taking Institution License from Bank of Uganda in 2004, have been increasing and are projected to grow by 4.17% by reaching UGSHS 50 billion by the end of 2005. As of December 31, 2004, it was known that UGSHS 48 billion had been given out annually. Deposits by over 10,000 depositors including members and non-members had also increased and were projected to reach UGSHS 4 billion at the end of 2005, up from UGSHS 2.5 billion, collected since September 2004.³³²

According to Ms. Caroline Tuhwezeine, the Information Officer for the Association of Micro Finance Institutions of Uganda (AMFIU), data submitted to the

³³⁰ Kauju Peter (quoting Colin McCormack, DFCU Group's Managing Director), "DFCU mortgages amount to sh25b," in the New Vision, Uganda [on-line] February 11, 2005. Available: <http://www.newvision.co.ug/D/32/417122> .

³³¹ Juuko, Sylvia, "Financial Sector Grows by 95%," in the New Vision, Uganda [on line] of December 6, 2004. Posted to the Web December 7, 2004.

³³² Ssonko, Kiganda, "FINCA loans to reach sh50b," in the New Vision, Uganda [on-line] of February 17, 2005. Available: <http://www.newvision.co.ug/D/9/32/418436> .

Micro-credit Summit Campaign in April 2005 earned Uganda praise because of meeting the micro-credit campaign goals and the improvement in the saving culture. The Micro-credit Summit is a non-governmental campaign that was launched in 1997 where over 2,900 people from 137 nations assembled in Washington, DC, USA. The 9-year campaign aimed at reaching 100 million of the world's poorest families, especially women, with credit for self-employment and other financial and business services by the year 2005.³³³

According to the AMFIU, there are now over 900,000 micro-finance clients, up from 50,000 in the 1990s and 600,000 in 2001. Micro-finance institutions – including informal and semi-formal – have risen in number from 500 in 2001 to 1,000 as of April 2005. As of April 2005, the clients' savings in the micro-finance industry in Uganda stood at UGSHS 129 billion (US \$ 75.4 million) up from UGSHS 64.7 billion (US \$37.8 million) in 2001. The outstanding loan portfolio was UGSHS 127 billion (US \$74.27 million). World wide, more than 54 million of the world's poorest people, 81% of them being women, received loans to start or expand businesses by 2004.³³⁴

6.2.8 The Growth of the Insurance Industry and Market

The insurance industry and market is growing very quickly with many companies coming in from Kenya, Zimbabwe, and South Africa and creating healthy competition. There are over 18 insurance firms in Uganda. This number may decrease following the

³³³ Kagumire, Rosebell, "Uganda praised for meeting micro-credit campaign goals," in the Monitor, Uganda [on-line] March 16, 2005. Available: <http://www.monitor.co.ug/business/bus03161.php>.

³³⁴ Kagumire, Rosebell, "Uganda praised for meeting micro-credit campaign goals," in the Monitor, Uganda [on-line] March 16, 2005. Available: <http://www.monitor.co.ug/business/bus03161.php>.

raised minimum paid-up capital established in August 2002. Some insurers are contemplating merging to raise the minimum capital by the deadline of August 2006.

The Uganda Insurance Association, which is an association with all insurance companies operating in the country, is vibrant and comprises various committees. These committees look at the discipline of all insurers and the perception by the public of the insurance companies. No company practices insurance services in Uganda unless it is a registered member of Uganda Insurance Association, which is the trade organization.

Uganda's insurance sector registered an increase of 13.2% by writing premiums worth UGSHS 64.7 billion in 2003 up from the UGSHS 53.5 billion realized in 2002. Compared to the late 1990s, the trend of gross premiums is positive.

Figure 4-(6) presents the growth of Insurance Industry in the late 1990s

Year	1996	1997	1998	1999	2000	2001	2002	2003
Gross Premiums (UGSHS billion)	29.6	30.5	32.9	33.9	39.1	47.2	53.5	64.7
Gross Claims Payable (Billion)	6.1	8.1	10.6	9.9				
Loss Ratio	20.40%	26.60%	32%	29.20%				
Contribution to GDP	0.50%	0.47%	0.43%	0.41%				
Growth of the Insurance Sector (UGSHS Billion)	29	31.5	33.2	33.8				

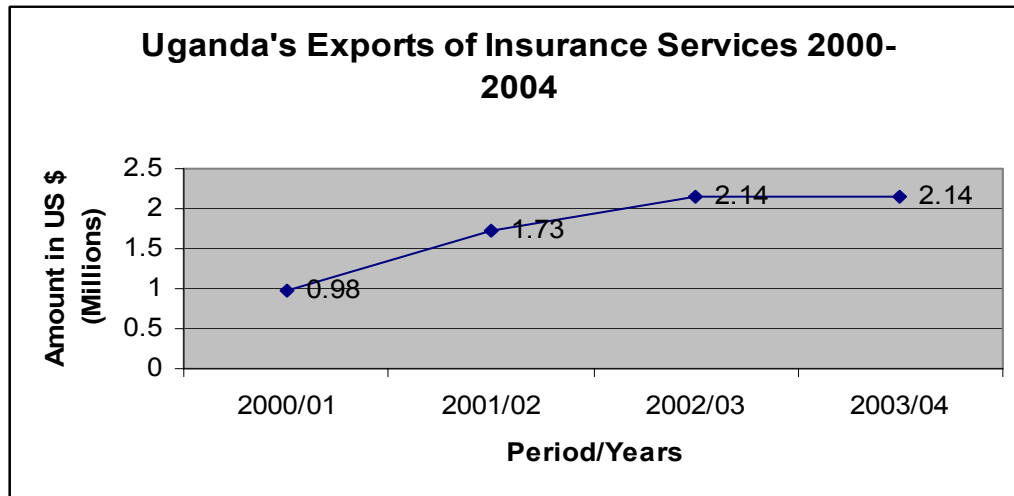
Source: Musoke, Badru, Kazibwe, R.O., Kaye, P and Lubega-Kadunabbi: A Presentation for the Strategic Insurance Management Course for Senior Managers, Country Report for Uganda, 2000.

Insurers mobilize savings by collecting premiums. These savings, which are deposited in or borrowed by banks and other financial institutions, are accessed by investors or entrepreneurs. Other funds are invested in real estate, government treasury bonds or bills and/or corporate stocks and bonds.

Uganda's exports of insurance services have been increasing. According to the Background to the Budget for Financial Year 2004/2005, Uganda's exports of services including travel, transportation, communication, insurance, computer services, financial

services and government services totaled US \$219.10 million in 2000/01, US \$ 224.97 million in 2001/02, US \$266.01 million in 2002/03 and US \$299.30 million in 2003/04. Exports of insurance services have improved from US \$.98 million in 2000/01 to US \$ 2.14 million in 2003/04.

Figure 5–(6) highlights Uganda’s Exports of Insurance Services 2000-2004



Data Source: Background to the Uganda Budget for Financial Year 2004/2005 quoting Bank of Uganda

Many factors contributed to this scenario: (i) increased competition within the insurance industry, (ii) increased vigilance by the Uganda Insurance Commission including elimination of “briefcase” or nominal insurance companies that had been used to exploit the unwary public, (iii) economic growth and derived economic activities navigated by the financial sector, (iv) a raised level of public sensitization as a result of more trained and skilled marketers and sales promoters, (v) improved public confidence in insurance as a consequence of an established complaints and comments bureau at the

Uganda Insurance Commission (UIC), and (vi) improved services including swift, transparent and accountable response to obligations and settling policy holders' claims.³³⁵

For example, as a demonstration of devotion and swiftness to policy holders, on February 23, 2005 within a period of at least one month, Excel Insurance Company paid Robert Kiwanuka, a Kampala City businessman, a cheque (check) of UGSHS 17 million (US \$9,830), as recompense for damage of his car during an accident that had occurred on January 19, 2005. The businessman had opened a comprehensive motor insurance policy with the company on November 24, 2004.³³⁶

6.2.9 Inspirational Reform of the Pension or Provident Industry

As of May 2005, the National Social Security Fund (NSSF) was the only pension and provident institution in Uganda and was undergoing reform. The inspirational reform process of Uganda's pension sector, which began in September 2004 with the transfer of the NSSF to be under the Ministry of Finance and Economic Planning, is a strength of the financial system. Its board and top managers had become involved fraud and other corrupt practices.

By law, all institutions or companies – private or public – employing more than 5 persons between 16 and 55 years old (with the exception of employees under the Government Pension Act or Scheme), are expected to enroll their employees with the National Social Security Fund (NSSF). As of June 30, 2002, 11,211 employers were

³³⁵ Juuko, Sylvia, "Insurance bags UGSHS 64billion," in the New Vision, Uganda [on-line] of July 2, 2004. Available: <http://www.newvision.co.ug/D/8/220/369887>.

³³⁶ Odomel, James, "Excel Insurance gives sh17m to customer," in the New Vision, Uganda [on-line] of February 25, 2005. Available: <http://www.newvision.co.ug/D/220/419961>.

registered with NSSF and the number of employees with open accounts at 1,013,761.³³⁷ Asset base had grown from UGSHS 4.8 billion in 1992 to UGSHS 50 billion in 1997.

The Fund provides for the enrollment of junior staff cadres and lower line managers in all corporations and institutions. As of May 2005, each employee was expected to make a payment of 5% of his or her monthly salary with the employer matching the payment with 15% of the employee's monthly salary, forwarding it to the NSSF.³³⁸ The collected money, at the interest rate of 3%, is then pooled and invested in income generating projects. Legitimate employees access their savings with the NSSF at the retirement age of 55, when they are disabled or as a death benefit for their family.

As of May 2005, the investment portfolio of NSSF was composed of real estate, fixed or time deposits, treasury bills, corporate loans or institutional lending, joint ventures, equity, and share in viable companies on the Uganda Securities Exchange.

A restructured and liberalized pension sector draws many investors into the industry thereby encouraging competition. It improves the ratio of saving to gross domestic product (GDP) and provides long-term funds. The funds are provided using investment vehicles including government securities (treasury bonds and bills), real estate, corporate stocks, etc. and through such vehicles the money from the sector can be accessed by institutions like the government.

³³⁷ National Social Security Fund: About NSSF-Uganda: Background. Accessed January 11, 2005. Available: <http://www.nssfug.org/background.php>.

³³⁸ Badru Musoke, Kazibwe O, Kay P, Kadunabbi Lubega , “ Country Report for Uganda: A presentation for the Strategic Insurance management Course for Senior Managers,” 2000 Accessed May 13, 2003 Available: <http://bicon.org/en/sidor/uganda.htm>.

In January 2005, the Central Bank of Uganda started supervising the operations of National Social Security Fund (NSSF). The supervision included monitoring the usage of funds totaling UGSHS 414 billion and the projects of the pension body.³³⁹

6.2.10 Establishment and Implementation of the Early Warning Systems (EWS)

The establishment, development and implementation of the Early Warning Systems (EWS) in Uganda's financial system constitute one of the strengths of the system. The EWS is an important tool in assessing the vulnerability of countries to currency and financial crisis. It also helps financial institutions meet their risk management requirements.³⁴⁰ Through it, banks provide suitable information, preventing the collapse of banks similar to the banking crisis of the late 1990s.

Early Warning Systems (EWS), which are designed with adaptability, aren't only useful for natural disasters such as the tornados or earthquake tsunami vulnerabilities. Financial systems also require *Financial Early Warning Systems*. It is conventional knowledge that mistakes become useful if they serve as lessons for correction and prevention of future mistakes. The collapse of many Asian currencies and the resultant financial crisis in the late 1990s, invigorated attentiveness in both academic and policy quarters in the potential causes and symptoms of currency and financial crisis.

Further, after experiencing problems in the years 1997, 1998 and 1999 following the closure and/or suspension of a number of commercial banks, the banking system in

³³⁹ Ahimbisibwe, Fortunate and Allio Emmy, "BOU begins to supervise NSSF," in the New Vision, Uganda [on Line] of January 11, 2005. Available: <http://www.newvision.co.ug/D/8/13/411190>.

³⁴⁰ Emmanuel Tumusiime Mutebile (Bank of Uganda Governor), "Donor funds hike interest rates," in the Monitor, Uganda September 7, 2004 on line. Available: <http://www.monitor.co.ug/businessweek>.

Uganda has to comply with Early Warning Systems (EWS) project established at the Bank of Uganda.

The EWS project aims at developing automated data input systems for all the reporting returns received from commercial banks and non-bank financial institutions. According to the Governor of the Central Bank of Uganda, Mr. Emmanuel Tumusiime Mutebile, the EWS project “ *also aims at establishing a broader centralized data storage for the returns received by the central bank, develop statistical models to help with timely detection of problems in supervised financial institutions to allow the central bank take early corrective action, develop enhanced and effective indicators and tests for financial distress in order to ensure early detection of problems in the financial sector and so trigger action to ensure financial stability, soundness and robustness.*”³⁴¹

6.3 Weaknesses

6.3.1 What are the weaknesses of a financial system and what are the weaknesses found in Uganda’s financial system?

The weaknesses or shortcomings refer to current features specific to the financial system that characterize in-competencies and inconveniences. The following are the weaknesses:

6.3.2 Small Size, Underdevelopment, Limitedness and Shallowness

Although Uganda’s banking industry is generally stable, relatively efficient and agile, Uganda’s financial system as a whole is still small, underdeveloped, limited and

³⁴¹ Emmanuel , Tumusiime, Mutebile, Bank of Uganda Governor, “Donor funds hike interest rates,” in the Monitor, Uganda September 7, 2004 [On line]. Available: <http://www.monitor.co.ug/businessweek>.

shallow. Both the financial intermediaries and markets are wanting in financial depth, capital assets, capacity building and rural outreach.

According to the 2003 IMF Financial System Stability Assessment for Uganda, the financial sector had assets totaling 29.5% of GDP in June 2002. The pointers of financial depth were lower both in absolute terms and relative to most Sub-Saharan Africa comparators including Kenya, Botswana, South Africa, Mozambique, Zambia, and Zimbabwe. Moreover, the financial system is dominated by the banking sector, especially the commercial banks, which accounted for 82% of financial assets in June 2002.³⁴²

The banking industry of Uganda is dominated by a large share of foreign ownership. The leading commercial banks in the banking industry are 4 foreign-owned banks: UCB/Stanbic Bank (U) Ltd., Barclays Bank, Standard Chartered Bank and Bank of Baroda. In June 2002 they represented 73% of total industry assets, 68% of industry loans and 75% of deposits. The 3 medium-size commercial banks constituted 14% of assets with the rest represented by 12 small banks.³⁴³

In addition, branch bank distribution is quite low estimated at one branch per 150,000 Ugandans. The available branches are urban based or suburban based. Only two banks: CERUDEB and Stanbic/UCB Bank (U) Ltd exceeded 7 branches and had some bank branches in rural or up-country areas. Yet, rural or upcountry villages constitute over 80% of Ugandan dwellers.

³⁴² 2003 IMF Country Report No.03/97: Uganda: Financial System Stability Assessment. April 2003.

³⁴³ *ibid*

6.3.3 High Financing Costs and Interest Rates

When asked in an interview in January 2005 about what causes business failure in Uganda, Charles Ocici, CEO of Enterprise Uganda did not hesitate to include limited finance in his long list of factors. In addition to limited access to markets, technology, and macro-economic environment, he pointed out that limited finance was one of the unfavorable factors. The issue is not only lack of finance or inaccessibility to credit, but also “most of the available debt-finance to business is short-term and expensive.”³⁴⁴ Since the mid 1990s, while Commercial banks’ prime lending rates are between 11% and 25%, micro-finance institutions’ average lending charges were between 20% and 28% as of December 30, 2004. Some charged as much as between 36% and 54%.

High financing costs and interest rates prevalent in the financial system are no doubt a weakness of the system. Interest rate spreads are usually high as an indication of high levels of perceived credit or default risk, administration costs, greed, trend of macro-economic signals, and minimum competition among commercial banks. High interest rates are a hindrance to investors and impede rapid capital formation. Commercial banks, for example, notoriously charge high interest rates to borrowers and investors making it a hindrance to investment overtures.

Borrowers and investors also bear the brunt of high non-interest expense passed on to them by commercial banks. In 2002, non-interest expenses stood at 5.8% of assets.³⁴⁵ Surprisingly, commercial banks charge too much from borrower even for the

³⁴⁴ Kaujju Peter (quoting Ocici Charles), “Low acumen threatens firms,” in the New Vision Uganda [on line] January 25, 2005. Available: <http://www.newvision.co.ug/D/32/412930>.

³⁴⁵ 2003 IMF Country Report No.03/97: Uganda: Financial System Stability Assessment. April 2003.

APEX loan, which the central bank lends to commercial banks at an average rate of between 7% and 9%.³⁴⁶ Public companies also incur high flotation costs.

According to the findings contained in an *Investment Climate Assessment Report* compiled by UMACIS Consulting, 60% of the firms surveyed in Uganda between 2002 and 2003 reported cost of finance as a major constraint to their businesses.³⁴⁷ Funded by the World Bank and conducted in central, north east and south western Uganda, the survey sampled 392 firms in the manufacturing, tourism, commercial agriculture and services sectors. It revealed that 45% of firms reported that accessing credit was quite difficult.³⁴⁸ In Uganda, only 32% of firms had access to credit, while in Kenya, a neighboring country, 80% of firms enjoyed credit facilities.

High interest rates and bank charges and erratic appreciation of the Uganda shilling against the US Dollar are weaknesses in Uganda's financial system because exporters, manufacturers and investors fail to be globally-competitive. Also, they fail to have an export-led growth of the industry. To attract more investment in agriculture thereby strengthening the financial system, there is a need for a general policy toward lower costs of finance and a mechanism for capital investment in the industry. Suggestions include involving the Uganda Development Bank (UDB) in the financing of medium-term lending and investment in agriculture.

³⁴⁶ APEX Loan is a scheme funded by the European Investment Bank (EIB) to the tune of Euros 80million and aimed at promoting economic development by encouraging and facilitating new investments and enhancing the growth of private enterprises in key sectors in Uganda.

³⁴⁷ Juuko, Sylvia, "Finance obstacles bog down investment," in the New Vision, Uganda, Online September 9, 2004. Available: <http://www.newvision.co.ug/D/9/32/384886> .

³⁴⁸ Juuko, Sylvia, "Finance obstacles bog down investment," in the New Vision, Uganda, [Online] September 9, 2004. Available: <http://www.newvision.co.ug/D/9/32/384886>.

Mortgage financing is also expensive. The high interest rates charged with mortgages are based on the rationale that Uganda, being a landlocked country, suffers from high shipping and transportation costs of imported materials for the housing and construction sector. Inadequate mortgage financing and the high cost of the available funds make construction very expensive. In turn, high interest rates inflate the cost of rents due to the landlords' pressure to settle outstanding bank loans.

6.3.4 Myriad of Constraints in the Micro-Finance Industry

The micro-finance industry comprising the micro-finance financial institutions, the financial services associations and the savings and credit cooperative societies are encumbered by a myriad of constraints. They include the following:

6.3.4.1 Perceived as Welfare or Grant Institutions

Because of distortions related to the early operations of financial cooperative societies and some NGOs, the tendency to perceive micro-financial institutions as there to provide subsidized credit or to give freely still persists. That is why some individuals and groups comprising small scale traders and medium sized investors refuse to service the credit or default to pay back the loan. They even take customer service geared to simplicity and quality service as a sign of weakness and attempt to exploit it. The problem is compounded, in some cases, by more affluent people who want to take advantage of the loans provided to rural dwellers at a reasonable interest rate.

6.3.4.2 Undercapitalization

Most of the micro-credit lending financial institutions operating in rural or suburban areas are undercapitalized. The number of loan clients, loans outstanding,

savings balance and savings accounts is still low. There is capital inadequacy thereby experiencing limitations in the volume of loans outstanding. The majority operate with a capital base of between US \$3000 and \$5000. Undercapitalization leads to insufficient provisions and under performance.

Undercapitalization impacts profitability, institutional sufficiency and operational self-sufficiency. Operational self-sufficiency is defined as operating income / (operating expense + financial expense + loan loss provision expense).³⁴⁹ This also limits the more affluent entrepreneurs who need funding but find the package of loans to be inadequate for their capital needs.

6.3.4.3 Overburdened by Inside Borrowing

Most micro-finances including financial service associations and financial cooperative societies engage in inside borrowing. The program staff is favored. Yet, there is compromise as loans to staff members are not collected as scheduled for reimbursement. Inside borrowing sometimes results in fraud in the form of unexplainable fund shortages.

6.3.4.4 Inadequacy of Trained or Skilled Personnel

Most of these financial institutions are incapacitated by inadequate training of staff. Insufficiency of skilled human resource affects the institution's performance. For example, (i) the management of some of these institutions fails to follow the recommended standards including failing to conform to the routine working hours, (ii) existence of partial shareholders' files including lack of identification photographs and

³⁴⁹ Bank for the Organized Poor – Fonkoze, at Glance as of December 2003.

specimen signatures, (iii) inability to carry out accounting according to the required standards, to control and monitor the institutions' assets and operations and (iv) inability to prepare and reconcile bank statements and members' savings.

6.3.4.5 High Rate of Member/Customer Dropouts

One of the challenges to micro-financial institutions in Uganda is the high rate of client dropouts due to many reasons including voluntary and involuntary departure. The research conducted in the early 2000s by Wright, Mutesasira, Sempangi, Hulme and Rutherford on client exits (dropouts) from Ugandan Micro- Finance Institutions revealed that *“there is evidence that MFIs operating in Uganda are experiencing high (often in excess of 25% per annum) levels of drop-outs amongst the clients...significantly in excess of drop-out rates amongst most Asian, Latin American and West African MFIs.”*³⁵⁰

6.3.4.6 Difficulty in Recovering Loans

Recovering loans is one of the most expensive routines in terms of money, credibility, energy and time for most of micro-finance institutions. Loan portfolio at risk greater than 30 days is common. Loan portfolio at risk greater than 30 days refers to total balance of loans overdue greater than 30 days over total loans outstanding. Most micro-credit financial institutions have financial statements that show high loan loss ratios. Loan loss ratio represents loans written off as bad debts over average portfolio outstanding.

The majority micro-finance institutions not only fail to make appropriate loan agreements, but also confront the problem of unsatisfactory loan collateral. Moreover,

³⁵⁰ Wright Graham, et al. “Client Exits (Dropouts) From Ugandan Micro-Finance Institutions.” Accessed June 15, 2004. Available: http://www.undp.org/sum/Microsave/studies_exits_uganda.html.

some of these securities are not legally binding as they lack formal documents such as lack of a recognized land title. This, together, with the above mentioned constraints have great impact on the operational and/or financial self-sufficiency of the micro-credit institution.

6.3.5 Limitations in the Insurance Industry

In spite of Uganda's insurance industry contributing to economic development through mobilization of savings by collecting premiums, which develop both capital and money markets, the insurance industry has notable limitations. These include (i) public ignorance of the services and benefits of life and property insurance; (ii) focus on the minority elite class underrating the majority of peasants and semi-skilled workers; (iii) coverage of the manufacturing and service industries leaving out the agricultural sector due to difficulty of risk assessment;³⁵¹ (iv) package of non-friendly products that are highly technical in nature and intangible; (v) reluctance to provide certain populations with insurance coverage particularly HIV/AIDS clients, who are deprived of life insurance policies because of high cost of premiums, and (vi) expensive premiums that become unaffordable to the majority of Ugandans who have low incomes.

The insurance market, which was worth UGSHS 64 billion as of January 2005,³⁵² is still small. There are over 18 companies competing for a small market. This forces companies to keep premium rates down thereby limiting the growth of insurance companies. With low premiums, some companies cannot survive. Many insurers prefer

³⁵¹ Musoke, Badru, et al. A Presentation for the Strategic Insurance Management Course for Senior Managers, Country Report for Uganda, 2000.

³⁵² Bwogi Charles (Interview with Barrie Cambridge, CEO of East African Underwriters), "Insurers face stiff competition," in the New Vision Uganda [on line] January 27, 2005.

fewer insurance companies doing larger business and having a healthy competition that leads to growth.

Another limitation is that of over 18 insurance companies, only 5 underwrite life insurance. There is low underwriting of life insurance in Uganda because people are poor and also they lack common information and education. Even the businesspeople and the academic community, including the relatively affluent, have not considered life insurance as a priority.

6.3.6 Multiple Inefficiencies of the Nascent Financial Market in Uganda

Unlike financial markets in industrialized countries such as Australia, Canada, China, Europe, Japan, USA and some countries of Asia and Latin America, the financial market in Uganda is dogged with multiple inefficiencies. In high income countries, financial markets are strong, financially deep, developed and relatively efficient. For example, by 1970, the securities traded in the US stock and bond markets consisted of about 65% of all the securities obtainable in world financial markets of the time. The total assets invested in the Global financial markets, dominated by USA, Europe and Japan, amounted to US \$ 2.3 trillion in 1969 and to US \$ 63.8 trillion in 2000.³⁵³

In contrast, financial markets in Uganda lack external or informational efficiency, that is, new information is not quickly reflected in asset prices. Asset prices such as corporate stocks, corporate and government bonds, and treasury bills do not always reflect all that is known about the economy and the issuing firm. The possibility of overvaluing or undervaluing stocks in financial markets in Uganda is very high. There are

³⁵³ Reilly, Frank, K. and Keith, C Brown. Investment Analysis and Portfolio Management. (7ed). USA & UK: Thomson, South-Western, 2003:69.

several factors that limit the investors in the Uganda Securities Equity Exchange. These include:

6.3.6.1 Small Size and Shallowness

The market capitalization of the Uganda Securities Exchange was at 1,441.7 billion in September 2004. Although more companies including Stanbic Bank (U) Ltd, Uganda Telecom Ltd., Barclays Bank (U) Ltd., and National Insurance Corporation (NIC) are slated for listing on the Uganda Securities Exchange (USE) in the near future, the number of investors and the financial depth of the market are wanting. The USE, which is just over 7 years old, is still young and small with only 7 equities, 1 corporate bond of UTL and 7 Government bonds. It is also hoped that the MTN corporate bond to be issued in 2005 will expand the size. Despite this, the size still remains small.

6.3.6.2 Low Savings and Limited Disposable Income

Many Ugandans have a low or limited level of savings which has a major impact on the investor base. The majority of people interested in saving and investing are crippled by limited disposable income. They live and save from hand to mouth. For example, a draft report of December 2002 on the level of civil education in Kasese, one of the districts in western Uganda, revealed that only 1% of the households in the district have a person earning a monthly cash income. Also, of the households that had a person with a monthly income, 44.6% earned less than UGSHS 5,000 per month. Only 36.9% earned between UGSHS 5,000 and 50,000 monthly.³⁵⁴ This is the trend in the whole country.

³⁵⁴ Nzinjah, John, "1% homes earn cash in Kasese," in *the New Vision, Uganda* [on-line] of December 16, 2002. Available: <http://www.new./detail.php?mainNewsCategoryId=8&newsCategoryId=18&newsId>.

Wages/salaries and benefits in Uganda are quite miserable. Uganda's minimum wage, a rate which was set in the early 1960s and last revised in 1984 at UGSHS 6,000 (US \$3.43), has reduced much of its purchasing power, with employees receiving less than US \$4 per month, limiting their ability to save. On contrary, the cost of living (the cost and rate of change over time of the market basket on basic products for household living) has been increasing.

Despite some continued increases in salary for years in service, the Ministry of Labor and Public Service's salary scale of civil servants still starts with unskilled labor at UGSHS 75,000 (US \$ 42.86) per month up to the administrators at UGSHS 600,000 (US \$342.86) per month. This never promotes savings. The migration of skilled manpower (brain drain) to USA, Europe and Japan in search of better pay reduces domestic savings and investment because not all who now live overseas save and invest in their home country.

Few runaway professionals, especially professors and scientists including economists, medical consultants and nurses send money back home. The majority of skilled Ugandans have preferred to get permanent residences in foreign countries and settled there. Mutabazi quoting Joachim Buwembo writes about this scenario: “ *It is those Ugandans who bathe invalids and senile Wazungu in retirement homes who send their big bucks...because of their tangible aspirations (building a house, starting a business, and paying relatives' school fees) they send their money back...the professors and professionals take up the Western way of life more easily...their salaries are paid into banks and they shop with credit cards, they are attached to their housing mortgages*

and their savings are invested in the stock exchange ...they are completely irrelevant to Uganda's economy."³⁵⁵ They demonstrate double concern.

Further, low pay in Uganda encourages professionals and professors to runaway and this affects the skilled labor market, which is critical and significant to Uganda's economic transformation and development process. According to the US National survey of nurses, by the end of 2004, there were more than 3,100 registered nurses from Africa, including Uganda, in the USA.³⁵⁶ The flight, especially of scientists and other professionals to industrialized economies, deprives Uganda of specialized manpower that local investors require. For example, Ugandan emigrant medical consultants in the United Kingdom earn between 63,000 and 85,000 pounds (about UGSHS 300 million) annually. In Uganda, they earn about UGSHS 1.3 million per month!

6.3.6.3 Biased Attitudes

Biased attitudes limit the investor base. The perception and attitude of the majority of Ugandans toward the stock/equity securities exchange is biased and largely erroneous. Many people, especially the majority of peasants living in rural areas do not have access to equity/stock market trading, which is urban centered. They often erroneously assume that investment in equity/stock securities market is for the affluent and elite. But also the literate and semi-literate believe in short-term returns. The attitudes and perception of the stock/equity exchange have yet to be changed. Unless attitudes towards investment in the stock exchange change, financial markets in Uganda will not

³⁵⁵ Mutabazi, Enoch, "Swallowing the bitter-sweet pill of Kyeyo cash," in the Business and Finance of May 3-9, 2005 in the Monitor, Uganda [on-line]. Accessed May 2, 2005. Available: <http://www.monitor.co.ug/bizfin/bf05032.php>

³⁵⁶ Mutabazi, Enoch, "Swallowing the bitter-sweet pill of Kyeyo cash," in the Business and Finance of May 3-9, 2005 in the Monitor, Uganda [on-line]. Accessed May 2, 2005. Available: <http://www.monitor.co.ug/bizfin/bf05032.php>

develop fast enough. People should know that saving and investing in stocks is a long-term program, with returns delivered in the long run.

The biased attitude toward saving and investment in long term financial assets is hampered by the life expectancy rankings of the country. According to the World Fact Book, as of July 2004, Uganda's average life expectancy was at 45.28 years because of poverty and limited access to health care. The perception that Ugandans live for short time is a disincentive to saving and investment especially in long term financial assets.

6.3.6.4 Ignorance and Socio-Cultural Hindrance Attitudes

Ignorance and sticking to traditional socio-cultural attitudes are also weaknesses of the Uganda's financial system. The presence of an enlarged informal sector poses a threat to Uganda's financial system because it does not enhance investment in financial instruments. The majority of the population in the informal sector are not only ignorant of the alternative investment opportunities but also are hindered by socio-cultural beliefs that encourage them to stick to traditional investment vehicles. They prefer investment in tangible but weaker items like livestock, land, vehicles and housing. There is still pride in being an absent landlord of an underutilized house or land.

Ignorance and negative attitudes affect the stock/equity securities market as the majority of Ugandans have not understood the nature and role of financial markets, especially the equity markets. Many Ugandans are ignorant of the existence, role and benefits of stock/equity securities markets in fighting household poverty through increment of household income levels. Ignorance is fueled by two elements: (i) high illiteracy rates and (ii) low levels of awareness. Rural Uganda is limited in financial business information.

A majority of Ugandans are not aware of such a market! For example, as of July 2004, there were only 5000 investors in five years in a country with a population of 26.8 million. In comparison, there were over 49,000 investors on the Tanzanian Stock Exchange,³⁵⁷ which opened almost the same time like Uganda Securities Exchange. The investor base needs to expand through sensitization and education.

A few people fully understand and appreciate that a share is a representation of ownership. To buy a share is to buy part of company, which entitles one to enjoy part of the profits of the company or carry the company's liabilities. Of course shares are not a get-rich-quick vehicle but those who understand their value know that shares benefit investors. Ugandans have to be helped to understand so that they might increase shareholding.

6.3.6.5 Lack / Low Confidence

Most Ugandan investors lack confidence nurtured by past experience of Insurance Companies and Bank failures and eventual closure of the Cooperative and Greenland banks leading to loss of financial and real assets by many. This discourages and hinders investment in financial institutions. For example, as of mid 2004 the government was yet to pay UGSHS 91 billion to defunct banks' debtors – debtors of former Cooperative and Greenland Banks. The Bank of Uganda (BOU) had closed the Cooperative Bank in 1998 and the Greenland Bank in 1999 due to insolvency and failure to meet the minimum capital requirement as set out in the Financial Institutions Act. At the closure, Cooperative Bank had 26 branches countrywide and six micro-finance agencies. It was

³⁵⁷ Kaujju, Peter, "USE calls for more investors," in the Business Vision of New Vision, Uganda [on line] 15th July 2004. Available <http://www.newvision.co.ug/D/9/32/372426>.

insolvent by UGSHS 15 billion and had lost UGSHS 10 billion in fraudulent transactions.³⁵⁸ Numerous Ugandans were affected by this and lost confidence in many financial institutions.

6.3.6.6 Pushing Options for Savers and Investors

There are some options that exist for savers and investors. First, incorporated companies have little interest in going public and getting listed. The majority refuse to list for any of the five reasons: (i) fear of extension and inclusion of ownership leading to loss of control and shareholder pressure, (ii) availability of alternative sources for raising funds for corporate growth including resort to business angels, founders, friends and families, commercial banks, non-financial companies and venture capitalists, (iii) avoidance of past dark records of bad image or reputation including exposure to ingrained corruption and taxation evasion that many have evaded, (iv) high costs including accounting, legal and underwriting fees and flotation costs, and (v) detailed disclosure of status of the company.

Second, savers and investors have options of investing their money in certificate of deposits (CDs) and real (physical) assets including buildings, land and equipment. Many have interest in debt securities markets in the form of government treasury bonds and bills, which are usually risk free and bring faster and higher returns.

6.3.6.7 High Volatility in Equity Markets Relative to Debt Securities Markets

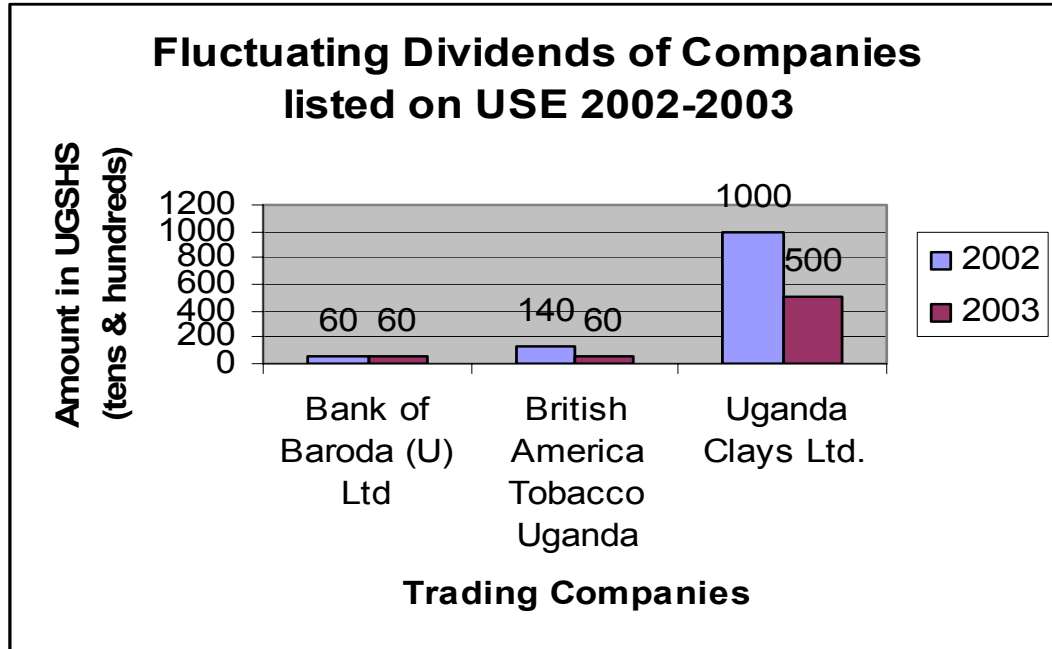
Comparatively, volatility in equity /stock markets is higher than in debt securities markets especially government treasury bills and bonds. The ever-fluctuating share prices

³⁵⁸ Karugaba, Mary, "Government to pay Sh91b to defunct banks' debtors," in the New Vision [on line] Uganda of July 23, 2004. Available: <http://www.newvision.co.ug/D/8/220/374300>

and dividends tend to disappoint and dissatisfy some investors leading them to switch their preferences to bonds. Moreover, because dividends fluctuate sharply for many reasons including national and international exogenous factors, shareholders sometimes have grudgingly received low dividends. For example, despite the share prices in the newly listed Bank of Baroda (U) Ltd. going up from UGSHS 600/= (US \$ 0.35) to UGSHS 800/= (US \$ 0.47) for two years (2002 and 2003), the company paid its shareholders the dividend of UGSHS 60/= (US \$ 0.04) per share before taxes. Shareholders of British America Tobacco Uganda (BATU), on the other hand, got a disappointment of dividends of UGSHS 60/= (US \$ 0.04) per share in 2003 down from UGSHS 140/= (US \$ 0.08) in 2002. And, Uganda Clays limited shareholders received dividends of UGSHS 500/= (US \$ 0.29) in 2003 down from UGSHS 1000/= (US \$ 0.58) in 2002.³⁵⁹

Figure 6-(6) shows dividend fluctuations in 2002 and 2003

³⁵⁹ Kaujju, Peter, "USE calls for more investors," in the Business Vision of New Vision, Uganda [on line] 15th July 2004. Available <http://www.newvision.co.ug/D/9/32/372426>.



Data Source: The Monitor, Uganda [Business Week July 20-26, 2004]

A majority of investors in Uganda avoid equity/stock markets in preference to debt securities markets, especially the government bonds and treasury bills, because these are risk free and as shareholders, they are not only interested in the highest returns (profits) but also they want them in the shortest possible time. They are not only sensitive to share performance but also want quick returns. Even though equity/stock markets elsewhere have historically proved to have higher rates of return than bonds in the long term trading, Ugandans seem to continue prioritizing their allocation of assets and investment strategies in government treasury bonds and bills. These, especially T-bills, are for short term benefits and not longer term returns. Ugandans have not yet created a culture of long-term investments. The risk tolerance for long-term investments is conservative due to cultural and historical factors.

6.3.6.8 Lack of Incentives to Companies Wanting to List

Lack of or limited incentives especially in the form of corporate tax relief to companies that want to list are a major weakness of Uganda's financial system. Financial markets flourish well with more companies going public. But according to Mr. Wafula, CEO of Uganda Clay Limited (UCL), which was the pioneer company on the Uganda Securities Exchange (USE) since 2000 and which as of May 2004 remained the best performer among local listings with a 28% increase in sales in 2003 to UGSHS 6.3 billion (US \$3.4 million) from UGSHS 5.0 billion (US \$2.7 million) in 2002, lack of incentives to companies wanting to list remained a major impediment to stock exchange growth.³⁶⁰ Although many companies realize that they are better placed to raise great amounts of capital through sale of shares and debentures, they lack the financial incentives to list, similar to those given to companies in countries like Kenya.

6.3.6.9 The Dominance of Core Investment in the Process of Privatization

Another obstacle to Uganda's Securities Equity Market is that privatization of most previously state-owned companies has been placed on core investors over individual investors. Even the recent announcement of the privatization of National Insurance Corporation (NIC) required that 60% become a core investor and only 40% be privatized through stock exchange. Core investors tend to undermine the significance of listing on the Securities Exchange, which would not only stimulate the market but also extend ownership.

³⁶⁰ Nakkazi, Esther (Special Correspondent), " Uganda Launches Project to Boost Bourse," in the East African Standard, East Africa, Monday , May 24, 2004 on line. Available: <http://www.nationmedia.com> .

6.3.6.10 Clash of Interests: Dividend-Hungry Investors' Malady versus Retained Earnings-Hungry Directors' Syndrome

The agency problem or clash of interest over dividends vis-à-vis returned earnings is another impediment to the success of equity markets in Uganda. In addition to low dividends due to increasing costs of production, which eat up profits, the clash of interests between the shareholders and the directors also affects Uganda's Securities Equity Exchange. In fact, one more important factor for low investor base in the Uganda securities stock exchange is the clash of interests between the CEO/Board of Directors and the shareholders of the few listed and trading companies.

While the management team of companies works hard to maximize the value and earnings of their companies' stocks and having more profits retained (retained earnings) for re-investment and business growth than giving dividends, the shareholders want the opposite. They want and are interested in the highest profits in the shortest possible time. Are shares worth having when they do not give an investor immediate and satisfying returns for the present problems? This is a common question asked by most investors or shareholders in the nascent Stock Exchange because the priority is having dividends now. Meanwhile, the directors/executives wonder and answer: what is the purpose of giving dividends today rather than re-investing them to bolster the company's capital base and make it stronger?

In other words, investors are hungry for dividends while the directors are hungry for retained earnings. This makes it a clash of interests and is a new threat to the Uganda Securities Exchange (USE) market.³⁶¹ For example, in April 2004 the shareholders of

³⁶¹ Kaujju, Peter, "USE calls for more investors," in the Business Vision of New Vision, Uganda [on line] 15th July 2004. Available <http://www.newvision.co.ug/D/9/32/372426>

British America Tobacco Uganda (BATU) were disappointed and disapproved the company's decision to retain profits in order to facilitate re-investment in a new plant at Namanve. Similarly, in 2004 the shareholders of Bank of Baroda (U) Ltd. did not feel happy when the bank's board of directors decided to give low dividends and retain profits for business expansion.³⁶²

6.4 Opportunities

6.4.1 What are the opportunities of the financial system and which current or prospective features do we find out in Uganda's financial system?

The opportunities of the financial system are the current or prospective features in the external environment, broadly defined, that generate favorable opportunities. The following are the opportunities of Uganda's financial system:

6.4.2 Stability of Uganda's Macro-Economic Environment

The stability of Uganda's macro-economic environment and especially Uganda's encouraging investment environment is one of the opportunities of Uganda's financial system. Trends in Uganda's investment environment are likely to increase saving and investment rates as well as the supply and demand for funds. For example, in spite of high levels of external indebtedness and weak public finances, as a result of a long track record of relative political and macroeconomic stability portrayed by robust growth and low inflation, on March 17, 2005, Fitch ratings, the International Rating Agency, rated Uganda's Long-term foreign and local currency with "B". This placed Uganda at parity

³⁶² Kaujju, Peter, "USE calls for more investors," in the Business Vision of New Vision, Uganda [on line] 15th July 2004. Available <http://www.newvision.co.ug/D/9/32/372426>.

with Benin, Mozambique and Papua New Guinea, which are among the Fitch-rated Sub-Saharan African countries. Fitch also assigned a Short-term foreign currency rating and Country Ceiling of “B”.³⁶³

The investment environment attracts both Ugandans and foreign investors. According to the Uganda Investment Authority (UIA) officials, Uganda’s encouraging investment environment characterized by government leadership’s good public relations campaign outside Uganda, increasing stability of the Eastern African region, with the launch of the customs union for Uganda, Kenya and Tanzania, and the end of the war in southern Sudan with the signing of the peace agreement in January 2005, make Uganda more attractive to investors.

Improvements in infrastructure, especially of transport and communications facilities, enhanced tax administration, and better cargo air handling encouraged investors in the year 2004 making the total of new investment to exceed the targeted amount in UIA’s five-year strategic investment plan (2000-2004).

For example, according to the 2004 investment results, Uganda Investment Authority (UIA) recorded worth UGSHS 721 billion (US \$ 417 million) of projects licensed as new investments. This figure is greater than the US \$ 250 million that had been targeted. Moreover, this was higher than the growth of the year 2003 that amounted to US \$353 million.³⁶⁴

³⁶³ Paul Rawkins and James McCormack of Fitch Ratings, “ Fitch Rates Uganda “B”; Outlook Stable,” Fitch Ratings –London- 17 March 2005.

³⁶⁴ Nakawesi, Dorothy, “Museveni’s PR campaign boosts investments,” in the Monitor, Uganda, on line January 17, 2005. Accessed January 17, 2005. Available: <http://www.monitor.co.ug/business> .

The encouraging investment environment saw 32 countries invest in Uganda in 2004, up from 31 in 2003. And of the 32 countries, 20 were old investors in Uganda indicating that they had found favorable factors. Though 11 countries moved out, they were replaced by the same number of new countries investing in Uganda.³⁶⁵ For the second year running, Ugandans lead in investments in Uganda with projects worth UGSHS 240 billion (US \$ 139 million) for the year 2004 and US \$ 388 million for the first quarter of 2005.

Figure 7-(6) highlights the leading investors in Uganda for the year 2004 and first quarter of the year 2005

Leading Investors in Uganda	Investments/Projects Worth (in US \$ million) (2004)	Investments/Projects Worth (in US \$ million (Jan- March 2005)
Uganda (Ugandans)	\$ 139	\$388
Bermuda	\$ 105	-
India (Indians)	\$ 47	\$1.1
U.S.A (North Americans)	\$ 45	-
Kenya (Kenyans)	\$ 17	\$8.2
Malaysia	\$ 10	-
Netherlands (Dutch)	\$ 4	-
Switzerland (Swiss)	\$ 3	\$1.0
China (Chinese)	\$ 3	\$4.0
UK	-	\$3.0
Iran	-	\$3.0
Egypt (Egyptians)	\$ 2	-
Norway (Norwegians)	\$ 2	-
Tanzania	-	\$1.5
Belgium (Belgians)	\$ 1	-
Lebanon (Lebanese)	\$ 1	-
New Zealand (New Zealanders)	\$ 1	-
Sudan (Sudanese)	\$ 1	-
Pakistan	\$ 1	\$.21
Mauritius	\$ 1	

³⁶⁵ Nakawesi, Dorothy, "Museveni's PR campaign boosts investments," in the Monitor, Uganda, on line January 17, 2005. Accessed January 17, 2005. Available: <http://www.monitor.co.ug/business>

Denmark (Danish)	\$ 1	
South Africans	\$ 0.9	\$ 0.36
Democratic Republic of Congo	-	\$ 0.7
Korea	-	\$ 0.3
Zimbabwe	-	\$ 0.27

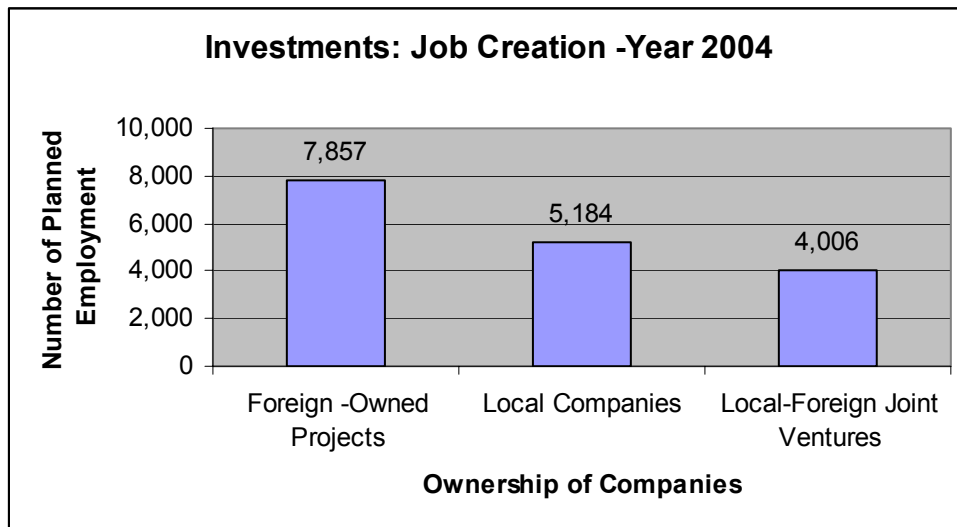
Data Source: The New Vision Newspaper of Uganda [on line] Uganda of January 15, and May 21, 2005 and the Monitor Newspaper of Uganda [on-line] Business of May 21, 2005.

A number of projects licensed also show an increasing trend. For example, while in 2003 only 160 new investments were licensed, in 2004, 193 projects were licensed making an increase of 21%. In the first quarter of the year 2005, the government earned UGSHS 737 billion (US \$413 million) from 46 companies/projects licensed by the Uganda Investment Authority (UIA) beating its intended investment target of UGSHS 624 billion (US \$353 million) by UGSHS 113 billion (US \$60 million).³⁶⁶

As new investments spring up, employment also rises and increases income and savings. With increased job opportunities, more people earn income. This income is either consumed or saved. Through financial institutions, these savings are again mobilized for further investments thereby building the capacity for the financial system and the economy. For example, although in 2004 only 17,047 jobs were created for planned employment, in 2003 the number was higher. There were 19,368 jobs created. From the registration of the 46 projects in the first quarter of 2005, at least a total of 5,500 jobs were expected, especially in the water, energy, services, and manufacturing sectors. All these are great achievements.

³⁶⁶ Nakaweesi, Dorothy, “ UIA beats investment target by \$60 million,” in the Monitor, Uganda [on-line] Business, May 21, 2005.

Figure 8-(6) shows jobs created as a result of Direct Investment in Uganda-2004.



Source: The Monitor Newspaper, Uganda [on line] January 17, 2005

The presence of several different investments becomes an opportunity for the growth in volume and value of financial institutions, especially the financial markets. First, many companies provide an opportunity for building a better diversified investment portfolio. They help in the process of asset allocation based on two factors: (a) return of the portfolio/asset and (b) correlation coefficient between different financial assets in different sectors and industries.

For example, financial assets within the manufacturing industry or sector have a similar correlation coefficient and so would not suffice for a diversification strategy. Investors prefer to diversify by investing in several different industries, in several different assets, and even across national boundaries. Second, they encourage multiple entries thereby promoting competition with consideration and adjustment of its four basic dimensions: (i) cost of transaction, (ii) quality of financial products and services, (iii)

flexibility, and (iv) response to customer needs. Third, they help to diversify non-market (specific) risks while leaving managers to wrestle with market risks.

Further, many companies with different sizes of market capitalization (small, medium and big caps) and in different sectors and industries, enhance diversification efficiency because they provide a variety of opportunities for asset allocation to reduce and balance risks.

As more companies stabilize, it is hoped many will prefer to go public by selling shares to raise capital. Many more companies going public mean more listings and more capital. And more capital means a more vibrant financial system.

6.4.3 Regional Trading Alliances

Uganda's acceptance and preference to join formidable regional trading alliances through economic integration and eventually political federation is an opportunity for Uganda's financial system. Globalization, regionalization and integration, cross-border initiatives and openness to the global economy increase competition in the financial system.

As a member of the East African Community (EAC) and its Customs Union effected on January 1, 2005, Uganda opens itself to the benefits of economic integration including an expanded financial sector market. Already, plans are underway to establish the East African Central Bank (EACB) to coordinate the monetary operations of the member countries. Also, COMESA Customs Union (COMESA-CU) is in pipeline. One main advantage of economic integration is an expanded market, which in turn gives an expanded horizon of savings and investments. The presence of many more investors is a

potential variable for the expansion and growth of both financial intermediaries and markets.

By forming a regional trading alliance with Kenya and Tanzania, Uganda has provided opportunities and benefits to the financial system. In addition to the GATT/WTO, there are the over 150 regional trade agreements now in force. They benefit both domestic and international financial institutions. Although there still exist a concern over whether regional trading alliances and blocs create or divert trade, or are opportunities or problems,³⁶⁷ unlike decades ago, international competition today is best described not in terms of country against country but in terms of integrated blocs and regional trading and cooperation agreements.³⁶⁸ And if Uganda's financial system is to compete globally, it must be shaped so.

Economic integration through agreements and/or alliances encounters overlapping commitments. Such trading blocs are sometimes opposed for being ploys to exploit weaker countries. While these arguments may have grains of economic truth, these integrations' advantages far outweigh disadvantages. For example, Uganda's financial system stands to gain from the East African Community's *market-size-pull-factor-effect* (MSPFE) on savings and investments from and for a total population of more than 90 million people. Global giant corporations will not hesitate to begin investments thereby creating more markets for financial intermediaries and markets.

³⁶⁷ Professor Burnham, James. "Global Economy" Course. Lecture Notes. Duquesne University, Spring 2004.

³⁶⁸ Robbins, Stephen and Mary, Coulter. Management. (7ed). Upper Saddle River, New Jersey: Prentice Hall Pearson Education, Inc., 2002:96

6.4.4 Government's Resolve to Privatization and Liberalization

Privatization and liberalization are two important aspects that enhance savings and investments, which boost the financial system. Unlike other governments that tend to interfere with operations of financial systems putting monetary and financial regulatory policies and structures that generate financial repression or suffocate financial intermediaries and markets, the current government of Uganda avoids that in its intervention.

Government involvement and commitment to the private sector including the financial sector is another notable opportunity to the financial system. The leadership of the current government is not only committed to the private sector but has also put in place firm structures and policies that promote a completely liberalized economy where the market forces determine prices including those of interest rates and the foreign exchange rates and where almost all economic activity is unrestricted.

On privatization, for example, the Public Enterprise Reform and Divestiture Statute of 1993 provides institutional framework for the implementation of the divestiture program in Uganda, being implemented by the Privatization Unit of the Ministry of Finance, Planning and Economic Development. Amended in January 2000, the PERD Statute addresses the institutional framework and procedures. For example, various methods of privatization are being used and include asset sales, share sales, management employee buyouts and concessions.³⁶⁹

Also, the current government of Uganda through the Land Act of 1998 annulled the Land Decree of 1975 issued by then President the late Idi Amin Dada. The 1975 Land

³⁶⁹ Investing in Uganda. Investment Opportunities in Privatization. Accessed on April 28, 2003 Available <http://www.ugandainvest.net/IPA>.

Decree had nationalized all land thereby impacting real estate markets, which are part of financial institutions in Uganda. All private real estate market transactions were considered illicit. However, with government intervention, the 1998 Land Act restored economic freedom, guaranteed security of land tenure and enforced property rights in private real estate markets.³⁷⁰

Since the privatization exercise kicked off in early 1990s, many previously state-owned enterprises have been privatized. During the fiscal year 1997/1998, for example, a total of 85 companies had been privatized. More privatizations are also being noted even of medium to large divestures including Electricity, Water and Rail among others. For example, in May 2004 the government sold Uganda Electricity Distribution Company Ltd (UEDCL) to a UK-South African Group in a deal that saw at least US \$65 million invested over the next five years.

Umeme Ltd, the purchasing company planned to pay government US \$1.4 million once control had been transferred, an annual rental of US \$18 million in the first year and invest US \$65 million on the power grid. This deal is an opportunity for Uganda's financial system in two ways: (i) a new power company would perhaps minimize the problem of power shortage in the country and (ii) the company would become a potential investor in the financial markets or even boost the financial intermediaries through its economic borrowing. The Uganda Railways Corporation is in the process of being privatized jointly with the Kenya Railways Corporation under a concession. Similarly, by January 2005, several bidders had submitted their applications for the National Insurance Corporation. In the first week of June 2005, a leading Nigeria

³⁷⁰ Knight, John R ,et al. , "Housing Prices and Maturing Real Estate Markets: Evidence from Uganda," in the Journal of Real Estate Finance and Economics. Volume 28, Issue 1, Article 1 (Abstract). Accessed on January 11, 2005. Available: <http://www.jrefe.org/ab28-1a1.html>.

insurance firm, Industrial and General Insurance Company Ltd (IGI) bought 60% stake in NIC Ltd. at UGSHS 6 billion (US \$3,625 million).

6.5 Threats

6.5.1 What are the threats to the financial system and which threats do we notice in Uganda's financial system?

The threats refer to current or prospective features in the external environment, which are likely to be intimidations or comprise a “worry-list”. Uganda's financial system has the following threats:

6.5.2 The Problem of Land Tenure and Security

Land, whether in urban or rural milieu, is a very sensitive issue with Ugandans so much so that its tenure and security is a concern of everyone. For the financial system to thrive, it requires investors. Yet investors find it very hard to get adequate land for investment. Although, a land database has been established at UIA to market private lands and other government lands to investors and the government of Uganda has facilitated Uganda Investment Authority (UIA) to acquire several pieces of land for industrial development such as Kampala Industrial and Business Park (KIBP) at Namanve, Luzira , Nalumunye, Bweyogerere and up-country land like Kiryandongo, Masese land for BIDCO, Pian Upe land in Karamoja, Pallisa land and Mawogola land, the problem of land tenure and security still remains a constraint to investment.

Few individuals have land titles in Uganda and this is a big problem to private property rights and ownership. It is also a major problem in being able to borrow, since the land could be used as collateral for any borrowing; but if the title is not clear, banks become reluctant to lend. Although under the World Bank funded program, the less

privileged of the rural countryside are meant to get land titles with ease, little has been done and very few Ugandans understand land tenure. In Uganda, land is owned in four tenure systems: customary, freehold, *mailo* and leasehold. The majority of Ugandans do not understand the difference.

The 2004 land proposal by the Cabinet to Parliament for compulsory acquisition of land for investment became controversial and was immediately withdrawn after meeting great opposition.

6.5.3 The Cyber Security Concerns: Online Banking and E-commerce Fraud

Although there are many Web problems, credit or debit card cloning³⁷¹ and “phishing”³⁷² are the two common fraudulent transactions threatening Uganda’s financial system and e-commerce. In spite of companies confronting many economic obstacles when endeavoring to introduce and launch electronic commerce (e-commerce), which is the marketing, promoting, buying, and selling of products electronically, particularly through the Internet³⁷³, e-commerce is emerging in Uganda. Its emergence is not without new threats. An international spill over in on-line financial fraud renowned as “phishing,” which uses e-mail to trap unsuspecting people into disclosing their financial data at

³⁷¹ Credit or debit card cloning is a fraudulent transaction carried out during payment with cards, especially by dishonest staff. While a credit card is being swiped for payment, the fraudster or “cloner” swipes the credit or debit card particulars, which are downloaded on computer thereby exposing private information that is used to make a duplicate card. The fraudster uses the duplicate card to begin a purchasing or spending spree and until the subsequent credit or debit card statement is received, nothing sinister may be realized or detected.

³⁷² Wikipedia, the free encyclopedia, describes phishing as “ the act of attempting to fraudulently acquire through deception sensitive and private personal information, such as passwords and credit or debt card details by masquerading in an official-looking e-mail.”

³⁷³ Kuratko Donald F and Richard, Hodgetts. Entrepreneurship: Theory, Process and Practice. 6th Edition USA and UK: Thomson, South-Western, 2004:13.

phony bank and e-commerce Web sites³⁷⁴ is a potential threat to Uganda's financial system as cashless transactions or payment cards start to emerge in the country.

Although promoters of use of plastic money in the form of debit or credit cards and online banking argue that for *“an emerging economy like Uganda's that is fraught with fraud and corruption, cashless transactions or payment cards could save the government and businesses billions of shillings, quicken transactions and shrink national borders since cardholders transact business anywhere in the world,”*³⁷⁵ this isn't without problems. Identity theft or cyber crime, which is common even in developed countries, could become more dangerous and damaging.

Cyber crime is a new threat associated with e-commerce and online banking. For example, in April 2005, Tsubira Allan, a former cashier at the Imperial Resort Hotel in Entebbe, Uganda was arrested over a credit card scam in which clients comprising a team from the International Criminal Court (ICC) and delegates to a Petroleum Conference were defrauded of thousands of dollars. The fraudsters cloned their credit cards before having a spending spree with money from their accounts.³⁷⁶

Traditionally, banks have addressed security concerns with visible enhancements including security camera (electronic surveillance), security guards, elaborate bank vaults and early warning or early response systems.³⁷⁷ However, as many global countries

³⁷⁴ Krebs, Brian, (washingtonpost.com Staff Writer), “New Industry Helping Banks Fight Back,” Yahoo News. Accessed March 2005. Available: <http://story.news.yahoo.com/news?tmpl=story&u=/washpost/>

³⁷⁵ The Monitor, Uganda [on line] <http://www.monitor.co.ug/business/bizw03231.php>.

³⁷⁶ Candia, Steven, “Former cashier held over credit card scam,” in the New Vision Uganda [on-line] of April 27th April, 2005. Available: <http://www.new.vision.co.ug/D/8?13/431332>

³⁷⁷ Walsh, Christen (Classmate-Student), “Online Banking: Privacy versus Progress,” Project Presentation for the Course: GRBUS 515 Information Systems for Managers at Duquesne University, John F. Donahue Graduate School of Business, Fall 2004: October 14, 2004.

embrace e-commerce and online banking with unparalleled growth, insecurities and privacy violations have grown. For example, in 2003, 29.6 million households in the USA used online banking and the USA commercial banks spend 40% annually on security and privacy concerns as part of capital spending priorities. Western Europe, which dominates online banking, had 47.7 million users while Japan had 19.6 million, Asia-Pacific 9.8 million and the rest of the world including Uganda registered 5.1 million online banking users.³⁷⁸

Worldwide, online banking is increasing and performs the following services:(i) maintain checking and saving accounts, (ii) pay bills, (iii) wire money internationally, (iv) maintain credit cards and (v) transfer funds between accounts. Online banking is increasing in customers because of the value-added services, which increase convenience. However, losses and fears of skeptics are not unfounded and are threatening Online Banking. For example, according to the USA Federal Trade Commission Survey, 4.6% of Americans reported being victims of identity theft over the course of the year and nearly 10 million Americans discovered their privacy had been compromised.³⁷⁹ Research by the Gartner Group revealed that in United States of America, raiding checking accounts in 2003 led to bank losses of US \$2 billion and “phishing” losses of US \$1.8 million.³⁸⁰

³⁷⁸ Walsh, Christen (Classmate-Student), “Online Banking: Privacy versus Progress,” Project Presentation for the Course: GRBUS 515 Information Systems for Managers at Duquesne University, John F. Donahue Graduate School of Business, Fall 2004: October 14, 2004: quoting Jupiter Research, November 2003 and International Data Corporation 2004.

³⁷⁹ Sager , Ira (Editor), “Up-Front ...The Stat,” in Business Week, April 4, 2005:16

³⁸⁰ Walsh, Christen (Classmate-Student), “Online Banking: Privacy versus Progress,” Project Presentation for the Course: GRBUS 515 Information Systems for Managers at Duquesne University, John F. Donahue Graduate School of Business, Fall 2004: October 14, 2004: quoting Gartner Group, June 2004.

This data has relevance to Uganda's financial system because the cyber crime and threat is borderless and many Ugandan banks have correspondent USA banking arrangements. These include (i) Nile Bank with Citibank, New York, (ii) Standard Chartered Bank with Standard Chartered Bank, New York, (iii) Bank of Baroda with Chase Manhattan Bank, New York, (iv) Stanbic with Bankers Trust, New York, and (v) Barclays with Barclays Bank PLC, New York.

Further, there are over 12 million Point of Sale (POS) machines all over the world and there are over 500,000 Visa enabled ATMS including those in Uganda. The cyber threat elsewhere affects Uganda's financial system too because of the international linkage.

Globally, the anti-phishing" industry and market is young. Ugandan commercial banks have not deployed strong commercial protective technologies to prevent online swindle artists and hackers. Hackers are good at transferring money illegally from checking and saving accounts thereby making online banking a major global fraud. Identity theft is high and costs incurred by banks are high. For example, in 2003, USA banks spent US \$2.2 billion on identity theft costs up from US \$1.4 billion in 2002. In 2004 they spent about US \$2.8 billion.³⁸¹ Online banking security weaknesses include: (i) database leaning message boards that are vulnerable to pop-up windows and scripting attacks, (ii) low level encryption programs, which are not compatible with users' browser capabilities, (iii) badly configured firewalls and web applications that fail to protect

³⁸¹ Walsh, Christen (Classmate-Student), "Online Banking: Privacy versus Progress," Project Presentation for the Course: GRBUS 515 Information Systems for Managers at Duquesne University, John F. Donahue Graduate School of Business, Fall 2004: October 14, 2004: quoting Communications, August 2002.

databases from hackers and weak password practices that are susceptible to basic scripting attacks.³⁸²

6.5.4 Local Companies' Failure to Keep Books of Account and Lack of Insight

One of the threats to Uganda's financial system is that many local firms do not keep correct, adequate and up to date books of accounts thereby failing to qualify for government contracts and to get bank loans. If the trend of lack of adequate record-keeping continues, it threatens the financial system.

Although by law companies with limited liabilities are required to provide returns to the Registrar General periodically, few of them do so. Good records are important because they furnish the banks with relevant information about the performance of the company seeking loans. Usually in Uganda, a company seeking a credit line from the bank is required to submit records for the last 3 to 4 years to serve as a measure of income stability. But because they are either not available or are inconsistent due to figures being ill-prepared or tampered with at the last hour when demanded by the bank, the bank loan managers find it difficult to extend credit to such entrepreneurs.

According to Uganda's investment state minister, Sam Kutesa, SMEs are often unable to access finance from loanable funds markets because they do not keep audited account books.³⁸³ They also fail to take advantage of tax incentives because they are often making losses. Lack of accountability is also a cause of economic corruption in the private sector.

³⁸² Ibid, presentation, October 19, 2004.

³⁸³ Odeu, Steven, "Uganda has low labor productivity," in the New Vision, Uganda, online. Wednesday, 28th July, 2004. Accessed on July 28, 2004. Available: <http://www.newvision.co.ug>.

But in addition to failure to keep proper records, lack of or low insight threatens entrepreneurship in Uganda. Ocici, CEO of Enterprise Uganda, calls it lack of acumen. Many enterprises ranging from small enterprises to big corporations, lack insight, mishandle public acclaim, have unplanned expansion or growth and disregard advice of experts. For example, many managers obtain short-term loans to finance medium or long term projects thereby mismatching cash flows.³⁸⁴ Others disregard the law and tend to evade taxes. The consequences of long-term tax evasion are terrible to an enterprise forced to repay accumulated tax when discovered.

6.5.5 Economic Corruption, Accounting Professional Deficiency and Fraud

Economic corruption, accounting professional deficiency and fraud form an intertwined threat to Uganda's financial system. The accounting profession in Uganda not only continues to fail to satisfy some important demands of the financial system but also lacks enough personnel. The World Bank estimates in the year 2000 put the requirement of qualified accountants needed for Uganda at 2,000 professional personnel. But as of November 2004, there were only 182 Association of Chartered Certified Accountants (ACCA) qualified accounting technicians and 794 ACCA qualified accountants in Uganda.³⁸⁵ Sufficient and competent accountants lack in Uganda despite the fact that Mr. Christopher Forster, the Deputy President ACCA United Kingdom (UK), revealed in November 2004 that ACCA had over 320,000 students and members in 160 countries

³⁸⁴ Kauju, Peter, "Low Acumen threatens firms," in the New Vision, Uganda [on-line] of January 25, 2005. Available: <http://www.newvision.co.ug/D/9/32/412930> .

³⁸⁵ Olanyo, Joseph, "230 ACCA accounting graduate," in the Monitor, Uganda [on line] of November 12, 2004. Accessed on November 12, 2004. Available: <http://www.monitor.co.ug/business/business11122.php>.

including 45,000 in Africa.³⁸⁶ This scenario is caused among other things by the education background in schools that does not halt “mathematics-phobia” attitudes.

Moreover, even in neighboring Kenya, qualified accountants are few. For example, on May 28, 2004, the Kenyan Local Government Minister revealed that only 39 out of 175 council treasurers employed to manage finances for civic bodies countrywide were properly trained or had degrees and relevant qualifications for the job they were employed to do.³⁸⁷

The accounting profession demands that accountants and auditors live and work by the standards of ethical conduct including competence, confidentiality, integrity and objectivity. International accounting standards also demand that there be comparable, transparent, and reliable financial information for the smooth functioning of loanable funds markets as well as foreign exchange and financial markets. There is need for the harmonization though not standardization of accounting and auditing codes.

The reasons for this demand are numerous but the presence and pace of globalization and liberalization facets in world economies top the list. The presence and pace at which many and big (i) multinational corporations (MNCs), transnational corporations (TNC) and borderless organizations (BOs), (ii) cross-border purchases, buyouts acquisitions and mergers, (iii) trade in domestic and foreign equity and debt securities markets, and (iv) foreign direct investments are operating globally demand that there be harmonization of accounting standards.

³⁸⁶ Olanyo, Joseph. “230 ACCA accounting graduate,” in the Monitor, Uganda [on line] of November 12, 2004. Accessed on November 12, 2004. Available: <http://www.monitor.co.ug/business/business11122.php>.

³⁸⁷ Nyassy, Daniel. “Maitha: Only 39 council treasurers are qualified,” in the Sunday Standard, Kenya [on line] May 30, 2004. Accessed May 29, 2004. Available: <http://www.eaststandard.net/headlines/news30050>.

For example, there are many multinational, transnational and global corporations operating in Uganda especially through foreign direct investment. The majority are British, American, Indian, Kenyan and South African firms. Uganda is an actual and potentially attractive investment hub because of its strategic location, stable and liberal macro-economic policies, and abundant resources. Despite divergent economic and financial realities in different countries, there is a call for harmonization of accounting standards and practices to foster the comparison of financial statements.

The threat to Uganda's financial system is not so much lack of the harmonization of accounting standards and integrity of financial reports, that is, different accounting for similar transactions in different countries, but of fraud in the accounting profession. There is evidence that the auditing and accounting profession in Uganda, which would otherwise be eligible to uproot economic corruption and improve efficiency in public and private sectors, is itself falling prey to the crime. For example, during the graduation of the Association of Chartered Certified Accountants (ACCA) Uganda branch students in the early November 2004, Mr. Mungereza, the President of the Institute of Chartered Public Accountants of Uganda revealed that corruption had invaded the accounting profession and was devouring it.³⁸⁸

Until all accountants, certified accounting technicians, and financial managers desist from economic corruption, demonstrate competency and perform their jobs ethically and professionally, the financial system in Uganda shall continue to underperform.

³⁸⁸ Olanyo, Joseph. "230 ACCA accounting graduate," in the *Monitor, Uganda* [on line] of November 12, 2004. Accessed on November 12, 2004. Available: <http://www.monitor.co.ug/business/business11122.php>.

6.6 Conclusion

Uganda's financial system has strengths and opportunities but also weaknesses and threats. While the strengths and opportunities must be consolidated and utilized for higher yields, the weaknesses and threats must be keenly addressed. The next chapter provides us with a plan of action that contributes to both concerns. Constructing a market-oriented robust financial system with emphasis on the rural reach refocus model (3-R Financial Model) is the answer to the raised concerns.

CHAPTER SEVEN

7 CONCLUSION AND PLAN OF ACTION: CONSTRUCTING A ROBUST FINANCIAL SYSTEM WITH EMPHASIS ON RURAL REACH REFOCUS FINANCIAL MODEL (The 3-R Financial Model)

7.1 Overview

Reliance, which is intrinsic to economic poverty, and the incapacity to overcome it without a market-focused robust financial system compels us to respond with a feasible financial model that can make a difference. The previous chapters of this thesis have largely focused on one main goal: explaining and recognizing the nature and role of a financial system as an outstanding economic system as well as assessing the strengths, weaknesses, and opportunities of Uganda's financial system. But it is not just enough to be aware and lament.

Data, information and knowledge, which are not translated into action, lack realism and remain merely conceptual and unproductive. Becoming aware of the monetary problem without suggesting a monetary solution means nothing to the struggle. It upholds prolonged lamentation and postpones economic radiance.

Lack of financial capital not only sustains economic poverty but also internal and external economic and political oppression. It perpetuates deprivation and subservience to domestic and foreign interests. Unless foreign economic reliance is lessened and domestic productivity increased with financial capital accumulation, Uganda's economic light will remain dim. Until each rural household becomes financially empowered, psychological, physiological and social deprivation will remain the norm and the chains of domestic and foreign political, cultural, and religious oppression will remain fastened.

With this insightful reality and the nature, role and power of a financial system acknowledged, the situation commands a plan of action. This chapter is devoted to the second goal of our thesis: to make it today's priority to construct a robust financial system as an outstanding economic system, capable of lessening poverty and foreign economic reliance through enhanced productivity, economic growth and development. The plan of action entails constructing a robust financial system with emphasis on utilizing a *Rural Reach Refocus Financial Model* (3-R Financial Model).

7.2 The Rural Reach Refocus Financial Model (3-R Financial Model)

7.2.1 Meaning, Nature and Purpose of Rural Reach Refocus Financial Model

7.2.1.1 Meaning

The Rural Reach Refocus Financial Model refers to the expansion, adoption and adaptation of a market-oriented robust financial system to Rural Uganda to spur the Entrepreneurial Revolution to enhance economic transformation. The aim is to extend mobilization and allocation of financial resources and assets to rural and sub-urban areas. These areas constitute over 87.7% of the total population and are predominantly informal. In doing this, resources from surplus units will reach deficient units, especially rural entrepreneurs and agriculturalists, and stimulate the entrepreneurial revolution. This in turn, will spur economic transformation and result in improved living standards.

Emphasis is on expanding formal and efficient financial institutions and services including banking, micro-finance institutions, saving and credit cooperative societies, finance companies, insurance firms and financial markets especially the mutual funds to Rural Uganda through private-public financing partnerships. Through increased rural and village household savings facilities, convenient and quick funds transfer and payment,

credit or financing accessibility and coverage of business or entrepreneurial risks, entrepreneurs, peasants and equity investors increase productivity and create market.

The 3-R Financial Model advocates for the recognition, support and development of a three-fold activity that is intimately linked. It comprises: (i) financial capital proximity, accessibility and accumulation, (ii) value added entrepreneurial production including agro-processed products and (iii) market formation for mass consumption.

For Uganda's economy to change for the better, reasonably priced financing for agriculture, agro-business products, and small and medium enterprises engaged in manufacturing, commerce and service sectors must be available and accessed. Just as Urban Ugandans have somehow accumulated financial capital, Rural Ugandans need to be empowered financially not only to enhance production through entrepreneurial activities but also to create demand.

7.2.1.2 Nature

7.2.1.2.1 The Structural Elements of the 3-R Financial Model

The basic constitution of the Rural Reach Refocus Financial Model is financial capital proximity, accumulation and empowerment of Rural Uganda through private rural-run efficient financial institutions with a public-private financing partnership. There are four important blocks that distinguish a private from a public institution. These include (i) ownership status, (ii) management and control, (iii) level and manner of financing and (iv) level and manner of consumption.

The model advocates for a market-oriented robust financial system with room for public-private financing partnerships of autonomous ownership and management of financial institutions in Rural Uganda with an exit policy for the government.

Figure 1-(7) highlights the structural elements of the 3-R Financial Model

Variable of Definition	Private	Government
(1) Form of Ownership	<p>YES:</p> <ul style="list-style-type: none"> ○ Proprietorship (Capital –Equity) ○ Partnership (Share-Equity) ○ Corporation (Stock -Equity 	<p>ONLY TWO:</p> <ul style="list-style-type: none"> ○ Postal Service and Postal Bank Uganda =100%] ○ Central Bank of Uganda = 100%
(2) Management	<p>YES:</p> <ul style="list-style-type: none"> • Unlimited Personal Liability • Shared Partner Liability • Legal Entity: Limited Liability 	<p>NO:</p>
(3) Financing	<p>YES:</p> <ul style="list-style-type: none"> ✓ Internal Financing ✓ Family and Friends Financing ✓ Debt Financing ✓ Government Financing ✓ Equity Financing 	<p>YES:</p> <ul style="list-style-type: none"> ✓ Rural Development Matching Grants (through bids) ✓ Rural Development Finance Grants (through bids) ✓ Direct Loans to Rural Financial Institutions (through bids) ✓ Rural Uganda Credit Government Guarantees ✓ Pro-Poor Credit Channeled via Financial Intermediaries (Transitional Support at a Cost)
(4) Consumption (the level of public and private involvement in spending or borrowing)	<p>YES:</p> <p>High Level; Open and Unlimited</p>	<p>YES:</p> <p>% of Government Spending or Borrowing (Controlled / Managed)</p>

In other words, the private sector will prevail in ownership and management but the government could assist in co-funding the financial entity with an explicit exit policy. Government cooperation in co-funding is required for a three-fold purpose: (i) to support the emerging privately rural-run financial institutions with venture expansion capital and

enhance their efficiency with cheap loans, (ii) to use the autonomously managed financial institutions to channel government credit to those who are not economically active with cheapest loans to eliminate the tendency of direct dependency and welfare, and (iii) to maintain perfect competition and monitor imperfect competition which diminishes community's welfare.

The co-funding private-public partnership should be limited and geared to jump-start private entrepreneurs or investors to self-reliant level and support the non-economically active poor to obtain credit lines at the cheapest prices, and capacity building to uplift them to become economically active in competition for funds in the loanable funds markets. This can be done in two ways. First, the government could establish financial institutions in each sub-county but let them be managed privately. These institutions could be privatized at an appropriate time. Second, the government could provide cheap loans to the economically active entrepreneurs through the operating financial institutions.

7.2.1.2.2 Scope and Focus of the 3-R Financial Model

- *Rural*

The 3-R Financial Model comprises *rural* as its basic feature because its economic and geographical scope for resource mobilization and asset allocation is Rural Uganda. The majority Ugandans live in rural or suburban areas. Most operational financial institutions are situated in urban areas comprising about 12.3% of the total population. This leaves Rural Uganda, which consists of 87.7% of the population, limited to financial services offered by formal financial institutions. To decisively and inexpensively win the

poverty war, strong economic forces must be tactfully located where the poverty battlefield is most dreadful. It is formidable in Rural Uganda.

- *Reach*

The 3-R Financial Model has *reach* as one of its attributes because increased convenience and proximity for Rural Uganda to access affordable financial services and resources is significant and critical. Rural Uganda wants convenience and accessibility to financial services including equity and debt financing, savings facilities/institutions, micro-credit short-term and long-term lending, funds transfer and payment facilitation, and risk balance and mitigation including insurance policies to cover business liabilities.

Reach also implies integration and connectedness in resource mobilization and asset allocation. The 3-R Financial Model integrates the formal and informal sectors and local and national areas as well as the domestic and foreign (international) institutions and resources. The *reach* feature incorporates the view that deficient units are able to demand and access financial surplus resources supplied nationally and internationally for creative investment.

- *Refocus*

The 3-R Financial Model has a *refocusing* trait because it is and should not be static. It is dynamic and operates according to the signs of the time. When the financial system and model's ability to perform its tasks has been outdone by modern needs and opportunities, on-going reform must be integral. Review and assessment of the model's economic and financial impact and viability should be on-going.

A refocused, well-functioning market-oriented robust financial system offers insights into today's most significant entrepreneurial challenges and dexterously responds to

them. Therefore, reforming the reforms to keep responding to changing and emerging local, national and global trends and events is essential.

- *Financial*

The 3-R Financial Model has a *financial* attribute because financial capital accumulation and empowerment is the feasible weapon of ousting household poverty not only from Urban Uganda but also from Rural Uganda. The financial attribute incorporates the sources and uses of capital for entrepreneurs and the level of risk involved. Financial capital accumulation and empowerment boosts production and consumption and impacts the supply and demand curves of many markets: the loanable funds market, labor market and goods and services market.

For example, a strong, developed and diversified financial market would enable the government of a developing country like Uganda to survive economically in the event of foreign aid cutting and/or with-holding. The government would sell treasury bills!

7.2.1.2.3 Position of the 3-R Financial Model: Leading Sector of the Economy

- *Financial Sector as Leading Sector*

A leading sector is that sector of the economy that can stimulate other sectors to quicken economic development. A market-oriented robust financial system tops the list of the leading sectors that can stimulate other sectors in the economic transformation of Uganda. It is the leading sector because without financial capital accumulation and purchasing power, nothing can be realized. It drives economic growth. It is the only sector capable of engendering incomes to boost entrepreneurial capabilities and the supply and demand for products. It is also a sector that can vigorously support a developing country still reliant on foreign aid in an event of foreign aid reduction.

- *Financial Products and Services Required in Rural Uganda*

For Uganda to drive out household poverty quickly and equitably with improved sustainable purchasing power in Rural Uganda, appealing and relevant financial products and services must be offered by the private sector. Growth, innovation and diversification of financial products and services should be encouraged. For example, Rural Uganda lacks sustainable financial services that derive from financial intermediaries and markets.

There should be consideration of many facets and products of rural financial intermediaries including (i) savings facilities, (ii) credit facilitation, (iii) funds transfer and payments, (iv) insurance and (v) financial securities markets tailored to the SMEs in Rural Uganda .

For example, the micro-finance industry should be developed with government intervention to provide suitable products and services for the poor. The Consultative Group to Assist the Poor (CGAP) defines a micro-finance as “*an organization – credit union, down-scaled commercial bank, savings and credit institutions, financial NGOs, self-help financial groups – that provides financial services for the poor and needy.*”³⁸⁹ Formal financial private voluntary organizations (FPVOs), financial services associations (FSAs), finance companies and rotating savings and credit associations (ROSCA) are included in the definition.

Its focal package of products and services must be affordability, adapted collateral, long-term credit lending, quality financial services including (i) personal loans for post-primary education, (ii) home loan mortgages backed by land titles, (iii) support for agriculturalists and agro-business industry entrepreneurs engaged in agricultural

³⁸⁹ CGAP (an acronym for Consultative Group to Assist the Poor), “ About Micro-Finance.” Accessed on May 21, 2004. Available at <http://www.cgap.org/about/faqo5.html>.

processing activities, (iv) lines of credit for fixed assets financing and working capital for small and medium rural based enterprises in both manufacturing and service sectors, (v) leasing arrangements, and (vi) equity financing through common stock or venture capital financing. It should provide entrepreneurs with formidable alternatives for firms' capital structures.

Rural financial markets should also have a variety of products including agents, brokers and rural points of sale in (i) treasury bills and bonds, (ii) equity stocks, (iii) corporate bonds, (iv) mutual funds, (iv) foreign exchange, (v) mortgaging trade, and (vi) derivative services.

7.2.1.3 Purpose

The main purposes of a Rural Reach Refocus Financial Model (3-R Financial Model) are (i) spur and steer Entrepreneurial Revolution through filling up a significant debt and equity financing gap necessary for poverty reduction and a transformational direction and (ii) to enable government finance its deficit and promote economic transformation. When fairly utilized in Rural Uganda, the 3-R Financial Model becomes the “local loan shower model to the local loan sharks models.”

It functions to mobilize savings and increase private financial capital inflow through domestic and foreign direct investment, portfolio investment flows, and financial institutions such as micro-finance, banks, venture capital markets and savings and credit cooperative societies.

The model is an effective means of spreading financial services to improve agriculture, industry/manufacturing, and service sectors to a wider geographical scope. Constructing a robust financial system with emphasis on Rural Reach Refocus Financial

Model is recommended as the most feasible strategy and approach to transform Uganda's economy from a chiefly peasantry and informal economy to a principally commercial agriculture, industrial and formal economy. This is because the majority of consumers are reached and there is a focus on the most underdeveloped and informal sector of the economy.

The presence and operation of an efficient and effective financial system in all of Uganda's 961 sub-counties, in every sector and throughout the country's industry, is the goal of this plan. This mechanism will initiate and sustain small, medium and big firms, purchasing powers, competitive capacities and niche markets, which are necessary to jump-start and sustain economic transformation based on local, regional and national competitive and comparative advantages.

Also, a robust financial system, especially an efficient financial market with a developed and well-functioning bond market can be the alternative to funding the government budget in the absence of foreign aid and without having recourse to foreign reserves. In the absence of foreign aid, aid cutting and/or aid withholding, sometimes due to disagreement between the donors and governments over aid conditionality including fiduciary and macro-economic environment policy matters, the government can sell treasury bonds and/or bills to survive economically.

It facilitates the alleviation of economic poverty. Through a public-private financing partnership of privately rural-run financial institutions, this proposed model is hoped to alleviate poverty by:

- (i) Consolidating and advancing the existing level of robustness of the financial system in mobilizing resources and allocating assets, facilitating capital payments and transfers and mitigating unique risks through diversification and correct management;
- (ii) Generating robustness by making the financial system less susceptible to monetary frailty through a saving and investment multiplier effect;
- (iii) Enhancing financial capital accumulation and making this capital accessible to deficient units at favorable prices through its capital transfer and payment structure thereby proliferating and dispersing purchasing power within Rural Uganda and between Rural Uganda and Sub-Urban or Urban Uganda or Outside Uganda;
- (iv) Instigating the entrepreneurship revolution with its associated advantages of renovation, job creation, household income rise, improved revenue, and enhanced living standards;
- (v) Supporting the efficient management of the supply and value chains or the cycle of production-distribution-consumption activities, especially facilitating resourcefulness of their activities within enterprises and to the actions of suppliers, channels, and buyers to effect competitive advantage³⁹⁰; and
- (vi) Balancing social and economic inequities, showing particular concern for social justice in response to the cry of the rural poor and the persistence of incapacitating poverty in individuals elsewhere.

The 3-R Financial Model is significant to developing countries like Uganda because it enhances and empowers accessibility to creative resources and assets such as land, education, capital, and entrepreneurial skills, which are significant determinants of high

³⁹⁰ Professor Presutti Bill, Jr., Ph.D., C.P.M in the course of Understanding the Value Chain , Duquesne University PA, USA Fall Semester 2004, (quoting Porter, Michael <1985> Competitive Advantage, New York , NY. The Free Press).

income, savings and investments. It also balances and discounts regional inequality in employment. Regional inequality in Uganda increases income inequalities amidst high economic growth rates. It is a participatory model because it involves the private and public sectors in economic development, respects the dynamics of the market economy and links the rural and urban and rural and international community.

7.3 Embodiment of Corrective Measures of Weaknesses and Threats

7.3.1 Urge and Justification

The urge to advance the consolidation and extension of the robustness of a market-focused financial system to Rural Uganda is due to the profound evidence of the power and role of financial robustness in economic development that the previous chapters have attested. The need to consolidate and utilize the prevalent financial strengths and opportunities as well as correct and address the weaknesses and threats is impelling. For example, this thesis has attested that the economy has been making significant steps towards economic independence after the economic and financial sector reforms to trounce productivity crises and financial depression. It has been revealed by the improved performance of real, fiscal, financial and external sectors of the economy that the more robust the financial system, the more economic growth and productivity the economy registers.

Though Uganda's financial system is an emerging system in robustness, there exist affirmative testimonies about its great contribution to economic development. Despite the fact that for the last three years economic growth rates have failed to hit the required 7%, Uganda's economy has improved largely due to an ever bettering financial

system sanctioned by the structural adjustment programs and locally implemented policies initiated by the World Bank and IMF.

There is a strong linkage between the robustness of a financial system and high economic growth rates. It will broaden and deepen with a 3-R Financial Model. We noted that between 1963 and 1973, shortly after political independence that Uganda's annual GDP average growth rate was 6% and the balance of payments was in surplus.³⁹¹ It eventually declined only to recover later on at the improvement of the financial sector and its system.

7.3.2 Long Term Remedy of a Dysfunctional Financial System

A successful and sustainable Rural Reach Refocus Financial Model is a long term remedy of a dysfunctional financial system. A dysfunctional financial system depicts market failure of financial institutions. On the dark side of the story, the thesis has proved that throughout the economic history of Uganda, an inefficient financial system failed to contain the oppression of poverty.

Hindered by historical and modern factors, Uganda's financial system had failed to spearhead economic transformation allowing Rural Uganda to remain poor. Current factors including low labor productivity, high reliance on primary commodity trade, external burden debt, an enlarged informal sector and economic corruption accentuated the problem and ingrained rural household poverty.

³⁹¹ Siddhartha, Prakash (WTO Consultant) and Kostecki, Michel (Professor, University of Neuchatel, Switzerland), "Trade and Development Centre: Issues –Country Studies: Uganda Case Study," 1998. Edited by WTO Information and Media Relations Division, WTO Geneva, Switzerland, 1997: On-Line. Accessed March 31, 2004. Available < <http://www.itd.org/issues/ugan2.htm> >

The exploration and examination has revealed that there were low income and high poverty trends in the 1970s and early 1980s under Amin's military and Obote II's governments. This is a time Uganda experienced both political and economic decline. As the financial system was repressed, capital formation was stalled, and households and firms were financially distressed thereby hindering economic growth and development. The economy's crisis unfolded so much so that during the mid-1970s, real GDP growth rate averaged 0.2% for 1971-1975 and -3% for 1976-1980. Uganda's crumbling economy was a reality that could not be ignored.

Lacking an efficient and effective financial system, capital formation was absent and the export sector dominated by strategic exports like cotton, tea and coffee regressed. Peasants, smallholder farmers, out-grower schemes and larger agricultural plantation owners were disillusioned. Siddhartha and Kostecki (1997) valuably note that *“between 1970 and 1981, two of Uganda's principal exports were almost wiped out: cotton slumped from 80,000 metric tones to 5,000 metric tones, and tea from 21,000 to 3,000 metric tones...only coffee kept going, its contribution to total exports rising from 50% to 95% over the same period...moreover the standard of living shrunk as per capita GDP declined 40% in the period between 1971 and 1981.”*³⁹² Reforms made a turnaround.

7.3.3 Value-Adding: Expansion of Financial Robustness to Rural Uganda

Due to a relatively improved financial system, today's story of Uganda's economy is different. There is a spark of life. The Rural Reach Refocus Financial Model is to add value and strength to the system's capacity to transform the economy.

³⁹² Ibid, 1997.

As a consequence of on-going privatization, liberalization, price stabilization, prudential regulation and supervision, adherence to observance of standards and codes, competition in the financial system, accessibility to loans and other credits, public listing of 7 companies on the Uganda Securities Exchange, introduction of money market funds, diversification and improved financial services among other reasons, Uganda's economy has fared better though it is still wanting in many ways. The following are the highlights of its improved performances:

1) Increased Export Earnings:

Though not without weaknesses, threats and wanting in robustness, Uganda's financial system in its emerging robustness status is contributing more to the growth of export earnings. Uganda's export earnings have been growing by 9.2% annually over the last four years ending in 2004. For instance, while exports stood at UGSHS 695 billion (US \$ 401 million) in 2000, they grew to UGSHS 905 billion (US \$ 522 million) in 2003 and UGSHS 954 billion (US \$ 550 million) in 2004.³⁹³

2) Expansion and Growth of the Financial Market Sector:

The whole financial sector grew by 93% in 2003. Also, the financial market is developing with the Uganda Securities Exchange (USE) increasing in number of participating investors from 5,000 in July 2004 to over 10,000 as of March 2005. Although Uganda's is still low compared to Tanzania's Stock Exchange with over 60,000 in spite of starting almost at the same time, there is increasing awareness.³⁹⁴ Seven companies are listed and 7 government bonds and 1 corporate bond are traded. The total market capitalization has steadily increased from UGSHS 383.8 billion in September

³⁹³ Mirembe, Jovita, "Export earnings grow by 9%," in the New Vision, Uganda [on-line] of January 31, 2005. Available: <http://www.newvision.co.ug/D/8/220/45538>

2003 to UGSHS 1,414.7 billion in August 2004, to UGSHS 1,870.5 billion (US \$1,093.9 million) on February 24, 2005 and to UGSHS 2,125.1 billion (US \$1,242.75 million) as of April 1, 2005.³⁹⁵

3) *Savings and Investment Increase:*

Uganda's saving rate to GDP has increased from 1.1% in 1986/1987 to 8.0% in 2003/2004. The saving culture is taking root. Direct investments have also increased with a recent record showing licensed projects increasing by 21% and worth UGSHS 721 billion (US \$417 million) in 2004 up from US \$353 million. Portfolio investments are also increasing.

A market-oriented robust financial system expanded to Rural Uganda is expected to achieve greater results thereby improving living standards for many in the near future.

7.4 The *AICG*: Conditions for the Success of the 3-R Financial Model

The *AICG*, which is the acronym for awareness and attitude change, information efficacy, competition candor, and government friendly intervention, constitutes the package of necessities for the success of the 3-R Financial Model. Without these four factors in operation, the proposed financial model falls short of ceasing inefficiencies and seizing efficiencies. The effective optimal profitability depends on the Model's operation and development under the *AICG* factors. Next, we highlight the importance associated with them.

7.4.1 Awareness and Attitude Change

³⁹⁵ The New Vision, Uganda [on Line] April 1, 2004

Just as forced freedom and imposed governments provoke sentiments of opposition, the Rural Reach Refocus Financial Model is not likely to achieve its purpose – which is to vigorously advance mobilization of resources and asset allocation for creative investment in Rural Uganda – unless there is not only awareness but also attitude change toward poverty reduction by concerted efforts of rural households, rural oriented entrepreneurs and policy makers. Poverty alleviation requires commitment, sacrificial service, respectful responsibility and teamwork. For example, parsimony in drinking and time management and use of meager resources must emerge from within households. Responsible parenthood including investments in the formal education of children must be initiated and encouraged by the parents or guardians. Though incentives drive a rural saving culture, a parsimonious foundation sustains this culture.

The Rural Reach Refocus Financial Model serves to fortify the hope and lead to resolute efforts on part of all stakeholders who believe in fighting poverty through financial capital empowerment. Awareness and attitude change is a significant factor in utilizing both equity and debt financing opportunities and in making difficult investment decisions posed by divergent selection problems eminent in choosing companies that yield high returns. It is also necessary to make difficult capital structure choices for the firm.

Awareness and attitude change gives rural and urban Ugandans real inspiration and dedication to utilize their creative powers and natural skill to further economic transformation. Public opinion must favor and support economic change and must have the will power to execute the change. It is the awareness and attitude change that

instigates the entrepreneurship revolution and boosts participation of the majority in economic transformation.

Self-motivation as well as awareness and attitude change are important personal and institutional factors of economic transformation because they act as internal incentives to save and invest productively. Saving and investment remain the key ingredients of the loanable funds market and of long-term economic growth and improved living standards.

Corruption, greed, envy, pride, lust, selfishness and other deadly evils, which have grossly invaded the business world and retard equitable economic development, can only be reversed and/or prevented by attitude or behavior change. Moral consciousness is an important factor in addressing economic corruption and working hard toward the common good or promoting economic development without the exploitation of the weak.

7.4.2 Informational Efficacy

Without informational efficacy, Rural Ugandans cannot access the necessary reliable, accurate and immediate information, which is important for making the market prices or actual prices of financial assets equal to their intrinsic values. Lack of informational transparency and efficiency distorts the market. In order that the financial system effectively and efficiently carries out the critical roles of mobilization of savings and allocation of financial capital, payment and transfer facilitation of financial capital and balance, reduction and mitigation of non-market risks in the loanable funds market, information efficacy – private or public – is a requirement.

Strong and accurate public and private opinion about participation in loanable funds markets and trade in financial assets can only be correctly formed if individuals and

institutions (both rural and urban) have access to both the sources and the channels of information. For example, the modern media of social communication offers economic opportunities such as enhancing advertising, promotion and distribution of products and helps industry to develop. Complete, regular and precise information is required for potential savers and investors and lenders and borrowers to discover what goes on in the world market and how other participants behave.

Therefore, all efforts to remove impediments or barriers of informational efficacy such as illiteracy, limited communication infrastructure, lack of rural electrification and inaccessibility to mass media and news should be made. Balanced media reporting as opposed to biased or skewed news reporting should be encouraged. Further, there is a vigorous need to encourage the promotion, usage and management of information and communication technology (ICT) especially the rising trend of mobile phones, computer, internet, e-mail and e-commerce. Mobile phones have become the most important part of ICT infrastructure in developing countries.

Electronic commerce or e-commerce refers to the practice of transacting business electronically by means of the internet. The world is now sensing the revolutionary impact of the Information Revolution with weighty economic changes. These include changes of economies, markets, and industry configuration, of management and control, of distribution channels for goods and for services, of consumer value and behavior, and of customer service. Responding vibrantly to this emerging trend is critical and significant for the success of the 3-R Financial Model.

Although it is impossible to eliminate asymmetric information, since directors or managers of public firms and financial institutions are acquainted with the company's

future prospects and intrinsic value more than outside investors are, information efficacy endeavors to present symmetric information to loanable funds market participants.

7.4.3 Competition Candor

Competition, which involves large number of loanable funds market participants, is another critical factor and condition required for the success of the 3-R Financial Model. A competitive market is a market in which there are many buyers and sellers so that none of them has a significant impact on the market price.³⁹⁶ To mobilize and allocate financial capital efficiently and effectively in Rural Uganda, the system and model must be unimpeded. It must be competitive with no market power or monopolies.

Successful operations of a market-focused robust financial system require that in the fullest way possible, there be multiple financial assets and participation of many suppliers and buyers in a competitive environment. Making information available to a large number of competing potential savers and investors and lenders and borrowers makes it reasonably certain that one will receive a fair price equal to the intrinsic value.

7.4.4 Government Friendly Intervention

7.4.4.1 Why Government Intervention?

Although capitalists including Adam Smith since 1776 and other advocates of a market economy argue that “markets guided by the ‘invisible hand’ are usually a good

³⁹⁶ Mankiw, Gregory. Essentials of Economics. Third Edition. United Kingdom and United States: Thomson , South-Western, 2004:64

way to organize economic activity,”³⁹⁷ they also agree that “governments can sometimes improve market outcomes,”³⁹⁸ through protecting the invisible hand such as ensuring property rights, issuing licenses and safeguarding consumers. Government intervention is required for the 3-R Financial Model for two reasons: (i) promotion of efficiency or competence and (ii) advancement of equity or fairness.³⁹⁹

Contrary to criticisms that government intervention is bad to economic activities in a market economy, government aloofness to economy concerns can become disastrous. No country has managed to practice a laissez-faire economy, that is, to completely leave the free enterprise system to operate on its own, devoid of government intervention in the market economy. Unlike developed and high-income countries, developing countries including Uganda desire to support domestic producers but *nemo dat quod non habet*.⁴⁰⁰

In most economies, including the USA and EU, government intervention manifests itself in the form of economic and social regulation of the private sector.⁴⁰¹ Consumer protection and issuing trade licenses are two particular cases of government involvement. It also manifests itself in the form of government spending in some sectors. For example, the North American government intervenes in the agricultural and business sectors of the economy. In the agricultural sector, the US government intervenes to help its producers by three methods, which include (i) price policies such as tariffs, quotas, and taxes, etc.,

³⁹⁷ Ibid, 9-11.

³⁹⁸ Ibid, 9-10.

³⁹⁹ Ibid, 11.

⁴⁰⁰ *Nemo dat quod non habet* is a Latin adage and Metaphysical principle, which is translated as “Nobody gives what s/he does not have.”

⁴⁰¹ International Information Programs [USINFO.STATE.GOV], “ The Role of Government in the Economy.” Accessed February 21, 2005. Available: <http://usinfo.state.gov/products/pubs/oecon/chap6.htm>.

(ii) direct payments such as shortage payments, alteration payments, disaster payments, etc., and (iii) input policies such as below-cost rural electrification, fertilizer and irrigation subsidies and loan interest rebates or interest tax shield.

In the business sector, the US government intervenes by employing and executing strict safety and health regulations, tariffs on imports, and subsidies and government loans.⁴⁰² Social regulation such as safer workplaces or an uncontaminated environment restrain or proscribe harmful corporate behavior and promote socially desirable conduct.

Further, the economy is often times manipulated by politics and interests thereby inviting government intervention. The government intervenes in the economy to arbitrate for the common good against different political interests and orientations.

7.4.4.2 Nature of Government Intervention: Minimal, Indirect and Friendly Manner

In a society and country grossly marred by the vicious circle of poverty, the majority would advocate for government direct intervention to mobilize and allocate resources efficiently. However, the 3-R Financial Model does not approve of high, direct, “heavy handed”, and aggressive government intervention in the financial system and the economy. It advocates for minimal, indirect and friendly intervention of the financial system by the government.

7.4.4.3 Role of Government: Creating a Robust Loanable Funds Market Framework

Government role in the financial system of a market economy is summed up into:
“The state [government] is also crucial in a more indirect way. Markets do not

⁴⁰² Copyright@2003 OnlineEssays.com , “Government Intervention and Its Disadvantages.” Accessed February 21, 2005. Available: <http://www.onlineessays.com/essays/business/bus018.php>

*spontaneously come into being. They operate satisfactorily only within a particular political, economic and legal framework. If this framework does not obtain, it must be created, and this is the role of the state [government].*⁴⁰³

Creating a robust loanable funds market framework is the role of government. There are five actors or parties in the loanable funds market and include (i) the users or borrowers or the demand group of people, (ii) the financial institutions/lenders/venture capitalists that are the providers or supply group of people, (iii) the savers or investors who supply and/or demand for funds, (iv) the government as the regulatory and supervisory authority and (iv) the micro and macro-economic environment framework. Government's major interventionist role is to create a suitable loanable funds market framework for fairness and efficiency.

In a conducive and robust loanable funds markets framework, a market-oriented robust financial system exists because particular efficiencies exist. Particular efficiencies include: informational, operational, pricing, diversification, depth and maturity, and integration and connectedness.

7.4.4.4 Framework and Areas of Government Intervention in the Model

Three areas require government friendly intervention. They include (i) the macro-economic environment in the form of infrastructure and political stability or security, (ii) prudential regulation and supervision of the financial system, and (iii) timely and relevant monetary and fiscal policies. These areas enhance particular efficiencies and market efficiency.

⁴⁰³ Sandbrook, Richard, "Economic Crisis, Structural Adjustment and the State in Sub-Saharan Africa" in The IMF and The South: The Social Impact of Crisis and Adjustment. Dharam Ghai (editor) Geneva: Zed Books Ltd, 1991:96.

7.4.4.4.1 Macro-Economic Environment Framework [Infrastructure and Political Stability]

Efficiency of the financial system requires promotion of macroeconomic and political stability and sustainable development. Although a suitable macro-economic environment may only minimize credit or default risks for the micro-credit providers, it reduces transaction costs, which in turn, reduce the cost of loans.

Economic indicators of most micro-credit lenders include profitability (financial and operational sufficiency), portfolio quality efficiency (loan loss rate, prompt repayment rate and portfolio at risk) and loan cost portfolio.⁴⁰⁴ A typical financial product cost by a rural micro-credit institution comprises: cost of capital ranging from 18-24%, average inflation rate ranging from 5-10%, administrative cost ranging from 10-14%, loan loss or bad debt provision of between 2% and 5% and reserve build up ranging from 1 to 4%. These make interest rates high. A suitable macro-economic environment framework would reduce some of these costs thereby making loans cheaper.

Moreover, to be profitable and sustainable – operationally and financially self-sufficient – a market-oriented robust financial system with emphasis on a rural reach refocus financial model (3-R FM) requires: (i) on-going high trend of domestic private financial capital savings, (ii) passionate attraction of domestic and foreign direct investment, and (iii) enhancement of domestic and foreign portfolio investments –debt and equity capital flows. These require a suitable macro-economic environment that minimizes business, financial and credit risks.

The rule of law, democracy, popular participation, transparency and accountability and political and socio-economic stability are components of a suitable macro-economic

⁴⁰⁴ Social Finance Unit: Microfinance in Post-Conflict Countries: The case Study for Uganda. Accessed April 13, 2005 <http://www.ilo.org/public/english/employment/finance/papers/Uganda.htm> .

environment. For example, the most recent World Bank research notes that it takes an average of about 4 days to satisfy the regulatory requirements to start a business enterprise in North America, while in Africa it takes nearly 70 days, or 17 times longer.⁴⁰⁵ It takes 22 days to start a business in South Korea, 41 days in China and 89 days in India. Meanwhile, it takes over 3 months to start a business in Uganda.

Therefore, addressing the investment climate worries of entrepreneurs is important. Entrepreneurs' anxieties include bureaucracy, uncertainty of policies, macro-economic instability, tax regime, law, corruption, credit accessibility, erratic electricity, insufficient or horrible roads, poor job and value skills, crime and many more. The problem of cost and time to start and operate a business in Uganda can be addressed by a combination of government reduced bureaucracy, improved infrastructure, reduced interest rates and government policy certainty and ability to forecast expected returns and knowing more about the future prospects. This can be possible in a stable micro and macro-economic environment.

7.4.4.4.2 The Supervisory/Regulatory Framework [Organizational Management]

Legislation belongs to the Government's authority. The task of creating laws in the country belongs to the legislative arm of the government, the Parliament. The most important supervisory and regulatory framework is one that imposes discipline in the financial sector and creates image, reputation and confidence. For example, when banks fail, the economy is affected generally and not only the banks' clients or customers. It is essential that regulations safeguarding financial efficiency must be sound. Deposit

⁴⁰⁵ Government and Development in Africa: the Critical Nexus. Accessed February 24, 2004.

insurance, for example, should be stressed. Anti-corruption laws must be strong while accountability and institutional transparency should be highly monitored.

To promote efficiency and equity, prudential regulations and supervision should be upheld. Laws, regulations and instructions play an important role. Without discipline in the financial sector as well as in other economic sectors, efficiency, transparency and accountability fail to stand. The government should intervene in Uganda's financial system to establish effective regulation to replace the partially effectual regulations.

For the 3-R Financial Model to stimulate economic transformation and increase economic growth at capacity, government intervention is needed to create a supervisory and regulatory framework. For example, the following should be emphasized:

✓ *Legislating Good Corporate Governance:*

It is the task of the government to legislate laws on good governance, bankruptcy, reorganization and liquidation of firms that stumble upon financial troubles. Regulations on corporate control and good governance and regulation of private sector and industries is significant for the financial system.

For instance, a law on bankruptcy should be strong and fair to all stakeholders. Stakeholders including bankruptcy courts, bankruptcy law professors, credit-card firms and retailers or wholesalers who extend credit should be involved. Also consumer groups, civil rights groups, religious organizations and bar associations should participate in the decision making process. The law should check frivolous bankruptcies for the financial troubled families and households that increase the cost of credit and products for other consumers and avert pretense by the affluent who are inclined to file bankruptcies to evade paying off the debts.

✓ *Regulating enhancement of the linkage between the Informal and Formal Institutions:*

The microfinance designs of financial institutions such as CERUDEB bid encouraging projections to link the more developed units, households and firms of the formal sector with the urban or suburban savings and credit cooperative societies in the informal sector. Special rules and supervision are required to enhance this activity.

7.4.4.4.3 Policy Incentives Framework [Monetary and Fiscal Policies]

7.4.4.4.3.1 Government Spending Policy as Incentive for the 3-R Financial Model

In the national income accounts, saving must be equal to investment ($I=S$) because the financial system coordinates savers and investors.⁴⁰⁶ Government alters GDP by either increasing spending in recession or decreasing spending in expansion. Excess government spending leads to large budget deficit, that is, government revenue less than government expenses in a given year. The accumulation of past government annual deficits becomes national debt.⁴⁰⁷

Government budget deficit has impact on the supply and demand of loanable funds in the loanable funds market especially in Rural Uganda. Budget deficit reduces national saving (private and public) and decreases the supply of loanable funds thereby raising interest rates and lowering investment. Government finances its deficit by either borrowing from banks or financial securities markets through the sale of treasury bonds.

⁴⁰⁶ Mankiw, Gregory. Essentials of Economics. Third Edition. United Kingdom and United States: Thomson , South-Western, 2004: 394.

⁴⁰⁷ Professor Davies Anthony, "Fiscal Policy: Government Spending," in the course of Macro-Economics at Duquesne University, PA, School of Business Administration. Lecture Notes , Spring Semester, February 14, 2003

This results in crowding out, that is, the fall in investment because government lessens the borrowing opportunities and competencies for households and companies.⁴⁰⁸

To support the 3-R Financial Model for Rural Uganda, it is important and critical that government moderates its spending to lead to government surplus. When there is government surplus or at least moderation in government spending, the supply of loanable funds is higher or relatively high thereby lowering interest rates and enlivening investment.⁴⁰⁹ The net result of increased investment is capital formation and accumulation, which quickens the pace of economic transformation.

7.4.4.4.3.2 Taxation Policy as Incentive for the 3-R Financial Model

Government taxation policy has impact on prices and choices and judgments of households and companies because they pay revenue from their income. It has an effect on the market participants. Therefore, government taxation policy comprises ways of government interventionist role in increasing savings and investments and thereby enhancing economic transformation.

For example, to increase savings, that is, an increase in the supply of loanable funds, Ugandans can be induced by government taxation policy incentives favoring raised income and reduced consumption. Mankiw (2004) argues that “if a reform of the tax laws encouraged greater saving, the result would be lower interest rates that would stimulate greater investment.”⁴¹⁰

⁴⁰⁸ Mankiw, Gregory. Essentials of Economics. Third Edition. United Kingdom and United States: Thomson , South-Western, 2004:401.

⁴⁰⁹ Mankiw, Gregory. Essentials of Economics. Third Edition. United Kingdom and United States: Thomson , South-Western, 2004:401.

⁴¹⁰ *ibid*, 397.

Conversely, to increase investments, that is, an increase in the demand for loanable funds, local and foreign firms operating in Uganda can be induced by government taxation policy incentives favoring investing more. Mankiw (2004) argues that “if a reform of the tax laws encouraged greater investment, the result would be higher interest rates that would stimulate greater saving.”⁴¹¹

7.5 Other Recommendations

7.5.1 Property Rights through Land Reform

The issue of property rights is important in attracting foreign direct investment and developmental programs. Although Uganda has ample land that is not utilized, the existing land tenure system does not give opportunities for investments. For example, two commercial agriculture investors, Eco Friendly Farming and Executive Estates, wanted to establish a project worth UGSHS 11.79 billion in one of the districts in Eastern Uganda but communal land tenure prevented the sale of land to investors.⁴¹² Under this tenure system, sale of land must be decided by the community. This frustrates investors and reduces demand for loanable funds. Also, much of the land in western Uganda is fragmented and discourages investors who prefer consolidated land for expansionary purposes.

Article 26 of the constitution of the government of Uganda permits the central government or local government to acquire land in the public interest but conditions governing the acquisition must be approved by Parliament. Politics may enter in. Altruism for the common good should instead prevail.

⁴¹¹ *ibid*, 399.

⁴¹² Muwanga, David, “ Poor land tenure system frustrating investment,” in the New vision, Uganda [online] Accessed April 13, 2005.

Land system should be reformed to attract and encourage investors in Uganda. Investment is the source of demand for funds in the loanable funds market and therefore has impact on the 3-R Financial Model. Land reforms and property rights laws should guarantee to residents and non-residents and trading and non-trading the right to own property and have them protected.

7.5.2 Prioritize Rural Electrification and Telecommunication

To be informed and formed about market efficiency, rural lenders, borrowers and investors need to access information. Much information eludes rural residents because of failure to access information and communication technology and media. These are lacking in Rural Uganda chiefly because of inadequate rural electrification. To have a transparent market, information should be available to all participants. Village investors, lenders or borrowers fail to access information because they lack electricity and access telecommunication. Companies should be encouraged to competitively bid to extend such utilities and then receive government incentives including tax benefits from debt financing (interest tax shield) for such projects. Government should support mobile phone companies to expand in Rural Uganda with cheaper facilities and services for internet connection without first depending on land lines or fixed phones.

7.5.3 Discourage Welfare Loans to the Micro-Enterprise Sector

Because we need to diminish the grant or dependency syndrome among Rural Ugandans and to maintain institutional sustainability, only the organized non-economically active poor should receive government credits at the lowest interest rates and as a kick-starting strategy. This government credit should be channeled through the

privately run-financial institutions. By the example of the failed *Entandikwa Government Credit Schemes*, history has proven that giving welfare credit encourages loan abuse and default.

7.5.4 Build Strong Social Services and Social Security Systems

Illiteracy and diseases hinder productivity and affect incomes, savings and investment, which have impact on the financial system and the 3-R Financial Model in particular. Education and health play a part in productivity and impact the loanable funds market. The education and health systems should be qualitatively strengthened. For example, government should minimize urban-residence and wealth-status discrimination in admission to top schools that favor urban residents and wealthy minority by improving rural schools.

It is crucial to bridge the wealth gap through focus on factors that promote social inequality. It is unjust and burdensome to promote an economic surge that skips the poor in Rural Uganda. This can be done by encouraging and supporting rural-based enterprises to minimize rural-urban migration and by promoting efficient education and training institutions in Rural Uganda. Similarly, the government ought to promote efficient health care systems.

7.5.5 National Young and Minors' Savings Account to be promoted

Just as to improve the literacy and education levels in Uganda, the government of Uganda introduced Universal Primary Education for all in 1997, an introduction of the National Young and Minors Savings Account (NYAMSA) to instill the spirit and culture of saving in the country is recommended. Children should be supported and encouraged

to open savings accounts aimed at instilling the sense of the saving culture and responsibility. Withdrawals without genuine and approved reasons should be restricted.

7.5.6 Negotiation for Market Accessibility, Fair Trading Rules and Foreign Aid

✓ *Develop and Support Market Capacity Building for Products of Micro-and Macro-Enterprise Sector:*

By May 2005, Uganda's micro and macro-entrepreneurs struggled to access six main coordinated markets: (i) the Local Market, (ii) the National Market, (iii) the East African Community Market, (iv) the COMESA Market, (v) the Cotonou ACP/EU Partnership Agreement Market, and (vi) the AGOA Agreement Market. Government should keep negotiating for more markets to enhance high consumption, high production, more trade, new investments, increased income, and more savings, which in turn, boost the financial width and depth of the financial system.

✓ *Fair Trading Rules and Practices:*

The Uganda government should cooperate with other countries to negotiate for the lessening of political and economic barriers including subsidies that the USA, EU and Japan provide, especially to the domestic agricultural producers thereby thinning chances of Uganda's competitiveness in the international market.

✓ *Foreign Grants and Loans to Development Projects:*

To implement this program, further support is required because poverty still prevails. Without support from high-income countries, it would be tough to handle Uganda's present poverty levels, especially to initiate development projects. Europe is also what it

is today because of *The Marshall Plan*⁴¹³ also called the European Recovery Program (ERP). It is the ERP that backed economic restructuring, integration and growth that characterized Europe's economic activity after World War II. Foreign aid in the form of debt cancellation, debt relief, grants, loans and technical assistance to Uganda's developmental projects is still required for sustainable development. For example, more funds in the form of cash rather debt relief is still required.

7.5.7 Implement a National Strategy to Secure Cyberspace and Promote Tips for E-Commerce and Online Banking Users

There is a need for a national strategy to secure Cyberspace. For example, there is need to establish a National Information and Communication Technology Cyber Crime Authority (NICTCCA) to protect genuine users of information technology from Web hackers. They should keep citizens protected from cyber misbehaviors including “*phishing*”, “*pharming*”, “*wi-phishing*”, etc. This should be done by focusing on software assurance, training and education and research and development.

Law enforcement on cyber crime should be very strong. Laws should be developed for the industry to protect consumer interests. Penalty for credit card fraudsters who invade different industries utilizing the e-commerce advantage should be heavy. A department in the Ministry of Finance, Planning and Economic development should link with the Ministry of Internal Affairs to charter, regulate and supervise commercial banks and other financial institutions.

⁴¹³ Viault, Birdsall, S. *Modern European History: The History of Europe since the Late Middle Ages*. New York, Milan , Madrid, Paris and Tokyo: An American BookWorks Corporation Project; McGraw, Inc., 1990: 503-4 recounts that “ the prospect of a total economic collapse of war-ravaged Europe increases fears that the Soviet Union might extend its power over the entire continent led George C. Marshall, the American Secretary of State, to propose a broad program of American Assistance to help all of Europe recover economically...between 1948 and 1952; the plan provided US \$ 13 billion in American Assistance for the Economic Revival of Western Europe.”

Guidelines or tips for online banking should be disseminated to on-line bankers. These include being (i) aware of unsolicited e-mails and letters, pop-up messages or advertisement, (ii) knowledgeable about bank procedures for requesting official information (iii) suspicious of any quest for private financial information, and (iv) conversant with standard online banking security including encryption, password authorization, personal verification questions, and enhanced security options.

To be safe, online bankers should be trained to keep software and browsers update and passwords in a secure location outside the computer, shred all private and security sensitive information before removal and use enhanced security options on public computers.

7.5.8 Education and Training in the Essentials of Financial Management

Another significant recommendation to support Uganda's financial system is to build capacity of financial institutions through education and training for job and value skills and essentials of financial management. Teamwork is required for capacity building. Banks, microfinance institutions, savings and credit cooperative societies, financial services associations, insurance providers and brokers and dealers in the stock exchange and mutual funds should make training of the customers and community a priority.

Proper farm or firm management and fund or finance management, which is absent in rural entrepreneurship, is significant. Therefore, training for current and potential entrepreneurs in management skills for their farms, small businesses and their investments in securities should be promoted. There is need for investment in human

resources and entrepreneurial skills including keeping the books of accounts professionally.

7.6 The Finale

We now conclude the thesis remarking that there are many lessons learned about the nature and role of a robust financial system in the economic transformation of Uganda. A market-oriented robust financial system utilizing a Rural Reach Refocus Financial Model holds a key to economic transformation and we are invited to pursue it to improve the quality of life especially for Rural Uganda.

Having examined the conceptual understanding of the nature and role of a financial system, the situation analysis of Uganda's economy, the investment and financial system milieu, the theory and practice of transforming an economy with an emerging robust financial system, and the strengths, weaknesses, threats and opportunities of Uganda's financial system and suggested the adaptation of the Rural Reach Refocus Financial Model, we now have abundant evidence to conclude that a robust financial system holds the key to quick and sustainable economic growth.

The work of economic and financial renewal carried out step by step during the past 18 years has not only shown the centrality of the market-oriented robust financial system in economic transformation but also prepared the way for the passage from low income and high poverty levels to improved economic growth. Now it can be said that a new and promising future lies ahead for increased productivity, economic growth and improved standards of living.

However, in order that we achieve fast and high results, a market-oriented robust financial system must be constructed with emphasis on a Rural Reach Refocus Financial Model (3-R Financial Model).

Moreover, in order that the Rural Reach Refocus Financial Model becomes a successful story, the *AICG* factors, which are: (i) awareness and attitude change, (ii) informational efficacy, (iii) competition candor, and (iv) government friendly intervention must characterize the economic and financial environment.

Ultimately, citizens and residents of Uganda's transformed economy should be self reliant and sustain their living with (i) decent home, food and clothing, (ii) assured economic and financial security of present and next family generations through quality education, health and medical care, health and life insurance and retirement protection, and (iii) a well diversified portfolio of investments in bonds, stocks, derivatives, and real estate. Employment rate should be high. There should be a stable and sound tax base for government to further its sovereign development programs and enhance high living standards at low living costs. We are invited to support and promote the project of constructing a market-oriented robust financial system with emphasis on the Rural Reach Refocus Financial Model.

APPENDICES

8 TABLES

8.1 Table One: INFORMATION AND PROFILE OF UGANDA-2005

Categorization Variable	Descriptive Variable	Figures / Statistical Information in %
Population (Total)	-Uganda's Total Population	26.8million people
Annual Growth Rate	-Annual Population Growth Rate	3.3%
Regional Distribution	- Buganda Region	27% (7.1 million people)
	- Western Region	26% (6.8 million people)
	- Eastern Region	25% (6.8 million people)
	- Northern Region	22% (6.1 million people)
Ethnic Groupings	-Total Number of Tribes	48 Tribes
Tribal Distribution	- Biggest 8 Tribes	70% of Population
	- Rest 40 Tribes	30% of Population
Most Populous Tribes	- Baganda	17.3%
	-Banyankole	9.8%
	-Basoga	8.6%
	-Bakiga	7.0%
	-Others/Rest (44 tribes)	57.3%
Most Populous Districts	- Kampala	1.2 million people
	-Mbarara	1.1 million people
Formal Education	-Literacy Rate	68%
Sex Literacy Disparities	- Males literacy Rate	76%
	- Females Literacy Rate	61%
Households/Population	-Use of Firewood	97%
	-Do not use Electricity	92%
	-Use Kerosene /Paraffin candles "tadooba" for domestic lighting	75%
	-Have a TV set	4.5%
	-Have a Radio	48%
	-Depend on Oral Information	49%
	-No Access to Toilet Facilities	17%
	-Access to save water supply	61%
Residency /Housing	-Housing Structures: Residing in shoved earth (mud) floors and	77.4%

	walls (but many have iron roofs)	
Household Size	-Average Household Size	4.7 persons
Urban Settlement	-Live in Urban Areas	12.3%
Rural Settlement	-Live in Rural Areas	87.7%
Gender Distribution	-Gender Ratio	95 males per 100 females
Backbone Occupation	-Agriculture Industry Employment	77%
	- Sales and the Services Industry	8%
	- Manufacturing Industry/Sector	2%
Agriculture Distribution	- Subsistence agriculture	68%
Disability Status	-Disabled persons	1 in every 25 persons
Children Population	Those < 18 years	56%
Religious Grouping	- Catholics	42%
	- Anglicans	36%
	- Moslems	12%
	- Pentecostals	5%
Orphan-hood	-Partial and/or Total Orphans	1.8 million orphans (War/AIDS)
Poverty Status	-Below the poverty line (2002)	38% (9.2 million people)

Source: Official Results of the 2002 Uganda Population and Housing Census Report Published and Released on March 22, 2005 in the New Vision, Uganda [on line] and Monitor Uganda [on-line] of March 23, 2005.

8.2 Table Two: IDENTIFICATION OF COMPONENTS OF UGANDA'S FINANCIAL SYSTEM (AS OF APRIL 2005)

A. Central bank	Bank of Uganda
<p>a) Development Finance Department: Manages five credit programs, which promote development in agricultural, manufacturing, services and sectors.</p>	<ol style="list-style-type: none"> 1. European Investment Bank (EIB)-APEX Private Sector Loan. 2. The Development Finance Fund. 3. The Bank of Uganda Export Finance Fund (EFF) 4. The Export Promotion Fund (EPF) 5. The Cotton Sub-Sector Development Project (CSDP)
<p>b) Development Finance Department: Manages and coordinates six credit related programs that aim at improving credit delivery systems and access by the rural population to viable and sustainable financial services</p>	<ol style="list-style-type: none"> 1. The African Rural and Agricultural Credit Association (AFRACA) 2. The Cotton Sub-Sector Development Project (CSDP) Capacity Building Program (CBP) 3. The Gender and Economic Reform in Africa (GERA) 4. The Uganda Capacity Building Activities for Women Financial Intermediary Organizations under the International Fund for Agricultural Development (IFAD) 5. The Rural Financial Services Component (RFSC) under the DANIDA Funded Agricultural Sector Program Support (ASPS) 6. Export Credit Guarantee Fund (ECGE) Funded by USAID/Bank of Uganda
B. Commercial Banks	<ol style="list-style-type: none"> 1. Allied Bank International (U) Ltd. (Since1991; 3 branches) 2. Bank of Baroda (U) Ltd. (Since 1969; 6 branches) 3. Barclays Bank (U) Ltd. (Since 1927; 2 branches) 4. Cairo International Bank Ltd. (Since 1995; 1 branch) 5. Centenary Rural Development Bank Ltd (Since 1992; 21 branches) 6. Citibank (U) Ltd. (Since 1999; 1 branch) 7. Crane Bank (U) Ltd. (Since 1995; 3 branches) 8. DFCU Bank Ltd (Since 1985; 3 branches) 9. Diamond Trust Bank (U) Ltd. (Since 1995; 1 branch) 10. National Bank of Commerce (U) Ltd. (Since 1992; 6 branches) 11. Nile Bank Ltd. (Since 1988; 3 branches) 12. Orient Bank Ltd. (Since 1993; 2 branches) 13. UCB/Stanbic Bank (U) Ltd (Since 1906; 68 Branches) 14. Standard Chartered Bank (U) Ltd (Since 1912; 6 branches) 15. African Tropical Bank Ltd. (Since 1973; 3 branches)
C. Post Office Savings Bank	1. Uganda Post office Savings (91 branches)

D. Development Finance	<ol style="list-style-type: none"> 1. Uganda Development Bank (UDB) (Since 1972; 1 branch) 2. East African Development Bank (EADB) (Since 1967; 1 branch) 3. DFCU Ltd (Since 1964; 1 branch)
E. Savings & Credit Institutions	<ol style="list-style-type: none"> 1. Uganda Cooperative Savings & Credit Union Ltd (UCSCU) (Umbrella of several Institutions*) 2. Uganda Cooperative Alliance (Village Banks) Ltd (Umbrella of 25 Institutions*) 3. Uganda Women's Finance & Credit Trust Ltd (UWFT is now known as U-Trust; 21 branches in 20 districts out of 56)
F. Merchant Banks, Leasing & Hire Purchase, Investment & Development and Credit Financing	<ol style="list-style-type: none"> 1. Capital Housing Company (U) Ltd 2. Commercial Finance (Plot 19) 3. Housing Finance Company (U) Ltd 4. Imperial Investment Finance Ltd 5. Interstate Finance Company Ltd 6. Mercantile Credit Bank Finance Ltd 7. Micro-Finance Ltd 8. Stanbic Bank International Finance(U) Ltd 9. Stanhope Finance Company Ltd.
G. Pension and Provident Fund	<ol style="list-style-type: none"> 1. National Social Security Fund (NSSF)
H. Insurance Companies	<ol style="list-style-type: none"> 1. AIG Uganda Ltd 2. East African Underwriters Ltd 3. Excel Insurance Company Ltd. 4. Gold Star Insurance Company Ltd. 5. Imperial Insurance Company Ltd. 6. Pan African Insurance Company Ltd 7. Paramount Insurance Company Ltd. 8. Statewide Insurance Company Ltd. 9. East African General Insurance Company Ltd. 10. TransAfrica Assurance Company Ltd. 11. United Assurance Company Ltd 12. Jubilee Insurance Corporation 13. National Insurance Corporation (NIC) 14. Insurance Company of East Africa (U) Ltd 15. Rio Insurance Company Ltd 16. First Insurance Company Ltd. 17. Pan World Insurance Company Ltd.
I. Foreign Exchange Bureaus*	<ol style="list-style-type: none"> 1. Afex Forex Bureau Ltd 2. Africa Currency Exchange 3. Allied Bank International Forex Bureau Ltd 4. Already Forex Bureau Ltd 5. Arrow Forex Bureau Ltd. 6. Biashara Forex Bureau Ltd.

	7. B.M. Forex Bureau Ltd.
	8. BICCO Forex Bureau Ltd.
	9. CFC Forex Bureau Ltd
	10. CFC Forex Bureau (Branch) Ltd.
	11. City Forex Bureau Ltd
	12. Crane Forex Bureau Ltd
	13. Crane Forex Burea (Branch) Ltd
	14. Crown Forex Bureau Ltd
	15. Dallas Forex Bureau Ltd
	16. Demo Forex Bureau Ltd
	17. Diamond Trust Forex Bureau
	18. Dollar House Forex Bureau Ltd.
	19. Dominion Bureau Dechange Forex Ltd
	20. Downtown Forex Bureau
	21. Downtown (Tororo) Forex Bureau Ltd
	22. Dots Forex Bureau Ltd
	23. El-Thiga Forex Bureau
	24. Executive Bureau Change Ltd
	25. Executive (Paraa) Bureau De Change Ltd.
	26. Express Forex Bureau (Branch) Ltd
	27. Forex Bureau 2000 Ltd
	28. Give & Take Forex Bureau
	29. Gold Finger Forex Bureau Ltd
	30. Gold Trust Forex Bureau
	31. Grand Forex Bureau
	32. Highland Hotel Forex Bureau
	33. Hotel Africana Forex Bureau Ltd
	34. HJS Forex Bureau Ltd.
	35. Hydrey Forex Bureau
	36. Imperial Forex Bureau Ltd
	37. Jaffrey Forex Bureau Ltd
	38. Jet-set Forex Bureau
	39. Jimalous Forex Bureau Ltd
	40. Jimalou Forex Bureau (Branch) Ltd
	41. Karibu Forex Bureau Ltd
	42. Kristal Forex Bureau Ltd
	43. La-Cedri Bureau De Change
	44. Lanex Forex Bureau Ltd
	45. Lloyds Forex Bureau
	46. Lloyds Forex Bureau (Branch) Ltd
	47. Metropolitan Forex Bureau Ltd
	48. Midland Forex Bureau
	49. Midwest Forex Bureau Ltd
	50. Mint Forex Bureau Ltd
	51. Money Point Forex Bureau Ltd
	52. Mt. Elgon Forex Bureau Ltd. Kampala
	53. Midsoc Forex Bureau Ltd
	54. Mukwano Forex Bureau Ltd
	55. Norfax Forex Bureau Ltd
	56. PM Forex Bureau Ltd
	57. Prime Forex Bureau Ltd

	58. Oxy Forex Bureau 59. Rafiki Forex Bureau Ltd 60. Red Fox Bureau De Change Ltd 61. Rolltex International Forex Bureau Ltd 62. Royal Cash Point Forex Bureau Ltd 63. S & A Forex Bureau Ltd 64. Salabed Forex Bureau Ltd 65. Shalom Forex Bureau Ltd 66. Shumuk Forex Bureau 67. Simba Forex Bureau Ltd 68. Sky Forex Bureau Ltd 69. Snow View Forex Bureau Ltd 70. Speed Bird Forex Bureau Ltd 71. Ssemanda Forex Bureau Ltd 72. Speke Hotel Forex Bureau 73. Stanhope Forex Bureau 74. Trend Forex Bureau Ltd 75. Unique Forex Bureau Ltd 76. Victoria Forex Bureau Ltd. 77. Walk IN Forex Bureau Ltd 78. Wall Street Forex Bureau Ltd 79. WestLink Forex Bureau
J. Micro-Finance Institutions	1. ACFODE (1995) – Bukoto , Kampala, Uganda 2. ACORD (1986)- Ggaba Road, Kampala, (U) 3. Action in Disability (1996)-Bombo, Kampala (U) 4. Adjumani Youth Association (1997)-Uganda 5. ADRA (1997)- Uganda 6. Agali Awamu Kasaala Savings & Credit Society Ltd 7. Alliance Building Society (1989) –Kampala, (U) 8. All Nations Christian Care (1997) –Lira (U) 9. Bale Community Based Organization (1998) (U) 10. Bakebezi Balina Ettu Growers Cooperative Society (1998)- Kajjansi, Kampala (U) 11. Bamunanika Cooperative Savings & Credit Society Ltd.(1998) – Bamunanika, (U) 12. Bigaijuka Cooperative Society Ltd (1997) –Hoima 13. Buddo Growers Cooperative Society Ltd. (1998)- Kitemu, Uganda. 14. Bufumbira Island Development Association (1997) – Kalangala,Uganda 15. Bukedea Women’s Strugglers (1995) 16. Bunyangahu Rural Training Organization (BURUTO) 17. Buruto (1995) Kibitto, Fort Portal (U) 18. Busiki Multi-purpose Rural Development Association 19. Busiro South Development Association (1997) – Mpigi 20. Buso Foundation (1987) –Kampala (U) 21. Busoga Development Agency (RUDA) (1998) Jinja 22. Buwekula Women Development Association (1998)-

	<p>Mubende (U)</p> <p>23. Catholic Relief Services (CRS) (1994) – Rubaga, Kampala</p> <p>24. Centenary Rural Development Bank (1983) – Kampala</p> <p>25. Christian Charity Centre (1992) –Lira (U)</p> <p>26. Cooperative Bank Micro-enterprise Program (1997) – Kampala (U)</p> <p>27. Demobilized Women Civil Servants Association (1996) –Kampala (U)</p> <p>28. Ecumenical Church Loan Fund (1998) –Kampala (U)</p> <p>29. FAULU (1995) – Namirembe, Kampala (U)</p> <p>30. Feed the Children Uganda (1994) –Kampala/Hoima</p> <p>31. FINCA-Uganda (1992) –Kamwokya, Kampala (U)</p> <p>32. Foundation for Credit and Community Assistance (FOCCAS) (1996) – Mbale (U)</p> <p>33. Goli Church of Uganda (CRS) (1997)- Nebbi, Uganda</p> <p>34. Hoima Catholic Diocese Social Services & Development Department (1997)-Hoima, Uganda</p> <p>35. Hoima-Kibaale District Integrated Community Development Project (1996) – Hoima (U)</p> <p>36. Hoima Rural Development Organization (1997)- Hoima (U)</p> <p>37. Ibanda Small Scale Industries Association (1996) – Ibanda (U)</p> <p>38. INCOFIN (U) Ltd (1999) –Hoima (U)</p> <p>39. Kabale Networking Organization (KABNETO) (1995)-Kabale (U)</p> <p>40. Kabwangasi Cooperative Society Ltd. (1998) –Mbale (U)</p> <p>41. Kameke Growers Cooperative Society Ltd.(1987)- Pallisa (U)</p> <p>42. Kampala Archdiocese Social and Economic Development (1996) –Kampala (U)</p> <p>43. Kasodo Growers Cooperative Society Ltd (1996)- Pallisa (U)</p> <p>44. Kassanda County Development Association (1996)- Mubende (U)</p> <p>45. Kidea Enterprises Ltd. (1998) –Hoima (U)</p> <p>46. Kigezi Diocese Rugarama (1997) –Kabale (U)</p> <p>47. Kiwafu Cooperative Savings & Credit Society Ltd (1998) –Entebbe (U)</p> <p>48. Kole Development Agency (1996) –Apac (U)</p> <p>49. Kolping Mityana Women’s Project (1998) –Mityana (U)</p> <p>50. Kyotomanya Savings & Credit Cooperative Society Ltd.(1997) –Masindi (U)</p> <p>51. Kutesa Development Taskforce (1998) –Njeru Town, Jinja (U)</p> <p>52. Lira District Development Agency (LIDDA) (1992)-</p>
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	<p>Lira (U)</p> <p>53. Lubaga Development Agency (1998) –Uganda</p> <p>54. Micro-Credit Development Trust (1997) –Kamwokya, Kampala (U)</p> <p>55. Micro-Projects Program (EDF) (1998) –Uganda</p> <p>56. Mityana Mwera Livestock Cooperative Society Ltd. (1996) –Mubende (U)</p> <p>57. Morukokume Abeberanut Growers Cooperative Society Ltd. (1997) –Uganda</p> <p>58. Mpigi Women Development Trust (1997) –Mpigi (U)</p> <p>59. Muhabura Diocese (1997) –Kisoro (U)</p> <p>60. Naddangira Agaliawamu Cooperative Society Ltd (1997) –Naddangira (U)</p> <p>61. Naggalama Growers Cooperative Society Ltd. (1996)- Naggalama (U)</p> <p>62. Namirali Growers Cooperative Society Ltd.(1997) – Nakaseke (U)</p> <p>63. NAWOU (1997) –Kampala (U)</p> <p>64. Nebbi Community (1997) –Nebbi (U)</p> <p>65. Opwateta Growers Cooperative Society Ltd.(1997) – Pallisa (U)</p> <p>66. Orphans Community Based Organization (OCBO) (1995) -Kyotera , Uganda</p> <p>67. Orungo Development Association (1997) –Soroti, Uganda</p> <p>68. Poverty Alleviation Credit Trust (PACT) (1996) – Masindi, Uganda</p> <p>69. Poverty Alleviation and Community Development Organization (1998) –Soroti / Mbale (U)</p> <p>70. Poverty Alleviation Project (PAP) –Kamwokya , Kampala, Uganda</p> <p>71. PRIDE AFRICA (1995) –Kampala & Mbarara (U)</p> <p>72. Ringa Finance and Commercial Development Ltd.(1996) –Kampala (U)</p> <p>73. Rub Systems Uganda/International Needs Uganda (1997) –Kansanga, Kampala (U)</p> <p>74. Rukungiri Gender and Development Association (1994) –Rukungiri, Uganda</p> <p>75. Rural Micro-Enterprise Credit Scheme (RUMECS) (1995) –Iganga, Uganda</p> <p>76. Save Mothers and Children Association (1997) – Hoima (U)</p> <p>77. SETCA Women Development Link (1995) –Jinja (U)</p> <p>78. Soroti Catholic Diocese Integrated Development Organization (SOCADIDO) (1989) –Soroti (U)</p> <p>79. Soroti Church of Uganda (1995) –Soroti (Uganda)</p> <p>80. St. Mulumba Friendly Society Ltd. (1984) –Jinja, Uganda.</p> <p>81. Support Organization for Micro-Enterprise Development (SOMED) (1999) –Masindi, Uganda.</p> <p>82. Talent Calls Club (1996) –Seeta, Mukono (U)</p>
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	<p>83. Teso Islamic Development Association (1997) –Soroti (U)</p> <p>84. Tororo Manufacturing Association Credit Scheme (TOMA) (1996) –Tororo (U)</p> <p>85. UGAFODE (1995) –Kampala , Uganda</p> <p>86. Uganda Association for Social-Economic Progress (1992) –Nkokonjeru Ngogwe Mukono (U)</p> <p>87. Uganda Cooperative Savings and Credit Association (UCSCU) (1971) –Kawempe, Kampala (U)</p> <p>88. Uganda Cooperative Alliance –Kyotamanya Village Bank Only – Uganda</p> <p>89. Uganda Demobilized Women Civil Servants Association (1997) –Uganda</p> <p>90. Uganda Foster Parents (1996) –Mukono, Uganda</p> <p>91. Uganda Kolping Society (1996) –Mubende, Uganda</p> <p>92. Uganda Micro-Finance Union (1997) –Busiika Gayaza, Kampala, Uganda</p> <p>93. Uganda Small Scale Industries Association Luwero Branch (1997) –Luwero, Uganda</p> <p>94. Uganda War Widows Foundation (1996) –Luwero (U)</p> <p>95. Uganda Women’s Finance Trust (UWFT) (1987) – Kampala</p> <p>96. Uganda Women Foundation Fund (1998) -Uganda</p> <p>97. URDT (1994) – Ambassador House, Kampala (U)</p> <p>98. USSIA –Luwero District (1998) –Wobulenzi, Uganda</p> <p>99. UWESO (1995) –Kampala (U)</p> <p>100. VEDCO (1992) –Mengo , Kampala (U)</p> <p>101. Victoria Building Society (1987) –Kyotera, Uganda</p> <p>102. Voluntary Action For Development (1998) – Kampala (U)</p> <p>103. Volunteer Efforts for Development Concerns (1997)-Luwero/Kampala</p> <p>104. World Vision Uganda-Med Net (1996) – Kampala (U)</p> <p>105. ZOKUDA (1995) –Kaliro, Uganda</p>
<p>K. Real Estate Mortgage Financial Services</p>	<p>1. National Housing and Construction Corporation</p> <p>2. Eastlands Agency</p> <p>3. Knight Fank Uganda</p> <p>4. Property Services (Real Estate Development & Property Management)</p> <p>5. Property Point (Letting Agency)</p> <p>6. Akright Projects Limited (Private Real Estate Developer)</p> <p>7. MOWIN Property Services (Residential Lettings & Sale)</p> <p>8. Namalusu Island (Luxury/leisure & watersport activities and financial services)</p> <p>9. Premier Property Services Ltd (Letting, Renewal of Leases and Rent Reviews)</p>

<p>L. Savings and Credit Cooperative Organizations [SACCOs] (Uganda Cooperative Alliance Ltd)</p>	<ol style="list-style-type: none"> 1. Alut kot Cooperative Financial Services -Apac 2. Aweikoko G.C.S Ltd Financial Services -Lira 3. Bubwaya Cooperative Savings and Credit Society-Mbale 4. Budadiri Cooperative Society Ltd-Mbale 5. Budondo Savings & Credit Ltd – Jinja 6. Bugongi Savings & Credit Ltd.-Bushenyi 7. Bukalisha Savings & Credit Ltd -Mbale 8. Bukinda Cooperative Financial Services-Kabale 9. Bululu Multipurpose Cooperative -Kaberamaido 10. Bulima Cooperative Financial Services-Masindi 11. Bunanimi G. C.S Ltd -Sironko 12. Bwetyaba G.C.S Ltd – Kayunga 13. Ddundu Youth Savings & Credit Ltd –Mubende 14. Ebirungi Biruga Savings & Credit Society-Mbarara 15. Elgon Village Savings & Credit Society -Sironko 16. FAMCO Savings & Credit Society -Lira 17. Gwaragwara Cooperative Financial Services 18. Kaaro G.C.S Ltd -Mbarara 19. Kabale Municipality Empllyees S & C. Society-Kabale 20. Kajara Peoples Cooperative Society -Ntungamo 21. Kalibaimukya Cooperative Financial Services-Kibale 22. Kidea Cooperative Financial Services 23. Kitana Cooperative Financial Services 24. Kitura Savings and Credit Society 25. Kibinge Kweterekera S & C Society Ltd -Masaka 26. Kayunga Cooperative Financial Services-Kayunga 27. Kacerere Cooperative Financial Services –Kabale 28. Kamuli Twisania S & C Cooperative Society-Kamuli 29. Kampala Shoe Shidders S & C Society –Kampala 30. Kateshani Savings & Credit Ltd -Mbarara 31. Kihanga Multipurpose Cooperative Society –Kabale 32. Kitagata Savings & Credit Society -Bushenyi 33. Kyabandara G.C.S Ltd –Bushenyi 34. Bugongi Savings & Credit Society Ltd.-Bushenyi 35. Kyagaju Twitukye Savings & Credit Ltd -Bushenyi 36. Kyotamanya Cooperative Financial Services -Masindi 37. Ibanda Buholho Cooperative Financial Services-Kasese 38. Lambala Environment & Technology Women Saving & Credit Ltd. 39. Lango Union Employees S & C Cooperative Society - Lira 40. Lyamujungu Cooperative Financial Services-Kabale 41. Lwengo Savings & Credit Ltd -Masaka 42. Masha Abarihamwe Savings & Credit Society-Mbarara 43. Mbale Women S & Credit Ltd -Mbale 44. Mitooma Savings & Credit Society -Bushenyi 45. Mubende Teachers Savings & Credit Society-
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	<p>Mubende</p> <ol style="list-style-type: none"> 46. Muhame Savings & Credit Ltd -Bushenyi 47. Mukono Savings and Credit Cooperative Society- Mukono 48. Mukono Teachers Savings & Credit Society -Mukono 49. Mukono Vanilla Savings & Credit Coop Society- Mukono 50. Muntuyera High School Savings & Credit Society- Ntungamo 51. Nakabago Cooperative Financial Services 52. Nyarwanya Cooperative Financial Services-Rukungiri 53. Rwemigali Cooperative Financial Services - 54. Rukooma Farmers Cooperative Financial Services 55. SAO Kisoga Savings and Credit Ltd -Mukono 56. SAO Ngogwe Savings & Credit Ltd - Mukono 57. SAO Wakiso Savings & Credit Ltd-Wakiso 58. SAO Zirowe Savings & Credit Society Ltd –Luwero 59. Shuuku Savings & Credit -Bushenyi 60. Soroti Hospital Employees Savings & Credit Ltd- Soroti 61. Syanyonja Cooperative Society -Busia 62. Twekorere Savings & Credit Society -Kabale 63. UCA Staff Cooperative Savings & Credit Society Ltd -Kampala 64. Zokunda Micro-Finance Cooperative Society
<p>M. Financial Services Associations (FSA) ; In Uganda: FSAIU = FSA International Uganda Ltd.</p>	<ol style="list-style-type: none"> 1. Bugongi 2. Bukimbiri 3. Bukoto - Kampala (U) 4. Bukunda 5. Butenga 6. Buwunga 7. Bwaise - Kampala (U) 8. Katuna - Kabale (U) 9. Katovu - Masaka (U) 10. Kawempe 1 - Kampala (U) 11. Kawempe II - Kampala (U) 12. Kazo Angola - Ibanda –Mbarara (U) 13. Kkingo-Kaganda 14. Kibinge 15. Kihhi - Rukungiri (U) 16. Kisiizi - Rukungiri (U) 17. Kisoro - Kisoro (U) 18. Kisekka Kiwangala - 19. Kyazanga - Rakai (U) 20. Kyotera - Rakai (U) 21. Kyebando - Kampala (U) 22. Lukaya - Masaka (U) 23. Masaka Municipality - Masaka 24. Matete

	25. Micerere 26. Mbirizi - Masaka (U) 27. Muhanga - Kabale (U) 28. Mulago - Kampala (U) 29. Ntungamo - Ntungamo (U) 30. Rukungiri - Rukungiri (U) 31. Ssembabule - Ssembabule (U)
N. Securities Exchange	1. Uganda Securities Exchange/Stock Market
O. Mutual Funds/Unit Trust Funds (Money Market Funds)	1.African Alliance Ltd.(Money Market Funds/ Collective Investment Scheme)

Source: (i)Uganda Cooperative Alliance http://ucalimited.com/rural_finance.htm (SACCOs-2004), (ii) FSA International Uganda Ltd [31 FSAs Combined Financial Statements Year Ended 30 June 2003], (iii) USE Website <http://www.use.or.ug/content.asp?contentid=29&category=listed> March 2005, (iv) BOU Website and (v) UCA SACCO Societies Website http://ucalimited.com/rural_finance.htm

8.3 Table Three: INDUSTRIES AND SECTORS IN UGANDA (AS OF APRIL 2005)

A. AGRICULTURE, HUNTING, FORESTRY AND FISHING
<p>(1) Agriculture</p> <ul style="list-style-type: none"> ○ Floriculture ○ Fruits and Vegetables ○ Dairy and Dairy Products ○ Livestock ○ Other Agriculture
(2) Hunting
(3) Forestry
(4) Fish and Fish Farming
B. MINING AND QUARRYING
(1) Mining
(2) Quarrying
C. MANUFACTURING
<p>(1) Agro-Industry</p> <ul style="list-style-type: none"> ○ Edible Oil ○ Grain Milling ○ Tobacco and Tobacco Products ○ Cotton and Textiles ○ Other Agro-Industry
<p>(2) Food and Beverages</p> <ul style="list-style-type: none"> ○ Beverages ○ Other Food Products
<p>(3) Machinery, Motors & Equipment</p> <ul style="list-style-type: none"> ○ Metal and Metal Works ○ Electronics ○ Other Machinery
<p>(4) Chemicals and Petroleum</p> <ul style="list-style-type: none"> ○ Pharmaceuticals ○ Manufacture of Paints ○ Manufacture of Soap ○ Other Chemical Products
<p>(5) Other Manufacturing</p> <ul style="list-style-type: none"> ○ Leather and Footwear ○ Paper and paper products

<ul style="list-style-type: none"> ○ Rubber and Plastic Products ○ Furniture and Fittings ○ Other manufacturing activities
D. ELECTRICITY, GAS AND WATER [UTILITIES]
(1) Electricity
(2) Gas
(3) Water
E. CONSTRUCTION
(1) Bricks and Tiles
(2) Cement Lime and Plaster
(3) Building and Construction
F. WHOLESALE AND RETAIL TRADE; CATERING AND ACCOMMODATION SERVICES
(1) Wholesale
(2) Retail Trade
(3) Catering
(4) Accommodation Services
G. TRANSPORT, STORAGE & COMMUNICATION
(1) Transport
(2) Storage
(3) Posts and Telecommunications
(4) Computer and related activities
H. FINANCING, INSURANCE, REAL ESTATE, TOURISM & BUSINESS SERVICES
(1) Banking
(2) Micro-Finance
(3) Insurance
(4) Real Estate /Property Services
(5) Tourism
(6) Business Services
I. COMMUNITY, SOCIAL AND PERSONAL SERVICES
(1) Community
<ul style="list-style-type: none"> ○ Health Care Services ○ Education Services ○ Entertainment Services ○ Cultural heritage Services
J. OTHER ACTIVITIES

Source: Survey on Foreign Private Capital in Uganda -2004

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Vashishta, Bhaskar, (Dr). “Lecture Notes and Handout” in the Course: Overview of Investment Environment. John F. Donahue Graduate School of Business Duquesne University, Pittsburgh, PA, USA: Summer Semester 2004.

10 DATA SHEET

1. **Name:** Rev.Fr. Nkwasiwe Leo Frederick, A.J
2. **Sex :** Male
3. **Birth:** January 10, 1966
4. **Place of Birth:** Kyerero [Uganda-East Africa].
5. **Nationality:** Ugandan
6. **Marital Status:** Single [Missionary Priest Ordained August 22, 1996]
7. **Present Contact Address:** Rev.Fr. Frederick Leo Nkwasiwe, A.J
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E-mail: frednkwassy@hotmail.com

8. Education Background and Information:

Level	Year	Award	Institute
Primary / Elementary Level Education	1974-1981	PLE Certificate	Kyerero & Kandago Prim Schools, Kabale, UG
Ordinary Level Secondary Education	1982-1985	UCE Certificate	A.J Moroto Seminary, Moroto, Uganda
Philosophical College Education	1987-1988	Diploma in Philosophy	A.J Moroto (U) & Nairobi (K)
Advanced Level Secondary Education	1989-1991	UACE Certificate	A.J Moroto Seminary (Uganda)
Theological College Education	1991-1995	Diploma in Theology	A.J Langata Theological Seminary-Nairobi, Kenya
Theological & Religious Studies–University Level	1995-1996	B. TH Degree	Urbana University-Rome, Italy (Affiliation).
Undergraduate studies in Business Administration	Fall 2002-Spring 2003	Complete prerequisites prior to Graduate	Duquesne University-Pittsburgh, PA,USA
MBA Graduate Program	Summer 2003 Summer 2005	MBA Degree	Duquesne University-Pittsburgh, PA, USA

9. Working Experience Information:

- **Spiritual Director:** Served as Spiritual Director/Chaplain Moroto Seminary [High School Level] [September 1996- December 1998].
- **Vice Rector and Coordinator:** In tandem, served as a Vice Rector of Bukinda Seminary [High School Level] and Coordinator of Kyerero-Italia Solidale (a private volunteer and non-profit local socio-economic development organization) [1999- April 2001].
- **Mission Office Secretary:** Served as Office Secretary for the Order of the Apostles of Jesus Missionaries –USA Zone [May 2001-May 2002].
- **Resident Missionary Priest cum Student:** In tandem, served as a Resident Missionary Priest at St. Bede Catholic Church, Point Breeze, Diocese of Pittsburgh, Pennsylvania, USA and undertook part time MBA studies at Duquesne University, Pittsburgh, PA, USA [Summer 2002 - Summer 2005].

10. Information about other Significant Profile Builders:

- **Representing:** Represented the Institute of the Apostles of Jesus Missionaries at the International Congress of Young Women and Men Religious, held at Hotel Ergife, Rome, Italy (EU) 29 September- 4 October 1997.
- **Teaching:** Taught Literature in English and Commerce at Apostles of Jesus Moroto Seminary (1996-1998) and Apostles of Jesus Bukinda Seminary (1999-April 2001) –Uganda [East Africa].
- **Writing:** Authored a book entitled: SHEEP WITH SHEPHERDS: A Thirty One Year History of the Congregation of the Apostles of Jesus: An Account of their Origin, Life and Progress 1968-1999. Kampala: Kisubi Marianum Press, 2000.
- **Founding:** Founded ST. MARY’S CLINIC SOLIDALE-KYERERO [Private Community Based Health Clinic] (May 1, 2001), QUEEN OF APOSTLES ACADEMY SOLIDALE-KYERERO [Secondary and Technical /Vocational Education and Training <STVET>] (January 3, 2004), and AVE MARIA SAVINGS AND CREDIT COOPERATIVE SOLIDALE-KYERERO <AMSACCOS-K> (June 3, 2005) –Uganda [East Africa].

11. Professional Goal/Career: To become an economist – be skilled with economics and business knowledge, teach economics, help in the economic and financial management of my Order, and participate in the economic and financial development of my Order, Church and Country. In short, I want to *teach* and *practice*.

READER APPROVAL SHEET

**DUQUESNE UNIVERSITY
JOHN F. DONAHUE GRADUATE SCHOOL OF BUSINESS ADMINISTRATION**

Thesis Proposal Approval Sheet

Name of Student: Frederick Leo Nkwasiwe

Thesis Topic: **Financial System in Economic Development: The Nature and Role of a Robust Financial system in the Economic Transformation of Uganda**

I hereby give my approval to the attached thesis proposal, in its present form, subject to the comments made below.

(Signed) _____ Reader Date _____

Comments:

I hereby give my approval to the attached thesis proposal, in its present form, subject to the comments made below.

(Signed) _____ Thesis Committee Date _____

Comments:

I hereby give my approval to the attached thesis proposal, in its present form, subject to the comments made below.

(Signed) _____, Thesis Committee Date _____

Comments:

Approved: _____, Director, Graduate Program

Date _____

