Policy note

December 2016

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International Growth Centre

Uganda: Improving export performance

Uganda, like most developing countries, is keen to leverage its external sector to support economic growth and employment creation through structural transformation. This has become increasingly urgent as commodity prices have leveled off and volumes have stagnated with the global slowdown. Policymakers need to establish a supportive environment within which the private sector can invest in exports. The overall objective of a recent IGC report on Uganda's export performance is to identify key measures donors can support to help bring that vision to fruition.

1. Overview of Uganda's industrial sector

Industrial sector development is a key priority of the Ugandan government, and it occupies a central position in the government's Vision 2040, which is the country's social and economic development plan outlining the government's aims to build a modern, competitive, and dynamic industrial sector that is fully integrated into domestic, regional, and global economies. Key strategic priorities in Uganda's 5-year National Industrial Sector Strategic Plan are to exploit and develop natural resource-based industries; promote agro-processing for value addition in niche markets; and support engineering for capital goods, agricultural implements, construction materials, and fabrication operations. However, to date there has been little systematic effort to develop vertical supply chains in areas where this would be possible (e.g. coffee, maize, tourism, and selected manufactures) in order to promote stronger linkages between multinational enterprises (MNEs) and domestic suppliers. Developing competitive value chains will be one crucial area for development over the medium term.

The most recent business establishment census, conducted by the Uganda Bureau of Statistics in 2010/11, reveals notable features of Uganda's manufacturing sector:

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- Businesses in the manufacturing sector employed an average of four people; 86% of businesses had less than five employees, and only 3% had at least 20 employees;

- Of the slightly more than 30,000 businesses in the manufacturing sector, 19% were in food processing and 81% in non-food processing (43% textiles, 17% furniture making, 13% metal products, and 8% in grain milling);

- Only 11% of businesses in manufacturing had an annual turnover of more than UGX 10 million, compared to almost 64% with annual turnovers of less than UGX 5 million;

- 93% of businesses in manufacturing were sole proprietorships, 3% partnerships, and 3% private limited companies; and

- Across the manufacturing sector, 95% of businesses did not own a computer, and only 3% used the internet for their business activities.

As these statistics suggest, Ugandan firms typically find it difficult to achieve production at scale. Developing mechanisms that allow firms to reap scale economies is one important policy objective for the government and donors. Small firms need to grow and become more productive before they can absorb the additional costs involved in exporting, so the problem of facilitating exports is linked to this issue of scale. Many factors come together to make firm-level growth challenging, from the difficulty of contracting for reliable, high quality input supplies, to problems accessing finance at reasonable rates, to trade and investment policies. Access to electricity also looms large, but it is to be hoped that with new generation capacity coming on stream, and possible progress on the East African Power Pool, firms may be able to access more reliable and cost effective electricity in the foreseeable future.

2. Recent export performance

Uganda's dominant export product is and has for decades been coffee, but other goods and service exports have grown in importance. Whereas in the 1990s coffee exports were higher than all non-coffee exports combined, coffee's share of merchandise exports had shrunk to about 24% in 2013.[1] Over the last decade, Uganda has begun to export significant amounts of fish, tobacco, tea, and cocoa, with shares of around 6% of merchandise exports each, depending on the year.

While food commodities still make up the majority of the export basket, the share of non-food exports has grown, with a variety of non-food exports produced mainly by agri-business and light manufacturing industries. This group of products includes cement, metal and steel, wood, chemicals, leather, and plastic products. Overall it is much more fragmented and diversified within than the food-commodity group of exports.

The biggest change in Uganda's export sector has come from the growth in services exports. In 1995,services made up about 15% of all exports, a value that has since risen to 42%.[2] This growth

1.Centre for International Development at Harvard University, "The Atlas of Economic Complexity." Official export statistics from UBOS quote a substantially lower figure for coffee export of 18% of formal merchandise exports, but don't change the ordinal ordering significantly.

2. Source: World Development Indicators, BoP definition, downloaded on October 23rd

is remarkable, especially considering that the share of services in the export portfolio in the rest of sub-Saharan Africa more or less stagnated at about 15% over the same time period. About 50% of services exports are travel and tourism services, which has become a major earner of foreign exchange. Other important service exports are transport and construction, with 11% and 10% shares in services exports,respectively; the rest is made up of business and government services.[3]

Structural changes in the export portfolio have gone hand in hand with structural changes in the Ugandan economy. Services now produce 55% of value added in the economy, up from 36% in 1995. At the same time agriculture's significance has nearly halved, from 49% of value added to 25%. Meanwhile, the relative size of the manufacturing sector remains almost unchanged at 8% of value added. But the manufacturing sector has changed within: its share of merchandise exports increased from 13% to 26%, implying a strong shift of focus from the domestic towards the external market.

3. Donor priorities to support structural change

A non-exhaustive review of current donor activity suggests that donors' current focus in Uganda is centrally on agriculture, agribusiness, and transport linkages, with comparatively little attention paid to the development of the manufacturing and services sectors. To be sure, some attention is devoted to cross-cutting skills-promotion, to tourism, and implementation of the EAC market protocol with regards to services trade, but more could be done. Priority areas include lowering trade costs, improving competitiveness of services, developing domestic supply chains, attracting FDI, harmonising standards, and promoting exports.

3.1 Lowering trade costs

Organising and consolidating value chains so as to reduce the real resource costs of moving goods from producers to consumers, both domestically and overseas, is a priority. Background studies for this report covering the dairy and maize sectors highlight precise measures that could help develop capacity in these areas. In services, the tourism value chain has clear potential, both in terms of a Ugandan export, and also a source of demand for input producers in goods as well as services markets.

Generally speaking, it is important to take a two-pronged approach to developing competitive value chains. First, barriers to engagement by large, foreign lead firms need to be reduced. The issue is not only explicit policy barriers affecting FDI, but also the business and investment climates more broadly, and in particular the level of transaction costs associated with building and operating value chains. Investment promotion is an important part of these efforts, and can be stepped up.

Second, the environment needs to be supportive of the development of supplier linkages between lead firms and domestic enterprises. Part of the task at hand relates to matching supply and demand, and overcoming information asymmetries, but the more fundamental issue is competitiveness. Contact with global markets can help promote productivity upgrading among domestic firms, by shifting resources from less- to more-productive firms. This process needs to be intensified, to the extent possible given regional constraints. Development of an internationally engaged ecosystem of firms can use initiatives like Special Economic Zones (SEZs), but their current implementation suggests caution

3. UNCTAD Stat, downloaded on October 23rd. Many services exports such as education services are not captured, but are known to be large in Uganda

in relation to some fundamental issues of design and focus.

3.2 Improving the competitiveness of services markets

Efficient services as inputs are key to increasing productivity in manufacturing and export industries, including in the specific context of East Africa (Hoekman and Shepherd, 2015). A large scale program of regulatory analysis should be undertaken for backbone services sectors like transport, finance, business services, logistics, and professional services. It is likely that streamlining the regulatory burden, consistent with important public policy objectives, while at the same time developing private sector capacity, could help downstream manufacturing firms become more productive and develop linkages to foreign markets, both intra- and extra-regionally.

In finance, for example, more research into the possibility of reducing policy barriers to integration within the region could yield ways to increase competition that would drive down notoriously high spreads that stifle private investment.

Services can also be a dynamic source of exports. Tourism is an obvious source of new potential earnings, and additional analytical work would be useful. A less obvious services export industry is education. Uganda has been successful in exporting education services within the EAC for a long time now, even though the industry's performance has recently weakened. Further investments in higher education institutions could not only strengthen education as a service export, but also help the country gain the necessary high-skilled labor force required to compete in global value chains (GVCs). The process of moving up in a value chain is intimately linked to the availability and quality of human capital, so investments in education can have significant payoffs if manufacturing activity grows substantially.

3.3 Developing domestic supply chains

Active government efforts to develop domestic supply chains for existing efficient firms would replace imports, add domestic value added, create jobs, and be a source of vertical technological transfers. The investment promotion agency could put together such "local content programs", which bear no similarity to local content requirements: the idea is to remove distortions and market failures that prevent domestic suppliers from taking advantage of their location and cost profile, not to artificially shift demand towards domestic producers at the expense of competitiveness in using sectors. Supplier development programmes, supported by lead firms in global value chain sectors, could help build the productive base and support manufacturing growth.

As part of investment promotion efforts, potential GVC lead firms in competitive sectors should be identified. Working collaboratively with them can help develop a competitive web of local suppliers, and can potentially lay the foundations for moving up into higher value added activities. Although light manufacturing sectors are crowded internationally, there may be scope for Uganda in sectors like processed agriculture, horticulture, and the leather industry, where there is already some evidence of increasing internationalisation among leading Ugandan firms

3.3 Facilitating foreign direct investment

A review of investment restrictions affecting key partners should be undertaken with a view to facilitating flows of inward FDI, particularly in manufacturing. The review should go beyond market access and national treatment issues to look at aspects of the business climate that affect the locational decisions of firms.

Investment promotion efforts should focus on a few key sources (or potential sources) of inward FDI, particularly the developed Northern markets, but also China, South Africa, and potentially India.[4] Supporting analytical work to better understand the reasons why inward FDI from these emerging markets is still relatively limited will be important, including firm-level interviews with incumbents and potential investors.

3.4 Harmonising standards

Policymakers should support efforts to develop common standards, mutual recognition agreements, and quality infrastructure in the EAC region. Key issues include take up of regional and international standards, including those in force in key developed country markets, as well as support of testing and certification facilities.[5] There may be scope for innovative mechanisms to help support firms in getting financial support to cover the costs of adapting products and processes to foreign standards.

3.5 Promoting exports

The Government is working to establish SEZs. It is not clear that they are being properly designed and managed (and there are plenty of failures in Africa). There is potential to support the Government in learning from international experience, and adopting a more coherent approach in attracting potential investors.

More detailed analysis is necessary to identify particular sectors and products where Uganda has been successful, or where it has a comparative advantage that remains underexploited. Support should be made available for detailed sectoral studies and firm-level analysis to support a better understanding of what makes these areas competitive, and how lessons can be transferred to other sectors in the interest of diversification. One option to be explored is making use of the Trade-DSM software developed in South Africa to aid in identifying firm-product-partner relations worthy of systematic investment of government and private sector time.

Given the high capital-intensity of the manufacturing sector and the poor functioning of capital markets in Uganda, there could be a case to expand current credit facilities from agriculture to the manufacturing sector, which has begun to show promising prospects to substitute imports and for regional exports. Effective interest rates for Ugandan businesses are high, so comprehensive financial sector reform—including addressing barriers to a regionalisation of activity—is a priority, as part of a broad initiative to reinvigorate the services economy.

4. The DFID-funded Supporting Indian Trade and Investment for Africa project could be used as a model to connect to further markets. DFID should attempt to build capacity for such initiatives within the GoU.
5. USAID Feed the Future and aBI trust at the national level, and TMEA on the regional level have projects/funding facilities to support the improvement of product quality and standards, both from the government and the private sector side. However, the focus is almost exclusively on ag products.