



The Horn Economic and Social Policy Institute

ENHANCING THE DEVELOPMENT OF THE PRIVATE SECTOR FOR INCLUSIVE GROWTH AND JOB CREATION IN THE IGAD

Osman Sheikh Ahmed (PhD)
(Visiting Scholar of HESPI)



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The Horn Economic and Social Policy Institute (HESPI)

HESPI is an autonomous regional institute that conducts economic and social policy research, policy analysis and advisory service to assist African governments, the private sector and other stakeholders with a special focus on the IGAD sub-region. HESPI conducts commissioned studies and interacts with principal policy makers and change agents to address the challenges the region faces. HESPI's focus also covers institutional capacity building and instilling values for better management of social and broad based sustainable economic growth aimed at prosperous future for the region.

APPFEVIATIONS AND ACRONYMS

AfDB	African Development Bank
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ECOWAS	Economic Community of West African States
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GCI	Global Competitiveness Index
HDI	Human Development Index
ICT	Information and Communications Technology
IFC	International Finance Corporation
IFIs	International Financial Institutions
GCI	Global Competitiveness Index
GII	Global Innovation Index
IGAD	Intergovernmental Authority on Development
MDBs	Multi-lateral Development Banks
MSME	Micro, Small and Medium-scale Enterprises
PPD	Public Private Dialogue
PPP	Public-Private Partnership
PSD	Private Sector Development
RECs	Regional Economic Communities
SADC	Southern African Development Community
SME	Small and Medium-scale Enterprises
UNDP	United Nations Development Program
WEF	World Economic Forum
WIPO	World Intellectual Property Organization

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EXECUTIVE SUMMARY¹

The IGAD region has tremendous untapped potential, including abundant agricultural and livestock resources, considerable mineral, hydrocarbon and water resources, unique tourism assets, and a long coastline lying along the busiest shipping lanes in the world. While there are variations between countries, the region on the whole has lower per capita incomes, higher poverty levels, and lower access to basic social and infrastructure services than most other regions. The region's economies are also characterized by dependence on primary production, undiversified exports, and low levels of industrialization and technological absorption. The region lags behind most Regional Economic Communities (RECs) in Africa and the rest of the world in all measures of development.

The challenge for the IGAD states is to address the obstacles and constraints which stand in the way of realizing their potential, and use their considerable endowments to propel the region forward, to meet the aspirations of its peoples

An important avenue to realizing that potential is the development of the private sector—the most viable vehicle for sustained economic growth and job creation. That would in turn depend on adequately addressing the most binding constraints to improve the business environment, increase the economic space for private activities while enhancing the synergy and complementarity of the public and private sectors, and improving the overall economic management of the economy.

The main common constraints and impediments to private sector development in the IGAD region are: (i) restrictive policies and regulations in such areas as business startups, getting land and construction permits, registering property, resolving business conflicts, and providing avenues for exit and insolvency; (ii) limited access to infrastructure services, particularly transport and power (iii) low skill level of the work force which results in low global competitiveness; (iv) limited access to finance and credit; (v), limited access to, and even rationing, of foreign exchange, which tends to favor public or government-affiliated enterprises; (vi) low intra-regional trade and investment which particularly affects smaller economies and militates against economies of scale; and (vii) poor economic and political governance issues. In addition, political instability in a number of countries may discourage private investment, domestic and foreign, that is highly sensitive to uncertainties and risks.

The region has made strides in recent years to address a number of these impediments, especially in infrastructure where a number of major projects are ongoing or in the pipeline in a number of countries. Also, the constraints are not equally binding in all the countries. But overall, the region has still a long way to go to access the full potential of its economy; and that of private economic activity in particular. To address the remaining constraints and move on a proactive agenda of private sector development, some of the following actions should be considered:

- The policy makers should start with reforming and further simplifying the laws and regulations that govern businesses in the countries where the business environment is not yet fully conducive to private investment (and this includes most of the countries in the region but in varying degrees), particularly in facilitating private direct investment. Attracting Foreign Direct Investment (FDI) can have a catalytic impact on domestic businesses (through linkages, supply chains, technology

¹ Dr. Osman Ahmed is a former senior official of the World Bank/IFC and the Islamic Development Bank. He also worked with both the public and private sectors in the US and the Middle East and written extensively on economic and social development issues, including on private sector development.

and know-how transfers etc.) and impact on overall country/regional development. International experience has shown that generous incentive packages such as tax holidays and exemptions, which many countries rely on, are not as effective as macroeconomic and political stability and policy consistency.

- Clearly delineate the respective roles of the public and private sectors to reduce uncertainties and create space for private activities. Restrictions on the entry of the private sector, including FDI, into some productive activities (e.g. financial services, ICT) would need to be eased or lifted; and the crowding out of the private sector by public enterprises in the allocation of financial resource needs to be addressed.
- Improve physical and financial infrastructure services. The countries in the region are among the lowest in the world, in terms of meeting infrastructure needs of their economies. Major investments would be needed in all the countries to bring the region on par with other RECs in Africa and beyond. External sources of financing, and Public-Private Partnerships would need to be sought. Restrictions on private sector entry into the financial sector, including by FDI, would need to be reassessed with aim of removing them.
- Establish regular public-private dialogue for more effective interaction and collaboration between governments and the business community. Public-private dialogue (PPD) is essential to get business input in reforms intended to improve the business environment, and to convey government policy directions and its vision for the future, on a transparent and open platform. Public private dialogue is well accepted in almost all countries in the region but effective two-way interactions are not always there.
- Foster entrepreneurship development and promote Micro and Small and Medium-scale Enterprises (MSMEs), where the bulk of businesses belong and a key for job creation. The emphasis could initially target unemployed youth and recent secondary and university graduates looking for work who have base level of education but lack practical business skills.
- Develop value chains and promote diversification. *Diversification* of products and export markets, improvements in productivity (by adopting globally available technologies, for example), and *value-addition* in main productive sectors would advance sustainable growth and create jobs. This is particularly important for sectors such as agriculture and livestock where the bulk of the poor earn their living. Enhancing the productivity and value addition in those sectors would have a direct and immediate impact on poverty reduction.
- Promote knowledge and innovation. Pursuing a knowledge and innovation-based development is feasible even for the least developed countries in this era of global knowledge and cross-border information sharing. The fact that countries like Kenya and Somalia are at the forefront of mobile banking is an indication that IGAD countries can find niches where they are highly competitive or exceed expectations.
- Ensure enhancements of the efficiency and effectiveness of the public sector, and its interface with the private sector. In particular ensure proper management of natural resources such as

minerals and hydrocarbons, and avoid “resource curse”, which can stunt productive sectors, fuel corruption, and contribute to conflict in fragile states.

The above principals are meant to provide a basis for discussion and further drilling-down by policy makers and key stakeholders on how to develop the private sector and to advance the development objectives of countries in the region. Good policies, enhanced human capital and seizing opportunities in the global economy, where knowledge, innovation and technology can be accessed and utilized, and borrowing successful experiences and best practices from others, can help the IGAD region to become economically competitive and use its considerable potential for improvements in the welfare of its people and to contribute to the wider world.

INTRODUCTION

As noted in HESPI's analysis of IGAD economies (2013), most IGAD member countries are among the least developed in the world by all indicators of development. Though variations among member countries are significant, all lag behind most regions in the world, as measured by GDP per capita income, poverty levels, improvements in health and education, access to roads and communication etc. Despite the potential to excel in tourism, in utilizing their natural resources, young labor force, and sizable diaspora; countries in the region have yet to embark on a stable growth path².

The objective of this study is to examine the private sector, a key vehicle for embarking on a sustained growth path, and explore ways of enhancing the development of the sector and its contribution to the overall development goals of countries in the region—sustained growth, job creation and poverty reduction.

The study examines the current status and performance of the private sector in IGAD states, drawing commonalities and contrasts between countries, and analyzing the main impediments and constraints it faces and how those can be overcome. It also examines the role that regional integration can play in opening opportunities for trade and investment. The study makes broad proposals, at the policy level, for moving forward on an agenda for private sector development (PSD). Those proposals are intended to provide a basis for deeper discussion by policy-makers and key stakeholders, on developing a holistic regional strategy and action plans for PSD.

The study report covers Djibouti, Eritrea, Ethiopia, Kenya, Somalia and Uganda. Sudan and South Sudan are not included mainly because of lack of data. While there is also very little data and information on Somalia's economy, there is more available on the private sector, which has drawn a lot of attention for its performance under a situation of absence of effective state authority.

The main data sources are various country reports by World Bank, African Development Bank and other international organizations, and cross-country studies by the World Economic Forum, the World Intellectual Property rights, UNDP and the World Bank's Doing Business Reports. One difficulty in conducting this study was limitations and inconsistencies on data in a number of countries. Reliable data and information on the informal sector, which is normally unregistered and unrecorded, is particularly difficult to get, even though this is a critical sector for the IGAD economies, particularly for overall employment and poverty reduction.

Section I of the paper covers the overall background, including socio-economic conditions. Section II analyzes the structure and performance of the private sector and the main constraints it faces. It does so for the region as a whole in section II. 1 and separately for the six countries covered by this study in section II.2. A regional perspective on key social and economic issues and their policy implications is covered in Section III. The international experience and lessons that can be learned from the successful efforts of other countries is provided in Section IV. Finally, proposals on actions needed to address the issues discussed above, and a roadmap for moving forward on a private sector development agenda is covered in Section V.

² HESPI, annual report on the state of IGAD economies, trade performance and prospects, July 2014

I. BACKGROUND

With high levels of poverty, and unemployment, dependence on primary production, undiversified exports, and low levels of industrialization and low technological base, the IGAD region needs a concerted collective effort to move forward. In a globalized world, with fast-paced technological advancements, the gap between the region and the rest of the world would, without concerted actions, become even wider. But with its considerable natural and human resources, and the diversity of its physical environments, the region can, with the right policies and strategies, succeed and catch up with other developing sub-regions. Private sector development (PSD) would be key to such success. Realizing the potential of IGAD economies would depend on tapping the unrealized potential of the private sector. That would in turn depend of improving policy and regulatory environment, addressing the interlocking challenges of raising skill levels of the workforce, infrastructure deficiencies, access to finance, and enhancing the overall productivity and competitiveness (regionally and globally) of IGAD economies.

Beyond economic growth and increased competitiveness, the level of human well being is a key indicator, as well as determinant of the level of development of a society. The UNDP's Human Development Index (HDI) was created to emphasize that people and their capabilities should be the ultimate criteria for assessing the development of a country, not economic growth alone. Broadly, the main measures of HDI are a long and healthy life, being knowledgeable, and having a decent standard of living.

Almost all IGAD countries are towards the bottom of HDI with Eritrea, Ethiopia and Djibouti ranked at 186th, 174th and 168th respectively out of the 188 countries included in the 2015 report. Kenya (145) and Uganda (163) are slightly better placed and Somalia was not included in the exercise (table 1, below)

Table 1: Human Development Index, 2015

Country	Index	Ranking
Norway	.994	1
Switzerland	.930	3
Kenya	0.548	145
Uganda	0.483	163
Djibouti	.047	168
Ethiopia	0.442	174
Eritrea	0.391	186
Somalia	NA	NA

Source: UNDP, Human Development Report, 2015

II. THE ROLE, STRUCTURE AND PERFORMANCE OF THE PRIVATE SECTOR

1. The Private Sector Across Countries in the Sub-Region

There is full consensus that sustainable economic development cannot be achieved without a vibrant private sector. It is also recognized that private sector is essential for advancing all countries' development goals-- inclusive growth for poverty reduction and job creation; and international experience collaborates that view. However, that realization is not always reflected in government policies or in the relations between the public and private sectors, in the IGAD region.

With the exception of Kenya, which has, the most developed private sector in IGAD, and indeed in the wider East Africa region, the sector remains weak, underdeveloped and operates at substantially below its potential. In all the countries, the performance of the private sector is constrained by a difficult business environment which makes it among the most difficult regions to do business worldwide, according to World Bank's Doing Business reports, an annual exercise that ranks world economies on the ease of doing business³. Table 3 below shows the global ranking of the IGAD countries overall and in 10 key areas which are important to businesses—registration and licensing, getting, permits, access to finance and credit, access to physical infrastructure, minority shareholder protection, contract enforcement, and exit mechanisms. Rwanda's ranking is including table 3 to show progress made by a post conflict country in the region.

2. Status, structure and performance of the private sector by country

DJIBOUTI

The Djiboutian economy grew at an annual average of 6.3% in 2014 – 16 and is expected to grow at 7% in 2017⁴. Economic activity in Djibouti is driven by port-related activities such as transit trade with Ethiopia and transshipments. The economy is highly dualistic with a modern sector based on rental revenue from ports and military bases rented to industrial countries, on the one hand, and a large informal sector concentrated in trade and services, on the other. Because of its extremely arid environment, agriculture plays a minimum role in contrast to other countries in the region. Djibouti is a lower-middle-income country, with a per-capita income of about US\$1,787 in 2015 (almost three times

Table 2.1. Djibouti – Selected Economic and Financial Indicators

	2014	2015	Est. 2016	Proj 2017
Population (in millions)	0.939	0.966	0.993	1.020
GDP (in billion \$)	1.589	1.727	1.894	2.088
GDP growth (in percent)	6.0	6.5	6.5	7.0
Inflation (in percent annual average)	2.9	2.1	3.0	3.0

Source: Djibouti authorities; and IMF staff estimates and projections

³ World Bank Group: Doing Business—Measuring Business Regulations
<http://www.doingbusiness.org/rankings>

⁴African Development Bank, Djibouti Economic Outlook, 2016 @ <https://www.afdb.org/en/countries/east-africa/djibouti/djibouti-economic-outlook/>

that of Ethiopia), yet estimates suggest that 42% of the population lives in extreme poverty (compared to 33% in Ethiopia).⁵

According to the World Bank, Djibouti’s private sector consists of approximately 3,000 companies, about two-thirds of which are informal, individually-owned microenterprises with one wage earner on the average⁶.

As shown in table 3, Djibouti ranks 171 of 190 economies worldwide on the overall ease of doing business, but with wide variation in performance on individual components of the index. The ranking of Djibouti on those components range from a relatively good performance on facilitating cross-border trade (60th) and resolving conflicts (71st) to low performance on access to credit (181st) and protecting investors (178th). Though still ranked low, it has substantially improved in some components such as business startups—from 188th in 2013 to 172nd in 2016. Efforts to update commercial legislation to facilitate start-ups are ongoing.

Main constraints

The key constraints and impediments to private sector growth, in addition to cumbersome legal and regulatory framework, include the high labor costs (an unskilled worker earns more than four times the monthly wage of counterparts on Ethiopia), low worker productivity, and high cost of electricity and telecommunications supplied by government-owned monopolies. Electric bills, for example, can account for approximately 25 percent of business expenses, and businesses note the high cost of electricity and outages as one of their most critical constraints. Access to telecommunications services is limited, and expensive compared with some countries in the region (e.g. estimated at about \$10 a month in Somalia against more than \$60 in Djibouti).

ERITREA

Eritrea’s GDP growth was estimated at around 4.5% in 2014-16. Despite recent growth (resulting mainly from the mining sector), Eritrea remains one of the least developed countries in the world. About 65% of the population lives in rural areas and 80% depend on subsistence agriculture for their livelihoods. Eritrea’s Human Development Index is among the lowest in the world (Table 1) and way below the average for Sub-Saharan Africa⁷.

The private sector in Eritrea is small and underdeveloped. Outside of agriculture, the private sector is concentrated in the service sectors. The public sector dominates the economy with

Table 2.2. Eritrea – Selected economic and financial indicators

	2014	2015	Est. 2016	Proj 2017
Population (in millions)	5.1	5.2	5.4	5.5
GDP (in billion \$)	5.44	5.70	5.911	6.11
GDP growth (in percent)	5.0	4.8	3.7	3.3
Inflation (in percent)	10.0	9.0	9.0	9.0

Source: Eritrea authorities; and IMF staff estimates and projections

⁵ World Bank: Djibouti Country Partnership Strategy, (2014-2017)

⁶ Ibid p. 13

⁷ World Bank: Eritrea Country Overview, December 7, 2016

a heavy government footprint, in terms of control and ownership. Privatization of some state-owned enterprises was announced in 2012 but implementation has been slow. The small private sector outside of mining is concentrated in the informal sector.

In recent years, the mining sector has shown considerable potential as a source of foreign direct investment (FDI), which accounted for 28% of gross capital formation in 2010 (compared to 8.8% in the East Africa region)⁸. However, investments in the mining have been declining because of regional instability, governance challenges, and continued UN pressures on the mining companies.

Remittances from the Diaspora, an important source of Eritrea's capital inflows and a lifeline for many families, declined sharply in recent years. From a high of about one-third of GDP in 2005 it declined to 16% of GDP in 2008 and to 7.2% in 2014. The sharp decline in remittances was due to combination of factors including support by Eritreans in the diaspora for people to leave Eritrea instead of mainly supporting relatives at home, and external restrictions resulting from the UN sanctions. However remittances will continue to be an important source of capital inflows over the long term.

Main constraints

The main constraints to private sector development in Eritrea are: difficult macroeconomic and exchange rate policies, and restrictive laws and regulations affecting private activities. Limited infrastructure (particularly roads and energy), poor skill level of workers, lack of access to credit and foreign exchange, and global isolation resulting from UN sanctions are also key impediments to doing business in Eritrea. Access to credit and foreign exchange are particularly binding.

Shortage of foreign exchange for essential imports is a major constraint to businesses. The domestic currency, the Nafka has been fixed at 15.38 since 2005 while the parallel market was over three times the official rate in 2013, and foreign exchange is rationed, putting private sector business at a clear competitive disadvantage with public and favored private entities that can access foreign currency at the official rate. The decline in remittances (from 16% to 7.2% of GDP between 2008 and 2014) has put further pressure on the exchange rate.

Eritrea's financial sector is weak with only four banks, three of them government owned. It also is not integrated into the sub-region's financial system because the country has not yet fulfilled the precondition for COMESA membership and has not, as a result, been able to attract investment from the region

The World Bank's Doing Business Report ranked Eritrea as second to last (189) out of the 190 countries in 2016. As shown in Table 1, the country ranks low on all components of the Doing Business index--

⁸ African Development Bank: Eritrea, Interim Country Strategy Paper 2014-2016

ETHIOPIA

Ethiopia experienced a robust economic growth during the past decade growing at an average of 10.8% during 2004-15. This overall growth resulted in improved human development indicators. According to the World Bank, Ethiopians living in extreme poverty (those living at \$1.9 a day or less) as a percent of the population was reduced from 55.3% in 2000 to 33.5% in 2015⁹. However, starting from a low base, the country remains one of the poorest (9th) in the world¹⁰.

Annual growth seems to have slowed

down but is still relatively high by global standards—at annual average of 9% in 2014-16. Ethiopia's recent fast growth was fueled by agriculture and services, which account for 48% and 38% of GDP respectively. The agriculture sector accounts for 80% of employment and 85% of Ethiopia's exports¹¹. The manufacturing sector's contribution, on which the Government banks as a driver of its Economic Transformation Plan, intended to help transform the country into Middle-Income status by 2025 has been stable at around 4%¹².

Public investment has been a key ingredient in economic growth. Despite attempts at privatizing state-owned enterprises, several large enterprises that the Government considers strategic, remain in the public domain resulting in limited scope for private participation and competition¹³. Ethiopia had the third highest rate of public investment in the world with public investment amounting to 18.6% of GDP in 2011 and exceeded only by Turkmenistan (38.6 percent) and Equatorial Guinea (24.3 percent). Private investment rate at 6.9% of GDP was, on the other hand, the sixth lowest in the world¹⁴

While current emphasis on public investment, particularly on infrastructure, has resulted in high growth, the sustainability of that growth would depend on the private sector playing an increasing role in the economy. International experience, including East and South-east Asia, demonstrates that for long-term growth the private sector would need to be the engine of growth. In Ethiopia, non-agriculture private sector is presently composed mainly of informal, service activities.

Main constraints

Besides public sector dominance, some of the key constraints to private sector development are cumbersome regulatory procedures, which particularly impede business start-ups, and access to credit and foreign exchange. Infrastructure services, while improving, are still inadequate.

Table 2.3. Ethiopia – Selected economic and financial indicators

	2014	2015	Est. 2016	Proj 2017
Population (in millions)	96.6	98.9	101.9	104.3
GDP (in billion \$)	55.51	61.63	69.22	76.91
GDP growth (in percent)	10.3	10.2	6.5	7.5
Inflation (in percent)	8.1	7.7	9.7	8.2

Source: Ethiopia authorities; and IMF staff estimates and projections

⁹ World Bank: Ethiopia, Economic Overview October 11, 2016

¹⁰ World Bank: Country Partnership Strategy (2012-2016)

¹¹ African Development Bank, Ethiopia Country Strategy (2011-2015)

¹² World Bank: 4th Economic Update—overcoming constraints in manufacturing sector, July 2015

¹³ World Bank: Ethiopia Economic Update --Laying the Foundations for Achieving Middle Income Status June 2013.

¹⁴ Only Angola, South Sudan, Malawi, Swaziland and Azerbaijan had lower rates of private investment in 2011.

Telecommunication, the backbone of modern businesses in the digital age, is poor and way below such services in neighboring Somalia, which has not had an effective central government for a long time. The business community also considers the lack of a level playing field in relation to public enterprises and favored other entities as a binding constraint.

World Bank’s latest ease of Doing Business report (2016), ranked Ethiopia at 159th out of 190 economies in terms of the overall ease of doing business. It ranks particularly low in the ease of starting a business (179th); getting construction permits, which would particularly affect industry (176th); protecting minority interests (175th); getting credit (170th); and trading across borders (167th). It does relatively better in enforcing contracts (80th) and paying taxes (90th).

Given that the a large part of existing small private sector is in informal activities, formalization would be important, but cumbersome regulations would tend to militate against that. The difficulty in trading across borders presents a significant barrier to Ethiopia’s export-driven growth and in the context of regional collaboration. Limited access to finance is a major constraint, which significantly results from the underdeveloped nature of Ethiopia’s local banking system and the fact that there are no foreign-owned banks, the public sector dominates both in supply and demand side of credit. The state-owned Commercial Bank of Ethiopia accounts accounted for about 70 percent of the banking sector’s total assets. On the demand side of credit, the public sector, particularly state-owned enterprises absorb two-thirds of available credit thereby crowding out the private investment.

KENYA

With an estimated GDP of about \$66 billion in 2016, Kenya has the largest economy in East and Central Africa, with a growth rate of about 6% during the year. According to the IMF, macroeconomic stability in a market-friendly environment continues to provide a favorable business climate, attracting the interest of foreign investors. The fact that Kenya was able to successfully place its first US\$2 billion Eurobond at favorable terms, with proceeds to be used for infrastructure development, is an indication of business confidence¹⁵. The country’s financial sector is relatively well developed and has been exporting its successful business model to countries in the East Africa region.

Table 2.4. Kenya – Selected economic and financial indicators

	2014	2015	Est. 2016	Proj 2017
Population (in millions)	44.8	46.0	47.3	48.5
GDP (in billion \$)	59.3	62.6	66.3	72.0
GDP growth (in percent)	5.3	5.5	5.8	5.6
Inflation (in percent-annual average)	4.6	6.6	6.9	6.0

Source: Kenya authorities; and IMF staff estimates and projections

Kenya’s private sector is relatively vibrant, diversified and growing, and would continue to be the country’s long-term economic engine¹⁶. The economy is highly dualistic, however, with a formal, large business sector, which is relatively healthy and productive, and a massive, informal small business sector that is poorly understood and gets little support. Nevertheless, the informal sector exhibits energy and dynamism, and could be a principal source of growth. It currently employs the vast majority of the

¹⁵ IMF Article IV Consultation for Kenya, 2016

¹⁶ World Bank: Kenya Country Partnership Strategy (2014-2018), p.7

country's non-agricultural workers. While data on the informal sector is sparse and its size and contribution to GDP and employment is not clear, some government statistics show that 85% of new jobs were created in informal activities during 2011-2015¹⁷. Given the importance of this sector, it is deemed essential that links between it and the formal sectors, which are presently weak, be strengthened and initiatives to bridge the gap taken as a priority.¹⁸

Data on the private sector is contribution to GDP and employments is not clear, even for a country with good statistical base as Kenya. But it is known that the Government's role is relatively small, with the contribution of public administration and defense (a proxy for public expenditures) only 4% of GDP in 2016¹⁹. Sectorally, agriculture, trade, manufacturing, tourism, transport and communications, and financial services, account for 80% of private sector contributions to GDP. Agriculture accounts for 30% of GDP (compared to 42% in Ethiopia). Its contribution has shown modest decline in recent years, while trade, transport, ICT and financial services are growing, and the manufacturing sector's contribution has remained steady at 10%. Few agricultural products dominate Exports, including tea and horticulture)²⁰

Constraints

The business environment, though above its cohorts in IGAD, is still weak at 92nd among the 190 countries included in the World Bank's latest (2016) Doing Business report. This is a significant improvement from its 113rd position in 2015. Kenya's performance on individual components of Doing Business is varied. The country ranks at 29th among countries worldwide in "getting credit" (29th), way above its IGAD partners, which are close to the bottom of world rankings (180-185 out of 190). Kenya's high ranking in this area is due to the country's better-developed financial sector. On the other hand, Kenya ranks low in "starting a business", "getting construction permits" and "registering property" (116th, 152nd, and 121st respectively), which imply weaknesses in the regulatory framework and the institutions that administer them.

Key constraints which particularly affect the large informal sector (and prevent it from formalization), include low skills and lack of access to technology, high effective tax rates (which informal activities can escape), and unfriendly regulatory environment for small business (e.g. trading restrictions and minimum wage regime), inadequate access to financial services, and a poor collective voice of small business, particularly in policy decisions.

The private sector, overall, is sensitive to political developments and uncertainty. Tourism, an important source of employment and foreign exchange, is particularly sensitive to political developments and perceptions of insecurity. Tourism, for example, fell sharply after the Westgate attacks in September 2013. Widespread perception of corruption, political interference and patronage are factors that hinder businesses, especially MSMEs. Lack of adequate infrastructure, especially transport and transport logistics, and energy are also major impediments. The low ranking (106th) in "getting electricity" reflects the high cost of energy and power cuts. The component "Trading across border" is also ranked low (106th) mainly because due to inadequate transport infrastructure and logistics systems-- customs,

¹⁷ Kenya, National Bureau of Statistics, Economic Survey (2016), p.5

¹⁸ AfDB and Government of Kenya: The status of Kenya's Private Sector, 2013

¹⁹ Government of Kenya: Economic Survey (2016), p.3

²⁰ Ibid, p.7

goods clearance and weigh bridges. A mismatch in the skill mix is another impediment especially for fast-growing sub-sectors such as the ICT.

Despite the impediments, the private sector in Kenya has a lot going for it. The country has a significant pool of a well- educated workforce and growing entrepreneurs. Kenya’s private sector is competitive both regionally (as reflected in its net positive trade balance with all its neighbors—see table 4), and internationally in certain niche areas such as tea, cut flowers, and leguminous vegetables. The discovery of oil in the Lake Turkana region and offshore could, if properly managed, propel the private sector and the overall economy forward. Should these finds prove significant, efforts to avoid the so-called resource-curse would be necessary. Improperly managed, the new wealth can spawn corruption, stunt non-oil growth and exacerbate internal tensions.

SOMALIA

The private sector in Somalia and the role it played in the economy over the past 25 years is almost unique in recent world history. With the collapse of the central state authority and all its formal structures (in 1991), the total destruction of the country’s asset base during the lengthy civil war, and general lack of security and absence of the rule of law, the private sector not only survived but thrived and carried the economy with it (which is estimated to have grown at an average of 3.5% per annum in real terms in 2014-16).

All through those difficult times, the private sector provided not only basic goods and services competitively but also started to take on some of the functions of the state, public services, providing health, education, water, power. Sometimes it provided “better and more efficient services than the state before the civil war. Telecommunication and air transport services, for example, are now available in towns that never benefited from those services in the previous regimes”²¹. New economic activities such as money transfer businesses services grew well during this period, and livestock exports continued. The Information and Communication Technologies (ICT) sector has especially thrived during this period, of unregulated environment. Mobile communications and mobile payments is one of the bright spots for the Somali economy, with mobile phone penetration rates that are currently higher and prices lower than in neighboring Djibouti and Ethiopia, both with state-owned monopolies²². Agriculture and livestock are the main productive sectors and the source of livelihood for the bulk of the population. Manufacturing is practically non-existent. The private sector has also a large footprint on the social sectors. There are over thirty private

Table 2.5. Somalia – Selected Economic and Financial Indicators

	2014	2015	Est. 2016	Proj 2017
Population (in millions)	10.5	10.8	11.1	11.4
GDP (in billion \$)	5.95	6.11	6.34	6.55
GDP growth (in percent)	3.6	3.6	3.4	2.5
Inflation (in percent, end year)	1.3	1.4	1.5	2.7

Source: Somali authorities; and IMF staff estimates and projections

²¹ World Bank: Somalia Country Economic Memorandum (2006):

²² World Bank: Somaliland’s Private Sector at a Crossroads Political Economy and Policy Choices for Prosperity and Job Creation, 2016

universities and colleges and a large number of private primary and secondary private schools, and clinics and hospitals.

Constraints

Those positive attributes notwithstanding, the business environment in Somalia is very difficult, reflecting absence of an effective government and non-existent public sector institutions. The World Bank's Doing Business report (2016) ranks Somalia as last among the 190 countries examined. The country is also at the bottom in the sub-components of Doing Business—starting a business, registering property, getting credit and electricity²³.

A separate Doing Business and Enterprise Survey done by the World Bank shows that Somaliland would, at 174th ahead of several African countries including Benin (176), CAR (178), Guinea (179), Eritrea (180) and Chad (183); as well as Haiti (175) and Venezuela (177) outside of Africa²⁴.

Lack of infrastructure, lack of access to finance and credit owing to near-absence of viable banking, absence of public sector support institutions, and difficulty in access to international markets is some of the major constraints. Lack of investments and absence of any maintenance of infrastructure facilities for over twenty five years, has left major infrastructure facilities, particularly the roads system, dysfunctional. Access to electricity is limited, sporadic and very expensive (over \$1.00 per kilowatt hour)²⁵. The majority of the financial transactions take place through informal credit network of business owner, lenders and Diaspora investors. As a result, a significant amount of working capital sometimes is tied up in financing basic needs like food and fuel. This leaves no room for business expansion, additional hiring, productivity investments and market development.

Land ownership and lack of clarity of titles has been a source of conflict and is likely to be a source of risk for new investors outside of the fast turn-around activities such as trade. The existing legal and regulatory framework is also weak or cumbersome as are the institutions that enforce them – construction permits and business licenses, land registration and property rights, enforcement of contracts, customs administration and tax collection—are weak. Even where institutions function reasonably well favoritism and side payments often play a role in enforcement and application of laws and regulations. There is also no exit mechanism and processes for insolvency.

²³ World Bank: Doing Business in Hargeisa, 2012
<https://openknowledge.worldbank.org/handle/10986/13417>

²⁴ World Bank: Enterprise Survey in Somaliland, 2013

²⁵ Ahmed, Osman S.: "private sector development in Somalia/Somaliland—obstacles and opportunities" paper written for HESPI as part of 2014 IGAD Economic Conference.

UGANDA

Uganda enjoyed a sustained period of economic growth since the 1980s following a series of stabilization and pro-market structural reforms. GDP growth averaged about 6.9 % per year during 1987-2010, transforming it to one of the fastest growing economies in the world²⁶. Growth slowed to an average of about 5% over the past decade and is estimated at an annual average of 5% in 2014-16.

Agriculture and huge public sector investments, particularly in roads and power (section IV.7 below) have been the main drivers of growth. Agriculture is the dominant sector employing approximately 69% of the population and contributing about 26% to the GDP (2015). This sector also contributes to over 70% of Uganda's export earnings and provides the bulk of the raw materials for predominantly agro-based industries²⁷. Agriculture has the potential to transform the economy of Uganda in general and that of specific sectors such as manufacturing and services²⁸. However, growth in agriculture has been slow in recent years (2.3% over the past 8 years) compared with other sectors²⁹. The relatively low growth of agriculture has major implications for employment, especially of youth. Uganda is reported to have the most youthful populations in the world, with 78% under 30 years of age in 2012³⁰. A high proportion of those youth are unemployed.

Formal sector manufacturing accounts for 6.1% of GDP and is only slightly more than its share a decade and half ago³¹. This sector is important because it plays an important role in structural transformation and productivity improvements of the economy.

The informal sector, mainly in services and trade, is where most of the unemployed growth look for work. A large segment of the informal sector is increasingly comprised of graduates who could not find formal sector jobs³². The contribution of the informal sector to GDP and employment is difficult to know, mainly because it is by definition unregistered and unrecorded. But there is no doubt it is an important sector of the economy and exhibits a measure of dynamism. The latest survey (1993/94) by the Uganda Bureau of Labor Statistics shows that 21% of households own an informal business³³. That

Table 2.6. Uganda – Selected economic and financial indicators

	2014	2015	Est. 2016	Proj 2017
Population (in millions)	38.7	39.9	41.1	42.3
GDP (in billion \$)	70.46	77.85	84.91	93.64
GDP growth (in percent)	5.2	5.1	4.8	5.0
Inflation (in percent-annual average)	4.6	3.3	6.7	4.8

Source: Ugandan authorities; and IMF staff estimates and projections

²⁶ World Bank: Uganda Economic Overview: Update, April 16, 2016

²⁷ World Bank: Agriculture—a driver of growth and poverty reduction (September, 2016) @ <http://www.worldbank.org/en/country/uganda/publication/uganda-poverty-assessmen>

²⁸ Deloitte: Uganda Economic Outlook--the story behind the numbers, (June, 2016)

²⁹ Government of Uganda: National Web Portal @ <http://www.gou.go.ug/content/agriculture>

³⁰ Uganda Bureau of Statistics (2015) table 2.1.2 P. 14 @ http://www.ubos.org/onlinefiles/uploads/ubos/statistical_abstracts/Statistical%20Abstract%2020

³¹ <http://www.bis.org/review/r140401e.htm>

³² <http://allafrica.com/stories/201605180378.html>

³³ Government of Uganda: Bureau of Statistics, chapter 12 @ http://www.ubos.org/UNHS0910/chapter12_the%20informal%20sector.html

number is likely to have increased since that survey. Some reports indicate that it is the fastest growing sector in the economy. Formalization could enhance its contribution to the overall economy and employment but is impeded by “high cost of graduation” due to restrictive regulations, and lack of access to finance.

Constraints and risks:

The land locked nature of the country and poor transport systems, inordinately relying on road transport, increases the cost of doing business and puts businesses at a competitive disadvantage. Cheaper water and rail transport options are not utilized; only 10% of Uganda’s trade is transported by rail and water³⁴.

Uganda ranks 116 among 190 in business environment according to the World Bank’s latest (2016) Doing Business report. It ranks particularly low in some components--“starting a business” (162th), “dealing with construction permits” (153th) and “trading across borders” (141th), and “getting credit”.

One of Uganda’s most binding constraints is availability of land. According to a World Bank report only about 8% of Uganda’s land is registered and titled (compared with Ethiopia, more than 50% of land is titled and Rwanda where more than 60% of land was titled over a period of five years).

Unregistered land cannot be as collateral to access credit, and cannot be used to create equity³⁵. Estimates show that 5-11% of agricultural output is lost due to land disputes and over 50% of civil cases are related to land disputes³⁶.

Access to financing is also one of the top constraints. According to a World Bank report, access to finance was cited by more firms than any other constraint. Economy-wide, private sector credit is only 13.5% of GDP in Uganda compared to 32% of GDP in Kenya³⁷.

³⁴ World Bank: Uganda Economic Update—unleashing trade potential

<http://www.worldbank.org/en/news/feature/2013/02/14/uganda-economic-update>

³⁵ World Bank: Uganda Economic Update Land and Economic Transformation, September 2015

33. Ibid

³⁷ World Bank: Uganda Enterprise Survey, 2013, P.11

Table 3: Global position of IGAD countries in (the ease) of Doing Business

	Overall	Starting business	Getting Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Minority Interests	Paying Taxes	Enforcing Contracts	Resolving Insolvency	Trading Across Borders
Kenya	92	116	152	106	121	32	87	125	87	92	105
Uganda	115	165	151	161	116	44	196	75	64	111	136
Ethiopia	159	179	176	127	133	170	175	90	80	120	167
Sudan	168	156	145	113	89	170	187	141	184	147	153
Djibouti	171	172	120	172	168	181	178	106	184	71	155
South Sudan	158	145	113	89	170	187	141	147	73	169	177
Eritrea	189	186	187	141	178	185	165	147	189	121	169
Somalia	190	184	187	188	148	185	190	190	156	109	169
Rwanda	56	76	158	117	4	2	102	59	87	95	87

Source: World Bank: Doing Business Report (2016)

III. REGIONAL PERSPECTIVES: KEY CHALLENGES AND POLICY ISSUES.

1. Governance and the role of governments in the economy

In general, governments in the region have a big footprint on the economy, limiting the space of private sector activities through restrictive policies and regulations, ownership of productive assets, or crowding out the private sector from investment and credit markets. To be sure, the public and private sectors have complementary roles in promoting economic growth. The role of the public sector is mainly in creating an enabling environment, including macroeconomic stability and a conducive business climate, and providing for appropriate regulations; rule of law, and institutions that facilitate rather restricts private activities³⁸. Strong leadership and a vision for the country, a capable administration, and undertaking public investment in essential public goods, in such areas as infrastructure and social services where the private sector may not have the incentive or the capability to provide, are also essential roles of governments and the public

The private sector, driven by competitive forces, on the other hand, is the most effective avenue for undertaking directly productive activities and in, in the process, advancing the countries' development goals—inclusive, sustainable and high growth for poverty reduction and job creation. There is full consensus on these respective roles of the public and private sectors, and international experience of successful economies corroborates this. The growth of China since it adopted market-based policies starting in 1989 is a prime example (see section V). Most governments in the IGAD region realize this complementarity but that realization is not always reflected in government policies or in the relations between the public and private sectors.

The role of the public sector varies between the countries in the region but there are broad similarities. A predominant public sector crowds out private investment in some countries (Eritrea and Ethiopia) or imposes heavy costs on private activities that use publicly services provided by inefficient public sector monopolies (e.g. Djibouti), in such areas as power and telecommunications.

Eritrea has a command economy with extensive government control and a large public sector, which crowds out private investment. The role of the private sector is concentrated in small trade and service activities. Djibouti is an open economy and the investment environment is more liberal but private sector growth is held back by the high cost of factors such as electricity and telecommunications, which are in government hands. Ethiopia has recently taken steps to improve business environment but the government controls commanding heights of the economy (finance, power, and telecommunications). Public investment also crowds out the private sector in finance as up to two-thirds of investment resources go to public sector. Moreover, foreign investment is not allowed in key sectors such as banking. Djibouti, Ethiopia and Eritrea are the only countries in Africa where the important and fast-growing telecommunications sector are in government hands.

The governance structure, including the manner in which regulations are administered (in a facilitative rather restrictive manner on private activities) and laws enforced (transparently and equitably without regard to political clout and connections), are critical for the emergence of a vibrant private sector. With

³⁸ International Finance Institutions: Developing Through the Private Sector, joint report of 31 multilateral and bilateral development finance institutions, 2011

few exceptions, IGAD countries have a long way to go in this regard. Corruption and inefficient bureaucracy are also major obstacles, undermining country competitiveness and attractiveness for inward investment (FDI).

Those factors are cited as major contributors to low levels of global competitiveness for countries in the region. According to the World Economic Forum's (WEF) Global Competitiveness Index (GCI), the three IGAD countries included in their annual assessment (Ethiopia, Kenya and Uganda) are among the least competitive worldwide. Countries not included in WEF's global exercise (Djibouti, Eritrea and Somalia) are likely to be even less competitive due mainly to poor economic governance.

Somalia is an exception to the large public sector role compared with other economies of the region. Reflecting partly the absence of effective government and weaknesses of all public sector institutions, the private sector in Somalia is dominant in the economy (accounting for upwards of 90% of GDP) operating under an almost "laissez faire" environment. However, the sector is still weak and embryonic because the enabling environment, in terms of the rule of law and protection of private property, is lacking and absence of legal framework in key areas poses entry problems. In that environment, monopolistic positions of few large companies, which are unregulated, tend to crowd-out small and medium-scale enterprises (SMEs).

An issue in all the countries is corruption. Somalia is reported to have the highest levels of corruption in the world. As measured by Transparency International's Corruption Perception Index (the higher the number the greater the level of corruption), Somalia is ranked at 176 of the 176 countries for which the Index was measured, followed by Eritrea (164), Uganda (151), Kenya (145), Djibouti, (123). Ethiopia is significantly better than its peers in the region but still way below the world average³⁹.

2. Regional integration and intra-regional trade

Regional integration can advance private sector development by opening up larger markets for trade and investment. While the economies of the region are all producers of primary goods with little industrial capacity, and in that sense may seem to have limited complementarity, there is in fact significant complementarity. For example, land-locked Ethiopia next to Somalia with the longest coastline in mainland Africa, sharing of pastoral lands on either side of the border, Djibouti as an expanding gateway for not only Ethiopia but for countries further south, and diverse environments and resource endowments (especially water with some water-abundant and others water-stressed) offer room for greater, mutually beneficial, collaboration.

The region has, collectively, a considerable resource base—agriculture, livestock, minerals and hydrocarbons, water, and long coastlines with considerable marine resources. Those resources and the larger markets and geographic depth that regional integration brings about would, with the right policies and harmonized incentives, increase the scope for private investment, domestic and foreign. This is particularly important for investments in industries where economies of scale is important.

Economic integration among IGAD countries is hampered by Inter-state conflicts (Ethiopia/Eritrea) as well as intra-state conflicts (Somalia and South Sudan). The Ethiopia/Eritrea conflict and instability in Somalia remain the chief obstacles to than regional integration. Collaboration between the IGAD

³⁹ Transparency International: Corruption Perception Index, 2016
http://www.transparency.org/news/feature/corruption_perceptions_index_2016

countries is also mainly seen through a security rather than an economic lens. Moreover, the big three economies--- Ethiopia, Kenya and Uganda--look more to COMESA or the East African Community (EAC), for economic collaboration than to other IGAD states. Greater economic integration, possibly including joint export processing zones in coastal areas, trade and logistics facilities, and free movement of goods and people would be a win-win for all.

There is significant informal intra-regional trade, by definition unrecorded and unregistered, but there appears to be little formal trade (except between Ethiopia and Somalia or Kenya and Uganda) among the countries in the region; they trade with other countries and regions more than they do with each other, as shown in table 4 (a and b).

Table 4 (a): IGAD states-- Top five import sources (% of total imports, 2013)

Djibouti	Eritrea	Ethiopia	Kenya	Somalia	Uganda
China (34.2%)	China (31.9%)	China (27%)	India (23.8%)	Oman (23%) C	India (28.8%)
India (12.9%)	Egypt (14.6%)	India (11.2%)	China (19.5%)	Ethiopia (22.9%)	China (10.7%)
Indonesia (9.6%)	Germany (9.4%)	Saudi Arabia (8.5%)	Japan (5.5%)	India (13.4%)	Kenya (9.7%)
Saudi Arabia (6.6%)	Italy (8.4%)	Japan (4.7%)	South Africa (4.9)	China (9.6%)	UAE (6.7%)
USA (5.7%)	Saudi Arabia (4.1%)	USA (4.7%)	UK (4.3)	Pakistan (4.5%)	Japan (5.7)

Sources: from 4(b)

Table 4 (b): Top five export destinations (% of total exports in 2013)

Djibouti	Eritrea	Ethiopia	Kenya	Somalia	Uganda
Saudi Arabia (38.7%)	Canada (60.3%)	Somalia (12.3%)	Zambia (13.5%)	Saudi Arabia (56.3%)	Sudan N&S (17.2%)
Egypt (10.2%)	China (19.8%)	China (11.9%)	Uganda (10.8%)	Oman (21%)	Kenya (13.1%)
Yemen (6%)	Republic of Korea (7.1%)	Germany (6.8%)	Netherlands (9.3)	Yemen (8.4%)	DRC (11.1%)
India (5.8%)	Venezuela (3.9%)	Netherlands (6.5%)	USA (8.8%)	India (7.4%)	Rwanda (9.0%)
USA (4.6%)	Egypt (3.7%)	Saudi Arabia (6.4%)	UK (8.1%)	China (3%)	Swaziland (6.1%)

Source: ITC Trade Map, cited in “The political economy of regional integration in Africa, Intergovernmental Authority on Development (IGAD)”, Bruce Byiers, (2016)

Beyond trade, there is room for increased interdependence in relation to geography, the environment, physical infrastructure and water. The facts that three of the countries (two in this study) are landlocked while others have a long coastline (6,417 KMs in total), give room for economic synergy and collaboration, especially in import/export trade and in-ward investment. Ethiopia uses the port of Djibouti for most of its imports and exports, and to a much more limited extent, the port of Berbara in

Somaliland. However, the passage of Ethiopia-bound shipments through these ports, have little spillover or impact on those economies.

A greater role for the private sector, which looks to market opportunities rather than political considerations could, with reduction in cross-border barriers and improvements in overall business environments, help open new opportunities for trade and investment, including foreign direct investment (FDI) where economies of scale are import, and consequently advance regional integration. Greater FDI can have a catalytic impact on domestic businesses (through linkages, supply chains, technology and know-how transfers etc.) and impact on overall country/regional development.

Poor infrastructure impediments, particularly transport and roads, are major impediments to regional integration and cross-border trade. A number of major projects, which are currently underway or planned (see section 3 below), should help facilitate increased regional trade.

3. Infrastructure constraints

The IGAD region's long term growth and development will hinge, in large part, on the quality and effectiveness of its infrastructure services—transport (rail, roads, ports and airports), power, water and sanitation and Information and Communications Technology (ICT). The Region falls short in those areas—lower than other sub-regions in Africa (SADCC, ECOWAS, and even the EAC, with which IGAD shares some common membership) and among the lowest in the world⁴⁰. In access to electricity, for example, most countries in the region are among the lowest in the world, increasing the cost of doing business, reducing international competitiveness and impeding the industrialization process.

Effective transportation systems—rail, road, air transport and ports—are also essential for reaching markets within the region and beyond and enhancing regional integration. This is particularly crucial for landlocked countries like Ethiopia and Uganda. Ethiopia has taken major strides in recent years but the country has a long way to go and coverage is still inadequate.

A number of major cross-border projects are planned or underway including the connection of South Sudan and Ethiopia to Kenya's northern coast at Lamu, which is expected to be East Africa's biggest infrastructure project (at an estimated cost of \$26 billion). The 1,500 km Djibouti-Addis Ababa railway, which is expected to be fully operational by the end of 2017. A 1,500 km pipeline from Kenya and Uganda to transport crude oil, mainly from newly discovered oil in Uganda, is planned. These efforts notwithstanding, there is a general lack of regional vision for infrastructure. Most countries plan and implement projects in isolation focused on national development goals.

In addition to physical transport infrastructure, trade logistics, and customs delays at ports, and holdups at national borders and check points result in higher costs than any other region in the world⁴¹. Major investments would be needed in all the countries to bring the region on par with their peers in Africa and beyond, not only in physical infrastructure, but also in trade policies, logistics and customs procedures.

⁴⁰ AfDB Status of Infrastructure in East Africa, April, 2013

⁴¹ AfDB: Overcoming East Africa's Infrastructure Challenges, International Trade Forum magazine, July 2015]

4. High youth unemployment

One of the main challenges facing IGAD countries is youth unemployment. About 70% of the population is under 30 years of age or younger in most countries. This can be a demographic dividend or a demographic “bomb”. With adequate health, education and jobs, the energy and vitality, and indeed versatility in a fast-changing technology-driven world, the youthful population can foster sustainable development. Absent adequate jobs, the youth can become potential sources of instability or are likely to undertake risk-ridden outmigration. On the latter, the cases of Eritrea and Somalia are most pertinent.

With current high unemployment and high number of new entrants into the job markets, creating adequate jobs for a fast-growing youthful population would be a challenge even under more favorable circumstances. A vibrant private sector can help in meeting that challenge, given the right incentives and requisite support. The public sector is not likely to create many new jobs even for countries where the public sector currently plays a dominant role as public sector wage bills are already high and governments in general are reducing their role in productive activities,

Experience in most other developing countries shows that private sector investment and growth creates new jobs, and access to jobs is the route to poverty reduction. While overall growth is important, growth of micro, small and medium scale enterprises (MSMEs), where most jobs are created and where the poor earn their living, is critical and at the heart of the economic ecosystem in many developing economies. MSMEs can also link the local economy into larger value chains – providing raw materials, components and specialized services. Policy makers in the region should put special emphasis in promoting MSMEs. Some policy prescriptions are indicated in the Conclusions and recommendations section at the end of this paper.

5. Agriculture and poverty reduction

In discussing private sector development, most people focus on non-agricultural activities. Yet, agriculture and related sub-sectors, such as livestock, form the largest segment of the private sector in the region and in Africa generally. The agricultural sector, consisting mainly of private smallholders, accounts for over three-quarters of employment in most countries of the region. In Ethiopia, agriculture is the foundation of the economy, accounting for almost half of GDP, 80% of employment and 85% of exports.⁴² It is also where the bulk of the very poor earn their living. According to the World Bank, agricultural growth was a key driver of Ethiopia’s impressive rate of poverty reduction--from 52% of the population in 2000 to 33% in 2015. Similar, though less dramatic, stories can be told of other countries. Policies aimed at poverty reduction should, therefore, help develop rural areas and agriculture and livestock sectors where the poor are located and derive their income and employment.

Despite the challenges faced by many countries in developing agriculture--limited rainfall, degradation of agricultural land due to adverse environmental factors, poor agricultural practices with little or no use of modern technology etc.—there is considerable potential in the region. Promotion of new technologies and practices, such as dry farming and water saving irrigation technologies, could help enhance the sector’s productivity and value-addition. There is also potential for development of agro-

⁴² World Bank: Financing expanded agriculture and better living opportunities for small holders in Ethiopia, press release March 31, 2015

based industries, potentially stemming the rural-urban migration and urban unemployment, and enhancing food security.

Livestock, which is a main mainstay in the northern areas of the region, is a related important sub-sector. It is also where the poorest segments of the population (possibly even poorer than agriculturalists and more subject to the vagaries of nature) earn their living. Introduction of new technologies in animal husbandry and development of downstream industries, such as meat products and leather goods, to capture domestically more of the sector's value in the supply chain, would have potentially high-payoff in terms of economic growth, employment and poverty reduction.

Fishery is another potentially important sub-sector for employment generation and poverty reduction. However, despite its potential, including the longest coastline in Africa and considerable marine resources, its contribution to GDP, employment and exports is negligible. Promotion of private sector investment, domestic and foreign, developing marketing channels, training fisherman to improve their fishing techniques, support for on-land facilities such as cold storage and coastal roads would enhance value-addition, raise the sector's contribution to growth and could open up employment opportunities, for coastal communities.

6. Poor global competitive positions of regional economies

Worker productivity is a main determinant of a country's global competitiveness. That in turn depends on the skill level of the workforce and the level of technology. Skill levels in IGAD countries are low compared to other regions and this militates against the regions' competitive position

Global competitiveness reports, done annually by the World Economic Forum, (WEF) compare country competitiveness worldwide. These reports assess the competitiveness landscape of 138 economies, providing insight into the drivers of their productivity and relative competitiveness. The latter is a key determinant of economic growth and resilience to adverse external shocks. According to WEF's Global Competitiveness Index, IGAD countries rank among the lowest in the world with Kenya, Ethiopia and Uganda ranked 96th, 109th and 113 respectively, out of the 138 countries included in the 2016 rankings. The rest of countries in the sub-region (Djibouti, Eritrea and Somalia) region are not even included in the report⁴³.

On the other hand, Rwanda, a post-conflict country in the East Africa region, has done relatively well in recent years. Rwanda is ranked 52nd in 2016 and has made significant progress in recent years, improving from 66th in 2013, indicating that with the right policies and incentive structures, countries can significantly improve their competitive positions⁴⁴.

Among the most problematic factors in the business environment that impact competitiveness are: inadequate supply of infrastructure services, access to finance, inefficient government bureaucracy, corruption, and foreign currency regulations (the latter is particularly important in Ethiopia and Eritrea). Workers skill levels, work ethic and national labor markers are also significant factors in the productivity and relative competitiveness of an economy⁴⁵.

⁴³ World Economic Forum: Global Competitiveness report (2016)

⁴⁴ WEF Global Competitiveness report(2013, 2014, 2015)

⁴⁵ WEF: Global Competitiveness report, County profiles, 2016-17

Table 5: Global Competitiveness Index (GCI) for IGAD and selected countries (2016)

Country	Rank (Of 138)	Income	S.S. Africa/IGAD Countries	Rank	Income
Switzerland	1	HI	Mauritius	45	UMI
Singapore	2	HI	South Africa	47	UMI
USA	3	HI	Rwanda	52	LI
Netherlands	4	HI	Kenya	96	LMI
Germany	5	HI	Ethiopia	109	LI
Sweden	6	HI	Uganda	113	LI
UK	7		Djibouti	NA	LI
Japan	8		Eritrea	NA	LI
			Somalia	NA	LI
			Sudan	NA	LI

Source: Global Competitiveness Report (2016-2017) issued annually by World Economic Forum

Note: HI= higher income; UMI=upper middle income LMI=lower middle income; LI= Low income

7. Low levels of technology and innovation

Underpinning global competitiveness is the level of technology and innovation embodied in an economy. Knowledge and innovation--technological innovation in particular--rather than resources, are increasingly becoming the main drivers of economic growth and socio-development. Pursuing a knowledge and innovation-based development is not inappropriate even for the least developed countries in this era of global knowledge and cross-border information sharing. The fact that countries like Kenya and Somalia are at the forefront of mobile banking (with respectively one-fourth and one-third of their citizens receiving money and making payments electronically), is an indication that IGAD countries can find niches where they can leapfrog and raise overall the productivity of their economies.

The Global Innovation Index, published annually by World Intellectual Property Organization (WIPO) and others, ranks the innovation performance of 128 countries and economies around the world, based on 82 indicators⁴⁶. Those indicators include: ease of starting a business (as in Doing Business Report—table 3), information and [communications technologies](#), [business](#)-model creation and relative expenditure on [education](#).

While more developed, high-income countries rank at the top because of their research and development infrastructure, knowledge and innovation are becoming more widespread and increasingly available globally. Many developing countries are taking advantage of those opportunities. It may seem a stretch to even talk about factoring-in knowledge and innovation as a vehicle of growth and development for IGAD countries, but this is where the world is heading and the IGAD countries should aim for what is possible. A number of African countries are making significant strides in the innovation landscape, though from a low base.

⁴⁶ World Intellectual Property Organization (WIPO), Global Innovation Index report, Cornell University and INSEAD, 2016

Table 6: Global Innovation Index

Country	Rank (of 138)	Score (0-100)	Income	Sub-Saharan. Africa/IGAD Countries	Rank	Score	Income
Switzerland	1	66.28	HI	Mauritius	53	35.86	UMI
Sweden	2	63.57	HI	South Africa	54	35.85	UMI
UK	3	61.93	HI	Kenya	80	30.36	LMI
USA	4	61.40	HI	Uganda	99	27.14	LI
Finland	5	59.90	HI	Ethiopia	110	24.83	LI
Singapore	6	59.16	HI	Djibouti	NA	NA	LI
				Eritrea	NA	NA	LI
Germany	10	97.94	HI	Somalia	NA	NA	LI
				Sudan	NA	NA	LI
Japan	16	54.52	HI	South Sudan	NA	NA	LI

Source: World Intellectual Property Organization, Cornell University and INSEAD: Global Innovation Index report, 2016

World Intellectual Property Organization (WIPO) noted in its 2016 report, that since 2012, Sub-Saharan Africa counted more countries than any other region among the group of “innovation achievers” – countries that perform better than their level of development would predict. It notes that “better rankings on the indicators for institutions, business sophistication, and knowledge and technology output have allowed the region to catch up to Central and Southern Asia, and to overtake Northern Africa and Western Asia,”⁴⁷

8. Positive recent trends in the region

The IGAD region has the fastest growing economies with average growth rates well above world and African averages. But the growth is from a low base and poverty is still pervasive. But most countries in the region particularly Kenya and Ethiopia are putting in place the ingredients for further growth, including in infrastructure, which remains to be one of the key constraints to continued economic growth and private sector development. In addition to major regional infrastructure projects (section IV.2) most countries are making great strides to reduce their domestic infrastructure deficits.

In **Kenya**, a number of mega projects are planned including an oil pipeline, railways, ports and renewable energy. A \$3.8 billion Standard Gauge Railway Project from the main seaport of Mombasa, a 1 gig watt solar plant (est. \$2.2 billion) and a huge port project, to connect Kenya’s Indian Ocean port of Lamu with the hinterland countries⁴⁸ are among the planned projects.

Ethiopia’s success story is in aviation through its successful national carrier (Ethiopian Airlines), which is reported to have made more profits in recent years than all African airlines put together⁴⁹. The country’s major infrastructure deficits have always been in electricity and transport (especially roads). In power, Ethiopia has huge hydropower potential (the second biggest in Africa after the Democratic Republic of Congo) and can meet its domestic needs and also become a major exporter of electricity in

⁴⁷ WIPO et al: Global Innovation Index, press release, August 15, 2016

⁴⁸ Various sources-- e.g. Mail Guardian Africa, September 4, 2015 @: <http://mgafrica.com/article/2015-09-03-kenya-home-to-mega-infrastructure-projects-here-are->

⁴⁹ Financial Times, Feb 9, 2016

the region⁵⁰. The Grand Ethiopian Renaissance Dam, is slated for completion next year at a cost of \$5.0 billion and have an installed capacity of 6,000 Megawatt MW. Together with other large hydropower plants, such as [Gilgel Gibe III](#), which was inaugurated in December, 2016, with a capacity of 1870 MW, Ethiopia is expected to have enough generating capacity to meet its domestic power needs, and export some to neighboring countries.

Despite large deficits, Ethiopia is also making major strides in transport, particularly roads, which have focused mainly on major corridors. However, the country still has low road density with only 10% of the rural population living within 2 km from an all-weather road⁵¹. This compares with Kenya where 57% of rural population lives within 2 km of good road⁵².

Uganda plans infrastructure investments in the next ten years, include planned electricity projects worth \$4.6 billion. The Karuma and Isimba dams and related sub stations are under construction and smaller hydropower plans and related transmission lines are planned. Transport infrastructure worth \$4.7 billion is also planned⁵³.

In recent years, Djibouti has progressively expanded its port facilities, through which 80% of Ethiopia's trade passes, with new oil and container terminals at Doraleh with \$427 million loans and investment guarantee from multi-lateral development institutions. A 752-kilometre railway linking Djibouti to Addis Ababa is nearing completion. A multi-billion-dollar pipeline to transport natural gas from Ethiopia to a liquefaction plant and export terminal in Djibouti, and a pipeline to carry diesel, gasoline and jet fuel from Djibouti's ports, in reverse direction, to central Ethiopia are also planned. In addition, many other infrastructure projects—new ports an airport, free zones-- worth billions of dollars are planned, with Chinese support.⁵⁴

⁵⁰ Deloitte: Ethiopia--a Growth Miracle (p.15) @ https://www2.deloitte.com/content/dam/Deloitte/na/Documents/strategy/za_ethiopia_growth_miracle_july2014.pdf

⁵¹ World Bank Country Partnership Strategy, 2012-2016

⁵² World Development Indicators (2016), p. 19 @ <https://openknowledge.worldbank.org/bitstream/handle/10986/23969/9781464806834.pdf>

⁵³ International Monetary Fund, Uganda: Staff Report for the 2015 Article IV Consultation and Fourth Review Under the Policy Support Instrument, July 12, 2015 (Box 4, p.13)

⁵⁴ Mail Guardian Africa @<http://mgafrica.com/article/2016-04-06-tiny-djibouti-thinks-big-with-a-complex-web-of-infrastructure-spending-tied-to-ethiopia-and-chinese-credit>

IV. INTERNATIONAL EXPERIENCE AND LESSONS

Relevant lessons and experiences from other countries and regions can be drawn upon, especially in regulatory reforms. One such example is Rwanda, where the country's one-stop center has been able to cut the time it takes to start a business from fourteen days to three days and the number of procedures from eight to two. At the same time, the cost of starting a business has dropped from 109 percent to 10 percent of income per capita between 2008 and 2009⁵⁵. On business registration and start-ups, this improvement is clearly illustrated in Rwanda's high ranking on some components of Doing Business rankings.

Borrowing lessons from countries in other regions where knowledge (rather than resource-based development) was pursued, and the right strategies and policies adopted, should be examined for appropriate lessons. China joined the world's top innovators for the first time in 2016 when it was ranked 25th in Global Innovation Index⁵⁶. From 1979 when China opened up and adopted market-oriented policies, China's economy began to transform and accelerated since the early 1990s growing at 10% per year (with GDP doubling every 7 years). Poverty was reduced from 60% of the population in the 1980s to just 7% in 2012 and it became the second largest economy surpassing Japan in 2010. China is today the largest world exporter, with exports amounting to over \$3 trillion (10% of world exports) rising from a modest level of \$20 billion (less than 1% of world exports) in 1978⁵⁷.

Some features of that transformation, and policies behind the transition, may be relevant for IGAD and other countries in Africa. Market-oriented reform programs, that are carefully managed to avoid socio-political disruptions, is key. The Chinese themselves call this reform “change the system, open the door.” “Change the system” means altering incentives and ownership and shifting the economy from near total state ownership to one in which private enterprise is dominant. “Open the door,” means liberalizing trade and direct investment. Heavy investments in infrastructure, high savings rates, reorienting development strategies towards areas of comparative advantage, beginning with labor-intensive industrial production and export orientation, and careful attention to agriculture and rural development, in the meantime, were important strategic choices⁵⁸.

Foreign direct investment, initially attracted by cheap labor and huge potential market, but later by disciplined workforce and rising domestic consumption due to rising incomes, played an important role in China's development. The IGAD region, and Africa in general, can similarly rely on their comparative advantage for trade and for attracting investment. The role of the large Chinese Diaspora, before the country fully opened up to world economy, especially from pre-1997 Hong Kong, in providing capital and expertise was also important. The large Diaspora from the IGAD could play a similar role. A major ingredient of Chinese success, and one which Africa needs to emulate, is a strong work ethic—one in which rent seeking and reliance on extraction, are not rewarded. It is a big factor in productivity and competitiveness.

⁵⁶ Global Innovation Index (2016)

⁵⁷ China as a Trading Superpower, Xiao Jun Li:

<http://www.lse.ac.uk/IDEAS/publications/reports/pdf/SR012/li.pdf>

⁵⁸ David Dollar, Lessons from China for Africa, World Bank Policy Research Working Paper, 2007

<http://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-4531#>

At the other end of the size spectrum is Singapore, a small city-state with no natural resources except its people and a deep-water harbour in a strategic location—think of Djibouti. It is relevant because of the rapid and impressive transition it has made over the last 50 years (around the time of Africa’s independence) from a trading economy which faced major problems of unemployment and poverty at independence, to labour intensive industrialisation, then rapid movement up the value chain to what is now a true knowledge-based economy. In that relatively short time, Singapore, has become one of the wealthiest countries in the world and its citizens now enjoy a very high standard and quality of life. However, it is relevant because of the rapid and impressive transition through multiple stages of development with wise leadership and right policies. Today, it is ranked among the top countries in the world in terms of competitiveness, innovation and ease of doing business.

The choice of the three examples cited above—Rwanda, China and Singapore-- is meant to say that size alone does not matter. China and Singapore (a behemoth of a country and a city-state) can be examples to emulate, despite cultural and other differences. Closer to home, Rwanda, a neighbouring country which only recently emerged from a devastating civil war, can provide an example to conflict-affected states in IGAD.

V. CONCLUSIONS AND RECOMMENDATIONS

As mentioned previously, IGAD countries lag behind the rest of the world in most measures of development. With high levels of poverty and high unemployment, dependence on primary production and undiversified exports, low levels of industrialization and technological base, the region needs concerted collective efforts to move forward. In a globalized world, with fast-paced technological advancements, the gap between the region and the rest of the world could become even wider. But, with its considerable natural and human resources, the region can succeed, with the right policies and strategies. Private sector development would be key to such success. In undertaking the necessary policy reforms and other measures needed to improve the business environment and to catalyze private investment, the IGAD countries can use international experience and best practices elsewhere—in the continent and beyond.

The IGAD countries have the potential and the opportunity to move forward but the region needs to utilize its considerable potential and, in attempting to do so, seize opportunities available in the global economy-- where knowledge, innovation and technology can be accessed and successful experiences and best practices adopted.

Proposals for supporting development of the private sector

- **Clearly delineate the respective roles of the public and private sectors.** While almost all the IGAD countries state their intention to rely on the private sector as the engine of growth and job creation, there is not always a thorough follow-through in policies and actions. In some cases, private sector activities are constrained by policy, in others a large public sector crowds out private sector in resource allocation.

The role of the public sector is critical in creating an enabling environment, including macroeconomic stability, appropriate regulations, rule of law; institutions that facilitate rather than restrict private activities, and public investment in essential public goods. At the same time, restrictions on the entry of private sector into some productive activities, including FDI, would need to be eased or lifted.

- **Create an enabling business environment.** Reform and simplify the laws, regulations which govern businesses and strengthen the institutions that administer them in such areas as business registration and start-up, land acquisition and titling, customs procedures, and exit/liquidation mechanisms.
- **Establish regular public-private dialogue** for more effective interaction and collaboration between government and the business community. Public-private dialogue (PPD) is essential to get business input in reforms intended to improve the business environment, and to counter the pressures of narrow interest groups on a transparent and open platform. While some countries (e.g. Kenya and Uganda) have developed a reasonably functioning Public-Private Forums, most others have not.
- **Improve intra-regional trade and investment.** A greater role for the private sector, which looks to market opportunities rather than political considerations could, with reduction in cross-border barriers and improvements in overall business environments, help open new opportunities for trade and investment, including foreign direct investment (FDI) where economies of scale are

import, and consequently advance regional integration. Countries, such as Kenya in which the private sector is relatively advanced, can have a positive spillover into others in promoting private sector development.

- **Improve the environment and incentivize FDI.** Greater FDI can have a catalytic impact on domestic businesses (through linkages, supply chains, technology and know-how transfers etc.) and impact on overall country/regional development. In an attempt to attract FDI, a number of countries (e.g. started to provide generous incentive packages such as tax holidays and exemptions. However, experience shows that macroeconomic and political stability and policy consistency are much more important than such incentive schemes. More important, infrastructure and institutional bottlenecks act as deterrents to FDI.
- **Foster entrepreneurship development and promote MSMEs.** The emphasis could initially target unemployed youth and recent secondary and university graduates looking for work who have base level of education but lack practical business skills. In addition to improvement in the overall business environment, potential entrepreneurs would need direct support in such as training – vocational (skill training for certain occupations), business and financial training – and financial support (grants, in-kind assistance and microcredit), which have been found effective elsewhere ⁵⁹. Consideration may be given to establish pilot programs consisting of entrepreneurship training and incubation centers for start-up businesses. Incubation centers work with small businesses at the start-up or early development stage in such areas as mentoring, prototype development, and co-funding where needed, particularly in innovation and technology areas. Some countries have started to implement such programs (Kenya); these need to be strengthened.
- **Develop value chains and promote diversification.** *Diversification* of products and export markets, and improvements in productivity by adopting available technologies, is critical for Value addition. Also *value-addition* is required by moving down the value chain in main productive sectors such as agriculture, livestock and fisheries, and would advance sustainable growth and create jobs.
- **Promote knowledge and innovation.** Pursuing a knowledge and innovation-based development is not inappropriate even for the least developed countries in this era of global knowledge and cross-border information sharing. The fact that countries like Kenya and Somalia are at the forefront of mobile banking, is an indication that IGAD countries can find niches where they can leapfrog and raise overall productivity of their economies.
- **Continue to implement public sector reforms.** Civil Service Reform, and Public Financial Management, to improve the efficiency and effectiveness and of the public sector, and its interface with the private sector need to be strengthened. Improving the efficiency and transparency of public procurement systems in line with international best practices to ensure that businesses can equitably participate in tendering for government purchases of goods and services, would help open opportunities for businesses.

⁵⁹ Yoonyoung Cho and M. Honorati, “Entrepreneurship Development Programs in Developing Countries: a meta regression analysis”, World Bank Policy Research Paper, April 2013

- **Ensure proper management of natural resources** such as minerals and hydrocarbons, and avoid the so-called “Dutch disease” or resource curse. There have been major discoveries of oil and gas in several countries, and proper management of those resources should be a top priority—to maximize benefits to the country, and to do so in a transparent and accountable manner. The emergence of a “resource curse”, which can stunt productive sectors and could contribute to conflict in fragile states, must be avoided. Lack of transparency in awarding licenses to companies for oil and mineral exploration and development pose major risks, in light of poor governance structures, and could fuel internal conflict, particularly with communities in the areas where such resources are located.

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THE HORN ECONOMIC AND SOCIAL POLICY INSTITUTE

Addis Ababa, Ethiopia
P.O.Box 2692 Code1250
Tel: +251 11 515 3263/65
Fax: +251 11 515 0763
Email: hespi@ethionet.et
Website: www.hespi.org



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