Remarks by

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The Export Promotion Strategy and the Buy Uganda Build Uganda

International trade is of profound importance for long term economic development. Most countries which have developed rapidly, achieving sustained and rapid growth and the structural transformation of their economies, have done so on the basis of outward looking export led economic strategies.

This is because it is participation in export markets which provides the main stimulus for productivity gains and technological upgrading in developing countries. Hence it is crucial that we have clarity as to the essential components of a viable export promotion strategy.

The most important relative price for exporters is the real exchange rate, because this affects their commercial viability. Most exporters, outside of the natural resource industries, operate on relatively small profit margins and these profit margins can be wiped out if the real exchange rate is uncompetitive.

On the other hand, a competitive real exchange rate gives exporters incentives to maximise the domestic value added of their products.

What does it require to achieve competitive real exchange rates on a sustainable basis? In the final analysis, the real exchange rate must reflect macroeconomic fundamentals and, in particular, the balance between output and total spending on all final goods and services in the economy (sometimes referred to as absorption). The difference between output and absorption is the trade balance.

In the medium to long run, output is determined on the supply side of the economy, by factor inputs and productivity, while absorption is determined by demand from the public and private sectors and the availability of foreign savings to finance any trade deficits. If absorption increases, relative to output, the real exchange rate must appreciate, to balance the supply of, and demand for non-traded goods.

Conversely, a reduction in absorption also reduces demand for, non-traded goods, which will induce a deprecation of the real exchange rate and thus an increase in the competitiveness of exports and other traded goods. Hence there is a strong link between the overall level of demand in the economy, relative to output, and the incentives facing the private sector to produce exports.

The Ugandan economy absorbs, in total expenditure, approximately 12 percent more than it produces; hence there is a trade deficit in goods and services of around 12 percent of GDP. Uganda's trade deficit is a macroeconomic phenomenon, determined by the savings and investment propensities of the private sector and by the size of the fiscal deficit.

In contrast, most of the fast growing economies of developing Asia, which have pursued successful export led growth strategies, have recorded sustained trade surpluses.

The message that I want to emphasise is that if we are serious about re-orienting our economy towards export promotion, we will have to reduce domestic absorption, so as to shift the incentives for the private sector to produce exports instead of non-tradeable goods. This is not simply a short term imperative; it will have to be sustained over the long term if we are to expand our export industries.

Reducing total expenditure can be achieved by raising private sector savings rates and/or by reducing fiscal deficits. Private sector savings rates are mainly determined by demographic factors and public policy has little traction over them in the short term. They are only likely to increase in Uganda when the demographic transition accelerates and pulls down age dependency ratios. Hence if we want to reduce domestic absorption, the burden must be borne by the public sector, in the form of lower fiscal deficits.

A sound public policy rationale can be made for running large fiscal deficits, provided that these can be financed in a sustainable manner, in order to meet demand for public goods and infrastructure. But we cannot pursue a development strategy which emphasises both high levels of public spending and export promotion at the same time, because the two objectives are not compatible in terms of macroeconomic fundamentals.

This is because, if we want to re-orient our economy towards producing for export markets, we have to shift scarce resources away from producing for the domestic market, and this will only be possible if we reduce demand on the domestic market over the long term.

Let me now turn to the **Buy Uganda Build Uganda** campaign. This is essentially a campaign for import substitution. To the extent that it is successful, it will give domestic producers incentives to supply the domestic market for tradeable goods.

There are many potential problems with this campaign, not least that it is incompatible with our commitments to our partners in the East African Community to implement a customs union and common market.

The **Buy Uganda Build Uganda** campaign essentially involves the use of trade distorting non-tariff measures, which are a direct violation of the EAC Customs Union Protocol, which prohibits partner states 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. If Uganda were to breach this principle, it would inflict serious damage on economic integration in the EAC, and would invite retaliation from our partner states.

Uganda gains important benefits from economic integration in the EAC, which provides a market for almost half of Uganda's merchandise exports and for more than half of Uganda's manufactured exports.

Protectionist measures which discriminate against our partner states in the EAC will put this market at risk, jeopardising the economic prospects of Uganda's manufacturing exporters, which are the most efficient manufacturing firms in the economy.

The **Buy Uganda Build Uganda** campaign also makes little sense from a macroeconomic perspective. As I have just noted, to the extent that the campaign actually has any significant impact, it will induce domestic firms to supply more tradeable goods to the domestic market. But for this to be done on a sustainable basis, resources – labour and capital - must be shifted from other sectors of the economy into the sectors afforded protection by the Buy Uganda Build Uganda campaign.

Where will these resources come from? There is no evidence that there are significant idle resources in the economy which could be reallocated to import substituting industries. The **Buy Uganda Build Uganda** campaign will not reduce demand for non-tradeable goods, so resources cannot be released from that sector. That leaves the export sector as the only sector from which resources could be drawn to supply increased demand from import substituting industries protected by the Buy Uganda Build Uganda campaign.

Consequently, even if there were no retaliation from our EAC partners against Uganda's exports, measures which aim to promote import substitution will unavoidably damage Uganda's exports, through their impact on the relative incentives to produce exports and import substitutes. Import substitution policies shift incentives towards the production of import substitutes but away from the production of exports.

The export promotion strategy and the **Buy Uganda Build Uganda** campaign are not mutually compatible. We can choose one or the other, but not both.

To conclude, because it is difficult to envisage the long term development of the Ugandan economy without a vibrant export sector, public policy should focus on export promotion.

But for this to be successful, we have to adopt macroeconomic policies that are compatible with a competitive real exchange rate, which means reducing absorption. We must also avoid ill-conceived import substituting industrialisation policies.