AFRICAN DEVELOPMENT BANK GROUP

FROM ECONOMIC GROWTH TO ECONOMIC TRANSFORMATION

Speech by

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Your Excellencies,
The Minister of Finance, Planning and Economic Development Hon. Maria Kiwanuka,
Ministers and other Eminent Personalities,
Prof. Emmanuel Tumusiime Mutebile, Governor of the Bank of Uganda
Distinguished Guests,
Ladies and Gentlemen,

Introduction

I would like to thank the Government of Uganda and Governor Mutebile for inviting me to give this talk on **Economic Growth and Economic Transformation**.

I also believe it is in order to congratulate the people of Uganda on reaching the 50th Anniversary of Independence.

Ladies and Gentlemen,

What is economic transformation?

Let me give you a definition of this important challenge, which is attracting considerable focus and attention from policymakers, development practioners and indeed all of you gathered here today.

Economic transformation is characterized by at least three key features.

First, the structure of the economy changes depicting an increase in the share of manufacturing coupled with a sustained decline in the share of agriculture.

Second, the share of agriculture employment falls while the share of total labor force in other sectors of the economy increases.

Third, economic activity shifts from rural areas to the cities leading to an increase in the degree of urbanization.

Therefore, economic transformation is a comprehensive change that encompasses the modernization of a country's economy, society and institutions.

In countries where economic transformation has taken place, the middle class has become larger, changes have happened in the way politics works, with emphasis on market-friendly policies and government has become more effective.
Experience shows that transformation processes are not uniform. The points of departure matter as much as the leadership and the politics.

The process can reveal weaknesses and contradictions in each country that have to be dealt with.

In all cases where economic transformation has succeeded, the articulation of a national vision to motivate the people has been crucial.

There is no doubt that since independence, African countries have struggled to free the continent from ignorance, poverty and disease.

Despite the setbacks, progress is underway, but beyond that narrower objective.

Slow growth made it impossible to go to the next step which is to transform Africa.

For while you can have growth without economic transformation, you can never have economic transformation without growth.

As other regions of the world embarked on economic transformation, Africa was addressing four policy syndromes:

1. The economic incentives structures that were promoted in the 1960s were counterproductive—emphasizing government ownership and control of the commanding heights.

2. There was little discipline in public finances, leading to boom and bust scenarios in many countries.

3. Elite capture of state resources, rampant in many countries—irrespective of the regime.

4. Failed or fragile states.

Ladies and Gentlemen,

The quality of Africa's growth during the past 10 years has not been inclusive, with too few jobs created especially for the young people in the booming economies.

Youth unemployment was 20% in 2011, twice the average global rate.

The events of the Arab Spring have shown us the paradox of high growth and rising inequality and unemployment requires all of us to reflect seriously on the causes.

The Case for Economic Transformation

Ladies and Gentlemen,

In the African Economic Conference 2012, I have just attended in Kigali the issue of economic transformation was the key.

The challenge for Africa's policymakers is to ensure that this time growth leads to economic transformation.

Geography is Not Destiny

A survey of international experiences shows that there are no cultural or geographical obstacles to economic transformation.

Brazil's example

It happened in Brazil, a country the size of the United States, and with two-thirds the population, with an equally disparate ecology.

The 1960s and 70s were the years of military dictatorship.

In the 1980s, the country experienced hyperinflation, up to 40% per month and the economy declined in real terms. However, it did not return to autocratic rule.

The introduction of the Real Plan in 1994 brought about stability but little growth.

Beginning in 2000, the Lula Presidency introduced “income redistribution policies”, which worked well, because they had broad support, including from the private sector.

Poverty decreased as well as inequality. Lula’s innovative approach to targeting subsidies to the poor, including payments to parents who ensured that their children went to school, have been emulated in many other parts of the world.

Above all, the economy started growing again. Brazil had built competitive companies even during the long period of slow growth. It was able to take advantage of an expanding global economy in 2000s.

At the beginning of the 1990s, Brazil’s middle class was a third of the population, now it is 50% of the population—totalling 95 million people.

This strong internal market is among the factors behind Brazil’s resilience in the aftermath of the 2008 financial crisis.

Political competition became an important change agent in the economy with inflation control becoming a political imperative.

The country is now an economic powerhouse in its own right, the “B” in the BRICS. Above all it has moved millions of people out of poverty.

Brazil is the home of Embraer, the maker of short distance jets that now dominate a part of the global aircraft market.

The case of China

In China, the world’s most populous nation, economic transformation is happening under policies spearheaded by the Chinese Communist Party.

The country has in a matter of two decades become the largest exporter of manufactured goods on record.

In ICT, Huawei has produced the world’s fastest super computer.

How did China do it?

- Agricultural reform provided a foundation for an export growth process. The rural surpluses were the basis for industrialization. The government also expanded investment in rural infrastructure. It focused on enterprise development.

- China experimented with a special economic zone in Shenzen near Hong Kong. It was the beginning of a supply chain-based model of industrial learning. The latter allows the interaction of new ideas, products and models of management from the international market place. Models that work are adopted and those that don't are dropped.
- International aid was a supplement and not a replacement of national effort. Aid was not lost to corruption. The aid brought in good analytical methods for economic development.

- Progressive liberalization of the domestic market—allowing peasants to sell produce outside collective shops and markets. Making people richer was a national policy.

- However, China's experience has also been characterized by various bottlenecks such as structural economic imbalances in the coastal regions and the hinterland which has contributed to the rural-urban divide, high levels of inequality and persistence of extreme poverty, which affects 170 million people.

- This demonstrates that economic transformation is not nirvana—it will not be complete if it is not inclusive, creating economic opportunities for the majority of the population.

How does India's experience differ from the previous two?

India, the world's largest democracy and once one of its poorest, has, beginning with agricultural technologies (the green revolution) helped the country eliminate famine, overcome its "Hindu" rate of growth, which never exceeded 2%, to post growth rates of up to 10% in recent years.

Some of the leading global companies are Indian owned. .

Growth and innovative safety nets have lifted millions out of poverty.

Above all, India, despite hesitations which remain until today, instituted reforms to remove the Licence Raj, whereby the private sector was subject to a heavy regimen of licenses and controls, which ushered in unprecedented growth with economic stability.

The new industrial policy enabled foreign firms to enter India and Indian conglomerates to expand abroad.

Development in India is significant in that rampant poverty, the caste system, and ethnic and religious strife have not prevented the emergence of a middle class.

This is partly thanks to improved access to good education and healthcare and partly to encouragement to innovation.

I will conclude my survey with South Korea

In South Korea, the “miracle on the Hun River”, economic transformation happened partly under a period of authoritarian rule.

In the 1950s, Korea began its transformation from a very low base.

Today, South Korea’s GDP per capita at about US$30,000 is comparable to that of many European economies. It commands strong brands in the ICT (Samsung) and car industries (Hyundai) globally—again unimaginable a few decades ago.

After the war, Korea introduced policies to address increasing inequality.

- Two key factors are responsible for South Korea’s success: strong institutions and the motivation to sacrifice today for a better tomorrow.

- Strong institutions enabled a conducive environment for growth in productivity, skills development, technology and innovation, emulation, and competiveness.
- Korea launched the New Village Movement in the late 1960’s and this became the driving force for its social and economic development.

- By producing hardworking, motivated, and skilled human resources, this movement laid the foundation for Korea's industrial development.

These examples show that there are multiple paths to economic transformation and progress.

Indeed, there are "many roads to Damascus".

Uganda's Experience

Comparisons are inherently deceptive, but there is something compelling about the case of Uganda and South Korea. As you will recall, South Korea and Uganda were poor countries at the beginning of the 1960's with per capita GDP of around USD 100.

Today Uganda's GDP per capita is about USD 500, and that of South Korea about 60 times more.
The gap is largely explained by what was not happening in Uganda.

Several well-known bottlenecks impeded Uganda from emulating South Korea's development: low skills development; a weak private sector; poor infrastructure; small internal markets; internal strife, and slow development in agriculture.

Strategies for Economic Transformation

Ladies and Gentlemen,

It is now almost a truism that economic transformation begins with reforms in agriculture to raise productivity. This was the experience of South Korea in the 1950s and early 1960s and China in the late 1970s.

Along the way, labor moves from low to high productivity sectors. In Asia, governments actively encouraged rural–urban migration to provide cheap labor to the nascent manufacturing sector.

The prominent economist Schultz has noted that productivity-led agricultural growth is more important for economic transformation than merely sending “surplus” labor to urban industry.
Smallholders are capable of adopting new technologies but need support to overcome external shocks and other impediments.

However, African governments spend much less on agricultural R&D and outreach than their counterparts in Asia and Latin America. It is also significant that only 4% of food crops in Africa are irrigated compared to 30% in Asia.

However, countries that transformed their economies also put emphasis on basic education.

There is broad agreement that the best way to end the transmission of poverty from one generation to the other is quality education to the children of the poor.

Research indicates that smallholders with some education are more willing to adopt new agricultural technologies, such as use of fertiliser, and command higher incomes.

Another imperative is linking the economy to the global value-chain.

This requires improvements in product design, marketing, and logistics.

The "embedded" technology and know-how that comes with foreign direct investment also raises efficiency and productivity.

Developmental State

Of late, there has been significant debate vis-à-vis the so called "Development State".

The state's role in formulating policies and promoting the private sector is acknowledged. However, that developmental state must be accountable, ensure stability, policy coherence, mobilize the population around a common development agenda, and ensure that resources are set aside to achieve national goals.

However, the risk of the state picking winners and obstructing the market is real. It is therefore important to ensure that state interventions are temporary and that the regulatory framework does not hinder the private sector.

Above all, a developmental state puts emphasis on raising the technical capacity of the country in all relevant areas, including innovation. It uses its convening power to set national goals that are supported by the private sector and civil society.

The Case of Ethiopia

In 2010, Ethiopia introduced its “Growth and Transformation Plan” spearheaded by its late Prime Minister Meles Zenawi. Its implementation illustrates some of the challenges, but also the opportunities, linked to economic transformation. While Ethiopia shows that it is difficult to build economic momentum from a low base, it also underlines that dedicated leadership is fundamental.

To address the high cost of doing business in a landlocked country, the government has invested heavily in transport, energy and skills development.

The country’s exports are still mainly raw agricultural commodities. However, non-traditional exports, notably shoes and other skinwear

have increased in recent years, offering hopes for establishing backward and forward linkages in the economy.
The financing of the Plan has been challenging. FDI is rising, but not at the pace required. Remittances are important, given the Ethiopian Diaspora, but official bank channels are cumbersome. Recourse to deficit financing in recent years has raised inflation. The country still experiences residual food insecurity challenges.

In the same way, I applaud Uganda’s commitment to address constraints to economic transformation.

Indeed, imperatives such as private sector development; quality education; infrastructure and institutions that can deliver, are clean and accountable, will allow Uganda to bridge the current development gap with its economic peers.

Intra-African Trade and Regional Integration

The Lagos Plan of Action of 1980 envisaged that trade and regional integration would be key to Africa’s economic transformation, bringing scale economies in the drive toward industrialization. Regional integration also enables countries to take part in *production sharing*.

Regional integration is already helping countries in East and Southern Africa to develop robust service industries, including transport and telecommunications, by expanding markets, logistics and supply chains.

The recent Tripartite Free Trade Area agreement between COMESA, EAC and SADC is a good example. It brings together twenty six countries, nearly 600 million people, 57% of Africa's population, and a GDP of US$700 billion, 58% of Africa's GDP.

Infrastructure as an Enabler of Regional Integration

For the first time, Africa has a coherent blue-print for the transformation of the continent's infrastructure, the Programme for Infrastructure Development in Africa (PIDA) approved by the African Heads of State and Government at their 18th Summit in Addis Ababa, Ethiopia in January 2012.

According to PIDA, Africa will require US$360 billion in infrastructure investments in the next 30 years. Using an average GDP growth rate of 6.2% per year, PIDA has estimated that Africa's energy demand will grow six fold to 700 GW, traffic through the major maritime ports by 6 to 8 times to 2 billion tonnes, and demand for ICT services to grow twenty fold.

A total of 51 priority regional infrastructure projects (worth US$67.9 billion) in energy, transport, ICT and trans-boundary water constitute the PIDA Priority Action Plan to be implemented by the year 2020.

Financing Economic Transformation

The public sector alone cannot provide the financing and human resources required to modernize Africa's infrastructure.

There is therefore scope for innovative financing involving the private sector.

Infrastructure Bonds have become important for the mobilization of infrastructure financing and the development of domestic capital markets.

Kenya, Ghana, Nigeria, and most recently Zambia, have issued Eurobonds to partly finance infrastructure.

In the case of Zambia the issue was oversubscribed to the tune of US$12 billion, although it only sought US$750 million.

The yield, at 5.625%, was better than for distressed economies in Southern Europe.

East Africa is the world's newest oil and gas frontier with oil in Uganda, Sudan, South Sudan and Kenya and gas in Tanzania and Mozambique.

If managed well, with broad cooperation on technologies, pipelines and policies, natural resource wealth could help accelerate economic transformation in the region.

The Africa Infrastructure Bond—Bold and Transformative

In the past several months, I have presented the Africa Infrastructure Bond project at a number of fora, including the African Parliament in Midrand, South Africa, and to African Governors of the African Development Bank in Tokyo.

Today, African Central Banks have accumulated up to half a trillion US dollars in reserves.

These are held is safe assets, such as US treasuries, but at historically low yields, around 1%.

We have estimated that if only 5% of these reserves are invested with the African Development Bank, a triple A rated institution, to invest in infrastructure, it would amount to US$22 billion.

Countries would receive a higher return on their investment, and they would be contributing directly to Africa’s development.

The Bank recognizes that there are technical, legal, safety and soundness issues, and fiduciary responsibilities relating to these pools of capital and many other considerations related to investment guidelines.

But I do not see insurmountable obstacles.

I continue to see this as part of the big push that Africa needs to get on the path to economic transformation.

CONCLUSION

Economic transformation has been the hope and ambition of many African leaders.

Today, that challenge remains as valid as ever.

The examples I have shared indicate that economic transformation is possible across a diversity of countries including in Africa.

In addition to the key imperatives such as quality education, improving efficiency and productivity, infrastructure development and regional integration, ensuring that economic transformation is inclusive is equally important.

Economic Transformation cannot be achieved in the absence of dedicated and visionary leadership. Many African countries have adopted Vision Statements to guide them toward middle income status.

I gather that Uganda is shooting for first World in the next 50 years.

None of these ambitions are misplaced. Africa has the resources and the manpower to achieve most of its goals.

The new technologies will make the process easier in some respects, enabling Africa to leapfrog.

However, Economic Transformation is a process and not a goal in itself. The goal is to eradicate poverty.

Success requires that the whole country is carried along, and no one is left behind. It also requires that policy makers are able to resolve the many difficulties and contradictions that accompany the process of transformation.

The African Development Bank will do whatever is possible to help our countries undertake this process of economic transformation.

Like many others, we believe that the 21st Century is the African Century.

Thank you for your kind attention.