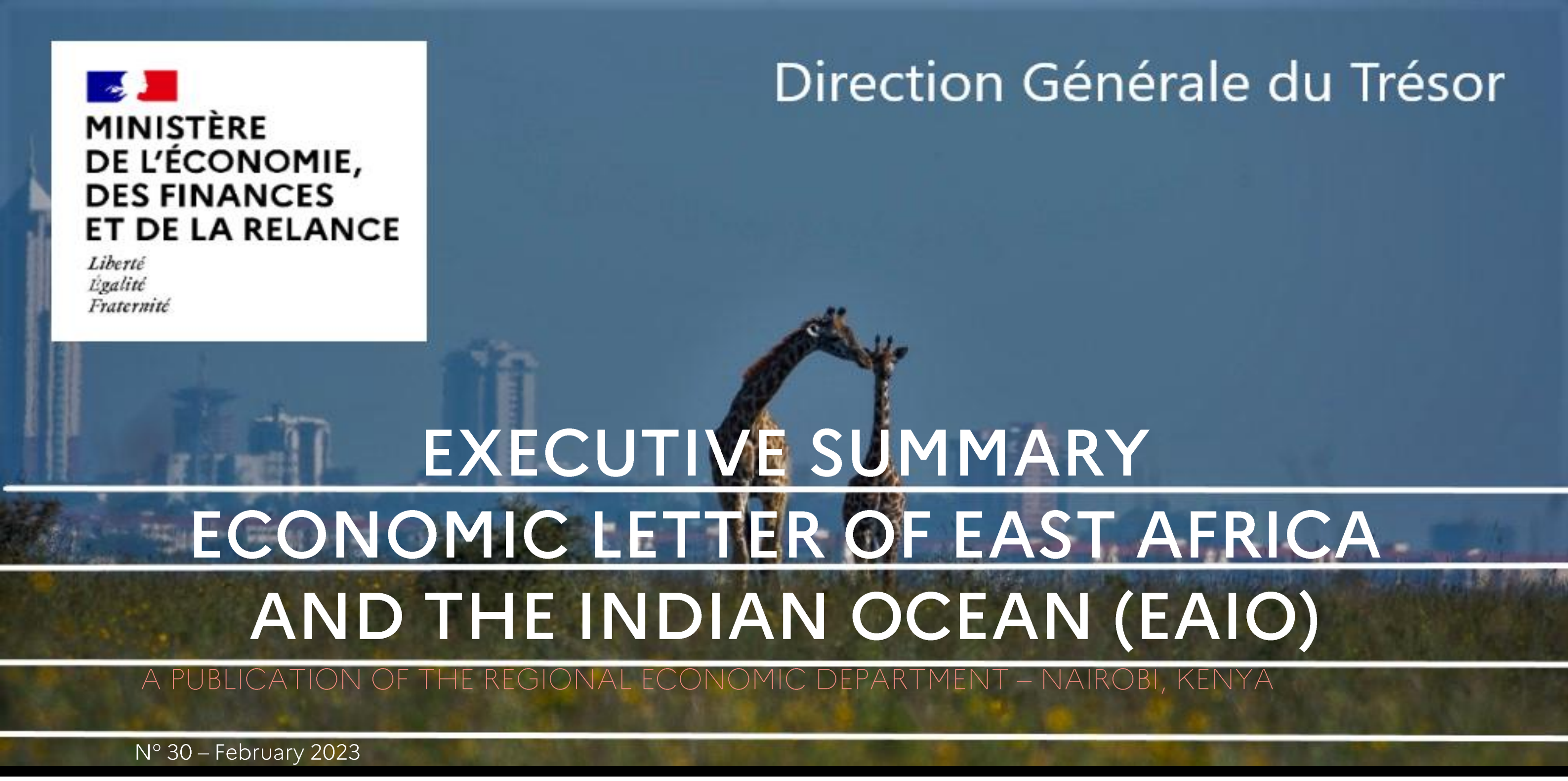

MINISTÈRE DE L'ÉCONOMIE, DES FINANCES ET DE LA RELANCE

Liberté Égalité Fraternité

Direction Générale du Trésor

EXECUTIVE SUMMARY ECONOMIC LETTER OF EAST AFRICA AND THE INDIAN OCEAN (EAIO)

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Balance of payments and remittances in the EAIO

In concise…

Most of the EAIO countries have structural current account deficits, mainly due to a strong value-added differential between their exports and imports. To ensure the balance of payments equilibrium, these countries are highly **dependent on international transfers and more particularly on remittances from the diaspora**, which have grown significantly over the last decade (+95%). Aware of the crucial role played by remittances in the development of their economy (fight against poverty, financing of the private sector, source of reserves, stabilisation of the economic cycle, development of human capital, etc.), many countries have implemented policy strategies aimed at increasing remittances.

In detail…

Structural current deficits caused by a value-added differential in traded products

Except for Djibouti, Eritrea and South Sudan, **the EAIO countries have structural current account deficits. Over the period 2010-2019, the current account deficit in the EAIO region was around -4.9% of GDP**. Over this period, Seychelles and Burundi had the highest current account deficits in the region, averaging -16.0% and -13.9% of GDP respectively, while Eritrea and Djibouti had surpluses of 12.3% and 7.4% respectively.

The region's current account deficits are mainly explained by imbalances in their trade balance. **The EAIO countries tend to export raw materials (agricultural commodities, oil), increasing their exposure to international prices volatility, which make them net importers of products with higher value-added.** These vulnerabilities are exacerbated by the recent deterioration in the global economic situation, attributable to the health crisis and the war in Ukraine. In 2020, the current account deficits of the countries in the zone widened to -6.0% of GDP on average, with no improvement expected in 2023 according to the IMF (-6.1%). **The aggregate balance of services of the EAIO countries is structurally in surplus** (USD1.9 billion on average over the 2010 decade, 0.5% of EAIO GDP), **driven upwards by tourism**. Due to the closure of borders during the health crisis and the disruption of value chains, the trade balance in services nevertheless moved into deficit in 2020 (USD-2.4 billion or -0.6% of GDP, compared with USD+3.7 billion in 2019, +1.0% of GDP). This significant deterioration will be gradually absorbed as international tourism recovers. In addition to the trade balance deficit, there is also a **primary income balance deficit** (averaging USD-3.9 billion each year between 2010 and 2019).

To mitigate the impact of their trade balance and structural primary income deficits, countries in the region can rely on their secondary income balance, especially institutional grants and remittances from their diaspora. Between 2010 and 2019, AEOI governments and households received USD4.42 billion in grants and USD4.37 billion in remittances on average each year.

Diaspora remittances as a pillar of East African economies

Diaspora remittances received by countries in the EAIO region have increased significantly over the last decade, from USD4.4 billion in 2010 to USD8.6 billion in 2020. Geographically, at the regional level, the bulk of these remittances are sent from the US (33%), the UK (8.8%) and France (5.7%).

Diaspora remittances are of key importance to the countries in the region. First, they have a significant impact on the incidence of poverty and food security. For example, in Somalia, the proportion of remittance recipient households living below the poverty line is 58%, compared to 71% for non-recipient households. Also, while remittances are primarily used for subsistence purposes, a significant share is usually allocated to education expenses **Second, because of their counter-cyclical nature, they provide an informal safety net for recipients during a crisis**. For example, diaspora remittances increased in most countries in the region during the Covid-19 crisis, including Rwanda (+7.7% between 2019 and 2020), Kenya (+9.5%), Somalia (+10.1%) and Madagascar (+21.5%). **Third, remittances are also a means of financing the economy.** As many countries in the region are characterised by underdeveloped banking systems and weak or non-existent capital markets, these income flows contribute to increasing the demand for financial services to securely store remittances. Remittances also contribute to increasing the creditworthiness of households and the likelihood of them obtaining loans from financial institutions. **Finally, they are an important source of reserves. In 2021, net remittances received in AEOI amounted to USD11.2 billion**. **This is comparable to multilateral donor allocations (USD15 billion) and much higher than net FDI flows (USD6.4 billion).**

Remittances, a means of financing enabled and accelerated by the rise of mobile money

The digital revolution and the rise of mobile money services have played a key role in the development of remittances in EAIO for three reasons: (i) mobile banking services offer lower transfer fees than traditional players; **(ii)** they do not require a bank account in countries characterised by underdeveloped banking systems; and **(iii)** beneficiaries do not need to go to a counter to collect the money sent. While this may seem anecdotal, a 2015 *Guardian* study revealed that on average, in Burundi, people were forced to spend more than US$20 on transport costs to withdraw US$100.

A significant proportion of remittances transferred informally

For the EAIO countries, several factors explain this phenomenon. **First, the existence of parallel exchange rates in several countries** of the zone, especially Sudan, Eritrea, Ethiopia and Burundi. Indeed, sending remittances informally allows the recipients to convert them into local currency at the parallel exchange rate, more favourable for them. **Second, the high cost of money transfers in the zone.** According to the World Bank, the average cost of EAIO transfers is 8.6% in 2021, well above the global average (6.7%). This high cost has a significant impact on the volume of remittances sent. In a 2016 report, the World Bank estimated that a 2-5% reduction in fees could increase remittance flows by 50-70%. Significant disparities exist between countries in the region. While Uganda (10.2%) and Rwanda (9.9%) have the highest transfer costs, Comoros (4.6%) and Ethiopia (6.7%) have the lowest**. Third, the irregular status of immigrants**. The diaspora often chooses to send money through informal channels for the simple reason that they do not have the official identification necessary to access formal financial services. For example, most members of the Ethiopian diaspora living in the Middle East or Africa are forced to make informal transfers because of their immigration status. This prevalence of informal remittances has a significant cost for governments as it deprives the authorities of a considerable amount of currencies and potential tax revenues.

Aware of the importance of diaspora contributions, many countries have implemented policy strategies to increase them. This is for instance the case of Kenya which, in addition to the creation of a Ministry of Diaspora, is banking on significant investments in human capital to increase the number of qualified Kenyans working abroad and thus the number of remittances received.

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