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UGANDA'S MICROFINANCE POLICY REGIME: AN EXPLORATION THROUGH A  
POLITICAL-ECONOMY FRAMEWORK

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Biographical brief:

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## ABSTRACT

In 2005, Uganda's government fundamentally shifted the direction of its microfinance (MF) policy. Hitherto it had focused on integrating MF institutions into the financial sector, allowing them to take deposits. Since 2005, it focuses on savings and credit cooperatives (SACCOs); with government funding of and ostensibly interfering in the SACCOs' operations.

This paper explores the reversal of policy direction, drawing on public choice theory. It finds that the shift of policy direction served the objectives of Uganda's politicians to maintain political power, as it offered them an avenue to create loyalty through patronage. MF special interest groups – particularly development agencies – had chosen a strategy based on information and financial contributions that failed to incite politicians and to maintain univocal support from technocrats and MF practitioners.

## 1 INTRODUCTION

Microfinance (MF) has been high on the development agenda of East Africa since the 1990s. Development agencies have supported technically and financially governments and central banks in drawing policies and regulations for Microfinance Institutions (MFIs).

Between 1999 and 2005, Uganda gained international recognition for an MF policy that was centred on integrating the microfinance market into the financial sector. In particular, it incited non-government organisation (NGO)-MFIs to transform into central-bank-supervised and deposit-taking institutions (MDIs). Around 2006, Uganda's neighbours Kenya and Tanzania enacted comparable legislative frameworks. Regarding savings and credit cooperatives, Tanzania and Kenya had created tiered regulations in 2003 and 2008 respectively, while the same is still being discussed in Uganda.<sup>1</sup>

Development practitioners emphasize that they seek to engage policy makers for 'building favorable policy and regulatory frameworks'.<sup>2</sup> In contrast to this emphasis on policy advice, there is nearly no literature on the political economy of microfinance.

In 2005, Uganda's government chose to reverse the direction of its MF policy. Yet, it had thus far been thought of as 'state-of-the art' by development agencies; having been shaped by some widely acknowledged members of the MF practitioner community. That shift of direction has neither been studied comprehensively by development agencies nor by scholars. The objective of this chapter is twofold. The first is to present the case of Uganda's MF policy and its making in the 2000s and the shift of direction in the middle of that period. The second objective is to suggest an exploratory political economy-framework which draws on public choice theory.

The remainder of the paper is organised as follows. Section 2 outlines the theoretical framework. Section 3 presents the case of Uganda's MF policy since 1999, and its shift of direction in 2005. Section 4 interprets Uganda's MF policy-making through the political-

economy-framework. It highlights how politicians, technocrats and MF special interest groups weighed their resources for influencing policy. While the latter relied on generation and provision of information, the former relied on financial and loyalty prospects. Section 5 concludes with an outline of research questions that arise from the exploratory nature of this paper's theoretical framework.

## 2. THE PERSPECTIVE OF POLITICAL ECONOMY

### 2.1 Introduction

Political economy is the study of policy-making through the 'lenses' of economics. Policy making can be analysed with a two-stage principal-agent-framework. The electorate is the principal that chooses politicians as its agents; politicians are principals who work through technocrats as their agents.<sup>3</sup> Principal-agent-relationships are shaped by political and social institutions. These form the regime or 'the rules of the game'.<sup>4</sup>

### 2.2 Policy-makers and policy-making

Politicians are usually modelled as agents who pursue political power. Political economy models vary with regard to the motives for political power as well as the means to pursue it. In any case it is realistic to assume, smart to presume, and justified to support the view that politicians pursue their own objectives and that these objectives differ from those of the citizen.<sup>5</sup>

Special interest groups are defined broadly as any subset of voters who share concerned characteristics, or beliefs and interests.<sup>6</sup> Special interest groups have a wide array of means to influence policy-making from the first draft until implementation.<sup>7</sup>

Policy-making entails generating, enacting and implementing of policies.<sup>8</sup> Policies are generated by politicians, technocrats or special interest groups. Each of them may (co-)author a platform, or a draft policy, or a bill. However, politicians and technocrats do not do so as individuals, but as agents of a broader interest. 'In modern democracies, a politician is a

spokesman for some broad-based opinion, and what he or she hopes to become is the holder of an office'.<sup>9</sup>

When it comes to enacting and implementation of policy, political office holders rely on the technocrats employed by those offices.<sup>10</sup> Analogous to politicians, technocrats pursue their own objectives. The landmark model of Niskanen suggests it to be maximization of budgets at the technocrat's disposal.<sup>11</sup>

### **2.3 Policy-making strategies**

Politicians, technocrats and special interest groups can choose different strategies to steer through those policy proposals that are closest to their objectives, and to fend off those policy proposals that conflict with their objectives. These strategies may be classified by the resources drawn on, including information, finance, and loyalty.

*Information-based policy-making strategies* seek to generate and provide knowledge about the contents and expected effects of the policy. If policy-makers are well informed, they may be comfortable to act upon that information. However, the tasks of gathering and vetting information are costly. Therefore, policy-makers must decide which portion of their budget to allocate to the information tasks.

Special Interest groups bear the cost of information to signal its credibility to politicians and technocrats.<sup>12</sup>

Politicians and technocrats seek information from special interest groups who have tacit knowledge of the respective policy issue. 'While such lobbying typically reduces the uncertainty facing a policymaker, it cannot eliminate it entirely. Importantly, in most cases, the sharing of information is beneficial to both the policymaker and the interest group. Even when two groups with disparate preferences lobby a policymaker, each group gains relatively from the outcome that would result from an uninformed policy choice'.<sup>13</sup> Under the two-stage

principal-agent framework, the same conclusion would apply to the interaction between politicians and technocrats with regard to tacit knowledge of administrative procedures. From the above concludes that no policy-maker has the financial or technical capacity to reduce information uncertainty to zero. That means that information is always incomplete. Politicians, technocrats and special interest groups, then, must choose which level of incompleteness of information is acceptable to them. Different academic fields suggest different approaches to that choice. Rational choice theory suggests risk management based on probability-based models. Behavioural theory suggests, based on models of human cognition that most people rely on heuristics and framing of selective information. ‘Story-telling’ composes thus selected, incomplete information into a seemingly comprehensive narrative.<sup>14</sup> Due to limitation of space, this paper discusses information-based strategies under the axiomatic assumption that uncertainty of information is negligible towards the outcomes of policy-making. The exploration of policy-making strategies based on incomplete information has to be left to a future paper.

*Finance-based policy-making strategies* involve offering financial incentives in exchange for support to a given policy proposal. Politicians may request financial contributions for their election campaigns. It has been shown that special interest groups signal their preferences by paying voluntarily before a policy issue arises.<sup>15</sup> Politicians could also impose access costs on special interest groups who wish to present their issues.

Technocrats may expect political office holders to allocate increased budgets to them in return for smooth processing of a given policy. They may administratively delay policies that imply reductions of their budgets.<sup>16</sup>

Technocrats are usually legally prohibited from accepting direct financial contributions from special interest groups. However, they can accept indirect expansion of their budgets, for example financing of departmental retreats and business trips.

Special interest groups often include allocation of funding into the policy proposals they advocate for. Thus, enacting and implementing of their policy proposals is regularly linked to financial flows to the special interest groups.

*Loyalty-based policy-making strategies* rely on people who have the right to vote on the policy or whose role is to take its formulation forward. It also relies on people who have the capacity to mobilise opposition or criticism against proposed policies but refrain from doing so. Thus, the political power of a politician depends on loyalty by people.<sup>17</sup> However, it is important to note that loyalty to a policy and loyalty to a politician are different from each other. They may or may not be aligned. Political loyalty may be offered based on issues, performance, and identity.<sup>18</sup>

Politicians generate loyalty through patronage, social capital or the use of aggression.

Patronage is the exchange of offices or finance in exchange for support; it could also take the form of exchanging support for one policy for support for another policy.<sup>19</sup> Some authors suggest that rewarding loyalty through patronage is more important for consolidating power than financial incentives.<sup>20</sup>

Social capital emerges from a shared interest or from a shared identity. Shared interests or identity can create a network within which information and other transaction costs are reduced.<sup>21</sup> By emphasising shared interests and identity, for example of rural or young populations or of people with the same ethnicity,<sup>22</sup> politicians seek to invoke a bond with those sections of the electorate. It can be 'capitalised' as loyal voting behaviour, whereby the politician is elected regardless of the policies he pursues.

Finally, loyalty can also be generated by intimidating opponents or rigging ballots. Other aggressive methods to generate loyalty include assassination, riots and guerrilla activity.<sup>23</sup>

Use of aggression characterises semiauthoritarian or authoritarian regimes.



### 3. MAKING MICROFINANCE POLICY IN UGANDA

#### 3.1 Uganda's political regime since 1986

Uganda, alongside Kenya, Rwanda and 21 other African countries has been characterised as a hybrid regime of semiauthoritarian nature while Tanzania has been categorized as semi-democratic.<sup>24</sup> 'Hybrid regimes (both their semidemocratic and semiauthoritarian variants) are neither liberal democracies nor autocratic regimes; rather, they are situated along a spectrum, in between these two types'.<sup>25</sup> The hybrid political system of Uganda was established in 1986 under the leadership of Yoweri Museveni. Mr. Museveni had led the 'National Resistance Movement (NRM)' through guerrilla activity against Uganda's authoritarian regimes of the 1970s and 1980s.<sup>26</sup>

Mr. Museveni has been president of Uganda since 1986; the NRM has ruled with an absolute majority since. Accordingly, Uganda's politicians have mostly emerged from the NRM – and even the majority of those in the opposition are former protégés of the NRM. With 50 percent of the population aged fifteen years and below, generational change takes place among the lower ranks of politicians.

#### 3.2 Uganda's economic policies between 1986 and 1999

With regard to its macro-economic management, the NRM-led government had leaned towards interventionism in its early years. Since the first half of the 1990s it shifted its focus towards market-building.<sup>27</sup> This shift was inspired by World Bank and IMF and led to the emergence of a strong technocracy in the central bank (Bank of Uganda – BoU).<sup>28</sup> In 1992, it brought about the creation of the ministry of finance, planning and economic development (MoFPED) which was the result of a merger of the ministries of finance and of planning; the latter had been established in the 1960s.<sup>29</sup>

Unlike its macro-economic policy, the micro-economic policies of the NRM-led government remained mixed, with both interventionist and market-building approaches. This is borne out

by Uganda's financial sector policies. Thus between 1988 and 1994, the government pursued direct credit provision through the country's largest and government-owned bank.<sup>30</sup> But the 1990s saw a phase of liberal licensing which led to an increase in the number of regulated financial institutions (FIs).<sup>31</sup> However, over the same period the government pursued three schemes for directed credit, two of which were administered through ministerial and local government offices.<sup>32</sup>

At the end of the 1990s, Uganda's regulated segment of the financial sector fell into a crisis that culminated in the closure of four commercial banks and demise of the largest and government-owned bank. In the aftermath of those events, BoU consolidated its position as the sole supervisor of FIs; MoFPED technocrats lost their stake in that budget.<sup>33</sup> At about the same time, the government's credit schemes failed due to poor administration and high default rates.<sup>34</sup>

### **3.3 A market-building MF policy regime from 1999 to 2005**

Uganda's market-building MF policy was based on a 1999 policy paper by the BoU.<sup>35</sup> It followed a comprehensive campaign of NGO-activists and development technocrats and led to the MDI-act in 2003.<sup>36</sup>

Most of these NGOs used compulsory savings as part of their lending model although some of them mobilized voluntary savings. However, they were legally prohibited from accepting deposits; that is savings from the public to be intermediated into loans. SACCOs are allowed to intermediate savings from their members (but not the public) into loans for their members. Development technocrats were involved in both shaping the growth of NGO-MFI operations and in influencing the development of related policy of the BoU and MoFPED. Table 1 presents the building blocks and institutions that embedded Uganda's market-building MF policy.

Table 1: Building Blocks of Uganda's Market-building MF Policy

Item	Type	Year	Role
Core Documents	Policy Paper	1999 <sup>37</sup>	‘supported the view of microfinance as a line of business and foresaw the initiation and creation of a four tiered financial structure’ (AMFIU, 2008:40)
	Cabinet Paper	1999	basically adopted the policy paper which had been authored by BoU
	MF Regulation Bill	2000	based on its policy paper, BoU produced this draft bill which was widely debated at AMFIU, in the MF Forum and in parliament
	Cabinet Statement	2001	‘it [Government of Uganda] had pulled out of direct delivery of financial services and would concentrate on improving the operational environment (policy regime) for private sector institutions to do the business’ (AMFIU, 2008:41)
	MF Deposit-taking Institutions (MDI) Bill	2003	emerged from the discussions between 2000 and 2003, when it was enacted by parliament
	MDI-regulations	2004	The MDI-act authorised BoU to implement the regulation of MDIs, for which they stipulated regulations about licensing, reporting and performance requirements of the MDIs. MDI-licenses have been given on the basis of these regulations <sup>5</sup>
Organisations	BoU	Founded in 1966	authored the MF policy paper and the MF Regulation Bill; licenses and supervises MDIs
	MoFPED	Founded	authored the MF cabinet paper and the cabinet

		in 1992	statement that supported a market-building direction; steered bill through parliament towards its being passed as MDI-Act; oversaw administrative unit that coordinated MF Outreach Plan
	Association of MFIs in Uganda (AMFIU)	founded in 1996	with active support of development technocrats, this member-based organisation became a major platform of the campaign for a change of the regulatory framework in Uganda
	MF Support Centre Limited (MSCL)	Founded in 2003	replaced earlier schemes through which government had directed credit; mandated to advance wholesale loans to MFIs by business performance principles, though at subsidized lending rates
Frameworks	MF Forum	Founded in 1998	a consultancy mechanism for debating and refining policy in which development technocrats were prominently involved
	MF Outreach Plan	Founded in 2002	‘a strategic plan for expanding the outreach of Micro-finance into the rural areas [...] multi-donor/government plan [...] based on [...] increased efficiency, commercial viability and market development for capacity building services’ (Kamuhanda and Tanburn, 2005:13)

Sources: AMFIU (2006; 2008), BoU (2004), Godwin-Groen et al (2004), Kamuhanda and Tanburn (2005), Schmidt (2011).<sup>38</sup>

### 3.4 An interventionist MF policy regime since 2005

In the run-up to the 2006-parliamentary and presidential elections, NRM endorsed a platform of ‘Bonna Bagagawale’ (Prosperity for all). The minister of state in charge of microfinance (2005 to 2009), Caleb Akandwanaho<sup>39</sup> was a leading protagonist of that platform and had his technocrats draw an MF policy of an interventionist spirit.<sup>40</sup> Based on this framework, the government intended to channel all MF funds into the formation of ‘one SACCO per sub-county’. Table 2 gives the building blocks and institutions that embed the interventionist policy. By June 2011, the Ugandan government supported 735 SACCOs nation-wide financially and technically.<sup>41</sup>

Table 2: Building Blocks of Uganda’s Interventionist MF Policy

Item	Type	Year	Role
Core Documents	Manifesto of the NRM in the presidential and parliamentary elections	2006	a multi-faceted development agenda for ‘Bonna Bagagawale’ (Prosperity for All), it endorses an interventionist economic policy; perceives microfinance as a ‘social service’ that should be available to every citizen; describes government’s role in microfinance provision as ‘creating and building a nationwide network of rural financial infrastructure’
	MF policy	2005	‘translated’ objectives of ‘Bonna Bagagawale’ into guidelines for government policy; focus on SACCOs and the objective of forming ‘one SACCO per sub-county’

Organisations	MoFPED	Founded in 1992	authored the MF policy paper that supported an interventionist direction; drafted an MF regulation bill that would bring SACCOs under its purview; oversees administrative unit that coordinates RFSP
	Uganda Credit and Savings Cooperative Union	Founded in 1972	formally a member-based organisation, government through financial and personnel intervention shaped it to be the main implementing agency of RFSP; spearheads the formation of ‘one SACCO per sub-county’; supports young SACCOs with physical assets, staff salary subsidies and trainings
	MF Support Centre (MSCL)		The government shifted the criteria of MSCL lending from business performance towards political-administrative (SACCOs, including young and inexperienced ones); also included Farmers’ Marketing Cooperatives into the MSCL target group; set up an agricultural credit facility with an annual interest rate of 9 per cent, which requires SACCOs to retail agricultural credit at not more than 13 per cent annually

Frameworks	The Rural Financial Services Program (RFSP)	Founded in 2007	replaced the MF Outreach Plan; the coordinating unit for the interventionist policy, administering government funds to the cooperative union and its member-SACCOs
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Sources: Akandwanaho (2007), AMFIU (2008), MoFPED (2005), RFSP (2009), Schmidt (2008)<sup>42</sup>

#### 4. EXPLAINING UGANDA'S MICROFINANCE POLICY MAKING

##### 4.1 Objectives of Uganda's MF policy makers

###### 4.1.1 *Politicians*

In terms of winning elections, Uganda's ruling party and its politicians have been overwhelmingly successful. They won all national election since 1986 at a substantial margin. Their MF policy has added to that record in two main ways.

First, during the presidential and parliamentary election campaign of 2001, the market-building MF policy distanced the government from the failures of its directed credit schemes as well as from the failure of FIs. Furthermore, the process of implementing a market-building MF policy required the active involvement of development agencies, through AMFIU and through the MF Forum. This was appreciated by the development agencies who described it as 'best practice'.<sup>43</sup>

Second, the presidential and parliamentary election campaigns of 2006 and 2011 were won by mobilising rural and first-time voters who constitute the majority of Ugandans. The interventionist MF policy appealed to these voters because it raised their expectations for a quick and tangible access to finance in the form of SACCO-loans. Moreover, young voters could hardly remember the failed directed credit schemes of the 1990s and were eager for the opportunities promised by 'Bonna Bagagawale'.

#### *4.1.2 Technocrats*

The market-building MF policy served the interest of technocrats both at BoU and at MoFPED.

BoU technocrats defended their consolidated role through pro-actively taking up the MF topic. At the same time, they were cautious to avoid the responsibility of supervising a large number of NGO-MFIs and SACCOs. Indeed, the technocrats were aware that they would not be able to effectively supervise all the NGO-MFIs and SACCOs. In the 1990s, they had experienced rapid growth in the number of financial institutions outpacing BoU's supervision capacity. This had been a factor in the banking crisis at the end of that decade.<sup>44</sup> Meanwhile, MoFPED technocrats expected their profile and budgets to rise with the growing number of development agencies.

In 2005, MoFPED technocrats might not have been convinced of the new direction. On the one hand, they had professionally embraced the Rutherford and Robinson paradigms (see 4.2.1). On the other hand, the interventionist policy increased the influence of politicians over spending decisions, as opposed to MF budgets being largely controlled by technocrats. This became particularly visible in MSCL, where a politician became chairperson of the board of directors and assumed managerial roles.

However, MoFPED technocrats knew that BoU had expanded its staffing when its supervision function was strengthened with international funding. BoU-technocrats through their cautious MDI-licensing approach<sup>45</sup> had signalled that they were not interested in taking responsibility for the vast number of non-regulated MFIs. Therefore, MoFPED-technocrats could assume that the change of MF policy would hand more staffing to them. This reasoning is borne out by the SACCO-regulation bill that has since been drafted and promoted by MoFPED.<sup>46</sup>



However, that bill removes SACCOs from the oversight of the Ministry for Tourism, Trade and Industries. This ministry is responsible for the registration and, nominally, supervision of all cooperatives. Supported by cooperative activists, the technocrats of the Ministry for Tourism, Trade and Industries have since agitated for policies that delay the tabling of MoFPED's SACCO regulation bills in cabinet.

BoU-technocrats had hitherto been among the most critical of the new policy, and their resistance altered some of the elements included in the earlier proposal. These had concerned the role of government-owned Post bank, a BoU-regulated financial institution. The major focus of the new policy was on SACCOs, though, and those remain outside the realm of BoU.

#### *4.1.3 MF Special Interest Groups*

Special interest groups that advocate for MF policy in Uganda comprise of NGO- and cooperative activists, bankers and development technocrats. Most of them supported the market-building MF policy and were critical of the interventionist approach for a number of reasons.

First, NGO-activists who work in internationally based NGO-MFIs (three of which later transformed into MDIs) were among the supporters of the market-building MF policy, because it provided them with career opportunities. For example, as the NGOs grew and transformed into MDIs, salaries increased and staff were also offered many training opportunities, often abroad. Moreover, the growth of MDIs opens many opportunities to their staff such as the chance to become branch or regional managers or even department heads.<sup>47</sup>

Second, another interest group who supported the market-building MF policy were bankers who joined transforming NGO-MFIs or who organised MF 'product lines' in regulated FIs. Accordingly, they supported the market-building MF policy, because it created opportunities for their business and their careers.<sup>48</sup>

However, not all NGO-activists remained supportive of the market-building MF policy. It was becoming clear towards the middle of the decade that many NGO-MFIs would not be able to transform into MDIs, as the market space was occupied and transformation funding was reducing.<sup>49</sup> In NGO-MFIs that were struggling to transform into MDIs or to operate self-sufficiently, NGO-activists experienced increasing job insecurity and stagnating opportunities. These NGO-activists realised that the interventionist MF policy might offer them better career opportunities, for instance by joining the cooperative union that distributed government funds to SACCOs, or by joining those SACCOs. Indeed, one NGO-MFI even abandoned its legal form and registered as a SACCO.

Technocrats employed by development agencies that were subsidiaries of 'donor countries' were another group with interests in supporting market-oriented MF policy. At least nine bi- and multilateral development agencies supported financially and technically Uganda's MF sector during the period of market-building. They were also active participants of the MF Forum and (some of them) have been the main funders of AMFIU. Most of them stopped that support after the shift to the interventionist MF policy.

Cooperative activists, on the other hand, have divided interests and loyalties. Those working in large and operationally self-sufficient SACCOs were supporters of the market-building policy, because they did not wish politicians and government technocrats to interfere in their organisations. Members or staff of smaller SACCOs regularly supported the interventionist policy, because it created opportunities for them. In fact, many of these small SACCOs had been formed for the purpose of accessing government funding. The divide among cooperative activists is also visible at national level, where one cooperative association is strongly opposed to the interventionist MF policy, while another is its lead implementer (box 2).<sup>50</sup>

## **4.2 Strategies adopted by Uganda's MF policy-makers**

### *4.2.1 Information-based strategies*

NGO-activists and development technocrats were at the forefront of the evolution of microfinance as a knowledge field; notable are the 'Robinson-paradigm' and the 'Rutherford-paradigm'. The former proposed the view that MFIs should be financial service providers exclusively, rather than social service providers, or a mix of the two.<sup>51</sup> The latter drew on the fact that until the 1990s, microfinance basically involved micro-credit only, and stressed the demand of poor people for savings.<sup>52</sup> This implies, amongst other things, regulation of the industry.

The Robinson and Rutherford paradigms informed MF policy-making in Uganda between 1999 and 2005.<sup>53</sup> However, when Uganda's parliamentarians passed the MDI-bill in 2003, they also passed a resolution calling for additional government interventions towards the mostly rural SACCOs that were considered unlikely to transform into MDIs.<sup>54</sup> This showed that the information provided by development agencies met with scepticism of many Ugandan politicians.

In other words, Ugandan politicians accorded the market-building MF policy low credibility, despite the efforts of development technocrats, NGO-activists and bankers to provide supportive information. For most Ugandan politicians, the information they had or believed to have about the merits of interventionism enjoyed higher credibility. They felt that rural outreach of microfinance in Uganda expanded very slowly,<sup>55</sup> and they embraced the promise of 'Bonna Bagagawale' to accelerate it. Consequently, in 2005 they embraced the change of MF policy toward interventionism.

It is noteworthy that the financial support of development agencies and international NGOs appears to have added little credibility of the information they provided. This observation points to the scope of finance- and loyalty-based strategies.

#### 4.2.3 *Finance-based strategies*

Donor countries contributed substantially to organisations and frameworks of the market-building MF policy.<sup>56</sup> However, most of this finance was not distributed through government agencies. It was provided to MFIs to finance expansion of their operations and their transformation into regulated FIs; much of it in form of technical assistance.

Also, the budgets injected into the MF sector were small compared to the financial means provided to priority interest areas of the leading donor countries. Those are security and military spending.<sup>57</sup>

If development agencies had translated their disagreement about the reversal of MF policy direction into reduced security and military spending, it would probably have outweighed the political gains expected from that reversal. However, the NRM-government had experience with ‘trade-offs’ of security/military policy against other fields of policy.<sup>58</sup> They had reason to assume that the change of MF policy direction would not upset military priorities. Indeed, it did not.<sup>59</sup>

#### 4.2.3 *Loyalty-based strategies*

Under the conditions of a semi-authoritarian regime, rewarding loyalty and retaining loyalists is likely to be the most important consideration of political power.<sup>60</sup> Uganda’s three presidential elections since 2001 have been contested by an ‘illoyalist’; a former army officer who is also a former leading member of the NRM.<sup>61</sup>

Furthermore, in 2005 Uganda held the first election under a ‘multi-party-regime’.<sup>62</sup> In previous elections under the current constitution, the NRM was the only organisational platform allowed for campaigning. All other candidates were formally independent individuals.<sup>63</sup> The multi-party-regime had been advocated for by international development agencies in a rather pushy way. Moreover, they were calling for reforms that would separate

organisational structures of party and local government, which thus far had been de facto identical.<sup>64</sup>

That meant that the objectives of the development agencies and the interests of the ruling politicians were in strong conflict. Maintaining political power meant to steer through that conflict, and at the same time assure loyalties, either through patronage or through means of aggression.

Against this backdrop, the reversal of MF policy direction sent a message both to the government's own followers and to the international development agencies. The message was that the NRM was standing up to defend its own interests, as opposed to being 'pushed around'. Moreover, it created alternative avenues for patronage, as funding was channelled into young, small SACCOs which had often been created for that very purpose.

## 5. CONCLUSIONS

Between 1999 and 2005, development technocrats and NGO-activists successfully shaped Uganda's MF policy through financial contributions and 'state of the art' information. Four NGO-MFIs transformed into MDIs under the market-building policy. Three MDIs are growing robustly, and in 2010 reached out to about 430,000 savers. The fourth MDI had over 110,000 savers in 2008, when it was taken over by a commercial bank.<sup>65</sup>

However, this information did not make a deep impression on Uganda's politicians. Since 1986, they had been informed that MF was a social service that makes loans available at highly subsidised interest rates. Accordingly, they can point to a phase of rapid SACCO growth between 2005 and 2008, resulting in over 800,000 savers reached in 2010.<sup>66</sup>

Moreover, the interventionist policy aligned with their main objective and strategy. Those are to maintain political power through loyalty based on patronage. From this angle, the market-building MF policy was an outlier which emerged from a strategy for political power rather than from 'learned lessons', as MF special interest groups liked to believe.<sup>67</sup>

Furthermore, technocrats and MF-activists did not hold unanimous views on MF policy. Though most of them had supported the market-building direction, MoFPED-technocrats, and probably activists in some NGO-MFIs and in most SACCOs could expect the interventionist direction to align better with their interests.

The analysis of Uganda's MF policy regime in the 2000s offers insights for the provision of policy advice by development agencies and for the study of MF developments across countries. However, the exploratory nature of this political-economy-framework requires testing through further research. The hypothesis that information is relatively low priority as compared to finance- and loyalty-based strategies needs to be explored further. With the current dataset, the effects of different objectives and strategies on policy-makers and policy-outcomes cannot be established authoritatively. This calls for further study, for example comprehensive interviews with those involved. Such studies would also allow exploring the role of information uncertainty, and how policy-makers deal with it. Last but not least, a systematic comparative approach would show why the MF policies in other East African countries were sequenced differently, for example regulating SACCOs before transforming NGOs.

The case of Uganda's MF policy emphasises the relevance of gaining deeper understanding of the political economy of its making; this paper proposes a starting point in terms of theoretical framework and in terms of empirical material.

## NOTES AND REFERENCES

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<sup>1</sup> In Tanzania, the threshold for SACCOs to be regulated by the central bank is a deposit portfolio of Tanzanian Shillings 800 million (approx. Euro 387,000) (Millinga, 2007).

In Kenya, SACCOs that offer daily liable deposits must be licensed by the SACCO Societies Regulatory Authority and comply with its prudential regulation (among others minimum capital of Kshs 10 million [approx. Euro 82,000]; capital adequacy requirements, and compulsory deposit insurance). Other SACCOs can only offer deposits liable at 60 days notice. The SACCO Societies Regulatory Authority is a semi-autonomous institution, closely linked to the central bank as well as to the Ministry of Cooperative Development and Marketing (Wolff et al, 2011).

In Uganda, the discussion about SACCO regulations leans towards the Kenyan framework, which would be placed under the purview of MoFPED (AMFIU 2008).

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<sup>2</sup> CGAP, 2012. Our Work – Government and Policy Available at <http://www.cgap.org/p/site/c/govt/> [accessed on 3 March 2012].

<sup>3</sup> Besley, T., 2006. *Principled Agents? The Political Economy of Good Government*, The Lindahl Lectures, Oxford and New York: Oxford University Press.

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<sup>4</sup> North, D., 1990. *Institutions, Institutional Change and Economic Performance*. Cambridge, UK: Cambridge University Press, p. 3.

<sup>5</sup> Besley, op. cit.

Kirsch, G., 2004. *Neue Politische Oekonomie*, 5<sup>th</sup> edn. Stuttgart: Lucius and Lucius.

<sup>6</sup> Grossman, G. M. and Helpman, E., 2001. *Special Interest Politics*. Cambridge, MA: MIT Press.

<sup>7</sup> Schmidt, O., 2011. *Association – Concept, Management, Context*. Saarbruecken: VDM.

Fritsch et al, op. cit.

<sup>8</sup> Kirsch, op. cit.

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<sup>9</sup> Minogue, K., 1995. *Politics – A Very Short Introduction*. Oxford and New York: Oxford University Press, p. 64.

<sup>10</sup> The route of enacting a political platform or policy proposal into law usually includes a number of milestones. Those include a policy paper by an agency, for example the central bank; a cabinet paper, that is a pronouncement by politicians (the members of cabinet); tabling a bill to parliament, usually a privilege by members of the legislative and of the executive; and parliamentary consultation which usually does not only involve members of parliament but also openly or covertly special interest groups.

Technocrats are involved in achieving each milestone. The ultimate ‘gate-keepers’ are politicians who hold the according offices. They are the only ones to take binding decisions on cabinet papers, or tabling of bills, or acts of parliament, or authority to technocrats to take action on or under a policy enacted.

<sup>11</sup> Niskanen, W. A., 1975. Bureaucrats and Politicians, *Journal of Law and Economics*, 18; quoted by Kirsch, op. cit.

<sup>12</sup> Grossman and Helpman, op. cit.

<sup>13</sup> Grossman and Helpman, *Ibid.*, p. 138. They model in mathematical detail how politicians or technocrats (which they subsume under ‘policymakers’) and special interest groups interact over information and information uncertainty.

<sup>14</sup> Kahneman, D., 2011. *Thinking, Fast and Slow*. New York: Farrar, Straus and Giroux.

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<sup>15</sup> Grossman and Helpman, op. cit.

<sup>16</sup> Wintrobe, R. , 1997. Modern bureaucratic theory. In Mueller, D. C. (ed) *Perspectives on Public Choice – A Handbook*. Cambridge, UK: Cambridge University Press, pp. 429-454.

<sup>17</sup> Hirschmann, A. O., 1970. *Exit, Voice and Loyalty, Responses to Decline in Firms, Organizations, and States*. Cambridge, MA: Harvard University Press.

<sup>18</sup> Collier, P., 2009. *Wars, Guns and Votes – Democracy in Dangerous Places*. London: Vintage.

<sup>19</sup> This is called ‘logrolling’ in public-choice-literature. Stratmann, T., 1997. Logrolling. In Mueller, D. C. (ed.) *Perspectives on Public Choice – A Handbook*. Cambridge, UK: Cambridge University Press, pp. 322-341.

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<sup>21</sup> Dasgupta, P., 2000. Economic Progress and the Idea of Social Capital. In Dasgupta, P. and Serageldin, I. (eds.), *Social Capital – a Multifaceted Perspective*. Washington D. C.: World Bank.

<sup>22</sup> Collier, op. cit.

<sup>23</sup> Collier, *Ibid.*.



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<sup>24</sup> Tripp, A. M., 2010. *Museveni's Uganda – Paradoxes of Power in a Hybrid Regime*. London and Colorado: Lynne-Rienner Publishers.

<sup>25</sup> Tripp, Ibid., p. 9.

<sup>26</sup> Meredith, M., 2006. *The State of Africa – A History of Fifty Years of Independence*. London: Free Press.

<sup>27</sup> Whitworth, A, and Williamson, T., 2010. Overview of Ugandan Economic Reform since 1986. In Kuteesa, F., Tumusiime-Mutebile, E., Whitworth, A. and Williamson, T. (eds.), *Uganda's Economic Reforms – Insider Accounts*. Oxford and New York: Oxford University Press, pp. 1-34.

<sup>28</sup> Tumusiime-Mutebile, E., 2010. Institutional and Political Dimensions of Economic Reform. In Kuteesa, F., Tumusiime-Mutebile, E., Whitworth, A. and Williamson, T. (eds.), *Uganda's Economic Reforms – Insider Accounts*. Oxford and New York: Oxford University Press, pp. 35-51.

Byaruhanga, C, Henstridge, M. and Kasekende L., 2010. Exchange Rate, Fiscal, and Monetary Policy, In Kuteesa, F., Tumusiime-Mutebile, E., Whitworth, A. and Williamson, T. (eds.), *Uganda's Economic Reforms – Insider Accounts*. Oxford and New York: Oxford University Press, pp. 52-88.

<sup>29</sup> Tumusiime-Mutebile, Ibid.

<sup>30</sup> Muhumuza, W., 2007. *Credit and Reduction of Poverty in Uganda*. Kampala: Fountain Publishers.

<sup>31</sup> Kamuhanda and Tanburn (2005) record an increase from seven to 23 FIs\*.

Kamuhanda, R. and Tanburn, J., 2005. *Making Service Markets Work for the Poor – the Experience of Uganda*. Kampala: ILO and DFID.

\* FIs refer to commercial banks, credit institutions and MDIs which all provide retail credit and/or savings and/or payment services; according to the scope of their BoU-license. Their licenses also require different amounts minimum capital.

<sup>32</sup> AMFIU, 2008, op. cit.; Muhumuza, op. cit.

<sup>33</sup> Tumusiime-Mutebile, op. cit.; Byaruhanga et al, op. cit.

<sup>34</sup> Muhumuza, op. cit.

<sup>35</sup> AMFIU, 2008, op. cit.

<sup>36</sup> Schmidt, 2011, op. cit.

AMFIU, 2006. *Ten years of AMFIU (1996-2000)*. Kampala: AMFIU.

<sup>37</sup> There is an inconsistency in AMFIU's publications about the year of the BoU and cabinet policy papers. AMFIU (2005), which was edited based on discussion with a number of development practitioners who were present at the time in question, records it for the year 2000. AMFIU (2008) records it for the year 1999.

AMFIU, 2005. *Regulating and Strengthening tier 4 Microfinance Institutions in Uganda – Background Studies*, Kampala: AMFIU.

AMFIU, 2008, op. cit.

<sup>38</sup> AMFIU, op. cit.; Schmidt, 2011, op. cit.; Kamuhanda and Tanburn, op. cit.;

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Godwin-Groen R. Bruett, T. and Latortue, A., 2004. *Uganda Microfinance Sector Effectiveness Review*, Available at [www.fsdu.or.ug/pdfs/Uganda\\_Microfinance\\_Sector\\_Review.pdf](http://www.fsdu.or.ug/pdfs/Uganda_Microfinance_Sector_Review.pdf), [accessed on 22<sup>nd</sup> October 2011].

<sup>39</sup> Retired General Caleb Akandwanaho, popularly known as Salim Saleh, is a younger brother of Uganda's President Yoweri K. Museveni. He was among the military leaders of the guerrilla activity that Mr. Museveni led in the 1970s and 1980s.

<sup>40</sup> MoFPED, 2005. *Microfinance Policy and Regulatory Framework in Uganda 2005-2015*, Available at [www.finance.go.ug/docs/Introduction\\_to\\_Microfinance\\_bklet.pdf](http://www.finance.go.ug/docs/Introduction_to_Microfinance_bklet.pdf), [accessed on 20<sup>th</sup> October 2011].

<sup>41</sup> Agabalinda, C., 2012. Sustainability Prospects of Government Supported SACCOs, *Presentation at Makerere University Business School's 1<sup>st</sup> Annual Microfinance Workshop*, 28 and 29 February 2012. Kampala: MUBS.

<sup>42</sup> AMFIU, 2008, op. cit.; MoFPED, op. cit.;

Akandwanaho, C., 2007. Strategy for Rural Financial Services, *Presentation at the public expenditure review workshop*, 8 May 2007. Kampala: MoFPED.

RFSP (2009). Rural Financial Services Programme. In AMFIU (ed.): *The Uganda Microfinance Directory 2009/10*, Kampala.

Schmidt, O., 2008. Finanz- und Bankenmaerkte in Niedrig-Einkommenslaendern: Erfahrungen aus Uganda, Ostafrika. *Wirtschaftswissenschaftliches Studium*, Vol. 37, Issue 2 (2/2008), pp. 95-99.

<sup>43</sup> Goodwin-Groen, op. cit.

<sup>44</sup> Byaruhanga et al, op. cit.

<sup>45</sup> Between 2004 and 2005, BoU issued four MDI-licenses; two to 'spin-offs'\* of international NGOs (FINCA and Uganda Finance Trust), one to an NGO-turned-company\* founded by a Ugandan and an US-American entrepreneur (Uganda Microfinance Limited), and one to the 'spin-off'\* of a government project which had initially been funded by USAID (PRIDE MF). UML was taken over by Kenya Commercial Bank (KCB) in 2008. A fifth MDI-license was issued in 2011 to the 'spin-off'\* of a Ugandan NGO (UGAFODE).

\*The MDI-act requires the legal status of a company limited by shares; therefore NGOs had to transform to that legal status. All MDIs maintained, except for minor adjustments, the names of the NGOs they had been.

<sup>46</sup> See note 1.

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<sup>47</sup> Muzigiti, G. and Schmidt, O., 2010. Careers in the Banking and Microfinance Industry in Uganda. In Karugaba, D. and Schmidt, O. (eds.), *Career Perspectives in Accounting, (Micro) Finance and other Sectors, Yearbook of MMU School of Business and Management Studies*, Vol. 1, Fort Portal.

<sup>48</sup> Muzigiti and Schmidt, Ibid.

<sup>49</sup> AMFIU, 2008, op. cit.

<sup>50</sup> Schmidt, 2011, op. cit.

<sup>51</sup> Robinson, M., 2001. *The Microfinance Revolution – Sustainable Finance for the Poor*. Washington D. C.: World Bank.

<sup>52</sup> Rutherford, R., 1999. *The Poor and their Money – An Essay about Financial Services for Poor People, Institute for Development Policy and Management*. Manchester: University of Manchester.

<sup>53</sup> Schmidt, 2011, op. cit.; AMFIU, 2006, op. cit.

<sup>54</sup> AMFIU, 2005, op. cit.

Already in 2001, Mr Museveni had first pronounced the intention to direct funding to each sub-county for financial service provision. Concerted effort of MF special interest groups transformed that announcement into the MF Outreach Plan (Kamuhanda and Tanburn, op. cit., p. 13). Parliament's SACCO-intervention-resolution of 2003 was thus not a first signal but a reminder of the scepticism that Ugandan politicians at all levels held against the market-building MF policy.

<sup>55</sup> In 2006, regulated FIs reached about 20 percent of Uganda's population; NGO-MFIs and SACCOs reached about six percent. Between 2003 and 2007, NGO-MFIs and MDIs hardly expanded their outreach (Schmidt, 2012, with further references).

Schmidt, O., 2012. *Microfinance in Uganda: 2012 and beyond, Presentation at Makerere University Business School's 1<sup>st</sup> Annual Microfinance Workshop*, 28 and 29 February 2012. Kampala: MUBS. Available at <http://mmumf.wordpress.com> (web site) [accessed on 31<sup>st</sup> May 2012].

<sup>56</sup> Between 1999 and 2003, US\$ 60 million were allocated to the MF sector (Goodwin-Groen et al, op. cit.; AMFIU, 2008, op. cit.). That equals on annual average less than two percent of foreign aid.

<sup>57</sup> 'Between 1990 and 2005, aid [inflows to Uganda] averaged US\$ 738 million per year' (Mwenda, 2010:47). Of this amount, annual defence spending represented about 18 percent.

Mwenda, A., 2010. *Uganda's Politics of Foreign Aid and Violent Conflict: The Political Uses of the LRA Rebellion*. In: Allen, T. and Vlassenroot K. (eds.) *The Lord's Resistance Army: Myth and Reality*. London: Zed Books.

<sup>58</sup> Mwenda, Ibid.

<sup>59</sup> Since 2005, aid inflows for microfinance have been shrinking, while aid allocated to military and security has been increasing (Mwenda, Ibid.).

<sup>60</sup> Tripp, op. cit.

<sup>61</sup> Tripp, Ibid.

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<sup>62</sup> Uganda had held multi-party-elections in 1962, marking independence from colonial rule, and in 1980, marking the end of the regime of Idi Amin Dada. However, the 1980-elections were highly disputed, ‘plunging Uganda into an anarchic civil war’ (Meredith, op. cit. p. 238).

<sup>63</sup> Tripp, op. cit.

<sup>64</sup> Tripp, Ibid.; Meredith, op. cit.

<sup>65</sup> Schmidt, 2012, op. cit., with further references.

<sup>66</sup> Schmidt, Ibid.

<sup>67</sup> CGAP, 2004. The Role of Governments in Microfinance. *Donor Brief No. 19*, June 2004, p. 2.