Emmanuel Tumusiime-Mutebile: Achieving middle income status by 2017 – prospects and challenges

Remarks by Mr Emmanuel Tumusiime-Mutebile, Governor of the Bank of Uganda, at the First Economic Dialogue on the Vision 2040, Kampala, 26 August 2013.

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1. Need for a realistic time scale

The World Bank defines middle income countries in terms of Gross National Income (GNI) per capita, with a lower bound of $1,036 for lower middle income countries. Uganda's GNI per capita was $510 in 2011. To attain the minimum threshold of $1,036 for lower middle income status, Uganda must double its GNI per capita in real terms. With real GDP growth of 7 percent and population growth of 3.2 percent, per capita incomes will grow at 3.7 percent per year. At this rate of per capita income growth, it will take 19 years for Uganda to double its real income per capita. It is, therefore, clearly not possible for Uganda to double its real income by 2017. A more realistic target would be to reach middle income status by the early 2030s.

To achieve middle income status, Government needs to adopt a long term approach to economy strategy, focusing on the policies which can generate sustainable high rates of growth for the next 20 years. Uganda has established a good track record of macroeconomic management over the last two decades. It is imperative that macroeconomic stability is maintained over the long term, which means that demands for public spending must be accommodated within the available budget resource envelope so that public debt remains sustainable and does not crowd out private sector borrowing from the banking system. But macroeconomic stability is a necessary but not sufficient condition for sustainable growth over the long term. It must be combined with structural reforms which strengthen the supply side of the economy, enabling the economy to generate growth in productivity. There are three crucial areas pertinent to the supply side of the economy where Uganda needs to do much better if it is to achieve middle income status and transform the structure of its economy. These are: i) the modernization of agriculture; ii) accelerate the demographic transition and iii) raise private sector investment rates.

2. Modernisation of agriculture

There are very few developing economies, other than city states, which have successfully transformed their economies and reached middle income status without modernizing their agriculture. Agricultural modernization is a prerequisite for industrialization, for three reasons; i) to generate agricultural surpluses which can then be used as raw materials in agro-processing industries; ii) to free up labour for employment in modern industries, and iii) to create a rural market for the products of domestic industry.

Uganda formulated the Plan for the Modernisation of Agriculture in the 1990s but this has not been implemented effectively with dire consequences for the performance of the agricultural sector. Labour productivity in Ugandan agriculture is among the lowest in the world. Most of the smallholder food crop sector is characterized by subsistence farming, with no use of modern inputs.

The strategic objective of agricultural policy should be to help Uganda's smallholders to adopt good agricultural practices, produce more output for the market and to start to use modern farm inputs. The first step towards agricultural modernization is an effective agricultural extension service which can reach the mass of smallholder farmers and encourage them, through technical advice and demonstrations, to adopt good agricultural practices. The returns to investing in modernizing smallholder agriculture are potentially huge. The combination of adopting good agricultural practices and low input technology could enable smallholders to double their yields, which would raise farm incomes and generate marketable surpluses. It is a mistake to believe that Ugandan agriculture can be modernized by focusing on large scale commercial farms, rather than smallholders. Given the structure of agriculture in Uganda, which is dominated by smallholders, large scale farms are never likely to account for more than a small share of farm output. Furthermore, yield per area of land in Ugandan agriculture is inversely related to farm size; hence replacing smallholder agriculture with large scale farms is likely to reduce total farm output.

3. Accelerate the demographic transition

The demographic transition plays a key role in economic development. No developing country has achieved middle income status and structural transformation of the economy without undergoing a demographic transition. A demographic transition entails a fall in the total fertility rate, which reduces the population growth rate and the pulls down the age-dependency rate.

Uganda has only just begun its demographic transition. It has a total fertility rate of 6.1 children per woman and so has one of the highest age-dependency rates in the world, at over 100 dependents per people of working age. Many of the fast growing economies of developing Asia have age-dependency rates of around 50, because they began their demographic transitions several decades ago. Lower age-dependency rates are closely correlated with higher savings rates and greater real spending per person on human capital development, which is crucial for structural transformation, because it allows an economy to invest in physical and human capital.

Uganda's demographic transition has stalled because insufficient effort has been devoted to population policies. Across the developing world, in countries with diverse cultures (e.g. Iran, Malaysia, Sri Lanka), fertility rates have been brought down because Governments actively promoted smaller families, made contraceptives available to all the population and invested in reproductive health and women's education. Uganda should follow these examples and prioritise population policies to reduce the fertility rate as quickly as possible.

4. Private investment in labour intensive modern industries

Uganda's record of attracting private investment into labour intensive industries such as manufacturing is poor, which is one of the reasons why so few formal sector jobs in medium and large scale enterprises are being created. The essence of structural transformation is a large shift in the labour force out of low productivity, informal, traditional activities into modern, formal sector industries with higher productivity. This is what is driving structural transformation in developing Asia. However, such a shift in the labour force is only possible if there is private investment in the modern sector, to create jobs in high productivity industries.

Private investment rates in Uganda are around 20 percent of GDP, but this is only half the private investment rates in developing Asia. Uganda's policies to boost private investment have been ad hoc and ineffective. Fiscal concessions, such as tax holidays, by themselves, are not an effective tool for raising the overall rate of private investment, even if they are successful at attracting investment in a few individual cases.

To boost private investment, many different aspects of the business environment must be improved, to reduce the cost and risks of doing business in Uganda. These include: reducing the regulatory burden on business and the burden of lengthy customs procedures for exporters and importers, reducing the burden caused by demands for corrupt payments, strengthening the legal system to resolve commercial disputes fairly and expeditiously and improving the infrastructure in the transport and power sectors. Because the Ugandan domestic market is very small, the country will become a much more attractive destination for private investment only if firms located in Uganda can serve the entire East African market. But this will only be possible if non tariff barriers (NTBs) to intra-regional trade in the EAC are removed. The customs union in the EAC has not yet been properly implemented because a multitude of NTBs are still in place, slowing down trade across borders within the region.