International Trade Expo: Keynote Address

Good morning ladies and gentlemen,

I would like to begin by thanking the Private Sector Foundation for inviting me to deliver this keynote address and to commend the Foundation for its excellent work in organising the International Trade Expo. My theme is morning is the economic policy prerequisites for maximising the export potential of our economy.

Exports play a critical role in long term economic development. This is because export markets are highly competitive and thus long term success in these markets is only possible if exporting firms continuously innovate to increase their productivity, through technological upgrading to strengthen their efficiency and improve the quality of their products. It is the rapid productivity growth of the export industries which has driven the sustained economic growth and the structural transformation of the most successful developing countries in the world in recent decades, notably those in Asia, and which has lifted these countries to middle income status. If Uganda is also to become a middle income economy, it must develop vibrant, competitive export industries which will provide the engine of log term growth for our economy.

A strategy to promote sustainable export growth must include three fundamental policy components: macroeconomic stability, competitive real exchange rates and open trade policies, including comprehensive regional economic integration.

Exporters require macroeconomic stability so that they can plan for make long term investment in productive capacities and be confident that the viability of these investments will not be undermined by large unanticipated shifts in relative prices or other macroeconomic shocks. The most relevant metric of macroeconomic stability is inflation.

High inflation makes long term investments more risky, and, therefore, deters such investments. That is one of the main reasons the primary policy objective of the Bank of Uganda's monetary policy is the control of core inflation. Our policy target is to hold core inflation to a maximum of 5 percent on average over the medium term. Since the BOU introduced its inflation targeting monetary policy in 2011, that policy target has been achieved. Average core inflation over the last five years was 4.9 percent. Given our record, and our commitment to delivering low inflation, I think it is reasonably for private sector investors to expect that, over the next five years, core inflation will also average approximately 5 percent and incorporate this expectation into their investment plans.

The long term level of the real exchange rate is also of particular importance to exporters, because it is crucial for the financial viability of their businesses. Many non traditional export industries operate on relatively thin profit margins which can be wiped out if the real exchange rate appreciates.

Our exchange rate is market determined and, therefore, its movements are dictated by supply and demand. Over the long term, movements in the real exchange rate are determined by supply and demand at the aggregate level; the so called fundamentals of the economy. In particular, the long term real exchange rate depends on the relationship between the aggregate domestic output of the economy and total expenditure. The more total expenditure exceeds output – that is, the larger is the trade deficit – the more appreciated the real exchange rate must be to ensure internal macroeconomic balance. But a more appreciated real exchange rate makes export industries less commercially viable.

The unavoidable logic of economics is that, if we want to pursue an export led growth strategy, we must have a competitive real exchange rate and sustain this over the long term. But a competitive real exchange rate requires constraints on aggregate domestic expenditure. This is a key lesson from the success of the fast growing export led economies of Asia. From the public policy standpoint, the

most feasible way to constrain domestic expenditure is through fiscal policy, by avoiding large fiscal deficits.

Finally let me turn to trade policy. Exporters require both guaranteed access to their export markets and the ability to import freely all of the inputs they need to produce and market their exports. Uganda's trade policy is determined by its membership of the East African Community (EAC), which implements a customs union among all its members, which means that the EAC partner states have a common trade policy.

The EAC customs union allows tariff free trade within the EAC and imposes a common external tariff, at relatively modest levels, on imports from outside of the EAC. Nevertheless there are still numerous non tariff barriers (NTBs) imposed by the EAC partner states which impede intra-EAC trade, even though many of these NTBs have not been imposed for explicitly trade restricting purposes. It is worrying that, despite what on paper appears to be a liberal trade policy, Uganda and other EAC partner states rank poorly on the World Bank's Doing Business Indicators which pertain to trading across borders. This reflects the often costly and time consuming procedures which traders face in complying with customs requirements.

The EAC has proved to be of immense benefit for Ugandan exporters. In particular, access to the reginal market has enabled Ugandan firms to expand into a market which is nearly six times as large as the domestic market but which still affords them a modest degree of protection against imports from outside the EAC through the common external tariff, as well as through the natural barriers of transport costs. Because the EAC market is so much larger than the Ugandan domestic market alone, Ugandan firms must improve their productivity to compete successfully on it. Over time, as productivity is strengthened through the competitive pressures of the EAC market, these firms will be able to compete in wider export markets. The EAC thus offers a stepping stone to global export markets for Ugandan firms.

Over the last 10 years Uganda's exports to the (now) five other partner states of the EAC have risen very rapidly, at an average of 20 percent a year in US dollar values. In the 2016/17 fiscal year, Uganda exported $1.3 billion of goods to the EAC, which amounted to 41 percent of all our merchandise exports. The EAC is our fastest growing export market; ten years ago it accounted for only 25 percent of our total exports. For Uganda's manufactured exports, the EAC is even more important, accounting for 54 percent of all Uganda's manufactured exports in 2016. If Uganda is to develop a vibrant manufacturing base, creating employment and export earnings, exporting to the regional market will be an essential first step in that development, providing opportunities for Ugandan manufacturing industries to strengthen productivity through learning by doing and by achieving economies of scale.

Unfortunately Uganda risks jeopardising its success in exporting to reginal markets through ill conceived protectionist trade policies. The proposal for Buy Uganda Build Uganda legislation would, if implemented, offer domestic producers preferential treatment on the domestic market over our EAC partners, for example through preferential public procurement policies. In effect Buy Uganda Build Uganda offers trade protection through administrative measures, rather than through tariffs. It is a violation of the EAC Customs Union Protocol, which prohibits partner state from undertaking any administrative measures which discriminate in favour of its own producers at the expense of those of its partners. A level playing field for producers in all partner states is a fundamental principle of a customs union and a common market. The Buy Uganda Build Uganda proposal contradicts this principle.

The Buy Uganda Build Uganda proposal is potentially very damaging for Uganda's exports for two reasons.

First, if implemented, it will invite retaliation from our partners in the EAC. Why should they offer a level playing field to Ugandan firms in their markets if Uganda does not do so in its own market? As I have already discussed, the EAC market has become indispensable for Uganda's exports. It offers great potential for the future growth of our exports which in turn can provide the engine of

growth and structural transformation of our economy. We cannot afford to put at risk our access to the regional market by inviting retaliation to our ill thought out protectionist trade measures.

Second, the Buy Uganda Build Uganda campaign are designed to promote import substitutes; to encourage Ugandan firms to produce what can be imported more cheaply, by giving local production preferences over imports. If these measures are to have any tangible effect, they must induce a shift of resources – labour and capital - into the production of import substitutes. Given that such resources are in scarce, supply, this shift in resources in favour of the production of import substitutes must unavoidably come at the expense of resources used to produce exports. The Buy Uganda Build Uganda campaign is not compatible with an export promotion strategy. We can choose one or the other, but not both. Experience from all over the world shows that an export promotion strategy is far more likely to generate long term development and structural change than is an import substitution strategy.

To conclude, I what o stress the importance of making the right policy choices. It is possible, with sound macroeconomic policies, open trade policies and a commitment to genuine and comprehensive regional economic integration, to pursue an outward oriented, export led, economic development strategy. Such a strategy will take time to deliver results, but in the long term export led growth is likely to prove much more sustainable than inward looking growth strategies.