

IMPORT SUBSTITUTION UGANDA'S POST-COVID-19 INDUSTRIAL POLICY STRATEGY

Ramathan Ggoobi

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IMPORT-SUBSTITUTION: UGANDA'S POST-COVID 19 INDUSTRIAL POLICY STRATEGY

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On the road from Jinja to Kampala: the left side of the road worn off by imports, the right side still smooth for lack of exports.

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FOREWORD

Induced by the pandemic the Government of Uganda is rethinking its economic strategies. All over the world the lockdowns and restrictions caused by the spread of the virus have accelerated ongoing developments and exacerbated those challenges societies had already been facing before.

COVID-19 has stressed the need to reemphasize the role of government in steering the economy. Not only in Uganda neo-liberalism had lost its shine before, but in the shadow of the pandemic the need for practical alternatives to just relying on the market has become more urgent. And the impact of closed borders to its East African neighbours has revitalised the old debate about the advantages and disadvantages of import-substitution as an economic strategy.

It is in this context that the FES Uganda Office has commissioned a paper to document the history and the arguments of this debate, both, at the level of economic theory and of political practice in Uganda. This paper should be read as a continuation of two investigations into Economic Development and Industrial Policy and into the Implementation of Uganda's Industrialisation Agenda which Ramathan Ggoobi had authored for FES in 2017 and 2019.

This new paper Import Substitution: Uganda's post-COVID-19 Industrial Policy Strategy complements the insights of those earlier studies: that the success of economic strategies like import substitution is not so much determined by its underlying economic theory as by the manner of its respective implementation. Yes, one can find plenty of fault with Western economic thinking, World Bank or IMF prescriptions and their lax conditionalities of the past. But in the end the failure of such policies is caused by dysfunctional bureaucracies, lobby driven interventions and political ad hocism. Whatever economic arguments for or against import substitution are deployed, only a sound combination of functional state institutions, an energetic private sector plus an adequate banking system will allow for its success.

FES-Uganda is proud to continue its association with the Makerere University Business School, its Economic Forum and Ramathan Ggoobi as the author of this research paper. And we are looking forward to a constructive discussion among the stakeholders about concrete measures towards import-substitution as a post-COVID-19 industrial policy strategy.

Rolf Paasch

Resident Representative

Friedrich-Ebert-Stiftung (FES), Uganda

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ABSTRACT

The purpose of this paper is to review, discuss and document Uganda's record in import-substitution industrialisation (ISI) policies and pick lessons from success stories in economic literature to guide the current industrial policy ambitions. Although standard literature depicts ISI as an inadequate strategy that causes more problems in the economy than benefits, some scholars have argued that it was not ISI per se that was at fault in its classic failures, but its implementation due to a poor institutional context. Since import substitution strategy is not new to Uganda, how can the mistakes that failed it in the past be avoided this time around? What lessons can be drawn from success stories?

Keywords: **Import substitution, industrial policy, manufacturing, political economy, implementation**

ABBREVIATIONS

AfCFTA	African Continental Free Trade Area
BoT	Balance of Trade
BoU	Bank of Uganda
BUBU	Buy Uganda, Build Uganda
COMESA	Common Market for Eastern and Southern Africa
COVID-19	Coronavirus Disease
EAC	East African Community
EOI	Export-Oriented Industrialisation
FDI	Foreign Direct Investment
FES	Friedrich-Ebert-Stiftung
GDP	Gross Domestic Product
GoU	Government of Uganda
ILO	International Labour Organisation
IMF	International Monetary Fund
ISI	Import Substitution Industrialisation
ITC	International Trade Centre
MDAs	Ministries, Departments and Agencies
MoFPED	Ministry of Finance, Planning & Economic Development
MoGLSD	Ministry of Gender, Labour and Social Development
MoTIC	Ministry of Trade, Industry and Co-operatives
NDP	National Development Plan
NPA	National Planning Authority
NRA	National Resistance Army
NRM	National Resistance Movement
OPM	Office of the Prime Minister
SOE	State-Owned Enterprise
SSA	Sub-Saharan Africa
UBOS	Uganda Bureau of Statistics
UDB	Uganda Development Bank
UDC	Uganda Development Corporation
UEPB	Uganda Export Promotion Board
UGX	Uganda Shilling
UIA	Uganda Investment Authority
UMA	Uganda Manufacturers Association
UNBS	Uganda National Bureau of Standards
URC	Uganda Railways Corporation
WB	World Bank

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EXECUTIVE SUMMARY

Uganda has set out to turn the misfortunes of the coronavirus pandemic (Covid-19) into an opportunity by converting the country's huge import bill into a boost for domestic manufacturing capacity.

The NDP III cites "import replacement/promotion of local manufacturing" as one key development strategy Uganda is going to pursue between the financial years 2020/21 and 2024/25 to achieve the plan's objectives. The NPA has prepared an Import Substitution Action Plan to guide implementation of the strategy.

This paper set out to review, discuss and document Uganda's record in import-substitution industrialisation policies and also pick lessons from success stories to guide the current industrial policy ambitions. The analysis relied entirely on an extensive document and literature review.

Some of the key industrial policy documents reviewed include: the Vision 2040; the third National Development Plan (NDP III) 2020/21-2024/25; the Import Substitution Action Plan (2020/21-2024/25); the National Trade Policy 2007; and the Draft National Industrial Development Policy (2018) among others.

A critical review of past research established that although ISI is necessary to restrain the growth of "other" imports and thus release foreign exchange for capital equipment required by the growing manufacturing sector, standard literature depicts ISI as an inadequate strategy that causes more problems in the economy than benefits.

However, some scholars have argued that it was not ISI per se that was at fault in its classic failures, but its implementation due to a poor institutional context which constrained policy makers and economic actors. Since import substitution strategy is not new to Uganda - actually it is as old as the country itself - the difference will be created by avoiding the mistakes that failed it in the past. Some lessons that may be drawn from success stories and have been cited as recommendations of the paper include:

First, start with industries that will not over-stretch existing capabilities such as food processing and agrochemicals. Then move to relatively more complex ISI industries such as paper and wood industry, aluminium and other related building materials.

Use industrial policies such as production subsidies and preferential access to credit and equity capital for manufacturers. Desist from using trade policies such as higher tariffs, quantitative restrictions or import prohibitions of imports.

Secondly, substitute products with the largest multiplier leakages and produced by manufacturers that source locally produced raw materials. These include: machinery equipment and other accessories used in repairs of motor vehicles and motorcycle service; repair and installation of machinery and equipment; as well as repair of computers and personal and household goods service.

Thirdly, do not promote import substitution at the expense of exports. Avoid high levels of protection to industries and over-valuing of exchange rates which typically disincentivise exports. Instead, permit exporting industries to continue purchasing their needed intermediate goods and raw materials at world prices if they are to be competitive.

Fourthly, in order to avoid undermining the existing regional trade agreements, particularly the EAC and COMESA, and instead leverage them to access the large regional markets, strong state-business relationships should be built to enable the manufacturing firms engaged in import substitution to favourably compete with regional firms in both the domestic market and those regional markets.

Fifth, to steer the private sector away from speculation and rent seeking behaviour, the GoU should develop and sustain reciprocal control mechanisms (carrot and stick) with the beneficiaries of import substitution incentives. The incentive programmes should be characterised by conditionality, sunset clauses, built-in program reviews, monitoring, benchmarking, and periodic evaluation. Non-abiding firms should be penalised by withdrawal of subsidies and obliging them to refund the support offered at commercial interest rates.

Additionally, since Uganda is likely to continue relying more on foreign investors who possess two of Uganda's most scarce resources—capital and technology—to lead the ISI strategy, efforts should be made to ensure FDIs transfer technologies to Ugandan firms. To achieve this, the Uganda's Investment Code (2019) should be amended to require FDIs to partner with local entrepreneurs as a pre-condition to invest in particular industries. In addition, local firms should be adequately supported to achieve these partnerships such that the benefits accrued from ISI investments are absorbed within the local economy in case foreign firms leave in future.

To ensure effective implementation of ISI strategy, the GoU should execute the recommendations proposed by FES (2019). Key among them was the need to create a separate Ministry for Industry and Investment (MolI) to lead the industrialisation agenda. Others included stopping the Office of the Prime Minister (OPM) from engaging in implementation and concentrate on its Constitutional duty of monitoring and coordinating the implementing agencies; rationalisation of government MDAs and pay reform for civil servants; enhancing, consolidating, ring-fencing and mainstreaming the budgets for industrial development among others.

Finally, while pursuing import substitution, social and political institutions should maintain overall macroeconomic stability, while avoiding/reducing "wild" liberalisation. Policy should avoid ad hocism and resist industrial lobbies; for example, in the choice of priority industries for import substitution. Also during implementation, the State should act in decisive and subtle ways.



Photo by the New Vision

1.0 INTRODUCTION

President Yoweri Museveni has announced that post-Covid-19 Uganda is on the way to policy reversal into inward-looking import-substitution. During his several televised national addresses about the novel coronavirus disease (Covid-19) and the June 2020 State of the Nation Address, the President said the misfortunes of the pandemic should be turned into an opportunity by converting the country's huge import bill into a boost for domestic manufacturing capacity.¹

The President has argued several times that Uganda imports too much from China and other countries, including goods that could be produced locally. Following the outbreak of Covid-19, a number of senior GoU officials have spoken about the "opportunity to implement the import substitution." While addressing Parliament on March 19, 2020, the Minister of Finance, Planning and Economic Development, Matia Kasaija, said, "It is about time that we woke up and produced goods and commodities for ourselves so that we can support the notion of buying and building Ugandan."²

The third National Development Plan (NDP III) cites "import replacement/promotion of local manufacturing" as one key development strategy Uganda is going to pursue between the financial years 2020/21 and 2024/25 to achieve the plan's objectives.³ Some of the industries proposed to be set up under this strategy include: assembly of motor vehicles and/or electronic products; manufactures of metals e.g. simple spare parts; iron and steel; textile yarn, fabrics, made-up articles; paper, paperboard, and related articles; prefabricated buildings e.g. sanitary, plumbing, fixtures and fittings; furniture and parts thereof; beddings and mattresses; pharmaceuticals; starch; and manufacture of ceramics "tiles and china" kitchen ware.⁴

In its "Import Substitution Action Plan," the National Planning Authority (NPA) argues that import substitution is a strategy aimed at: attainment of the country's development goals, self-sufficiency, increasing forward and backward linkages, improving balance of trade and complementing export promotion in the medium to long term, improving competitiveness and strengthening the private sector; and providing learning ground for nurturing companies to build capacity for export.⁵

Economists generally agree that a country's income is determined by its trade balance (exports minus imports). Indeed, it is a key indicator of a nation's economic health. Like many other poor countries, Uganda experiences a trade deficit (imports have been greater than exports) that has rapidly been growing in the past four decades. From the 1980s to date, the country has experienced a balance of trade (BoT) deficit year-in-year-out. The deficit has grown from US\$ 56 million (UGX 207 billion) in 1980 to US\$ 3.9 billion (UGX 14.4 trillion) in 2019.⁶

1 See: <https://www.monitor.co.ug/News/National/President-Museveni-bans-use-of-private-vehicle/688334-5509474-livqgw/index.html>

2 See: <https://www.parliament.go.ug/news/4579/minister-urges-public-focus-import-substitution>

3 NPA (2020a)

4 Ibid

5 NPA (2020b)

6 Data extracted from IMF Data Warehouse 28/04/2020 6:48:23 AM. <https://data.imf.org/regular.aspx?key=61013712>

For clarity, Uganda's total import bill in 2019 was US\$ 7.3 billion (UGX 27.1 trillion), compared to total export receipts of UGX 3.4 billion (UGX 12.7trillion).⁷ The proportion of manufactured imports has not changed much over the past two decades, averaging at 69% of merchandise imports.⁸ Merchandise imports have grown by nearly seven times in the past 20 years, while exports have increased by a factor of five.

Economists also agree that a country's trade balance may be improved using two models: an export-oriented model, and/or a focus on import substitution. Since the 1960s, researchers have identified "rapid extension of domestic manufacturing to supply many goods currently imported" as one of the central elements of Uganda's development strategy to achieve structural change.⁹ Two reasons were cited why import substitution was necessary for Uganda: First, that it was the only way to restrain the growth of other imports and thus to release foreign exchange for importation of capital equipment. That is, in order to create room for expansion of imports of capital equipment required by the growing manufacturing sector, it was necessary to reduce other items in the import bill, so as to keep within the foreign exchange constraint.¹⁰

Secondly, that given the likely institutional limits on the rate of expansion of agricultural exports, even with the most energetic agricultural efforts in order to attain the target rate of growth for overall GDP, some non-agricultural sectors besides construction must take the lead in growing at more than the target rate. Other researchers have also argued that the growth of imports may be taken as a necessary condition for the establishment of a domestic industry in demonstrating the fact that the market is there.¹¹

Latin American countries were the first to initiate import substitution policies.¹² Then South-East Asia paid attention to their experience and achieved the greatest success in the policy. What did the East Asian countries do differently to succeed where Latin America, Sub-Saharan Africa (SSA) and many other countries elsewhere have struggled? Can Uganda emulate the East Asian approach to import substitution;¹³ is the Asian 'developmental' state applicable in today's globalised world anyway?

7 *ibid*

8 *These are imports of tangible products, such as vehicles, shirts, and all other physical products, excluding services. These include goods brought into Uganda directly for home consumption plus goods imported into Customs (bonded) warehouses.*

9 Clark P. G. (1966), *Development Strategy in an Early-Stage Economy: Uganda*. *The Journal of Modern African Studies*, 4, 1 (1966), pp. 47-64, pp. 47-64. Cambridge University Press.

10 *Ibid*

11 Maitra P. (1967), *Import Substitution Potential in East Africa*. E.A.I.S.R. Occasional Paper No. 2. Oxford University Press

12 Zobov A. M., E. A. Degtereva, V. Y. Chernova, and V. S. Starostin (2017), *Comparative Analysis of the Best Practices in the Economic Policy of Import Substitution*. *European Research Studies Journal*, Volume XX, Issue 2A, 2017, pp. 507-520

13 *Literature shows East Asian developmental states approached import substitution industrialisation (ISI) in terms of 'picking winners' among local capitalists and supporting them to partner with foreign investors so that they could step in if the latter left once incentives to them were reduced. Success stories in East Asia also combined ISI with Export-oriented Industrialisation (EOI) and promoted both of them hand in hand. To achieve all these, East Asian Tigers relied on carefully thought-out plans, or "growth strategies", and the State was very present but acted in decisive and subtle ways.*

The last time Uganda tried the import substitution policy, failure “arrived early and the negative impact on [the economy] had a greater magnitude.”¹⁴ Yet the policy of import-substitution was aggressively pursued.¹⁵ How can Uganda avoid the mistakes made in the past and also by other countries to ensure her latest efforts to “turn the country’s huge import bill into a boost for domestic manufacturing capacity” succeeds? What are the factors for successful import substitution that Uganda may adapt to her conditions and turn the Covid-19 global supply chain disruptions into an opportunity to produce goods and commodities currently imported? What accumulated experience can be summarised to help Uganda develop a robust implementation policy for successful import substitution?

The analysis of these and related questions formed the subject-matter of this study. The analysis highlights several political economy arguments of import substitution. How Uganda can balance the need to meet domestic, regional and international political constraints to implementation of an industrial policy such as a conventionally inward looking import-substitution. Can Uganda seek to build reciprocal control mechanisms with emerging capitalists while attempting to access large markets through regional integration?

This analysis aims at contributing to the understanding of the process of import-substitution industrialisation (ISI) policies that are practical for nations at Uganda’s stage of development and how successful import ‘substituters’ go about its implementation.

1.1 Rationale and Objectives of this Analysis

The overall purpose of this paper was to review, discuss and document Uganda’s record in import-substitution industrialisation (ISI) policies and pick lessons from success stories to guide the current industrial policy ambitions. The specific objectives include:

- *To identify the main difficulties that botched implementation of import substitution in the past;*
- *To examine Uganda’s current import bill to inform the choice of import-substitution industrialisation policies applicable to Uganda;*
- *To establish how Uganda may implement import substitution policies without shortchanging the gains from trade;*
- *To highlight the political economy arguments of recapturing the domestic market at the national level versus a regional approach;*
- *To make recommendations to ensure GoU’s industrial policy objectives yield the desired results.*

¹⁴ See Paula et al. (2014)

¹⁵ Marti and Ssenkubuge, 2009

2.0 APPROACH AND METHODOLOGY

The analysis relied entirely on an extensive document and literature review. This involved a critical review of key industrial policy documents for Uganda (both current and past). These include: Vision 2040; the outgoing Second National Development Plan (NDPII) 2015/16 – 2019/20 and Draft NDP III 2020/21 – 2024/25; the National Trade Policy 2007; the national budgets for the period 2015/16 – 2020/21; Trade and Industry Strategic Plan 2015/16 – 2019/20; the Draft National Industrial Development Policy (2018) and other relevant industrial policy documents. Several academic and policy research papers have also been reviewed and critiqued, including newspaper articles with a view to answering the study's objectives. Some quantitative data analysis was carried out to examine Uganda's current import bill (b). The data have been sourced from Bank of Uganda (BoU), Uganda Bureau of Statistics (UBOS), International Monetary Fund (IMF), International Trade Centre (ITC) and the World Bank.

3.0 THE CONCEPT OF IMPORT-SUBSTITUTION

Simply put, import substitution is an economic development strategy that emphasises the replacement of imports with domestically produced goods to encourage the development of domestic industry. It consists of establishing domestic production facilities to manufacture goods that were formerly imported. Most authors have equated the ISI policy to “using trade measures to encourage the domestic production of manufactured goods in place of imports.”¹⁶ Many mid-nineteenth century political economists, such as Friedrich List, advocated the use of protectionist tariffs to promote industrialization in countries that were behind the industrial leader, then the United Kingdom.¹⁷

Almost all of today's rich countries used tariff protection and subsidies to develop their industries in the early stage of their development. It is particularly important to note that Britain and the USA, the two countries that are supposed to have reached the summit of the world economy through free-market, free-trade policies, are actually the ones that most aggressively used protection and subsidies (Chang, 2012: 44).

Literature shows wars (or catastrophes such as pandemics) and economic depressions have historically been most important in bringing industries to countries of the “periphery” which up to then had firmly remained in the nonindustrial category.¹⁸ Other distinct origins of ISI include: balance-of-payments difficulties, growth of the domestic market (as a result of export growth) and official development policy. The main objective of import substitution policy is to encourage national production in order to create jobs, reduce demand for foreign currency, stimulate innovation, and ensure the country's independence in such areas as food, defence, industry and advanced technologies.¹⁹

¹⁶ See Irwin (2002); Balassa (1971)

¹⁷ Ibid

¹⁸ Hirschman (1968)

¹⁹ Bhagwati (1986)

A significant motive for late industrialising countries to pursue import substitution, particular during the post-World War II period, was a debilitating trade deficit, which forced foreign exchange shortages because of fluctuations in global commodity prices.²⁰

However, early research in ISI shows pursuing this policy because of balance-of-payments difficulties leads to a bias in favour of nonessential industries.²¹ On the other hand, when ISI is pursued as a deliberate development policy, it is likely to produce exactly the opposite bias; while wars and gradual growth of income are neutral with respect to the luxury character of the industry developed under the ISI policy. The standard literature depicts ISI as an inadequate strategy that causes more problems in the economy than benefits.²² However, some scholars show that it was not ISI per se that was at fault in its classic failures, but its implementation due to a poor institutional context which constrained policy makers and economic actors.²³ A corrupt political elite, for example, will have good ISI policies translate into inefficient economic development.

Import substitution strategy is not new to Uganda. Back in 1960s, at her independence, researchers identified “rapid extension of domestic manufacturing to supply many goods currently imported” as one of central elements of Uganda’s development strategy to achieve structural change.²⁴ This paper sets out to identify the main difficulties that botched implementation of import substitution in the past in order to inform the latest efforts. The rest of the paper is organised as follows: In the next section, we provide a brief of import substitution in Uganda since the colonial times to-date. Then we examine Uganda’s current import bill to inform the choice of import-substitution industrialisation policies applicable to Uganda. Then in section four we draw lessons from history and experiences elsewhere to establish how Uganda may implement import substitution policies without shortchanging the gains from trade. Then we highlight the political economy arguments of recapturing the domestic market at the national level versus a regional approach. We conclude by making recommendations to ensure GoU’s industrial policy objectives yield the desired results.

3.1 Import substitution in Uganda

In precolonial kingdoms and chiefdoms that formed present-day Uganda, apart from subsistence farming which predominantly employed their populations and the trade in ivory and animal hides with Asian traders at the East African coast, there was a small but fast-growing industry. In particular, the precolonial Bunyoro-Kitara and Buganda had developed a mining industry and its associated industries as well as a crafts industry and bark cloth production.²⁵ For example, the people of Bunyoro-Kitara had been mining iron ore since time immemorial and used it to manufacture implements like spears and hoes among others. They also mined salt at Lake Albert and Katwe, graphite, copper, chalk, and also made different types of pottery and raffia products centuries before the arrival of colonialists.

²⁰ Hirschman (1968)

²¹ *ibid*

²² Balassa, 1971; Bhagwati, 1978; Krueger, 1978; Balassa et al, 1986

²³ Pouget-Abadie, 2016

²⁴ See Clark, 1966; Stoutjesdijk, 1967

²⁵ Uzoigwe, 1972

On these add a crafts industry, prominent among which were basket-workers, dressmakers, jewelers, canoe-builders, wood carvers, and pipe manufacturers.

When Uganda became a British protectorate at the end of the 19th century, efforts were mainly invested in securing Britain's economic interest - raw materials, markets, and taxes. Uganda was, therefore, designed to produce primary products²⁶ for Britain, and to import manufactured products from Britain. Various authors agree that the British economic policy undermined African industry and stifled the private sector development in Uganda.²⁷ Agriculture remained the main economic activity for over 80 percent of Ugandans, primarily as small-holder subsistence farmers. In the post-Second World War period, colonial industrial policy adopted a two-pronged strategy designed to (a) increase exports of primary commodities, and (b) increase production in dollar-earning and dollar-saving industries.²⁸

To facilitate transformation of Uganda's economy into a modern industrial economy, the British colonial government aggressively pursued ISI policy.²⁹ However, Kaberuka (1987) argues that "by introducing import substitution industries as a means of reducing Uganda's imports from countries other than Britain, the [1946 colonial development] plan made Uganda's economy more vulnerable to the vagaries of the world economic system. To implement the policy, major capital projects were embarked upon in the 1950s, including the construction of a hydro-electricity power station at Jinja; promotion of mineral exploration at Kilembe and Tororo in western and eastern Uganda respectively; and the westward extension of the railway from Kampala."³⁰

The colonial government also established, in 1952, the Uganda Development Corporation (UDC) with an initial capital input of £5 million (equivalent to £144.52 million or UGX 695 billion at 2019 exchange rate)³¹ to promote manufacturing enterprise "to give local investors a start, and gradually be able to pass over to the private investor...both the capital burden and the managerial responsibility in the industries".³² Needless to emphasise the UDC targeted the domestic market through import substitution.

Back then, several measures were introduced to nurture infant industries. Foremost was an overvalued exchange rate that discriminated against imported finished goods, but allowed exceptions for imports of intermediate inputs. Interest rates were influenced by government intervention to help spur domestic investments. There were also provisions for special loans and equity capital; as well as quotas allowing access to foreign exchange for imported inputs and remittances at subsidised official rates.

26 Crops such as cotton, coffee, sugar, rubber and tea were introduced.

27 Kasozi, 1999; Mamdani, 1996, Mahmood Mamdani, "The Asian Question Again: A Reflection," Published in the *Sunday Vision*, Kampala, Uganda, 28 April 2007.

28 Memorandum from the Colonial Office to Governor of Uganda, *The Colonial Empire and the Economic Crisis*, 6 August 1948, in *Main Papers*, AR MA 5/34, Standing Finance Committee, 1944-49: 1.

29 Marti and Ssenkubuge 2009; Kaberuka 1987.

30 Obwona et al., 2013

31 Gann & Duignan, 1975

32 Obwona et al., 2013

These industrial policies registered some good results. At independence in 1962, the small economy of Uganda imported manufactured goods worth £133,000 (or UGX 625 million at today's exchange rate), and exported processed/manufactured goods worth £29.6 million (UGX 139 billion), turning a surplus of £29.4 million on its trade balance.³³ However, much of the industrial activity remained in primary agro-processing. For example in the early '60s Uganda had 78 coffee hulleries, 145 cotton ginneries, and only two factories engaged in higher value added activities such as cotton-spinning, weaving and finishing.³⁴

Since 1980s to date, however - when Uganda stopped pursuing industrial policy - the country has experienced a BoT deficit year-in-year-out (see Figure 4). The deficit has grown from US\$ 83 million (UGX 298 billion) in 1980 to US\$ 2.3 billion in 2015.³⁵ Of the 1,176 factories subject to the Factories Ordinance of 1957, 254, were involved in wood processing; 360 were in food and tobacco processing; and 233 were in the metal and engineering sub-sector (dominated by motor vehicle and plant repairing, with 148 firms).³⁶

Given this background, Clark (1966) cited two reasons why import substitution was necessary in Uganda: First, that import substitution was the only way to restrain the growth of other imports and thus to release foreign exchange for capital equipment. That is, in order to create room for expansion of imports of capital equipment required by the growing manufacturing sector, it was necessary to reduce other items in the import bill, so as to keep within the foreign exchange constraint. Secondly, given the likely institutional limits on the rate of expansion of agricultural exports, even with the most energetic of agricultural efforts in order to attain the target rate of growth for overall monetary GDP, some non-agricultural sector besides construction needed to take the lead in growing at more than the target rate.

Therefore, Clark called for import substitution in processed foods, consumer goods (particularly non-durables), intermediate goods other than fuels, and construction material. He reasoned that a substantial degree of import substitution was a necessary condition for making manufacturing a leading sector. His views were supported by other analysts who argued that given the limitations on the rate of growth for manufactured exports, special efforts to increase import-substitution were the most realistic option to reduce Uganda's trade deficit.³⁷ In line with this strategy, four categories of industries were considered: (i) industries processing locally produced agricultural commodities especially cotton, coffee, and tea; (ii) industries which manufacture articles which are costly to transport relative to their intrinsic value, such as beer; (iii) assembly industries, such as suitcases, and (iv) industries producing perishables, such as bread.³⁸

33 Stoutjesdijk, 1967

34 Elkan, 1961

35 Data extracted from IMF Data Warehouse 8/01/2017 8:39:48 AM

36 Obwona et al., 2013

37 Maitra (1967)

38 Stoutjesdijk, 1967



4.0 WHY IMPLEMENTATION OF IMPORT SUBSTITUTION FAILED IN THE PAST

First, literature shows ISI was used in Western Europe, the United States and East Asia in the early stages of industrialization. And that it worked quite well in those places, yet it failed in Latin America, Africa and parts of Eastern Europe. What explains this? In particular, why has implementation of import substitution in Uganda failed in the past? Did it fail anyway?

Given the relatively poor performance of the manufacturing sub-sector - with average value added of 8.8 percent since 1960 - it would not be far-fetched to assert that the ISI strategies by and large have in the past failed. However, as FES (2017) argues, industrialisation policy in Uganda in general and import substitution in particular failed mainly because of state failure³⁹ between the early 1970s and the mid-1980s, and market failures⁴⁰ during the late 1980s to date.

It should be noted that Milton Obote's First Five-Year Development Plan for the independent Uganda (1961/62-1965/66) did not consider industrialisation - let alone import substitution - a development priority.⁴¹ Instead it underlined agricultural development as its priority. Industrialisation only featured prominently in the Second Five-Year Plan (1966/67-1970/1971) and import-substitution manufacturing was pursued.⁴² However, even this was destroyed after Idi Amin's rise to power, his expulsion of Asians in 1972 and the political instabilities his regime initiated in Uganda.

Other authors argue that lack of competition for local producers following the introduction of ISI policies may have resulted in inefficient implementation of the industrial policy and by extension price increase.⁴³ The introduction of ISI led to un-competitiveness of the products manufactured. As a result, the positive effect of the imposed import restrictions was very short-term.

Others attribute it to the fact that earlier development plans in Uganda did not budget for ISI but simply left it to the private enterprise, and also emphasised growth through the deployment of foreign resources and especially foreign manpower.⁴⁴ As a result little could be achieved by simply providing infrastructure without improving the ability of local population to participate in or purchase the products of the proposed industries.

39 In Uganda, 'state failure'—when the basic functions of the state were no longer performed—began with the rise to power of Idi Amin, whose administration destroyed the economy and disorganised industrial infrastructure.

40 Imperfections that prevent efficient allocation of resources. For example, information asymmetry leading markets to send wrong signals to entrepreneurs—invest here, not there yet they should invest there; coordination problems; underinvestment by firms in skills development; failure to invest in scale etc.

41 World Bank, 1962

42 Stoutjesdijk, 1967

43 Molchanova, 2015

44 Kaberuka 1987

In addition, beginning in the late 1980s, and more aggressively during the 1990s, Uganda embraced the Washington Consensus⁴⁵ where it liberalised the finance industry along with international trade, privatised its formally state-owned enterprises (SOEs) and deregulated nearly all sectors of the economy in pursuit of a 'private sector-led economy'. These neo-liberal policies weakened institutions such as UDC and its enterprises that were driving industrialisation in Uganda. The UDC was closed and all other strategic public enterprises were privatised.⁴⁶

In sub-Saharan Africa (SSA), literature identifies some of the factors that botched the implementation of import substitution in the past as: i) obstacles imposed by the agricultural sector; ii) problems with the balance of payments; iii) lack of human capital; and iv) little knowledge of the required technology.⁴⁷ Other authors have cited overreliance on ad hocism and lack of economic rationality⁴⁸ as well as the fact that development of ISI depended more on "results left to chance" rather than deliberate steps and actions undertaken by the state.⁴⁹ The process went beyond the limits of human resource capacity, endowment of financial resources, and market size. In addition to these aspects, there was a high level of interference from the State in the market and a poorly developed economic infrastructure. In the 1970s, the failure of ISI had become clear to economists and policy makers.

Some researchers, however, argue that it was not so much the ISI strategy in itself but its implementation that failed.⁵⁰ And that this failure stems from the fact that ISI policy did not address the fundamental causes of economic growth: physical and human capital accumulation. Most countries that tried to pursue ISI did not address important prerequisites, particularly the infrastructure gaps (transport and energy), as well as the knowledge, skills, and experience that workers require to run industry. Will implementation of the new import substitution agenda avoid these past huddles? What deliberate efforts has Uganda put in place to address the abovementioned causes of ISI implementation failure?

Zobov et al. (2017) warns that ISI policy failure typically leads to: a slowdown or reduction of welfare growth, a deterioration of the balance of payments, the emergence of the risk of a trade war, and a negative impact on employment. It goes without saying that these effects need to be avoided. In addition, some researchers argue that since the market is small in Africa, due mainly to low income, there is no public for manufactured goods, thus making production at profitable levels unviable.

45 A set of ten economic policy prescriptions that in 1990 the Washington, D.C. based institutions (the World Bank and IMF) considered, on the recommendation by economist John Williamson, as "standard" reform package for developing countries

46 Obwona et al., 2013

47 Paula et al, 2014

48 Bruton, 1998

49 Vitta, 1990

50 For example see Pouget-Abadie, 2016

5.0 ESTABLISHING THE IMPORT-SUBSTITUTION POTENTIAL FOR UGANDA

President Museveni has been arguing for years that Uganda imports too much from China, India and other countries, including goods that could easily be produced locally. He has continuously encouraged Uganda and other African countries to produce some of the imports locally, and also export more to China and Japan. Yet, what industries are available in Uganda; what do they manufacture and who owns them? In particular, what is Uganda's present import-substitution potential of the manufactured commodities on the basis of present imports? What exactly is Uganda's current import bill? What product-mix does Uganda import? How viable are these products on the basis of the extent of domestic production capacity already available or that can be built in the short- to medium-term?

First, the manufacturing sub-sector in Uganda is divided into eight groups namely: food processing; drinks & tobacco; chemicals, paint, soap & foam products; metal products; bricks & cement; textiles, clothing & foot wear; sawmilling, paper & printing; and other manufacturing also known as miscellaneous.⁵¹ Food processing as well as drinks and tobacco constitute 60% of total value added by the sector. The food processing entails low-value activities such as grain milling, basic fish processing, coffee hulling, tea processing, edible oils, fruit juice processing, and so on. In recent years, manufacturing value added in Uganda has been driven by dairy products, processing and preservation of fish and meat, and manufacture of articles of concrete, cement and plaster.⁵² Others include grain milling & starch products, furniture, and pharmaceuticals products.

Secondly, most firms in formal manufacturing in Uganda are foreign owned. There is a relatively small proportion of private limited companies in Uganda as compared to sole proprietors. Hence, most manufacturing firms in Uganda are not listed and cannot therefore raise capital through the capital market. Niringiye (2014) reports that the largest proportion of manufacturing firms in Uganda is wholly owned by foreigners with an average of 41%, while local ownership averages 38%. Even joint ventures with the majority shares owned by foreigners are more than those with majority shares owned by local investors. Overall, more than half of the firms in Uganda's manufacturing sector are foreign-owned.

Uganda has remained a net importer of manufactured products, including very low-skill manufactures. Total merchandise imports⁵³ stood at US\$ 6.2 billion in 2019, compared to US\$ 0.74 billion in 2001.⁵⁴ This shows merchandise imports have grown six-fold in the past 20 years. In 2018 Uganda imported products such as cereals (US\$ 236.4m), edible fats (US\$ 248.4m), Plastics (US\$ 386.5m), salt (US\$ 133m), sugars and confectionery (US\$ 96.6m), wheat (87.5m), rice (US\$ 66.6m), used clothing (US\$ 60.6m), animal food (US\$ 20.5m), fake air (US\$ 10.4m), fruit juices (US\$ 1.5m) and straws (US\$ 267,000) etc. (see Annex 1). Figure 1 shows that nearly all Uganda's imports in 2019 were manufactured items, except for chemicals and other raw materials.

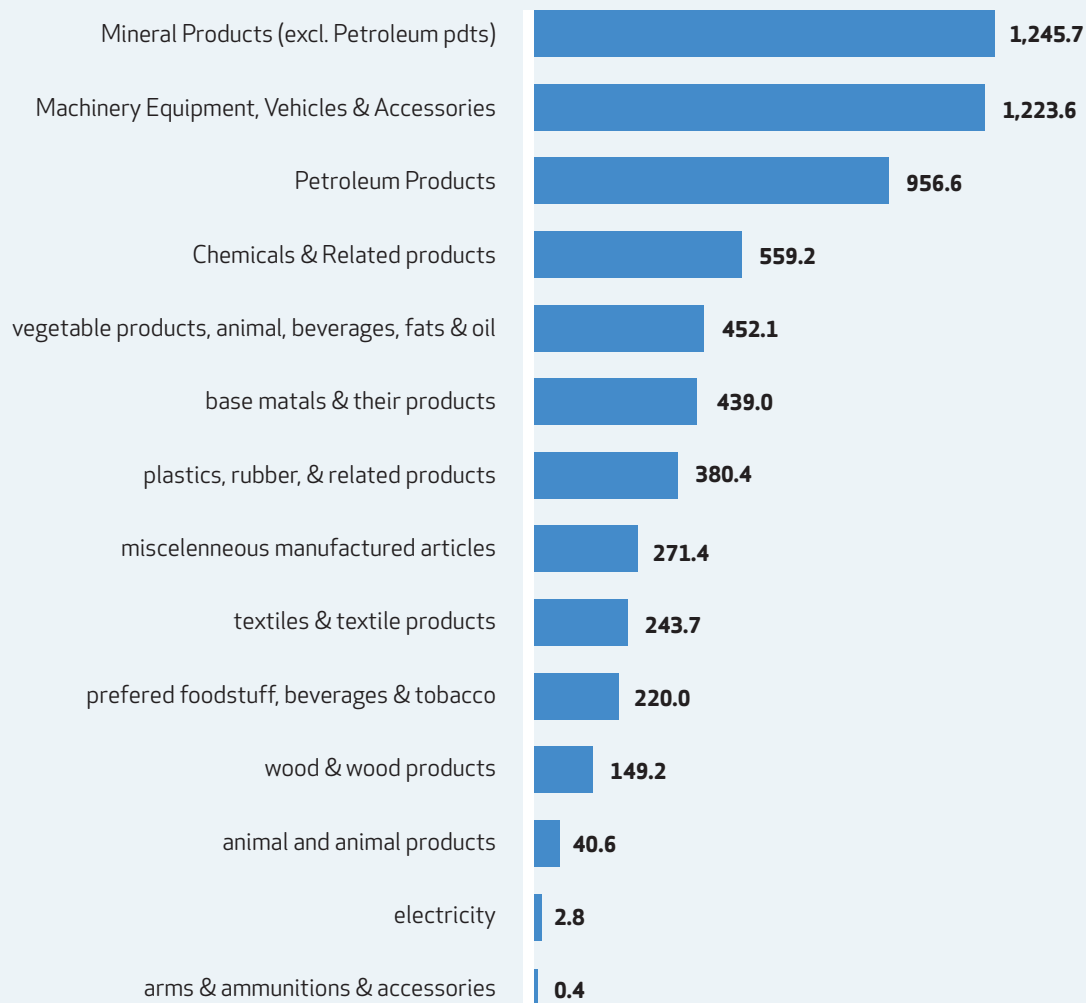
⁵¹ See UBOS, *Statistical Abstract 2019*.

⁵² *Ibid*

⁵³ These are imports of tangible products, such as vehicles, shirts, and all other physical products, excluding services. These include goods brought into Uganda directly for home consumption plus goods imported into Customs (bonded) warehouses.

⁵⁴ The quoted import data from Bank of Uganda (2020) shows formal private sector import expenditure based on harmonised coding system, free on board (fob).

FIGURE 1: UGANDA'S TOP IMPORTS IN 2019 (IN MILLION US DOLLARS)

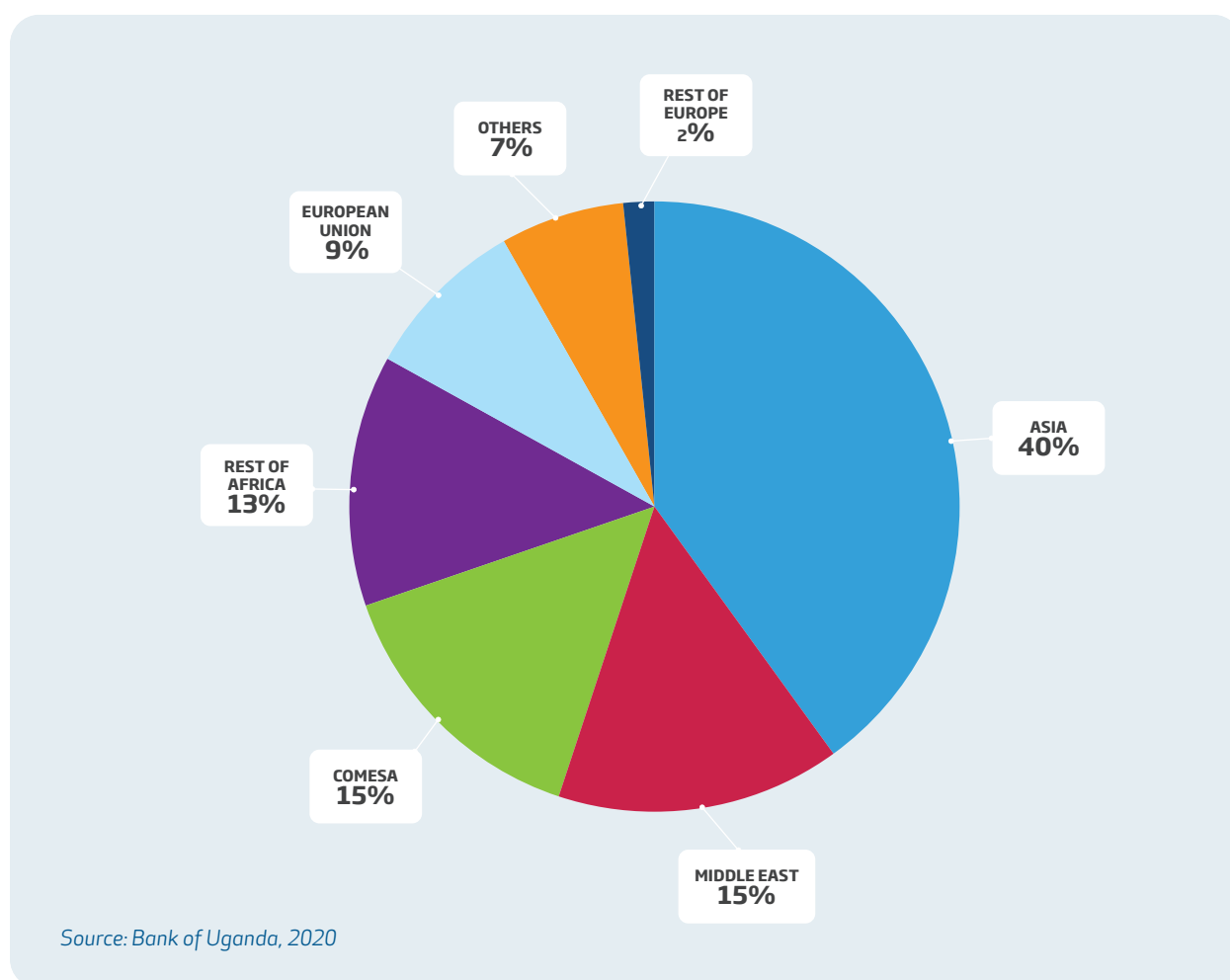


Source: Bank of Uganda, 2020

Figure 1 also shows that Uganda's top five imports account for 72% of the total merchandise import bill. The NPA also finds that service imports account for about 30% of the total import bill of goods and service, 95% of which are transport, consultancy, travel and construction.⁵⁵ Over 40% of Uganda's imports originate from Asia, followed by Middle East and COMESA (15% each) and the Rest of Africa (13%) (Figure 2). The European Union (EU) that used to be a source of over 19% of Uganda's imports in 2008, now contributes just 9%, while the rest of Europe has also seen its share reduce from 4% to 2% over the same period.

⁵⁵ NPA, 2020a

FIGURE 2: ORIGIN OF UGANDA'S IMPORTS IN 2019



Over a third of Uganda's import value originates from just two Asian countries; China (US\$ 1,030.8m) and India at US\$ 872.9m (Table 1). Other big exporters to Uganda include Kenya (US\$ 785.2m), United Arab Emirates (US\$ 636.8m), and Tanzania (US\$ 454.5m). Interestingly, most of the countries where Uganda picks a bulk of her imports do not import from Uganda.⁵⁶ Over the years, Uganda's trade has smoothed in intensity and direction away from inter- to intra-regional trade. In 1999 the EU was Uganda's main trade partner contributing over 57% (\$280m) of Uganda's total export receipts then (\$490m). In 2019, Uganda exported goods worth \$1.33 billion to EAC, COMESA and the Rest of Africa which constituted 37% of the total export receipts.⁵⁷ China and India, which constitute 31% (US\$ 1.9 billion) of Uganda's total import bill, bought a paltry US\$ 0.1 billion of Uganda's exports. This made Uganda suffer a bilateral trade deficit with the two countries of over US\$ 1.8 billion.

⁵⁶ In 2019, Uganda's exports mainly went to United Arab Emirates, Kenya, South Sudan, Democratic Republic Congo, Italy, Turkey, Netherlands, Belgium, and Germany in that order. On the other hand, apart from Kenya and United Arab Emirates, Uganda's imports mainly came from countries that do buy Ugandan such as China, India, Tanzania, Saudi Arabia, South Africa, Japan, and Indonesia in that order.

⁵⁷ Last year (2019), Uganda mainly exported unmanufactured commodities, mainly minerals such as gold, base metals, and crude oil, as well as agricultural commodities like coffee, fish & its products, maize, tea, cocoa beans, tobacco, cotton, flowers as well as a few manufactures like sugar, cement, and oil re-exports.

TABLE 1: UGANDA'S TOP 20 IMPORT ORIGIN IN 2019

RANK	COUNTRY	VALUE IMPORTED (MILLION USD)
1	China	1,030.8
2	India	872.9
3	Kenya	785.2
4	United Arab Emirates	636.8
5	Tanzania	454.5
6	Saudi Arabia	337.4
7	South Africa	325.6
8	Japan	290.6
9	Indonesia	150.0
10	USA	135.5
11	Germany	107.8
12	Denmark	99.5
13	Egypt	89.6
14	Malaysia	81.0
15	Other	69.7
16	Italy	67.0
17	Thailand	64.6
18	United Kingdom	62.6
19	Russia	62.0
20	Korea (Rep)	60.7

Source: Bank of Uganda, 2020

The above analysis clearly shows there is a strong market for manufactured products in Uganda that reflects the need to further develop domestic capacity. However, it is also important to note that the leading import expenses go to high value manufactures such as vehicles and their accessories (US\$ 1.2 billion) and petroleum products (US\$ 957 million) to fuel the vehicles. Other top consumers of Uganda's foreign exchange include raw materials used in industry and construction such as mineral products (US\$ 1.25 billion), chemical and related products (US\$ 559 million), and base metals and their products (US\$ 439 million). How many of these imports may Uganda realistically substitute? This requires upgrading the country's domestic manufacturing capacity, investing heavily in technological capabilities and innovation, as well as addressing Uganda's longstanding binding constraints to manufacturing especially patient capital, energy quality and costs, and quantity & quality of raw materials, among others.

The NDP III has identified ten (10) products and three (3) services for import substitution. These include: petroleum and petroleum products; iron and steel; medical and pharmaceutical products; cereals; plastics; vegetable fats and oils; textile; salt; fertilizer; sugars and sugar preparations; transport; construction; and medical services.⁵⁸ These are in line with Hausmann et al. (2014) work which identified products which will not overstretch existing capabilities (they call them parsimonious transformation industries), the top-ranking being food processing and agrochemicals (see their full list in Annex 2).

Hausmann et al. (2014) also identify relatively more complex ISI industries that Uganda should concurrently develop since they are reasonably within reach of current capabilities (they call them strategic bets). They single out construction and industrial materials as the top products that meet the criteria, particularly petrochemicals based on the emerging oil industry, paper and wood industry, aluminium and other related building materials (Annex 2).

Lin & Xu (2016) using the growth identification and facilitation framework (GIFF), call upon Uganda to avoid setting too ambitious goals while selecting the industries to develop. They provide two categories of industries Uganda should develop, one based on exports of benchmark countries (such as Cape Verde, China, Equatorial Guinea, India, Lao, Nigeria, Sudan, Uzbekistan, and Vietnam), and another based on Uganda's revealed comparative advantage (RCA). See the lists under each category in Annex 3.

5.1 How Uganda may implement import substitution policies without shortchanging the gains from trade

A forthcoming empirical paper by MoGLSD and ILO (2020) finds that Uganda is losing a lot of productive capacity due to high import content in domestic demand. This is shown by the high “multiplier leakages,”⁵⁹ particularly in industry. The largest multiplier leakages were found in manufacturing, where about 37.6% of commodity multiplier⁶⁰ for heavy manufacturing is lost. They also find a strong correlation between export intensity and import penetration especially in the industrial sector. This implies that industrial production is largely dependent on imported inputs. This has weakened the employment multipliers as most additional jobs are externalised through imports.

The empirics above suggest that for import substitution to reduce the leakages Uganda is currently suffering, focus should mainly be put on manufacturing firms (both light and heavy) that source local raw materials. However, given limited resources (capital, skilled human resources and technology) for industrialisation in Uganda, import substitution should not be promoted at the expense of exports. Empirical data shows there are sectors that by virtue of strong output and employment multipliers Uganda should promote for export to achieve both inclusive growth and high employment.⁶¹

58 *ibid*

59 *Ugandan capital or incomes that exit the economy every year out of the total generated rather than remaining within it, resulting in a gap in the supply and demand chain. The funds used to purchase imports leave the economy, resulting in an outflow and a loss for Uganda.*

60 *The total output produced by all industries in response to a shilling increase in final demand for an industry's output.*

61 *MoGLSD & ILO (2020)*

In industry, agro-processing and light manufacturing have been identified as having the highest untapped export potential particularly manufactured products from coffee, beans, maize, animal products; cane sugar, cocoa, and fish. If Uganda fully exploited her untapped export potential, it is estimated to result into over 1.9 million jobs (43.5% of them being direct jobs and the rest indirect).⁶²

Some of the industries will continue to import large amounts of inputs, at least in the medium term. For example, machinery equipment and other accessories used in repairs of motor vehicles and motorcycle service; repair and installation of machinery and equipment; as well as repair of computers and personal and household goods service. These are sectors with both high output and employment multipliers. According to NPA (2020b), the goods and services for import substitution have been selected based on a 10-point criteria: value/volume of imported goods and services; existence of some domestic production capacity; presence of raw materials; technological complexity involved; strategic importance of goods and/or services; high potential for job creation; essential commodity or service; linkages with other sectors or industries; capital requirements; and previous/ongoing Government investment.

The NPA has also developed an Import Substitution Action Plan (ISAP)—supported by policy frameworks such as BUBU and Local Content Bill - to guide the implementation of the ISI strategy. The planning authority argues that the ISI is going to be consistent with, instead of contrasting, the World Trade Organisation (WTO) provisions of international trade and regional trading agreements such as AfCFTA and COMESA. In principle this suggests the planners want to encourage domestic production of import-competing goods using tools such as subsidies to local manufacturers.

However, while speaking on Budget Day on June 11, 2020, President Museveni announced that his Government was going to increase tariffs on “imports that Ugandans can produce locally.”⁶³ This suggests the authorities might end up using the easy route of trade policy (imposing higher tariffs and/or quantitative restrictions or, in the extreme case, import prohibitions) instead of industrial policy (e.g. production subsidies to offer pricing incentives to manufacturers, preferential access to credit, a realistic and favourable exchange rate for investors,) to implement the ISI strategy.

Research shows that using trade policies to protect the import-substituting domestic industry tends to discourage exports.⁶⁴ This is because the resources employed in the protected industry would otherwise have been employed elsewhere. So protection of import-substituting sectors automatically discriminates against all other sectors, including potential exporting ones. In any case, the establishment of a new domestic industry usually requires imported capital goods, and in early stages of the industry’s development the value of these imports is likely to exceed the international value added of import-substituting production.⁶⁵

62 *ibid*

63 *Actually this is already happening. In 2018 the government of Uganda imposed a 25% duty on some of the imported goods such as potatoes, honey, tooth brushes, ball point pens, exercise books, toilet papers, etc. Nevertheless, imposition of higher tariffs may end up benefiting a few powerful interest groups while diminishing the benefits of the society as a whole. For example, when import duty 25% was imposed on honey from UAE in 2018, the quantity imported reduced from 107,373kg of honey in 2017 to 89,425kg in 2018. However, the value of the honey imported increased respectively from \$64,307 (Shs241m) to \$67,232 (Shs251.9m), implying Uganda spent more of its foreign exchange for lesser quantity of honey due to the rise in prices which in itself may have caused a welfare loss to Ugandans. See <https://www.monitor.co.ug/Business/Prosper/Import-substitution-local-production/688616-5160602-ew5q93z/index.html>*

64 *See for example Krueger (1983)*

65 *ibid*

Since subsidies are costly to government budgets, and are clearly visible, they tend to be politically unpalatable. This explains why authorities tend to go for high levels of protection to a number of industries or even overvalued exchange rates which disincentivise exports. Therefore, Ugandan authorities should be mindful of this and avoid raising tariffs on imports that might crowd out exports and also maintain a realistic exchange rate that in itself encourages exports (and reduces the balance of payments motive for tariff protection). However, Uganda should simultaneously continue to permit exporting industries purchase their needed intermediate goods and raw materials at world prices if they are to be competitive.

Seminal authors such as Gerschenkron (1962) suggest that successful import substitution in countries such as Uganda will most likely to depend on 'picking winners' and retaining space to experiment and learn from failure using a market-friendly approach. The need to remain open to regional competition so as to access larger markets does not need to be over emphasised. The NPA argues that "the fact that majority of Uganda's imports are from countries outside regional blocs implies that ISI does not have negative significant implications on the existing regional trade agreements, but instead Uganda can leverage upon these regional markets."⁶⁶ However, Behuria (2017) argues that for NPA's view to hold, regional engagements under EAC and COMESA and also, the Congolese market - necessary to access larger markets - must be counteracted by strong state-business relationships to compete with regional firms in the domestic market and those regional markets.

There is also an argument that for import substitution to succeed, the GoU has to develop and sustain reciprocal control mechanisms with capitalist partners to prevent wasteful rent seeking behaviour (Amsden, 2001), and to discipline and monitor private enterprises to promote learning (Khan 2000). In almost all ISI success stories around the world, incentive programmes were characterised by conditionality, sunset clauses, built-in program reviews, monitoring, benchmarking, and periodic evaluation.⁶⁷ Non-abiding firms were penalised by withdrawal of subsidies and obliging them to refund the support offered at commercial interest rates. Additionally, a comprehensive program of aspiration, philosophy, mass campaign, factory projects, training, awards, and institution-building was used.⁶⁸ This carrot and stick approach generated lots of new economic activities, while allowing failures to wither away.

NPA (2020b) argues, previous efforts towards import substitution in Uganda were largely hampered by: liberalization of the economy in the early 1990's without adequate preparation of the private sector; weak management of public corporations; under capitalisation of state corporations; and high cost of doing business among others. However, it is not clear how these will be addressed this time around. Behuria (2017) argues that any attempt at recapturing the domestic market by a typical African country requires a strategy close to the policies of East Asian developmental states in terms of 'picking winners' among local capitalists. He adds that though foreign investors have been supported initially, actions must be put in place to develop local capitalist partners who may step in if foreign investors leave once incentives are reduced.

⁶⁶ NPA, 2020b

⁶⁷ Rodrik, 2008

⁶⁸ Studwell, 2013; Chang 2002

Indeed, NPA (2020b) posits that ISI strategy will require either attracting FDIs from previous exporters to Uganda or building local production capacity. Since foreign investors possess two of Uganda's most scarce resource—capital and technology—it goes without saying that Uganda is likely to continue relying more on foreign investors as the lead capitalist partners in this 'domestic market recapturing' strategy. In order to ensure transfer of technologies, local firms should be supported to partner with the FDIs such that the benefits accrued from these investments are absorbed within the local economy in case foreign firms leave in future.

Uganda's Investment Code (2019) baits FDIs to invest in priority areas as defined in the Second Schedule of the Act.⁶⁹ The twenty-six sectors, by and large, cover all the areas that have been identified by the NPA (2020b) for import substitution. These also are the sectors that Uganda has been prioritizing since early 1990s.⁷⁰ The challenge has been effective failure of actual implementation of the investment code in the past. The key lesson from successful industrializers is not to just author good strategy papers and investment codes; rather is building a strong bureaucracy and total government system that supports the whole value chain for manufacturers.

The NPA (2020b) has attributed the slow implementation in the past to uncoordinated stakeholder efforts, a weak private sector and a government approach to only provide an enabling environment with limited participation in actual investment regulatory frameworks. FES (2019) interrogated the factors that actually fail implementation in Uganda and found weak leadership, poor planning and budget indiscipline, corruption, as well as implementers without decision-making power as the top four. Others were conflict and poor conflict management; a long, bureaucratic and corrupt procurement cycle; weak oversight; and inadequate human resources necessary for industrialisation.

To address the implementation challenges of the ISI strategy, the NDP III has targeted interventions such as direct Government support to existing local manufactures to install recycling facilities for Polyethylene terephthalate (PET), High-Density Polyethylene (HDPE) Low-Density Polyethylene (LDPE) and Polypropylene (PP); and automotive assembling and manufacturing. The plan also targets to extend support to existing cereal processing facilities to add value and replace the imported cereals.

However, FES (2019) warns that unless certain hard decisions are undertaken, Uganda might not succeed in implementing its industry policy interventions such as ISI. One of the decisions that was recommended was the need to create a separate Ministry for Industry and Investment (MolI) to lead the industrialisation agenda and also end the mandate wars between Ministry of Trade, Industry and Cooperatives (MoTIC) and Ministry of Finance, Planning and Economic Development (MoFPED). The study also called for the Office of the Prime Minister (OPM) to stop engaging in implementation and concentrate on its Constitutional duty of monitoring and coordinating the implementing actors. Others were, implementation of the recently Cabinet-approved proposal to rationalise government MDAs and reform pay for civil servants; enhance, consolidate, ring-fence and mainstream the budgets for industrial development; and invest in client-driven, objective, accurate and timely data among others.

69 The Republic of Uganda (2019). *The Investment Code Act 2019*.

70 The Republic of Uganda (1991). *The Investment Code Act 1991 (Cap. 92)*.

5.2 The political economy arguments of recapturing the domestic market

Trade statistics, the history of industrialisation, and common sense confirm the relevance of the strategy of import substitution for Uganda. What about economic theory, empirics and most importantly the political economy? Do they support the proponents of the strategy? Authors of ISI present the strategy as an opportunity for Uganda to replace the imports and boost domestic production of the priority commodities to meet both local and international demand. It is important to note that ISI policy is as old as Uganda itself.

As shown in Section 3.1, the British colonial government founded UDC in early 1950s to lead Uganda's industrial and economic development. The investment arm of the state quickly set up import substitution industries to start producing hitherto imported essentials such as construction materials, textiles, metal products, agro-chemicals and fertilizers among others. By 1970, UDC had become the engine of Uganda's transformation with 38 subsidiaries and 19 associated companies, employing over 24,000 persons and contributing 33% of the country's total revenue.⁷¹ However, the political and by extension socio-economic upheavals that afflicted the country in the 1970s to mid-1980s did not spare the Corporation and its investments. In the end, the emerging industrial base of the country that Obote I's government had nurtured was destroyed.

While in the bush (1981 – '86), President Museveni and his National Resistance Army (NRA) wrote what they called "The NRM Ten-Point Programme."⁷² They identified steps they were going to take to "build manufacturing industries that use locally produced inputs," among which was "an extensive import substitution in order to reduce the import bill, especially of basic consumer goods." President Museveni and his NRA/NRM government has historically held strong mercantilist views.⁷³ However, Uganda's import bill has instead grown much faster in the past three decades than it has ever done in the history of the country. This paradox is explained by Museveni's ideological shift from his populist (and Marxist) ideas to the neo-liberal reforms he inevitably pursued from 1987 to ensure that his government could access the much needed donor support from IMF and World Bank to reconstruct the economy and ensure survival of his regime. Rodrik (1999) argues that although protectionism is often erroneously cited as having ruined economies in the 1980s, openness has not worked much better for them either.

The growing trade imbalance could not allow Museveni resist the temptation of looking in the rear mirror. The corona-virus pandemic has reinforced his long-standing campaign against imports. "When you look through [the list of Uganda's imports], you see that there is no reason why we should import many of these items... they can and will be made here."⁷⁴

The question is not only about the veracity of the narrative but also the capacity of the state to implement it. Literature strongly argues that the failure of ISI is not to be found in the policy itself, but in its implementation, and that the reasons for its poor implementation are often of a deep-rooted institutional nature.⁷⁵

71 Uganda Development Corporation (UDC) *Strategic Plan 2020 – 2030. Driving Industrial Development for the Economic Transformation of Uganda.*

72 *Ten-Point Programme: National Resistance Movement (Uganda), 1986.*

73 *The mercantilist view of trade is that exports should be promoted because they produce payments from other countries, while imports should be discouraged because they produce payments to other countries. Mercantilists oppose free trade based on "traditional arguments."*

74 *State of the Nation Address. June 4, 2020. The import substitution narrative is clearly included the Real Economy argument by the President and the Buy Uganda Build Uganda (BUBU) Policy fronted by the Ministry of Trade, Industry and Cooperatives.*

75 *For example see Pouget-Abadie, 2016*

FES (2019) conducted a stakeholder analysis that identified the institutions and other actors involved in the implementation process of Uganda's industrial policy. It highlighted the power, interests and expectations of persons and groups influencing implementation of Uganda's industrialisation agenda. It concludes that Uganda's industrialisation intentions will be turned into sustainable results only if the key players⁷⁶ (those who are highly interested and powerful) are mobilised to lead the agenda, and the subjects (those highly interested but powerless) are empowered by giving them more formal authority and/or resources.

The institutional failure among ISI poor implementers sheds a new light on what actually matters. In the end, what is important in driving economic development is not reducing imports or boosting exports. The fundamental focus is on boosting investment and human capital. The other is a domestic investment strategy. Zhu (2006) argues that Taiwan and China combined ISI and Export-oriented Industrialisation (EOI). Both strategies worked hand in hand: EOI provided foreign exchange to ISI, while ISI developed East Asian economic independence. Behind this was a set of institutions, which played a key role (the government, public enterprises, and the banking sector in particular).

On the contrary, Latin America failed to implement a domestic investment strategy. Rodrik (1999) argues that these investment strategies need to be backed up by a set of strong domestic institutions of conflict management. Successful countries were those that had social and political institutions that maintained overall macroeconomic stability. Failures adopted and/or maintained "wild" liberalisation.

Another major difference between unsuccessful and successful implementers of ISI cited by other authors is the role the State play. In the former, policy was ad hoc, and responsive to the needs of industrial lobbies.⁷⁷ On the other hand, in success stories of ISI, particularly in East Asia, there were carefully thought-out plans, or "growth strategies", and the State was very present but acted in decisive and subtle ways.⁷⁸ In his article, "Real Economy vs. Vulnerable Economy," President Museveni proposes an ad hoc list priorities Uganda's ISI strategy should focus on: cassava (starch, ethanol and animal feeds), banana flour and starch to replace wheat flour "that consumes US\$300million of our foreign exchange," surgical masks, N-95, scrub-suits, rubber gloves, test kits and the vaccines; drugs such as hydroxy-choloroquine; industrial grade sugar (to US\$40.251million per annum); etc.⁷⁹

However, authors have also argued that current account balance showed a large deficit because the import-substitution process required a great import of machines, parts, and other intermediate inputs for production, in addition to skilled labour, thus causing great pressure on external accounts.⁸⁰ Moreover, foreign businesses preferred importing synthetic inputs to using natural domestic inputs, overburdening the balance of current account, and also breaking the connection between sectors.

76 The challenge is that Uganda has many institutions that are supposed to facilitate implementation of the industrialisation agenda that are powerful but less interested in the agenda. They are more preoccupied with their "core mandates". Yet those that are highly interested are powerless to influence the implementation process of the industrialisation agenda (by virtue of having small budgets and/or less formal authority). Interestingly these include even the Ministry responsible for industrialisation (MoTIC) and its agencies, and the Ministry responsible for labour (MoGLSD). Others include the Uganda National Council of Science and Technology (UNCST) and Uganda Railways Corporation (URC), among others. See FES (2019) for details.

77 Haber, 2006

78 Bardhan, 2005

79 See Museveni, 2020

80 Paula et al., 2014



6.0 CONCLUSION AND RECOMMENDATIONS

6.1 Conclusion

Uganda has set out to turn the misfortunes of the coronavirus pandemic into an opportunity by converting the country's huge import bill into a boost for domestic manufacturing capacity. The NDP III cites "import replacement/promotion of local manufacturing" as key development strategy Uganda is going to pursue between the financial years 2020/21 and 2024/25 to achieve the plan's objectives. The NPA has prepared an "Import Substitution Action Plan" to guide implementation of the strategy. This paper sets out to review, discuss and document Uganda's record in import-substitution industrialisation policies and also picks lessons from success stories to guide the current industrial policy ambitions.

Scholars argue that import substitution is necessary to restrain the growth of "other" imports and thus release foreign exchange for capital equipment required by the growing manufacturing sector. It is thus needed to develop non-agricultural sectors besides construction to take the lead in economic growth. Standard literature, however, depicts ISI as an inadequate strategy that causes more problems in the economy than benefits.

Conversely, some scholars have argued that it was not ISI per se that was at fault in its classic failures, but its implementation due to a poor institutional context which constrained policy makers and economic actors. Since import substitution strategy is not new to Uganda - actually it is as old as the country itself -how can the mistakes that failed it in the past be avoided? Some lessons have been drawn from success stories and converted into specific recommendations summarised below.

6.2 Recommendations

S/N	RECOMMENDATIONS	EVIDENCE
1	Although the NPA has identified ten products and three services for import substitution, there is need to start with industries that will not overstretch existing capabilities. These have been identified by researchers as food processing and agrochemicals. Then move to relatively more complex ISI industries such as the emerging oil industry, paper and wood industry, aluminium and other related building materials.	NPA (2020b); Hausmann et al. (2014)
2	To successfully implement the ISI strategy, the GoU should use industrial policies such as production subsidies to manufacturers, preferential access to credit and equity capital, and a realistic and favourable exchange rate for investors. Uganda should desist from using trade policies such as higher tariffs, quantitative restrictions or import prohibitions of imports. Such policies tend to discourage exports since they discriminate against all other sectors apart from the import-substituting sectors.	Krueger (1983)

S/N	RECOMMENDATIONS	EVIDENCE
3	To implement ISI policies without short-changing the gains from trade, Uganda should substitute products with the largest multiplier leakages and produced by manufacturing firms (light or heavy) that source locally produced raw materials. These include: machinery equipment and other accessories used in repairs of motor vehicles and motorcycle service; repair and installation of machinery and equipment; as well as repair of computers and personal and household goods service.	MoGLSD and ILO (2020)
4	Given limited resources (capital, skilled human resources and technology) for industrialisation in Uganda, import substitution should not be promoted at the expense of exports. Authorities should avoid high levels of protection to industries and the temptation to overvalue exchange rates which typically disincentivise exports. Instead, they should continue to permit exporting industries purchase their needed intermediate goods and raw materials at world prices if they are to be competitive.	Krueger (1983); MoGLSD & ILO (2020)
5	To avoid undermining the existing regional trade agreements, particularly the EAC and COMESA, and instead leverage them to access the large regional markets, strong state-business relationships should be built to enable the manufacturing firms engaged in import substitution to favourably compete with regional firms in both the domestic market and those regional markets.	Behuria (2017)
6	To steer the private sector away from speculation and rent seeking behaviour, the GoU should develop and sustain reciprocal control mechanisms (carrot and stick) with the beneficiaries of import substitution incentives. The incentive programmes should be characterised by conditionality, sunset clauses, built-in program reviews, monitoring, benchmarking, and periodic evaluation. Non-abiding firms should be penalised by withdrawal of subsidies and obliging them to refund the support offered at commercial interest rates.	Amsden, 2001; Khan 2000; Rodrick, 2008; Studwell, 2013; Chang 2002
7	Since Uganda is likely to continue relying more on foreign investors who possess two of Uganda's most scarce resources - capital and technology - to lead the ISI strategy, efforts should be made to ensure transfer of technologies. To achieve this, the Uganda's Investment Code (2019) should be amended to require FDIs to partner with local entrepreneurs as a pre-condition to invest in particular industries. The local firms should be adequately supported to achieve these partnerships such that the benefits accrued from ISI investments are absorbed within the local economy in case foreign firms leave in future.	Studwell (2013); NPA (2020b)
8	To ensure effective implementation of ISI strategy, the GoU should execute the recommendations proposed by FES (2019). Key among them was the need to create a separate Ministry for Industry and Investment (MolI) to lead the industrialisation agenda. Others included stopping the Office of the Prime Minister (OPM) from engaging in implementation and concentrate on its Constitutional duty of monitoring and coordinating the implementing actors; rationalisation of government MDAs and pay reform for civil servants; enhancing, consolidating, ring-fencing and mainstreaming the budgets for industrial development among others.	FES (2019)
9	While pursuing import substitution, social and political institutions should maintain overall macroeconomic stability, while avoiding/reducing "wild" liberalisation. Policy should avoid ad hocism and resist industrial lobbies; for example, in the choice of priority industries for import substitution. Also during implementation, the State should act in decisive and subtle ways.	Haber (2006); Bruton (1998)



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ANNEXES

ANNEX 1: LIST OF ALL PRODUCTS UGANDA IMPORTS FROM THE REST OF THE WORLD (FIGURES IN '000)

PRODUCT CODE	PRODUCT LABEL	IMPORTED VALUE IN 2018
TOTAL	ALL PRODUCTS	6,729,377
'27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral ...	1,318,770
'84	Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof	535,907
'87	Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	508,596
'85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television ...	411,522
'39	Plastics and articles thereof	386,504
'72	Iron and steel	369,384
'71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad ...	335,513
'30	Pharmaceutical products	281,159
'15	Animal or vegetable fats and oils and their cleavage products; prepared edible fats; animal ...	248,426
'10	Cereals	236,357
'48	Paper and paperboard; articles of paper pulp, of paper or of paperboard	162,383
'38	Miscellaneous chemical products	150,267
'25	Salt; sulphur; earths and stone; plastering materials, lime and cement	133,182
'63	Other made-up textile articles; sets; worn clothing and worn textile articles; rags	121,498
'90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical ...	101,876
'17	Sugars and sugar confectionery	97,639

PRODUCT CODE	PRODUCT LABEL	IMPORTED VALUE IN 2018
'29	Organic chemicals	95,806
'33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	84,744
'40	Rubber and articles thereof	75,726
'73	Articles of iron or steel	75,235
'64	Footwear, gaiters and the like; parts of such articles	73,992
'28	Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, ...	53,721
'88	Aircraft, spacecraft, and parts thereof	51,564
'32	Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring ...	47,741
'96	Miscellaneous manufactured articles	46,309
'55	Man-made staple fibres	44,487
'94	Furniture; bedding, mattresses, mattress supports, cushions and similar stuffed furnishings; ...	41,286
'31	Fertilisers	38,996
'62	Articles of apparel and clothing accessories, not knitted or crocheted	35,777
'34	Soap, organic surface-active agents, washing preparations, lubricating preparations, artificial ...	35,446
'22	Beverages, spirits and vinegar	35,112
'69	Ceramic products	34,698
'21	Miscellaneous edible preparations	34,311
'76	Aluminium and articles thereof	28,396
'70	Glass and glassware	27,951
'23	Residues and waste from the food industries; prepared animal fodder	23,438

PRODUCT CODE	PRODUCT LABEL	IMPORTED VALUE IN 2018
'19	Preparations of cereals, flour, starch or milk; pastrycooks' products	22,996
'61	Articles of apparel and clothing accessories, knitted or crocheted	20,513
'83	Miscellaneous articles of base metal	20,351
'82	Tools, implements, cutlery, spoons and forks, of base metal; parts thereof of base metal	19,052
'12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal ...	17,201
'54	Man-made filaments; strip and the like of man-made textile materials	16,303
'42	Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles ...	15,864
'49	Printed books, newspapers, pictures and other products of the printing industry; manuscripts, ...	14,470
'11	Products of the milling industry; malt; starches; inulin; wheat gluten	12,729
'07	Edible vegetables and certain roots and tubers	12,463
'52	Cotton	12,457
'09	Coffee, tea, maté and spices	12,261
'79	Zinc and articles thereof	11,648
'35	Albuminoidal substances; modified starches; glues; enzymes	10,858
'03	Fish and crustaceans, molluscs and other aquatic invertebrates	9,956
'08	Edible fruit and nuts; peel of citrus fruit or melons	9,120
'56	Wadding, felt and nonwovens; special yarns; twine, cordage, ropes and cables and articles thereof	8,950
'20	Preparations of vegetables, fruit, nuts or other parts of plants	8,689
'68	Articles of stone, plaster, cement, asbestos, mica or similar materials	7,841

PRODUCT CODE	PRODUCT LABEL	IMPORTED VALUE IN 2018
'01	Live animals	6,859
'24	Tobacco and manufactured tobacco substitutes	6,817
'74	Copper and articles thereof	5,785
'26	Ores, slag and ash	5,730
'04	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere ...	5,323
'41	Raw hides and skins (other than furskins) and leather	5,143
'95	Toys, games and sports requisites; parts and accessories thereof	5,139
'44	Wood and articles of wood; wood charcoal	4,753
'59	Impregnated, coated, covered or laminated textile fabrics; textile articles of a kind suitable ...	4,386
'16	Preparations of meat, of fish or of crustaceans, molluscs or other aquatic invertebrates	3,520
'18	Cocoa and cocoa preparations	2,994
'67	Prepared feathers and down and articles made of feathers or of down; artificial flowers; articles ...	2,958
'65	Headgear and parts thereof	2,851
'37	Photographic or cinematographic goods	2,434
'57	Carpets and other textile floor coverings	1,899
'13	Lac; gums, resins and other vegetable saps and extracts	1,574
'89	Ships, boats and floating structures	1,430
'06	Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage	1,365
'02	Meat and edible meat offal	1,313
'36	Explosives; pyrotechnic products; matches; pyrophoric alloys; certain combustible preparations	1,150
'58	Special woven fabrics; tufted textile fabrics; lace; tapestries; trimmings; embroidery	1,139

PRODUCT CODE	PRODUCT LABEL	IMPORTED VALUE IN 2018
'91	Clocks and watches and parts thereof	1,048
'86	Railway or tramway locomotives, rolling stock and parts thereof; railway or tramway track fixtures ...	1,034
'60	Knitted or crocheted fabrics	1,015
'47	Pulp of wood or of other fibrous cellulosic material; recovered (waste and scrap) paper or ...	932
'66	Umbrellas, sun umbrellas, walking sticks, seat-sticks, whips, riding-crops and parts thereof	729
'05	Products of animal origin, not elsewhere specified or included	456
'92	Musical instruments; parts and accessories of such articles	397
'53	Other vegetable textile fibres; paper yarn and woven fabrics of paper yarn	353
'81	Other base metals; cermets; articles thereof	310
'46	Manufactures of straw, of esparto or of other plaiting materials; basketware and wickerwork	267
'97	Works of art, collectors' pieces and antiques	228
'80	Tin and articles thereof	213
'45	Cork and articles of cork	164
'75	Nickel and articles thereof	65
'43	Furskins and artificial fur; manufactures thereof	60
'93	Arms and ammunition; parts and accessories thereof	52
'51	Wool, fine or coarse animal hair; horsehair yarn and woven fabric	24
'14	Vegetable plaiting materials; vegetable products not elsewhere specified or included	12
'78	Lead and articles thereof	12
'50	Silk	4

Source: ITC (UN COMTRADE statistics)



ANNEX 2: POTENTIALLY PROMISING PRODUCTS FOR UGANDA BASED ON ECONOMIC COMPLEXITY AND PRODUCT SPACE

	Parsimonious transformation Ranking		Strategic bets Ranking
1	Margarine etc.	1	Printed matter, nes
2	Confectionery, non-chocolate	2	Varnishes and lacquers; distempers etc
3	Jams, jellies, marmalades, etc.	3	Miscellaneous articles of base metal
4	Edible products and preparations, nes	4	Paper and paperboard cut to size or shape, nes
5	Fruit, temporarily preserved	5	Wadding, wicks and textiles fabrics for machine use
6	Other materials of vegetable origin, nes	6	Aluminum and alloys, worked
7	Tobacco, manufactured	7	Structures and parts of, of aluminum;
8	Bakery products	8	Wood packing cases, boxes, cases, crates, etc
9	Plastic packing containers and closures	9	Metal casks or drums for packing goods
10	Fixed vegetable oils, nes	10	Trailers and transports containers
11	Cigarettes	11	Articles of paper pulp, paper, paperboard, nes
12	Packing containers of paper	12	Polyvinyl chloride
13	Beer made from malt	13	Polyethylene
14	Bottles etc of glass	14	Structures and parts of, of iron, steel
15	Flour and meals of fruit and vegetables	15	Builders' carpentry and joinery
16	Vegetables, frozen or in preservative	16	Printed books, pamphlets, maps and globes
17	Non-alcoholic beverages, nes	17	Gauze, cloth, grill, netting, reinforced fabric, etc

18	Insecticides	18	Plastic packing containers and lids
19	Fertilizers, nes	19	Fibre building board of wood or vegetable material
20	Propellant powders and other explosives	20	Paper and paperboard, creped, crinkled, etc
		21	Other sheet and plates, of iron or steel, worked
		22	Polypropylene
		23	Packing containers, box files, etc, of paper
		24	Construction materials of cement
<p>Source: Hausmann et al. (2014)</p> <p>Note: nes means “not elsewhere specified”</p> <p>The shaded industries appear in both rankings.</p>			

ANNEX 3: POTENTIALLY PROMISING PRODUCTS FOR UGANDA BASED ON GROWTH IDENTIFICATION AND FACILITATION FRAMEWORK (GIFF)

BASED ON EXPORTS OF BENCHMARK COUNTRIES

Cotton yarn

Non-Knit Men's Suits, Non-Knit Women's Suits, Non-Knit Women's Shirts, Non-Knit Men's Shirts, Knit T-shirts

Processed Leather; Leather Footwear, Leather Apparel, Rubber Footwear

Radio Receivers, Video Recording Equipment, Video Displays

Based on Revealed Comparative Advantage (RCA) indexes for Uganda

Edible fruit and nuts; peel of citrus fruit or melons*

Preparations of meat, of fish or of crustaceans*

Paper and paperboard; articles of paper pulp, of paper or of paperboard

Printed books, newspapers, pictures and other products of the printing industry; manuscripts, typescripts and plans

Tanning or dyeing extracts; tannins and their derivatives; dyes, pigments and other colouring matter; etc.

Glass and glassware

Source: Lin & Xu (2016)

Note: * indicates sectors for which RCA increased as of 2013 but decreased as of 2010

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