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Regional Integration in East Africa; some lessons from history and thoughts on the way forward

1. Introduction

Please accept my most heartfelt thanks to the organisers for extending an invitation to me to this very wonderful event when Uganda is celebrating its golden jubilee since independence. I am greatly honoured by the invitation. Tunis is my second home having spent three and half years in this country serving as the Chief Economist at the African Development Bank. My return to the AfDB for the first time since my departure brings fond memories of my time here. I remain very grateful to President Kaberuka for giving me the opportunity to serve the premier African institution in that capacity.

One of the greatest achievements in the three and half years I spent at the AfDB was to present and position Africa as the next frontier for global development. Africa is a continent full of potential and should take its appropriate place in the global discourse. We should not be reluctant to remind our development partners that the time for Africa to take a lead in global growth has come. In the ten year period before the global financial crisis, Africa posted an average growth of 5.5 percent and has one of the fastest growing middle income populations in the world. The crisis has taken its toll on a number of countries across the globe, but the response in Africa has been quite impressive leading to only relatively short
lived adverse consequences in a large number of countries on the continent. The
cost is reflected in slower growth and the depletion of the buffers accumulated
over the years before the global crisis; the good news is that we have learnt from
the experience. We now need to accelerate the structural reforms to generate
more sustainable growth of the continent over the long term; and in particular to
generate far more formal sector jobs for the growing workforce.

Uganda will be celebrating her Golden jubilee on October 9th, 2012. The story of
Uganda over the past 50 years is one that is shared by many countries in Sub-
Saharan Africa. Many of these countries at independence had low levels of an
educated and experienced cadre to inherit leadership of the African states. As
President Kaberuka reminded us recently\(^1\) that, “Like all pioneers they often
made mistakes, sometimes costly ones, and you know the results, the history,
military dictatorships, one party states, and economic experimentation”. The
first years of independence were characterized by strengthening the state as a
tool to consolidate gains from independence. Given the weaknesses in the state
combined with internal and external shocks, and sub-optimal policies, the
economies stagnated. Countries opted to a shift to market based policies in the
1990s to restart growth. My aim today is not only to limit myself to the

\(^1\) Speech at the Annual Conference of Speakers of African Parliaments, Midrand, 30\(^{th}\) August 2012 on
“African Economic Integration-Time to raise the Bar”
experience of Uganda, but to share few insights about the other East Africa Partner States in a regional context.

I have chosen as my theme for this lecture the subject of regional integration. Although I will focus on regional integration in East Africa and our efforts to build the East African Community, many of the points I will make have relevance for the other regions of Africa, which are also implementing various regional integration initiatives, such as that of ECOWAS in West Africa and SADC in Southern Africa. Regional economic integration is a cause which is dear to the heart of President Kaberuka, who in a speech in August to the Annual Conference of Speakers of African Parliaments, argued for a deepening of African economic integration to put an end to the Balkanisation of the continent which is a legacy of colonialism. He pointed out that, although African governments have repeatedly committed themselves to the pursuit of greater regional economic integration, they have failed to implement these commitments fully, largely because perceived national self interest has taken priority over regional needs. He also told his audience that the AFDB has prioritised regional integration and has committed 11 billion dollars over the last five years to build the infrastructure to support regional trade in Africa.
My objective tonight is to convince you that transforming Uganda into a modern and prosperous country can best be secured through a deepening of regional economic integration in East Africa, under the auspices of the East African Community, and that this unavoidably entails the ceding of many elements of national sovereignty to the regional level. Regional integration efforts in Africa are often viewed with understandable scepticism by the public, not least because the continent has given birth to a plethora of different regional organisations, many with overlapping membership, which have delivered far less than they have promised. For reasons that I will explain, I believe that the East African Community can overcome the difficulties which have plagued other regional groupings and deliver tangible benefits for all of the five partner states, but only if we learn the lessons of past failures and have a very clear understanding of what regional integration entails and what this implies for the responsibilities of the partner states, both collectively and individually.
My talk will be in three parts. First I will explain why I believe that regional integration within the EAC is so important for Uganda’s prospects for long term development. Secondly, I will identify some of the lessons we must learn from previous regional integration efforts and from integration efforts in other parts of Africa if the EAC is to be a success. Finally I will set out what economic integration in East Africa implies for national policies and the pooling of national sovereignty at the regional level.
2. **Why is regional economic integration in East Africa essential for Uganda’s future?**

Uganda’s long term strategic development goal is to transform its economy to middle income status; which at a bare minimum requires a doubling of real per capita incomes. Such a structural transformation will only be possible with a radical improvement in our competitiveness such that the Ugandan economy can sustain rapid growth in productivity per worker and hence living standards. In successful developing economies, such as those in East Asia, structural transformation has almost always been driven by growth in trade. This is because there are strong, mutually reinforcing, linkages between competitiveness and trade. Open economies in which a large share of output is sold on world markets are subject to competitive pressures which provide strong incentives for domestic firms to continuously increase their productivity. In turn, economies which are more competitive are more able to penetrate export markets. By becoming more competitive and exporting more, we can help set in train a virtuous cycle which will propel growth and development.

The challenge facing Uganda, which it shares with many other African countries, is that large sections of its economy are characterised by very low productivity and are not anywhere near competitiveness on world markets.
However, many of these activities face very limited competitive pressure in the domestic market, because they are either non-tradable sectors or because they derive an element of protection from the very high costs of importing goods to a landlocked country; an example of the latter is food production. Because many goods and services are inputs into the production of other goods and services, low productivity in one sector often has adverse consequences for the competitiveness of other sectors of the economy. As a result, the economy becomes trapped in a low productivity equilibrium in which domestic producers lack both the incentives and the means to raise their competitiveness to levels required to penetrate global markets but can still survive in the domestic market. Uganda has recorded buoyant economic growth over the last two decades, averaging 7 percent in real terms, but a large part of this growth is attributable to the rapid expansion of the workforce, which in the 2000s grew by 4.7 percent a year, rather than to growth in factor productivity which has been very modest. In addition, it has not achieved very much structural transformation of the economy to raise productivity and until it does, growth of income per capita will remain very slow.

Regional economic integration can help Uganda to break out of this low productivity equilibrium through several channels. First, access to regional
markets offers a stepping stone for Ugandan producers to begin exporting, without first having to become globally competitive. Ugandan exports to our EAC partners are not subject to tariffs whereas competing goods from outside of the EAC are subject to the common external tariff. If Ugandan exporters can exploit this advantage, access to the EAC market offers them the opportunity to realise economies of scale which should reduce the unit costs of their production, thus boosting their competitiveness.

Domestic food production is a good example of how intra-regional trade could stimulate major changes in productivity, output and incomes. Productivity in this sector is pitifully low; the average value added per worker in Ugandan agriculture is only slightly more than $200 per year, which is lower than even the average for sub-Saharan Africa and far less than in most regions of the world which have undergone a green revolution. Productivity per worker in Uganda is very low because of the rudimentary farm technology employed and the low level of commercialisation; food growing smallholders are mainly subsistence farmers. These factors tend to reinforce each other, because there is little incentive for farmers who do not sell their output on the market to upgrade technology which involves purchasing farm inputs such as fertiliser.
Uganda exports a tiny fraction of the food it grows, only about 13 percent by value, even though it could grow substantial food surpluses for export. The regional food market offers huge potential for Ugandan farmers, which could spur the commercialisation and modernisation of smallholder agriculture, thus enabling Ugandan smallholders to raise productivity, add value to their products and increase their incomes. It will also give an incentive for everyone involved in food production and marketing to improve the quality of the product; for example by improving storage to reduce post harvest losses and ensure that the quality of food meets the proper standards. Regional integration alone will not bring about a green revolution in Uganda – this requires major supply side measures to support smallholder agriculture – but it does provide part of the solution by expanding the market available for food grown in Uganda.

The agricultural strategy should be comprehensive in terms of supporting the broad mass of smallholders in the country to adopt more modern farm technologies and to move away from subsistence farming to begin to produce for the market. I believe that the agricultural strategy should not be focused on promoting large scale commercial farming at the expense of smallholder agriculture. Although large scale commercial farming may be optimal for some specific plantation type crops, such as sugarcane, tea or palm oil, it is also not
desirable more generally because the social consequences of displacing smallholders from their land to make way for large scale commercial farms will be very harmful. Furthermore, there is little evidence that large scale farms are more efficient in Uganda or elsewhere in East Africa than small farms, especially in regard to food production.²

Secondly, the competition in the domestic market provided by imports and service providers from other partner states of the EAC will force Ugandan producers to become more efficient. Thirdly, Ugandan producers will be able to access more efficient factor and material inputs, from our partner states, thereby raising their own productivity. These advantages of course will only be realised if there is genuine economic integration in the EAC, with no restrictions on the movement of goods, services, labour and capital within the EAC. If we bow to sectional interests and try and maintain protection for domestic producers or domestic workers, the benefits of economic integration for the wider economy will be lost. Economic integration should also provide a stimulus to the development on a joint basis, by all the partner states, of regional infrastructure such as transport links and power grids, which are essential for reducing the onerously high costs of doing business in the region.

One of the arguments often made against regional integration is that Uganda is less developed than Kenya, especially in terms of manufacturing production, and hence Kenyan firms will benefit from the removal of intra-regional trade barriers at the expense of Ugandan firms (Refer to Graph 1 below). Similar arguments are made to justify why restrictions should be placed on the free movement of labour within the EAC. These arguments have no economic basis. Reducing barriers to intra-regional trade always confers mutual benefits on all of the economies involved. There will undoubtedly be some distributional consequences which adversely affect specific firms, but at the aggregate level welfare will increase in all five partner states. Furthermore, regional integration provides a very strong spur to economic convergence of the economies involved; this was very clear in the European Union after the accession of poorer new member states in the 1970s and 1990s. Over time per capita income in Uganda will converge towards that of the richest partner state in the EAC, which is Kenya.
3. Lessons from previous regional integration efforts

The EAC in its current incarnation is not the first time that East Africa has attempted to implement regional economic integration. Integration of the three East African Countries, Kenya, Uganda and Tanganyika evolved as a result of historical ties, influenced by the colonial rule. On one hand, the British colonialists developed common services in East Africa, such as Railways, Post Office and an Airline, partly as a means to reducing the costs to the British exchequer of subsidizing the services (Tarrosy, 2006). The common infrastructure therefore made easier the free movement of goods, services, persons, capital and labour among the three states. There was also the selfish interest of the colonisers of developing transport infrastructure to support trade
with their home countries. On the other hand, the pioneer leaders of post
independence states pursued African unity in principle and wanted to create
regional groupings although they did not pursue it with the “vigor, commitment
and sincerity it deserved”\(^3\). After independence, the three East African countries
as a compromise all agreed to turn their attention to economic cooperation,
thereby giving birth to the East African Community in 1967. The community
lasted for only 10 years, before it was dissolved in 1977. Twenty years later the
concept was revived, leading to the signing of the treaty to establish the current
EAC in November 1999. This raises the question of why the first attempt to
build the EAC failed and whether the current efforts have better prospects for
success.

The reasons for the failure of the first EAC to bring about regional economic
integration are not difficult to diagnose. By 1960, the three East Community
members had a total population of 24.4 million and a GDP of US$1.895 Billion.
The income per capita was on average about US$79 per capita. These were
small nation states relative to other countries in Africa and even combined, they
presented a small regional grouping that would gain enormously from pooling of
resources and jointly implementing development programmes. However, the
governments of the three partner states of the first EAC – Kenya, Uganda and

\(^3\) Kaberuka ibid
Tanzania – implemented very different political ideologies and this was reflected in different approaches to economic policy which hindered cooperation in that sphere. Furthermore, there was often mutual political distrust and antipathy between the governments, especially between Uganda and Tanzania during the years of the Amin dictatorship when Tanzania hosted Ugandan political exiles; trust is a basic tenet for the success of a regional grouping.

There is perhaps a more profound but less well understood reason why the first attempt to build the EAC floundered. During the 1960s and 1970s, all of the East African governments pursued much more interventionist approaches to economic policy than is the case today, albeit to different degrees. Tanzania and Uganda both had heavily regulated economies but even Kenya imposed controls over key areas of the economy, and crucially over foreign trade and access to foreign exchange.

These controls over the economy had very crucial implications for regional economic integration. This is because the largest benefits of regional integration to economic welfare arise from the greater intra-regional trade in goods and services and intra-regional investment which is brought about by removing policy induced barriers to trade and investment, through for example the
removal of tariffs on intra-regional trade. Welfare is improved because private agents within the region derive mutual benefits from greater opportunities to trade with each other. But if the governments involved in a regional integration scheme still maintain controls over trade and investment, for example by controlling access to foreign exchange, the opportunity for regional integration to boost intra-regional trade and investment will be negated and hence the most important potential welfare benefits will not materialise. Under the first EAC various regional institutions were set up, but even if they had worked properly, the benefits of these institutions for welfare in the three partner states were peripheral compared to the potential benefits which could have been realised by boosting trade and investment within the region. Because the essence of regional integration is the promotion of trade and investment by the private sector, its efficacy is premised on a largely liberalised economy, with relatively few government controls. Liberalising intra-regional transactions in the context of controlled economies makes little sense because we know from the theory of the second best that removing one set of distortions while leaving others in place does not unambiguously improve welfare. It is difficult to avoid the conclusion that the first EAC, in terms of economics, was misconceived.
If this diagnosis of why the first EAC failed is correct, it suggests that the prospects for success the second time around are much more auspicious. There is now much greater harmony and trust among the governments of all five partner states of the EAC than was the case between the three partner states in the 1960s and 1970s. Clear evidence for this is the unprecedented degree to which they are cooperating to address regional security problems; for example in Somalia where Burundi, Uganda and Kenya have each committed troops to support the transitional government. Divergent views on economic strategy between the partner states have largely disappeared; all of the five partner states have adopted an economic strategy entailing liberalised markets and a commitment to macroeconomic stability. The liberalised economies prevailing in each of the partner states also mean that removing barriers to intra-regional transactions will have a meaningful impact in boosting opportunities for trade and investment within the region. As such, regional economic integration is much more likely to enhance welfare in the liberalised economies which now characterise the EAC than was the case 40 years ago when the region’s economies were subject to extensive controls.

There is a further reason for optimism about the prospects for success in the EAC. The structure and policy objectives of the current EAC is much better
thought out than was the case in the 1960s and it follows a logical sequence of reforms, with each major set of reforms preparing the ground for the next set of reforms. The EAC began with the introduction of a customs union, which liberalised intra-regional trade in goods. This is the most straightforward reform to implement, although even this has still not yet been fully implemented: some non tariff barriers to intra-regional trade remain in place. The next logical step in the sequence is the adoption of the common market, which began with the signing of the Common Market Protocol in 2011, and will allow free trade in services and mobility of factors of production within the region when fully implemented. Once the customs union and common market are working well, intra-regional transactions should increase substantially and this will then provide a solid foundation for the introduction of a monetary union.

**Intra-EAC Trade**

Inspite the above challenges, combined with poor infrastructure in the region, intra-EAC trade has increased in varying magnitudes between 2005 and 2010—more than doubled in the case of Rwanda, Tanzania and Uganda, and increased by 50% for Burundi and Kenya (see Chart 2). Kenya’s exports to the EAC exceeded the other four countries’ exports, implying that the four countries are net recipients of goods from Kenya. Tanzania and Uganda also recently
recorded positive net balances on intra-EAC trade, which could be reflecting the effect of the informal cross border trade. Despite the upward trend, intra EAC trade as a share of total trade has stagnated at 20%.

Chart 3: Intra EAC trade (US$ millions)

Chart 4: Trade within the EAC and with non-EAC countries

4. The challenge posed by oil and gas for regional integration in East Africa

It is very likely that at least three of the EAC countries – Kenya, Uganda and Tanzania – will become producers of hydrocarbons – oil and/or gas - during the medium term. The exploitation of hydrocarbon presents both opportunities and challenges for the region. There is potential for these countries to leverage these resources for the improved welfare of its people. In addition, oil and gas production is not, per se, a barrier to regional integration; all but one of the six members states of the Communauté Économique des États de l'Afrique Centrale (CEEAC) are hydrocarbon producers. However, oil and gas production complicates macroeconomic management because of the inherent volatility of oil and gas revenues, and the challenges this poses for macroeconomic stability are exacerbated in a monetary union if volatile oil and gas revenues generate serious asymmetric macroeconomic shocks within the union; i.e. shocks which do not affect every partner state in an identical manner.

Regional integration offers opportunities for cooperation between partner states in exploitation of hydrocarbon resources and the available infrastructure which should lead to more efficient production, and hence greater welfare, than would be the case if each partner state developed its own oil and gas industry
unilaterally. This is because there are large economies of scale to be derived from jointly exploiting hydrocarbons and jointly building supporting infrastructure. Unfortunately, what is rational from the standpoint of exploiting hydrocarbons at the regional level will conflict with nationalistic sentiments in each of the countries.

The Way Forward for Regional Integration in East Africa

I want to conclude this lecture by discussing some of the implications of regional integration for national sovereignty. Regional economic integration unavoidably requires a pooling of sovereignty at the regional level; decisions which were once taken at the national level on an individual basis by each partner state must now be made collectively at the regional level. The pooling of sovereignty has already begun with the implementation of the Common External Tariff; each partner state now sets tariffs on imports from outside the EAC at levels which have been agreed collectively at the regional level. Partner states have ceded their right to determine their own trade policy to the regional level.

As we implement the common market, the need to pool sovereignty will intensify. For example, allowing for the free movement of capital within the EAC requires a common set of banking laws. If each partner state imposed its
own individual banking laws, financial institutions would have incentives to locate in the state with the most lenient regulations, and use this state as a base from which to serve the rest of the EAC. This would spark a race to the regulatory bottom. Similar principles apply to the taxation of corporate income. If there are differences in tax regimes between the five partner states, companies will gravitate towards the state with the lowest tax burden, using this state as a base for exporting to the rest of the EAC. The desire to attract investment will provoke a beggar thy neighbour approach to tax policy, for example by offering firms ever more generous tax holidays. The only way to prevent this is for the EAC to agree on a standard tax regime to be applied across the five partner states.

The introduction of a monetary union has even more profound implications for the loss of national sovereignty. Each partner state will obviously give up independent national monetary and exchange rate policies. This will leave fiscal policy as the only tool of macroeconomic management which remains in the hands of national policy makers. But even fiscal policy will be circumscribed by regionally imposed constraints in the form of fiscal rules on public debt and budget deficits. Such fiscal rules are necessary to prevent expansionary fiscal policies at the national level from threatening sovereign default which would in
turn have potentially disastrous contagion effects in other partner states. The risk of region wide contagion from a sovereign default would put huge pressure on the regional central bank to bail out the defaulting sovereign, which would undermine the credibility of its monetary policy.

A potential drawback of the monetary union mainly stems from the unavoidable fact that a common regional monetary and exchange rate policy cannot simultaneously be optimal for each partner state if they are suffering from asymmetric macroeconomic shocks. If one economy is booming and its neighbour is in recession, the monetary and exchange rate policy which is optimal for the former cannot be optimal for the latter. These are some of the causes of the problems currently afflicting the Euro zone. The region should design mechanisms for supporting countries afflicted adversely by a desirable macroeconomic policy stance at a regional level.

Even before we face the challenges of a monetary union, the region faces the challenge of how to promote an effective customs union or monetary union in the face of multiple memberships. The countries currently belong to competing trade blocs with conflicting convergence criteria. Uganda, Burundi, Kenya and Rwanda currently belong to both COMESA and EAC while Tanzania currently belongs to both SADC and EAC. It is difficult, if not impossible, to design an
effective customs union with a single external tariff and cede sovereignty to regional institutions under multiple membership. This must be addressed by the countries as a priority to the success of the East African Community.

If we are to pool sovereignty at the regional level, with important decisions which affect the welfare of the citizens of each partner state taken by regional institutions such as the common central bank, we must also create regional political institutions which have democratic legitimacy and which can provide the democratic oversight and accountability for decision making at the regional level. If this is not done, the citizens of the East Africa will feel increasingly alienated from those who make decisions on their behalf. Hence the logic of regional economic integration leads unavoidably towards political union in East Africa. If we look forward to 2062, on the 100th anniversary of Uganda’s independence, I think it is almost inevitable that the political map of East Africa will be radically different to that which exists today, with some form of political federation encompassing all of the present day partner states of the EAC and perhaps also some of our immediate neighbours.

Thank you for listening to me.

Louis Kasekende (PhD)