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# Missing Links for Economic Transformation: Securing Policy Coherence in Eastern Africa

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# Contents



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## EXECUTIVE SUMMARY

Africa's launch in early 2018 of the Continental Free-Trade Area marked the continent's ambition to integrate, industrialise and modernise its economies. Eastern Africa is the region that is arguably making the greatest strides towards achieving this goal when compared with other parts of Africa. The governments of Ethiopia, Kenya, Rwanda, Tanzania and Uganda have a stated ambition to be not only exporters in global markets but also regional hubs for various sectors. Kenya wants to supply cars to the region, Ethiopia textiles and apparel, Rwanda business tourism.

**To transform their economies, Eastern Africa's governments, with the support of development partners, should focus on improving policy coherence. Doing so is vital for the region to meet its growth ambitions and create enough jobs for its rapidly rising population.**

**This report was written as a collaboration between the Tony Blair Institute for Global Change and the Overseas Development Institute.**

The region has made excellent progress in recent years in driving growth, boosting trade and investment, and kick-starting sector development efforts. One-stop border posts are now common across the region; electronic single windows for customs are in place; trains run from Addis Ababa and Nairobi to Djibouti and Mombasa; and the ports of Mombasa, Djibouti and Dar es Salaam are functioning well. Foreign direct investment (FDI) in manufacturing in Ethiopia and Rwanda is growing rapidly, while industrial parks are proliferating across the region. All of this has contributed to substantial increases in regional trade and economic growth.

Despite these advances, Eastern Africa has not secured the type of growth—rooted in job-creating high-value sectors—that it aspires to. The region's growth in recent years has been driven primarily by mining, construction and non-tradable services rather than by high-productivity agriculture, manufacturing and tradable services. The region's population is expected to double in the next 40 years.[1] As a result, accelerating economic transformation—which includes agricultural transformation and the development of high-productivity, exportable services—and creating jobs are top priorities for these governments.

One of the most common asks from the job-creating and value-adding private sector is policy coherence and consistency, as highlighted in a 2017 report by the United Nations Economic Commission for Africa (UNECA) and the Overseas Development Institute (ODI) on transforming African economies through smart trade and industrial policy.[2] Policy coherence enables the private sector to plan its investments and better anticipate and manage its risks.

1 "World Population Prospects: The 2017 Revision", United Nations Population Division, United Nations Department of Economic and Social Affairs (UNDESA), accessed June 2018, https://esa.un.org/unpd/wpp/DataQuery/.

2 Linda Calabrese, Maximiliano Mendez-Parra and Lily Sommer, "Transforming African economies through smart trade and industrial policy", United Nations Economic Commission for Africa (UNECA), October 2017, https://www.uneca.org/sites/default/files/PublicationFiles/transforming-african-economies_smart-trade_industrial-policy_eng.pdf.

## KEY FINDINGS

This report looks at three policy areas and cases of incoherence between them in Eastern Africa. These areas are trade policy, investment promotion and policies to develop productive sectors. There are disconnects between each pair:

- **Trade policy and sector development:** Policies on tariffs and non-tariff barriers are often not synchronised with efforts to build a country's export capability. For example, critical imported inputs for priority sectors are still classified as finished goods, thereby incurring high tariffs; tariffs are applied to incentivise import substitution in sectors that are not prioritised for development; critical imported inputs are restricted without efforts to ensure an appropriate local substitute is available; priority imported inputs are taxed as non-priority inputs; and customs fast-tracking is not implemented in priority sectors.[3]
- **Investment promotion and sector development:** Efforts to promote investment into various sectors are often not aligned with efforts to create an investment product. For example, special economic zones (SEZs) are not targeted to priority sectors; there is limited coordination in the planning of export-processing zones (EPZs) and SEZs across different levels of government; and investment promotion efforts by promotion agencies are focused on too broad a range of sectors. In addition, infrastructure planning beyond SEZs is often not targeted to priority sectors, so planning of railways, roads, flights, ports and electricity is not as aligned as it could be to promising sectors that need investment.
- **Trade policy and investment promotion:** Efforts to improve trade links with countries are often not in line with efforts to attract investors into sectors that can exploit those links. For example, there remain cases of misalignment between export and investment promotion strategies; trade facilitation

3 This is not the case everywhere in Africa. Calabrese et al., "Transforming African economies", finds that for most countries in Africa, on average, the effective rate of protection is higher than most-favoured nation tariffs. However, the anecdotal evidence collected shows that this issue affects producers in Eastern African countries.

measures are promised to investors but then not met; and countries do not always capitalise on their opportunities to be members of trade blocs.

These disconnects result in policy incoherence that complicates—and quite probably holds back—investment by high-productivity, job-creating firms that governments want to attract. They occur in large part due to poor coordination within government and between government and private actors.

## RECOMMENDATIONS

To address these systemic challenges, governments and their development partners should take two steps to make progress in this area:

- **Governments, helped by their development partners, should set a short priority list of well-chosen value chains across government as a policy anchor.** These value chains should be fully endorsed by the presidency or the prime minister's office to ensure ownership at the highest levels of government. They should have input from the department of industry and, to a degree, the ministry of agriculture, the department of trade and the investment promotion agency.
- **Governments should establish and invest in a workable but targeted coordination mechanism.** The mechanism should be tailored to the local context and could involve systems and structures in different ministries. It should have overriding power over ministries and agencies, with direct anchoring in the presidency, and a clear and targeted mandate. And it should be designed to align policy and implementation to priority sectors and products across the multiple agencies responsible for sector development, investment promotion and trade.

## INTRODUCTION

Eastern Africa is on the move. Ethiopia, Kenya, Rwanda, Tanzania and Uganda have all sustained average economic growth of 5 per cent or higher since 2001.[4] Ethiopia leads the pack with average growth of 9.1 per cent between 2001 and 2016, followed by Rwanda, Tanzania, Uganda and Kenya, in that order.[5] Gross domestic product (GDP) per capita in Kenya hit $2,900 in purchasing power parity terms in 2016, while Tanzania's reached $2,600. Rwanda, Uganda and Ethiopia followed, at between $1,600 and $1,800.[6] In 2001, Ethiopia's GDP per capita stood at just $650, Rwanda's at $821.

This is impressive progress. The important question now facing these countries is how to maintain and top this performance by transforming their economies, while making growth more inclusive. This is crucial in part because of Eastern Africa's demographics. The region's population is booming: by 2040, Ethiopia's population is set to hit 166 million, Kenya's 81 million, Uganda's 84 million, Tanzania's 109 million and Rwanda's 19 million.[7]

According to the authors' estimates, these five economies need to create 125 million new jobs and decent livelihoods between 2015 and 2040.[8] To achieve this, governments in the region know that the main drivers of their economic growth need to change.

Yet between 2005 and 2016, growth in four of these countries was driven by sectors that do not create quality jobs at scale: mining, construction and forestry (see figure 1).[9] Countries that have depended on these sectors have eventually seen growth peter out. In Kenya, services played a key role but lacked sufficient domestic linkages.[10] In Kenya and Tanzania, manufacturing growth,

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4 "World Development Indicators", World Bank, accessed June 2018, https://data.worldbank.org/products/wdi.

5 Ibid.

6 Ibid.

7 "World Population Prospects", UNDESA.

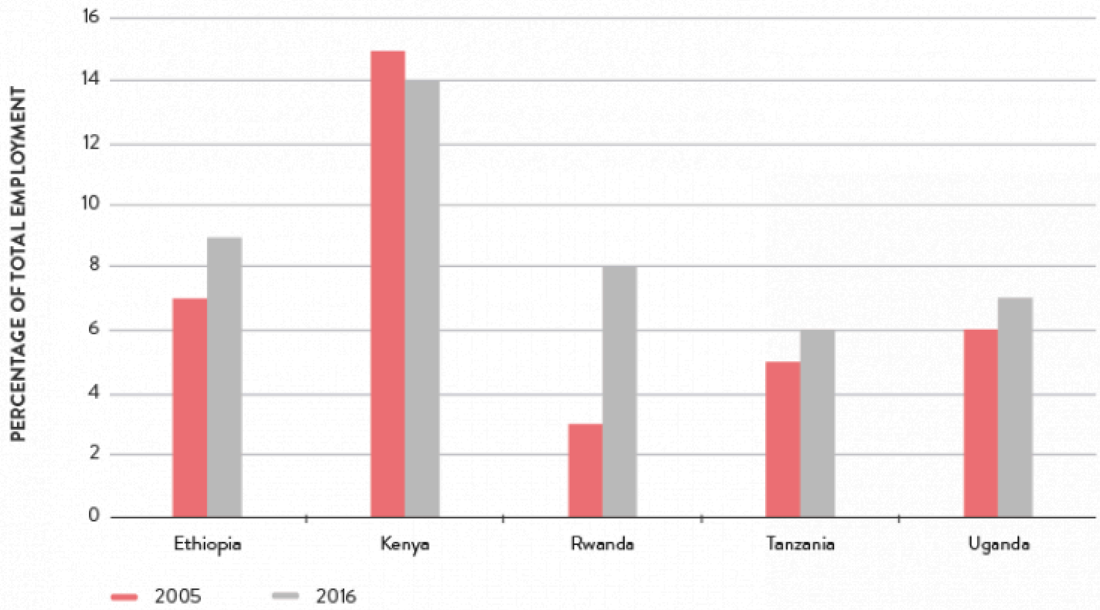
8 This represents the expected growth in the labour force of these countries based on its compound annual growth rate between 1990 and 2016.

9 "World Development Indicators", World Bank.

10 Anupam Khanna, Phyllis Papadavid, Judith Tyson and Dirk Willem te Velde, "The Role of Services in Economic Transformation – With an Application to Kenya", Overseas Development Institute Supporting Economic

which is labour intensive, averaged a mere 4 per cent a year. In Rwanda, manufacturing growth averaged 8 per cent in 2015 and 2016, and in Ethiopia it surpassed 18 per cent, but the sector still only accounts for a mere 6 per cent and 5 per cent of each country's economy, respectively. Uganda has bucked the trend, with manufacturing and services driving growth. With services accounting for 52 per cent of the economy in 2016 and manufacturing only 9 per cent, the service sector is the greatest driver in value terms.

*Figure 1: Compound Annual Growth Rate in Gross Value Added by Sector (Constant Prices), 2005–2016*



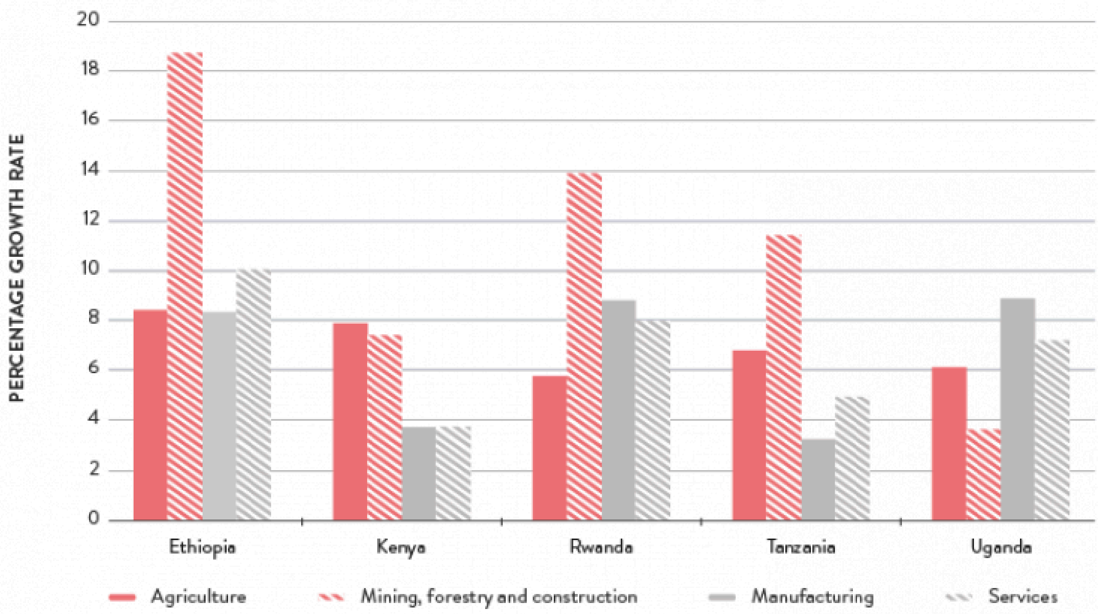

*Source: World Bank World Development Indicators*
*Note: Industrial sector includes manufacturing, mining and construction*

On the employment front, Rwanda significantly increased its share of employment in the industrial sector between 2005 and 2016, potentially on the back of the opening of C&H Garments and other manufacturers that have invested there in recent years. In other countries, the increase in share has been marginal, with Kenya recording a slight decline (see figure 2).[11]

Transformation (ODI SET) Programme, February 2016, https://set.odi.org/the-role-of-services-in-economic-transformation-with-an-application-to-kenya/.

11 "World Development Indicators", World Bank.

*Figure 2: Employment in the Industrial Sector as a Share of Total Employment, 2005–2016*




*Source: World Bank World Development Indicators*

When it comes to FDI, these five countries still face an estimated FDI shortfall of $3.2 billion per year compared with a key growth period in East Asia's rapidly industrialising countries.[12] This investment gap is only 28 per cent of the net overseas development assistance ($11.5 billion) received by these five countries in 2016.[13]

All in all, Eastern Africa has yet to shift its drivers of growth to inclusive, job-creating, high-productivity sectors. Hence, economic transformation is now a top priority for most governments in the region.

12 This calculation is based on the rate of FDI inflows as a share of GDP between 1982 and 1997 (a period of particularly fast growth in East Asia in the run-up to the 1997 crisis) in countries such as China, South Korea and Singapore. FDI levels in this 15-year period were compared with equivalent rates in Eastern Africa between 2002 and 2017.

13 "International Development Statistics", OECD.

## THREE POLICIES FOR ECONOMIC TRANSFORMATION

To achieve economic transformation, it is essential to get three policy areas right:

1. trade policy and regional integration;
2. investment promotion; and
3. market-based sector development.

These are the main tools governments have at their disposal to set the enabling environment for the development of transformative and inclusive sectors such as agriculture, manufacturing and tradable services. They can help governments alleviate market failures; address government limitations; enable market linkages and connections to regional, continental and global value chains; and guide strategic private investment so it can spur inclusive growth. Other policies, such as monetary, fiscal, labour and others, are important but less crucial to countries' ability to achieve economic transformation and industrialisation.

### TRADE POLICY AND REGIONAL INTEGRATION

#### Governments' Efforts

Trade policy and efforts at regional integration have arguably gained most attention and made most progress in Eastern Africa. The region's embrace of trade and regional integration is exemplified by the East African Community (EAC) Common Market, which was launched in 2010 on the back of the Customs Union in 2005.[14] The emphasis in the EAC has been on making trade easier. A number of one-stop border posts have been opened, leading to a 62 per cent reduction in the time taken to pass through major borders.[15]

There have also been improvements in customs systems, including the roll-out of electronic single windows and customs-

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14 The East African Community is a regional economic community composed of Burundi, Kenya, Rwanda, South Sudan, Tanzania and Uganda.

15 "Challenges and Progress on Trade and Investment in East Africa", TradeMark East Africa, presentation to Wilton Park conference, June 2017.

management systems. Transport infrastructure has been prioritised, such as at the ports of Mombasa and Dar es Salaam and in the reconstruction of numerous primary roads.[16] The completion of the new railway from Nairobi to Mombasa, which is planned to reach Kampala and beyond, was another major milestone. Finally, there has been significant investment in harmonising standards, reducing non-tariff barriers and building the capacity of institutions such as customs and standards bureaus.[17] On the services side, there have been some efforts to boost trade, such as in energy through the East Africa Power Pool.

Beyond regional trade, efforts have continued to strengthen broader trade arrangements. Alongside bilateral agreements between individual countries, these arrangements include:

- the Common Market for Eastern and Southern Africa (COMESA) Free-Trade Area;
- the Southern Africa Development Community (SADC) Free-Trade Area (in the case of Tanzania);
- the Tripartite Agreement (the Africa Free-Trade Zone);
- the Continental Free-Trade Agreement (CFTA);
- the Everything But Arms (EBA) agreement with the European Union (EU); and
- the Africa Growth and Opportunity Act (AGOA) with the United States (US).

Similarly, Ethiopia has embraced international trade. Its focus has been on exports through the Port of Djibouti and the transport infrastructure necessary for these exports—as epitomised by the construction of numerous roads to Djibouti and the new Addis Ababa–Djibouti railway, as well as the recent introduction of a new electronic customs-management system.

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16 According to TradeMark East Africa, the Port of Mombasa has seen a reduction in import and export processing time from 11.2 days in 2010 to less than seven days in 2015. In Dar es Salaam the reduction for the same time period was from 11.2 days to 7.3 days for imports and from 14 days to 5.3 days for exports.

17 Joe Amoako-Tuffour, Neil Balchin, Linda Calabrese and Max Mendez-Parra, "Trade Facilitation and Economic Transformation in Africa", ODI SET Programme, March 2016, https://set.odi.org/wp-content/uploads/2016/03/SET-ACET-ATF-Trade-Facilitation-Paper.pdf.

### Impact of Governments' Efforts So Far

There have been important gains in reducing the cost of transporting goods. The average costs of transporting a 6-metre container to and through Mombasa dropped from $2.90 per kilometre in 2011 to $2 in 2016.[18] This has helped Rwanda and Uganda increase the share of their exports to the EAC and its neighbours in COMESA and SADC. Rwanda's share of goods exports to the EAC and its neighbours, particularly the Democratic Republic of the Congo and Tanzania, increased from an average of 32 per cent in 2001–2003 to 48 per cent in 2013–2016.[19] That rise reflects Rwanda's emphasis on regional trade as the country seeks to reduce dependence on expensive exports outside Africa. Uganda tells a similar story, with an increase from 20 per cent to 38 per cent in the same period, driven by significant export growth to Rwanda, South Sudan, the Democratic Republic of the Congo and Kenya.

Intra-regional trade from Kenya, Tanzania and Ethiopia has grown in value terms over the past ten years but remained roughly constant as a percentage of GDP.[20] Tanzania's share of exports to the EAC and its neighbours has been largely stagnant and overshadowed by the growth in gold exports to South Africa.[21] Kenya's geographic exports shares remained largely unchanged. Meanwhile, Pakistan, the US and the Netherlands have become more important markets for Kenya's coffee, textiles and cut flowers. Finally, Ethiopia's share of exports to its neighbours increased only marginally, driven by an uptick in exports to Somalia and Kenya.

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18 "Challenges and Progress on Trade and Investment in East Africa", TradeMark East Africa, presentation to Wilton Park conference, June 2017. There remains a need for further progress—the target is $1 per kilometre, as in middle-income countries—though it is widely recognised that the region has made significant progress in this area.

19 "Trade Map", International Trade Centre, accessed June 2018, www.trademap.org.

20 "World Investment Report 2018: Investment and New Industrial Policies", United Nations Conference on Trade and Development (UNCTAD), 2018, http://unctad.org/en/PublicationsLibrary/wir2018_en.pdf.

21 Ibid.

## INVESTMENT PROMOTION

### Governments' Efforts

Governments in the region are increasingly trying to attract foreign investment. Ethiopia, Rwanda and Kenya have all strengthened their investment promotion capabilities, with institutions like the Ethiopian Investment Commission (EIC), the Rwanda Development Board (RDB) and Keninvest gaining prominence in their respective governments and attracting some of the countries' best talent. EIC, RDB and the Tanzania Investment Centre are all one-stop shops for investment promotion and report to the head of state. Their chief executives are senior figures in each country's cabinet. These factors are not true in many other African countries.

### Impact of Governments' Efforts So Far

These efforts have borne real results, particularly in Ethiopia. In 2017, Eastern Africa attracted $7.6 billion in FDI, with Ethiopia accounting for nearly half of this, mainly in textiles and other light manufacturing. Ethiopia ranked second in FDI in Africa in 2017, attracting $3.6 billion, trailing only Egypt.[22] Rwanda has attracted C&H Garments, the country's new largest employer, while Uganda has made inroads in manufacturing and scores relatively well on the product space, with sectors such as paints, plastics, hair preparations, packaging and processed foods growing significantly and demonstrating further potential for growth.[23]

In contrast, Kenya attracted only $672 million in FDI in 2017, mostly through investments in information and communication technology (ICT), other tech-oriented sectors and retail—but relatively little in manufacturing.[24] In Tanzania, gold and technology—through the likes of Facebook and Uber—led foreign investment into the country, not manufacturing or high-value

22 Ibid.

23 "Atlas of Economic Complexity", Center for International Development, Harvard University, accessed June 2018, http://atlas.cid.harvard.edu/rankings/growth-projections/.

24 "2018 World Investment Report", United Nations Commission on Trade and Development.

agriculture. The policy incoherence in Tanzania's mining sector further highlights the importance of focusing on inclusive sectors.

## MARKET-BASED SECTOR DEVELOPMENT

### Governments' Efforts

There has also been progress on market-based sector development—smart, modern industrial policy—although arguably less than in the other two policy areas. Improvements were made during the 2000s and 2010s in agriculture, particularly in Tanzania, through the Southern Agriculture Growth Corridor of Tanzania (SAGCOT);[25] in Ethiopia, through former Prime Minister Meles Zenawi's prioritisation of agriculture from 1993 and the roll-out in 2010 of the Agriculture Transformation Agency (ATA);[26] and in Kenya, which prioritised value chains such as floriculture and horticulture, beyond productivity improvements in traditional crops such as coffee and tea. In addition, Kenya has led the region in high-value service sectors, such as ICT development and digital and mobile finance, while spearheading the growth of the tourism sector with Ethiopia, Tanzania and Rwanda.

In the 2010s, manufacturing started to take centre stage again, following the shunning of heavy-handed industrial policy common during the 1960s and 1970s and structural adjustment programmes (SAPs) of the 1980s and 1990s. This decade, Ethiopia, Kenya, Rwanda and Tanzania have all put particular emphasis on industrialisation. While Kenya has the largest and strongest manufacturing sector, Ethiopia has led the charge since 2012. Having invested in agriculture from the 1990s, Ethiopia prioritised manufacturing in its Growth and Transformation Plans I and II in 2010 and 2015, respectively.

Kenya has recently re-embraced sector development, with agriculture and manufacturing taking a central place in President

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25 "Southern Agricultural Growth Corridor of Tanzania (SAGCOT)", SAGCOT Centre Ltd., accessed June 2018, http://sagcot.co.tz/.

26 Martin Plaut, "The legacy of Meles Zenawi", Review of African Political Economy 39, no. 134 (2012), https://doi.org/10.1080/03056244.2012.738796; "Origin & History", Ethiopian Agricultural Transformation Agency (ATA), accessed June 2018, https://www.ata.gov.et/about-ata/origin-history-2/.

Uhuru Kenyatta's Big Four plan, launched in 2017. Tanzania's second five-year development plan, which runs from 2016 to 2021, is subtitled "Nurturing Industrialization for Economic Transformation and Human Development".[27]

**Impact of Governments' Efforts So Far**

It is still early days for these efforts to reap transformative change. Manufacturing value added as a percentage of GDP has actually fallen in recent years in four of the five countries; Ethiopia is the lone country showing a positive trend.[28] Across all five, the biggest exports in 2001 remained the biggest in 2016, and contributed the most to the countries' growth in export value.[29] Unfortunately these are commodity-based sectors that do little to support the economic transformation process because the scope for domestic value addition is severely limited—as seen in their poor performance on the product space. These sectors include gold and gemstones in Tanzania, gold and coffee in Uganda, coffee and tea in Ethiopia and Kenya, and coffee, tea, tin, tantalum and tungsten in Rwanda.

However, below the surface there are encouraging developments in high-value agriculture, certain manufacturing sectors and tradable services. In Rwanda, the five traditional commodity exports mentioned above saw their share of total goods exports decline from 87 per cent in 2001 to 66 per cent in 2016.[30] Wheat and corn—both produce and their processed flours—as well as beverages have eaten into this share, accounting for 13 per cent of the country's exports, compared with just 1 per cent in 2001. Corn and wheat allow many downstream value-added products to be produced with a relatively low investment compared with agro-commodities like coffee. Tourism has also grown significantly to become Rwanda's top export sector and foreign-exchange earner.[31]

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27 "National Five Year Development Plan 2016/17–2020/21", Ministry of Finance and Planning, The United Republic of Tanzania, June 2016, http://extwprlegs1.fao.org/docs/pdf/tan166449.pdf.

28 "World Development Indicators", World Bank.

29 "Trade Map", International Trade Centre.

30 Ibid.

31 "An Outlook of Rwanda's Export Performance", World Bank, May 2014, http://www.worldbank.org/content/dam/Worldbank/document/Trade/Rwanda%20Infographic%20-%20An%20Outlook%20of%20Rwanda%27s%20Export%20Performance.pdf.

In Ethiopia, large-scale investment in agriculture from 2004 has reduced the country's dependence on coffee exports.[32] While horticulture, floriculture, oil seeds and meat accounted for 21 per cent of Ethiopia's goods exports in 2001, this share had risen to 46 per cent by 2016, worth $1.3 billion in new annual exports relative to 2001.[33] In addition, Ethiopia's shift into manufacturing in 2012 and its prioritisation of industrial-park development since has started to yield results, with footwear and garments increasing their share of exports from 0.2 per cent in 2001 to 4.5 per cent in 2016, and with increasing exports to the US under AGOA. Ethiopian manufacturing exports rose to $238 million in 2016 from $100 million in 2012.[34]

Beyond coffee and tea, which still dominate as the principal drivers of agriculture growth in Kenya, the country has done well to develop floriculture exports, which grew from $153 million in 2001 to $600 million in 2016. These value chains are the main drivers of growth in Kenya's economy, in addition to the service sector. Sectors like garments, plastics and pharmaceuticals doubled their goods-export share from 5 per cent in 2001 to 10 per cent in 2016, while beverages, soaps and machinery also performed well. As in Ethiopia, Kenya's exports of textiles and apparel to the US under AGOA have also increased, reaching $338 million in 2017.[35]

Notwithstanding Tanzania's dependence on gold and gemstone exports—untouchable at 30 per cent of goods exports—encouraging signs are coming from agro-processing, glassware, horticulture and oil seeds, reflecting the gains from SAGCOT and agriculture investment generally (and their spillovers into light manufacturing). Previously large sectors like fish and tea continued their decline.

Finally, Uganda has also made some progress in transforming its composition of goods exports. Coffee and tea's share in exports declined from 29 per cent to 21 per cent, fish declined from 18 per

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32 Lars Christian Moller, "Ethiopia's Great Run: The Growth Acceleration and How to Pace It", World Bank, February 2016, http://documents.worldbank.org/curated/en/693561467988949839/pdf/99399-REVISED-PUBLIC-thiopia-Economic-Update-2-11-16-web.pdf.

33 "Trade Map", International Trade Centre.

34 "World Development Indicators", World Bank.

35 "Trade Map", International Trade Centre.

cent to 5 per cent, while gold retained its share at around 10 per cent. These have been replaced by exports of corn and wheat, horticulture, sugar, dairy, other agro-processing, and plastics and packaging, whose collective share increased from 4 per cent of goods exports in 2011 to 21 per cent in 2016.[36]

36 Ibid.

## STEPPING UP PROGRESS

Despite Eastern African governments' increased focus on trade policy, investment promotion and sector development, growth has largely come from extractives, coffee and tea.[37] Meanwhile, the region's rapid population growth and its transformation ambitions require that value-adding agriculture, manufacturing and high-productivity (tradable) services drive their economies. Eastern African countries need to up their game.

The region's economic transformation needs synchronised efforts by governments to support private investment. This entails lowering the costs faced by investors, making the investment process easier and providing the right infrastructure.[38] The neoliberal tradition promoted under the Washington Consensus advised policymakers in developing countries to provide the optimal environment for investment, without selecting sectors or picking winners. More recently, as governments realised that this neutral or horizontal approach has not delivered the results it promised, selective industrial policy has experienced a resurgence.[39] Buoyed by recent successes in China and Vietnam, this modern industrial policy mixes a vertical approach of sector promotion with targeted horizontal measures that strengthen the business-enabling environment.[40]

Eastern African countries have tried to follow this approach to some extent. They often identify sectors to be developed, in a multitude of policy and strategy documents. Yet it is common to find different sectors identified as priorities in the same country, with the national industrial policy differing from the export

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37 As shown by the GDP and export data presented in the previous chapter.

38 Dani Rodrik, "Industrial Policy for the Twenty-First Century", John F. Kennedy School of Government, Harvard University, September 2004, https://drodrik.scholar.harvard.edu/files/dani-rodrik/files/industrial-policy-twenty-first-century.pdf.

39 Joseph Stiglitz, Justin Lin, Célestin Monga and Ebrahim Patel, "Industrial Policy in the African Context", Policy Research Working Paper 6633, World Bank, September 2013, http://documents.worldbank.org/curated/en/443841468002407129/pdf/WPS6633.pdf.

40 Jesus Felipe, "Modern Industrial Policy", in Development and Modern Industrial Policy in Practice: Issues and Country Experiences, ed. Jesus Felipe (Manila: Asian Development Bank and Edward Elgar Publishing, 2015), 1–23, https://www.adb.org/sites/default/files/publication/158170/development-modern-industrial-policy-practice.pdf.

promotion policy, and both differing from short- or medium-term planning documents.[41] These differences are not overly surprising, as they emerge from a sequenced policy process, in which each document is drafted at a different point in time and thus reflects the policy priorities of the moment. However, their incomplete overlap is not ideal, as it can generate confusion and inhibit coordinated use of scarce government resources.

Moreover, this vertical approach is often limited to sector support. Investment promotion and trade facilitation are typically oriented towards purely horizontal or cross-sector purposes but are not employed in service of the sectors that have been identified as priorities. So far, the literature has tended to look at these policy areas in isolation.[42] Yet, work by the Tony Blair Institute for Global Change and the Overseas Development Institute across Eastern Africa suggests that these three policy areas are not as synchronised with each other as they need to be.

To move to the next stage in its growth trajectory, the region needs to strengthen the links between these policy areas, rather than working on them separately or at cross purposes. For Eastern Africa to transform, it needs more effective policy and implementation coordination, particularly within governments, on the development of transformational value chains and subsectors.[43] This can enable cooperation between countries in the region as well as with their neighbours.

41 For an example based on the case of Rwanda, see Linda Calabrese, "Assessing the potential impact of investment options in Rwanda", ODI SET Programme, forthcoming.

42 Dirk Willem te Velde, Neil Balchin, Karishma Banga and Sonia Hoque, "Manufacturing in Africa: Factors for Success", ODI SET Programme, June 2018, https://set.odi.org/wp-content/uploads/2018/06/Manufacturing-in-Africa-Factors-for-Success_June-2018.pdf.

43 Kartik Akileswaran, Antoine Huss, Dan Hymowitz and Jonathan Said, The Jobs Gap: Making Inclusive Growth Work in Africa, Tony Blair Institute for Global Change, June 2017, https://institute.global/insight/governance/jobs-gap-making-inclusive-growth-work-africa.

## THREE POLICY DISCONNECTS

To sketch out the contours of the policy coherence challenge, this chapter looks at specific examples of disconnects between trade policy, investment promotion and sector development, taking each pair in turn. The aim is to use these examples to make specific recommendations governments can follow to address this challenge.

### TRADE POLICY AND SECTOR DEVELOPMENT

Effective trade policy can help countries promote domestic value addition.[44] However, trade policy and market-based sector development (or modern industrial policy) remain largely disconnected. To speed up Eastern Africa's economic transformation, the trade policies of each country and of the region need to be centred on the goods and services that each nation seeks to produce for export—immediately or in the future, to the region or beyond.[45] Below are four examples of specific disconnects that currently hold up progress.

#### Critical Imported Inputs Defined as Finished Goods

The EAC Common External Tariff (CET) is designed to promote domestic value addition by discouraging the import of finished goods and encouraging the import of raw materials. It has three tariff bands: 0 per cent on raw materials, 10 per cent on semi-finished goods and 25 per cent on finished products.[46] However, in practice, some goods that are critical inputs in the production process in priority sectors are defined as finished products and therefore taxed at 25 per cent. Examples of such inputs are price

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44 "Economic Report on Africa 2015: Industrializing Through Trade", United Nations Economic Commission for Africa (UNECA), March 2015, https://repository.uneca.org/bitstream/handle/10855/22767/b11524819.pdf?sequence=1.

45 Exports are particularly important because Eastern African economies are small relative to the rest of the world. As a result, gaining a greater share in international markets has the potential to substantially boost growth.

46 There are exceptions, however, including sensitive items and items excluded from the three-band system, which usually attract higher tariff rates.

tags for finished products, steel rods (which are used to make bolts, among other things), buttons, zips and packaging materials.[47]

This arrangement reflects the mismatch between the region's desire to promote value addition and its trade policy.[48] A review of the CET is under way, which should aim to correct these disincentives.

**Reliance on Trade Policy to Develop Selected Sectors**

Demand for edible oils has grown significantly in Tanzania.[49] The country produces large quantities of sunflower seeds, but relatively little edible oil. Currently Tanzania imports 60 per cent of its edible oil. Because exports are limited, much of the surplus sunflower seed is consumed domestically without further processing.

The Tanzanian government believes it has a business case for increasing the domestic value addition of edible oil. This has driven the development of the Sunflower Sector Development Strategy 2016–2022. To encourage domestic producers to process more edible oil, the government has opted to use trade policy and stay the application of the EAC CET on an imported competitor, crude palm oil, thereby applying a 10 per cent (instead of 0 per cent) tariff to it. This was first applied in 2016–2017 and was extended in 2017–2018.

However, at the moment, the sector has limited capability to respond to this policy. Tanzania has only a few large-scale

47 Interview with producers, interview by Linda Calabrese, May 2018. A manufacturer interviewed by ODI in May 2018 said that he often needed spare bolts, but it was very difficult to find the right ones in the region; if he wanted to produce bolts, the steel rods that he would have needed as inputs would be charged at 25 per cent. Interviews with manufacturers, interviews by Linda Calabrese, May 2018, and James Anyanzwa, "EAC set to miss another common tariff deadline", East African, 1 January 2018, http://www.theeastafrican.co.ke/business/EAC-set-to-miss-another-common-tariff-deadline-/2560-4247570-c2bctaz/index.html.

48 Calabrese et al., "Transforming African Economies".

49 This example is drawn from Neil Balchin, Josaphat Kweka and Maximiliano Mendez-Parra, "Tariff setting for the development of the edible oil sector in Tanzania", Agricultural Non-State Actors Forum and I4ID Inclusive Development, February 2018, http://dev.ansaf.or.tz/wp-content/uploads/2018/04/I4ID-Tariff-setting-in-Tanzanias-edible-oil-sector_FINAL-Report_26-Feb-2018.pdf.

processors in the sector, and the small-scale processors face significant constraints. These include the use of poor-quality or outdated technology, inputs and machinery; challenges in accessing finance and reliable electricity; and limited market linkages and warehousing facilities. Despite the existence of the sunflower strategy as a document, there is no coherent cross-government strategy to address these constraints in a timely and effective manner, to match Tanzania's trade policy on sunflowers.

This raises questions about the effectiveness of the trade-policy measure. Tariff policies on their own are unlikely to be effective unless they are accompanied by measures to address binding constraints on production and processing and encourage investment in downstream processing and upstream seed production.

Moreover, using tariffs to protect sectors that are not genuinely prioritised for development risks causing symptoms similar to Dutch disease—the stunting of productive sectors like agriculture or manufacturing due to currency appreciation stemming from the growth of other (often high-rent) sectors. This is because tariff protection may lead the protected sectors to expand domestically, drawing in and raising the cost of inputs and making it more expensive for other sectors (including priority sectors) to purchase those inputs, making these sectors less competitive. In addition, in countries with flexible exchange rates, applying tariffs on imports to non-priority sectors may lead currencies to strengthen, making actual priority sectors less competitive.

**Priority Imported Inputs Taxed as Non-Priority Inputs**

Firms operating in priority manufacturing sectors in Ethiopia are entitled to duty-free imports of capital goods, raw materials and other inputs. Although straightforward, this policy runs into challenges when it comes to implementation, in part because some raw materials are imported by firms in both priority and non-priority sectors.

A medical-gloves manufacturer explained in an interview that it imports rubber extensively but often runs into trouble with the customs authority in Ethiopia, because the latter believes the rubber is being imported for the production of tyres, which is not a priority manufacturing sector. The company has attempted to clarify the different uses of rubber as an input with the Ethiopian Ministry of Finance and Economic Cooperation, with little success so far. As a result, it has been forced to pay the tariff on its rubber imports despite operating in a priority sector. As this example demonstrates, the disconnect between de jure and de facto trade policy hinders development of important sectors.

**Customs Facilitation Not Prioritised for Priority Sectors**

In 2014 the EAC introduced the concept of authorised economic operators (AEOs) under a framework developed by the World Customs Organisation.[50] Under this framework, businesses that are considered trusted and low risk by the domestic revenue authorities qualify for preferential treatment for the clearance of goods, through the use of simplified procedures that can reduce time at borders. This reduces costs and increases reliability for companies that receive this status.

Since ratification, 73 businesses in the EAC have obtained AEO status.[51] A closer inspection reveals a wide variety of companies—for example in Kenya, transporters, freight forwarders, retailers, and producers of food and fast-moving consumer goods.[52] In Uganda, AEO companies include producers of food and construction materials, telecoms companies and importers.[53] These are typically not sectors that governments in the region are prioritising for development. Instead, companies receiving AEO

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50 Haike Barczyk, "WCO Supporting Implementation of the WTO Agreement on Trade Facilitation", presentation, Geneva, 16 June 2014, https://www.wto.org/english/tratop_e/tradfa_e/2.pdf.

51 Eunice Murathe, "73 firms join plan for fast EAC trade", Daily Nation, 9 April 2018, https://www.nation.co.ke/business/73-firms-join-plan-for-fast-EAC-trade/996-4378490-686qcgz/index.html.

52 Rodgers Tumo, "KRA recommends five Kenyan Authorized Economic Operators for regional recognition", Kass FM, 29 March 2018, http://www.kassfm.co.ke/home/2018/03/29/kra-recommends-five-kenyan-authorized-economic-operators-for-regional-recognition/; Brian Otieno, "Authorised Economic Programme to reduce cost of regional business", Star, 6 April 2018, https://www.the-star.co.ke/news/2018/04/06/authorised-economic-programme-to-reduce-cost-of-regional-business_c1741238.

53 Paul Ampurire, "URA grants 28 local businesses Authorized Economic Operator Status", SoftPower, 14 February 2018, https://www.softpower.ug/ura-grants-28-local-businesses-authorized-economic-operator-status/.

status are those that have built good relationships with revenue authorities.

This issue also crops up in Ethiopia, where investors in sectors targeted by the government for investment and growth, such as pharmaceuticals, face challenges in getting their equipment through customs.[54] To an extent, this reflects a lack of coordination between sector development agencies, such as ministries of industry and trade, and customs and revenue authorities. While maintaining high quality and rigour in their customs control, trade and customs authorities should also ensure that their activities enable sector development priorities.

## INVESTMENT PROMOTION AND SECTOR DEVELOPMENT

The prioritisation of sectors for investment promotion is important because it indicates to investors which sectors the government is serious about and signals to government agencies where they should focus their energy, so they can coordinate with each other. It also helps create an investment product by ensuring that the enablers needed to make investments feasible—such as affordable access to energy, roads, inputs, land, markets, finance, technology and a coherent tax and regulatory environment—are provided as cost effectively as possible.

This policy coherence and consistency is essential for investment planning by the private sector because the factors that determine the success of an investment are shaped by many parts of government—from energy agencies to roads ministries to tax collectors to customs managers and more. In practice, the current extent of this coherence leaves much to be desired, as the following three examples show.

### Investment Promotion Efforts Lacking Sectoral Focus

54 Helen Hai, "Why invest in Africa: markets, know-how and comparative advantage", in China-Africa: a maturing relationship? Growth, change and resilience, ed. Linda Calabrese (London: DFID-ESRC Growth Research Programme, 2016), 13–16, https://dl.orangedox.com/DEGRP-China-Africa-Essays-May-2016.

At the highest level, this disconnect is manifested is through different government agencies focusing on different sectoral priorities, which are not always reflected in the broader policy agenda.

Take the case of Uganda. Many planning documents in the country identify sectoral priorities, but they do not always match. Uganda Vision 2040, the overarching framework that guides the national development agenda, identifies the main opportunities in tourism, agriculture, oil and gas, minerals, industry, and the knowledge and ICT sector.[55] Meanwhile, the Uganda Investment Authority refers to agriculture, agribusiness, ICT, tourism, packaging, mining, oil and gas, renewable energy, manufacturing, infrastructure and services as priorities. These are long lists that contain overly broad categories of economic activity. In other words, they are not prioritised. Other government documents and strategies also fail to prioritise sectors for the country. The Government of Uganda has created a broadly stable macroeconomic environment conducive to investment but has not determined strategic priorities to take advantage of this environment.[56]

As a result, it is unclear how these broad priorities translate into action. Regional opportunities are identified, but they reflect what investors could be interested in, rather than areas of government focus.[57] There do not seem to be special incentives or fast-track processes for any sectors. Similarly, the Uganda Investment Authority does not have dedicated capacity to develop bankable projects that can be marketed to target investors.

This challenge is not unique to Uganda. During an event in Rwanda in February 2018, the Rwanda Development Board mentioned that in an analysis of government policies, 60 subsectors had been identified as priorities in recent years—rendering the

55 "Uganda Vision 2040", National Planning Authority, Government of Uganda.

56 Marios Obwona, Isaac Shinyekwa, Julius Kiiza and Eria Hisali, "The evolution of industry in Uganda", Learning to Compete working paper no. 9, Brookings Institution, July 2016, https://www.brookings.edu/wp-content/uploads/2016/07/L2C_WP9_Obwona-et-al.pdf.

57 "Investment Profiles", Uganda Investment Authority, accessed June 2018, http://www.ugandainvest.go.ug/priority-sectors/other-investment-opportunities/investment-profiles/.

prioritisation rather futile.[58] This lack of coordination and prioritisation between sector development and investment priorities represents a missed opportunity. Scarce government resources are allocated across the board, rather than channelled towards the sectors that countries can best compete in.

**Special Economic Zones Not Targeted to Priority Sectors**

Another area where this disconnect plays out is in clustering efforts. The agglomeration of firms is important to increase productivity and support sustained growth. Historically, countries like the United Kingdom and Italy, and more recently China and the US (specifically Silicon Valley), have benefited from clustering.[59] The advantages of agglomeration, especially for companies that produce similar goods, have been highlighted in Asia and in studies that focus on the experiences of firms.[60] Creating clusters of firms has several benefits. First, it reduces transport and transaction costs by locating firms close to their suppliers or customers. Second, it creates a pool of workers with the common skills that firms need. Third, it promotes knowledge spillovers and the exchange of ideas.

When these clusters do not arise naturally, they require active promotion efforts to be developed. To promote investment and value addition, many African countries are developing dedicated areas that offer appropriate infrastructure, such as industrial parks; special investment regimes, such as export-processing zones (EPZs);

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58 "Rwanda's development path over the next 30 years", International Growth Centre and Tony Blair Institute for Global Change, 14 February 2018, https://www.theigc.org/multimedia/rwandas-development-path-next-30-years/.

59 Célestin Monga, "Theories of Agglomeration: Critical Analysis from a Policy Perspective", in The Industrial Policy Revolution I: The Role of Government Beyond Ideology, ed. Joseph Stiglitz and Justin Yifu Lin (London: Palgrave Macmillan, 2013), 209–224.

60 Arkebe Oqubay, Made in Africa: Industrial Policy in Ethiopia (Oxford: Oxford University Press, 2015); Carol Newman and John Page, "Industrial clusters: The case for Special Economic Zones in Africa", WIDER Working Paper 2017/15, United Nations University—World Institute for Development Economics Research, January 2017, https://www.wider.unu.edu/sites/default/files/wp2017-15.pdf; Jiajun Xu, Stephen Gelb, Jiewei Li and Zuoxiang Zhao, "Adjusting to Rising Costs in Chinese Light Manufacturing: What opportunities for developing countries?", ODI SET Programme, December 2017, https://set.odi.org/wp-content/uploads/2017/12/SET_Survey-report_Chinese-manufacturing_Final.pdf.

or both, as in the case of special economic zones (SEZs). Examples abound, from the many SEZs in Ethiopia and Rwanda to the free zones in Uganda and the EPZs in Kenya.

A common issue in developing countries is that given the scarce interest of investors, all investors are encouraged to invest, without any particular attention to the sector. In the words of Célestin Monga, vice president and chief economist of the African Development Bank, policymakers in developing countries "assumed that any foreign firm that would be willing to join an SEZ or EPZ would create some employment, which would be better than nothing. One consequence of the absence of identification strategies was the random emergence of small single firms from very different types of industries."[61]

These zones are widely studied in the economic literature, which has recognised their costs and benefits.[62] Despite these benefits, which are all essential if Eastern Africa is to fast-track its economic transformation, most SEZs and industrial parks in the region are mixed use—that is, they welcome investment of all types. For example in Uganda, the free zones do not set limitations on eligible sectors. Similarly, Rwanda's main economic zone currently hosts firms that produce garments and food products, laptop and motorcycle assembly, and light-emitting diode (LED) manufacturing. A biscuit manufacturer in the zone had significant quality problems caused by the emissions of its next-door neighbour, a chemicals company.

Often the lack of demand in the targeted sectors, combined with the desire to fill the zones, leads zone authorities to accept investment from a range of sectors. This can be traced to a lack of coordination between investment promotion and sector priorities, because sector priorities are not complemented by proactive and targeted investment promotion campaigns.[63] It also sometimes

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61 Monga, "Theories of Agglomeration", 215.

62 Douglas Zhihua Zheng, "Special Economic Zones: Lessons from the Global Experience", PEDL Synthesis Paper Series No. 1, Department for International Development, 1 November 2016, https://assets.publishing.service.gov.uk/media/586f9727e5274a130700012d/PEDL_Synthesis_Paper_Piece_No_1.pdf.

63 David Booth, Linda Calabrese and Frederick Golooba-Mutebi, "Kick-starting economic transformation in Rwanda: Four policy lessons and their

reflects poor coordination between those in government planning zones and those prioritising sectors, as the former may not satisfy all of the infrastructure and other requirements of the targeted sectors. And lest we forget, SEZs and industrial parks are costly investments.

All of this said, the region is increasing its focus on clustering. In Kenya, there are plans to set up zones dedicated to the processing of textiles and garments, and leather.[64] One example is Textile City, to be set up in the Athi River EPZ. Another is Navaisha SEZ. Here the government is actively trying to attract suppliers of yarns, elastics and other materials to the zone. In Ethiopia, Hawassa Industrial Park focuses on textiles and apparel, and several other parks have been inaugurated that will also focus on the sector. In addition, Kilinto Industrial Park will specialise in pharmaceuticals.[65]

**Limited Coordination With Local Governments**

Efforts to develop EPZs and SEZs require not only a clear prioritisation of sectors but also a clear division of labour between levels of government. Kenya started a devolution process in 2010, to assign powers and responsibilities to 47 county governments. These included responsibilities in trade and investment.[66] If designed correctly and without excessive emphasis on financial incentives, the devolution process can have positive effects by encouraging counties to develop their own investment promotion capacity and thus generate healthy competition.[67] Counties have

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implications", ODI SET Programme, June 2018, https://set.odi.org/wp-content/uploads/2018/06/SET-Briefing_Kickstarting-ET-in-Rwanda_Final.pdf.

64 Aarti Krishnan, Dirk Willem te Velde and Anzetse Were, "Kenya-UK Trade and Investment Relations: Taking stock and promoting exports to the UK", ODI SET Programme, July 2018, https://set.odi.org/wp-content/uploads/2018/07/SET-EPC-Kenya-Export-Promotion_Final.pdf.

65 Sonia Hoque, "Ethiopia's economic transformation and job creation: the role of Hawassa Industrial Park", ODI SET Programme, 24 August 2017, https://set.odi.org/sonia-hoque-odi-ethiopias-economic-transformation-job-creation-role-hawassa-industrial-park/.

66 Benard Ayieko, "Ease of Doing Business Index for counties key to investment growth", Business Daily, 6 September 2016, https://www.businessdailyafrica.com/analysis/Ease-of-Doing-Business-Index-/539548-3371710-t8jfdaz/index.html.

67 Anzetse Were, "Manufacturing in Kenya: Features, Challenges and Opportunities – A scoping exercise", ODI SET Programme, August 2016,

set up local investment promotion agencies and are organising investment forums.

However, counties may not have the capacity to translate their efforts into actual investment.[68]The lack of coordination between the national and the county levels on investment promotion exacerbates this problem. Interviews with experts revealed that major decisions at the national level related to the location and scope of investment promotion areas are not taken in adequate consultation with the counties that will host the investment.[69] This undermines the country's ability to secure commitments from investors. While much of the investment promotion drive lies with the national government, the counties are in a better position to understand the strengths and opportunities of their own areas, and should therefore be appropriately consulted.

## TRADE POLICY AND INVESTMENT PROMOTION

Trade and investment are two sides of the same coin. Often what makes investors interested in a location is the ability not only to sell their products in the host market but also to export to other countries. This is particularly true for African countries, as many of them have preferential access to European, US and other markets. Investors often see African countries as production platforms that allow them to take advantage of this preferential access. Yet many countries have been unable to capitalise on this investor interest because their approach to trade policy and facilitation is out of step with their investment promotion ambitions, as the following three examples illustrate.

### Misaligned Export and Investment Promotion Strategies

If Eastern Africa is to take advantage of its market access advantages, export promotion and investment promotion need to be synchronised. Kenya is an example where such alignment seems missing. Table 3 shows the sectors identified as priorities by the preparatory work for the National Export Development and

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https://set.odi.org/wp-content/uploads/2016/09/Manufacturing-in-Kenya-Anzetse-Were.pdf.

68 Ibid.

69 Interviews by Linda Calabrese, May 2018.

Promotion Strategy for Kenya 2017–2022 and the investment opportunities identified by Kenya's investment promotion agency, Keninvest.[70] While there are areas of overlap (highlighted in bold), interviews with experts revealed that these priorities have not been developed with adequate consultation among government institutions.

*Table 3: Comparison of Kenya's Export Strategy and Investment Promotion Website*

| National Export Development and Promotion Strategy | Investment Promotion Agency (Keninvest) Website |
|---|---|
| • Livestock and livestock products<br>• **Agriculture**<br>• Fisheries<br>• **Manufacturing**<br>• Service sector (**tourism**, transport, **communication**, logistics, maritime services, professional services, **financial services**, **IT**, sports, performing arts)<br>• Emerging sectors (**mining** and minerals, oil and gas, **power**) | • **Energy**<br>• **Financial services**<br>• **ICT**<br>• **Agriculture**<br>• **Infrastructure**<br>• **Manufacturing**<br>• **Mining**<br>• Real estate<br>• **Tourism**<br>• County-level opportunities (for example, construction opportunities created by the political devolution process) |

70 "The National Export Development and Promotion Strategy for Kenya 2017–2022", Report of the Initial Preparatory Work 2017: Institutional Framework and Scope of Work for Sector Working Groups, Republic of Kenya, June 2017, https://kepsa.or.ke/download/national-export-development-and-promotion-strategy/?wpdmdl=16490.

*Source: Government of Kenya*

The lack of policy dialogue between investment and export promotion agencies is another missed opportunity to support priority sectors, rationalise these long lists of priority sectors and focus on promising subsectors and value chains.

**Regional Hub Goals Not Matched by Trade Bloc Membership**

For many sectors, Ethiopia's status in trade agreements aligns well with the story it tells investors to attract them to the country. Textiles and apparel are a prime example, because investors can take advantage of the country's status under AGOA and the EBA agreement to export to the US and Europe, respectively. However, some priority sectors have fallen through the cracks in this regard, and not enough effort has been given to understanding and laying the groundwork for export opportunities in the future.

For example, Ethiopia aspires to become a regional hub for pharmaceuticals. Yet it has not aligned its trade policy with this aspiration. The country is a member of COMESA but is not party to the COMESA Free-Trade Agreement (FTA), so it does not benefit from reduced tariffs on these products in the COMESA region.[71] This will be essential if the country wants to become a regional pharmaceutical export hub. The Ethiopian Investment Commission has rightfully been proactive in engaging with investors in pharmaceuticals, but its efforts have left the Ministry of Trade behind. Hence, the sector strategy should pay explicit attention to this sort of trade issue to signal to investors that the government is working towards its regional export goal. Improving communication between agencies such as the Investment Commission and the Ministry of Trade is important to address such challenges.

**Promised Trade Facilitation Measures Not Met**

Another risk of weak alignment between trade facilitation and investment promotion is the setting of false expectations for investors. For many priority manufacturing sectors in Ethiopia, the government offers a series of incentives to attract investors, many

71 Ethiopia has signed the Africa Continental Free-Trade Agreement and made steps in recent years towards eventual accession to the COMESA FTA. The key will be to follow through in practice on these initial on-paper commitments.

of which relate to enabling the import of inputs and the export of finished products. After investors establish themselves in the country, however, they often face difficulties in availing themselves of these incentives. Dealing with the customs agency and process is a major source of frustration for investors, due to its inefficiencies and spotty implementation of duty-free import and other incentives.

These mismatches may seem like small frustrations for investors, and in many cases they are being rectified. But unmet investor expectations pose a risk to the government's industrialisation plans. They signal to other potential investors that the reality on the ground falls short of what they have heard and thus harm the country's reputation as a desirable investment destination.

## FACTORS FOR SUCCESS

There remains a gap in evidence on what works best to address these three policy disconnects. Based on the collective experience of the Tony Blair Institute for Global Change and the Overseas Development Institute, countries can best address these challenges by investing in two tasks:

- setting a few promising value chains as a cross-government policy anchor; and
- establishing a coordination mechanism embedded in the centre of government.

### SETTING PROMISING VALUE CHAINS AS A POLICY ANCHOR

Given their limited political capital and institutional capacity, which make coordination across these three policy areas difficult, top leaders in government should identify a focal point around which different ministries and agencies are asked to orient their priorities and operations—a policy anchor. Setting a few promising value chains as a policy anchor promotes focus by, and coordination across, the ministries and agencies involved in sector development.[72] This makes it straightforward for heads of state and champions of economic transformation to communicate their priorities, thus setting a clear sense of direction for multiple stakeholders—in both the public and the private sector—to rally around. It also provides a basis for governments to have a coherent thread running through their prioritisations: from vision to sectors to subsectors to value chains and, finally, to bankable and flagship projects.

Sectors and products bring the politics of these policies closer to home. The political economy and vested interests in specific sectors are, in fact, specific: policymakers and development partners can more easily identify the key players in them, what their interests are and how they may be influencing policymakers.

When trade policy and investment promotion are carried out without a sectoral development anchor, as has typically been the

72 Akileswaran et al., The Jobs Gap.

case in Africa since the 1980s, their objectives are often not moored to broader economic transformation objectives, such as job creation, productivity growth and the widening of the tax base. This approach has exacerbated the disconnects discussed above.

On investment, these past efforts may have led to too little investment in value-adding sectors, as the example of edible oils in Tanzania shows. Instead, investors operating in non-labour-intensive sectors with limited value addition (such as extractives), as well as those receiving implicit (or explicit) guarantees from government, have been more prevalent. To attract the former type of investment, governments must offer an investment product—a package of affordable access to land, electricity, logistics, and a manageable regulatory and tax environment. These are the critical inputs that investors in job-creating, productivity-boosting, value-adding sectors need, and sector development is what enables governments to offer this package.

The same is true for trade policy, which is highly technical, is complex and requires constant travel. As a result, unless there is clear sector development guidance, trade policymakers and negotiators have little capacity on their own to link their efforts with the sectoral opportunities on the ground that have growth potential. As the example of EAC defining critical inputs as finished products shows, trade policy departments are often disconnected from those in government who can identify how trade policy can support priority sectors to access new market opportunities. If trade policy is anchored to sector development efforts, however, it becomes easier for trade negotiators and policymakers to know what to offer and what to ask for in their negotiations with their counterparts—even without formal coordination mechanisms in place. This entails not only tariffs but also non-tariff barriers that could hinder development of key sectors.

For example, Kenya's plans to build a textile city clearly indicate that the Kenyan government sees this sector as a priority. If the government seriously pursues these plans, this signals to trade and investment policymakers, to those in charge of infrastructure development and to investors that textiles should be prioritised. Being on the same page in this way allows different parts of government to enable the country's trade to promote a fast and predictable flow of goods.

Sector prioritisation, while potentially originating in the ministry of finance, industry or agriculture, should be driven by the centre of government. If the president's or prime minister's office and the ministry of finance or planning do not set clear priorities for sectors and products, then line ministries and agencies are unlikely to agree to focus on the same sectors and products, as seen in countries like Uganda and Rwanda.

## ESTABLISHING A COORDINATION MECHANISM

Fundamentally, the problems presented in this report—and in the 2017 UNECA-ODI report on smart trade and industrial policy—arise because of insufficient coordination between government ministries and agencies at the planning and implementation stages. Trade policy, investment promotion and sector development fall under different ministries and agencies. Trade policy is owned by the ministry of trade. Investment promotion is handled by the investment promotion agency, while investment policy may be set by the ministry of finance. Sector development can be driven by a range of line ministries and agencies, ranging from the ministry of agriculture to the ministry of industry to industrial-park or economic-zone agencies to export promotion agencies to the ministry of finance or planning. This fragmentation may lead to overlapping mandates, turf battles and a reduced ability on the part of the government to row in the same direction.

The solution lies in the efforts of government champions and leaders of the economic transformation agenda, backed by the private sector and development partners, to strengthen the systems and structures that can synchronise these three policy areas at the planning and implementation stages. These coordination mechanisms should be tailored not only to the different institutional frameworks in a country but also, and more importantly, to the different people and politics involved. They need to be targeted and staffed by the right personnel so they do not become box-ticking exercises. They should be based on an understanding of how government can implement solutions that are fit for purpose, according to a sector's needs.

This approach also requires those involved to adapt, be politically smart and try different approaches to identify which form of mechanism delivers the best function. There is no one-size-fits-all solution. What matters is not whether there is a structure in place, but that the mechanism fosters sufficient co-design and co-implementation of policies and programmes.

Indeed, coordination mechanisms can be set up in different ways. They could span various ministries or sectors, or just one or two. They could be based in the presidency or the ministry of finance, or in a strong ministry of industry, export promotion agency or investment promotion agency.[73]Countries should not rely on best practice to establish a coordination mechanism; rather, they should find, fit and modify as necessary the mechanisms that are best suited to their context.[74] And even this is no guarantee of success: many countries have set up coordination structures that do not meet their potential. Sometimes they lack sufficient cross-governmental convening power, a suitable or senior enough chair, sufficient resources or an effective secretariat and supporting delivery mechanism.

Yet some African countries have made significant progress in fostering effective coordination. Examples of successful coordination mechanisms include the National Economic and Social Council in Mauritius; the Seychelles Tourism Board; the Ministry of International Trade and Industry in Japan, which was one of the most powerful ministries in the Government of Japan and oversaw Japanese industrial policy, trade and investment; Cambodia's Trade Sector Wide Approach, which was chaired by the prime minister; and Singapore's Economic Development Board. The factors that helped them succeed include:

- being a central element of the government's development and

73 Malokele Nanivazo and Isaac Marcelin, "Can export promotion agencies stem the deindustrialisation in Sub-Saharan Africa?", African Development Bank, 2017, https://www.afdb.org/uploads/tx_llafdbpapers/Can_export_promotion_agencies_stem_the_deindustrialisation_in_Sub-Saharan_Africa.pdf.

74 Felipe, "Modern Industrial Policy".

political agenda;
- being able to use the authority and convening power of the centre of government;
- having a consistently focused mandate;
- being able to account for the political context, while ensuring economic robustness;[75]
- having access to sufficient managerial, analytical and financial resources, including an effective secretariat or delivery team to follow through with action; and
- having focused engagement with the private sector in targeted sectors.[76]

These examples can be instructive for the region. For instance, Rwanda set up several mechanisms to coordinate its economic policies, including the creation of an economic cluster (a group of senior government officials who coordinate policies), and more innovative, home-grown solutions such as imihigo (performance contracts), which set targets for government officials that require extensive coordination across government. Although the latter delivered some results, such as Rwanda's excellent progress on the World Bank Doing Business Index, it is yet to foster the coordination needed for economic transformation.

To tackle this challenge, a 2017 Overseas Development Institute study recommended focusing the overly broad mandate of the Rwanda Development Board (RDB), the country's investment promotion agency, increasing its resource allocation, and investing in the government's ability to engage with and understand the private sector's needs.[77] Rwandan transformation efforts should aim to take a more holistic approach to policy design and implementation—beyond investment promotion—to guarantee that investors' needs are fulfilled. A more focused coordination effort in

75 Akileswaran et al., The Jobs Gap.

76 John Page and Finn Tarp (eds), The Practice of Industrial Policy: Government-Business Coordination in Africa and East Asia (Oxford: Oxford University Press, 2017).

77 David Booth, Linda Calabrese and Frederick Golooba-Mutebi, "Coordinating Public and Private Action for Export Manufacturing: International experience and issues for Rwanda", ODI SET Programme, July 2017, https://set.odi.org/wp-content/uploads/2017/07/SET-Rwanda_Coordinating-export-manufacturing_FINAL.pdf.

the presidency or in RDB with greater ability to influence and convene across government would be beneficial.

In Kenya, the Big Four Agenda includes food security and manufacturing: textiles and garments, leather, agro-processing, construction materials, oil and gas, iron and steel, ICT, and fish processing. This agenda has the potential to provide a basis cross-ministerial coordination in these sectors. Using the Delivery Unit in the President's Office to ensure coordination of agencies like Keninvest, the Ministry of Industry, Trade and Cooperatives, the Ministry of Finance and others, also at the county level, could foster greater coherence in both policy development and implementation.

In Uganda, the Presidential Investors' Round Table (PIRT)—a high-level forum that allows investors to discuss their challenges with the president, who can then spur quick resolution of these problems—has produced some successes. However, while some rank it as one of the most successful initiatives of its kind in Africa, the PIRT is not one of the key players in the investment scene in Uganda, nor does it have enforcement mechanisms for its decisions.[78] The PIRT changes selected sectors every two years and has not focused on manufacturing. If this were its focus, it could better coordinate government players and others to promote industrialisation.

In Ethiopia, previous coordination efforts in the horticulture sector, focused on cut flowers, can serve as a positive model for the country's current industrialisation efforts and those of others in the region.[79] The take-off of the Ethiopian flower industry occurred only once government had taken on a more proactive coordination role in the early 2000s.[80] The Prime Minister's Office took the lead, initially charging the Ministry of Trade and Industry with

78 John Page, "Importing coordination: Africa's Presidential Investors' Advisory Councils", in The Practice of Industrial Policy: Government-Business Coordination in Africa and East Asia, ed. John Page and Finn Tarp (Oxford: Oxford University Press, 2017), 275–293.

79 This discussion draws on Mulu Gebreeyesus and Michiko Iizuka, "Discovery of the flower industry in Ethiopia: experimentation and coordination", Working Paper Series #2010-025, United Nations University-Maastricht Economic and social Research and training centre on Innovation and Technology, March 2010, https://www.merit.unu.edu/publications/working-papers/abstract/?id=3929.

80 Oqubay, Made in Africa.

developing a five-year action plan for the sector, which highlighted sectoral constraints. Through the authority of the Prime Minister's Office, the government then devised a series of policy measures and enabled coordination across a number of public and private actors to address both sector development challenges, such as access to land and credit, and trade facilitation challenges, like air-transport operations.

The coordination that the government enabled significantly contributed to Ethiopia becoming the fifth-largest non-EU exporter to the EU cut-flower market, and the second-largest flower exporter from Africa in 2007. This experience holds lessons for the government's current efforts to support industrialisation in Ethiopia. For example, in Ethiopia's pharmaceutical-manufacturing sector, the Tony Blair Institute for Global Change is supporting a sectoral coordination mechanism involving many government and private players to enable them to work together to address sectoral constraints, attract investment and lay the groundwork for exports.[81]

Meanwhile, Tanzania has struggled to develop appropriate and effective coordination mechanisms in sectors like manufacturing. The result has been weaker performance in manufacturing sectors.

These successes and challenges underscore the importance of development partners providing flexible and adaptable support to promising leaders—and, crucially, to a variety of them across government—to help them establish, strengthen or leverage coordination mechanisms to align these three policy areas.

81 Akileswaran et al., The Jobs Gap, elaborates on this coordination mechanism in the pharmaceutical-manufacturing sector.

## CONCLUSION



Eastern Africa is making great strides in its pursuit of economic transformation, across the areas of trade policy and facilitation, investment promotion and sector development. However, growth remains led by sectors such as mining, construction and non-tradable services, rather than by manufacturing, high-productivity agriculture and tradable services. This needs to change if the region is to meet its ambitions and create sufficient jobs for its rapidly growing population.

A missing piece of the puzzle in this transformation process is policy consistency across these three policy areas. Disconnects between these policies, particularly in their implementation, are holding back economic transformation. To address these disconnects, governments and their development partners should prioritise two tasks.

The first is to agree a short priority list of promising value chains across government as a policy anchor. These should be fully endorsed by the presidency or the prime minister's office to ensure ownership at the highest levels of government. They should have input from the department of industry and, to a degree, the ministry of agriculture, the department of trade and the investment promotion agency. Likewise, the buy-in of regional, county and provincial governments is important.

The second task is to establish and invest in a workable coordination mechanism. The mechanism should be tailored to the local context and could involve systems and structures in different ministries. It should have overriding power over ministries and agencies, with direct anchoring in the presidency, and a clear and targeted mandate. And it should be designed to drive the alignment of policy to priority sectors and products, across the multiple agencies responsible for sector development, investment promotion and trade.

These recommendations complement those in the 2017 UNECA-ODI report on transforming African economies through smart trade and industrial policy. That report called for the strengthening of national development policies, industrial policy and trade policy by increasing coherence between them.[82] This report offers ideas—based on experience on the ground—as to how Eastern African governments, backed by more suitable support from their development partners, can make this aim a reality.


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82 Calabrese et al., "Transforming African Economies".

To transform their economies, Eastern Africa's governments, with the support of development partners, should focus on improving policy coherence. Doing so is vital for the region to meet its growth ambitions and create enough jobs for its rapidly rising population.

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