Executive Summary

Introduction

Improving the quality of life of the people of East Africa is at the heart of the regional integration process. The State of East Africa Report 2013 emanates from the following three elements of the objectives, fundamental and operational principles in the Treaty for the Establishment of the East African Community.

The first is the attainment of *sustainable growth and development* of the partner states by the promotion of a more *balanced and harmonious* development of the Partner States (Article 5). The second is the *equitable* distribution of benefits (Article 6) and the third is the commitment to *people-centred* and market-driven co-operation (Article 7).

On Inclusiveness and Equity

The concepts of 'inclusiveness' and 'equity' are normative, meaning that they are about 'expressing value judgements or prescriptions' on how things should or ought to be, how to value them, which things are good or bad, and which actions are right or wrong.

In this report, *inclusiveness* refers to how much the most disadvantaged East Africans are participating in the process of growing the region's economy. From this perspective, focusing on an average metric such as per capita GDP, to evaluate inclusiveness leads to misleading conclusions. Furthermore, average changes do not say anything about what is happening to the first and last person in the income distribution. *Equity* describes how the fruits of economic growth are shared among the region's citizens. Recent analysis shows that inequality is really about the share of income that goes to the richest (top 10 per cent of the population) and the poorest citizens (bottom 40 per cent of the population). Simply stated, inequality is about what is happening at the tail ends of a country's income distribution.

This report explores inclusiveness and equity in the context of the East African regional integration process. It aims to describe, analyse and understand the region from an inclusiveness perspective and to explore the dynamics that are influencing equity, in order to understand how the economic, social and political integration agenda might influence the equity dynamics at play in the region.

The People of East Africa

East Africa's population in mid-2012 was estimated at 144 million people, representing an increase of five million from 139 million in 2010. Birth registrations in East Africa are low. The percentage of registered births among East Africa's poorest households indicate that at best, a little over half of the children born into poor families are formally 'invisible'.

East Africans are very young. The median age in East Africa – the age that divides the population into two equal halves above and below it - ranges from 15 years in Uganda to 19 years in Kenya and Rwanda.

Malnutrition in East Africa manifests itself most clearly in the 10 million East African children, 42 per cent of the region's 24 million under-five who were stunted in 2010.

All East African countries have achieved the global target of 100 per cent gross enrolment at the primary school level. However, enrolment in secondary school is much lower at between 28 per cent in Uganda and 49 per cent in Kenya as most children do not make the transition to secondary school. Uganda and Rwanda have the highest primary school leaving exam pass rates while Tanzanian and Kenyan students produced the worst results in East Africa. A far lower proportion (less than 30 per cent in 2012) of Kenyan and Tanzanian secondary school students pass their respective national exams compared to their peers in Rwanda and Uganda where more than 88 per cent passed.

The East African Economy

The East African economy continued its impressive growth rate trend with an average of 6 per cent growth in 2011 and a GDP of $83 billion in that year. However, income per capita data for 2011 shows the significant intra-regional differences between Burundi's per capita income of $271 and Kenya's $808.

East Africa expanded the value of its total trade by $8.2 billion to $45.8 billion in 2011 from $37.5 billion in 2010. Imports continue to dominate the region's trade. Import growth of $6.5 billion in

2011 was responsible for 79 per cent of the region's total trade expansion and for 72 per cent of total trade in that year. Although exports increased by $1.76 billion they accounted for just 21 per cent of that year's trade growth and only 28 per cent of the region's total trade in 2011, the lowest since 2005. The $18 billion value of East Africa's top five imports in 2011 was more than twice as large as the $7 billion value of its top five exports. East Africa's five most important export products can barely pay for its fuel bill.

East Africa attracted foreign direct investment (FDI) inflows of $3.9 billion in 2012, a $1.8 billion increase from $2.6 billion in 2011. With a combined total inflow of $3.4 billion, the two main energy-rich countries of Uganda and Tanzania received 90 per cent of the investment inflows into the region. In addition to the lure of the extractives sector, other investors in East Africa are targeting regional and domestic consumers with healthcare, financial services and cement production.

In 2011, the region received $8.3 billion in total net disbursements of aid up from $7.9 billion in 2010, and representing 18 per cent of total aid flows to sub-Saharan Africa for 2011. Uganda and Rwanda experienced aid cuts in 2012. This year also saw a shift in aid allocations by donors away from the poorest countries, towards middle-income countries. These are signs that declining aid flows to the region could soon be a strong feature of its economic relationship with donor countries.

The Quality of East Africa's Institutions

Corruption continues to blight the landscape of East Africa's most important institutions including those responsible for security and justice. The police account for 50 per cent of the most corrupt sectors in the region followed by the judiciary at 30 per cent. The police departments in all five East African Community states appear in the top ten most corrupt institutions, which points to the harsh reality experienced by many citizens in their dealing with law enforcement institutions in the region. When confronted with corrupt practices, few citizens in the region bother to make official complaints: In Kenya, only five per cent indicated that they reported incidents of bribery to the authorities. The figure in the other EAC member states was eight per cent in Uganda, 10 per cent in Burundi, 11 per cent in Tanzania and 15 per cent in Rwanda.

There is a pervasive feeling that the economic conditions have worsened in the past five years. In the 2012 Tanzania Afrobarometer Survey, 40 per cent of adults felt that current economic conditions in Tanzania were very bad, compared to 25 per cent in 2008. In 2012, 62 per cent of Ugandans felt that their living conditions were at least fairly bad compared to 42 per cent just two years earlier. In Kenya, 84 per cent of adults described the current economic conditions as either 'very bad' or 'fairly bad' in 2011, a 30-point jump from 54 per cent in 2005.

Economic Drivers of Inequality

Burundi is the least unequal country in the East Africa, followed, in order of rising inequality, by Tanzania, Uganda, Kenya and Rwanda. The trends in the last two decades point to Rwanda and Burundi reducing inequality more recently, albeit from a very high level in Rwanda. Kenya and Tanzania seem to be expanding the gap between rich and poor, while Uganda has kept it mostly stable for two decades.

The rapid change in the structure of the East African economy is one of the most important drivers both of the region's economic performance and the uneven distribution of income and other benefits of growth. In 2003, Kenya's was the only regional economy in which the services sector had a bigger share of the economy than agriculture. A decade later, all East African economies are in a similar position. While developing economies are usually characterized by a falling share of the agricultural sector in the overall economy, the trouble in East Africa is that the speed of change is overwhelming the capacity of the industrial and services sectors to provide the needed jobs and alternative livelihood opportunities.

The share of industry in the economy increased modestly in four of the five East African countries. East Africa's industrial sector employed about 560,000 workers in 2012. Assuming a labour force of about 77 million in 2010, industrial employment accounted for less than 1 per cent of the region's total labour force. In order to reach the goal of having 2.3 million people working in manufacturing, the region's industrial sector jobs will have to expand five times in the next 20 years.

A formal, wage-paying job is a privilege reserved for a tiny minority of East Africa's working population. Just 1.6 per cent of Uganda's, 4 per cent of Burundi's, 5 per cent of Tanzania's and 6 per cent of Kenya's working populations are formally employed. For those fortunate enough to find a paying job, the wage data highlights further the disparity in earnings. The lowest official monthly minimum wages across East Africa vary from $81 in Uganda to just $3.10 in Burundi, which is four times lower than its official poverty line of $12. The median monthly wage ranged from $176 in Rwanda to $84 in Tanzania. However, at $176, Rwanda's median wage is lower than its own official poverty line ($192) and furthermore, less than half of working Rwandans were paid a wage that was higher than the country's poverty line.

Social Drivers of Inequality

The probability of upward social mobility is determined by the nutritional quality, health and learning that are obtained during the first 1,000 days of life for most people. The good news includes the fact that infant and under-five mortality rates have decreased significantly across East Africa's wealth spectrum, demonstrating progress made in improving early childhood healthcare, particularly vaccination, across the board.

Analysis of the data on stunting among children, a sign of malnutrition, makes for sobering reading. The share of stunted children in Tanzania and Kenya expanded in both rich and poor households. The gap between rich and poor children in both countries narrowed but for the wrong reason; stunting among children in the richer households grew at a faster pace than that of their poorer compatriots. This gap also widened in Rwanda, but it was because the rate of stunting fell faster among richer children than poorer ones. In Uganda, the gap closed as stunting fell overall but it did so faster among the country's poorest children.

The difference in the quality of social service delivery highlights the urban-rural inequality. In Tanzania, 60 per cent of urban health facilities have electricity, clean water and improved sanitation compared to just five per cent of rural facilities. In Kenya 58 per cent of health facilities in urban areas share the same advantage of infrastructure.

Just 2 per cent of schools in rural Tanzania have adequate infrastructure and little comfort is given by the fact that urban schools are hardly better off on this measure. Tanzania compares badly to Kenya, where almost 60 per cent of all schools – rural, urban, private and public – have access to essential services. Children in rural Tanzania are taught for less than half of the scheduled teaching time, and those in urban areas are taught for an even more dismal 27 per cent of scheduled teaching time. Children in Kenya's public schools receive more hours of instruction than their Tanzanian peers. Furthermore, Kenya's private school students enjoy an extra hour of instruction compared to their public school compatriots, which works out to two extra months of teaching during the course of an academic year.

One People, One Destiny?

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The Future of Inequality in East Africa

Two powerful driving forces are shaping the future of inclusiveness and equity in East Africa. One is the inclusiveness of growth - a measure of how much the poorest East Africans are participating in generating economic growth. The second driving force is the degree of equity, which describes how the benefits of economic growth are shared among the region's citizens, and particularly the share of income and wealth that accrues to the poorest East Africans.

The *Winner Takes All* outlook describes a future in which the poorest are excluded from participating in East Africa's growth process. In an economy based on the extraction and export of oil, gas, unprocessed precious metals and agricultural commodities, there are few opportunities for them. Furthermore, not only is the regions' physical and financial wealth concentrated among the rich few, but the disparity widens dramatically over time as the poor get a shrinking share of the expanding income. As a result the majority of East Africans exist in conditions of deprivation and desperation, while a select few enjoy a lavish but fear-filled lifestyle.

The *Social Bribery* outlook outlines a possible future in which much is promised to the region's poorest, and on the face of it, delivered. But it actually does little to improve their welfare. It is about the illusion of growing personal prosperity based on expanding debt-fuelled consumption of modern conveniences. The people's participation in the economy is rewarded with wages that are suppressed just enough to protect profit margins, but not enough to kill their purchasing power. The poorest consume a little more, but never catch up with the richest of their compatriots. Indeed, the wealth gap continues to widen gradually but inexorably.

The *Transformation* outlook highlights a future in which the region's underlying economic strategy changes its outward orientation following a youth-led protest that chokes the regional economy at its most vulnerable points. The resolution of the crisis turns the economic policy inwards to nurture domestic demand, supporting an ecosystem of local value-chains to meet the growing demand and upgrading the skills of ordinary East Africans. At its core is a deliberate effort to directly tackle inequality head-on, and it is led by a re-purposed and revitalized East African leadership.

It must be concluded that in order for the regional integration process to meet its fundamental objective of improving the quality of life for East Africans, increased trade, investment, competitiveness and value addition can only be one side of the story. Addressing the social dimensions of improved welfare by achieving a greater degree of equity-enhancing inclusiveness must be the second and equally important side of East Africa's regional integration narrative.

The way in which the current East African regional integration outlook, strategy and execution addresses the challenges of structural economic change, food security for children and the quality of their education, will shape how inequality evolves well into the future. 'Business as usual' will leave the uncomfortable status quo firmly in place. Emphasizing and accelerating the growth agenda will damage even further the fragile social fabric that holds East Africans together. Only a deliberate and determined strategy to truly forge *One People* from three groups of East Africans - the richest 10 per cent, the poorest 40 per cent and the middle majority - stands a good chance of leading to the *One Destiny* that is the destination to which all are travelling.

Agenda for Active Policy Engagement

Economic policy: Strengthening the local economy, raising domestic demand, increasing value addition.

A major economic policy objective should be to increase productive capacity and promote product diversification (what to produce), foster horizontal and vertical integration across and among sectors (how to produce), multiply growth poles across the East African region (where to produce), engage in market development, trade promotion and facilitation (where to sell).

The average size of economic actors in East Africa is either very large or very small. The presence of a "missing middle" is a strong indicator of how difficult it is for the majority of economic actors, such as subsistence farmers and informal traders, to move beyond survival entrepreneurship. A new approach could be that of creating and promoting a new generation of economic actors who are skilled competitive and "fit to run" on a playing field that is level due to regulatory clarity and fairness.

Governments could invest in capabilities (such as vocational training, skill development, technology transfer), create mechanisms for start-up and scale-up support (including business incubation units, incentives, new financial instruments), and actively engage in market development and trade facilitation (using pro-youth and pro-women public procurement policies, minimum local content regulation, product cluster promotion boards and export consortia).

Social policy: Managing aspirations, leveraging resources, exploring new delivery mechanisms

The challenge for social policy is to navigate the 'triple pressure' that East Africa faces. The first comprises citizens' growing expectations for more and better social services delivered by the public sector. This calls for managing expectations and greater honesty in establishing priorities and in the sequencing of interventions.

The second source of pressure is a shrinking public purse due to declining aid flows coupled with the difficulty of enhancing domestic resource generation. Without changes in the structure of the economy (higher wages, increased size of economic actors, greater value addition) that generate a broad expansion of income, it is almost impossible to increase tax collection without resorting to desperate but ultimately unproductive measures such as chasing informal street vendors.

The final pressure comes from the changing roles of the private sector and civil society in the face of growing social stratification of service provision (as the rich seek private solutions leaving the poorest households to rely on 'free' but poor quality state services). Improving the delivery of social services so as to enhance the quality of the outcomes requires a bold conversation about the allocation of scarce resources in the most efficient (least cost) and effective (high returns) ways.

Political domain: The concept of democracy, the developmental state and the principle of subsidiarity.

Three elements of East Africa's political domain that collectively embody the nature of the power relationship between citizens and the state need to be considered. The first is the very concept of democracy and what it means for the inclusion and empowerment of the region's poorest citizens. Without these two elements, ballot-box democracy is essentially useless as an instrument of change. A new social contract based on transparency and accountability is essential to restoring transformative power to the ballot box.

The second touches on degree to which government influences the activities of economic agents towards a set of specific objectives. Would a developmental state in East Africa, focused on economic development through proactive and direct interventions such as industrial policies, be more desirable than a regulatory approach that nudges an economic and social system towards a desired set of growth, integration, inclusion and equity objectives?

The third concerns the division of authority, decision-making and executive power between central and local government. Is government action most inclusive, equitable and effective when it is conceived, decided upon and executed centrally or locally?

Two Basic Realities

This State of East Africa Report argues that the extent of inequality is driven by what happens at the tail ends of the income distribution. Therefore, the 'average' East African, who monopolizes the attention and affection of researchers, policymakers and marketers, exists only as a statistical being created by an arithmetic combination of millions of vastly different life experiences. In this context, the first reality is that policies aimed at improving inclusiveness and enhancing equity must be designed for the populations at the edges – the rich 10 per cent at the top and the poorest forty per cent at the bottom of the wealth distribution. Addressing inequality means tackling the marginalization faced by the poorest but also addressing the advantage enjoyed by the rich. In the political domain, for example, the conversation must revolve around empowering the poor by addressing the privilege of the powerful elites.

The second reality revolves around the challenge of effective implementation. East Africa is replete with well-articulated policies of every description. However, achieving their goals must overcome two obstacles: the absence of political will and weak capacity for effective policy execution. These two ingredients – will and skill – are vital to the success of any effort to transform the region.

Fortunately, the growing number and vibrant youthfulness of East Africa's people suggests that the supply of both will and skill is as limitless as the region's potential.