

Priya Manwaring

Implementing the new Industrial Policy in Uganda

Key lessons from cross-country experience



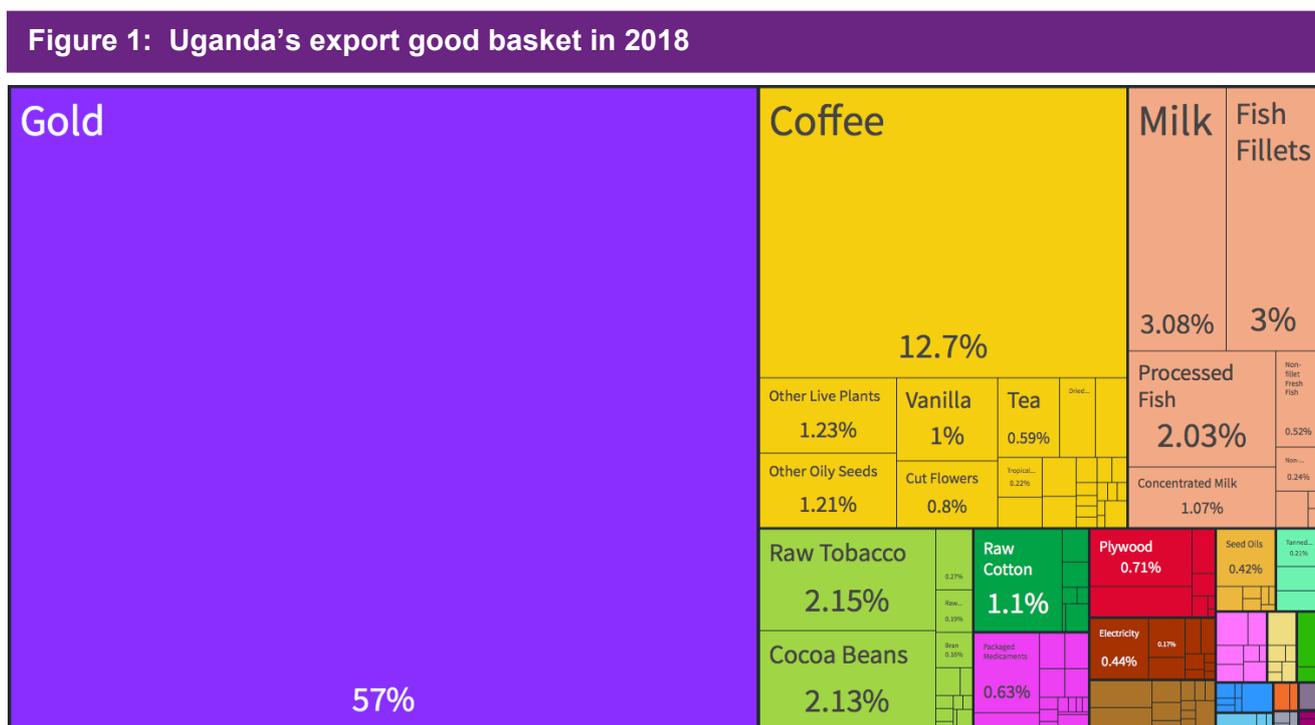
- In brief:**
- Leveraging industrialisation for growth in the long run in Uganda will require active policy reform to address key constraints to value addition and to unlock globally competitive production.
 - In light of this, the Ministry of Trade, Industry and Cooperatives has developed a revised 2021 Industrial Policy which provides direction to Uganda's future industrialisation efforts.
 - Cross-country experience highlights a number of key lessons for effective implementation of the Industrial Policy.
 - Industrial policies in Uganda must adjust to take advantage of the emergence of global value chains and the promise of 'industries without smokestacks'.
 - Policy coordination will be critical in implementing the new Industrial Policy, and the Cabinet Inter-Ministerial Implementation Coordination Committee can be instrumental.

This project was funded by IGC Uganda.

Industrialisation in Uganda

Industrialisation has historically been an engine for growth for a number of countries across the world. We have seen that as economies transition from subsistence agricultural production towards higher value manufacturing and service and agro-processing activities, these industries offer higher value addition and more productive jobs that drive long-term improvements in living standards.

While Uganda has experienced a transition away from agricultural production since the 1980s, this has not been accompanied by the emergence of a **globally competitive industry**. Economic activity continues to be concentrated in low value-added agricultural production, non-tradeable services and manufacturing activities such as construction that offer only a limited scope for long-term productivity growth and high wage employment.



(Source: Observatory of Economic Complexity, 2021)¹

Leveraging industrialisation for growth in Uganda is not automatic – it requires active policy reform to address key constraints to value addition and to unlock globally competitive production. Recognising this, the Ministry of Trade, Industry and Cooperatives has developed a revised 2021 Industrial Policy which provides direction to Uganda's future industrialisation efforts. This policy note highlights key lessons and opportunities for implementation of the new Industrial Policy.

¹ <https://pro.oec.world/en/profile/country/uga>

Three key messages from cross-country experience

Message 1: Exports are critical to successful industrialisation

Exports will play a critical role in Uganda's industrialisation story for two reasons. First, economic growth requires increases in productivity, and productivity growth requires producing at scale. Given Uganda's relatively small domestic market, attaining scale means exporting. At the same time, there is no better yardstick to measure productivity than the ability of firms to compete on the global market, with global competitive pressures forcing firms to upgrade over time.

Many studies have shown that countries with rapidly growing exports and with a rising share of exports in GDP have recorded longer sustained growth in national incomes.² Exports have been the cornerstone of successful industrial policy and growth in East Asia. China, Korea, Hong Kong, Singapore, Thailand, and other East Asian countries built their industrialisation success around exports. The growth miracle seen in South Korea in the 1960s, for example, was the result of a shift in policy focus and public support towards the development of competitive exporting firms.³

As such, despite forces of 'deglobalisation' seen in many countries, inward looking policies to promote production solely for the domestic market are not the solution for Uganda. The good news is that as part of the post-pandemic recovery, global trade this year is forecast to grow by 8.4%, creating new opportunities for East Africa and Uganda.⁴

Message 2: Industrial policies that are market-friendly and encourage entry and competition have proven more successful than policies that restrict competition from imports and foreign investors – or try to wall off local markets

South America's experience is instructive here. Brazil, Mexico, and Argentina all protected their market with high tariffs in the 1960s and 70s and, while they performed well for a few years, they later found themselves saddled with inefficient and unproductive industries that could not compete on export markets. When Chile unwound its import substitution policies in 1974, reducing effective protection rates from over 100% to below 15%, the country experiences substantial productivity gains to industry.⁵ This, together with other supportive macroeconomic policies propelled it to the highest sustained average growth in Latin America over the next four decades. These specific examples are supported by economic studies which have confirmed a positive relationship between reductions in protection and economic growth in a number of countries with complementary investment and macroeconomic policies.⁶

What this means is that there is a need to focus on entry-provoking, market-friendly industrial policies and avoid competition restricting policies – such as increased external protection and mandatory local content requirements – that result in the emergence and protection of uncompetitive domestic firms, often in monopolistic markets.

So what do pro-competitive policies look like?

² see Harrison and Rodríguez-Clare (2009) and Newfarmer and Sztajerowska (2012) for reviews of this literature

³ Ansdén (1989), Rodrik (1995)

⁴ IMF World Economic Outlook, April 2021

⁵ Tybout, Corbo and de Melo (1991) "The effects of trade reforms on scale and technical efficiency: New evidence from Chile" Journal of International Economics

⁶ Estevadeordal & Taylor (2009); Wacziarg and Welch (2008); Newfarmer and Sztajerowska (2012)

The recently revised Industrial Policy provides a clear framework for pro-competitive programmes, highlighting the importance of, for example, skill development, cheaper electricity, and increased domestic linkages. Evidence from a number of developing countries highlights a few key examples of successful pro-competitive policy that may be instructive in this context:

Supplier development programmes to make the most of foreign direct investment⁷

Evidence from Costa Rica, the Czech Republic, and Kenya suggests that transfers of knowledge and technology involved in supplying to large multi-national firms results in significant and persistent gains in domestic firms' productivity, sales, employment, and eventual capacity to export.⁸ In many cases, however, these firm-to-firm linkages are limited due to limited information on the part of firms as to what suppliers exist, or limited quality and reliability of local suppliers.

Providing or facilitating information on what suppliers exist and their quality and aligning national quality standard with those required by MNCs can help to overcome some of these information constraints.⁹ At the same time, dedicated 'matchmaking' programmes that provide incentives for foreign firms to work with local suppliers on quality upgrading have proven to have transformational effects for domestic production in countries such as Chile and Costa Rica, though they come at significant cost and require government capacity to effectively implement.¹⁰

Enhanced monitoring and certification of standards to ensure effective quality control of Uganda products (as noted in the new Industrial Policy)

Efforts to improve regulations of standards has proven particularly important in expanding export quantities and values in countries such as Peru (for organic bananas)¹¹, Uganda (for coffee)¹², and Kenya¹³ (for flowers).

Exports of Ugandan meat, dairy, feed, fruit and vegetable products are often rejected as a result of not meeting sanitary regulations. A recent IGC study of agricultural inputs finds that 30% of nutrient is missing in fertilizer, and hybrid maize seed contains less than 50% authentic seeds.¹⁴ Not only is low quality an issue, there are also concerns about information on product quality – particularly international buyers might be unsure about the quality of local inputs due to lack of credible certification. Existing evidence suggests these types of information asymmetries are likely to be quite high.¹⁵

As emphasised in the new Industrial Policy, efforts to promote and signal higher quality through clearly enforced (and harmonised) standards, certification, and R&D support can go some way in raising prices and expanding markets for Ugandan products.

⁷Manwaring and Rauschendorfer (2020) Making the most of investment in Uganda: the role of supplier development programmes. IGC

⁸ Alfaro-Urena, Manelici, and Vasquez (2019) "The Effects of Joining Multinational Supply Chains: New Evidence from Firm-to-Firm Linkages"; Alfaro-Urena, Manelici, and Vasquez (2019) "The Effects of Multinationals on Workers: Evidence from Costa Rica"; Javorcik, B. S. (2003) "Does Foreign Direct Investment Increase the Productivity of Domestic Firms? In Search of Spillovers Through Backward Linkages," American Economic Review; Steenbegren et al. (forthcoming) 'Integrating countries into GVCs'

⁹ Steenbegren et al. (forthcoming) 'Integrating countries into GVCs'

¹⁰ Manwaring and Rauschendorfer (2020) *Making the most of investment in Uganda: the role of supplier development programmes*; Steenbegren et al. (forthcoming) 'Integrating countries into GVCs'

¹¹ ITC (2011) The Impacts of Private Standards on Producers in Developing Countries

¹² ITC (2011) The Impacts of Private Standards on Producers in Developing Countries

¹³ Borot de Battisti (2009) *Standard bearers: Horticultural exports and private standards in Africa*

¹⁴ Bold et al., (2015)

¹⁵ Eaton et al. (2017; Bai et al. (2020); Startz (2017)

Promoting access to affordable finance

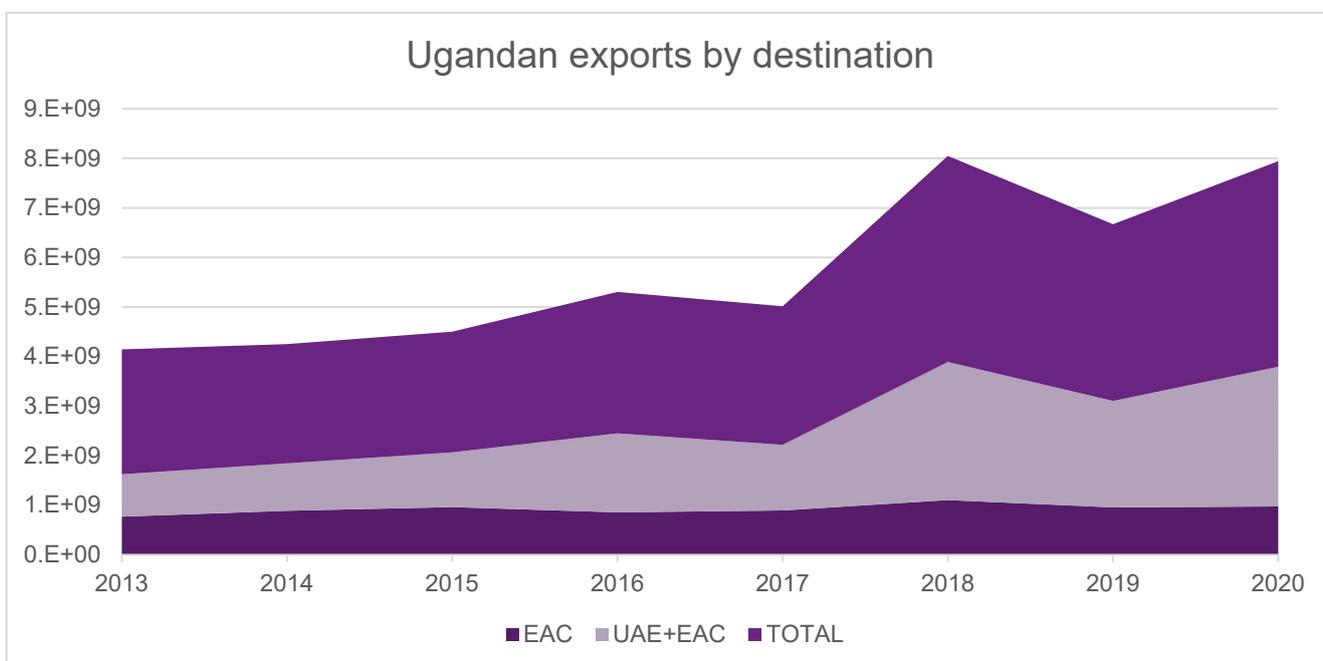
Access to affordable finance has been a cornerstone to industrial development in many countries. In South Korea, for example, targeted efforts were made to ensure that the banking sector provided a stable supply of “growth money” to target sectors at affordable rates given a severe scarcity of capital among firms in the 1960s and 70s.¹⁶

While the financial sector has developed significantly in Uganda, there remains an ongoing issue with high lending rates facing firms and households as commercial bank lending rates are typically 20% and above. This makes it difficult for firms to borrow for the productive investment that is required to achieve high rates of economic growth. Access to capital has been noted as a major constraint to firm productivity in Uganda.¹⁷ Efforts to address this will be critical. A recent event held by the Bank of Uganda and IGC highlighted a number of potential reforms, including increasing effective competition in the banking sector, and supporting banks in leveraging new data from the National ID architecture and Credit Reference Bureau to reduce non-performing loans.¹⁸

Leveraging trade policy for industrial growth

Pro-competitive trade policies play a critical dual role in Uganda’s industrial development. First, as mentioned above, trade expands the market for Uganda’s goods. The East African Community (EAC) plays an increasingly important role here – while in 2005, the EAC absorbed only a tenth of all Ugandan exports, this had grown to 40% by 2018, providing a key market for higher value manufactured goods in particular. The African Continental Free Trade Area (AfCFTA) offers a further expanded market for higher value exports.

Figure 2: Ugandan exports by destination



¹⁶ ADB (2017) Financing Industrial Development in Korea and Implications for Africa

¹⁷ Bassi et al. (2019) ‘Understanding productivity dispersion: Evidence from a new survey of manufacturing firms in Uganda’ IGC

¹⁸ <https://www.theigc.org/event/why-are-lending-rates-high-in-uganda/>

At the same time, there are a number of imports that are crucial intermediary goods essential for competitive production. Recent analysis by the IGC highlights that the majority of Uganda's imports that have fallen in recent months due to the global pandemic have been intermediary or capital goods such as transformers and turbines. Falling imports are therefore likely to come at a significant cost to domestic firms reliant on these inputs, negatively affecting the number of domestic firms and employment.¹⁹

Making the most of trade for industrialisation requires ensuring the flow of crucial intermediary goods essential for competitive production, whilst also simplifying documentation for trade and ensuring consistency of quality and safety regulations with EAC protocols to reduce non-tariff barriers to trade.

Message 4: Countries that have successfully used programs to promote specific industries have relied on time-bound, targeted and conditional fiscal support for firms along with M&E

In some cases, additional targeted support may be needed for firms in tapping into latent comparative advantages. In South Korea, for example, subsidies were critical in the development of the automobile and steel industries. A number of countries have targeted industrial policies towards the development of specific sectors. However, there has been a very mixed experience with this – while in South Korea and Thailand, targeted support has given rise to the development of competitive industries, in many countries in Latin America, Africa and Asia, this has not been the case. As the government considers specific policies to support targeted sectors, it is important to note that the success of such targeted policies has relied crucially on effective conditions and clear monitoring.

Conditional support

Any support provided to firms for industrial development need to be time-bound and matched with clear, enforceable and monitorable conditions. In South Korea, where firms did not meet the conditions outlines for industrial support, the government removed this support. This credible threat compelled firms to invest in enhancing global competitiveness. This is in contrast with the experience of many Latin American, African and Asian countries where firms received incentives with limited enforceable conditions, resulting in the perpetuation of uncompetitive industries propped up by government support and/or high tariffs that tax consumers.

Currently, industrial support does not appear to be effectively conditioned in Uganda – a number of different tax incentives, for example, are offered to firms that fit a range of pre-specified criteria, but these are provided without clear and monitorable performance conditions that could be associated with continuation of this support over time.

These incentives come at a considerable cost. The estimated fiscal cost of Uganda's tax incentives in 2017/18 was 888 billion UGX, corresponding to around 3% of total budget for 2017/18 or almost 1 percent of GDP in 2017. As such, it is critical to establish mechanisms to link the provision of tax incentives to pre-agreed future targets, as well as monitoring systems that ensure that "promises made" in return for preferential treatment are "promises kept".

Monitoring and evaluation

Related to this, effective industrial policy requires monitoring and evaluation of programmes to see what is going right and where things can be improved. The emphasis placed on monitoring and

¹⁹ Rauschendorfer and Spray (2020) *The COVID-19 impact on Ugandan Supply Chains: The importance of imports*

evaluation in the revised Industrial Policy is very welcome here. Annual reviews of plans to identify what has and hasn't worked and to adjust course accordingly is likely to be particularly useful, and the proposed Cabinet Inter-Ministerial Implementation Coordination Committee can play this critical role.

Industrialising in a different world

Uganda today is industrialising in a different world than East Asia did three decades ago and it has far different endowments – and so policies must adjust to take advantage of new circumstances and constraints.

Global value chains

Countries are far more connected in communication and transport than before, and so now global value chains – where different stages of production are located across different countries – dominate the world economy. The World Bank (2020) estimates that almost half of global trade is associated with value chains.²⁰ For countries like Uganda, this means there is a particular need to focus on bringing down trade costs and improving transport and telecommunication infrastructure.

Comparative advantage

In terms of industries for industrial support, another lesson from the experiences of other industrialising countries is the importance of working closely with existing comparative advantages and upgrade industrial capabilities over time.

Uganda's current Industrial Policy focuses in particular on agro-processing, oil and gas, and iron and steel, assembly of automobiles and manufacture of pharmaceuticals. While diversifying into agro-processing seems to be a natural extension of Uganda's current competitiveness in agricultural production, the other sectors of focus come with significant risks associated with large sunk costs, intense global competition, and price volatility.

In this context, policymakers would do well to look beyond traditional manufacturing. Several activities today including agro-processing, tourism, business services, horticulture, and ICT have the same characteristics that spurred early manufacturing success decades ago in East Asia – including the ability to profit from technological change, high productivity relative to agriculture, capacity to create new good jobs, and produce exports. Leveraging these "industries without smokestacks" can propel growth.

It is important to emphasise here that in 2018/19, prior to the onset of the pandemic, tourism was the single largest foreign exchange earner at USD 1.6 billion. Targeted efforts to ensure conservation efforts are adequately financed and effective branding and marketing will be critical in its recovery. More generally, many of these new and more technologically advanced sectors require investments in human capital to create a skilled labor force that can complement advanced technologies. As the nature of work changes, so should the educational system to reflect the need for greater 'soft' skills that require adaptability and decision making

²⁰ World Bank (2020) *World Development Report: Trading for Development in the Age of Global Value Chains*

Policy coordination is key

The effectiveness of implementation of the new Industrial Policy requires coherence among various government institutions responsible for implementation. In this context, the acknowledgement in the revised Industrial Policy of the different private and public actors involved in implementation and the related policies is well noted.

However, there is a need to further consider how different mandates interrelate – for example, how to ensure there is consistency and connection between the application of fiscal incentives and the promotion of local value addition, or in investments in infrastructure and the development of industrial parks. There also needs to be clear lines of accountability as to how specific interventions will be carried out by different agencies in particular sectors. Hopefully, the Cabinet Inter-Ministerial Implementation Coordination Committee can be instrumental here in clarifying this.

Uganda's new Industrial Policy provides the groundwork for pro-competitive policies towards sustainable industrialisation. If Uganda is successful in implementing this new policy and leveraging lessons from other countries, it will create the foundation of a dynamic and productive industrial sector for years to come.

Further reading

Alfaro-Urena, Manelici, and Vasquez (2019) "The Effects of Joining Multinational Supply Chains: New Evidence from Firm-to-Firm Linkages"

Amsden (1989) *Asia's Next Giant: South Korea and Late Industrialization*. Oxford University Press.

Harrison and Rodriguez-Clare (2009) *Trade, Foreign Investment, and Industrial Policy for Developing Countries*.

Leipziger and Manwaring (2020) *Uganda's industrialisation strategy: Challenges, opportunities, and lessons of experience*. IGC Policy note

Manwaring and Rauschendorfer (2020) *Making the most of investment in Uganda: the role of supplier development programmes*. IGC

Newfarmer and Sztajerowska (2012) *Trade and Employment in a Fast- Changing World*. OECD

Rauschendorfer and Spray (2020) *The COVID-19 impact on Ugandan Supply Chains: The importance of imports*

Rodrik (1995) *Getting Interventions Right: How South Korea and Taiwan Grew Rich*. Economic Policy.