Favouritism in Uganda: How the political economy impacts micro and small enterprise development

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Micro and small enterprises (MSE) build the vast majority of businesses in Uganda. This contribution shows that their economic development is not only hampered by 'normal' business constraints faced by many MSEs in developing countries. The system of favouritism prevailing in Uganda's political economy disproportionally affects the MSE sector, impacting the country's economic development to some extent as well. This contribution introduces a new concept of political economy for MSE development based on (1) corruption/rent-seeking, (2) a possible political bias in economic policy towards larger businesses, reflected in the institutional support structure (3) the economic and lobbying power of big enterprises vs. MSEs, (4) and a potentially biased tax system. The concept is applied to the Uganda under Museveni's rule in the period 1994-2014, giving empirical insights that show how political and economic development are intertwined and to what extent this affects MSE development.

Keywords: Uganda, political economy, MSE, economic development

A. INTRODUCTION

Micro and small enterprises (MSE) build the vast majority of businesses in Uganda. While many studies on Uganda identify growth constraints at the level of the firm - concerning the enterprise itself and its networks - and regarding the business environment, only few approaches explicitly deal with the political economy of MSEs. This contribution focuses on the role of political economy factors for the development of the MSE sector in the period 1994-2014 of President Museveni's rule.

Generally, political economy can be understood as the mutual effects between institutions, regulatory frameworks and state actors on the one hand, and economic actors and enterprise development on the other. In the development economics literature, political economy influences have not been sufficiently taken into account. The political economy lens is particularly fruitful from a macroeconomic perspective, identifying underlying political reasoning and barriers for economic development. Political science studies on the topic focus on factors such as government failure, institutional corruption, capture of public resources for patronage purposes, rent-seeking and distributional politics. Key players are likely to be local leaders, elites, and political and business coalitions. Relevant influencing variables in many Sub-Saharan African countries are likely to be the concentration of political power, granting of contracts and jobs based on personal favours and the use of state resources to legitimize these practices (Bratton/van de Walle 1997). To our knowledge, no specific concept of political economy for MSE development exists. We argue that this is necessary to take a careful look at the actual existence and impact of corruption and political-economic networks on MSE

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economic development, whether it takes the form of neopatrimonial rule, competitive clientelism or rent-seeking and rent-management (Mkandawire 2015; Booth et al. 2014; Whitfield 2011; Krueger 1974).

This paper therefore asks how political institutions, the political environment, and the political-economic system influence the development of MSEs in Uganda. To answer these questions, we propose a political economy concept that captures those factors that are most relevant from the perspective of MSE sector development. Drawing on the available literature, these factors are (1) corruption/rent-seeking, (2) a possible political bias in economic policy towards larger businesses, reflected in the institutional support structure (3) the economic and lobbying power of big enterprises vs. MSEs, (4) and a potentially biased tax system.[2]

We make two key arguments. The political economy of favouristim limits Uganda's overall economic development to some extent, but disproportionally affects the MSE sector; and the Ugandan elites established a clientelistic system which leads to selective measures of support or neglect for enterprises, depending on the impact of the lobby power of various associations and business networks, and negotiations.

To achieve this, we proceed as follows. Section 2 gives an economic overview and the performance of manufacturing MSEs in Uganda, presenting trends in the business environment between 1994 and 2014. It indicates the value-added of a political economy approach. Section 3 conceptualizes political economy for MSEs. Section 4 analyses how much MSE development is affected by the key political economy factors identified, drawing on available literature, descriptive surveys and some data. The final section concludes with a brief reflection on current developments and the contribution of political economy to explain the different facets of discriminatory policies.

B. THE DEBATE ON MSE DEVELOPMENT IN UGANDA

This section summarizes the existing literature on the MSE sector in Uganda and adds insights from our own quanatitative and qualitative surveys, conducted in various projects between 2004 and 2014. Critical factors that limit MSE growth can be found at the level of the entrepreneur, between firms and in the business environment.

In Uganda, the government defines a micro enterprise as an enterprise employing up to four people, with annual turnover and/or total assets up to UGX 12 million (1 million UGX = 281 USD). A small enterprise employs between 5 and 50 people (with turnover/assets of up to UGX 360 million) and a medium enterprise employs between 51 and 100 people, with a turnover or assets between UGX 360 million and UGX 30 billion (GoU 2014). MSEs make up more than 90% of Ugandan enterprises, but only contribute to about 30% of the Gross Domestic Product (GDP). The overall number of businesses in Uganda is about 460,000 registered businesses in 2010/11 (UBOS 2011). The average size of MSEs, however, decreased from 3.4 employees (2001) to just 2.35 by 2011. While 52% of employees were working in businesses with five or more workers in 2001/02, i.e. in small enterprises, this had fallen to 36% by 2010/11 (GoU

[2] We exclude the manipulation of the exchange rate, foreign exchange licensing systems and import controls due to a lack of empirical data at the firm level.

2014). An analysis of the data by employment size confirms that 94 percent were employed in micro-enterprises with less than 4 employees and 4 percent were employed in small businesses with 5-9 employees (UBOS 2011).

These data show that Uganda has a vast MSE sector, a very small proportion of large scale firms and a missing middle of medium-sized enterprises (Gelb, Meyer, Ramachandran 2014; Kappel 2016). While this applies to Uganda at large, there are more medium sized enterprises in urban centres like Jinja and Kampala compared to rural Uganda (Kappel 2016). Gelb, Meyer, Ramachandran (2014: 10) offer a macro-economic explanation for the lack of industrialisation and transformation, pointing to a 'missing middle' due to two aspects. On the one hand, influential firms with bargaining power (which partly benefited form import-substitution policy) can extract rents. They have an interest to preserve the status quo and establish high barriers to entry and expansion. On the other hand, governments' regulatory systems are not in favour of small and enterprises, which face many constraints and a costly business climate and stay unproductive.

Poor performance of MSEs in Uganda has been associated mainly with limited capital, limited upgrading of capital stock and investment factors such as limited capital and limited access to finance (Kappel, Lay, and Steiner 2005; Okurut, Bategeka 2006; Johnson, Nino-Zarazua 2011). Limited access to finance is due to, first, the inability of entrepreneurs' to fulfill the required process by financial institutions, including the formulation of a business plan. Second, MSEs are also perceived as "high risk" by financial institutions, as there is little information available on their operations. MSEs do not have audited financial statements and credit bureau coverage is very limited, being concentrated in Kampala and other large towns (Fox 2015). To compensate, banks demand high levels of collateral, predominantly immovable, which most SMEs do not have (World Bank 2015). Bank sector politics is in favour of large enterprises. Most of the banks in Uganda are foreign banks and neglect MSE. Given MSEs' lack of access to external finance, entrepreneurs' decisions to upgrade their equipment and machinery by making new investments are further constrained by limited internal sources of financing, e.g. savings.

Inadequate provision of public infrastructure and services which affect private investment (Svensson/Reinikka 2001) and result in high transport and transaction costs (Rudaheranwa, 2006) hinders market access and growth of MSE. A limited access to differentiated markets provides an additional explanation. It is related to a lack of forward linkages, the concentration of MSEs in low quality production and ease of entry to market segments. Low levels of trust and minimalistic entrepreneurial strategies, low education, lack of cash flow management, poor managerial skills competence at the level of the entrepreneurs as well as limited network activities environment also hamper MSE growth (Ishengoma/Kappel 2011; Nuwagaba/Nzewi, 2013; Nangoli et al. 2013; Uwonda/Okello/Okello 2013; Khayesi/George/Antonakis 2014; Babirye/Aggrey/Eseza 2014). Studies show that a majority of Ugandan enterprises fail: 90 percent of MSEs do not longer exist than one year (Sejaaka, Mindra, Nseroko 2015).

Compared to large enterprises, MSEs are less efficient and incur high costs per unit of revenue. They use labor-intensive technologies to compensate for the lack of technical capacity in order to perform well. The larger firms are more capital-intensive than the smaller ones. A comparative analysis of Ugandan firms in different size categories conducted by Gauthier

(2001) and a more recent report (GoU 2015) indicate that the already low performance of the manufacturing and other sectors on average further decreases due to the poor performance of MSEs. MSEs and large enterprises in the manufacturing industry grow differently: the larger enterprises have higher growth rates than the smaller ones. Reinikka and Svensson (2002) have also shown that investment in productive assets is constrained by a low capacity for private investment in public complimentary assets (for example, electricity, generators), which are needed because of the poor quality of public infrastructure in Uganda and MSEs' limited access to this infrastructure.

Although the overall environment for enterprise development has improved, the World Bank's "Doing business" indicators show the situation remains critical. The costs of starting a business decreased from 462 US dollars in 2013 to 262 US dollars in 2015, for instance – they are still much higher than in neighbouring countries such as Kenya. This is why Uganda's competitiveness ranks below the average for Sub-Saharan Africa on infrastructure endowment, human development index, technological readiness and market efficiency (World Bank /IFC 2013; World Bank 2016).

Recent World Bank and IFC surveys as well as research contributions uncover which factors the entrepreneurs themselves perceive as obstacles (Tushabomwe-Kazooba, 2006; Nkiko 2013; World Bank, IFC 2013; Never 2016): Taxes, access to electricity and informal sector practices are ranked as major obstacles. Furthermore, the Government of Uganda (2014) recognizes that low barriers to market entry results in destructive imitation rather than innovation and positive market selection. Most of the factors identified are important for explaining limited growth and performance of Ugandan MSEs. But both qualitative and quantitative studies detected that constraints vary across business sectors. For example, limited access to long-term financial resources and operation space are the major obstacles to the growth potential of Ugandan manufacturing MSEs in wood/furniture and metal, but not to those in textiles (Sengondo et al. 2001).[3]

This overview shows which factors are limiting growth dynamics in Uganda's MSE, but existing research does not sufficiently consider political economy factors. MSEs have not much benefited from general growth in the Ugandan economy which may indicate that the MSE sector enterprises have not tapped their full potential during the last 15 years. A political economy perspective adds to the understanding why rent-seeking, corruption and the institutional support structure favour big business. It shows whether and how larger enterprises benefit from the prevailing political and economic system, while MSEs do not.

[3] Multiple regression analyses (Ishengoma/Kappel, 2011) confirm that MSEs' growth potentials are affected by dominating large firms and the business environment favouring state owned companies and powerful private enterprises. The reasons for MSE's low investment range from limited access to external finance, low internal sources of finance - related to poor access to domestic and foreign markets - to high overhead costs resulting from diseconomies of scale, poor access to public services and high tax, limited supply of spare parts or equipment and technical services, and bureaucratic procedures.

C. CONCEPTUALIZING THE POLITICAL ECONOMY OF MSEs IN UGANDA

The political economy impacting MSEs involves more than economic business constraints such as access to markets, finance or lack of infrastructure. Political struggles and power as well as the shape and impact of institutions, including the activities of different lobby groups, impact economic policy and the conditions for economic development. In many Sub-Saharan African economies, the political economy has been characterized by the concentration of political power in the hands of the president, the granting of jobs and contracts due to personal favours as well as the use of state resources for legitimizing these practices have been identified as characterize the political economy of many SubSaharan African countries (Bratton/van de Walle 1997). Given the variety of potential influencing variables, the definition of political economy's analytical boundaries becomes challenging.

For Uganda as a case study, a political economy perspective needs to uncover how political institutions, the political environment, power structures in the presidential regime and the NRM-system (National Resistance Movement)[4] influence the development of Uganda's MSEs. Both apparent and underlying links between the political and economic sphere come into focus. So far no specific concept of political economy for MSE development exists. Therefore it is necessary to take a careful look at the actual existence and impact of institutions and political-economic networks on MSE economic development, whether it takes the form of neopatrimonial rule, or rent-seeking and rent-management (Krueger 1974; Booth et al. 2014; Mkandawire 2015). For the analysis of MSEs in Uganda, we define political economy to consist of *a set of formal and informal rules and practices, personal relations, interests and power manifestations that influence whether MSEs have equal opportunities to enter the market and grow*. Based on the debate of African business-state relations as such and MSE development and existing characterizations of Uganda's political system (e.g. Asiimwe 2013; Tripp 2010), we construct our political economy concept with four interlinked elements.

First, *rent seeking and corruption* are likely to affect output and distort incentives, leading to a misallocation of resources (Mkandawire 2015: 22f). The concepts of rent-seeking, neopatrimonialism and crony capitalism all capture a form of *favouritism*. Rent-seeking explains the persistence of inefficient economic policies that favour certain groups or companies, limiting competition with others. Producers spend resources in order to obtain this privilege and therefore, the costs of production and transaction costs increase (Krueger 1974; Dragos Aligica/Tarko 2014). The obtaining of investment incentives and policy rents becomes a major entrepreneurial activity. Political capture of government by interest groups is possible as well, perpetuating to high or distorted incentives for these economic groups in the rent allocation process (Schmitz, Johnson, Altenburg 2013). Corruption or personal relations in neopatrimonial structures are usually necessary as an entry ticket to rent-seeking opportunities and preferential business activities. While neopatrimonialism has been widely used as an analytical lens for economic development in Africa, it has recently been criticized as too blunt and formalistic an instrument (Mkandawire 2015). We therefore focus on rent-seeking,

[4] Museveni's family is in the middle of a system of patronage, strategic assignment of posts and buying of opposition members across all layers of administration by way of the NRM; Tripp 2010.

lobbying power of different actors, support schemes for different enterprise strata, the institutional setting favouring or discouraging enterprises and corruption as analytical tools.

Second, *a political and institutional bias in economic policy* towards larger business is relevant as well in Uganda. This may be a result of the overall economic strategy or the rent-seeking system, including the different economic and lobbying power of MSEs and large companies. The degree of centralization in economic decision-making and the role of the state as facilitator are important, as the industrial policy debate has shown (Stieglitz et al 2013; Lin/Monga 2010). An analysis of the privatization process, attraction and inflow of foreign direct investments through political interventions and the established institutional support structures for MSEs and larger businesses could provide further insights.

Third, we include *the economic and lobbying power* of MSE vs large business as a separate item in our concept of political economy. Economic power captures more than a simple market share. It is about influence and the capacity for political action, attracting and controlling skilled labour, material flows, technologies and access to supporting services as much as about lobbying power and taking part in rent-seeking and clientelistic networks. Successful lobbying is a form of institutional power (Barnett/Duvall 2005), i.e. the shaping of rules and organisational set-ups. In a rent-seeking system that relies on personal favours, exerting institutional power is only possible through participation in the relevant networks. Power through direct coercion then is likely to manifest itself through corruption and strategic exclusion rather than punishment. In this paper, we focus on the influence of lobby groups and well-connected businesses vs lobby power of MSEs.

Fourth, we understand the existence of a *preferential tax system and preferential access to utility services* to be a feature of the political economy impacting MSEs. An explicit analytical focus on the taxation system and the access to electricity and water is useful. Higher taxation, tax reductions or evasion of prosecution in cases of non-compliance can strongly affect the competitiveness of businesses (Keefer 2000; Never 2016). The politics of taxation include factors such as legitimacy and trust, functions of (in-) formal institutions, power constellations shaping bargaining games and historical legacies (von Haldenwang/von Schiller 2016).

Assessing political economy and favouritism in a methodological rigorous fashion is challenging. This applies as much to our concept and empirical assessment as to others in the past (e.g. Booth et al 2014). Much of the proposed relations and effects happens informally in the shadows, will hardly be talked about or are based on perceptions and thus hard to quantify. In the following analysis we will indicate the pros and cons of the evidence available, indicaqting restrictions where necessary. We elaborate more on rent-seeking/corruption and political/institutional bias in economic policies as reliable data on lobby power and taxes/utilities is unfortunately rather sparse and very hard to obtain.

D. ANALYSIS

Rent-seeking and corruption

Inefficient economic policies that favour certain groups or companies, limited competition and the distortion of economic activities towards acquiring policy rents indicate the existence of a rent-seeking system. In Uganda, the focus on large-scale infrastructure and oil projects and the tendering for these projects indicate rent-seeking quite clearly, while competition outside these specific sectors is more open. The obtaining of government contracts is clearly in the interest of a vast amount of businesses, but this may be as much due to normal reasons of income stability as to disproportional rents. Corruption and rent-seeking often go hand in hand. Corruption of government officials alters government spending and investment allocation. In principle, it discourages private investment and has a negative effect on income growth

The current-rent seeking system roots in the legacy of the past, which was characterized by a weak civil service. Civil servants were underpaid and ”corruption was a survival strategy for civil servants … taking what opportunities they could to enrich themselves as quickly as possible” (Coolidge, Rose-Ackerman 2000: 78-79)**.** Today, rent-seeking has become widespread, quite subtle and well-organized in Uganda. Bureaucrats performing complementary activities coordinate their activities for personal gain, and officials in a position to collect bribes sometimes sold their positions to newcomers (Mbabazi 2013).

The main rent-seeking actors are important political NRM-leaders and economic actors which are able to avail themselves of the NRM-favouritism-system. The elites have a stronger interest in keeping the political NRM system running and developing large projects than putting more effort in economic development of all regions and sectors and all parts of the population. The Museveni family, for example, increasingly used its political power and businesses to expand their economic activities in tourism, coffee companies, in the security and military sector, and in oil extraction.[5]

Oil sector favouritism presents a striking example of diverting huge amounts of public resources for patronage purposes, detracting them from genuine development efforts. The legislative bills governing the oil industry grant “authoritarian-like” powers to the Minister responsible for oil, known as Clause 9 (Mbabazi 2013: 22). According to Clause 9, the Minister will be able to approve or reject licenses for oil exploration and drilling. The passing of the clause asserts that the most important body is the Minister for Oil and not the legislative nor the executive branch of government. Many newspaper articles demonstrated how much the President, his personal networks, the minister and foreign companies benefited from Clause 6 and oil deals. They used insider information within government through corrupt officials and at the end of the day foreign companies and large Ugandan firms benefited while many local enterprises were not incorporated.

Intense personalization of authority depends on the distribution of these spoils to stay in power. The tender processes and assignment of contracts in large infrastructure projects in recent years and in the current developments of oil drilling give some examples. For instance, the management of the Jinja oil reservers was first assigned to the firm of one of President Museveni’s son in-law in 2008, but protests from international companies saw this reversed. The oil contracts were then assigned to Tullow Oil and Heritage Oil with a profit margin of 35% - much more than the usual margin. Heritage Oil was allegedly tied to the Museveni networks and sold its share to Tullow Oil. In 2012, Uganda’s drilling concessions were finally re-assigned to a consortium of British-led Tullow, the French company Total and Chinese

[5] For an overview of Musveni family ties to the Ugandan business sector, see: Tangri/Mwenda 2006; Tripp 2010.

CNNOC .[6] Other examples of rent-seeking are particularly visible in lucrative and large-scale development projects such as the constructcion of the Bujagali and Karuma hydropower dams.

The developments in the oil sector are clearly linked to corruption. Mbabazi (2013) interviewed 34 Ugandans ranging from high level public officials, researchers, to local NGO respondents and journalists. As argued by the respondents, “The government has failed to curb corruption...and now with oil money, once the country begins exporting oil, Uganda is going to become like Congo or Angola” (Mbabazi 2013: 20). She also made it clear that President Museveni who presides over corruption at the centre has lost the moral ground to enforce discipline among his ministers and the general public:”In fact, as long as a corrupt civil servant remains loyal to the president and the ruling party, there is very little chance of concrete action ever being taken against them and all the money from our oil is likely to be taken” (Mbabazi 2013: 21).

The analysis of the Ugandan oil business shows how politics favours foreign companies, large Ugandan business and the President’s entourage, but does not actively encourage MSE in this sector. A World Bank (2015) report on participation of small and medium sized enterprises in oil value chains focuses on diagnosing the constraints, including access to finance, for local small and medium enterprises to enter into the oil and gas supply chains and highlights some case studies on how best to overcome these constraints. The report notes that small and medium-sized firms usually need to scale up their businesses significantly and/or buy specialized equipment to meet the high quality standards needed to participate in the capital-intensive and quality-driven oil and gas sector. At the end scaling up and securing financing was too big a challenge for small and medium enterprises, so they were not integrated in oil value chains.

An indicator of widespread favouritism can be demonstrated by the data on corruption. They show that Uganda belongs to the most corrupt countries in Africa. In Transparency International’s corruption perception index (2014), Uganda ranks 142 out of 175 countries with a score of 26 points (0= highly corrupt, 100= very clean; anything below 50 points can be considered as endemic corruption). Various researchers, journalists in Uganda and local as well as international researchers share this view (Tangri/Mwenda 2006, 2013; Booth et al. 2014). Corruption on the national, regional and local levels is widespread and has been accelerating in the last decade. Corruption in the public sector has remained high in spite of the development and implementation of an anti-corruption framework in 2012. This is largely due to the normalization of bribery practices, the increased bureaucracy in public institutions and vested interests in the rent-seeking agenda.[7]

Corruption can be a major financial and administrative burden to MSEs and disproportionally harm these enterprises (Tanzi/Davoodi 2000; World Bank 2013), especially if bribery does not allow entrepreneurs access to the relevant networks and lucrative public contracts. Large enterprises find it much easier to protect themselves from corrupt officials. Svensson (2000) found that the median firm paid bribes equivalent to 28 per cent of its investment in machinery

[6] Mbabazi 2013; Shephard 2013.

[7] Transparency International Kenya (2014), East African Bribery Index 2014. http://www.tikenya.org/index.php/the-east-african-bribery-index#

and equipment. Those involved in exporting have a higher probability of facing corrupt bureaucrats and having to pay bribes.

The World Bank/IFC (2013) incidence of graft index shows to which extent MSEs and large enterprises have to resort to corruption and to operate their business (Table 1). MSE and medium firms are clearly more affected than large firms.

Table 1: Corruption: Small, Medium and Large Firms in Uganda, percent, 2012

Incidence of graft index	Uganda average	Small firms (1-19 employees)	Medium firms (20-99 employees)	Large firms (> 100 employees)
per cent of firms experiencing at least one bribe payment request	19.3	19.8	18.8.	11.1
per cent of firms expecting to give gifts to secure government contract	5.8	6.1	8.3	1.8
per cent of firms expecting to give gifts to get a construction permit	6.5	6.5	10.9	0
per cent of firms expecting to give gifts to secure government contract to get an import licence	1.0	1.0	1.2	0
per cent of firms expecting to give gifts to get an operating license	17.8	16.9	23.4	17.1

Source: World Bank, IFC 2013.

Even the government (GoU 2014) identified corruption and regulatory requirements as major constraints for MSE development, but not for larger firms. Only 8% of large firms (with more than 100 employees) but 28% among medium-sized firms identified corruption as a major constraint: “Medium firms are almost twice as likely as large firms to be visited by tax officials, and much more likely to be expected to give gifts in these meetings. … Corruption acts as additional tax on SMEs” (GoU 2014: 33).

In sum, the degree of corruption and rent-seeking in specific sectors point towards favouritism that discriminates MSEs and favours large enterprises. However, rent-seeking may not pervade all sectors of the economy. Here, a lack of emprirical data impedes clear conclusions.

Political and institutional bias in economic policy

State dominance of the Ugandan economy in the restructruning phase of the economy since 1994 did not lead to the neglect and crowding-out of private business as such, but favouring large businesses, which depend on political connections rather than performance. This paragraph analyses the political and institutional bias in government policy and focuses on privatization, the investment agenda, the institutional setting and deals with the question how much MSE benefit inside the political and institutional setting.

Privatisation of public enterprises and agencies took place during the period of structural adjustment programmes in the 1990s. The large-scale sale of state-owned companies was negotiated between the President, the NRM and private investors. Large Ugandan and foreign companies were favoured. In total the Ugandan government has privatized more than half its parastatal companies. It has liberalized trade, lifted controlled producer prices on export crops, liberalized investment laws to facilitate the export of profits and encourage foreign investment, and opened up capital markets. One striking example for privatization is the Uganda Commercial Bank, which had huge non-performing loans of over $70 million in the mid-1990s, the result partly of political interference and corruption under the NRM (Tangri/Mwenda 2008). The sale of public enterprises was managed and manipulated to the personal benefit of influential individuals. The result was that cabinet ministers and senior officials acquired state-owned assets, especially in hotels, beverages, transportation, and printing, at favourable prices and on generous terms (Tangri & Mwenda, 2001: 122). The Museveni family also benefited directly, for example in the acquisition of Uganda's Grain Milling Corporation to the brother of President Museveni (Kjær 2015). The World Bank criticised the privatisation process for "non-transparency, insider dealing, conflict of interest and corruption". They argue that "many privatisations benefited those with political connections" (quoted in Tangri & Mwenda 2005). While it is clear that MSEs could not take over entire former parastatal enterprises, a more inclusive economic policy would have required large scale investors to cooperate and support MSEs through industrial cluster development, supporting integration of MSEs in regional and global value chain development, upgrading in the and climbing the value chain ladder, support competitive small and medium enterprises and jobs for unemployed. This partly happened in the fish, the floriculture and horticulture, and coffee value chains. But these are rare examples (Ishengoma, Kappel 2011; Evers et al 2014).

In the field of foreign direct investments, a certain degree of favouritism has become apparent as well. Many foreign investors participated in the privatization of state-owned enterprises and joined the Ugandan clientelistic networks in order to stay in the market. Foreign companies integrated Ugandan notables in their businesses as board members. Large multinationals like East African Breweries, Shoprite, South African Breweries (SABMiller), MTN, Airtel, Uganda Telecom, Eskom, Unilever, Total, Barclays and Standard Chartered have close links to well-known politicians and the NRM (Booth et al 2014; Hickey et al. 2015). During the last years Chinese enterprises pushed their participation and in the meantime they became the biggest single investors in Uganda, also using clientelistic networks and corrupt practices. The Chinese enterprises conducted highly secretive negotiations with the government to obtain oil contracts and concessions for Uganda's large-scale hydropower projects such as the Karuma and Simba dam projects. While the Chinese side only wants to deal with the President to keep the arrangements away from public eyes, "the President has sought to cut out the type of 'middlemen' involved in this episode, with only one close family member now empowered to explore options with different companies in advance and a smaller ministerial team involved in oil negotiations in a bid to centralise rent-seeking behaviour in line with a strategy of 'developmental patrimonialism'" (Kelsall 2013, quoted in Hickey et al. 2015).

Due to rising lobby power of business associations and some pressure from international aid agencies and international donor organisations during structural reforms of the 1990s and 2000s different Ugandan institutions partly promoted MSE development. Sectoral reforms contributed to the liberalisation and stabilisation of the economy. These included the Medium-Term Competitive Strategy for the Private Sector (MTCS) and the Strategic Export Programme. MTCS addressed bottlenecks to firm level competitiveness, business regulation, cluster development and integration in value chains and value creation (Kappel, Lay, Steiner 2004), while Uganda's National Industrial Policy (since 2008) supports private sector-led industrialization through development of an efficient and reliable infrastructure. Economic reforms were accompanied by important institutional reforms, such as decentralisation, and abolishing of state-owned marketing boards. These strategies concentrated on medium and large enterprises and not on the small ones and micro firms. The different strategies lacked detailed concepts for MSE sector development and relevant funding. It was also short of a clear vision for a MSE oriented business support system.

Recent developments indicate that the institutional setting favours big enterprises, even though different support structures for MSEs exist as well. The most important organisations are the National Competitiveness Forum (NCF), the Presidential Investors Roundtable (PIRT), the Private Sector Foundation Uganda (PSFU), Uganda Industrial Research Institute (UIRI), Uganda Investment Authority (UIA), Youth Venture Capital Fund (YVCF) and Microfinance Support Centre (MSC). There are also various business organizations that have formed to give stronger voice to the business community's needs (Haussmann et al. 2014), amongst them the Uganda Manufacturers' Association (UMA), which is the main driver in establishing influential forums for public–private sector engagement (Kjær 2013).

Support schemes are biased towards large enterprises and against MSE, even though one of the major institutions, MSC, is a pro-MSE-actor. Since 2001, the MSC has helped to expand access to affordable financial and business development services. Wholesale credit is channelled to the so-called Savings and Credit Cooperatives (SACCOs). There are about 2,800 SACCOs across the country, with a total membership of more than 1.1 million members (GoU 2014: 23). The MSC is dealing with basic needs of small entrepreneurs, but they have limited resources, outreach and impact. Many studies in Uganda show that existing business services like MSC/SACCO do not lead to growing and competitive small and medium enterprises.

Subsidised loans have benefited large firms more often than credit-constrained MSEs – despite a range of micro-finance institutions (MFI) and SACCOs. Access to loans remains difficult for MSEs as interest rates are very high for them and informal businesses have difficulties to access bank loans. The German KfW Bank and the East African Development Bank have set up credit financing programmes for MSEs in rural areas to tackle this problem. Regulatory requirements currently still place a disproportionate burden on new and small firms.

Existing forums such as the PIRT, the NCF, and the PSFU have tended to focus on high-level strategic issues and have had only limited and indirect input from MSEs. "In general, the governments' policies towards the industrial sector have been either non-existent or ad hoc and aimed at particular enterprises whose political support has been important" (Kjær et al. 2012: 28).

PSFU works closely with the government and donors on several projects and programs to strengthen the private sector. These include the Business Uganda Development Scheme (BUDS) and training community groups in different skills. The Technology Acquisition Fund managed by PSFU, which aimed to increase the competitiveness of Uganda's exports, only supported a few MSEs. The same applies for the Business Linkages Promotion Project under Enterprise Uganda which was conceptualized in ensuring participating MSEs in linkages with transnational corporations. The Ugandan Small-Scale Industries Association (USSIA) offers some training programmes and support services for members, but is generally under-funded and under-staffed to achieve a consistent outreach and impact across all of Uganda.

UIRI is the lead implementing agency supporting the industrial sector in research, transfer and diffusion of technology. Its funding has been increased significantly over recent years. The UIA is responsible for promoting and facilitating private sector investment and offers some small enterprise training. The agency provides land and infrastructure to investors and services to large enterprises and MSEs, also offering a "one stop"-service center for new MSEs. The UIRI activities providing facilities and common services to help 'incubate' MSEs have only limited outreach. YVCF established a fund in partnership with DFCU Bank, Stanbic Bank and Centenary Bank, to finance viable projects proposed by young entrepreneurs, at a subsidised interest rate. Most public funds have been disbursed to larger, more established borrowers, and not to MSE. Decisions taken by the government and the activities of pro-business institutions show that MSE are disadvantaged. Even Government reports (GoU 2014, 2015) made it clear that large business benefited while MSEs are struggling to be heard. The National Development Plan 2015-2019 (GoU 2015) also emphazises that MSEs need more support, access to technology, knowledge, and services, but a clear agenda how MSE could be developed and create jobs for the unemployed is not recognized.

The establishment of the PIRT in 2006 can be seen as a clear indicator of President Museveni's pro-business and large enterprise orientation. PIRT's mandate is to advise the government on how to attract competitive investors (Page 2014; Kjær 2013). At the beginning, PIRT was an influential, small group whose members wanted to provide the government with advice. But members of the ruling elite took over, focusing PIRT's activities on narrow business interests rather than collective ones. In 2009 the PIRT was extended to 25 members, 13 from Uganda's private sector and 12 from the international business community. MSEs are represented through industry associations.

In 2014, the Ministry of Trade and Industry Cooperation has set up a directorate for micro, small and medium enterprises that is supposed to act as a mediating agency. Previously, responsibilities and contact options for MSEs were scattered across ministries and agencies: "Before, it was even difficult for the donors to know who to address, we find that sometimes duplications have been done because the ministries don't talk to each other."[8] These new initiatives will change the regulatory environment and the intendend measures will enlarge

[8] Interview with a representative of the Ministry of Trade and Industry Cooperation, April 9, 2014.

MSEs channels to coordinate and demand effective Government support, making policy less responsive to the constraints they face.

State dominance of the Ugandan economy in its restructuring phase since 2000 did not lead to the neglect and crowding-out of private business as such. Economic policies came with a certain support of the MSE, as research on the business environment indicates (Reinikka/Svensson 2002; FSD 2015; World Bank 2016). Programs supporting MSEs and a better environment for MSEs improved private sector activities. Nevertheless, the analysis shows that, on the one hand, trade and investment policies, incentive systems and concrete plans and finance were not spurring development of MSEs and medium-sized enterprise. On the other hand, massive constraints hinder dynamic development, technological upgrading and competitiveness of micro, small and medium enterprises.

Economic and lobbying power of large enterprises vs. MSEs

Economic elites and organized groups representing business interests have substantial impact on government policy. Lobby means attempting to influence. The different agenda setting capacities of Ugandan lobby groups indicate huge differences between MSEs support organisations and large enterprises bargaining power.

As in most countries, larger businesses have a better chance to acquire more economic power than micro and small enterprises due to their financial and innovative capacities and potential to attract well-educated staff. The business environment favouring large enterprises in Uganda as well as the favouritism in government contracting strengthen this initial power asymmetry. Weak support for MSE is an outcome of the wielding of power.

The possibilities for business associations to successfully shape governmental economic policy to their interests indicate this. In Uganda, 750 of the large and medium sized enterprises are organized in the UMA, which is one of the most influential business organizations, having successfully lobbied government to take business-friendly initiatives (Kjær 2013). Small and micro enterprises are not representated by UMA. Other lobby groups and parastatal institutions use their institutional power to influence support programs for the development of the industry. Compared to UMA, USSIA only has very little lobbying power. Other, even smaller MSE business associations such as the Kisenyi grain millers association in Kampala have practically no power to influence the government or service providers at all.[9] Support programs for Ugandan enterprises favour large enterprises which profit from participation in the NRM-dominated clientelistic network and redistribute to the NRM. MSE and their associations have widened their activities but the last years have shown that their influence stays small.

UMA and large and foreign companies have lobby power and centralize decisions and thus serving the political system of favouritism and the NRM. As Kjær (2015: 231) notes: “Ruling elites will tend to support sectors when this helps to cement the ruling coalition or otherwise keep the ruling elites in power. More particularly, when economic entrepreneurs in a certain sector are important either because of their provision of government revenue or because they provide funding for the ruling party, ruling elites are likely to implement policies to favor their

[9] Focus group discussion with Kisenyi millers, Kampala, April 23, 2014.

particular sector". In an interview with us, a representative from UMA akcknowledged the influence of large enterprises and their lobby organisations: "We are discussing a lot with government, they are listening to us. We are one of the biggest and most important business associations in Uganda. Sometimes they even revise existing regulations after discussing with us."[10]

Unequal taxation and preferential access to utilities

Taxation and access to utilities present major costs to enterprises. Fair taxes and secure and permanent access to utilities remain of high importance to enterprise growth.

Several studies have shown that taxing is highly unequal in Uganda and that the majority of MSEs see taxes as a severe problem. In practice, tax exemptions and investment incentives benefit large firms the most. A World Bank/IFC (2013) report emphasizes that the tax system is distorted to the detriment of MSEs. Effective tax rates decrease with taxpayer size, in part due to the exploitation of exemptions and investment incentives for aggressive tax planning and avoidance. Large enterprises can exert economic power and benefit from tax reductions, while MSEs are either neglected or pay higher taxes. A government report (GoU 2014) confirmed that high taxes limit the performance and growth potential of MSEs in several ways: They reduce their internal sources of financing, discourage them to expand, formalise and hence participate in subcontracting arrangements. The GoU (2014: IX) states: "Tax exemptions are poorly targeted, favouring larger firms".

Another example of inequal treatment is the restricted access to electricity, although the situation improved somewhat in recent years. The electricity price impacts MSEs' ability to pay and to some extent also their willingness to pay; the bulk metering system that has been put into place to allow individual MSEs to access a lower tariff in a group has various flaws in may locations (Never 2015). Whereas large enterprise have better access to the grid system and pay less for electricity ,MSEs face constraints of access to electricity in general, more often experience power outages and bribery (GoU 2015: 184). Many MSEs bribe the utility provider to receive or keep the electricity connection. Transparency International's Global Corruption Barometer (2013) stated that 40% of Ugandans paid a bribe to the utilities. The persecution of unpaid bills and electricity theft also differ between the electricity consumers, as a metal fabricator explains: "Umeme [the electricity provider] also goes to the small customers first and disconnects them first, larger businesses get more time. They go to them later, that's not fair."[11]

The newspaper *This is Africa* reports in December 2015: "A major reform introduced in 2015 was to reduce delays for new electricity connections by deploying more customer service engineers and reducing the time needed for the inspection and meter installation. The number of days required to establish an electricity connection fell from 132 days in 2014 to 86 days. Furthermore, the costs of obtaining electricity fell by 9.7 percent, while the quality of the

[10] Interview conducted in Kampala, April 12, 2014.

[11] Focus group discussion in Iganga, April 17, 2014.

electricity supply increased during this time".[12] While this is an improvement, connection time, access in smaller towns and remote areas as well as the current imperfections of the bulk metering system remain challenges for MSEs. The quality of service delivery will continue to impact MSEs' willingness to register formally, making them part of the tax system, while precived and objectively existing discrepancies in taxation of MSEs compared to larger enterprises impact actual payments.

E. CONCLUSION: THE CONTRIBUTION OF POLITICAL ECONOMY

Ugandan politics are characterized by a personalistic and hierarchical patron-client system, dominated by leading actors of the NRM. Their networks of favouritism bring together politicians, the executive, and members of the business community, who operate on the basis of mutual dependence. The system of favouritism protects those enterprises that provide support for the ruling elite; it is not a competitive clientelistic model that gives equal opportunities to all enterprises to enter the system via different competing coalitions. On the contrary, those who have political power exercise significant economic power. A variety of supporting institutions for small, medium and large firms exist. However, these institutions, combined with instruments such as tariffs and taxes currently provide inequal opportunities to MSEs and medium or large firms in Uganda. We have argued that this is due to underlying political economy that supports rent-seeking.

The biggest sources of rents are government contracts for enterprises. This paper has shown how small elite circles use the institutional setting, primarily in the oil sector and via big infrastructure projects, to access rents. These rents are mainly benefitting large and foreign enterprises, while MSEs are disadvantaged. Because the NRM system favours these alliances, it does not necessarily promote growth and enterprise development per so but unequal favouritism, which leads to a misallocation of resources.

In spite of the strong NRM system, various different economic institutions and lobby groups with different clientele exist. These groups allocate private benefits to those groups on whose support they rely on, albeit without forming larger coalitions. This situation gives smaller lobby groups (including MSE associations) a chance to participate in the distribution of rents, at least in theory. This paper has shown that lobby groups of the small business sector are weak, fragmented and do not have enough economic and political power to transform the system of favouritism under President Museveni.

Our contribution proposed a concept of political economy for MSE development that adds to a better understand why MSE do not only face "normal" business constraints but also political disadvantages. Normal business problems include access to finance, transport costs, lack of managerial skills, etc. Additionally, we have shown that MSEs are neglected, delinked or excluded systematically by the political and economic power structures under the established system of favouritism. Government support has benefited large firms and restricted competition. There is a "missing middle", which is symptomatic of persistent policy distortions. Under the current circumstances, informal and many formal MSEs will most likely stay poor,

[12] *This is Africa* 10 December 2015, http://www.thisisafricaonline.com/News/Uganda-Kenya-lead-on-better-ease-of-doing-business?ct=true see http://www.tradingeconomics.com/uganda/ease-of-doing-business.

will not be able to grow to a critical size, and will therefore play a limited role for growth, employment and development.

Although many Government documents acknowledge that MSE face specific constraints that limit the sector's potential for achieving growth, not much has been done to overcome the most essential obstacles. First, constraints and institutional distortions have not been removed. Second, MSE associations lack appropriate channels to coordinate and demand effective government support. Third, MSE-related innovation and research activities, and national innovation systems are still underdeveloped. Economic measures that foster innovative industrial clusters and integration of MSE in global value chains might help to overcome localisation and risk minimisation, but due to the unequal distribution of power MSE have limited influence. As long as the system of favouritism persists in Uganda's economic policy and as long support programs are biased in favour of larger local and foreign enterprises, MSEs' capacities will not be fully utilizied.

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