

The Hidden Costs of Doing Business in Uganda

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List of Acronyms

BMW	Bonded Manufacturing Warehouse factory scheme
CBI	Cross-Border Initiative
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Cooperation
FDD	Fixed Duty Drawback Scheme
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
NORAD	Norwegian Agency for Development
TRIMS	Trade-Related Investment Measures
UIA	Uganda Investment Authority
UMA	Uganda Manufacturers Association
URA	Uganda Revenue Authority
WTO	World Trade Organization

Executive Summary

The Uganda development target of increasing private sector investment and reduce mass poverty, which has recently been reaffirmed, contrasts sharply with experience on the ground, where investors are confronted with a combination of obstacles ranging from restrictive government regulation and lack of respect for property rights to corruption and poor macroeconomic environment. Competition places pressure on the firms to cut costs, yet many of the costs such as costs associated with corruption, bureaucracy, infrastructure deficiency, transport and telecommunication, utility tariffs, tax regime, interest rates, etc are not in the control of the firms. This highly constrains business growth. Where taxes and bureaucracy are inhibitory to business survival others try to cope by going under or pay bribes in order to avoid making full payment of tax and utility bills, or to avoid losing out on business opportunity due to excessive delays.

This study, conducted under the auspicious of the Anti Corruption Coalition Uganda, attempted to analyse the impact of corruption on private businesses, using a number of case studies. Using a data set for 100 firms interviewed in September 2002 – comprising manufacturers (textile, and beverages/soft drinks); exporters (coffee traders and processors, and textile firms); and importers (textiles, and computer dealers, among others), the study:

- i) Analyzed the (corrupt) behaviour of officials or agents supposed to facilitate trade and investments and how it has impacted on private businesses and government revenue, and subsequently service delivery;
- ii) Analyzed the cost attributed to payment of bribes, other impediments, and opportunity cost of waiting (custom clearance, obtaining license and permits, etc), as a share of total cost of doing business;
- iii) Identified the major impediments to private sector investment in the country and rank these in order of priority;
- iv) Assessed why registered investments do not take off and why (foreign) investors prefer to contract out management.

Key findings

The study found that, among the serious factors undermining private sector investment in Uganda, as also inhibiting business competitiveness, is the persistence level of corruption. Seventy-two out of the 100 firms surveyed (72%) considered corruption as a major constraint to business investment. The forms of corruption, which are most detrimental to businesses and the economy, were identified as bribery, evasion of taxes and discrimination in the application of regulations and in the provision of services.

- **Bribes payment**

Businesses in the export, imports and manufacturing sector have succumbed to the necessity to pay bribes to obtain their export and import papers, custom clearance, licenses, and so on. Seventy-two, out of the 100 firms interviewed reported bribe payment as a problem. In the analysis, 50% of importers, 30% manufacturing firms and 20% of the exporters paid bribe in the process of obtaining their licenses, export/import papers or customs clearance.

In a single encounter, a coffee exporter/trader pays from Ush 100,000 - Ush 500,000 to officials in the customs, licensing department, and other government offices to 'quicken' the process of export documentations, license and related legal papers. On the other hand tax evasion is also rampant in this sector. Among coffee-processors (also exporters), average bribe payment (per firm per year) is estimated at Ushs 1.7 million (i.e. amount paid between July 2001 and September 2002), accounting for 4.2% of the average total cost of doing business.

- **Tax evasion/smuggling**

The evasion of taxes occurs in two ways: falsification and forging of documents, faulty recording or under declaration of both value and quantities of goods, and proceeds. The second form of tax evasion: smuggling, makes the substantial part of tax evasion.

Annual partial tax evasion among the coffee traders is estimated at the magnitude of Ushs 282,000 per firm per year thus equivalent loss in Government revenue of the same magnitude. In the textile sector (imports), partial tax evasion and non-payments of other related fees amounts to about Ushs 3.2 million per firm, which implies a significant loss in revenue to government from this sector.

Smuggling is cited as a major business malpractice that has not only grossly affected the performance of industries but has also resulted in loss of government revenue. Ninety seven percent (97%) of the firms interviewed believe that smuggling and illegal business activities significantly affect growth of private sector investment.

- **Discrimination**

The study found that, of the different forms of corruption, discrimination against certain investors is the most serious hindrance to investment. Eighty, out of 100 firms reported this as a big problem to them (48.7% rated it as a high constraint, 30.8% as a medium constraint). Discrimination is practiced in different ways: selective application of regulation e.g. some people pay tax while others don't; others are kept waiting while others access their licenses, import papers, etc. in record time. Keeping a blind eye or deaf ear to harassments and complaints of certain groups of investors in another problem cited by about the same number of firms (80%), and deliberate delays with corruption related motives (46.2% of the firms reported this).

Firms that seem to be more affected by corruption are coffee processors (100% of the firms in this sector cited it as a major constraint), textiles and garments manufacturers (100% of the firms), beverages manufacturers (100% faced with problem of customs delays, discrimination, and failure to attend to cases of harassments and political interference in judiciary process), and clearing and forwarding agents (100 of firms).

- **Bureaucratic administrative procedures**

Close to corruption are bureaucratic administrative procedures, for example, the licensing requirements, exports and import documentations. Some firms believe that the experience with the existing bureaucracies could even be worse than bribe payment in terms of the delays and

mistreatment they go through. Bureaucracy in the export procedure is one of the major hindrances in ensuring competitiveness of the Ugandan exports. The process of export documentation approval is long, cumbersome and cause unreasonable delays, which only encourages corruption. Most of the firms dealing in imports experienced delays in having their goods cleared at the customs between July 2001 and September 2002. Only 16.6 percent of the firms were able to clear their goods in time. Forty percent (40%) of the exporters paid bribe (at least once) between July 2001 and September 2002. Further delays are caused by exclusive use of sealed containers and the operation of the convoy system.

Other factors affecting private sector investment

Besides corruption firms listed a number of other factors that affect their businesses, including poor condition and inadequacy of infrastructure (roads, telecommunication, power supply, availability of/access to market); inadequacy of investment finance, including access to and unfavourable terms of bank loans; encumbered government regulations and policies; and customs delay. Other obstacles include insecurity (experienced in certain parts of the country)/political instability or uncertainty about future political events, and lack of adequate understanding of some of the legislative requirements - resulting sometimes into non-compliance e.g. of VAT application.

- **Electricity/power supply**

It is established that, while the larger firms can insulate themselves from power supply problems by installation of generators, majority of small firms are totally exposed to the consequences of erratic power supply.

- **Inadequate financial resources and commodity market**

Ninety two percent (92%) of the firms were found to lack adequate financial resources to run their businesses profitably. They have limited access to bank loans and high interest rates on loans raise operation cost and discourage many from borrowing. The main reasons given for low capacity utilization are inadequate market and financial constraint. Over 200 projects registered in Kampala over a year or two, wound up for the same reasons.

- **High taxes/poor tax administration**

Businesses are also constrained by high taxes. Only 18.4% of the firms were happy with the present tax system and considered tax rates as reasonable. Seventy four percent (74%) had mixed views about the tax policy. Some complained about the tax rates (e.g. corporate tax), which they consider to be high and regressive, while others did not have much problem with the tax rates, but the general system of tax administration itself like the level of tax thresholds, which seems to work against small businesses. Selective enforcement of tax law, and proliferation of illegal businesses are another issues of contention is seen as a source of market distortion.

- **Limited access to information**

Lack of access to information is a challenge to many businesses. For example, the majority of firms are not aware of the requirements of Tax Laws and procedures. It is possible, the

difficulties in tax administration are partially a result of failure to educate the public about the basic requirements in the tax law.

- **Political instability**

Besides corruption and other structural problems mentioned above investors are also greatly concerned about political instability. Some expressed fears about the wars in the North (Northern Uganda) arguing that it will drain public resources and constraint development, including eroding the purchasing power of the public. Majority of investors (74%) considered political instability (uncertainty) as an important constraint to increased private investment in the country. Of those who were more concerned about political stability were the exporters. Ninety three percent (92.8%) rated this as a major problem.

Recommendations

Based on these findings the study came up with six areas, which policymakers, private sector, donors and other stakeholders need to address:

- Removing bureaucratic procedures where necessary
- Creating a wider platform for Government/private sector/NGO contact
- Appropriate systems of control and simplified documentation
- Continuous monitoring of agencies and system
- Harmonizing policies across common borders
- A fair, efficient and incorrupt tax administration

Streamlining bureaucratic procedures

The import, export and licensing requirements need to be reassessed and kept to a minimum. Customs for example is one of such areas, which lends itself to a streamlining of procedures. Computerization of the clearing system can advance this process while enhancing the monitoring of the speed with which goods are cleared. Official time limit should be announced for processing of licence, export/import papers, work permits, etc. Any delays, would be reported, explained and investigated by relevant authority.

Contracting out some functions of the customs department

As part of improving efficiency and accountability, some function of Customs Department could be contracted out to a firm with appropriate expertise. Nigeria is an example where this model has been tried and has proved successful. Government could investigate this further to see if such model could work for Uganda. In the meantime, Government could go ahead to contract another Pre-shipment firm and to impose penalties for wrong valuation/classification.

Appropriate systems of control and simplified documentation

To reduce customs delays caused by demands for thorough verification of mixed cargo, URA could adopt appropriate systems of control and simplified documentation by introducing a manifest for small exporters to present to customs. URA could encourage the development

of export consolidation and transportation hubs where small exporters can group consignments for exports and use certified transporters to transport their goods.

Automatic export licensing

Export licensing should be made automatic. Such licensing should be continued only for purposes of recording and monitoring. The duty drawback scheme is a welcome effort, but there is need to simplify the procedure and to develop a formula for accurate estimation of fixed drawback rates. If this seems difficult, a flat-rate refund based on a notion of average duties paid could also be tried.

Continuous monitoring of agencies and system

Experience shows that, for example, in revenue (URA) corruption, it is not enough to clean up a corrupt revenue collection agency. Unless a mechanism is established for continuous monitoring, sooner or later the agency will backslide once more into the old stealing habit and it will require yet another extraordinary effort to try to rehabilitate it. It is not enough to 'fire' corrupt officials without reforming aspects of the system that provide opportunities for stealing and ensuring that honest officials are being appointed in position of trust. Where personal contact is necessary, the introduction of elements of unpredictability as to which particular official may handle a matter or certain category of clients, and routine transfers reduce the potential for bribery.

Creating a wider platform for Government/private sector contact

A joint private sector / government working groups would help with a dialogue between government and the private sector – discussing the outlook for different sectors, particularly certain manufacturing sub-sectors, tourism, exports and imports. The idea would be that private sector and government would agree to aim at certain goals for the sectors. On the other hand, the private sector could apprise government about the barriers for reaching certain goals and the policies needed to remove obstacles. The cooperation would also help to reduce business malpractices like smuggling or other form of tax evasion as the private sector (through their association) volunteer timely information of any suspect to government, and advising government on how to deal with such situation. The present UMA/PSF/Government dialogue is a very good basis to build on.

Improvement in infrastructure and financial services

Equally important are complementary policies in respect of infrastructure, and the financial sector, which would facilitate or at least not inhibit private investment or the economy's response to the liberalization-induced change in incentives. The shift from a national to a regional mindset in addressing the road problem is going to be imperative for the enabling of an efficient commodity distribution network and equitable development.

1. Introduction

This paper deals with “the impact of corruption on private sector activities in Uganda”. In recent years, there has been a new paradigm shift in development thinking, with attention being drawn to private sector as an engine of economic growth. In Uganda, Government made a strategic choice that the modernization of the economy would be delivered primarily by the private sector. It has also recognized that any future ability to finance any government expenditure is critically dependent on the private sector. You often come across statements, which clearly show the important role private sector plays in the overall economic development: “if we do not make provision now to support and promote the private sector, this will undermine not only our strategy for development and modernization but also the revenue base for future budgets” (Budget Speech, June 1997). In the past, the public sector in Uganda was the dominant engine of socio-economic development. With the recent reforms, however, the private sector is beginning to assume a leading role in socio-economic development and Government now sets the enabling environment within which business invests and produces. The government is mainly concerned with rules and regulations. The basic agenda has been to streamline and downsize the machinery of Government, requiring a fundamental shift towards Government withdrawal from direct involvement in commercial activities.

Privatisation is only a partial response to this policy shift. There have been major areas of reform initiatives; the civil service reform, the legal, fiscal, monetary and exchange rate reform, among others. We shall not go into detailed elaboration of these reforms, but shall straight away return to the main theme of this research by considering the question once asked in one of the publications by Transparency International: “If development is to be private-sector led, what is the impact of corruption on the environment in which the private sector must work?” And what will be the consequence? My first impression is that it will undermine not only government strategy for development and modernization but also the revenue base for future budgets (the same fears expressed in the budget speech).

On the investor’s side we would explain that, corruption creates uncertainty. Investors are not sure that their dealing with Government departments or individuals will lead to successful contract; or the court won’t be impartial in resolving business disputes in which they are involved; or about the eventual cost of doing business since corruption related costs are often difficult to predict. Federer (1993) explores the empirical relationship between uncertainty and aggregate investment spending. The study found that uncertainty has a negative impact on investment and also has a larger impact on investment than does the cost of capital ratio.

And of course, uncertainty is considered largely synonymous with risks. As risk escalates, investors will be looking for investment with exceptionally high and quick returns. Corruption generally creates rent seeking, which is not healthy for the economy. Yet, serious step to address the problem of corruption in the private sector is at very early stage: the talking stage and not the “doing” stage. Up to now corruption has not been a subject of thorough research. It is in this context that this research was conducted to shed light on the impact of corruption on private sector investment in the country. The intention is to assist Government in examining the magnitude of corruption in the various forms it occurs, and to give recommendations on how it could be handled at various policy levels.

1.2 Objectives

The purpose of this paper is therefore, three-fold: First, to make an assessment of the magnitude of the problem of corruption – affecting private sector investment in Uganda. This includes examining the corruptive tendencies of officials or agents supposed to facilitate trade and investments and how these impact on private businesses in the short and long term; as well as on government revenue, and subsequently service delivery. It also involves critical analysis of the cost attributed to payment of bribes, other impediments, and opportunity cost of waiting (custom clearance, obtaining license and permits, etc), as a share of total cost of doing business.

Second, to examine the overlap between corruption and bureaucracy (Government procedures). There is widespread belief that these two problems are highly correlated. It also involves pointing out some of the factors that may cause or encourage corruption. The third purpose is to generally identify other major impediments to private sector investment in Uganda, and to assess why some registered investments do not take off. At the heart of this approach is the effort to eradicate corruption by coming up with appropriate policy recommendations that could assist different stakeholders involved in the anti-corruption campaign.

1.3 Empirical literature

A number of studies have been undertaken on factors that affect private sector investment, as well as the extent to which the development latecomers could draw lessons from policy experiences in countries like those in Eastern Asia. It is no doubt that there are still other factors that affect investment which are not fully captured by these studies. For example, nearly all these studies did not look into the issue of corruption. Most of the studies that have attempted to investigate empirically the experiences with corruption are based on developing countries in general.

Other studies are based on the Uganda experiences, but their primary focus has not been the effect of corruption on private sector investment. They tell us very little about the corruptive tendencies of public officials whom the private investors seek services from and the costs associated with corruption generally. It is only one study we came across: *The Cost of Doing Business: Firms' experience with Corruption in Uganda* by Jakob Svensson (2002) that tries to talk more authoritatively about corruption. But still, the study looks at corruption from a narrow perspective in the sense that it concentrates on payment of bribes. Corruption takes different forms as we shall see shortly, and payment of bribes as you may realise is just a sub-set or “a member of the corruption family”. While we may claim that as far as we know there has been hardly any study on the empirical assessment of the impact of corruption on private sector investment, we would also want to highlight some of the findings from the empirical literature on related studies.

According to the study by Jakob Svensson, most firms in Uganda perceive corruption to be one of the most serious impediments to conducting business (Svensson, 2000). The study highlights four important issues. First, firms typically have to pay bribes when dealing with public officials whose actions directly affect their (firms') business operations. These happen in services related

to exports, imports, payment of taxes, and in requiring public infrastructure services. Second, bribe may vary in amount depending on firm's specific characteristics and the firm's ability to pay – there is no fixed rate. Third, firms can significantly differ in the amount they pay in bribes even if their scale of operation is the same once they visualize the potential impact on the firm's profit and the opportunity cost of refusing to pay bribes.

Fourth, relative to other costs of operation, corruption constitutes a heavy burden on firms. The study found that 19 percent of the 176 firms that responded to questions about bribery reported that they did not have to pay bribes, 81 percent reported that they had to. Again, bribe payment amounted to equivalent of USD 8,280 on average, approximately 8 percent of total cost of doing business. What we found is a little lower than this, but nevertheless, Svensson's (2000) study leads to a very interesting conclusion, which we have found to be true in most cases. You will be able to appreciate this when it comes to the discussion of our research findings.

Other studies like that by TechnoServe and Norwegian Agency for Development (NORAD) succeeded to identify impediments to private sector development in Uganda. The TechnoServe study looked broadly, at trade flows within the East African region and identified the following obstacles: technical barriers, such as quality and standard requirements; administrative procedures such as customs clearance and border delays; cumbersome transit procedures and charges, pre-shipment and immigration requirements; government regulations and policies, notably suspended duties, import bans and food security concerns. Also included in the lists are the condition and adequacy of infrastructure (roads, storage facilities, etc), and axle load limit regulations (The EastAfrican September 16-22, 2002).

The NORAD's findings for Uganda did not differ much from the finding reported by TechnoServe. The study shows that private sector development is constrained by poor infrastructure, costly capital and corruption, making it difficult to enforce contracts and collect debts. The major difference in the two studies is that NORAD's study is more country specific and managed to identify corruption as a serious factor, which TechnoServe study missed out. TechnoServe's long list of constraints, nevertheless, demonstrates an intensive scope of investigation into the factors affecting investment in the region.

Evidence from a 1998 survey of foreign investors in Uganda (funded by The World Bank) revealed that the poor quality of infrastructure, the lack of skilled labourforce, high level of corruption, the uncertain situation in the legal system are seriously hindering the flow of investment into the country. The report, pointed out some positive factors that characterize investment environment, which without the constraining factors above, could have led to more investment in the country. They include the overall growth prospects of the economy, the transferability of funds, the overall political climate and business environment, and the low cost of labour. Here, it is easy to see that corruption can indeed undermine the achievements that the country has scored in attracting investors.

Evidences are also noticeable in non-conventional sources such as Government policy or non-policy statements, documents and press reports, which support the preposition that corruption is a major constraint to private sector investment in Uganda. This is easily noticeable in Government publication like the *Medium-Term Competitive Strategy for the Private Sector*

(2000-2005)¹, *the Background to the Budget. The National Integrity Survey 1998 Baseline for Uganda* too, reports several incidences of corruption including payment of bribes to service workers e.g. health, police, local administration, Judiciary and Uganda Revenue Authority staff. Being a baseline study the survey did not go into details as to the amount incurred by firms in bribe payment, but gives us a very good indication about the level of corruption in Uganda.

In conclusion, there are two lessons that can be drawn from the sample of studies we have just looked at; investment related problems have been studied quite intensively but the subject of corruption has been tackled with limited intensity. And two, corruption is a serious deterrent to investment. The existence of wide spread corruption, especially in commodity import and exports for which the profit-margins are already quite low, is an indication of the lost opportunity to compete in the liberalized market environment. It also means that removal of official trade barriers such as tariffs, alone may not spur private sector investment unless all “non-official tariffs” (such as bribes) and other forms of corruption are eliminated. Corruption in all its forms increases the transaction costs and reduces market competitiveness. The next section on definition enables us to see the various facets of corruption.

1.4 Conceptual Issues and Methodology

1.4.1 Defining Corruption

Corruption, in Uganda’s legal language is “*the abuse of office for private gain and includes but is not limited to embezzlement, bribery, nepotism, influence peddling, theft of public funds or assets, fraud, forgery, causing financial loss or property loss or false accounting in public affairs*” (see The Inspectorate of Government Act, 2002 is S.2). Comparing this definition with that provided in The Prevention of Corruption Act 1970 enables us to see the new perception about corruption and perhaps the evolution of changes that underlies the ‘term’, which suggest that corruption is a multi-dimension affairs going beyond just ‘stealing’ and bribery to social/moral issues. It also shows that corruption must have grown both in dimensions (new forms have emerged) and magnitude in the last three decades.²

Recent literature on Uganda also has definition, which agree in many respects with the current legal definition. It defines corruption as the abuse of public position (or use of public office) for personal gain or for benefit of an individual or group to whom one owes allegiance such as family member(s), friends, certain ethnic group, Religious or political affiliation. It goes further to present corruption as a two-way process, involving public official who may accept, solicits, or extorts a payment; and the private sector agents who may offer a payment, to circumvent the law for competitive or personal advantage.³ Corruption takes a variety of forms, including bribery, that is, payments used by private agents, or sought by public officials, in turn for the

¹ The Republic of Uganda (2001) Medium-Term Competitive Strategy for the Private Sector (2000-2005), Ministry of Finance, Planning and Economic Development, pp 28 and 31.

² In defining corruption, The Prevention of Corruption Act 1970 prohibits the soliciting, receiving by one or on behalf of another as well as giving, promising and offering any gratification as an inducement or reward to a member, officer or servant of a public body. In essence, the Act seems to look at corruption from the point of view of bride payment only.

³ See also Parliament and Good Governance: The Challenge of Controlling Corruption – 1998 Laurentian Seminar.

supplying of favours such as government contracts, lower taxes, trade licenses or legal outcomes.

The theft or misuse of state assets and embezzlement are also corruption, as is the evasion of taxes, nepotism, patronage, self-dealing, influence peddling, diversion of revenues or electoral fraud (regarding campaign finances and voting).

In this study, however, we shall try to restrict ourselves to the forms of corruption that affect private sector investors directly. It is important to note that while some analysts have laboured to make a distinction between “petty” corruption, which is practiced by officials who may be grossly underpaid, and “grand” corruption, practiced by senior officials who obtain large benefits for themselves, the end result is the same because the level of corruption cripples the economy and denies the poor their rights to basic services. At the same time, it is easy for such distinction to obscure the complex web of connecting forces behind corruption, for example, the linkage between domestic and international sources of corruption. Otherwise, it may as well be asked: how petty is petty? In fact in a country like Uganda where petty corruption is so rampant, the consequences for the country’s political, social and economic life can be severe.

1.4.2 Defining private sector

Although it is difficult to find a standard definition of “private sector” in Uganda, for purposes of uniformity with definitions of previous research studies, we shall use the term when we are referring to business community, which includes small and medium scale enterprises, and large scale businesses operating outside the machinery of Government direct (administrative) control.

1.4.3 Data and sample characteristics

The study used a data set for 100 firms (interviewed between August and September 2002: in Kampala, Entebbe and Busia Border areas). The survey questionnaires in annex A, contained information at the firm level, including general background information about the firm: location, type of business, etc.; and data related to corruption e.g. bribes payment, discrimination, behaviour of officials - practiced with the intent of extorting bribes from businesses/investors e.g. “go-slow” tactics by officials in processing of import or export papers, or in licensing of operation or selective application of regulations to discriminate against certain investors. The later case includes public officials turning a blind eye or deaf ear to harassments and complaints of certain group of investors either by origin or type of businesses undertaken. The data also catalogue the various forms of corruption and the impact each has on businesses.

The distribution of firms in the selected clusters is summarized in Table 1.1. Discussions were also held with two finance institutions providing export and import facilities and supporting manufacturing activities; and affiliated association/federations (where these firms are members).

Table 1.1. Composition of firms in the survey sample

Cluster	Number of firms
Coffee traders and processors	32
Textile and garments manufacturers	1
Importers - textile and garments	30
Importers - computers and computer accessories	15
Manufacturers - of beverages/soft drinks	5
Clearing and forwarding agents	6
Others (associations, border traders)	11
TOTAL	100

To understand differential impact and intensity of corruption as it applies to different scale and type of firms, firms were further classified by ownership and scale/size (small and large scale) to capture this aspect. The data broadly captured the complete set of official policies or procedure for doing business (e.g. cost of registration, tax, etc) and to document actual practices (that often entail unofficial ‘modification’ of the official requirements) for commodities and transactions in the selected clusters.

Each barrier labeled ‘corrupt practice’ was described and analyzed in terms of its historical basis and nature, its effects (e.g. on firm’s profitability or business sustainability, infant industry, employment, government revenue, quality standard, etc). In addition to traders, we interviewed a sample of Government officials (customs/URA officials, staff from tax policy department – Ministry of Finance) in the circuits for the selected commodities and paid a visit to Busia border post in order to establish the trade practitioners’ knowledge base, their perception and interpretation of the “unofficial tax” and overall investment climate.

We also talked to some civil society organizations to generate a database of the social impact of diverted income through ‘unofficial door’ (loss in tax revenue due to under-declared goods, and revenue going to personal pocket thus limiting basic service delivery), and so forth. Data generated was basically primary data, by use of questionnaires through formal interviews; supplemented with key informants interviews using checklists. Three enumerators recruited and trained by IPRA carried out field interviews. Some of the firms did not respond to certain questions, and that explains the sensitivity of the subject of research. The study has avoided making strong worded conclusions in cases where there were missing data.

The rest of the report is organised in four parts. The second section looks at the different forms of corruption. Section Three discusses the experience of firms with corruption on a case-by-case basis: manufacturing firms, importers and exporters. Other factors affecting private sector investment (besides corruption) are discussed in Section Four. Section Five concludes with recommendations.

2. Forms of Corruption

2.1 Overview

Seventy two percent (72%) of firms interviewed considered corruption as a major constraint to business investment. They particularly singled out payment of bribes; discrimination against certain investors; deliberate delays at customs with intention to extort bribes from traders; evasion of tax through smuggling, illegal operation, and falsification of papers as the major forms of corruption.

Thirty three percent (33%) assigned corruption a scale of 4 (high constraint) and 69% of the firms assigned corruption overall scale of 3 (medium constraint). Table 2.1 demonstrates that, of the different forms of corruption, discrimination against certain investors is perceived as the most serious problem to investment (48.7% of the firms reported this). Also, 46.2% of the firms reported deliberate delays (with corruption related motives), payment of/demand for bribes (38.5% of firms), keeping a blind eye or deaf ear to harassments and complaints of certain groups of investors (25% of firms). One of the respondents wrote, *“customs tend to give us foreigners a hard time. If there is a way this kind of discrimination can be done away with, we shall be grateful”*

Firms that rated corruption as one of the most serious problems include coffee processors (100% of the firms in this sector), textiles and garments manufacturers (100% of the firms), beverages manufacturers (100% faced with problem of customs delays, discrimination, and lack of attention on the part of authorities concerned to harassments and other related problems), and clearing and forwarding agents (100% of the firms).

2.2 Bribes payment

Seventy-two, out of the 100 firms interviewed reported bribe payment as a problem. Businesses in the export, imports and manufacturing sectors have succumbed to the necessity to pay bribes to obtain their export and import papers, custom clearance, licenses, and so on. Bribes are paid to officials in the customs, licensing department, and other government offices to ‘quicken’ the process of export documentations, license acquisition, and awarding of tenders, among others. Among the computers firms interviewed, some reported that they ever supplied Government Ministries with computers and printers, but to qualify for the tender they had to go through “someone” they knew in the ministry and that involved some money.

One of the computer dealers asked our research assistant whether he knew any ‘big person’ in the Ministry of Tourism, Trade and Industry. The computer dealer had learnt of opportunity/a tender to supply computer and the simple way to go about it was to get someone in the Ministry whom he could use as ‘middleman’ to get the tender. Our research assistant didn’t know anyone, so the conversation ended. What we are trying to convey here is that we have discovered that payment of bribes is very rampant in the dealings between Government and the private sector: at customs, process of collecting tax, awarding of tender, etc. Bribes raise the cost of doing

business. New entrants into business may be discouraged and abandon the business at early stage of registration/licensing or a few years later in case the business manages to take off.

Table 2.1. Firms' perception of different forms of corruption

Firms	Bribes		Deliberate delays		Discrimination Selective application of regulations		Behaviour of officials- -custom posts, URA, KCC, UEB, UEDC		Responding to harassment and complaints	
	Medium constraint	High const	Medium const	High const	Medium const.	High const	Medium const	High const	Medium const	High const
Coffee processors (10)	---	100	100	---	---	100	100	---	---	---
Coffee traders (10)	40.0	---	20.0	40.0	20	60	60.0	40.0	40.0	---
Coffee processors, also traders (12)	50	16.7	50.0	16.7	33.3	33.3	100	---	66.7	33.3
Textile/ garments manufacturing /exporter (1)	100	---	---	100	---	100	100	---	---	---
Textile & garments (importers) (30)	37.5	35.7	12.5	50.0	27.5	25	87.5	---	83.3	---
Computers and accessories (15)	18.2	45.5	18.2	45.5	36.4	45.4	36.4	36.4	50.0	50.0
Beverages manufacturing /export (5)	50.0	50.0	50.0	50.0	100	---	---	50.0	100	---
Clearing and forwarding agents (6)	---	100	20.0	20.0	---	100	20.0	80.0	40.0	40.0

Source: Author Survey Collection

Bribing and rent seeking affect economic productivity, result into additional business costs, create a burden to small enterprises, and result in misallocation of resources – both financial and human capital. Furthermore, bribery distorts public procurement of goods and services. Money spent on bribes raises the general cost of procurement, while quality of goods/services is compromised as less reputable firms are selected and eligible ones are denied tender. One may ask why new roads in Uganda become impassible hardly two years after they have been repaired. Again, as competition becomes a focused on the highest bribe, the public is denied the advantage of a competitive marketplace. In the end, it retards the growth of a modern private sector, and slows the flow of investment because intended investors will perceive payment of bribes as another form of tax.

2.3 Tax evasion

The evasion of taxes occurs in two forms: falsification and forging of documents, faulty recording or under declaration of both value and quantities of goods, and proceeds. This begins at the customs and continues at the firm premises when filing tax returns and availing records for tax purposes. We have too many firms or businesses under-declaring the VAT due or claiming excessive credits of input tax (personal conversation). We could not obtain reliable figures to illustrate the losses Government incur in form of tax revenue through this kind of malpractice but few will disagree that it is a problem of significant magnitude. The second form of tax evasion; smuggling, makes the substantial part of tax evasion, and was cited as a business malpractice that has not only grossly affected the performance of industries but has also resulted in loss of government revenue. We want to look at this in more details.

2.3.1 Smuggling and illegal business activities

The problem of smuggling has been particularly serious for goods like petroleum fuels, cigarettes, sugar and other highly taxed (high-value goods) or potential revenue sectors such as

steel, leather, wood, textiles, bicycles, and chemicals. Ninety seven percent (97%) of the firms interviewed reported smuggling and operation of illegal businesses as major deterrents to growth of private sector investment (Table 2.2). Interviews with informants at the Busia border post and some manufacturing firms revealed two forms of smuggling: that which takes place without the knowledge of customs officials or tax enforcement agents, and usually involves dodging the official border entry or check points and using unofficial routes - ‘panya routes’ or unofficial channels.

The second one, the “organized smuggling” happens with the knowledge of customs officials/agents, security agents, transporters and the concerned business individual(s). This is effected through a number or combinations of methods depending on the circumstance(s), such as non-declaration of goods; falsifying of documents; under declaration of both value and quantities; inadequate inspection of goods coming into the country; misclassification of products (imports) under tariff codes with lower tariff rates; misuse of COMESA that has lower duty rates in the assessment and application of duties on products; and changing of Number-plates for vehicles transporting transit goods.

Table 2.2. Firms perception on smuggling, and others factors affecting businesses

Constraint/Rank	Number of firms (%) which reported ...			
	Not a constraint	Low const	Medium constraint	High const
Operation of illegal businesses, smuggling, etc. [¶]	---	2.6	39.5	57.9
Lack of incentive investment policy	5.7	42.9	42.9	8.6
Lack of regulatory framework for quality and certification	14.3	25.7	31.4	28.6
Poor enforcement of environmental policy	32.4	17.6	32.6	17.6
Poor commercial dispute resolution mechanism e.g. fraud, breach of contract, etc.	16.7	13.9	47.2	22.2

Source: Author Survey Collection

From interviews, we discovered that steel products come to Uganda through Malaba and Busia, but bulk of smuggling takes place at Entebbe Airport. Leather products (shoes) are smuggled through Malaba, Busia, Entebbe Airport, Gaba, from Tanzania and Iganga through Lake Victoria. Wood is smuggled from Zaire via Kasese, Ishaka, Arua, Entebbe Airport, Southern Sudan and Mutukula. Textiles come through Malaba, while new bicycles are brought in as spare parts. Petroleum products (petrol, diesel, kerosene, lubricants, liquidified petroleum gases) pass through Malaba, Busia, Iganga (over the lake), Arua, Mutukula (Kyotera over the lake).

Cigarettes pass through Malaba, and some points between Malaba and Busia, and they find their way to Northern Uganda and West Nile regions through Soroti. Some portions are offloaded in Kampala under the pretext that consignments are export goods and then transported to Congo Kinshasa, Kihhihi and Rukungiri, Ntungamo, Mbarara, Ishaka and Kasese where they are sold. From Kisumu, Usenge in Kenya smuggled cigarettes enter Uganda through Iganga, Jinja, Luzira and Entebbe.

Water and roads transports are the frequent mode of smuggling, but use of bicycles is also common. One time Government tried to introduce tax stamps on both locally produced and imported cigarettes as a way to combat smuggling, but smuggling still continued. Based on a number of studies that have been done in the border areas with Kenya, revenue loss due to smuggling is estimated at over Ushs 24 billion annually.

Apart from the huge revenue losses involved, smuggling is killing local businesses and causing great inequality, for example, vis-à-vis those who comply with the law and pay taxes. Another effect is that illicitly imported goods are steadily displacing some locally produced goods in the market place. This is adversely affecting both employment and profit margins in domestic industries.

In the history of Uganda the budget outturns have always lag behind budgeted revenues, which means that we always have revenue shortfalls year after year. This shortfall mainly arises from under collection of import taxes, and big losses due to fuel smuggling and other cross-border commodity smuggling, among other factors. Combined with fiscal indiscipline, this can lead to a lower quality of infrastructure and social services in the short term, and adverse budgetary and monetary implications in the long term.

2.4 Discrimination

The study found that, of the different forms of corruption, discrimination against certain investors is the most serious hindrance to investment. Eighty, out of 100 firms interviewed reported that they experienced some form of discrimination during their course of doing business (48.7% rated it as a high constraint, 30.8% as a medium constraint). Discrimination is practiced in different ways: selective application of regulation e.g. some people pay tax while others don't; others are kept waiting while others access their licenses, import papers, etc. in record time. Keeping a blind eye or deaf ear to harassments and complaints of certain groups of investors is another problem cited by about the same number of firms (80%), and deliberate delays with corruption related motives (46.2% of the firms reported this).

Table 2.3. Firms' experiences with different forms of corruption

Corruption tendencies	Scale (% of firms that reported)...			
	Not a constraint	Low constraint	Medium constraint	High constraint
Bribes	7.7	20.5	33.3	38.5
Deliberate delays	12.8	15.4	25.6	46.2
General discrimination	7.7	12.8	30.8	48.7
Selective application of regulations- if it has ever discriminated against your firm	27.8	30.6	30.6	11.1
Responding to harassment and complaints	---	19.4	55.6	25.0
Behaviour of official – at custom post, UIA, KCC/town council, UEB, UEDC	2.6	10.3	59.0	28.2

Source: Author Survey Collection

A number of firms complained that they are made to pay bribes and that they are unnecessarily delayed or discriminated against by customs officials. And, at times they are forced to use clearing agents who are not of their choice.

Other problem was overvaluing of goods for some importers and under-taxing others. Over ninety percent (92.5%) of the clearing agents interviewed in Entebbe disclosed that the revenue officials at the Airport sometimes over-value their clients' goods and deliberately delay to release the goods in order to extort bribes from them (importers). They also said that some "well connected" people pay less tax or go without paying tax at all.

These clearing agents shared with us certain information, which indeed confirms what Justice Sebutinde and her team discovered in August when they toured URA terminal in Entebbe to acquaint themselves with revenue collection procedures a head of the public inquiry into alleged corruption in URA. This is part of what they said:

When we lodge an entry (invoice), we expect it to move faster, but these people (URA) take three days or even longer on something which could have taken only hours... The value charged here are different from those charged at other terminals and yet the tax on cargo that arrives through the airport should not include freight”.

Alex Kermundu, Chairman Uganda Clearing and Forwarding Association, Entebbe Branch)

The clearing agents emphasized that URA-officials delay processing invoices, claiming they are forged or have incorrect information.

2.5 Bureaucratic administrative procedures

“Bureaucracy may not be corruption in the common understanding of the term, but it can be said that when a system is bureaucratic, it has been corrupted because nothing gets done at all or in time. In some cases and at other levels, bureaucracy can actually be worse than corruption”

Mary K. Okurut, H.E. President Museveni’s Press Secretary⁴

Some firms believe that the experience with the existing bureaucracies could even be worse than bribe payment considering the potential loss of business opportunity due to the delays in the licensing process, exports and import documentations, and the mistreatment they go through. According to some traders interviewed, bureaucracy in the export procedure is one of the major hindrances in ensuring competitiveness of the Ugandan exports. They cited particularly, the process of export documentation approval, which they described as long, cumbersome and cause unreasonable delays, and only encourages corruption.

Most of the firms dealing in imports experienced delays in having their goods cleared at the customs between July 2001 and September 2002. Only 16.6 percent of the firms were able to clear their goods in time. Forty percent (40%) of the exporters paid bribe (at least once) between July 2001 and September 2002. Further delays are caused by exclusive use of sealed containers and the operation of the convoy system.

Table 2.4. Experience of firms with administrative procedures

Administrative Procedures	Scale (% of firms that reported...)			
	Not a constraint	Low constraint	Medium constraint	High constraint
Processing of import /export papers	10.8	35.1	45.9	8.1
Issuing of trade licenses/licensing of operation	13.2	47.4	34.2	5.3
Taxation (Tax administration & Tax rates)	2.6	15.8	73.7	7.9
Licensing and registration procedures	35.1	54.1	10.8	---

Source: Author Survey Collection

⁴ Article in the Monitor June 8, 2002.

This ‘elite corruption’ causes delays in the trade flows, which translates into high costs of production. This is worst for a country like Uganda, whose manufacturing sector depends heavily on imported inputs and raw materials. Promises to deal with this problem have become a routine issue in budget speeches, but constant use of the press might perhaps evoke some response.

“The slow and floppy approach manifested in the handling of investors has also taken its toll on the economic opportunities available for Uganda. As long as investors continue to have endless problems in securing licenses, work permits, residence permits and other paperwork, Uganda will continue to miss out on the benefits of globalization. We need a quick decision-making system based on a culture of business-likeness and decisiveness. Taking a whole year to process a work permit does not mean you are being thorough at what you are doing. That is simply being sloppy.”

Mary K. Okurut, H.E. President Museveni’s Press Secretary

From the private sector and would-be investors, much is made of the slowness and delays in Government procedures. Even when it comes to providing services of a standard nature, the process always takes so long. The firms interviewed were not short of examples.

- ⊕ One to several years for allocation of a commercial or industrial plot
- ⊕ Days to weeks/months for a telephone (Land line)
- ⊕ Several months for a post office box
- ⊕ Weeks to months for a business license
- ⊕ A few months to find out if the firm qualifies for a low manufacturing tax rate
- ⊕ A couple of months for approval of tender and payments
- ⊕ Hours for paying water and electricity bills
- ⊕ Days to get a vehicle license
- ⊕ Several months for a work permit
- ⊕ Two days to renew a vehicle road licence
- ⊕ Days to a week or two to clear goods at customs

2.6 Belated payment

Although the Government policy is to address issues of unemployment by encouraging expansion of the private sector and campaigning for new investment, the Government itself is and to some extent a factor in the collapse of some of these businesses. From the Auditor General’s report, line Ministries accumulated arrears totaling Ushs 62 billion by the end of June 1996. By financial year ending 30 June 2001, the stock of verified domestic arrears had reached about Ushs 260 billion. Substantial amount of these arrears were payments meant for suppliers. These arrears present enormous cash flow problem for suppliers. What does this imply? Instead of facilitating the expansion of the private sector, Government actions are hindering developments, particularly for small local suppliers that find it difficult and costly to borrow from banks. Indeed, 30 percent of the firms (that had previously supplied Government Ministries) reported delayed payments by Government as one of the major constraints to their businesses.

One of the firms, which supplied a Government Ministry with computers, reported that though Government would demand to be serviced, it usually takes two to three months to

settle its debt, and in the interim it will still want more computers. As a result, unless one has another side business running, to supplement the other and beat the cash flow problems ones business would collapse.

However, this problem seems not to affect small businesses only, but also big establishments that Government does business with. A snap survey we conducted in November 2000 to establish whether belated payment by Government could be a problem for big businesses too, revealed the same sentiments. This short survey covered filling stations and hotels in Kampala. The two filling stations supplied certain Government Ministries with fuel. By the time I talked to them they had not yet received payment for the fuel they supplied three months ago, and in the interim the same Ministries still wanted more fuel. The Government purchase orders take considerably long time (often more than two months) to be cleared before payment is made.

In sum, corruption is not a problem experienced only by small or large businesses or certain business sectors, but all investors seem to be victims of this evil. We discovered that firms, which reported that they did not experience problem at the customs, and in securing trade licenses, processing export documents, work permit, and so on, also reported to have paid bribes, which means corruption is essentially, part of the ‘business equations’ in Uganda. Before we wind up our discussion on this subject it is important to have an idea of the monetary costs accrued to investors due to corruption, particularly payment of bribes, and reciprocating revenue losses to Government in form of tax evasion.

3. Costs of corruption to firms and government

In the previous section we observed that corruption affects private investors in various ways: a financial burden to business enterprises, and results in misallocation of resources; delays in the trade flows, which translates into high costs of production; danger of killing local businesses and causing great inequality, and huge revenue losses to government. In this section, we shall go a step further to examine the cost of corruption in monetary terms such as the money paid by importers, exporters and manufacturers, based on our sample data.

3.1 Experience with corruption in the import sector

3.1.1 Direct costs

Virtually all the firms (100%) in textiles/garments imports, computers and computer accessories, including clearing and forwarding firms complained of corruption. Fifty percent (50%) of them reported that they paid bribes to customs officials, and met all their tax and non-tax obligations. Thirty percent (30%) reported to have paid bribes, but paid less in tax and non-tax obligations. The overall impact is an average per capita tax evasion of Ushs 3,180,000 per firm. This is a significant loss in government revenue if computed for all the firms in this sector. Substantial amount of revenue is also forfeited to businesses importing computers and computer accessories, estimated at Ushs 2,904,167 per firm.

Analysis shows that corruption is worse in this sector as the resultant non-payment of tax and other obligations account for significant 10.7% of the average total cost of doing business (Table 4.1).

3.1.2 Indirect costs of waiting as goods take long to clear

Apart from bribes, which entail a direct cost to the importer, there are other indirect costs in term of lost business opportunity due to customs delays, transport costs and contingent expenses incurred during the process of clearing the goods. Most of the firms dealing in imports experienced delays in having their goods cleared at the customs between July 2001 and September 2002. Only 16.6 percent of the firms reported that they always cleared their goods in time. Eight percent (8%) of the firms experienced delays in processing work permits [one of them wrote: *“I think this (meaning work permit) should be abolished, at least for E.A (meaning East Africa) residents”*].

The Forwarding and Clearing agents were more concerned about corruption, and bureaucratic administrative procedures and custom delays. All of them (100%) indicated that they experienced delays in processing import papers (clearing goods) between July 2001 and September 2002. Delays range from 7-8 days over the official time requirement. Again, all (100%) expressed dissatisfaction with the service of the customs officials e.g. in issuing of licenses. These are some of the things they wrote on the questionnaires:

“Monopoly enjoyed by Customs Department should be abolished because officials in this department do things the way they feel... Reduce the monopoly power of customs, unnecessary delays and regulations... Delays in customs are intentional and are just to extort money. Different authority should be entrusted with the business of licensing activity, and not the existing customs department, since they over charge us (500,000=+). Shift licensing roles to another (?) ...”

3.2 Experience in the export sector

3.2.1 Direct costs

Twenty percent (20%) of firms dealing in coffee trade/exports reported to have paid bribes to obtain license. They reported Ush 100,000 to 300,000 as payment in bribes in single encounter. They also reported average bribe payment of Ush 400,000 during process of acquiring export papers. The multiplier effect of this on business profitability could be more severe if the money is part of working capital from borrowed sources.

However, 40% of the firms paid less in taxes, license fees, permit, and other non-tax obligations. Overall, firms paid Ushs 282,000 less on average in taxes and other payments due to government (between 2001-2002), which suggests equivalent loss of Ushs 282,000 in tax and non-tax revenue from each coffee trader in the same period (Table 3.1). This way, each coffee trader saved on average 1% of the total costs of operation. These same firms, which paid less in taxes and other dues, also reported corruption/bribes as a major constraint to their business undertakings, suggesting that they actually paid bribes in exchange for favor (to pay less in taxes and non-taxes obligations) from relevant authorities.

These losses, when added for all the firms can be a significant loss to revenue. For the purpose of illustration, suppose there were 500 coffee traders government would lose Ushs 141,000,000

annually due to partial tax evasion and non-payment of other dues from this sub-business sector alone.

Table 3. 1 Extra Cost (bribes) Paid by Firms Between July 2001 and September 2002

Firms	Average Extra cost	Percentage of Extra Cost
Coffee Processing only		
Coffee Trade only	282,000	-1.46
Coffee Processing and Trade	1,750,000	4.16
Textile and garment (manufacturing)		
Textile and garment (Import)	3,180,000	-15.69
Computer and accessories (import)	2,904,167	-10.66
Beverages (manufacturing/export)	18,606,750	2.48
Clearing and forwarding firms	3,712,500	0.58
Average	4,165,761	5.84

Source: Author Survey Collection

Note: Figures in parenthesis represent negative extra costs incurred by firms

While most exporters in this sector (coffee) seem to gain from partial evasion of tax and non-tax obligations, they were nevertheless faced with certain indirect costs like cost of waiting to have their export papers processed. This is a source of market distortion, and can translate to substantial monetary loss to businesses since it affects returns on investment via rate of turn over. The accumulative effect can mean a slow-down in business growth in the long term.

Table 3.1 also shows that coffee-processing firms (also dealing in coffee exports) faced average extra cost of Ushs 1.7 million as payment in bribes between July 2001 and September 2002. This accounted for 4.2% of the average total cost of doing business in the same period. The sampled textiles firm that is dealing in exports reported payment of bribes, though it never disclosed the actual amount paid in bribes. This firm is a moderately large firm and it was not easy for officials to recall this ‘unrecorded’ payment committed over a long period under different circumstances and involving different members of staff under its establishment.

They officials interviewed were also too conscious to discuss with the researchers this ‘sensitive subject’ though they clearly admitted in principle that bribe payments had affected them. In the relative sense most firms (in this sector) considered bribe payment as a medium constraint (Table 2.1). They also indicated that they have ever experienced some delays in processing their export papers, but they did not admit that these were deliberately engineered to extort bribes from them. They did not consider that they ever suffered discrimination from customs officials or other agents that are supposed to facilitate their businesses.

Firms exporting soft drinks, and mineral water also reported that they paid bribes between July 2001 and September 2002 (period covered by the survey). Like many other firms, however, they never disclosed the actual amount committed in bribes or the major recipients. One of the firms reported to have ever suffered harassment, discrimination and excessive delays in the course of its business undertakings.

3.2.2 Indirect cost of waiting in the export sector

Firms dealing in exports did not consider corruption as serious as they were concerned with bureaucracy in export procedure. Bureaucracy in the export procedure was identified as one of the major hindrances in ensuring competitiveness of the Ugandan exports. The complaint is that the process of export documentation approval is long, cumbersome and cause unreasonable

delays, which only encourages corruption. Forty percent (40%) of the exporters indicated to have paid bribe (at least once) between July 2001 and September 2002 in the process of ‘seizing’ their export papers.

Further delays in this sector are caused by exclusive use of sealed containers and the operation of the convoy system. This requires the exporter to move the goods to the Customs Exit Point where clearance is only granted after the Convoy Section of URA at Nakawa physically sends the manifest to that point. Delays were also reported in processing claims for VAT refunds and duty drawback. Delays in Duty Drawback refund burden the exporters and manufacturers as it at times takes 6 months to a year to clear this tax refund claim.

Small customers who cannot afford dedicated shipments of cargo and would rather transport mixed consignments of duty paid and VAT paid goods to meet their own customers’ needs in the destination country are grossly affected by these requirements. The recommendations by Government for Fixed Duty Drawback Scheme (FDD) and introduction of 100% Export-Oriented Bonded Manufacturing Warehouse factory scheme (BMW) have been a welcome effort among exporters and manufacturers. Still, exporters are concerned about the long delays and frequent disputes in approved drawback applications; delays in processing duty drawback claims; and lack of awareness of the duty drawback schemes and its guidelines.

3.3 Experience of manufacturers

All the manufacturers visited complained that bribe payment, and customs delays are important constraints to manufacturing businesses. Thirty percent (30%) of manufacturers included in the survey reported to have paid bribe in the last one year, 20% decline to respond to the question of whether they paid bribes or not and the amount paid in the last one year. Analysis shows that bribes costs the firms over 18 million Uganda shillings annually and account for over 2% of the total cost of doing business at firm level.

3.4 Conclusion: revenue losses and social impact of corruption

When corruption occurs it is the poor who bear proportionately the heaviest cost. These include: (i) the immediate impact on the poor people of higher prices and fewer employment opportunities due to the distortions that corruption can cause, while corrupt officials may demand payment for public services which are supposed to be free. Our analysis has shown this very clearly in the current investment and employment trends illustrated in section five. (ii) The diversion of scarce public resources away from poverty programmes into unproductive expenditure or into the repayment of debts accumulated because of corrupt activities, as well as the loss of tax and customs revenues due to evasion have severe economic and social consequences. These can lead to a lower quality of infrastructure and social services in the short term, and adverse budgetary and monetary implications in the long term.

The Regional Trade Analytical Agenda (RTAA), through its regional partners, conducted a series of surveys on informal cross border trade between selected East and Southern African countries between 1994 and 1998. The total annual informal cross border trade (smuggling activities to be precise), was estimated at the equivalent of USD 140 million, 63% of which was in agricultural products. This figure is equivalent to about 7% of Uganda's 1999/00 gross domestic product and close to 60% of the value of formal trade between the two countries. Kenya was found to have an informal trade surplus of \$22 million, with exports to and imports from Uganda of \$81 million and \$59 million respectively.

So, the net loser from tax invasion that occurs across the Uganda-Kenya border is actually Uganda since there is greater flow of imports from Kenya than exports going to Kenya from Uganda. If this estimate is something to go by, Uganda is losing over 24 billion annually in revenue due to tax evasion along the border alone. This is equivalent to about 25% of annual budget for some government ministries. The impact of smuggling to the economy and the social sector is therefore tremendous. This is just an example, otherwise we have already seen how much Government loses in revenue from the different firms in terms of partial tax evasion, and how much firms lose in terms of bribe payment and customs delays, and so on.

In the history of Uganda, the budget outturns have always lagged behind budgeted revenues, which means that we always have revenue shortfalls year after year. For almost five consecutive years these shortfalls have averaged about Ushs 43 billion, which is approximately 1.5 percent of total Government expenditure or slightly above total agriculture budget. This shortfall mainly arises from under collection of import taxes, and big losses due to fuel smuggling and other cross-border commodity smuggling, among other practices.

Another way of looking at it is to compare Uganda's revenue/GDP ratio with other poor countries in the region/continent. Uganda's revenue/GDP is about 11 percent, compared to Kenya with 26% ratio, Tanzania 14%, Ghana about 19%, Malawi about 17%, Mozambique and Zambia about 20 percent. If Uganda was achieving at least 90% collection rate of its tax and non-tax revenue, its revenue/GDP could be in the region of 14.5 percent, which is the median point between the 18% average for the seven countries and its current 11% revenue/GDP ratio.

If this assumption is correct then Uganda could be losing annually revenue equivalent to about 3 percent of its GDP, that is, about 106 billion. This would mean 4 percent annual slow down in implementation of Government programme, and in ten years over 40% of the planned project in the long term will not have been implemented. This affects growth, and this way it will take longer (perhaps four times the number of years projected) to achieve poverty reduction target Government has committed itself to.

Combined with fiscal indiscipline, this can lead to a lower quality of infrastructure and social services in the short term, and adverse budgetary and monetary implications in the long term. The Uganda Debt Network (UDN) has a number of striking examples of this kind of fiscal indiscipline or the moneys simply lost or unaccounted for between 1994 and 1999 (Table 3.2).

Table 3.2. Amount of public funds lost

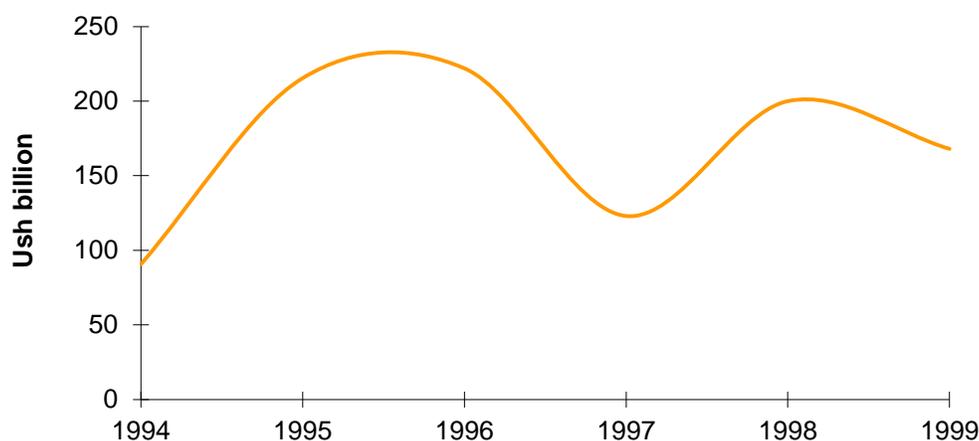
Year	Amounts (Ushs)
1994	90,708,589,949
1995	215,419,727,268
1996	222,277,836,464
1997	123,452,963,272
1998	200,037,024,733
1999	168,380,063,955

Source: UDN's compilation from Auditor General's Report

In most cases, accounting officers have taken advantage of the weakness of the public finance management system, to misappropriate funds. We were told that vouchers and documents, which support entries are difficult to trace when it comes to the audit. Accounting officers are known for inflating bills and overpaying suppliers (intentionally of course). This is the method they use to 'steal' money.

Figure 1 does not give a clear trend whether the problem is worsening or slowly declining, but it is easy to predict that the potential for future higher revenue loss is likely. This is possible because even the deepest fall witnessed in 1997 did not go below the 1994 figures, and soon there was a rise again.

Figure 1. Trends in loss of public funds 1994-1999



4. Other factors affecting private sector investment

4.1 Overview

Notwithstanding Government policies in favour of private sector, a number of problems have been found to constrain the growth of this sector. Investor consulted numerated over six constraints facing them, besides corruption related problems. The constraints include the condition and adequacy of infrastructure (roads, communication, power supply, availability of/access to market); financial constraint (access to capital, interest rates, etc); government regulations and policies; administrative procedures such as business licensing requirements and

procedures, and bureaucratic customs delay; and corruption. Other obstacles include security and political uncertainty; and health related concerns such as HIV/AIDS (Table 3.1).

In several budget speeches, government equally recognizes the difficulties faced by firms especially the small ones, to service and expand their operations in a very competitive environment. Competition places pressure on the firms to cut costs, yet many of the costs such as costs associated with infrastructure (e.g. utility tariffs, transport costs, and telecommunication), interest rates, etc are not in the control of the firms. This highly constrains business growth, often encourage others to go under or pay bribes in order to avoid making full payment of utility bills, taxes and other fees.

As shown in Table 3.1, conditions of infrastructure, access to capital and high interest rates, administrative procedures, corruption, high taxes, political uncertainty, policies and weaknesses in legal system remain severe constraints to private investment and to the overall development goal of the country. Sections 3.2 through 3.8 discuss this in more details.

4.2 Infrastructure

Seventy five percent (75%) of the Clearing and Forwarding companies interviewed assigned scale 3-4 (regarded as medium and high constraint) to infrastructure, to show that the poor condition of roads, high cost of communication (especially telephone) and electricity significantly affect their businesses. They complained that electricity is not stable; and the collection of charges is arbitrary and irregular. The extra cost firms incur by running fuel power generators is a distortion that reduces business competitiveness.

Table 4.1. Effect of infrastructure

	Number of firms (%) that reported infrastructure ...			
	Not a constraint	Low constraint	Medium constraint	High constraint
Roads (access/conditions)	31.6	18.4	31.6	18.4
Communications: Tel. Postal services, etc.	33.3	46.2	15.4	5.1
Power supply (electricity- access/cost/stability)	15.4	30.8	38.5	15.4
Processing facilities/plants	72.0	24.0	4.0	---

Source: Author Survey Collection

A recent World Bank survey (in collaboration with Private Sector Foundation) found that 77% of large firms, 44% of medium-sized firms and 16% of small firms own power generators. A survey of businesses conducted in 1995 established that the average cost of a generator is more than Ushs 31 million with annual operating costs of more than Ushs 12 million. Our study found that small firms with standby generators spend on average about Ush 120, 000 per months on fuel. While larger firms can insulate themselves from power supply problems by installation of generators, majority small firms are totally exposed to the consequences of erratic power supply.

There are other indirect costs associated with poor conditions of roads, which was implicitly illustrated during the interviews with Clearing and Forwarding companies. Cost of transport hire depends not only on the distance, and type of vehicle hired/used, but on condition of roads. Vehicle owners prefer goad roads and charge higher prices for failed roads, for obvious reasons.

According to a World Bank study conducted in 1999/2000, average vehicle operating costs per kilometer are US\$ 0.28 on a good paved road. This cost trebles to \$0.90 per kilometer on a failed road. The last scenario typically portrays the Uganda's situation, suggesting that more than \$0.6 could be saved for every km by Uganda's economy simply by having good roads.

A critically important reality is that the improvement of the road transport (vehicles) cannot be undertaken without due consideration of the impact of the surface conditions of our roads. Several sections of our roads are extremely rough and are made worse by occasional floods and construction work in some major roads. Improvement in the road network may result in increased usage as improved journey times and reduced operating costs result in lower end-user prices for traders, importers and exporters based locally as well as operators within the East Africa region. The shift from a national to a regional mindset in addressing the road problem is going to be imperative for the enabling of an efficient commodity distribution network and equitable development.

In-country transport costs also include cost incurred due to the inability of rural-based investors like farmers and businesses men to move the produce to market profitably (for the farmers) and in cost-effective manner (for the consumers). Telecommunications is another piece of infrastructure whose supply is still grossly inadequate. Connection to towns outside Kampala through landlines is difficult. Despite increased growth in the mobile telephone sector, not many people can afford cellular phones or afford airtime for their sets. Uganda has only about 2 lines per 1,000 people compared to Kenya with 7.1 lines per 1,000 people. Again, these lines are concentrated mainly in urban areas, leaving the rural areas largely unconnected.

The cost of telecommunications, especially on international calls remains high and affordable for many small businesses. On water supply, the most common complaints from investors is that the water supply is unreliable and that the tariff imposed on end-users is too high. The National Water and Sewerage Corporation (in the process of being privatized) is trying to restore water services, but this is still limited to major towns. It serves less than 50,000 connections. Some estimates indicate that 35% of these connections are inactive.

4.3 Market and Financial Constraints

In general, 63 percent of the firms indicated weak demand for their products and heavy competition from imported products (i.e. manufacturing firms) as a major constraint to their growth and survival. A shift in taste or lack of appreciation of locally produced products to foreign products was also reported to be a factor causing low demand.

The other problem of comparative significance is finance. About 65 percent of the firms indicated finance as the major concern for their investment. This is stated more as a constraint primarily on working capital than on investment.

Most of the firms reported that they lack adequate financial resources to run their businesses profitably. Complaints include limited access to bank loans and high interest rates on borrowed money. The short-term credit facility from commercial banks attracts an average interest rate of 24% per annum, and a commitment fee of 1-4% of the face value of the loan is charged. The development banks offer medium and long-term loan mainly in foreign currency at an average interest rate of 12% p.a. with a maximum grace period of 2 years. However, the formalities

involved in accessing these credit facilities are long and complicated and does not help investors who might be in urgent financial need.

Table 4.2. Market and information constraints

CONSTRAINTS	Number of firms (%) reporting...			
	Not a constraint	Low constraint	Medium constraint	High constraint
Availability of markets	7.9	28.9	44.7	18.4
Fluctuation of commodity prices in world market ^φ	---	---	25.0	75.0
Transport to markets (access/costs)	8.1	43.2	45.9	2.7
Lack of regular and reliable market information	7.7	43.6	33.3	15.4
Lack of business advisory services	16.2	48.6	32.4	2.7
Lack of access to technical data	16.2	43.2	32.4	8.1
Finance constraint				
Access to capital (bank loans) & interest rates ^φ	2.7	5.4	27.0	64.9

Source: Author Survey Collection

Introduction of mid to long-term treasury bills is seen by some businesses including UMA, as a way of reducing financial constraints among investors. But Government objected to the idea of introducing long-term treasury bills because of the high and volatile interest rates (on treasury bills) and the subsequent danger of crowding out private issuers from the very narrow domestic capital market. In addition, the legal framework for issuing treasury bills does not permit issuers with maturities of greater than one year.

4.4 High Taxes and Poor System of Tax Administration

Only 18.4% of the firms visited were happy with the present tax system and considered tax rates as reasonable. Seventy four percent (74%) did not have much problem with the tax rates (some of course complained about the high rates of corporate tax), majority were more concerned with system of tax administration like the tax thresholds, which they say do not favor small businesses. They also complained about selective enforcement of tax law, in that many illegal/informal businesses are allowed to flourish at the expense of other businesses – causing unfavourable competition as most of the illegal businesses rarely pay tax. Tax complaints were especially noted among the importers and mainly among firms dealing in textiles. Computer importers still want more tax concession, to make computers more affordable to potential users.

We also noted that the difficulties in tax administration are partially a result of failure to educate the public about the basic requirements in the tax law. Generally, the majority of firms surveyed are not aware of the requirements of Tax Laws and procedures. Some of the clearing and forwarding agents reported that they have difficulties interpreting the legal clauses in many documents they frequently come in contact with during the course of their business. Manufacturing firms recommended URA for setting up the Large Taxpayers Department in the effort to address some of their tax concerns. We learnt that the introduction of Large Taxpayers facility has helped to improve tax compliance through effective administration and communication, which has provided the basis for improving tax collection.

Many businesses, however, complained that the taxes are high and regressive – one of the reasons they gave for the increasing rate of cross-border smuggling. In Busia, traders stated

that the artificial price differentials for certain commodities like fuel (petroleum products), and groceries and the differences in tariffs have encouraged illegal trade (smuggling) across the common borders. Prices naturally dictate the direction of trade flow. Petroleum is smuggled into Uganda because it is cheaper in Kenya than in Uganda. Here, it is easy to see that some of the commodities being traded are reactions to misalignment in the policies of the two countries sharing the border (Kenya and Uganda). It also means that revenue from petroleum products is not maximized because petroleum products are overtaxed and smuggled from Kenya into Uganda.

In general, however, many wonder what the government accomplishes by the taxes. Protection of industry is not guaranteed because of smuggling, and frequent changes of trade taxes to maximize revenue, discourages investment.

In designing an appropriate tax policy, it should be borne in mind that company taxation (corporate tax) falls not only on the returns to investment, but also on the investment itself and therefore the rate should be fair enough. Taking investment even partly tends to reduce the amount of investment undertaken while the method of taxation distorts investment decisions. A fair, efficient and incorrupt tax administration will do far more to improve the investment climate in Uganda and sustain rapid economic growth and poverty alleviation.

4.5 Political Instability/Uncertainty

As Table 4.3 shows, investors were also concerned about the security of their own lives, and businesses. A number of them were concerned about the recent wave of robbery and killing in and around the city and some major towns. Some expressed fears about the wars in the North (Northern Uganda) arguing that it will drain public resources and constraint development, including eroding the purchasing power of the public. Majority of investors (74%) considered political instability (uncertainty) as an important constraint to increased private investment in the country. Of those who were more concerned about political stability were the exporters. Ninety three percent (92.8%) rated this as a major problem. This is expected because some of the firms have made long term investment involving tremendous financial outlays that can only be recovered over a long period of time. In this sense, political stability becomes important element of long-term or sustainable business success.

Table 4.3. Other impediments to private sector investment

Constraints	Number of firms (%) reporting ...			
	Not a constraint	Low constraint	Medium constraint	High constraint
Lack of technical/entrepreneurial skills	16.7	44.4	30.6	8.3
Lack of packaging materials and moisture meters for coffee	33.3	---	33.3	33.3
Effect of HIV, malaria, etc.	41.0	25.6	28.2	5.1
Labour loss in caring for the sick	31.6	52.6	15.8	---
Accessibility to health facilities	48.7	43.6	7.7	---
Income lost in treating the sick	10.5	52.6	34.2	2.6
Highway/urban robbery (business premises)	7.9	42.1	39.5	10.5
Banditry/civil strife	37.5	34.4	25.0	3.1
Political certainty/uncertainty	5.3	21.1	55.3	18.4

Source: Author Survey Collection

5. Reflection on macroeconomic environment and aggregate investment

5.1 Macroeconomic environment

During 1990s there was an important shift in the economic policies of Uganda. This included macroeconomic policy reforms aimed at stabilizing the economy such as fiscal, monetary and exchange rate reforms; and liberalization policies aimed at structural reform and growth, such as removal of relative-price distortions and the reduction of state intervention. Restrictions that had been imposed on the imports, mainly manufactures, high import tariffs, exchange control regulations, and export tax were either removed or relaxed. The policy of fostering and protecting local industries, which produce import-substitutes, was restricted to very few cases.

The investment Code of 1991⁵ managed to reverse long-standing antipathy towards foreign investment. It introduced standard provisions regarding investment incentives, profit repatriation and protection against expropriation of assets. These provisions, together with establishment of Uganda Investment Authority (as a ‘one stop facility’ for processing investment proposals and to offer assistance and advice to potential investors) and the recent wave of privatization, have created new opportunities for both local and foreign investors.

In order to encourage foreign investors, a number of investment promotions have been organized abroad, for example, in USA; Europe; India; Thailand; South Africa and Japan, to explain the trade and investment opportunities available in Uganda (Obwona, 1997). Special tax incentives were offered to foreign firms willing to invest in Uganda. Government belief has been that, investment flows can contribute to industrial and technical adjustment, facilitate structural diversification, and improve the market and export performance of emerging new industrial and service activities. Uganda’s open market regime is also expected to spur productivity, foster export competitiveness and improve resource allocation. Increased exports could help to underpin rapid investment and growth and ease balance of payments constraints. There are substantially correct from policy stance, but circumstances have made it difficult for such to be realized.

Uganda took stern measures to liberalize import and export procedures, including ‘adjusting’ the licensing requirements and replacing import controls (quantitative restrictions) with tariff-based protection (tariff equivalents), the reduction in the range of tariff bans as well as the reduction in the overall level of tariffs and the avoidance of excessive protection. Consequently, the temporary export stabilization tax on coffee exports was removed, and tariff and tax incentives, were introduced to encourage private investment.

Monopoly power of marketing boards and preferential treatments or trade privileges enjoyed by state enterprises and co-operatives were removed, as government sought to improve the commercial focus and resource efficiency of public enterprises (Kasekende *et al*, 1999). In the foreign exchange market, administrative allocation of foreign exchange and the official

⁵ The Investment code 1991 is the law governing investment in Uganda, which replaced earlier statutes such as the Foreign Investment Decree of 19.. and the Foreign Investment (Protection) Act of 1964, although priveleges and property rights enjoyed under previous legislation by holder of licenses were to continue, subject to amendments under the new code (Obwona, 19970).

determination of the exchange rate were abolished.⁶ Trade and exchange rate liberalization, coupled with abolition of marketing monopolies and reduction of administrative ‘red tape’ and rationalization of tax and tariff structure have contributed significantly in promoting exports and investment in the country.

Uganda’s outward oriented policies is also exemplified in its position as a GATT (old-time) member and as a GATT contracting party under the trade "succession" procedures acquiring the GATT rights and obligations previously accruing to the United Kingdom with respect to its territory. In the Uruguay Round of multilateral negotiations, Uganda bound tariffs on all agricultural products, photographic goods, rubber and some categories of machinery.⁷ These bindings are within a ceiling of 40 and 80 per cent. Uganda is also a founder member of the World Trade Organisation (WTO) – as she ratified the Marrakesh Agreement 29th September 1994.

Uganda subscribes to the binding arbitration of investment disputes scheme under the World Trade Organisation (WTO) protocol. The government is also in the process of incorporating the new WTO commitments into domestic legislation. The legislation will cover basically, intellectual property protection and Trade-Related Investment Measures (TRIMS).

On the regional fronts, Uganda is committed to initiatives such as the Cross-Border Initiative (CBI), Common Market for Eastern and Southern Africa (COMESA) and East African Cooperation (EAC). In January 1993, Council and the COMESA Authority directed the Secretariat to monitor the elimination of no-tariff barriers in member states and report to Council every year so as to ensure that non-tariff barriers are eliminated as quickly as possible. To-date, most members states have, by and large, eliminated all conventional non-tariff barriers such as import and export licensing, exchange controls, allocation of foreign exchange, quotas and other prohibitions, permits, discriminatory exchange rates and technical standards ill suited to imports.

In addition, COMESA has liberalized and simplified many bureaucratic procedures that previously hindered movement of goods and services among its member states. Consequently, intra-COMESA trade increased from USD 836 million in 1985 to USD 4.2 billion in 1999 (The EastAfrican, September 16-22,2002).⁸ Table 1 summarizes the key tariff policy changes that Uganda has implemented between 1993 and 2001, both for the COMESA (Common Market for Eastern and Southern Africa) and non-COMESA imports.

Uganda, being a member of the East African Community complied with tariff reductions under the same programme and agreed on the implementation of a programme for zero-tariff trade that was to take effect by July 2001, but only delayed due to disagreements over the modalities for the elimination of internal tariff. TechnoServe’s Report shows that intra-EAC trade grew from USD 94 million in 1991 to \$ 461.3 million in 1998 in response to the tariff reduction.

⁶ Chenery et al (1986) suggests that periods of trade liberalization also tend to be periods in which total factor productivity growth is unusually high.

⁷ A country binds a tariff on a product when it commits itself multilaterally not to increase the tariff above a specific level, except by negotiation with affected trading partners (Abreu Marcelo de Paiva 1995).

⁸ Newspaper Article by TecnoServe: “Non-Tariff Barriers Threaten Intra-Regional Trade

Table 5.1. Uganda's Imports Customs Duty Rates, 1993/94-2000/01

	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01
Plant and machinery								
COMESA	0-15	0-15	0	0	0-2	0	0	0
NON-COMESA	0-30	0-30	0	0	0	0	0	0
Raw materials/intermediate goods								
COMESA	0-10	0-10	0-5	0-5	0-5	4	4	4
NON-COMESA	10	10	5	5	5	7	7	7
Final products								
COMESA	0-118	0-118	0-118	2,4,6,12	2,4,6,12	6	6	6
NON-COMESA	10,20,30	10,20,30	10,20,30	10,20,30	20	15	15	15

Source: Ministry of Finance, Planning and Economic Development

Notwithstanding Government policies in favour of private sector, a number of problems have been found to constrain the growth of the private sector, and often hinder the realisation of the full benefits of these reforms. We have discussed this in great details in the previous sections. We now want to have a quick look at the investment flow to be able to correlate our findings with what is happening at the aggregate level.

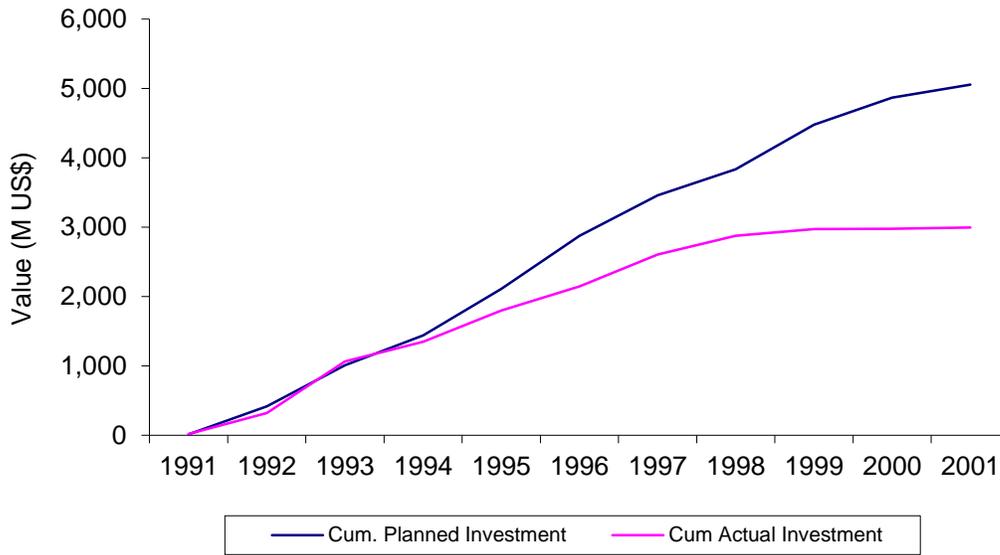
5.2 Investment flows

The figures in Table 5.2 show that private investment has not improved since the late 1990s and that investment is not going to sectors that significantly impact on poverty reduction. In Table 5.2, only 5.7 percent of licensed investments were intended for agriculture, 31 percent for manufacturing and 14.6 percent for water and energy sector (combined). The data exhibits encouraging surge of investment (i.e. intended investment) emerging in the manufacturing sector.⁹

Figure 2 depicts an upward trend in aggregate planned investment in the country. The upward trend in planned investment in Uganda is a promising indication of some significant improvement in the macroeconomic environment as discussed in the previous sub-section and some confidence in the relatively improved political economy. This, however, is not translated into actual investment flow, which has tended to stagnate since late 1990s.

⁹ The manufacturing sector is mainly composed of: food, beverages and tobacco, textiles, apparel, leather and footwear, wood and wood products, paper and paper products, printing and publishing, including rubber and plastics, fabricated metals with virtually non-existence of the chemical and basic metal.

Figure 2. Cumulative Value of Planned and Actual Investment 1991-01



Source: Uganda Investment Authority

Between 1993/94 and 1994/95, private sector investment increased by 3.5 per cent of GDP, but later slowed down and has not recovered since. Given that FGD constituted substantial portion of investment flow it is possible that the Bwindi experience (the killing of the tourists in 1999), the Congo war and fragility of the financial sector (as 3 banks were closed in a row), corruption perception and the other structural constraints examined in the previous discussion contributed to the slow down.

Table 5.2 and various UIA sector studies indicate that most of the post-1991 investment is going to the manufacturing sector, which accounts for over 50 per cent of investment being implemented on the ground. A number of policies have been put in place since 1986, which is trying to revitalize the sector, but available evidence shows that we have not yet fully regained the level of the 1960s.

The low investment in agriculture, forestry and fishing (5.7%) clearly shows the low priority given to the agricultural sector. Most of the investment in this sector is concentrated in the coffee and rehabilitation of tea estates, selected non-traditional agricultural export crops, fish products, horticultural products especially flower production. This probably impacts less on poverty because the poor are more concentrated in marginal subsistence sector, mainly the food sector.

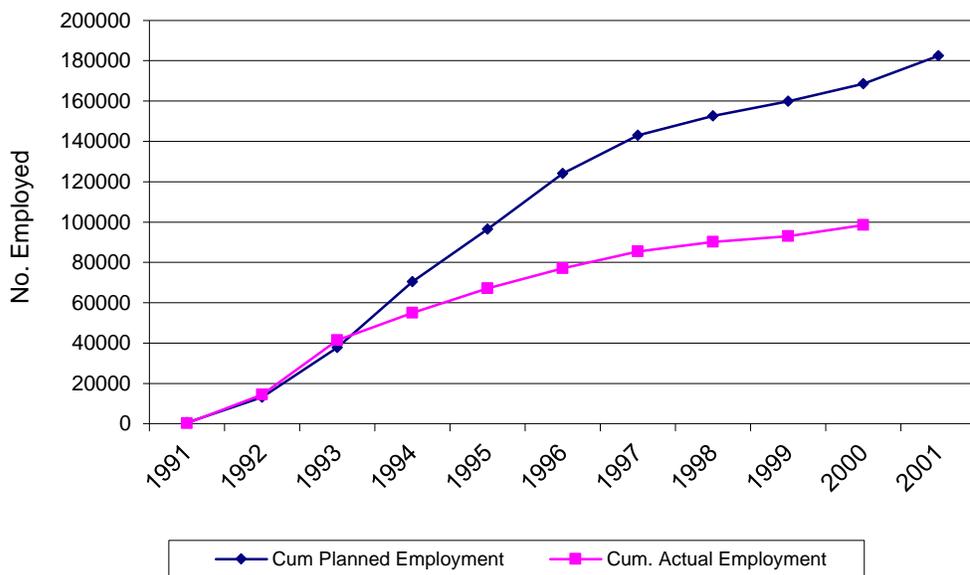
Investment in construction covers the manufacture of building materials from local or imported raw materials for the construction of buildings, roads, railways and bridges, etc. Real estates include residential houses, commercial buildings and warehouses, industrial estates or factory buildings. This is one of the fastest growing sectors but may not contribute significantly in poverty reduction.

Comparing Figure 2 and 3 enables us to see a casual link between investments flow and change in aggregate employment. Figure 3 illustrates that employment has not improved since the late

1990s when the economy has witnessed a slow down in the aggregate investment flow. This has implications for poverty reduction strategy. Increased investment offers the greatest potential in the long-term for employment absorption and poverty reduction via value-added. Given that investment raises productivity and this increase is not completely appropriated by the investor, the greater returns will be shared with others, and some other income groups will benefit directly. Domestic labour will benefit in the form of higher real wages, consumers by way of lower prices and government will receive higher tax revenue. From the present trend, this benefit is not likely to be achieved in the near future.

There is a casual link between corruption and growth in investment, productivity and employment. During the last 3-5 years that corruption seems to have been on the increase, aggregate investment and employment have stagnated.

Figure 3. Cumulative Planned and Actual Employment



Source: Uganda Investment Authority

Revenue yields as percentage of GDP have either remained static or declined, and yet the GDP has not improved. Similarly, unemployment rates have worsened, and internal fiscal balance has not been helped. Since the economy has not experienced major economic shock for the last five years, and with new development in export diversification and access to European, America, and regional markets we would expect some positive change in the basic indicators including increased private sector investment. This has not happened. There are a number of reasons for this, but corruption plays an important role.

Table 5.2. Total Investment (by sector) between 01/01/1991 and by 20/09/2002

Sectors	No of licensed projects	Percentage of total	Planned Investment (US\$)	Actual ¹⁰ Investment (US\$)	Planned sector Employment
Agriculture, forestry & fishing	176	5.7	297,871,309	113191097	29,885
Construction	100	3.5	185,122,455	70346533	13,472
Finance services	46	3.4	179,828,000	68334640	2,217
Manufacturing	1200	31.1	1,630,276,025	619504889	87,420
Mining and quarrying	46	4.8	251,259,730	95478697	5,708
Social services	121	2.2	115,342,660	43830210	5,253
Tourism (hotels, casino, etc.)	152	6.4	336,161,343	127741310	8,862
Trade	38	2.3	121,419,097	46139256	2,552
Transport, communication & storage	227	8.8	458,636,645	174281925	11,896
Water & Energy	26	14.6	766,763,200	291370016	6,676
Professional services	29	0.9	47,341,000	17989580	1,985
Real Estate	159	13.6	711,016,818	270186391	11,021
Other business services	138	2.6	133,544,450	50746891	8,172
Unspecified	1	0.0	317,000	120460	
TOTAL	2,459	99.9	5,234,899,732	1989261895	195,119

Source: Uganda Investment Authority

How public savings can be used to promote private investment

Following the declining trends in terms of trade of the early 1980s, consequent upon reduced Government revenues, the public sector failed to maintain the investments that relied heavily on government subsidies. The economic shock of the 1980s impacted very negatively on the public and private sector savings. The average domestic investment as a ratio of GDP came down to 8.5% while gross domestic savings came to -4 percent.

Due to adjustment effort, the investment-GDP ratio increased reaching an average of 13.9% between 1987 and 1993. Previous studies have demonstrated that fiscal adjustment has implications for the current account through its effect on investments and savings. An increase in government revenue is required for sustainable increase in productive public expenditure. But increase in revenue need to be accompanied by fiscal adjustment through reduced government expenditure in unproductive sectors such as defence and public administration (there are too many commissions). In such circumstance, the savings would then be used to promote private investment hence increasing the supply of tradable goods, which would sustain the current account deficit or reduce it.

¹⁰ Actual investment is taken as 38% of planned investment (see for example, Obwona 1997). Various in-house UIA surveys propose investment conversion rates ranging from 38 to 40%.

5. Conclusions and Recommendations

The study finds widespread corruption on the environment in which the private sector must work: licensing offices, customs department, awarding of tender, and the tax process. Corruption occurs in form of bribes, tax evasion, discrimination such as selective application of regulation and favoritism for certain investors, and excessive delays in providing services to investors. It affects all categories of businesses – imports, exports, manufacturing – irrespective of the size of the business. The study finds that these seriously undermine private sector investment in Uganda, causes delays in the trade flows, which translates into high costs of production thus inhibits business competitiveness. It also leads to low conversion rates of planned investment as only a few businesses make it to a take off stage.

Other economic consequences of corruption that have emerged in this study are the loss in government revenue, negative impact on productivity, aggregate investment and employment. The social costs of corruption have taken the form of decreased public investment in poverty areas like health and education due to budget deficits.

In addition to corruption, the study finds that poor condition and inadequacy of infrastructure (roads, communication, power supply); inadequacy of market for produce; inadequacy of investment finance, including access to and terms of bank loans; encumbered government regulations and policies; bureaucratic administrative procedures such as business licensing requirements and procedures, and customs delay are major constraints to private sector investment. Other obstacles include security and political instability/uncertainty, lack of adequate understanding of some of the legislative requirements resulting sometimes into non-compliance e.g. of VAT application.

Based on these findings the study came up with six areas, which the policymakers, private sector, and other stakeholders need to address:

- Removing bureaucratic procedures where necessary
 - Creating a wider platform for Government/private sector contact
 - Appropriate systems of control and simplified documentation
 - Continuous monitoring of agencies and system
 - Harmonizing policies across common borders
 - A fair, efficient and incorrupt tax administration
-
- **Streamlining bureaucratic procedures**

Licensing, and the process of export documentation approval are long, cumbersome and cause unreasonable delays, which only encourage corruption. This is worsened by inadequate administrative capabilities, which places a limit on the range of feasible tax instrument, as is inadequate flow of information between taxpayers and enforcement agencies.

The import, export and licensing requirements need to be reassessed and kept to a minimum. Customs for example is one of such areas, which lends itself to a streamlining of procedures. Computerization of the clearing system can advance this process while enhancing the monitoring of the speed with which goods are cleared. Standard time limit should be declared for processing of license, export/import papers, work permits, etc. Any delays, would be

reported, explained and investigated. The decision to move the VAT refunds and duty drawback claims from customs to the VAT department was to speed up the process of clearing of these tax refund claim. It is important to evaluate this approach again in order to identify the bottlenecks.

To solve the problem of belated payments, Government had previously asked the private sector to insist on the opening of local letters of credit before goods and services are supplied to Government departments. This seems not to have worked well, but it is a good basis to build on. The modification that I would suggest is that the private sector should be encouraged to insist on pre-payment for goods and services like telephone, electricity, water and fuel. That will install discipline in Government accounting offices while alleviating the cash flow problems that have crippled many Government suppliers.

- **Contracting out some functions of the customs department**

Some function of Customs Department could be contracted out to a firm with appropriate expertise. Nigeria is an example where this model has been tried and has proved successful. Government could investigate this further to see if such model could work for Uganda. In the meantime, Government could go ahead to contract another Pre-shipment firm and to impose penalties for wrong valuation/classification.

- **Appropriate systems of control and simplified documentation**

To reduce customs delays caused by demands for thorough verification of mixed cargo, URA could adopt appropriate systems of control and simplified documentation by introducing a manifest for small exporters to present to customs. URA could encourage the development of export consolidation and transportation hubs where small exporters can group consignments for exports and use certified transporters to transport their goods.

- **Automatic export licensing**

Export licensing should be made automatic. Such licensing should be continued only for purposes of recording and monitoring. The duty drawback scheme is a welcome effort, but there is need to simplify the procedure and to develop a formula for accurate estimation of fixed drawback rates. If this seems difficult, a flat-rate refund based on a notion of average duties paid could work.

- **Continuous monitoring of agencies and system**

Experience shows that, for example, in revenue (URA) corruption, it is not enough to clean up a corrupt revenue collection agency. Unless a mechanism is established for continuous monitoring, sooner or later the agency will backslide once more into the old stealing habit and require yet another extraordinary effort to try to rehabilitate it. It is not enough to ‘fire’ corrupt officials without reforming aspects of the system that provide opportunities for stealing and ensuring that honest officials are being appointed in position of trust.

Where personal contact is necessary, the introduction of elements of unpredictability as to which particular official may handle a matter or certain category of clients, and routine transfers reduce the potential for bribery.

- **A fair, efficient and incorrupt tax administration**

Possible shortcomings of the administrative procedures and tax structure could prevent the economy's revenue potential from being realised and this should be addressed by adjustments in policy. Administrative weaknesses (tax rates, procedures, and corrupt officers and their business allies) have resulted into widespread tax avoidance and evasion with adverse consequences for income and wealth distribution, and poverty eradication initiatives.

The difficulties in tax administration are partially a result of failure to educate the public about the basic requirements in the tax law. In designing an appropriate tax policy, it should be borne in mind that company taxation (corporate tax) falls not only on the returns to investment, but also on the investment itself and therefore the rate should be fair enough. Taking investment even partly tends to reduce the amount of investment undertaken while the method of taxation distorts investment decisions. A fair, efficient and incorrupt tax administration will do far more to improve the investment climate in Uganda and sustain rapid economic growth and poverty alleviation.

- **Harmonizing policies across common borders**

The structure of informal (unrecorded) cross-border trade suggests that some of the commodities being traded are reactions to misalignment in the policies of the two countries: Uganda and Kenya. Uganda and Kenya have different tariff regimes and the tax structure differ for many commodities. The policy implication here is that the government departments of the two countries responsible for formulating tax and trade policies need to come together and agree on appropriate measures or come up with a policy system that will work for the benefit of the two countries and the interest of the region.

The private sector can use the newly formed East Africa Business Council to lobby the two governments in support of the recommendations to harmonize the cross-border trade policies.

In the meantime Government could consider harmonizing the operations of various players in the Anti-Smuggling effort like the Revenue Protection Unit, and other departments of URA, and Uganda Manufacturers Association and equipping them to carry out their functions effectively. With support of UMA and other private sectors bodies Uganda Revenue Authority could think of ways to track down documentation of goods from Mombasa to the final delivery point so as to cut down on falsification of documents by officials at various checkpoints. It might also be important for the URA to carry out a market research to enable the prices of goods in town to be known. This will to some extent help in identifying smuggled goods.

- **Improvement in infrastructure and financial services**

Equally important are complementary policies in respect of infrastructure, and the financial sector, which would facilitate or at least not inhibit private investment or the economy's response to the liberalization-induced change in incentives. The shift from a national to a regional mindset in addressing the road problem is going to be imperative for the enabling of an efficient commodity distribution network and equitable development.

Creating a wider platform for Government/private sector contact

A joint private sector / government working groups would help with a dialogue between government and the private sector – discussing the outlook for different sectors, particularly certain manufacturing sub-sectors, tourism, exports and imports. The idea would be that private sector and government would agree to aim at certain goals for the sectors. On the other hand, the private sector could apprise government about the barriers for reaching certain goals and the policies needed to remove obstacles. The cooperation would also help to reduce business malpractices like smuggling or other form of tax evasion as the private sector (through their association) volunteer timely information of any suspect to government, and advising government on how to deal with such situation. The present UMA/PSE/Government dialogue is a very good basis to build on.

A number of recommendations have already been discussed in detailed in the first report under legal and institutional framework, which we don't have to over emphasize. They include favourable environment for operation of civil society organizations and the media, Raising public awareness in the existing laws related to procedure(s) of reporting corruption cases, and about the existing tax laws and requirements 2. Translating political will into reality and strengthening partnership with civil society.

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