Chapter 5

Dynamics of growth, jobs and inequalities in East Africa

This chapter seeks to investigate the links between growth, employment and inequalities in East Africa (Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Rwanda, Seychelles, Somalia, South Sudan, Sudan, Tanzania and Uganda). Specifically, the chapter analyses the evolution of economic growth, the drivers behind the growth process and the impact of growth on living standards of the people in the region. The chapter gives a comparative overview of the trends in economic growth, labour market outcomes and income inequality since the 1980s in East Africa.

The chapter is structured as follows. The first section provides key facts on East Africa. The second section gives an overview of the economic performance in the region. The third section focuses on the evolution of employment and unemployment outcomes. The fourth section analyses the main trends in poverty and income inequality. The final section provides policy recommendations.

IN BRIEF

Gross domestic product (GDP) has expanded at a fair pace in East Africa in recent years. However, economic growth is not translating into rapid structural transformation or job creation. Many East African countries have large and growing informal sectors, condemning many workers to low wages, lack of job security and limited opportunities to acquire skills. Rapid economic growth is not reducing poverty or income inequality at an equally rapid pace.

Since 1990, annual **growth** rates in the region have exceeded 4%. The services sector has grown to almost 60% of GDP, driven mostly by informal and non-tradable services, while industry has remained constant at 20% of GDP. GDP growth increasingly results from private consumption, while the role of public and private investment is diminishing. The region's trade is skewed towards primary commodity exports (52% of total exports) and imports of finished products (70% of total imports).

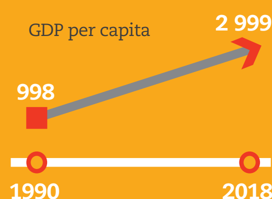
Despite agriculture's low productivity and declining contribution to GDP, it employs almost 60% of the labour force. The gender gap in **employment** (the ratio of male-to-female employment) has been decreasing slowly, from 1.41 in 1991 to 1.39 in 2017, with large disparities across sectors and countries. Growth has not increased the number of "good" jobs offering higher wages and better working conditions.

Income **inequality** varies across countries, but overall is on an upward trend. On average, only 37% of the population has access to electricity, 48% to drinking water and 20% to sanitation services, though large variations exist across countries and between urban and rural populations. Poverty remains high in the region at 35%, in spite of its decline since 1999. Several countries are addressing poverty by enhancing social protection programmes and by investing in education and skills development. Such investments will have to significantly increase for these programmes to deliver on their objective of supporting more inclusive development.

Dynamics of growth, jobs and inequalities in East Africa

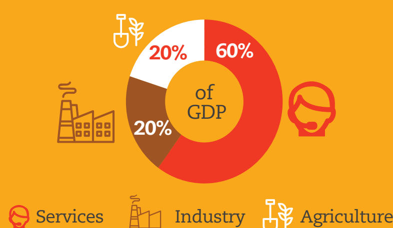
Growth

GDP per capita has tripled since 1990



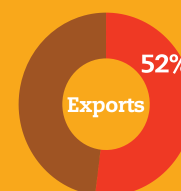
Service-led growth

The **services** sector grew, driven by informal and non-tradable services, while **industry** has remained constant



Trade

Primary goods compose *half* of total exports



while 70% of imports are finished goods

Labour

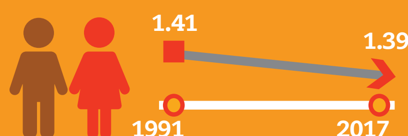
Despite agriculture's low productivity and declining contribution to GDP, it employs

almost 60% of the labour force

Employment

The gender gap in employment has been decreasing slowly

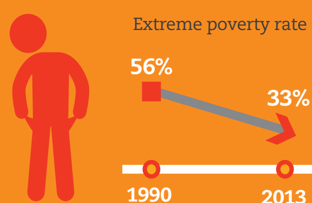
Ratio of male-to-female employment



Women are more likely to operate in the *informal sector*, as self-employed or wage workers

Poverty

Extreme poverty rate decreased, but 104 million people remain in extreme poverty



Access to basic services

Only **37%** of the population has access to **electricity,**

48% to **drinking water**

and **20%** to **sanitation services.**

Large variations exist across countries and between urban and rural populations

East Africa regional profile

Table 5.1. **Basic indicators for East Africa, 2017**

Population (thousands)	368 661
Land area (thousands of km²)	6 394
Population density (people/km²)	58
GDP, current (USD billion)	947
GDP per capita, current (USD)	2 840

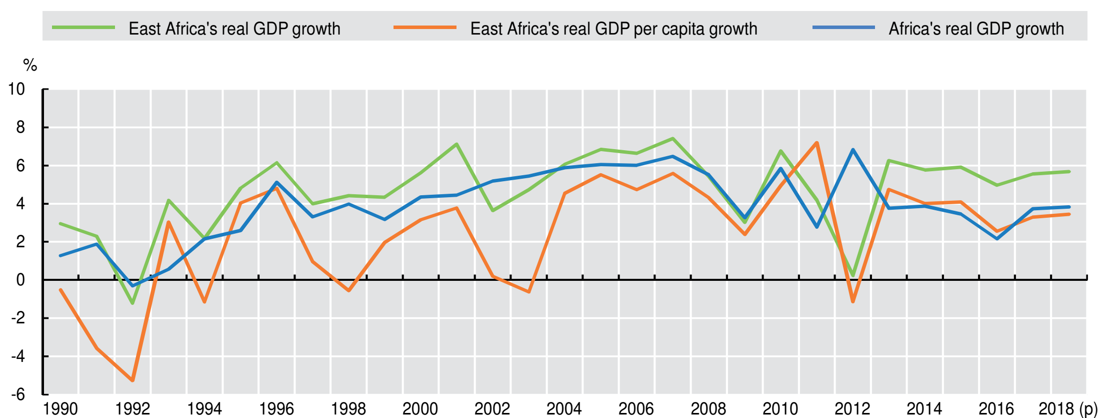
Source: Authors' calculations based on UNDESA (2017), *World Population Prospects* (database); World Bank (2017a), *World Development Indicators* (database) and IMF (2018), *World Economic Outlook Database.*

Table 5.2. **Financial flows and tax revenues to East Africa (current USD billion), 2009-16**

			2009	2010	2011	2012	2013	2014	2015	2016
Foreign	Private	Inward foreign direct investment	7.1	7.9	7.7	9.3	8.4	8.6	8.3	8.6
		Portfolio investments	0.0	7.6	5.7	2.5	1.1	4.7	0.0	-1.1
		Remittances	3.9	4.6	4.5	4.7	4.8	5.9	5.0	5.0
	Public	Official development assistance (net total, all donors)	15.4	14.3	15.5	15.8	18.4	16.5	15.9	16.0
Total foreign flows			**25.2**	**33.4**	**26.5**	**34.4**	**33.4**	**32.3**	**32.7**	**35.8**
Domestic tax revenues			**21.1**	**23.7**	**21.1**	**23.7**	**25.2**	**28.6**	**33.0**	**36.8**

Source: IMF (2018), *World Economic Outlook Database*, OECD (2018a), *International Development Statistics* (database), and World Bank (2017a), *World Development Indicators* (database).

Figure 5.1. **Growth dynamics in East Africa and Africa, 1990-2018**



Note: (p) = projections.
Source: Authors' calculations based on IMF (2018), *World Economic Outlook Database.*
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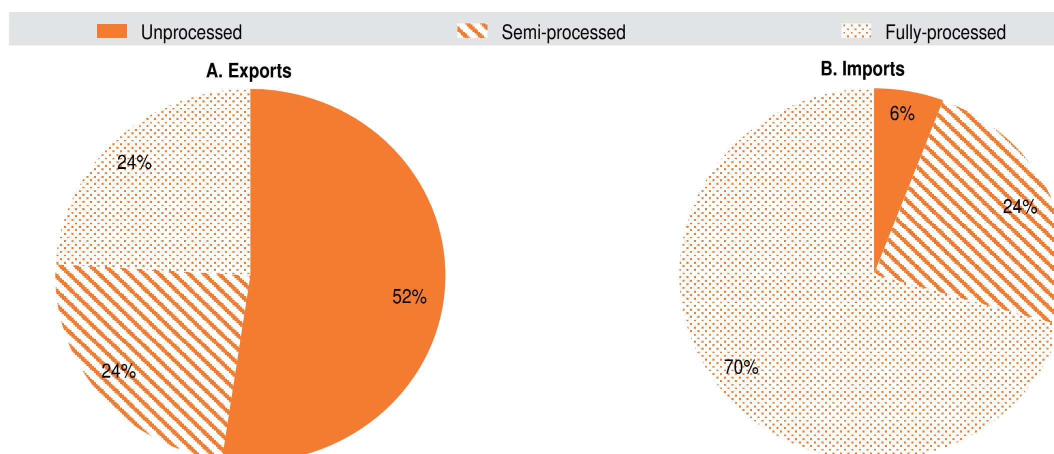
Figure 5.2. **Trade composition in East Africa, 2016**



Source: Authors' calculations based on United Nations Statistics Division (2017), *UNCOMTRADE* (database).
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According to the African Union grouping (under the Abuja Treaty, 1991), the East Africa region consists of 14 countries: Comoros, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Mauritius, Rwanda, Seychelles, Somalia, South Sudan, Sudan, Tanzania and Uganda.[1]

East Africa covers a total land area of 6 394 000 km^2, which is about 22% of Africa's total land area. It has a population of 369 million people (about 29.3% of the continent's total population) and a population density of 58 people/km^2. The region's population growth has averaged 2.9% per annum since 1990. The median age for the region is 18 years old.

The region's GDP at purchasing power parity (PPP) is USD 947 billion in 2016. The GDP per capita is USD 2 840. Real GDP growth has averaged 4.8% over the years 1990-2018, compared to 3.9% for Africa.

Two decades of sustained economic growth in East Africa

Economic performance in the East Africa region during the past two decades has been strong. Since 1995, the region has enjoyed annual growth rates of over 4%, well above the continental average (Figure 5.1). The services sector makes up the largest share of GDP in all countries except Ethiopia, Tanzania and Uganda, where the size of agriculture remains substantial. Informal and non-tradable services account for most of the recent growth in services but have had a limited impact on the economy. Private consumption is increasingly driving economic expansion, while the role of investment is diminishing. The region's trade concentrates on primary commodity exports and imports of finished products, thus slowing growth. Finally, macroeconomic stability and inflationary pressures in the region depend largely on fuel and food price fluctuations, to which economies remain vulnerable.

The region's countries vary significantly in terms of growth performance and demographic dynamics. The early 1980s to the mid-1990s was a period characterised by low and volatile GDP growth. Since the mid-1990s, the region has experienced sustained growth rates and lower demographic growth, which translate into increases in per capita incomes.

Different sectors have underpinned the growth of the region's top performers. Ethiopia has contributed to regional growth mainly through increased government expenditure on infrastructure (roads and hydro-power). Since 1980, Rwanda has contributed to regional growth via agricultural production, particularly of commodities such as coffee and tea. While huge investments in the energy sector have driven Uganda's growth, investments in the services sector have raised Mauritius' growth rates. In addition to these top performers, other countries have increased the region's growth like Kenya (infrastructure investment and household consumption), Seychelles (tourism) and Tanzania (manufacturing and services).

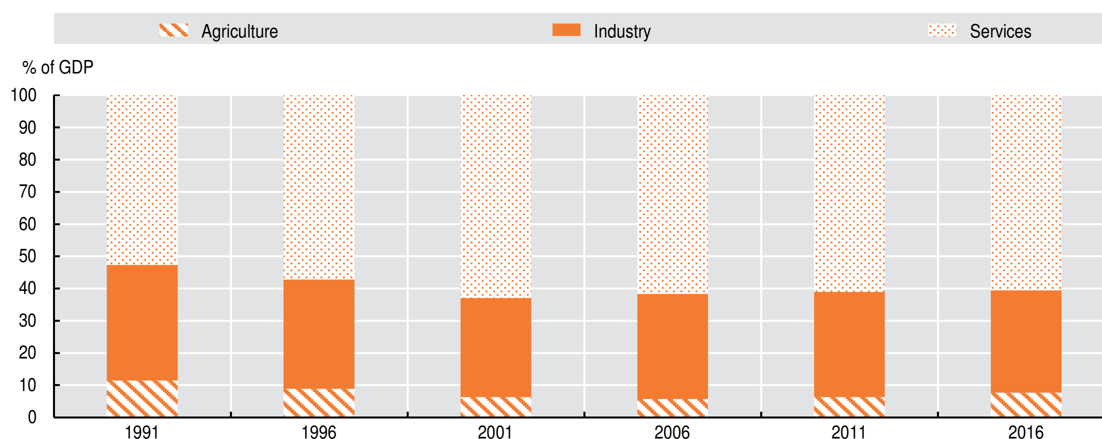
Changing composition of East Africa economic growth

The overall sectoral composition of GDP across the region has changed little since 1980 (see Figure 5.3). Until recently, the contribution of agriculture to GDP had declined steadily, and that of the services sector had increased. On average, the contribution of agriculture to GDP is higher in the top performing countries. In the early 1980s and 1990s, agriculture was the largest contributor to growth. Since the mid-1990s, the economies of most countries have shifted to the services sector. While the contribution of the manufacturing sector has remained fairly stable, there have been slight gains in the contribution of total industry to GDP.

The increases in the shares of the services and industrial sectors to GDP appear to coincide with the macro-economic reform period for most of the countries in the region. Low productivity activities such as informal and non-tradable services largely explain this increasing role played by the services sector. Therefore, the increase in the share of this sector has not transformed the economy. Since the 2000s, several of the top performers in the region have experienced a reduction in the contribution of the industrial sector towards GDP. This coincides with the slowdown in the global economy.

The decline in the share of agriculture could translate into economy-wide gains in productivity. Agriculture tends to have lower value-added than other sectors (McMillan and Rodrik, 2011; Gollin et al., 2014). Moreover, income and consumption are lower in agriculture than in any other sector (McMillan and Verduzco, 2012; Gollin et al., 2014). Thus, as workers leave agriculture for other sectors, value-added, income and consumption should increase.

Figure 5.3. **Average sector value added as a percentage of GDP in East Africa, 1991-2016**



Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database).
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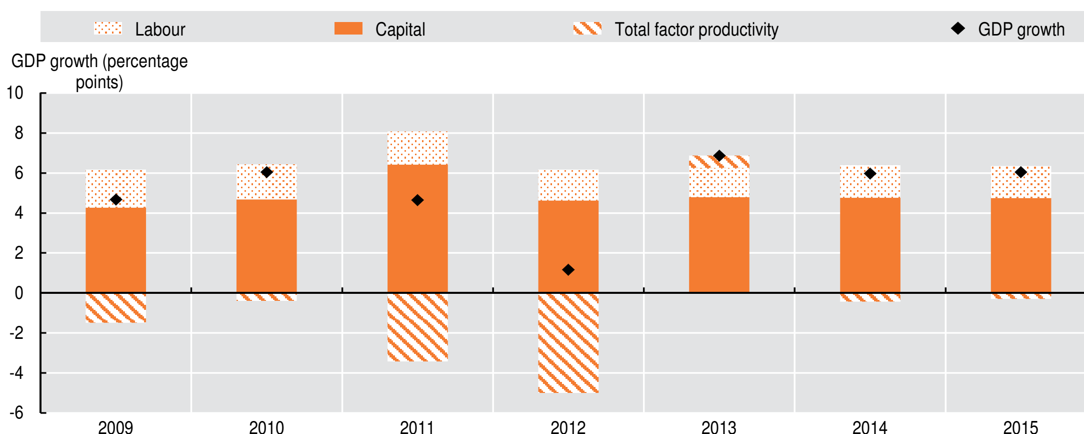
Services-led growth can take different forms. In Seychelles, tourism leads economic growth and the services sector, which accounts for approximately 80% of GDP. In recent years the government has encouraged foreign investment in order to upgrade hotels and other services. Djibouti, benefiting from its strategic location on the Red Sea, provides services as a transit port for the region and as an international trans-shipment and refuelling centre. Mauritius, on the other hand, has growing industrial, financial, information and communications technology (ICT) and tourist sectors. It developed from a low-income, agriculture-based economy (mainly sugarcane) to a middle-income diversified economy.

Factor contribution to growth in East Africa

Capital accumulation explains growth in the region more than gains in total factor productivity (TFP) (see Figure 5.4). In the early 1990s, decreasing TFP partly slowed East Africa's growth. In the mid-1990s, labour played a key role. However, since the late 1990s, capital has increasingly driven growth. Labour and TFP growth have posted minimal contributions to growth in GDP, with TFP growth also registering volatility over time.

Figure 5.4. **Decomposition of economic growth by factors of production in East Africa, 2009-15**



Source: Authors' calculations based on Conference Board (2017), *Total Economy Database*.
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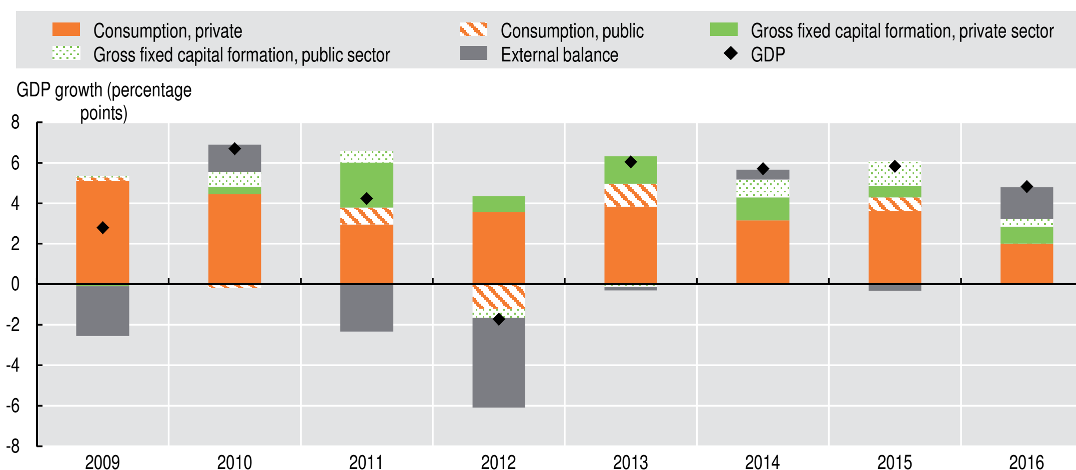
Recent drivers of East Africa economic growth

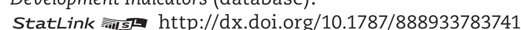
The strong economic growth performance in East Africa in the past decade was largely driven by increased investment and by private and public consumption. Exogenous drivers of growth, or those that are outside the control of individual countries, include the global price shocks and demand for commodities. Endogenous drivers include development strategies adopted by governments in the region, macroeconomic stability, investment, trade, and demographic and social factors. They will be briefly analysed below.

Investment in the region has been increasing since 2000. Investment rates in East Africa improved from 18.4% of GDP in 2000 to 25.6% in 2014. Countries that have managed to sustain increases in growth have also experienced steady increases in investment rates. Within the region, average investment is highest in Seychelles at 27.2% of GDP while it is lowest in Djibouti at 7.4%. However, East Africa's region witnessed a slight decrease in average investment rates in years 2015 and 2016 (respectively at 24.3% and 24.5% of its GDP).

Figure 5.5. **Growth decomposition by expenditure in East Africa, 2009-16**



Source: Authors' calculations based on IMF (2018), *World Economic Outlook Database* and World Bank (2017a), *World Development Indicators* (database).

StatLink  http://dx.doi.org/10.1787/888933783741

Consumption is the main driver of GDP growth and, despite some volatility, has rebounded since 2014. Private consumption almost consistently makes up over half of GDP growth in the region, growing on average at 4.7% between 2009 and 2016. The dip in private consumption between 2009 and 2014 can be partly attributed to the slowdown in global demand in the aftermath of the global financial crisis. East Africa is at least partially integrated into the global economy and is exposed to external economic shocks. Public consumption has been more volatile and less strong at 0.6% on average (Figure 5.5).

The contribution of the external sector (net exports) to recent GDP growth was largely negative until 2015. This negative contribution can be explained by the higher import price of energy between 2011 and 2014, and by suppressed external demand in part caused by the global financial crisis. Regional exports are still dominated by primary agricultural commodities (more than half the exports in 2016), while fully-processed goods dominate imports (at about 70% in 2016). Since 2000, exports have been progressively rising as a share of GDP and becoming more geographically diversified. This trend reflects rapid growth and a relative degree of structural transformation of regional economies, as they expand to a wide range of goods and services outside the traditional agricultural sector (see Annex 5.A1).

Dynamics of employment and unemployment in East Africa

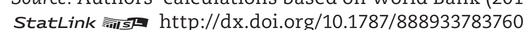
Economic growth in East Africa is not sufficiently diversifying the economy or creating enough jobs, both of which are key to inclusiveness and sustainability. Agriculture still employs almost 60% of the labour force, despite its declining contribution to GDP. The services sector is absorbing most of the workers moving out of agriculture, leaving employment in industry almost unchanged. This hampers development and employment prospects since most jobs in services are informal and unproductive and offer low wages and poor working conditions (UNECA, 2015). Youth unemployment remains a major challenge.

Growth strategies should aim to create increasingly attractive business environments that can enhance employment. Policies should encourage the private sector to grow, invest and employ workers, including small businesses such as start-ups and entrepreneurs that can create jobs. A case in point is Rwanda which, in parallel with macroeconomic and business reforms, has embedded entrepreneurship development into its policy frameworks. These include its employment policy in 2007, small and medium-sized enterprises policy in 2010 and Private Sector Development Strategy in 2013.

Trends in employment and unemployment in East Africa

Employment rates vary significantly across countries. In three countries, less than half of the labour force is employed. Almost half of the countries have employment rates of about 80%. Unemployment in the region has remained fairly constant, falling slightly from 7.5% in 1991 to just under 7.2% in 2017 (Figure 5.6).[2,3]

Figure 5.6. **Employment and unemployment rates in East African countries**

Note: Only the latest data available after 2009 for each country is shown.
Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database).

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The reallocation of labour to the services sector has not led to productivity increases. The agricultural sector still employs the largest proportion of the labour force, though its share has marginally decreased. In recent years, the services sector has absorbed most of the workers leaving agriculture and industry. Employment in services tends to be in low productivity activities such as retail trade and hospitality, limiting the gains of labour reallocation (see Chapter 1).

In recent years, women's participation in the labour force has increased in many developing countries including those in East Africa. There are at least three factors that explain this trend. With economic development and the ensuing shift of the population from rural and agricultural sectors to other sectors, more women choose to participate in the labour force. Second, with rising levels of education, women tend to work in greater numbers in order to capture returns on their investment. Third, falling household income and rising poverty in certain countries seem to have persuaded more women to join the labour force (Tandrayen-Ragoobur, Ummersingh and Bundhoo, 2011).

Inequalities in employment are decreasing, but women and youth remain at a disadvantage. Female employment is increasing while male employment is decreasing, although the gender gap is still significant. The overall gender gap (measured as the ratio of male-to-female employment) has been decreasing slowly, from 1.41 in 1991 to 1.39 in 2017, and large disparities exist across sectors and countries (see Table 5.3 for a sector breakdown). Youth remain vulnerable to unemployment in East Africa. The youth unemployment rate is higher than overall unemployment, at 13.5% in 2017.

Both women and men work mostly in agriculture. The sector employs 62% of the female labour force and 55% of the male labour force. However, female employment is shifting from agriculture and industry towards services, while male employment is moving to industry and services (see Table 5.3). This is consistent with men being more likely to undertake wage employment. In Uganda and Tanzania, for example, respectively almost 50% and over 62% of employed women work in the informal sector (ILO, 2015). The share reaches 80% in Kenya and Rwanda (UNECA, 2015). East Africa therefore follows the same trend as sub-Saharan Africa where over 75% of women are likely to engage in informal work (ILO, 2016).

Table 5.3. **Sector shares in East Africa's employment by gender, 1995-2017 (percentage)**

	Agriculture		Industry		Services	
	Female	Male	Female	Male	Female	Male
1995	63.1	55.4	10.6	11.5	26.4	33.1
2005	62.2	54.1	9.5	12.1	28.2	33.8
2017	60.1	52.8	8.7	13.7	31.2	33.5
Average (1991-2017)	62.1	54.4	9.8	12.4	28.1	33.1

Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database).

Box 5.1. **Explaining the disparity in gender employment in Mauritius**

Mauritius has often been cited as an outlier in sub-Saharan Africa with stable growth and sound macroeconomic conditions. Nonetheless, female unemployment remains a major problem of the Mauritian society. In 2010,[4] 64% of the unemployed were women. The economy has become more service-oriented and knowledge-based, and many lower-skilled jobs have been lost. Those who lost their jobs were mostly women, hence increasing the gender unemployment gap. Married women in Mauritius tend to remain outside of the labour force. Additionally, many women do not enter the labour force due to inflexible working hours and inadequate childcare options (Tandrayen-Ragoobur, Ummersingh and Bundhoo, 2011).

Dynamics of inequality and poverty in East Africa

This section analyses two main factors that prevent economic well-being: inequality and poverty. Income inequality varies across East Africa but overall is on an upward trend (see Table 5.4). Most countries also lag behind in providing access to electricity, water and sanitation, with large gaps between urban and rural populations. Poverty has declined in the region but remains high.

Inequality and poverty can decrease with growth, but policies for the long term are also required, since growth alone does not systematically reduce them. To reduce vulnerability and promote greater participation in the growth process, some countries have put in place social protection programmes (e.g. Tanzania). Others are investing in education, skills and entrepreneurship development to create better jobs in the longer term (e.g. Rwanda). Mauritius offers an example of policies to reduce poverty and inequality through education – such as targeted skills training for disenfranchised groups in particular women and youth –, health services and social safety nets.

High poverty rates do not necessarily imply high inequality. For example, despite an increase in Madagascar's poverty headcount ratio between 2001 and 2010, inequality decreased, driven by a return to agriculture as the economy failed to grow.

Inequality in East Africa

Looking at inequality of income and of opportunity, some countries are performing badly in terms of one indicator but perform well in others. For instance, Comoros has the highest Gini coefficient, meaning the most wealth inequality, but a high percentage of its population has access to electricity. Ethiopia, on the other hand, has a low Gini coefficient, but few citizens have access to basic services. These incongruences can be explained by different social protection programmes (or a lack thereof) across countries (World Bank, 2015).

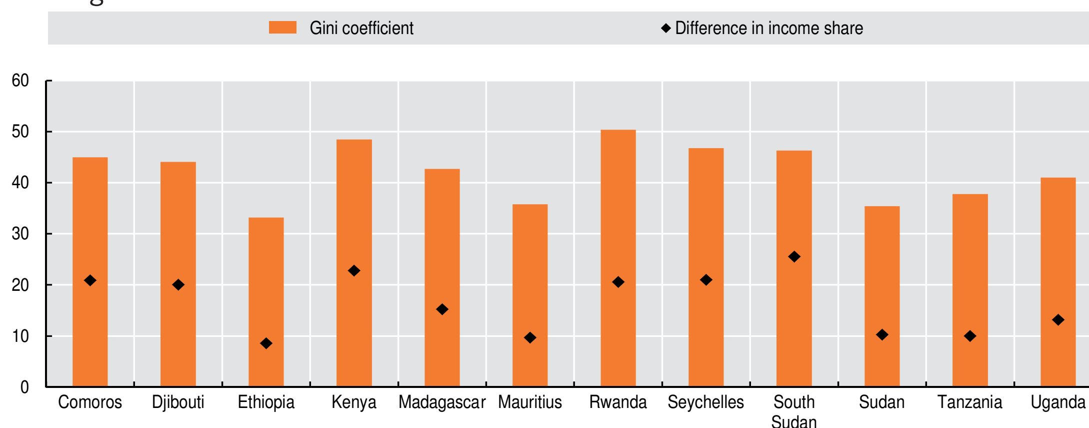
Table 5.4. **Inequality in East Africa as measured by the Gini index**

	1999	2005	2010	2012	2013
Comoros	-	55.9	-	-	45.0
Djibouti	39.1	41.5	44.1	45.1	44.1
Ethiopia	30.0	29.8	33.2	-	-
Kenya	46.9	48.5	-	-	-
Madagascar	38.6	39.9	42.4	42.7	-
Mauritius	37.7	35.7	35.7	35.8	-
Rwanda	48.5	52.0	51.3	49.7	50.4
Seychelles	42.8	42.8	43.4	45.7	46.8
Tanzania	37.3	40.3	36.4	37.8	-
Uganda	43.0	42.9	44.2	41.0	-

Note: - = data unavailable. The Gini index measures the extent to which the distribution of income among individuals or households within an economy deviates from a perfectly equal distribution. The index ranges from 0 in the case of "perfect equality" (each share of the population gets the same share of income) to 100 in the case of "perfect inequality" (all income goes to the share of the population with the highest income).
Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database).

Comparing the income shares held by the highest- and lowest-earning 20% of the population shows that inequality is generally high in East Africa (Figure 5.7). Rwanda, Comoros and Kenya have the highest levels of income inequality according to this measurement (see Annex 5.A2 for more detailed data). In comparison with the other regions in Africa, East Africa's inequality level is almost equivalent to that of the Central and West Africa. North Africa has the smallest difference between the highest and lowest quintiles, while Southern Africa has the largest.

Figure 5.7. **Gini coefficients and difference in income share in East African countries**



Note: The difference between the top and bottom group refers to the ratio between the income shares held by the richest 10% to the income held by the poorest 10% in the national income distribution. The latest available data is shown for each country.

Source: Authors' calculations based on World Bank (2017b), *PovcalNet* (database).

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Inequality can also be analysed in terms of access to basic amenities, and, on average, countries in East Africa lag behind. In the region, 37% of the population have access to electricity, 48% to drinking water and 20% to sanitation services (see Annex 5.A2 for breakdowns by country). A number of countries exhibit large gaps in access to basic amenities between the rural and urban populations, particularly in providing electricity and sanitation. By contrast, in Mauritius and Seychelles over 90% and 85% respectively of their rural populations have access to electricity.

Poverty in East Africa

Poverty has declined in East Africa but remains high. Generally East African countries have seen reductions in extreme poverty since they started their economic reforms in the 1990s (Table 5.5).

Table 5.5. **Poverty rates in East Africa, 1999-2013**

Poverty headcount ratio at USD 1.90/day (% of population)					
	1999	**2005**	**2010**	**2012**	**2013**
Comoros	-	13.5	-	-	17.7
Djibouti	-	20.6	-	18.3	22.5
Ethiopia	55.4	36.3	33.5	-	-
Kenya	21.5	33.6	-	-	-
Madagascar	63.9	72.0	78.5	77.8	-
Mauritius	-	0.4	-	0.5	-
Rwanda	77.0	68.0	60.3	-	60.4
Tanzania	86.0	55.1	49.1	-	-
Uganda	64.1	53.2	41.5	34.6	-
Poverty headcount ratio at national poverty lines (% of population)					
	1999	**2005**	**2010**	**2012**	**2013**
Comoros	69.0	44.8	-	-	-
Ethiopia	44.2	38.9	29.6	-	-
Kenya	-	45.9	-	-	-
Madagascar	70.8	73.2	71.4	70.7	-
Rwanda	-	56.7	44.9	-	39.1
Seychelles	-	37.8	-	-	39.3
Uganda	33.8	31.3	24.5	19.5	-

Note: - = data unavailable.
Source: World Bank (2017b), *PovCalNet* (database).

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Countries in the region have taken various approaches to tackling poverty:

- **Mauritius has a generous welfare system, a solid education system, and policies to support low-income families and the unemployed.** The country has focused its poverty reduction strategy on education (e.g. training to enhance employability) and health services, targeting the most vulnerable segments of the population – women and youth – through improved social safety nets. Mauritius' development in the early 2000s succeeded in reducing poverty through growth at roughly no cost in terms of inequality.
- **Rwanda's poverty reduction efforts are anchored in long-term and medium-term strategies.** The country put in place a monitoring mechanism for poverty through household surveying (i.e. the Integrated Household Living Condition Survey and the Demographic and Health Survey). Several factors contributed to rapidly reducing poverty: peace and political stability; high and sustained real GDP growth; sound macroeconomic management; and improved social services and social protection programmes (such as the 2020 Umurenge Programme). The Rwandan government is strengthening its efforts to create jobs through education, skills and entrepreneurship to further reduce poverty to the target of 20% of the population by 2020.
- **Tanzania has reduced poverty and inequality by increasing disposable income for the poorest households.** The government supports poor households through social safety net programmes (such as the Tanzania Social Action Fund and the Productive Social Safety Net Programme), conditional cash transfers and public works programmes.

Peace and stability are also key factors for poverty reduction. The two political crises that hit Madagascar in the 2000s cost the country dearly in terms of poverty reduction. Had Madagascar avoided the crises, almost 11% less of the country's population would have been poor in 2010 compared to 2001 (i.e. the poor population would have dropped from 70.8% in 2001 to 59.8% in 2010) (World Bank, 2014).

Policy recommendations

Most of East Africa has benefited from sustained economic growth as a result of a diversified economic profile, particularly compared to regions such as Central Africa and West Africa. Nevertheless, a large agriculture sector and an export-led growth model that focuses on a narrow set of products (e.g. coffee, tea and minerals) make the region vulnerable to commodity price fluctuations and currency depreciations. The region's growth has not created jobs nor substantially reduced poverty or inequality.

The following policy recommendations will try to direct countries towards greater economic diversification, job creation, inclusive growth and structural transformation. Governments can achieve these by enhancing the role of the growing domestic consumer base, increasing the productivity of sectors that employ large parts of the population and supporting job creation in higher productivity sectors. These recommendations address problems shared by all or most countries in the region. They aim to propose actions for a regional development agenda that is coherent with the commonalities across countries and their regional integration needs. As countries have different starting points, approaches, capacities and national priorities, they will have to prioritise and sequence policies according to their own specificities.

Countries in the region should pursue responsible fiscal and monetary policies, as these directly affect inflation rates and currency volatility. Macroeconomic stability matters for sustained economic growth, especially in the long run. Maintaining low and stable inflation rates requires *i)* controlling the supply of money, which influences price indices in the short term, and *ii)* shielding the economy from inflation spill-overs and

changes in oil and food prices, which impact inflation in the longer term (Nguyen et al., 2015; Simpasa and Gurara, 2011).

As the region increasingly integrates into the global economy, shielding the economy is particularly important to reduce poverty and could also be complemented by measures to protect low-income households from price shocks. Regional Economic Communities can help. For instance, the 2015 Monetary Union Protocol of the East African Community sets out macroeconomic convergence criteria that in the long term would lead to inflation below 5%, a regional tax-to-GDP ratio of 25%, a debt-to-GDP ceiling of 50% and a minimum reserve cover of 4.5 months of imports.

Improving the policy and regulatory framework and the overall business environment is crucial to foster diversification and more sustainable growth. Policy makers can stimulate productive investment in the economy through a number of structural and institutional measures:

- **Introduce reforms to improve the business climate.** Only four countries in the region – Kenya, Mauritius, Rwanda and Seychelles – rank among the top 100 globally for ease of doing business (World Bank, 2018). Specifically, these countries have somewhat consistently reduced the number and cost of procedures to register businesses and property and to obtain permits and public goods (e.g. electricity). Additional actions could include aligning investment, infrastructure and human capital development plans; centralising regulatory information and making it easily accessible to domestic and foreign investors; and empowering regulatory authorities to avoid government influence in certain sectors (e.g. electricity price setting) (OECD, 2013; 2014).
- **Investment promotion agencies (IPAs) are needed to cater for the needs of private investors, big and small.** Effective IPAs require a clear mission with strategic objectives as well as strong leadership (Morisset and Andrews-Johnson, 2004). For instance, Rwanda has set up an investment promotion agency with the clear mandate to attract and assist investors who can create jobs and foster economic activity in the country. The agency also benefits from a seat in cabinet, to ensure direct contact with other ministries and the president.
- **Governments can streamline trade policy to facilitate importing intermediate and capital goods and exporting final products.** According to the OECD Trade Facilitation Indicators, East Africa could prioritise removing trading fees and charges as well as involving more of the trade community in the decision-making process (OECD, n.d.). Lowering tariffs on intermediate inputs and capital goods that are essential for industrialisation can enhance the competitiveness of firms in the region. For example, in the East African Community (EAC), nearly 400 tariff lines for industrial inputs are misclassified as finished goods and therefore taxed at 25% instead of 10% (Frazer, 2017). Supporting firms with an export promotion agency or other trade facilitation measures can help countries increase exports and tap into value chains (WTO, 2014).
- **To further attract investment, governments in the region can support projects and services that crowd in private capital.** Governments should provide assistance and services such as seed funding and business support services and should facilitate interactions between domestic and foreign firms. Donors and development partners can contribute by providing technical assistance and funding to specific programmes (Powers and Butterfield, 2014). Governments could promote private sector participation in sectors and activities that offer good prospects for returns on investment such as infrastructure (e.g. toll roads) and public services (e.g. transport).

Developing quality infrastructure projects will enhance sustained growth. EAC countries alone will need approximately USD 100 billion by 2021 to close their infrastructure gap, which is hindering growth and keeping business costs at uncompetitive levels.[5] Co-ordinated investment in basic infrastructure can overcome the most salient constraints in electricity and logistics. Projects such as the East African Power Pool (EAPP) will help reduce the region's infrastructure deficit and strengthen cross-border co-operation. The EAPP aims to generate surplus capacity by 2030 as well as to create an integrated electricity exchange market among the six countries in the region that are part of the project (Deloitte, 2015). Countries should also aim to improve enabling infrastructure for the services sector (e.g. ICT connectivity), which can help firms to grown. Kenya's "Silicon Savannah", for example, is attracting entrepreneurs and has now expanded beyond Nairobi, partly thanks to the fast mobile broadband available across the country.[6]

Given the importance of human capital in promoting growth, countries should improve their education systems. Between 2005 and 2014, the share of boys graduating from secondary school increased by 24 percentage points and the share of girls by 27 percentage points, almost closing the gender gap. Nevertheless, the quality and job market relevance of education need improving.

Young people require at least a lower secondary education to have foundation skills to find work that pays a decent wage (UNESCO, 2013). In Ethiopia, however, over 75% of those aged 15-19 do not have foundation skills. The same is true for around two-thirds of young Ugandans. To provide the necessary education, governments should work towards increased learning outcomes in primary and secondary school and higher enrolment rates in science, technology, engineering and mathematics. They should promote specialised education and vocational training and involve the private sector in designing curricula and engaging with students.

Increasing coverage of social protection programmes can help countries manage the possible negative effects of growth on the more vulnerable. The region's demographic growth is not slowing down enough to prevent vulnerable people from facing inequality and falling into poverty. Governments can nevertheless extend coverage of social protection programmes to benefit the most vulnerable (see Chapter 8), including women, who often constitute a disproportionate share of the poor. Programmes could be designed to promote women's access to health and education services as well as to support them when they are out of the labour force caring for dependents. While financing such programmes will pose a serious challenge, estimates for four countries in the region show that removing fuel subsidies alone could free up to 2.1% of GDP (OECD, 2017).

Countries need to boost agricultural productivity and support the growth of high-potential firms in the industrial and services sectors. Agriculture remains the largest employer in the region. Increasing its productivity and competitiveness can create jobs in the sector beyond mere subsistence. Low productivity and non-tradable services also employ a large share of the population. Allowing firms in this sector to grow and encouraging workers to move into more productive industries could help countries accelerate their economic transformation.

- Interventions in agriculture could include introducing affordable and scalable technology and improved farm inputs to increase productivity, developing financial products (i.e. credit and insurance) tailored to the sector, and creating value chains to increase value addition (which can also generate additional jobs). For instance, the cut flower industry in Ethiopia has greatly benefited from investments by small foreign companies to develop trade with Europe, transferring knowledge and generating spill-overs to the local economy. Place-based and multi-

sectoral approaches can also help improve farming productivity. As part of their development strategies, Ethiopia and Rwanda are targeting the growth of secondary cities to strengthen the productivity of local food markets.

- Modern technology solutions can enable own-account workers to reduce costs and increase the productivity of their enterprises, as well as provide opportunities to diversify activities and sectors (AfDB/OECD/UNDP, 2017). Tourism is a key industry for East Africa and has the potential to create many jobs, particularly for women (UNCTAD, 2017). Promoting tourism (e.g. through private sector platforms and single tourist visas, such as in the EAC) can help establish linkages across economic sectors, reduce poverty and create more inclusive growth.

Mobilising more domestic revenue will allow countries to increase investment in key areas such as infrastructure and education. Several countries in the region have been able to increase their domestic resources mobilisation. For instance, Kenya and Rwanda have increased their tax-to-GDP ratios by 2 and 6.5 percentage points, respectively, between 2000 and 2015. In 2015, Kenya's tax-to-GDP ratio was at 18.4% and Rwanda's at 16.7%. The Rwandan government has expanded its tax base by registering informal businesses and simplifying compliance processes. It established a Small and Medium Taxpayers Office in 2006 and introduced a value-added tax in 2001 and new income tax laws and tax rates in 2005 and 2006 (OECD/ATAF/AUC, 2017).

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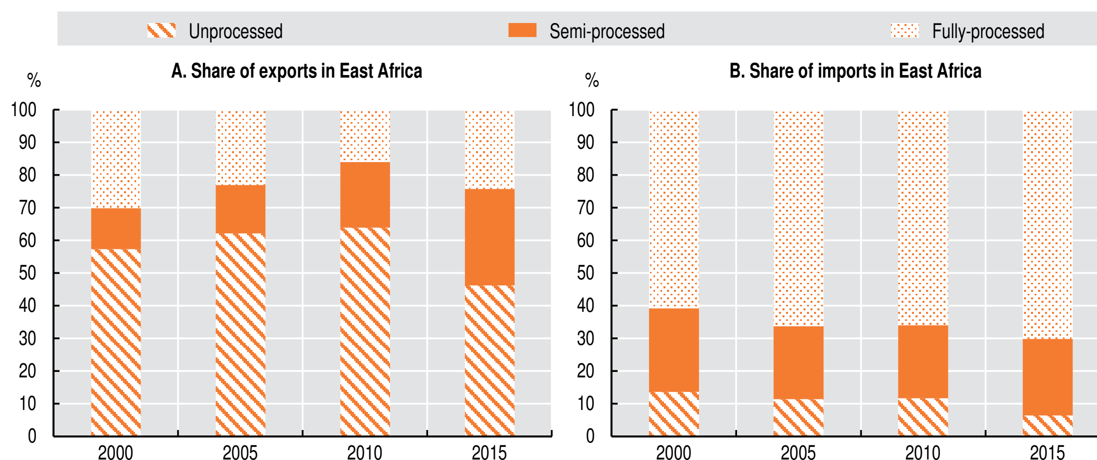
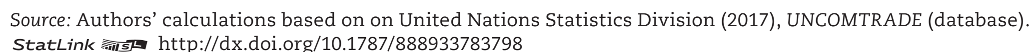
Annex 5.A1. Trade profiles

Figure 5.A1.1. **Composition of exports and imports in East Africa**



Source: Authors' calculations based on on United Nations Statistics Division (2017), *UNCOMTRADE* (database).

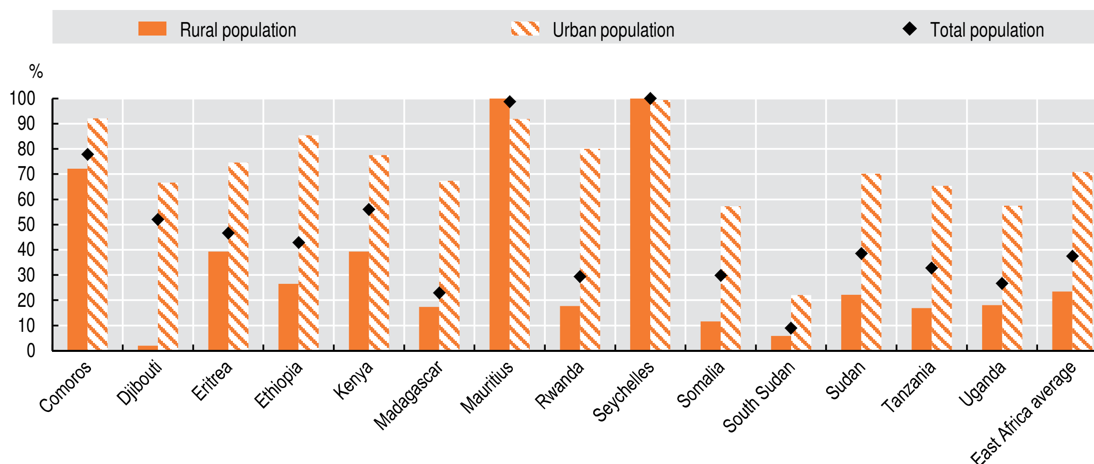

StatLink http://dx.doi.org/10.1787/888933783798

Although primary commodities dominate exports in the East Africa region, fully-processed commodities dominate imports (Figure 5.A1.1). The exported primary commodities include, among others, coffee, cut flowers, tea, tobacco, fish and vegetables. The imported fully-processed commodities are mainly heavy machinery, automobiles and chemicals.

Evidence shows that exports are playing an increasing role in GDP. This is consistent with the region's economies becoming more internationally integrated and thus their production processes and outputs becoming more modern (Gigineishvili, Mauro and Wang, 2014).

Annex 5.A2. Inequality profiles

Figure 5.A2.1. **Access to electricity in East African countries**

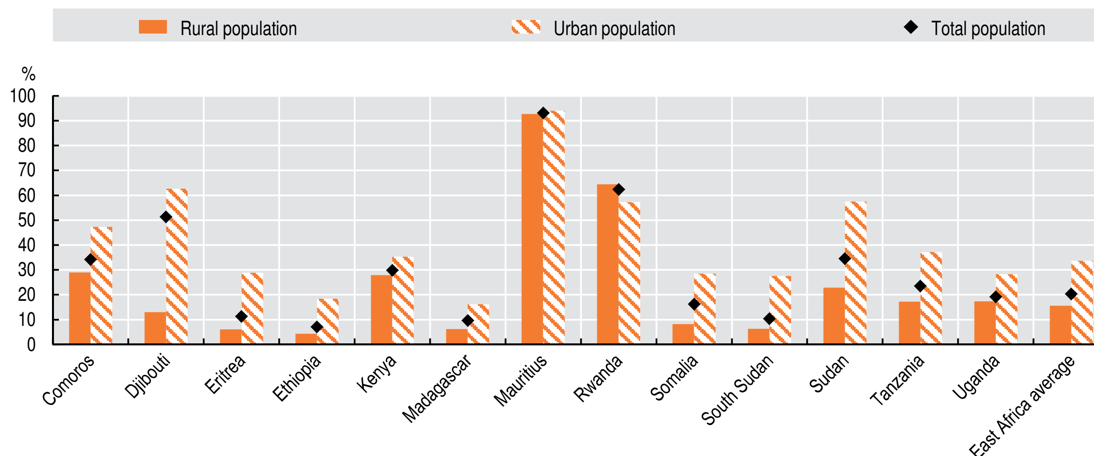


Note: Total = access to electricity (% of total population); Rural = access to electricity (% of rural population); Urban = access to electricity (% of urban population).

Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database).

StatLink http://dx.doi.org/10.1787/888933783817

Figure 5.A2.2. **Access to basic sanitation in East African countries**

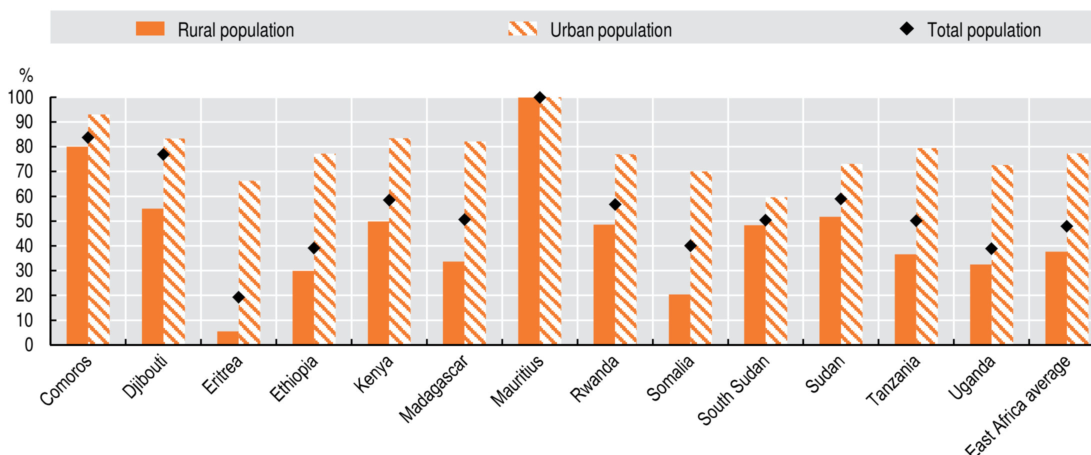


Note: Total = access to basic sanitation (% of total population); Rural = access to basic sanitation (% of rural population); Urban = access to basic sanitation (% of urban population).

Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database).

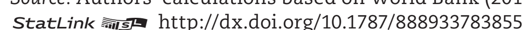
StatLink http://dx.doi.org/10.1787/888933783836

Figure 5.A2.3. **Access to drinking water in East African countries**



Note: Total = access to drinking water (% of total population); Rural = access to drinking water (% of rural population); Urban = access to drinking water (% of urban population).

Source: Authors' calculations based on World Bank (2017a), *World Development Indicators* (database).


StatLink http://dx.doi.org/10.1787/888933783855

Notes

1. Data availability determines the countries included in particular sections.
2. In this section, the study period has been adjusted to 1991-2017 due to data availability.
3. Unemployment rate as a percentage of the total labour force (modelled International Labour Organization estimate) (World Bank, 2017).
4. More recent data are not available.
5. www.theeastafrican.co.ke/business/EA--region-needs-100b-dollars-for-infrastructure/2560-4003018-nuwd1mz/index.html
6. https://qz.com/1059305/kenyas-newest-tech-hubs-are-sprouting-outside-its-silicon-savannah-in-nairobi/

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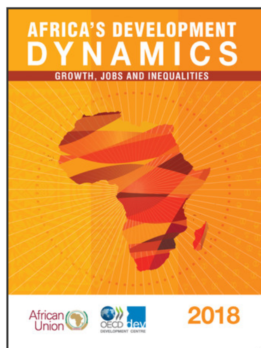

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