From Economic Growth to Economic Transformation

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The topic of our conversation today relates to a challenge facing all African countries; not just Uganda. That is economic transformation, which is not the same thing as economic growth and I will also speak about our role at the African Development Bank. I may not say anything new but I hope the experience I have had looking at 54 countries on the continent could be useful to those of you here who are policy makers or leaders of public opinion.

In the past decade, African countries have demonstrated a new growth momentum and barring unforeseen events, we believe that Sub-Saharan African countries outside South Africa will grow at 6.5% next year.

But here is a challenge. Despite the strong growth, the structure of the economies has changed very little. It is therefore not surprising that growth has not created as many jobs. Poverty is co-existing with strong growth. Indeed in some countries large sections of the population feel excluded from the benefits of that growth, and that is a seed of unsustainability.

For a country like Uganda, indeed many countries in this region that are about to become significant exporters of oil or gas, I cannot imagine a more urgent strategic question at this time.

You will be familiar with, say, an African country with a population of under 20 million people exporting a million barrels of oil per day and yet 60% of the people are living in absolute poverty.

That challenge of a country translating significant growth, natural resources into even stronger economic growth, higher incomes, broad based opportunities and jobs, moving up the global value chain rather than simply exporting raw materials is a challenge all African countries are facing at this time.

Please allow me to step back in time, over the past 50 years and examine some of the reasons transformation could be a challenge. Let us go back to the 1960s – a period of high hopes, high expectations and a generally bullish period in Africa. Those hopes were soon dashed by military takeover, impact of the cold war, including on how we think about development. Soon you had the Congo Civil War and the Nigerian Civil War.

By the 1970s, despite a commodity boom masking some of the weaknesses, the damage was worsened by successive external shocks. Two oil shocks in particular, debt accumulation, macro-economic policies that defied common sense and to cap it all, confiscation policies such as here in Uganda you called it “Mafuta Mingi”, or in Congo “Zairianization” and similar policies.
By the 1980s, prodded along by the Bretton Woods Institutions, the process of economic reform which was to take about a decade and a half in places like Ghana and Uganda had begun. Steadily, macroeconomic stability returned and the balance between the state and the markets were restored to a large extent. Some have even argued that might have been a period of "over correction".

From the mid-1990s, those reforms, plus debt cancellation were beginning to yield results.

As the new millennium was ushered in 2000, the growth pulses picked up even faster, essentially due to:

- Those previous economic reforms;
- Favourable commodity prices;
- A change in Africa’s risk profile and investment flows;
- Favourable demographic dynamics; and
- Strong international support especially in the post Gleneagles Summit of the G8.

The result has been that millions of Africans have been lifted out of poverty and large gains have been made in the human development area, of which the most dramatic have been: school enrolment of both genders; reduction in infant mortality; and progress vis-à-vis HIV/AIDS, TB, and malaria.

Which brings us to 2009, just before the financial crisis. This when the lexicon about Africa had changed dramatically. From a hopeless continent it was now unanimously a continent of the future. The McKinsey Report – *African Lions on the Move* – came to complete this seal of approval.

And then in comes the collapse of Lehman Brothers and the mayhem on Wall Street. It was interesting at that point to hear what the generally accepted views about African economies were in the aftermath of Lehman Brothers. First, the view that the first round effects would be minimal because:

- Our banks had limited exposure to toxic products and there was limited integration into the global financial system;
- Macroeconomic foundations were relatively good; and
- Regulators (Central Banks, that is) had done a good job on the prudential side, on issues of capital adequacy, liquidity, etc.

In short, as far as African banking systems were concerned, regulations were in place, supervision was robust, sanctions regime applied when necessary and resolution mechanisms in place if things went wrong, which I could not say for Wall Street.

Second observation: the view that the second round effects could be quite severe on many African countries on exports, investment flows, remittances, etc. In the event Sub-Saharan Africa has shown a remarkable resilience, to use the now commonly accepted terminology. In the words of the IMF: “The impact of the global economic crisis on Africa was brutal but mercifully brief.”

Sub-Saharan African economies resumed the growth path of before the crisis even as the global economy was still dealing with the aftermath of the crisis. Obviously, our shock absorbing capacity was weaker. But the fiscal or monetary counter-cyclical measures adopted in different countries had been effective and had minimized damage on our economies as well as longer term growth prospects.

In short, as far as “crisis management” is concerned, Africa could be said to have scored a B+ or, at the very least, a B -. But the continent did extremely well compared to the rest of the world.

However, having demonstrated those strong reform credentials correcting the errors of the first 25 years of independence, a strong track record of growth and a credible crisis management record, three big interrelated questions remain:

- Is this momentum sustainable?
- Is it inclusive enough?
- Is it leading to transformation of African countries?

Please allow me to digress a bit. There are many other longer term lessons from this crisis, which I will come to, including how we finance our development from internal resources and what it means for future policies given that the policies we have always held up as best practices have shown some deficiencies.

In the same period we are referring to in the 1980s and 1990s, another country was undergoing, perhaps the most dramatic transformation of our time – and that is China. For those of you who may be interested in that process, publications
abound but I would like to recommend only one. This is Ezra Vogel’s book “Deng Xiao Ping and the Transformation of China”.

Remember that in 1980, 80% of China’s then-900 million people were peasants. There was not enough food to eat, not enough clothing and there was widespread poverty. The rest, as they say, is history.

But when you dissect for details, there are a number of interesting features. The first one is the nature of the state itself and its relationship to development and to enterprise. The second is the role of agriculture. Between 1980 and 1984, consumption of fertilizers doubled. As a result, farmers’ incomes had doubled in four years.

Many other things were of course taking place in China at the same time including special economic zones and investment from Japan and South East Asia.

Notice however, that in terms of lifting millions out of poverty in a short time, making the process inclusive, the starting point was increasing agricultural productivity and farmers’ incomes. This is exactly what had happened in Japan and Korea years before. We do not know any country which has undergone a process of transformation without beginning from that point, with the exception of a few island states.

Another major element of transformation was the spread of education. I want to add the word quality education. Not simply high numbers enrolled in schools or the number of graduates.

By the way, I am told that in the last 20 years alone, over one million Chinese have studied and graduated at foreign universities. It is not surprising, therefore, that the first loan taken by China when it joined the World Bank as a member was for higher education.

I am not by any means comparing China with Africa. Remember, China is an old empire dating back to the Roman times. Along the way it weakened through successive civil wars, internal issues, occupation and some issues under Communist rule. I am only saying that transformation was possible within 30 years. A careful examination of countries other than China that have gone through that type of transformation point again to these series of issues, which seem to be characteristic of all the countries that have come before us in this process.

First, the nature of the state and its relationship with business. Second, the pursuit of broad based, inclusive growth through agricultural productivity and spreading quality education, especially to the children of the poor. The third element of
transformation has always been removing the infrastructure bottlenecks. Some of the first loans Korea took from the World Bank were for high speed trains and other major infrastructure pieces.

By the way, infrastructure itself being so fundamental for agricultural transformation. I come to this conference from Kisoro. I cannot imagine how before this highway we are building had gone to that region you can conceivably increase agricultural productivity in that region knowing very well that 40% of the produce will be lost. Now that there is a highway including others we are doing in the west, I can imagine that from now onwards, markets will be functioning, business people will be paying the due price and over the time the signals will go back to the farmers. I am therefore talking of infrastructure in the broad sense. Infrastructure for education and infrastructure for agriculture.

Finally, an early entry into labour intensive manufacturing.

It is typical at these types of lectures, to reminisce or even to lament as to why Uganda or Ghana did not become Malaysia or South Korea. I will not go there, Governor, as I am sure that you have heard this before. After all, an authority as famous as an Emeritus Professor at Sussex University sometime back in the 1950s had predicted that if there are any two countries which were bound to make it to the middle income category in the current generation it was the Gold Coast and Uganda. The two countries were said to have the basic conditions for take-off.

Now, you know Uganda better than I and particularly about what went wrong here from political breakdown, economic meltdown, the near collapse of the excellent education system and infrastructure. But I want to come back to what, as far as I am concerned, was the final blow to Uganda’s march to middle income country status and many other countries as well. This is the issue of what many academics now argue around the concept of a developmental state. How does a state work with the private sector to promote economic development. It would seem to me that here in Uganda especially beginning or maybe ending with “Mafuta Mingi” it was exactly the opposite. In Congo they called it “Zairianization” and in Ghana they called it Kalabule. In other countries they called it by different names.

You remember the story of a country where butchers were given dairy farms – and they proceeded to do the right thing. Or business people in the import substituting industries being allocated 20 million dollars to produce 10 million dollars’ worth of goods.

The idea that you can accumulate capital without risk taking, without hard work, without entrepreneurship encouraged rent seekers first of all in economics and
then in politics. My point is that many things would have gone wrong in Africa but
killing the enterprise by the state itself was probably the single biggest weakness
over the last 50 years.

As we seek to draw lessons of the past and find a path to transformation whose
elements we are now familiar with, and when rich countries are focused on own
problems and at a time when the middle income countries are suffering from what
is known as the middle income country trap, we have to draw the right lessons.
Draw the right lessons because natural resources are now being discovered in
every part of Africa. In Uganda and Kenya it’s oil. In Mozambique and Tanzania it’s
gas. In West Africa it’s bauxite and iron ore. This is a time when transformation is
possible. But remember that having oil, gas, iron ore or bauxite is not by itself a
guarantee of transformation. It could actually be the opposite. It is the choice
between “white elephants” or investing in infrastructure, logistics, and spreading
quality education, things which by themselves will guarantee transformation.

I referred to an African country with a population of 20 million people pumping one
million barrels of oil per day but with 60% of the people living below a dollar a day.
But it does not have to be that way. That was a matter of policy choice. It can be
avoided.

I am a long term resident of Tunisia. I woke up in January 2011 with a shock. Here
was a country that was supposed to be one of the leaders in economic growth in
North Africa at a growth rate of 5% for the previous seven years and moving
towards attaining all the MDGs. It turned out to be a house of cards. You had
unemployed graduates but who were probably unemployable due to the quality of
education. Other features were: crony capitalism; huge regional disparities;
absence of effective safety nets; and an elite completely cut off from realities.

This is what made Tunisia’s achievements unsustainable and prevented
transformation.

At the end of the day each country must choose its own path because our
countries are different. As I said in Rwanda a few days back, there is no “escalator”
or lift to development. There is no model to copy. It is a slog on the stairs, falling
and rising. At the end of the day you are fitter, but with your own experience.

There is another book on China which I like very much and would like to refer to it
here entitled “How Do China’s Leaders Think?” Some of the things they do are
relevant to our own thinking here. It is said they think stability, they think pride and
they think learning by doing. Perhaps for too long a time we in Africa have looked
for models to copy. In the process we perhaps undermine our own pride in
developing our own models of development. Since I referred to Deng Xiao Ping at length because I think he is one of the people who got it right. They used to say that there is no formula for development. In fact his famous expression was “cross the river by filling the stones”. You will also recall: “It does not matter whether the cat is black or white as long as it catches mice.” In other words it is what works that is important.

I can go back and reflect with you on elements of transformation but we must get the basics right. Before I come to what we at the African Development Bank are doing in light of this agenda, I would like to go back to the issue of the implications of the financial crisis for the long term. At this moment, rich countries are focused completely on their own problems and those will take time to fix.

Secondly, for a long time we depended on multilateral solutions. It strikes me that those solutions are now difficult to come by. Whether it is a trade deal, such as Doha to trade our way out of poverty, or whether it is a climate deal so that we can deal with the issues of climate change. Those solutions have become extremely difficult. This is because of defects in the international system right now. There are two issues where we are not getting it right. These are issues of legitimacy and effectiveness and I will explain.

You have institutions like the G20 which are extremely effective in dealing with issues such the financial crisis. But it is a group of 20 countries out of a world of more than 180 countries meaning that many are locked out of the room. The group is therefore effective but not legitimate.

A legitimate organization would be like the United Nations where all of us belong with one country one vote. But barring for some bits and pieces – and I apologize in advance to those from the UN who might be here – the UN is not an effective organization. It is very legitimate but ineffective. Until that day when we get institutions that combine legitimacy and effectiveness, multilateral solutions will always be difficult.

Therefore since rich countries are focused on their own problems and multilateral solutions are difficult, we need to see how we as Africans can move forward, for example, on issues such as financing our development, which declined for the first time in 20 years in real terms and I expect that to continue. There might be additional programmes but without additionality. It will be the same cheque being distributed around different programmes. Therefore, the time has come and this is the first lesson of this crisis for us: to define a way in which Africa can finance its own programmes.
I have referred to this issue of Africa’s own resources and would like to state the following: Africa’s foreign reserves pooled together total to half-a-trillion dollars. Some countries have more than others and these are not evenly distributed.

In addition, reserves serve a very important economic purpose. Before we touch reserves we have to be extremely careful. These reserves are now being invested abroad for a pittance – maybe 1% if you are lucky. At the same time, African countries troop to India and China to look for assistance. We may want to figure out how to ensure that Africa’s own resources work for Africa. But it cannot be done for charity.

We discussed with our ministers in Tokyo how we, the African Development Bank, using our strong financial muscle, our triple-A rating and our experience in investing, can assist in investing a small portion of those reserves. The proposal put forward is only 5% of those reserves. We believe we can give a greater return to our bankers but also invest in Africa’s infrastructure where we find high return investment projects. This was exactly the proposal put forward by the Prime Minister of India at the G20 Summit in Korea. A panel was put in place in the context of the G20 but has not come up with concrete proposals. There are many issues here of a legal and technical nature which we are working on. We hope we can find a solution to mobilize a small proportion of our own assets to finance Africa’s development.

The second lesson belongs to the policy area. The two biggest events in world history in the past 50 years were the collapse of the Berlin Wall and the collapse of Lehman Brothers. The collapse of the Berlin Wall put to an end an experience with communist politics and communist economics. That was the end of it and in fact someone said it was the end of history. Then came Lehman brothers. We realized that the forces of capitalism themselves left on their own, unfettered, unregulated would impose very high social costs, as they have. Yet we know that in the G20 you have countries that have come to the final destination through different routes and experience from Russia to China, to Korea, to Turkey, to Brazil and Indonesia. They have come to development through different paths. While we know what can kill development, we know that for sure our knowledge of what makes development is less comprehensive. That is why it might be useful to look at all these experiences and figure out how we can maximize and optimize the experience of different countries.

Let me now conclude with what we are doing at the African Development Bank. When I came to office in 2005, I put in place a high level panel including Governor Mutebile, Professor Stiglitz and many others to help us think about how best we can use our limited resources to have maximum impact. We agreed on four core
activities of the Bank: infrastructure; regional Integration; private sector; and higher education and skills

This choice was made because of our belief that we want to make Africa a place safe for business, where the business costs are coming down, where logistics allow enterprise to prosper and from the belief that regional integration is not only a necessity, but a must to unlock the potential of the African continent. But at the same time, we realized that while you can do all these things – after all, we built roads in Somalia for a long time – we needed institutions and governance that engender stability. So that is our other area of emphasis. Finally the particular short term focus on countries coming out of conflict because often the impact on themselves and the neighbourhood is quite large. This is what we have been doing for the past seven years and we believe these were exactly the right choices to unlock Africa’s economic growth and economic transformation.

Here in Uganda, to give you just an example of what we do and why we do it. I came here after being driven on the Kisoro to Kabale road which we are constructing. But why is that road so important? It is not only important for the people of the region, but it is a road to the Congo and a road to Rwanda. We are also doing a road from Fort Portal to the Congolese border. It is important for the country, but also for the region. We are doing a project of connecting power in this region with six countries. We believe that the best way to provide energy for these countries is to create an energy market. Every country cannot produce all the energy it needs. We need to have pools and trade energy among ourselves. We are participating in Bujagali in two ways: we provide a loan to the private sector people who are building that particular dam – the Aga Khan Foundation – but we also provided to the Government of Uganda a soft loan to do the transmission lines which made that dam economic. Right now we are doing water and sewerage in Kampala City.

These are things we believe over time will enable the country to lay a basis for transformation. We do not believe that some of the things that the Bank used to do in the past, which were somewhere between what an NGO does or what a bilateral does, was the right thing to being at this time, provided there is good partnerships with other institutions which fill in those gaps

Now as we go into the next 10 years, we are reviewing our strategy. Here is what we have decided to do after a lot of consultation. We have decided that this approach is still the right one. However, we are going to put emphasis on ensuring that the benefits of our interventions are broadly shared among the population including, of course, the experience of Tunisia. It is alright to promote economic growth, but if you leave behind 60% of the population that cannot be sustainable.
At some time it will come to an end. How do you do inclusion? You do inclusion by doing things I have been mentioning: promote agricultural productivity; get children of the poor into schools; and make sure that you have got safety nets, including subsidies which are targeted to the poor instead of subsidies that target everybody, which are not sustainable. Inclusion and broad based growth will therefore be a major feature of our new strategy without abandoning the choices we have made.

The second one is much more controversial. I need time to go over this with you. It is about how we take opportunities offered by greening the economies, clean energy, our forests, our land, our water. For a continent like Africa, which is very much dependent on nature, as climate change damages that natural capital our chances for development are thereby diminished. Therefore, a strategy that focuses on the areas I have mentioned, that brings inclusion, that leaves nobody behind and that deals upfront with issues of climate change is the right one and the one we will be pursuing over the next 10 years.

To summarize, we have very done very well as a continent in terms of economic growth after having wasted 30 years. However, we have to make sure that it is not simply economic growth or we go to the stage which is economic transformation including attracting manufacturing from some of the Asian countries where the real wage is increasing. Second we have to make this thing it sustainable by leaving nobody behind. We also have to make this sustainable by protecting our natural capital which is the environment.

Governor, I would like to thank you for inviting me. I think you have heard nothing new but it is better that I have said it here in front of you since you are one of the high level panel members.

Thank you Minister for being here with us and thank you friends for listening and I will answer your questions.

Thank you.