East African Economic Integration
Base Case Economic Analysis

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Abstract: *The paper presents a base case economic analysis of the current East African regional integration processes. The fast track political federation processes which started in 2004, establishment of East African customs Union (EAC-CU) in 2005, and the recent 2008 renewed African Economic Community initiatives are part and parcel of the third generation regional integration economic and political reforms pursued by the partner states, and aimed at fostering both national and regional competitive social economic capacities.*

The paper notes that East African economies are small, but with regional integration, there is a possibility for opening up new business activities, markets, access to finance and technology. These aspects are crucial for maximum utilization of natural and human resources for sustainable economic growth and reduction of poverty. Also, the paper finds that standards of living in these East African countries are similar, below average African continental standards and declining in many areas.

These similar features of the East African economies at the base year, suggest that further regional integration might provide a suitable mechanism for promoting economic growth and reduction of poverty through increased invest-ment, production and trade. But other features of the *EAC economies, such as high investment costs due to poor infrastructural services, have shown that step-wise regio-nal*

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integration may not provide a viable means of achieving the articulated equitable and sustainable economic growth. To realize this regional integration potential, there is need to search for new modalities of regionalism that lean towards more self reliance, indigenous control on natural resource utilization, cooperation and equal opportunities in the social and political economic development. These new cooperation arrangements have important contributions to make in helping to develop African social economic and political infrastructure and thus in reducing the region's unusually high transaction costs that inhibit trade, investment and economic growth.

Intégration économique de l'Afrique de l'est *Analyse économique*

Résumé *: Cet article présente un cas d'analyse économique des processus actuels d'intégration régionale de l'Afrique orientale. Les processus politiques qui ont suivi et débuté en 2004, la création de l'EAC-CU en 2005 et le récent regain communautaire de l'initiative Economique Africaine en 2008 font partie intégrante de la troisième génération du processus d'intégration économique régionale et des réformes politiques conduites par les États Membres, et visant à encourager la compétitivité économique au niveau national et régional.*

L'article note que les économies de l'Afrique orientale sont petites. Mais l'intégration offre des opportunités addition-nelles relatives à l'avènement de nouvelles activités commerciales, à l'accès au financement, et à la technologie. Ces aspects sont essentiels pour une utilisation optimale des ressources naturelles et humaines pour générer une croissance économique durable et réduire la pauvreté. En outre, l'article fait ressortir que le niveau de vie dans ces pays d'Afrique orientale sont semblables, inférieur à la moyenne et en, déclin dans de nombreux domaines.

Ces caractéristiques similaires des pays Est-africains, donnent à penser que l'intégration régionale plus poussée pourrait constituer un mécanisme approprié pour promouvoir la croissance économique et réduire la pauvreté par l'augmentation des investissements, la production et le commerce. Mais, d'autres caractéristiques des économies de l'EAC, tels que les couts élevés d'investissements en raison de la mauvaise qualité des infrastructures, ont montré que l'intégration régionale constitue une voie appropriée décision pour fournir un moyen viable de parvenir à la croissance équitable et durable articulé économiquement. Pour réaliser ce potentiel d'intégration régionale, il est nécessaire de rechercher de nouvelles modalités de régionalisme qui penchent vers une plus grande autonomie, et le contrôle des nationaux sur l'utilisation des ressources naturelles, la coopération et l'égalité des chances dans le développement économique, social et politique. Ces nouvelles modalités de coopération aident à développer l'infrastructure sociale, économique et politique et donc à réduire, des coûts de transaction de la région qui sont anormalement élevés et qui entravent le commerce, l'investissement et la croissance économique.

I. Background

It has been noted that, on the one hand, intensification of African regional integration may offer the most credible political strategy for weak and poor economically developing countries in the continent, (Ademola, 2000 and Adetula, 2004). On the other hand, the national economic weaknesses such as limited sizes, low capacities and inadequate resources of individual countries are major stumbling blocks to the form, direction, speed and expected benefits of regional integration. However, some of the low economic developing and small size countries, such as Rwanda, have shown that dynamic internal political and leadership commitment to investments, production and trade will put them in favorable conditions towards deep East African regional integration and have demonstrated capacity to overcome the daunting regional integration challenges.

It is suggested that on-going intensification of regional integration efforts will require a thorough assessment of initial economic conditions, bases, processes and the need to participate into East African regional integration, taking into account new African continental and global realities, (Adetula, 2004). This paper assesses the initial base year social economic performances and capacities of the East African Community countries.

The data and information analyzed at the base year will determine the objectives, modalities, format and expected results of the future steps required in the East African regional integration. We hypothesize that *birds of the same feather will always flock together*. It is suggested that Kenya, Tanzania, Uganda, Rwanda and Burundi have to focus and allow intensification of EAC economic regional integration as a first step towards political federation and African economic regional integration.

A key objective of the strategic moves must be to expand social economic opportunities for investment, production and trade that increase African incomes and tap unexploited resources—reducing dependence on the outside world and creating conditions for self-sustained and autonomous development, (Adetula, 2004).

These countries require policy, institutional and legal and regulatory capacities, to cooperate and integrate in meeting the challenges of domestic development, living standards, inflation, peace and security, environmental issues, political conflicts and instability, HIV/AIDS, malaria, and other social cultural indifferences.

1.1 Research objective, limitations of theoretical framework and available data

Current research objectives

The aim of this paper is to conduct a base case economic analysis of the current East African regional integration processes. This will be done by investigating economic information on the sizes and relative rankings, comparison of living standards, relative price levels, as well as comparative expenditure of East African countries at the base year 2005 relative to other African countries. In specifics, the paper will review a picture of these East African economies at the base year 2005, when the EAC common external tariff took effect on 1st January 2005 and provide policy recommendations on the way forward for the current social, economic and political regional integration process.

Research data base

The data and information about East African economies in this research paper is based on a study done by the African Development Bank, (2008), on *Comparative Output, Incomes and Price Levels in African Countries*. This is a United Nations *International Comparison Project*, (ICP), done by African Development Bank (AfDB) in 2005 with the aim of conducting global comparisons. A total of 48 African countries participated in this ICP and together they comprised the largest single regional participating group and one-third of the countries in the global comparison.

Research Model: Purchasing Power Parities

The Africa IPC study is founded on the theory and practice of Purchasing Power Parities. The Purchasing Power Parity, (PPP), is a form of exchange rate that takes into account the differences in price levels across countries. One can think of a PPP as a rate at which one country's currency would have to be exchanged to buy a homogeneous quantity of goods and services in another country. A PPP between two countries, A and B, is, therefore, the ratio of the number of units of country A's currency needed to purchase in country A the same quantity of a specific good or service as one unit of country B's currency would purchase in country B. PPPs can be expressed in terms of the currency of either country. Using PPPs allows for the comparison of real values of goods and services produced in various economies, adjusted through a common set of international (or regional) average prices. The PPPs can, therefore, be seen as the average price ratios in participating countries. This process allows for the removal of distortions caused by different price levels and market exchange rates observed between countries for similar goods and services, (African Development Bank, 2008). The PPPs generated for a country can then be used to facilitate real comparison of various economic aggregates across countries or across regions within the same countries.

Use and limitations of PPP's theoretical framework

We utilize the ICP data base to analyze the structural characteristics of the integrating East African economies, using international prices. We examine economic and price structures of these integrating countries at the base year 2005 in relation to other African countries. The objective is to investigate and provide policy recommendations to improve EAC competitiveness. While the use of PPPs provides a more robust method for spatial comparison of various economic aggregates across and within countries and regions, caution[2] must be exercised in using PPPs to draw conclusions about the appropriate exchange rates for any country. None the less it is one of theoretical investigation tools needed in the policy processes.

II. Recent East Africa and African Regional Integration Efforts

This section highlights the main events and processes which could be considered as recent East Africa and African regional integration efforts. These are fast tracking of Political Federation, Customs Union, and Agreement of the Free Trading Zone, (FTZ).

2.1 Fast Tracking of Political Federation

At their Extraordinary Summit in Nairobi on August 27-29, 2004 the Heads of State of the EAC countries resolved to expedite the process of regional integration so that the ultimate goal of a Political Federation is achieved, and

[2]Whereas PPP is a robust method for special comparison of economic aggregates across and within countries and regions, it should be used with caution: its theoretical assumptions of price flexibility holds only in the long run. When price-wage rigidities have adjusted; contract affecting transactions over different time-periods; have been synchronized; resource reallocation between tradable and non-tradable are adjusted; shifts in terms of trade have worked themselves out; and restrictions on trade, such as tariffs, are minor. For a theoretical discussion of the assumptions and limitations of PPP, see Caves, R.E., Frankel, J. A. and R. W. Jones (2007), **World Trade and Payments** 10th ed. New York, Pearson Addson Wesley chap. 19.2.

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directed that a Committee of three persons be set up to examine how the fast track mechanism can be achieved. The Committee on Fast Tracking East African Federation, led by Hon. Amos Wako, carried out wide consultations with the key stakeholders and submitted its Report to the 6th Summit of EAC Heads of State on November 26, 2004. The main recommendation of the Wako Committee was that a Political Federation is feasible and can be achieved through a fast track mechanism by 2010 as an interim period. The Committee recommended the period 2010 - 2013 as the consolidation phase during which the Federal Presidency could be held on a rotational basis amongst the EAC Partner States' sitting Presidents, to finalize the process towards election of the Federal Government.

The EAC Heads of State at their 3rd Extraordinary Summit in Dar es Salaam May 29-30, 2005 considered the Report of the Committee on Fast Tracking East African Federation and noted the positions of the respective Partner States on the various recommendations of the Report. The Heads of State then directed the EAC Council of Ministers to form national Consultative Mechanisms and collect views from the people of East Africa and report to the Summit the outcome in 12 months i.e., by May 2006. The objectives of the National Consultative Mechanisms were also to enlighten the general population, up to the grassroots, on regional cooperation and integration through sensitizing them on the benefits of the Political Federation, proposed structures of the federation and the proposed roadmap for establishing the Political Federation through rallies, meetings, and seminars/workshops.

The East African Heads of State met in 2008 and resolved that instead of fast tracking to political federation, these countries should first have a common market and a single currency by 2012, then move on to a political federation.

While noting indications for the support of East Africans for a political federation, the leaders decided to "move expeditiously towards establishing a common market and a monetary union by 2012." The common market would allow the free circulation of goods and movement of the people within the region. This marked the end of fast tracking of political federation.

The decision to end fast tracking efforts came after most Tanzanians rejected the proposal to fast-track the East Africa political federation whose ultimate objective was to have a federal president and parliament by 2013. Tanzania wanted a gradual movement towards the federation. It was argued that more time was required for consultations to take place in Rwanda and Burundi and there was a need to mobilize and deepen sensitization on political integration and stimulate greater political will to promote deeper economic integration.

2.2 The East African Community Customs Union

The EAC Customs Union (EAC-CU) Protocol entered into force on 1st January 2005, after its ratification by the EAC Partner States – Kenya, Tanzania and Uganda. The EAC common external tariff took effect on 1st January 2005; on the same date, tariffs on intra-EAC trade were partially liberalized and will be fully eliminated by the end 2009. For the last three years, EAC Partners Sates have been successfully implementing various EAC-CU policies, strategies and lines of activities. Studies suggest that there are three different types and levels but interlinked impacts associated with the implementation of the Customs Union in Tanzania, (Semboja, 2008).

The first round generic impacts of the establishment of the ECA-CU were institutional output results related with customs duties and customs operations, as part of the EAC-Customs Union protocol. These included an enactment of harmonized Customs Management Act and regulations which have thereon superseded the national Customs Laws and regulations of the three partner states. Transitional arrangements have been agreed upon. Also, the elimination of customs tariffs on goods originating from Uganda and Tanzania to Kenya is being effected on a phased basis in five years from coming into force of the Customs Union Protocol, based on agreed schedules.

The second generic impacts of the EAC-CU were related to direct firm economic impacts and performances. These were outcomes of the EAC-CU on business trade, business growth, and employment. Assessment of general firm economic performances entailed examining business issues before and after establishment of the EAC-CU, related with legal status of companies, forms of ownership, principle products/services of the firm, firms' sales, value and inventories; major production costs; normal mode of operation; rate of capacity utilization; input imports, output exports and models of financing.

The third and final general impacts of the EAC Customs Union were the creation of a single liberalized perfectly competitive output and input market of over 125 million people and a combined GDP of around US$30 billion.

There are suggestions that the EAC-CU has led to liberalization of intra-regional trade in goods on the basis of mutually beneficial trade arrangements among the Partner States, promoted efficiency in production, enhanced domestic and cross border trade plus foreign investment; it is also promoting economic development and diversification as well as industrialization, (Semboja, 2008). Specifically, the EAC Customs Union is designed to create a Common

External Tariff (CET) regime for goods originating from outside East Africa; establish Common Customs Laws and Regulations, which will apply uniformly in the Partner States; harmonize and simplify customs procedures and documentation.

2.3 Recent Deep African Integration Efforts

In October 2008, the EAC, after negotiations with the *Southern Africa Development Community*, and the *Common Market for Eastern and Southern Africa*, agreed to an expanded free single trade area that would pave the way for deep Africa economic development. The new African Economic Community and the Free Trading Zone have been agreed upon by 26 member states. These are: Angola, Botswana, Burundi, the Comoros, the DRC, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Lesotho, Libya, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Rwanda, Seychelles, South Africa, Sudan, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe.

The new trading bloc is only one state less than the membership of the largest economic community, the EU. The envisaged Southern, Central and East African free trade zone is expected to strengthen the region and foster much needed economic growth. The wider aim is to build the new regional economic community up into a stronger competitor in the global market economy, (WDR, 2005 and UNECA, 2006). This is seen as a crucial move particularly in an era of economic downturn where competition with protectionist economies is heightened. A more crucial point to note is that almost all of the member states of the new economic community are nurturing vibrant local economies. Rapid ideologically-driven integration or and wrongly politically motivated and unequal strength of other member states may be a constraint and thus prove destructive.

Global supply chains, while often operating as a disembedded circuit of trade relations, are fundamentally entrenched in local contexts, (UNECA, 2006). These local contexts are governed by national resources, priorities, the global market and membership of trade communities. Putting all these elements together — long-term (often exploitative) trade relations, entrenched modes of production and supply, and powerful systems of governance — results in an understating of just how cast - in - stone the trade relations may be. Clearly, African continental integration must begin somewhere, but an agreement to merge economic communities without first establishing and strengthening institutions and systems of governance will result in weak integration; a house built with twigs trying to protect itself against the big bad wolf.

2.4 Third generation regional economic integration

The first track political federation processes which started in 2004, establishment of EAC-CU in 2005 and the recent 2008 renewed African Economic Community initiatives are part and parcel *of the third generation regional integration economic and political reforms pursued* by the partner states, and aimed at fostering both national and regional competitive social economic capacities. To reap the benefits to the fullest possible extent, the East African countries needed to address national as well as regional *supply constrains and problems* that could negate the potential benefits from the EAC-CU, (Aryeetey and Oduro, 1996).

The intensification of regional integration, complemented with the lifting of barriers (both tariff and non-tariffs) and institutional capacity building measures, is expected to lower production costs, increase efficiencies and lead to an increase in social economic overall welfare. This, in turn, will improve the domestic competitiveness of national businesses; make the developmental strategy sustainable in the long term, which will be best achieved through trade liberalization.

Some studies found that the performance of regional blocs is constrained by: problems of variation in initial condition, compensation issues, lack of real political commitment, overlapping membership, policy harmonization, lack of diversification and poor private sector participation, (WDR, 2005 and UNECA, 2006). These problems seem to have made building successful economic groupings in Africa a daunting task, despite its perceived importance in the increasingly globalised world. This paper argues that the success or failures of these *third generation social economic and political reforms pursued* are complex functions of initial economic performances and capacities of member countries at the base years. The next section examines social economic conditions of EAC economies relative to other African countries at the base year 2005.

III. Base Case Economic Analysis

3.1 Economic Sizes

First and foremost the paper examines the sizes of East African economies relative to other African economies at the base year 2005, (ADB, 2008). Tables 1 shows the gross domestic product, (GDP), in real and nominal values, relative shares and ranks of East African and selected African economies at the base year 2005. The GDP is the most commonly used economic measure of the size of a country's economy. GDP is the sum of the value of goods and services consumed during a year and their respective quantities, (UNECA, 2006). The table provides summary statistical information on the distribution of Africa's GDP at current PPPs and prevailing exchange rates. ICP gives an opportunity to compare the size of heterogeneous economies on the basis of their purchasing power and rank countries' contributions to the region's output, (WDR, 2005 and ADB, 2008).[3] Data analysis reveals that when Africa's GDP is measured at PPPs, its size more than doubles in comparison to GDP size at market exchange rates, (ADB, 2008). This is because exchange rates often tend to understate the purchasing power of the currencies of developing countries, particularly for non-tradable goods and services.

Table 1 shows the well known feature of African economies i.e. the unequal economic sizes, and levels of development of its member states. These are a characteristic that can be found in other continental economic settings but the degree of inequality within African is noticeable. Table 1 shows that South Africa ranks number 1 and is responsible for about 22.35 per cent; followed by Egypt for about 19.88 per cent and Nigeria for about 13.91 per cent of the total African GDP. Regarding size and level of industrialization, South Africa completely dominates other Sub-Saharan African economies.

Table 1 shows that the total East African countries contribute about 8.6 per cent of the total African GDP. Kenya is in the lead; with a rank number 8, and is responsible for about 2.7 per cent; then followed by Tanzania for about 2.02 per cent and Uganda for about 1.48 percent. These results suggest that East African economies are small, but with regional integration there is a possibility

[3] The current results reveal some differences between previous estimates of GDP and GDP per capita published in the World Bank's *World Development Indicators* (WDI) and the results of the current ICP-Africa round.

for opening up new business activities, markets, access to finance and technology, (Aryeetey and Oduro, 1996). These aspects are very crucial for maximum utilization of natural and human resources for sustainable economic growth and reduction of poverty, (UNECA, 2006 and WDR, 2005).

Table 1: ***Real and Nominal Gross Domestic Product in Africa at the Base Year 2005***

	Real GDP		**Nominal GDP**		**Real GDP**
	Share (Africa=100)	Rank	Share Africa=100	Rank	Billion. US$
South Africa	22.35	1	28.84	1	397.46
Egypt, Arab Rep	19.88	2	11.78	3	353.41
Nigeria	13.91	3	13.52	2	247.24
Morocco	6.03	4	7.03	4	107.14
Sudan	4.48	5	4.19	5	79.59
Tunisia	3.64	6	3.46	7	64.79
Angola	3	7	3.61	6	54.97
Kenya	2.7	8	2.23	8	47.93
Tanzania	2.02	10	1.51	11	35.94
Uganda	1.48	13	1.09	15	26.25
Rwanda	0.4	33	0.28	34	7.15
Burundi	N.A.	N.A.	N.A.	N.A.	N.A.
Gambia	0.06	44	0.03	45	1.06
Guinea Bissau	0.04	45	0.04	44	0.75
Liberia	0.07	43	0.07	42	1.23

Source: *2005 ICP Final Results, WDI database (September 2007)*

Economic performance exhibits substantial disparities across the five sub-regions in Africa. North Africa recorded the highest acceleration in GDP growth, from 5.2 per cent in 2005 to 6.4 per cent in 2006. It is followed by Southern Africa, from 5.6 percent to 5.9 percent. There was a notable deceleration in growth momentum in West Africa, from 5.4

per cent in 2005 to 4.2 per cent in 2006. Heavy dependence on primary commodities remains a common feature of production, exports and growth in all sub-regions, (Aryeetey and Oduro, 1996).

This exposes the continent to external shocks and makes economic diversification a top priority for growth policies on the continent, (UNECA, 2006).

In East Africa, weather conditions as well as export commodity prices remained largely favorable despite sporadic drought in some countries. Higher oil prices were the main factor that prevented the sub region from achieving a higher growth rate as all the countries of East Africa are oil importers. Economic performance remained robust in Kenya (5.5 per cent), Tanzania (5.8 per cent), and Uganda (5.0 per cent) owing to higher commodity prices, especially tea and coffee. Burundi and Rwanda achieved higher growth rates in 2006 (3.8, and 4.2 per cent, respectively), thanks to growth in construction, trade and manufacturing, as economic activity is benefiting from the gradual restoration of peace in the region. This suggests that EAC countries are capable of converging towards each other and have a strategic a fundamental base towards a sustainable regional integration process, (Maleleka, 2007).

3.2 Economic Wellbeing

The second most important economic policy variable is the economic wellbeing of East Africans relative to other African economies at the base year 2005, (ADB, 2008). Real GDP per capita is one of the social economic indicators used to measure economic wellbeing and to distinguish between rich and poor countries. Deflating GDP by population removes the distortion created by population size and allows comparison of the standard of living across countries. Real

GDP per capita measures the flow of goods and services that are available to contribute to economic wellbeing. Table 2 shows the distribution of per capita income in PPP and in nominal terms (US$), by country. Table 2 suggests that, measured in terms of real GDP per capita, the five richest countries are Gabon (US$ 12,742), Botswana (US$ 12,057), Equatorial Guinea (US$ 11,999), Mauritius (US$10,115) and South Africa (US$ 8,477). Four of these five countries have small populations of between 1 and 1.7 million and their share in real terms of the regional output varies from 0.68 to 1.2 percent. Table 2 indicates that the region's average real GDP per capita is less than US$ 2,223 in PPP terms. This study considers the average real GDP per capita as a cut off point for poverty at macro levels.
Table 2 shows that the real GDP per capita for Kenya was US$ 1,359, followed by Tanzania US$ 1,018 and lastly by Uganda US$ 991 in the base year 2005. The real GDP per capita for Rwanda was about US $ 813 and about US$ 300 for Burundi. These results shows that on average the real GDP per capita for all East African countries are below the regions average real GDP per capita, suggesting that all are poor developing countries.

Table 2: ***Nominal and Real GDP per Capita for African countries***

	Real GDP/capita	Rank	Nominal GDP/capita	Rank
Gabon	12.742	1	6.19	2
Botswana	12.057	2	5.712	3
Equatorial Guinea	11.999	3	6.538	1
Mauritius	10.155	4	5.053	5
South Africa	8.477	5	5.162	4
Tunisia	6.462	6	2.896	7
Egypt	5.049	7	1.412	13
Kenya	1.359	25	0.531	27

Tanzania	1.018	31	360	32
Uganda	0.991	32	345	34
Rwanda	0.813	36	271	39
Burundi*	0.3	N.A.	N.A.	N.A.
Liberia	0.383	46	188	44
Congo, DR	0.264	47	120	46
African Average	**2.223**		**1.016**	

*Note * Data for Burundi was not included in computation and NA indicate Not Available*

***Data Source**: Africa Development Bank (April 2008) and CIA World Fact Book (2007 estimates)*

Kenya leads in terms of economic wellbeing. However, the disparities in real GDP capita are small, suggesting that these economies are comparable, i.e., they have more or less similar starting base cases. The economies of these countries are better than a number of countries. Table 2 shows that the poorest countries, namely Ethiopia (US$ 591), Guinea-Bissau (US$ 569) Zimbabwe (US$ 538), Liberia (US$ 383) and Democratic Republic of Congo (US$ 264) are least developing countries in Africa as per year 2005. Data analyses suggest that poverty is widespread in Africa; it is affecting countries irrespective of their natural resource endowment, population and economic sizes. Poverty is related with social and political crises in the region.

3.3 Living standards

The third most important economic policy variable the paper investigates at the base year, is the living standards of the people in East Africa, compared with people in other African countries, (ADB, 2008). The standard of living refers to the quality and quantity of goods and services available to people, and the way these goods and services are distributed within a population. The idea of a 'standard' may be compared with the ***quality of life***, which takes into account not only the material standard of living, but also other more subjective factors that contribute to human life, such as employment, leisure, safety, cultural resources, social life, mental health, environmental quality issues etc. More complex means of measuring well-being must be employed to make such judgments, and these are very often political, thus controversial.

The level of material comfort that an individual or group aspires to may include not only privately purchased goods and services but also collectively consumed goods and services such as those provided by public utilities and governments. While the full range of goods and services that enter GDP serve to measure countries' general economic development, to compare living standards in different countries, PPPs based on what household consumption should be is used. A more appropriate measure of economic well-being of the population is obtained by generating per capita actual Final Consumption Expenditure, (AFCE).

Table 3 shows the real and nominal per capita actual final consumption expenditure and price index for some African countries. Table 3 shows that Mauritius ranks highest in Africa in terms of standard of living. South African and Tunisia are second and third, respectively. The table shows that Congo DRC, Liberia and Zimbabwe have the lowest standard of living in Africa. The average African AFCE is 100.

Table 3: *Real and Nominal per Capital Actual Final Consumption Expenditure*

	Real AFCE/capita		**Nominal AFCE/capita**	
	Index	Rank	Index	Rank
Mauritius	488	1	527	1
South Africa	377	2	516	2
Tunisia	280	3	283	4
Egypt, Arab Rep	254	4	151	11
Gabon	214	5	314	3
Botswana	200	7	256	8
Kenya	77	19	64	26
Uganda	52	30	40	35
Tanzania	52	31	41	33
Rwanda	40	38	30	39
Mozambique	39	40	35	36
Malawi	33	41	29	40
Zimbabwe	28	45	27	43
Liberia	17	46	16	45
Congo DRC	10	47	12	46
Africa Average	**100**		**100**	

Data Source: *Africa Development Bank (April 2008) and CIA World Fact Book (2008 estimates)*

The AFCE index for Kenya, the leader in East Africa is 77 and ranks 19th in term of living standard in Africa. Table 3 suggests that Uganda and Tanzania have the same living standards, with AFCE index 52 and ranking 30th and 31st in Africa. However, it is important to note that the AFCE indices of all these East African countries are below the average for Africa. This suggests that the standards of living in these East African countries are below African standards and declining in many urban areas. Shantytowns that surround every capital city are similar and increasing. This suggests integrating or shifting people within East Africa countries may not be very problematic since they are used to similar economic and social life styles and conditions.

The common economic failures at the household levels have the following effects of undercutting a drive for political liberalization, raising ethnic, religious, gender and social rivalries to a dangerous level and forcing countries to impose politically inflammatory austerity such as cost sharing programs. But most of all it is spreading misery and unequal standard of living. In living standards, Africa is falling further behind the rest of the world. It is now the only continent where most poor people are getting still poorer and where health, education and other social services are deteriorating.

3.4 Price Levels

The fourth important economic policy variable this paper examines is the price levels in East African economies relative to other African economies at the base year 2005. A price index is a normalized ***average*** (typically a ***weighted average***) of ***prices*** for a given class of ***goods*** or ***services*** in a given region, during a given interval of time. It is a ***statistic*** designed to help to compare how these prices, taken as a whole, differ between time periods or geographical locations, (ADB, 2008). Price indices have several potential uses. For particularly broad indices, an index can be said to measure the economy's ***price level*** or ***cost of living***. More narrow price indices can help producers with business plans and pricing. Sometimes, they can be useful in helping to guide investment

The price level index (PLI) is the ratio of a country's PPP to the exchange rate of its currency to the US dollar. We can also define a price level index (PLI) as the ratio of a PPP to the market exchange rate of the numeraire currency. PLIs are used to compare price levels between countries. The price level index indicates the price levels of different countries relative to the Africa average. If the price level index of a country is higher than 1.00, the country is more expensive than average, and vice versa. The price level index is derived by dividing the purchasing power parity by the exchange rate of the US$ and the monetary unit of the country concerned, (ADB, 2008).

Price Level Indices for GDP in Africa 2005

Table 4.1 shows that PLI indicates the relative price of GDP (or its components) in a country, as if GDP were "purchased" after acquiring local currency at the prevailing exchange rate. PLIs are generally low in poorest countries. This reflects the common experience of travelers who find many (but not all) of the goods and services in the poorest countries relatively cheap compared to similar products in their home country.

PILs provide a comparison of the country's over all price level with respect to the African average. A PLI greater than 1 means that prices are higher than the region's average and a PLI less than 1 means that prices are relatively lower than the region's average, hence the price level index allow the identification of the most and the least expensive countries.

Table 4.1: ***Price Level Indices for GDP in Africa 2005***

	Index	**Rank**
Zimbabwe	3.27	1
Cape Verde	1.73	2
Namibia	1.48	3
South Africa	1.35	4
Comoros	1.27	5
Angola	1.22	6
Morocco	1.22	7
Djibouti	1.21	8
Cote d'Ivore	1.21	9
Equatorial Guinea	1.21	10
Kenya	0.86	35
Uganda	0.77	40
Rwanda	0.74	42
Madagascar	0.72	44
Tanzania	0.70	39
Burundi	0.70	45
Gambia	0.59	46
Egypt, Arab Republic	0.58	47
Ethiopia	0.56	48

Data Source: *Africa Development Bank (April 2008*)

Price levels generally increase with GDP per capita. In Sub-Saharan Africa, Zimbabwe, Cape Verde, Namibia, and South Africa have the highest prices; Ethiopia, the Gambia, and Burundi, the lowest. Zimbabwe is a noticeable outlier. Its price level index may be affected by high inflation and the disparity between its official exchange rate and the rate at which international transactions actually take place.

Comparing the GDP's price level indices of East African countries to the African Average, we find that Kenya has a price index of 0.86, Uganda is 0.77, Tanzania is 0.70, Rwanda is 0.72 and Burundi is 0.70. The PLI's of these East African countries are more or less the same and below the African average. This suggests that the costs of production in these East African countries are low compared to other African countries. However, low and poor production activities in these countries, may also suggest that lack of adequate investment and or that Africa is an expensive investment destination.

Price Level Indices for Fixed Capita Formation in Africa 2005

Several reasons account for the poor investment in East Africa and Africa in general. These can be attributed to high costs of investments and production. But, an understandable problem with investment in Africa may be linked to the abundance of its natural endowment in the absence of prudent policies, coupled with weak institutions, poor regulatory framework and lack of effective ownership, management and use of these resources by the indigenous population. Thus, Africa's generous bequest from nature, though a blessing, may in more ways than one be the leading stumbling block to investment on the continent, (Fine and Yeo 1997). The lack of effective ownership, management and use of these resources by the indigenous population is, in turn, linked to weak institutional structures in Africa – poor political settings, corruption, weak property rights, weak legal systems, and weak or imperfect markets.

The price level indices for Fixed Capita Formation are used as proxies for the cost of investments. (ADB, 2008). Table 4.2 shows the price level indices for Fixed Capita Formation, (PLI-FCF) in Africa 2005. The PLI-PCF may be used to measure hidden costs of investments. Table 4.2 shows further the PLI-PCF for Cote d'Ivore, DRC Congo and Equatorial Guinea as the leading most capital cost expensive countries while Malawi, Ethiopia and Egypt are the least capital cost expensive countries in Africa.

Comparing the PLI-PCF of East African countries with the African Average, it is noted that Kenya has a price index of 1.03, Uganda is at 0.95, Tanzania is at 0.83, Rwanda is at 0.82 and Burundi is 0.75. The PLI's of these East African countries are more or less the same and below the African average. This suggests that the costs of investments in these East African countries are low compared to those of many counties in Africa and therefore, the countries have an opportunity to attract foreign direct investments.

Table 4.2: *Price Level Indices for Fixed Capita Formation in Africa 2005*

	Index	Rank
Cote d'Ivore	1.92	1
Republic of Congo	1.92	2
Equatorial Guinea	1.60	3
Lesotho	1.43	4
Zimbabwe	1.39	5
Mozambique	1.35	6
Central African Republic	1.35	7
Sao Tome and Principe	1.29	8
Zambia	1.25	9
Cameroon	1.20	10
Kenya	1.03	22
Uganda	0.95	28

Tanzania	0.83	37
Rwanda	0.82	39
Burundi	0.75	44
Congo, Democratic Republic	0.72	45
Egypt, Arab Republic	0.71	46
Ethiopia	0.67	47
Malawi	0.46	48

Data Source: *Africa Development Bank (April 2008)*

There have been several studies which have identified the constraints to investing in Africa. These include corruption, weak infrastructure, increasing street crime, high inflation, poor financing, increasing organized crime, political instability, complex many and high tax rates, poor regulation, and fluctuating exchange rates. The poor infrastructure affects the supply of basic utilities needed for efficient production – water and electricity and thus the cost of investment and production. It is common to find entrepreneurs in East African countries making provision for generators and water tanks as back-ups in case of disruptions. This raises the cost of doing business and is a disincentive to investment.

Another constraint to investing in East Africa is the non-availability of skilled labour. The low level of education and literacy on the continent is a constraint on investment. Low-quality human capital implies lower productivity levels: this is matched with the wage bill, making Africa a high labour-cost environment. In summary, the combination of high regulatory costs, unsecured land property rights, inadequate and high-cost infrastructure, unfair competition from well-connected companies, ineffective judiciary systems, policy uncertainty, and corruption, raise the cost of doing business in Africa comparing to other developing regions.

Price Level Indices for Final Consumption Expenditure in Africa 2005

The cost of living in both rural and urban areas in EAC countries, has increased considerably in the recent years due to increasing food and energy prices, life style, technological development and globalization. Most large cities such Nairobi, Dar er Salaam and Kampala are not cheap places, particularly following property price increases, increasing rural-urban migration, liberalization of foreign exchange and capital markets. There is a large disparity between the cost and standard of living in the prosperous urban areas and those in the poor villages. However, it is interesting to note that the cost of living in the central urban areas in parts of East Africa's major cities, is much the same as in cities in developed countries elsewhere.

Food costs are slightly less in rural East Africa than in the urban areas. On the other hand, it is possible to live frugally in many parts of East Africa if you are willing to forego luxuries and 'live off the land'. Shopping for selected modern 'luxury' items (such as stereo equipment, electrical and electronic goods, computers and photographic equipment) from China, India and Middle East can also yield savings. Overall, it is difficult to determine an average cost of living in East Africa in comparison with other African countries. This is due to data limitations. We use the price level indices for Final Consumption Expenditure (PLI-FCE) as a proxy for cost of living, (ADB, 2008).

Table 4.3: ***Price Level Indices for Final Consumption Expenditure in Africa 2005***

	Index	**Rank**
Zimbabwe	3.57	1
Cape Verde	1.61	2
Angola	1.59	3
Namibia	1.50	4
Equatorial Guinea	1.47	5
Gabon	1.46	6
South Africa	1.36	7
Comoro	1.35	8
Botswana	1.27	9
Morocco	1.22	10
Republic of Congo	1.21	11
Congo, Democratic Republic	1.20	12
Zambia	1.13	13
Niger	0.92	31
Kenya	0.82	39
Tanzania	0.78	40
Rwanda	0.76	41
Uganda	0.75	42
Burundi	0.73	43
Guinea	0.73	44
Gambia	0.66	46
Egypt	0.59	47
Ethiopia	0.58	48

Data Source*: Africa Development Bank (April 2008)*

Table 4.3 shows the price level indices for Final Consumption Expenditure (PLI-FCE) in Africa 2005. The PLI-FCE may be used to measure costs living standards, i.e. the ***cost*** of maintaining a certain ***standard of living.*** Changes in the cost of living over time are often operationalized in a ***cost of living index***. Cost of living calculations are also used to compare the cost of maintaining a certain standard of living in different geographic areas. Geographic differences in cost of living can be measured in terms of relative ***purchasing power parity*** rates.

Table 4.3 shows the PLI-FCE for Zimbabwe as a very high standing at 3.57 at the base year 2005. The second high cost of living country is Cape Verde (1.61), followed by Angola (1.59), Namibia (1.50). Table 4.3 shows that Ethiopia (0.58), Egypt (0.59) and Gambia, (0.66) are the least cost of living countries in Africa.

Comparing the PLI-FCE of East African countries with the African Average, we find that Kenya has a price index of 0.82, Tanzania is at 0.78, Rwanda is at 0.76, Uganda is at 0.75, and Burundi is 0.73. The PLI-FCE of these East African countries are more or less the same and below the African average. This suggests that the cost of living in these East African countries is similar and low compared with many counties in Africa.

3.5 Relative investment expenditure

The fifth important economic policy variable considered in this paper is the investment expenditure in East African economies relative to other African economies at the base year 2005, (ADB, 2008). UNCTAD´s World Investment

Report 2006 notes that Africa received record high foreign direct investment (FDI) inflows in 2005 of US$31 billion, but this was mostly concentrated in a few countries and industries. A sharp rise in corporate profitability and high commodity prices over the past two years helped produce a growth rate of 78% in FDI inflows to the region. FDI continued to be a major source of investment for Africa as its share in gross fixed capital formation was about 19% in 2005. However, the region's share of global FDI remained low at about 3% in 2005. South Africa was the largest FDI recipient in the region in 2005, experiencing a sharp jump in inflows to US$6.4 billion from only US$0.8 billion in 2004. South Africa accounted for about 21% of the region's total. This was mainly due to the acquisition of Amalgamated Bank of South Africa by Barclays Bank (United Kingdom) for US$5.5 billion.

Africa's top ten recipient countries - South Africa, Egypt, Nigeria, Morocco, Sudan, Equatorial Guinea, the Democratic Republic of Congo, Algeria, Tunisia and Chad, in that order - accounted for close to 86% of the regional FDI total. In eight of these countries, FDI inflows exceeded US$1 billion (more than US$3 billion for Egypt, Nigeria and South Africa in particular).

At the other extreme, FDI inflows remained below US$100 million in 34 African countries. These are mostly the least developed countries (LDCs), including oil-producing Angola, which witnessed a drastic decline in FDI receipts in 2005 due to low prices and market instabilities. Many of the low FDI recipients in the region have limited natural resources; lack the capacity to engage in significant manufacturing, and, as a result, are among the least integrated into the global production system. Some countries have also experienced political instability or civil war in the recent past, which destroyed much of their already limited production capacity. FDI inflows to the region were concentrated in a few industries, such as oil, gas, and mining. Six oil producing countries (Algeria, Chad, Egypt, Equatorial Guinea, Nigeria and Sudan, in descending order of the value of FDI) accounted for about 48% of inflows to the region.

Although countries such as Kenya, Mauritius, Lesotho, Swaziland and Uganda had begun to receive FDI for their textile and apparel industries, due to the African Growth and Opportunity Act (AGOA), the trend changed following the end of the MFA[4] in 2005. In Mauritius there was a 30% contraction in the volume of garments manufactures in 2005 following the departure of Hong Kong (China)-owned companies. In Lesotho, six textile TNCs closed, with a loss of 6,650 jobs.

The setback demonstrates that the impact of trade-related initiatives can be short-lived in Africa, where domestic capabilities are inadequate for quickly absorbing and continuing production processes, (Fine and Yeo 1997). It also underscores the fact that Africa's industrial progress requires competitive production capacity, in addition to better market access and more welcoming regulatory frameworks. The persistence of the critical capacity problem may continue to hamper the region's ability to attract and retain FDI in the manufacturing sector.

FDI outflows from Africa in 2005 remained small and originated from a few countries. Six home countries --

[4] The Multi Fibre Arrangement (MFA), also known as the Agreement on Textile and Clothing (ATC)) governed the world trade in textile and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. This allowed developed countries to adjust to imports from the developing world. Developing countries have a natural advantage in textile production because it is labor intensive and they have low labor costs

Egypt, Liberia, Libyan Arab Jamahiriya, Morocco, Nigeria and South Africa -- accounted for over 80% of total outflows. The largest African TNCs are also from a small number of countries, (ADB, 2008). Gross fixed capital formation, as a measure of the country's investment expenditures, consists of many purchases of machinery and equipment goods and construction services. Gross fixed capital formation accounts on average for around 22 percent of regional GDP.

Table 5 presents real and nominal per capita GFCF in Africa at base year 2005. Table 5 shows that Gabon, Botswana, Equatorial Guinea, Mauritius and South Africa have the highest real GFCF per capita in Africa. The table shows that the real GFCF per capita index for Kenya was 49, followed by Tanzania at 48, Uganda 42 and Rwanda is 38. The real GFCF per capita indices for East African countries are below the average African index and their variations or disparities are small

Table 5 shows Price Level Indices, (PILs), at the level of gross fixed capital formation as a measure of the differences in investment prices between African countries in 2005, (ADB, 2008). On the one hand, Cote d'Ivoire and DRC Congo are almost twice as expensive as the average for the region. On the other hand, Malawi has the lowest PLI (0.46), for investment representing the cheapest investment destination in Africa. Table 5 shows that while PLI for Kenya is 0.89, Tanzania is 0.83 and Uganda is 0.95. The PLI for these East African counties is below the average for Africa (1.00) and variations are moderate. This suggests that investments costs are low and more or less the same in these countries.

Table 5: ***Real and Nominal Per Capita Fixed Capital Formation in Africa at base year 2005***

	Real GFCF Per capita		Nominal GFCF/capita		Real GFCF		Nominal GFCF	
	Index	Rank	Index	Rank	Share (Africa = 100)	Rank	Share Africa= 100	Rank
Gabon	745	1	731	2	1.23	15	1.24	15
Botswana	712	2	581	3	1.34	13	1.19	18
Equatorial Guinea	672	3	1.092	1	0.81	21	1.34	13
Mauritius	507	4	558	4	0.75	25	0.84	23
South Africa	404	5	455	5	22.43	1	25.8	1
Kenya	49	26	44	28	0.75	24	0.69	27
Tanzania	48	28	41	29	2.01	11	1.74	11
Uganda	42	31	40	30	1.31	14	1.29	14
Rwanda	38	32	32	35	0.4	33	0.34	34
Sierra Leone	23	40	18	40	0.14	39	0.11	39
Cote d'Ivoire	20	41	40	32	0.46	30	0.92	21
Congo, DRC	17	42	12	43	1.19	17	0.89	22
C African Rep	12	43	17	41	0.06	41	0.08	40
Africa Average	***100***		***100***		***100***			

Data Source*: Africa Development Bank (April 2008).*

CONCLUSION

Several similar features of the East African economies at the base year, such as small economic scale low standard of living, suggest that further regional integration might provide a suitable mechanism for promoting economic growth and reduction of poverty through the increased investment, production and trade, (UNECA, 2006). But other features of these economies, such as high investment costs due to poor infrastructural services, have shown that step wise regional integration may not provide a viable means of achieving the articulated equitable, converging and sustainable economic growth and poverty reduction objectives, (Adetula, 2004).

Yet, the potential for regional cooperation on a wide range of issues continue to exist in East Africa and Africa in general. To realize this potential, however, there is need to search for new modalities of regionalism that lean more towards self reliance, and indigenous control on natural resource utilization, cooperation and equal opportunities in social, political economic development[5], (Aryeetey and Oduro, 1996).

The principles of regional and national economic empowerment, patriotism and equitable benefit sharing could be usefully applied in this more targeting modality for defining the functions and powers of the various layers of the new regional cooperation institutions. These new cooperation arrangements have important contribution to make in helping to develop African social economic and political infrastructure and thus in reducing the region's

[5] This will be consistent if and only if there is political commitment, democratization and sense of political unity among African countries.

unusually high transaction costs that inhibit trade, investment and economic growth.

There are concerted efforts to establish a stable macroeconomic policy environment through regional coordination and harmonization of a wide range of policies, investment, production and trade enhancement – institutions in East Africa, (Semboja, 2008). African countries are being drawn increasingly into North –South type of differential trade agreements. In the absence of sufficient asymmetry of obligations and compensation packages, however, it is likely that these agreements will have substantial harmful impacts on the participating African countries, at least in the short run. In particular, these arrangements are likely to be strongly trade-diverting; and to have sharp negative impact in terms of fiscal revenue losses, de- industrialization and current account deficits.

It has been suggested that crucial policy issues in the success of integration schemes include speed, equitable distribution and effects of the gains from integration between countries, (Adetula, 2004). Locational effects have been important in these East African countries. It is noted that a common reason for the slow pace of regional integration in Africa is the concern among the poorest African countries that the implementation of the Custom Union may cause the few industries which they possess to migrate to industrially more advanced countries. The new economic geography of East Africa, after inclusion of Rwanda and Burundi, throws light on the location decisions of firms by focusing on the interaction between scale economies (which favor concentrating production in one or a few locations) and trade costs (of which investment, transport and energy costs are the most important but which also include any costs of moving goods to and keeping in touch with consumers). If production costs are equal, firms will want to locate close to consumers where the largest markets are. But there is circularity here. The largest markets will be where firms are located because of the importance of other businesses and employees as customers.

If some factors are immobile in the peripheral region, then a growing unevenness in dispersion of production will be accompanied by increasing costs of life and wage differentials. Eventually, relatively low costs may attract sufficient new investment to begin a process of cumulative growth and catch-up with the more prosperous regions, (Semboja, 2007). Then, the impact of regional integration on this process is likely to be ambiguous. Current data and statistics suggest that three years after EAC-CU, that poorer members in the East Africa such as Tanzania have failed to catch up with richer ones such as Kenya in terms of investments, production and trade performances. The more general lesson, however, is that current regional policies, laws and institutional settings will not facilitate any relocation of benefits as part of the process of regional integration. If it is politically unacceptable, then integration schemes need to include mechanisms which minimize or offset these effects.

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