THE RELATIONSHIP BETWEEN FOREIGN DIRECT INVESTMENT (FDI) AND INCOME INEQUALITY: THE CASE OF EAST AFRICA COMMUNITY (EAC)

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DECLARATION

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the Research Project contains no material previously published or written by another person except where due reference is made in the Research Project itself.

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This Research Project has been submitted for examination with my approval as the Supervisor.

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Abstract

This research investigates the intricate relationship between FDI and Income Inequality in the East African Community for the period 2000-2023. It has been observed that FDI inflow influences the distribution of income in its member states, including Kenya, Uganda, Tanzania, Rwanda, Burundi, South Sudan, and the Democratic Republic of Congo. In the process, the research makes a nuanced analysis of the short-run and long-run dynamics, using an ARDL model while controlling for important variables like GDP growth, employment, and sectoral distribution of investments. Results indicate the presence of a long-run equilibrium relationship between FDI inflows and income inequality, though with considerable variation across countries. Employment was always identified to be a major determinant of inequality reduction, especially in Uganda, Democratic Republic of Congo, and Kenya, when employment generation in labour-intensive sectors had the most significant effect. On the other hand, this study also identifies that FDI usually perpetuates inequality when invested in capital-intensive industries or sectors benefiting only the elites, as was noted in some extractive and technology-driven investments. It had mixed implications for GDP growth, as economic gains were sometimes unequally distributed and promoted increased inequality in

certain cases. The study underlines that the positive effects of FDI can be reaped without bearing its negative impacts only with well-targeted policy interventions. "This may include encouragement of FDI in labour-intensive industries such as agriculture and manufacturing, progressive tax policies to ensure that the distribution of wealth is equitably made and putting in place social safety nets to protect vulnerable groups.". Besides, the encouragement of regional cooperation among EAC member states to achieve a harmonization of FDI policies and sharing of best practices is highlighted as the route to more inclusive economic growth. This study, through its data-driven insights, sets out to inform policymakers and other stakeholders on how to balance economic development with social equity in the EAC region.

CHAPTER 1: INTRODUCTION

1.1 Background of the Study

Foreign Direct Investment (FDI) provides a critical impetus for economic growth in various economies all over the world, with developing regions like Africa earning huge benefits. Such capital, advanced technologies, infrastructure development, managerial skills that accompany FDI can impact industrial growth, creation of job opportunities, and enhancement of productivity in the host countries (Feenstra & Taylor, 2014). Over the last 20 years, the East African Community including Burundi, Kenya, Rwanda, South Sudan, Tanzania, and Uganda has witnessed increased (UNCTAD, 2023).

Foreign Direct Investment, as well as more recent inclusions, the Democratic Republic of Congo; making the region an appropriate investment destination as it is endowed with economies of varied forms and strategic advantages (Asiedu, 2002).

The attractiveness to foreign investors is drawn from the fact that the region is endowed with the vital water bodies, among them Lake Tanganyika, Lake Victoria, and the Nile River Basin. These resources provide essential water supplies within the region and support other economic activities evident in the regions of fishing and tourism (World Bank, 2023). Lake Tanganyika is among the deepest and oldest in the world; Lake Victoria is the largest in Africa and plays a very important role in the lives of millions of people who live within its catchment. The Nile River Basin area supports agricultural activities that are central to the EAC in maintaining a food source and economic base (UNDP, 2023).

The biodiversity and a wide variety of ecosystems in the East African region further add value to its investment. It is host to a variety of forests, including tropical and subtropical forests, Miombo woodlands, savannahs, Acacia woodlands, and mangrove. These forests become very vital in maintaining the ecological balance and supporting many species. They also have potential in eco-tourism, which has become very popular in this global awareness program for conservation. This therefore makes this region one of the key investment destinations for investors in sustainable and environmental-friendly projects, as these forests offer a variety of ecosystem services, from carbon sequestration, water regulation, and others (Rodrik, 2011).

Kenya, which is a key player in EAC, has had huge FDI, most of which are in the telecommunications and financial sector. Safaricom is the leading telecommunication in Kenya, with huge foreign investment from Vodafone, which is a British multi-national. This has given Safaricom enough leverage to expand its services and increase its technological capacity, as it can keep the effects of cybercrime to a minimum, hence boosting Nairobi's status as a key technology powerhouse. In the finance segment, Standard Chartered Bank, a global banking giant, has positioned its base in Kenya, one intended to give a hand in developing both the financial structure of this nation and improving the service base of its banking industry. Kenya's capital has, therefore, erupted as a fast hub in terms of technology startups and multinationals, fuelling economic growth and urbanization. The innovation in a rising tech scene in the city, which is backed by foreign investment, brings up innovation and has created many high-paying jobs in contribution towards Kenya's general economic advancement.
(Kenya National Bureau of Statistics, 2023).

Uganda and Tanzania have also received significant FDI in their oil and gas sectors.
The major investments are those of TotalEnergies, a French multinational corporation, and China National Offshore Oil Corporation, or CNOOC—both joining ExxonMobil, an American multinational, and Equinor, a Norwegian firm. The assistance in developing oil and gas infrastructure has been very instrumental and likely to spur further economic growth in that the countries have general energy production and job opportunities. The growth in the oil and gas sector will be required to further widen its economic advantages by increasing revenues and improving energy security (Adams, 2009).
Rwanda, often hailed as a model of economic reform and growth in Africa, has seen substantial FDI in the tourism and services sectors; as one can see, Kigali is one of the cleanest towns in Africa. Its stable political environment, efficient regulatory framework, and commitment to reform have drawn foreign investors eyeing opportunities in the tourism and related services sector. Such initiatives have enabled the country to strongly recover from that post-1994 genocide situation and to sustain growth by promoting eco-tourism and conservation efforts. Sustaining tourism initiatives remain a good recipe in not only promoting an environment friendly to business but also capitalizing on the natural beauty to make Rwanda a haven for such investors. (Javorcik & Narciso, 2017).

One such example of an FDI in the tourism sector is an investment made by a renowned luxury safari firm, Singita. The firm runs Singita Kwitonda Lodge, one of the premier venues in Volcanoes National Park, arguably one of Rwanda's most pre-eminent tourist destinations. This investment has increased the stature of the tourism industry in Rwanda, fostering the delivery of high-end accommodation whiles driving eco-tourism, especially about gorilla treks and wildlife conservation. It is worth noting that among the positive effects to the country of the inflow of some of these international companies eradicate negative actions such as corruption and nepotism, how the inflow helps the rural feeding the local economy and increases the country's country around the world, as a tourist country.

For Democratic Republic of Congo, one of the biggest cases of FDI It is the case of Glencore, a multinational mining company. In fact, Glencore has levied colossal investments in the mining sector of DRC and mainly in copper and cobalt.
These are strategic minerals that, among other industries, supply production for electronics and electric vehicles. Interest from abroad in the DRC's huge mineral resources is enormous, and Glencore's investment has underscored their strategic value in global markets. The development of the mining sector in the DRC not only allows for economic growth in the country but also greatly helps to meet the global demand for critical minerals needed in advanced technologies. (Herzer & Nunnenkamp, 2011).

The FDIs have played a large role in boosting the economic growth and developments in the East African community. The region is endowed with natural resources, diverse ecosystems, and a strategic location that has over the years been catalysing major investments. Considered from the different perspectives that exist among the sectors and countries in which FDI has flowed in the EAC, the records of FDI influence tack on a dynamic nature of the impacts and, therefore, stress the need for targeted policy formulations and investments towards all-inclusive sharing and sustainable growth of the region. (Kamau, 2013),

1.2 Problem Statement

As a result of this increased FDI inflow to the East African Community (EAC), per capita income inequalities are growing because usually the benefits are localized within specified places or specific sectors. For instance, in Kenya, although it fosters economic growth, creates

jobs, and induces new technologies in its urban areas, particularly in large cities and towns such as Nairobi, it remains a place where tech industries have massively transpired, and its rural areas are poor and with bad conditions. This has made the gap between urban and rural concentrations more pronounced, with corresponding consequences that much of the population has no share in the creation of new FDI-induced economic opportunities.

FDI flows into the capital-intensive sub-sectors of oil and gas of Uganda and Tanzania have tended to benefit only a small, elite segment of the population. Thus, the characteristics and patterns of FDI, particularly into few-job-providing sectors, have concentrated wealth to few against the adverse effects of globalization and further to the exposure to economic pressures from the globes that have, in most cases, affected the traditional sector. This only reiterates the point that it would be worthy to look deeper into how FDI in different economies, under the EAC, has affected income inequalities with a view to informing policy frameworks that would further distribute the gains accrued from such investment streams in a more equal manner.

However, any policy to capture the benefits of FDI while taming its possible negative effect must be based on an understanding of the specific mechanisms through which it affects income distribution. This paper will, therefore, attempt to analyse the nuanced effect of FDI on income inequality within the EAC, especially whether FDI contributes to the narrowing or widening of the income gap. This study is necessitated just to fill in this gap through which a holistic analysis on FDI and income inequality in the EAC can be provided. It therefore is set to clarify the conditions under which FDI contributes to either the reduction or enlargement of the income gap, offering insights which could inform more equitably economic policies in the region.

1.3 Research Objectives

The objectives of this study are as follows:

1. **To determine the impact of foreign direct investment on income inequality in EAC**; this also goes in line with making an empirical appreciation of the general impact of FDI on income distribution in this region.
2. **To establish and analyse the specific linkages through which FDI influences income inequalities in the EAC**. It shall try to address this by investigating ways in which FDI attributes to different socio-economic groups such as labor markets, technology transfers, and sectoral distribution.

1.4. Research questions

1. What is the impact of FDI to income inequality within the East African Community?
2. what linkages or channels are used by FDI to affect the income inequalities within EAC, mainly regarding labor markets, transfers in technology, and sectoral distribution?

1.5 Scope of study

This study will be focused on the link between FDI and income inequality within the EAC. This research goes to 2023, on FDI inflows and the impact on income distribution among the people in the EAC member states of Burundi, Kenya, Rwanda, South Sudan, Tanzania, Uganda, and the Democratic Republic of Congo.

The goal will be to determine the positive and negative characteristics of FDI and how, through various channels, such investment affects income inequality, such as labor market dynamics, technology transfer, or the distribution of investment across sectors.

After discussing the various theories linking income inequality and FDI, the study will attempt to evaluate their applicability in the East African context with particular attention to the empirical validity of modernization and dependency theories.

1.6 Significance of the study

According to this research, it is highly significant as it indicates extremely relevant and critical issues concerning the relation between foreign direct investment (FDI) and income inequality among East African Community (EAC) member states. By doing so, the findings will provide an insight into how foreign direct investments have effects on income distribution thus contributing towards comprehensive debates surrounding economies' roadmaps, overseas investments as well as social justice in East Africa region. Thus, these discoveries could essentially provide assistance to EAC policymakers in formulating economic policies that are more balanced and relatively inclusive so that they may maximize advantages of FDIs while still addressing its repercussions on disparities in earnings. It is also possible that this work could contribute considerably to existing foreign direct investment and income inequality literature in developing regions such as EAC making it useful for researchers, investors ad international development organizations with respect to making the development of this region sustainable and fair.

CHAPTER 2: LITERATURE REVIEW

2.0 Introduction

This chapter begins by reviewing the literature on the relationship between FDI and income inequality at the global level but narrows down to Africa with specific regard to the East African Community. It starts with a review of some of the essential theories and empirical evidence on FDI and then its relationship with income distribution in the world economy.

2.1 Theoretical Framework

2.1.1 Modernization Theory

The modernization theory, credited to writers like W.W Rostow (1960)and Simon Kuznets, (1955) thinks that FDI triggers economic development for under-developing economies.

FDI is seen as a vehicle that introduces capital, technology, and management that might develop the growth and profit it by offering jobs that will ultimately lead to minimalism in income inequality.

At the onset, there tends to be high inequality in income since the benefit is favoured in a few specific fields and regions.

Therefore, due to economic development experienced and the effects provided by FDI becoming quite vast, the aspect of income inequality is expected going down, hence balanced economic development.

2.1.2. Dependency and World Systems Theory

Dependency theory and world systems theory provide a critical view of the role of FDI in developing countries. According to Andre Gunder Frank (1966) and Immanuel Wallerstein, "FDI frequently reinforces, rather does not compensate; existing inequalities because it tends to flow to capital-intensive rather than to labour-intensive industries and to benefit foreign investors and local elites." Critically, for dependency theorists, "FDI can generate dependency: linked to global interests, disparities are deepened; economic development follows uneven, and informal income distribution rises."

If the investment is on ore mining or oil extraction, FDI could increase regional disparity and social inequality.

2.1.3 International Trade Theory

Another perspective on the FDI-inequality relationship is given by international trade theory, and by the Heckscher-Ohlin model. According to it, FDI should flow into those countries that

are labour-abundant and capital-scarce; therefore, the demand and remuneration of labor should rise. In case FDI is capital intensive, implying less workers, wage polarization and an increase in income inequality will result.

The Stolper-Samuelson theorem goes further to show that trade and investment alter income distribution by changing the factor prices in favour of some groups, for example, skilled workers, and against other group unskilled workers.

2.2 Empirical Literature

2.2.1 Global Perspectives on FDI and Income Inequality

Income inequality and FDI research are also debated worldwide. Literature shows that some of the studies confirm that FDI could reduce income inequality by creating jobs and enhancing productivity. For instance, in 1997, a study conducted by Feenstra and Hanson, investigated the impact of FDI on wage structure of Mexico, methodology conducted a panel data using Fixed effect models and study. They estimated the econometric models using data obtained from various sectors and tried to find out the changes in wages between different skill levels of labourers before and after huge inflows of FDI. Their approach was measuring these effects on income inequality using sectoral wage data and FDI data. This consequently led to the rise in wages for the unskilled workers. This was attributed to the modernizing role of FDI in industries and an increase in productivity in sectors where there was employment of unskilled labour. As such, it suggested that FDI had a positive effect in terms of reducing income inequality by improving the earnings of the lower-skilled workers.

A 1998 study by Borensztein, De Gregorio, and Lee used Generalised Method of Moments, which is quite efficient in bypassing the problems caused by endogeneity and heteroscedasticity in panel data analysis and assessed the various effects of FDI on economic growth and income distribution across different developing countries. The presence of FDI contributed to economic development, which positively affected income distribution through the creation of more economic opportunities and rising general income.

For example, Herzer and Nunnenkamp (2011) attempted to determine the precise relationship between FDI and income inequality by using Fixed Effects Models for panel data regression models.

Evidence on the distribution of FDI across sectors and its consequence on rising income inequality: Their methodology consisted of control for education, economic growth, and labour market conditions. In brief, the findings suggested that FDI often made the distribution of income worse by benefiting skilled labour and capital-intensive sectors that widened employees' remuneration gap between skilled and unskilled. The results suggested that FDI does not always 'contribute' towards reducing income inequality and can, at times reinforce the existing disparities. Tsai, 1995, has used OLS regression in cross-country econometric analysis to explore the direct and indirect impact of FDI on income inequality in the developing countries. It used regression models to analyse how FDI influences income distribution, with special attention paid to the role of institutional quality in that. In the countries where institutions are weak, direct positive FDI-to-income inequality relation was found. According to Tsai, benefits from FDI were often concentrated in sectors thereby increasing income disparities, as a way of portraying the role of institutions in countering FDI effects.

Mahmoodi and Mahmoodi (2016) used a panel data analysis to investigate the effect of FDI on income inequality in MENA countries. They used the GMM estimator, which is paramount in dealing with endogeneity and heteroscedastic issues in panel data . In their study, they adopted a more nuanced view by including such variables as FDI inflows, income distribution measures, and control variables of human capital, infrastructure, and political stability. The general findings reflected a relationship that was quite mixed: FDI inflows were associated with economic growth, although in general, they reduced income inequality. On the other hand, the gains from FDI were not shared equally in countries that were found to have poorer quality of institutions, contributing to increasing income disparity. This finding implies the importance of quality institutions in the impact of FDI on income distribution.

Javorcik and Narciso (2017) examined the implications for the relationship between FDI and income inequality using a dynamic panel data model with the System Generalized Method of Moments estimator. They examined various sectoral differences on the effect of FDI. The outcome from the above study stated that the effect of FDI on income inequality becomes negative FDI is in the manufacturing sector because the manufacturing sector has the capacity to create a plethora of job opportunities and to improve the level of skills of employees. But even the result suggests that FDI in extractive industries in allocation proves to be contributing to boosts in income inequality. As a result, the benefits in extractive industries are concentrated and mostly result in low job creation but high income gains for a small elite, hence the sectoral

disparity. The study is thus right in emphasizing the importance of the sectoral focus in determining the equitably FDI benefits.

Agrawal (2015) used panel data regression analysis to establish the relationship between FDI and HDI across the BRICS countries. The study, using Fixed Effects models and RE models, further assessed how FDI affects the individual components of HDI in terms of education, health, and income status. In summary, the results illustrated how FDI contributes to the standard HDI with the driving notion that it increases the development effects by improving greater access to education and health care services and increasing income levels. This implies that FDI results in human development through the creation of economic opportunities and further investments in social infrastructure, thus causing overall improvements in HDI.

An ARDL time-series analysis model helped Sethi and Sucharita (2017) determine the effect that FDI has on HDI in sub-Saharan Africa. It further helped in the discovery of short-run and long-run relationships. The study found a long-term positive significant contribution of FDI to HDI via better access to education, healthcare, and income. However, the short-term effects of FDI in influencing HDI, as reported by countries within the region, varied significantly due to differences in economic and institutional structures. This has included policies that stimulate absorption, contributing to the growth in FDI inflows, while the results suggested that though the FDI as a whole does promote human development, the extent of its impact depends on local conditions and policies affecting the absorption and utilization of FDI.

2.2.2 African Context

Disagreement over the impact of FDI on income inequality characterizes the literature that considers the continent. For instance, Asiedu (2002) I use ordinary least square (OLS) in the panel data from African countries to assess the impact of FDI on economic growth and income inequality. The study controlled for variables such as human capital, infrastructure, and political stability and revealed that while FDI could stimulate economic growth in Africa, its impact on income inequality was ambiguous. The benefits of FDI were not uniformly distributed, and the overall effect on income inequality depended on the sectoral focus of the investment and the quality of institutions in the host countries. Studies by Adams (2009) uses a panel vector autoregressive model (PVAR) which caters for both endogeneity and dynamism and investigates the relationship between FDI and FD over the time period spanning from 1990 to 2013. The analysis included sectors such as manufacturing, mining, and services, and

employed regression techniques to determine the effects of FDI on income inequality and the research indicated that FDI in capital-intensive sectors, such as oil and mining, often led to increased income inequality due to limited employment opportunities and minimal local linkages. In contrast, FDI in manufacturing and services sectors had a more favourable impact on income distribution, as these sectors provided more employment and had greater potential for local economic linkages. Akinlo (2004) analysis takes data from 1980 to 2012 into consideration by using system equation method or the concept of cointegration and the vector error correction Model of GDP Growth Rate (GDPGR), Development Assistance (DASSIS), Foreign Direct Investment (FDI), Migrants' Remittance (MIGREMIT), Real Exchange Rate (REEXR) and Domestic Investment (DOMINV). We pay a particular attention on the impact of Development Assistance, Foreign Direct Investment, and Migrants' Remittance. The result of analysis shows an insignificant impact of Development Assistance (DASSIS), Foreign Direct Investment (FDI), on the growth in contrast with our expectation. Migrants' Remittance on his side has a significant relation on GDP performance.

However, while other studies argue that FDI could have a positive impact on income distribution in Africa, transfer conditions should prevail. Thus, FDI in manufacturing and services ' favourably affect income distribution than FDI in natural resources. This can be taken to mean that income inequality can be effectively addressed by FDI, after all, if this is geared at sectors that have great local linkages and provide huge employment'.

2.2.3 The East African Community (EAC) Context

FDI and income inequality are issues on which scrutiny is increasing within East African Community. EAC has remarkably, over the years, become a host of FDI in infrastructural, energy, and telecommunications fronts. However, benefits accrued from these have not trickled down to all persons in the member states, which constitutes income inequality.

However, research on the EAC presents mixed results. FDI in Kenya's manufacturing industry by Gichuki and Moyi (2019) used Panel Data Analysis with Fixed Effects, econometric models to analyze the impact of FDI on employment and wages in Kenya's manufacturing sector. The study employed panel data and regression techniques to evaluate how FDI influenced income inequality within this sector and got that FDI in Kenya's manufacturing sector contributed to increased employment and higher wages, which helped reduce income inequality. The presence of FDI in this sector was associated with improved income distribution by creating job opportunities and enhancing earnings for a broader segment of the population and Kamau

(2013) used case studies along with OLS regression analysis to investigate the effects of FDI in Uganda and Tanzania, focusing on extractive industries. The study employed data on FDI flows, income distribution, and political economy factors, revealed that FDI in Uganda and extractive industries in Tanzania often led to increased income inequality. The benefits of FDI were concentrated among political elites and a small segment of the population, rather than being widely distributed. This concentration of wealth contributed to greater income disparities and highlighted the need for more inclusive FDI policies. This attribute underscores a more subtle approach to contrasting the impacts of the different FDI sectors on income distribution in the EAC.

2.3 Gap Research

Although voluminous literature does exist on the FDI and income inequality relationship, there exists a gaping hole when this concerns the East African Community dynamic. Currently, with the existing members, including Kenya, Uganda, Tanzania, Rwanda, and Burundi, plus the recently added Democratic Republic of Congo and South Sudan, the growth of FDI has been relatively high. Exactly how such flows affect income distribution is, however, not well established. Most of the existing research offers general conclusions for the developing world, not considering the economic and social specifics relevant to the EAC.

From this perspective, the paper will undertake a careful analysis about the impact of FDI on income inequality in the EAC, focusing on the most likely industries to attract FDI, the impact of such investment on the local labour market, and the role of national policies. The research will also consider the technologies related to FDI and their relationship to rising income inequality. The study is particularly intended to help in bringing out a clearer picture of whether FDI is leading to a reduction in income inequalities or if the existing divides are being widened in the EAC, thus providing insights for better policy decisions.

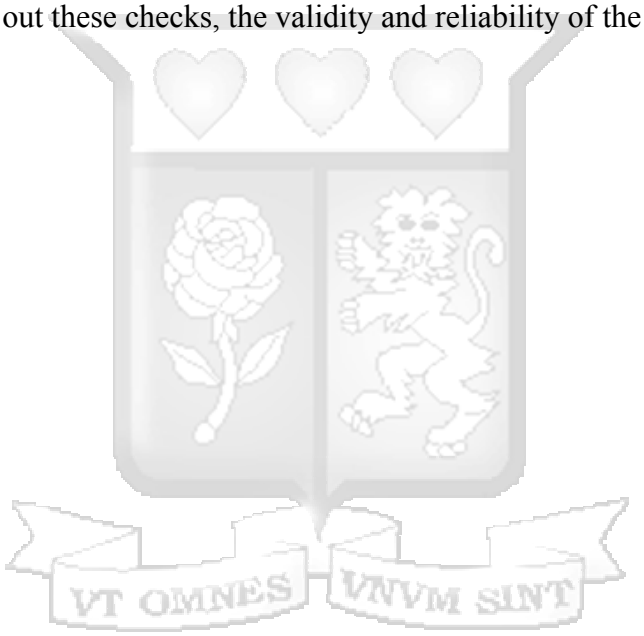
2.4 Conceptual framework

A conceptual framework represents an analysis of the relationship between FDI and income inequality in the EAC. The framework embodies some key variables or elements: FDI, measured in terms of inflows or a sectoral distribution; income inequality, which can be measured using income indicators like the Gini coefficient; and mediating forces such as economic growth, labour market dynamism, and technology transfer. This framework is harnessed by Modernization Theory which postulates that the FDI might be initially invasive

of inequality but could reduce inequality over time, Dependency Theory that posits that FDI exacerbates inequality by providing concentration of benefits amongst a small elite.

2.4.1. Operationalization of the study

This is aimed at converting general abstract concepts into measurable variables. FDI will be measured in terms of total inflows, percentage of GDP, and sectoral breakdown, using the World Bank data, among others. Income inequality will be measured with the Gini coefficient and the Theil index. The list of control variables includes economic growth, educational attainment, labour market conditions, government spending, inflation, and trade openness. Data will be collected from international and national statistics, following which panel data regression techniques will be used for the analysis to ascertain how FDI affects income inequality. In carrying out these checks, the validity and reliability of the results.



CHAPTER 3: METHODOLOGY

3.0 Introduction

This chapter outlined the methodology of the research in relation to income inequality effects attributed to Foreign Direct Investment (FDI) in the EAC. It described the research design, data collection techniques, and data analysis methods.

3.1 Research Design:

The study adopted a correlational design to establish a link between foreign direct investment and income inequality. Second, the approach used in quantitative analysis in this research was based on panel data covering the period 2000-2023. The measures in this research included FDI inflows, income distribution indicators, the Gini coefficient, and key economic variables like GDP, employment rates, and sectoral distribution of FDI. The design of the correlation identified and evaluated the strength and direction of the associations that linked FDI with income inequality, showing how differences in FDI inflows were related to changes in the distribution of income over time.

3.2. Population and sampling

The targeted population in this research included all the countries forming the East African Community, namely, Kenya, Uganda, Tanzania, Rwanda, Burundi, the Democratic Republic of Congo, and South Sudan. Since this research targeted understanding how FDI influenced income inequality in these countries, all the member states of the EAC were considered as the population under study.

Since the study focused on a given regional grouping in Africa, the population for the research was the totality of EAC member countries. Being done through this approach helped in understanding more detail about how FDI accounted for income inequality within these given regional perspectives. It captured the data across the region, bringing out the regional dynamics of FDI. This paper investigated the determinants and trends in FDI inflows in the EAC, particularly on income distribution and its effect on economic inequality.

3.3 Data Collection

The research relied on secondary sources to ensure the detailed analysis of the effect of FDI on income inequality within the EAC.

Such secondary data were obtained from the World Bank, which had critical data relating to FDI inflows and income distribution indicators like the Gini coefficient, major economic

variables like GDP, and employment rates. National statistical agencies of the EAC member states provided country-specific detailed data on income distribution, levels of employment across sectors, and distributions of local versus foreign investment. Moreover, academic bases such as JSTOR and EconLit were consulted for a literature review that contributed to FDI and income inequality through past research findings, theoretical frameworks, and methodologies.

Additional data were derived from the International Monetary Fund (IMF) reports.

Variable	Short representation	Measurement/Definition	Data source
Dependant variable			
Income inequality	Income inequality	Gini coefficient	SWIID
Independent Variable			
FDI inflows	FDI	Amount of FDI	World Bank, African development
GDP	GDP	the monetary value of final goods and services	World Bank
Employment	Employment	the state of having a job or being employed.	World Bank

3.3 Econometric Model Specification

The model employed Autoregressive Distributed Lag (ARDL). The resort to the ARDL was suitable for the analysis of short-run and long-run relationships, and it did not require that all variables be stationary. This was easier to apply on small sample sizes and, therefore, provided better insights on the long-term effects of FDI on income inequality.

3.4 Justification for the Chosen Methodology

Given the nature of the data, especially for small panels, the model needed to embody major strengths of various alternative techniques. Thus, an ARDL was highly appropriate for an assessment of the relationship existing between FDI and income inequality in the EAC.

In this context, the ARDL model incorporated stationary and non-stationary time series data, which was important because some variables, such as FDI inflows and measures of income inequality, could be non-stationary in a transient sense. This flexibility of ARDL regarding the integration order of the variable made it easy to analyze variables whose integration orders might differ, hence avoiding the complex restrictions typical of other models for which all variables were required to be stationary.

The ARDL model effectively captured the dynamics of both the short and long run. This was quite important to realize how changes in FDI eventually affected income distribution. The nuances that came out between the immediate and accumulated response distinguished it and assisted in the formulation of policy interventions.

In addition, the ARDL model was suitable for studies with small sample sizes like 23 years in this research. It was better than other models in this regard, as ARDL did not face the complications which other models faced with large data and, hence, was easier to apply and interpret. On the other hand, more complicated methods like GMM required a great deal of attention as far as the choice of instruments, among other endogeneity problems, was concerned.

The flexibility of the model in terms of choosing different lag lengths enhanced its ability to precisely determine the timing and magnitude of FDI's effects on income disparity rates. The distinction between the short- and long-term effects from the ARDL model made this model particularly valuable to policymakers who needed to address both the immediate and enduring consequences of FDI.

The analysis greatly benefited from the inclusion of control variables, such as economic growth rates, educational attainment, and labor market conditions, which enhanced robustness. These control variables helped isolate the specific impact of FDI on income inequality since other influences that might affect income distribution were accounted for. This holistic approach ensured the actual observation of how FDI and income inequality interplayed within the EAC region.

The flexibility combined with the ease of use and the fact that both short-term as well as long-term effects could be analyzed made the ARDL model an appropriate specification to be fitted to this research.

3.5 Data Analysis

Because the information was formatted as a panel, the Panel ARDL model was applied to analyze the short-run and long-run relationships between variables. In this regard, the method

provided a comprehensive description of the temporal connections among variables (M. Hashan Pesaran, 1999). This technique was used in real-world studies, which showed its great adaptability and dependability across various situations. The Panel ARDL model was specified as follows:

$$u_{it} = \mu_i + \sum_{j=1}^{p} \phi_{ip} u_{it-j} + \sum_{j=0}^{q} \varpi_{iq} X_{it-j} + \varepsilon_{it}$$

Where:

u_{it} is the dependent variable for the country i at time t in this case, this is the unemployment rate and X_{it} are the independent variables for the country i at time t.

μ_i entity specific effort

ϕ_{ip} is the coefficients for the lagged dependent variable

ϖ_{iq} is the coefficients for the lagged independent variable

ε_{it} the error term.

p and q are the maximum lags for the independent and control variables, respectively.

3.5.1Panel Unit Root Test

All of the variables because it was panel data, needed to be stationary (Fisher ADF test and Panel Unit Root test Pesaran et al., 2003). Each cross-section's ADF tests' p-values were combined in the Fisher ADF test which then calculated a test statistic. This allowed for more flexibility in managing the diversity in the panels.

Another panel unit root test that was efficient for consideration was the Levin-Lin-Chu test. The Levin, Lin, and Chu test, as developed in 2002 by Levin et al., was frequently applied in testing unit roots using panel data. The LLC test was designed for testing the null hypothesis that there existed a unit root in all panels of the dataset. It assumed that the autoregressive parameter of the process was homogeneous or the same across all cross-sections of the panel data.

In cases where the assumption of homogeneity was not appropriate, alternative tests such as the Im-Pesaran-Shin test or the Hadri test were considered. The IPS test allowed heterogeneous autoregressive parameters across panels and allowed heterogeneity in the panels more flexibly.

The Pesaran, M. H., & Shin (2003) panel unit root test incorporated cross-sectional averages of lagged levels and first differences into the ADF regressions. It accounted for cross-sectional dependence and provided a very reliable method of testing unit roots.

3.5.1 Lag Length Selection

The accuracy of the panel ARDL model depended upon the choice of lag duration, and the Schwarz Bayesian and Akaike information criterion were applied to determine the ideal lag length. They aided in finding the model which did not result in overfitting but also gave the best fit to the data.

3.5.2 Cointegration Test

The Panel ARDL model was used to check for the existence of a long-run relationship between the variables.

$$\Delta u_{it} = \mu_i + \delta_i(u_{it-1} - \pi_i X_{it-1}) + \sum_{j=1}^{p-1} \phi_{ij} u_{it-j} + \sum_{k=0}^{q-1} \varpi_{ik} X_{it-k} + \varepsilon_{it}$$

Where.

Δ is the first difference operator.

μ is the drift component

δ_i speed of adjustment parameter

$\pi_i$long-run relationship coefficient

The bounds test compares the F-statistic with critical values to determine whether the variables are cointegrated.

3.5.3 ARDL Error Correction Model

Once you establish that a long-run relationship exists between Yt and Xt, you can include an error correction term to model the short-run dynamics around the long-run equilibrium. The ECM version of the ARDL model can be written as:

$$\Delta u_{it} = \mu_i + \sum_{p=1}^{p} \phi_{ip} \Delta u_{it-p} + \sum_{q=0}^{q} \varpi_{iq} \Delta X_{it-q} + \theta \varepsilon_{it-1} + \sigma_{it}$$

Where:

θ is the error correction term, rate at which the deviation from the long run equilibrium is corrected in the short run.

ε_{it-1} the lagged error correction term from the long-run equation.

σ_{it} the disturbance term.

3.6 Validity and Reliability

The pursuit of validity and reliability in this study was achieved through triangulation with multiple sources of evidence. In addition, a robustness check ensured that consistency of results was duly scrutinized, and bias was mitigated at the level of gathering data and its analysis.

3.7 Ethical Considerations

The work was guided in integrating and upholding research ethical standards. This research observed a process of getting consent from the interviewee before conducting the process, upholding transparency, maintaining the confidentiality of information, and protecting against any manipulations and bias.

CHAPTER 4 : RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the empirical analysis of the key economic variables studied across six East African countries: Burundi, the Democratic Republic of Congo (DRC), Kenya, Rwanda, Tanzania, and Uganda. These countries were selected to represent a diverse cross-section of the region that captures a range of economic contexts, development stages, and unique challenges.

First, the stationarity of the data is checked, followed by the Augmented Dickey-Fuller test, which purports to see if there is cointegration among the variables: Gini Coefficient, FDI inflows, Gross Domestic Product, and employment. Then, in order to analyze the short-term dynamics and the speed of adjustment towards a long-run equilibrium, an Error Correction Model is estimated.

The results will be presented in tables and figures to give a comprehensive overview of the statistical analysis. The detailed interpretations will highlight the relationships that exist between the variables and what those mean in terms of implications for the economies selected.

4.2. Descriptive Analysis

The followinf sample use in the study is obtain from World bank , SWIID for all the country from 2004 to 2020 , the table below illustrate the descriptive statitistic for all variable :

Variables	No of observations	Mean	St. deviation	Max. value	Min. value
Gini coefficient	17	44.10392	3.43165	50.4	38.1
FDI inflows	17	678086980	648086980	2891607809	-243200000
GDP	17	26575772496	23530135133	1.010e+11	9.153e+18
Employement	17	69.69095	9.378986	85.43	51.88

4.2.1:Interpretation of Descriptive Statistics:

Gini Coefficient: The Gini coefficient's average stands at 44.10, indicating fairly high income inequality across the region. The standard deviation is 3.43, which is regarded as moderate; this implies moderate variations in inequality between the countries sampled. The highest rate of 50.4 would mean that the level of inequality is even greater in some nations, while for others, 38.1 is relatively the lowest inequality among the nations represented in this sample.

FDI inflows: From the mean value of 678,086,980, it indicates the huge amount of FDI that all EAC economies got on average; however, a very high dispersion around this average, with an SD of 648,086,980, describes considerable variation across countries. Maximum 2.89 billion indicates the highest FDI received by one economy, and the minimum is -243.2 million dollars, showing net negative FDI inflows because of either disinvestments or capital flight.

The mean **GDP** is an average of 26.58 billion, showing that the country has a medium economic size among EAC countries. However, the GDP levels vary highly in the sampled countries, with a standard deviation of 23.53 billion. The maximum GDP is 101 billion, which means there is an appreciably higher economy in the sample, while the minimum of 9.15 trillion is very suspicious and may be either a data error or an outlier that needs to be verified.

Employment Rate: The overall average of the series is 69.69%. This tells that the majority are above employment and thus employed. The standard deviation of 9.37% implies moderate dispersion in the levels of employment among different countries. The highest is 85.43%, while the minimum value of 51.88% suggests that some of these countries are below this minimum level of employment.

Overall, these descriptive statistics indicate the economic gaps between EAC countries in income inequality, investment inflows, and employment. These variations suggest that policy interventions may be necessary to ensure balanced economic development across the region.

4.3 Stationarity Test

In this chapter, we conduct a stationarity test on the sample. We apply the Im-Pesaran-Shin test, originally developed for panel data analysis, which allows individual heterogeneity across cross-sectional units. The IPS test will enable us to draw inferences about whether the variables are stationary or possess a unit root, which is a necessary precursor to subsequent

econometric models. The results of the IPS test will guide us as to whether any transformations-pre-differencing for instance-needs to take place.

Variables	Level	First difference	Conclusion
Gini coefficient	Non stationary	Stationary	I(1)
FDI inflows	Stationary	-	I(0)
GDP	Non stationary	Stationary	I(1)
Employement	Non stationary	Stationary	I(1)

4.4 Lag leng Selection

Optimal lag selection is highly crucial in time series modeling, as this allows for an appropriate capture of the dynamics without overfitting. Akaike Information Criterion, Schwarz Criterion, and Hannan-Quinn Criterion vary in certain ways of balancing model fit versus model complexity: AIC tends to choose complex models, whereas SC chooses simpler models in an attempt to avoid overfitting; HQ takes a middle course.

The optimal lag selected was one (1) to help avoid overfitting.

AIC	SC	HQ
1	1	1

4.5 Cointegration test :

The results of the ADF cointegration test do strongly indicate the presence of a long-run relationship between the variables under study, which include Gini Coefficient, FDI inflows, GDP, and employment. Its ADF test statistic is presented as -28.6487, which is far below the critical value of -2.58 at the 1 percent level of significance. This enormous magnitude of difference allows us to reject the null hypothesis of no cointegration, hence confirming that a stable long-term equilibrium relationship exists among the variables.

The implication of this result is that, even though there might be short-run deviations, the Gini Coefficient, FDI inflows, GDP, and employment are related in the long run. In practice, these variables do not move independently of one another, as their nature is to be interlinked, and every disruption in any one variable may impact for a long time on the rest. Cointegration, therefore, in evidence suggests that the model can meaningfully uncover the long-term dynamics and interdependencies of these key

economic indicators and is thus appropriate for further analysis and policy formulation based on the established equilibrium relationship.

4.6 ECM Test Results

The Error Correction Model (ECM) estimates how the system adjusts in the short term to restore equilibrium after a shock. Below are key results for some countries (Burundi, Democratic Republic of Congo, Kenya, Rwanda, Tanzania, Uganda):

Country	ECM term	FDI inflows	GDP	Employment
Burundi	-1.028	-1.306e-10	1.437e-10	0.09421
DRC	-1.52	-1.629e-11	1.134e-11	-0.07193
Kenya	-0.3478	-8.188e-12	-5.288e-12	-0.1072
Rwanda	-0.605	0.1035	1.274e-10	-0.03477
Tanzania	-0.2476	-3.682e-11	1.501e-12	0.04273
Uganda	-1.018	-5.677e-11	1.035e-12	-0.09956

Interpretation :

The outcome of the ECM shows how the economy of every country adjusts towards equilibrium in response to a shock basing it on the adjustment speed and direction of key variables like FDI inflows, GDP, and employment. For Burundi, the ECM term is highly significant at -1.028 showing that 102.8% of the disequilibrium gets corrected in the next period. This portends a strong and quick response to adjust towards the long run, mainly from the employment variable, with its positive coefficient of 0.09421, suggesting that whenever employment increases, inequality increases slightly. In addition, FDI inflows and GDP have very weak or negligible effects on short-run inequality in Burundi.

In the DRC, the strongly significant ECM term of -1.52% implies that in the subsequent period, the adjustment of the economy is over 100%, reflecting a very strong tendency towards equilibrium after shocks. Employment is playing an important role in this process of adjustment: with a negative coefficient (-0.07193), it is implying that higher employment reduces inequality in the short run. In contrast, GDP shows a positive effect on inequality, marginal in that sense; it means economic growth could lead to small increases in inequality, though the impact is not strong. FDI inflows, with a very tiny and statistically insignificant coefficient, do not appear to make any significant difference to DRC's short-term inequality.

The error correction term of -0.3478 in Kenya implies that the adjustment rate is more modest, with approximately 34.8% of any disequilibrium adjusted in the following period. Employment again performs a key role, with the negative coefficient (-0.1072) showing that increases in

employment tend to reduce inequality. However, both FDI inflows and GDP have no significant short-run impact on inequality, underlining the dominant role played by employment as a driver of changes in inequality in Kenya. In Rwanda, from the ECM term estimated at -0.605, there is a reasonable strong adjustment; hence, about 60.5% of disequilibrium would be corrected in the next period. While the coefficient of employment is insignificant, indicating no effect of the employment variable on inequality, the estimate for FDI inflows is marginally positive, indicating that foreign investment can slightly absorb some inequality. For Tanzania, the ECM term of -0.2476 is the smallest in the countries analyzed, indicating that the pace of adjustment to its equilibrium is very slow. Not one of the key variables-FDI, GDP, or employment-is statistically significant in explaining changes in inequality in the short run, which may suggest that Tanzania faces structural issues inhibiting effective adjustment or response to economic shocks. Lastly, Uganda presents an ECM term of -1.018, suggesting a strong adjustment toward equilibrium, and the effect of employment on inequality is negative and significant. However, FDI and GDP are insignificant at a short-run perspective, which further puts a greater importance on employment as the major determinant for inequality change in Uganda.

Comparision with other studies :

These findings are supported by the results of **Herzer and Nunnenkamp (2011),** who concluded that FDI tends to increase income inequality in developing countries because of its benefit to skilled labor and capital-intensive sectors. In the same light, **Asiedu (2002)** pointed out the sectoral concentration of FDI, which often leads to increased disparities in regions where institutional capacity to regulate distribution is weak.

In contrast, **Feenstra and Hanson (1997)** postulated that FDI may even reduce inequality if the available jobs provided are in the labour-intensive sectors. Such a perspective actually matches results found for Kenya and Uganda where employment became vital to bring down inequality.

In addition, **Javorcik and Narciso (2017)** underscored sectoral targeting as an aspect of FDI, arguing that manufacturing invest ments had the ability to create many jobs across the economy.

This is in support of why countries like Tanzania, missing major effects from FDI under structural challenges, might begin strategically diversifying their targeted sectors of FDI.

The findings range from these, thus underlining the complex and context-dependent nature of how FDI affects inequality, thereby making policies differ and lean on local economic and institutional contexts.

4.7 Summary of Findings

The empirical analysis of selected economic variables, such as the Gini coefficient, FDI inflows, GDP, and employment, across six East African countries reveals striking economic dynamics and inequality patterns that prevail in the region.

Country-Specific Findings

Burundi: As indicated by the ECM, the economy converges quickly to its shock because more than 100% of the disequilibrium is corrected in the next period. It appears that employment slightly contributes to higher inequality, though the level of employment is high; it may mean the equitability in the distribution of income. FDI inflows and GDP are of limited impacts in the short run on inequality.

Democratic Republic of Congo (DRC): The ECM term of -1.52 infers that the disequilibrium is corrected by more than 100% in the next period. Employment plays an important role in lowering inequality; hence, a high level of employment means low inequality. However, GDP has a marginal positive contribution to inequality while FDI inflows are insignificant in the short run. This means that employment is the major driver of economic adjustments in the DRC, while FDI and GDP have a minor influence in the short run.

Kenya: The speed of adjustment is lower compared to Burundi and the DRC, having an ECM term of -0.3478, which means that only 34.8% of the disequilibrium is corrected in the next period. Employment still remains one of the significant determinants of inequality reduction; the negative sign implies that the higher the level of employment, the lower the inequality. However, FDI inflows and GDP have insignificant short-run effects on inequality, indicating that employment is the main determinant of changes in inequality in Kenya.

Rwanda, with an ECM term of -0.605, has a moderately paced economic adjustment. Employment does not show any statistically significant impact on inequality, but FDI inflows are marginally positively related to inequality, showing that foreign investment may be slightly increasing inequality in the short run.

Tanzania shows the slowest movement toward equilibrium with an ECM term of -0.2476, indicating that structural rigidities get in the way of adjusting to equilibrium even after economic shocks. In sum, none of the key variables—FDI inflows, GDP, and employment—exert a significant short-run effect on inequality, indicating absence of any mechanisms or policies to deal with economic inequality.

Uganda: With an ECM term of -1.018, Uganda provides the highest convergence to equilibrium. Just like in the cases of Burundi and the DRC, employment is the most significant determinant in depressing inequality-as evidenced by its negative coefficient.

However, FDI inflow and GDP are insignificant in influencing inequality in the short run, further cementing the fact that employment remains the most crucial variable as far as addressing inequality in Uganda is concerned.

General Implications:

Results imply that while there may exist a long-run relationship between the variables studied, the speed of adjustment and contribution of each variable towards inequality in the selected East African countries vary widely. The most significant contributing variable is usually found to be employment, repeatedly showing up in this model or a related version; its effects do depend on particular national economic circumstances.

However, the impacts of FDI inflows and GDP have remained mixed, with some countries recording remarkable short-run effects, while others did not. This underlines the fact that economic inequality in the region is complex and context-dependent; hence, interventions at the policy level need to be country-specific and address country-specific challenges while ensuring inclusive economic growth.

CHAPTER 5 CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

The paper has examined the long-run and short-run relationships between the Gini Coefficient, FDI inflows, GDP, and employment for selected African countries. Therefore, the results of the cointegration tests and the resulting ECM stand out as a clear basis for the interaction of these variables in influencing inequality within income distribution.

5.2 Key Findings:

This study uncovered meaningful insights into how income inequality, FDI inflows, GDP, and employment interact within the East African Community (EAC). By using the Augmented Dickey-Fuller test, we found clear evidence of a long-term relationship amongthese variables. While short-term fluctuations exist, they tend to align over time, showing their deep connection within the region's economic fabric.

Employment stood out as a key factor in reducing inequality across most of the countries we analyzed. For example, in the Democratic Republic of Congo (DRC) and Uganda, higher employment levels were strongly linked to a reduction in income inequality. This underscores the critical role that job creation plays in fostering economic equality and providing opportunities for broader social upliftment.

However, the effects of FDI and GDP were more complex and less predictable. In some cases, like in the DRC and Rwanda, FDI had a small but positive role in reducing inequality. On the other hand, GDP growth often widened the gap between the rich and the poor, suggesting that the benefits of growth were not being shared equally.

The way countries adjusted to economic changes also varied significantly. The DRC and Uganda showed a strong ability to correct economic imbalances quickly, while Kenya and Rwanda adjusted at a more moderate pace. Unfortunately, Tanzania struggled to make significant short-term adjustments, indicating structural challenges that might be limiting its ability to respond to economic shocks.

These findings highlight both the opportunities and challenges within the EAC. They serve as a reminder that inclusive growth requires deliberate policies that ensure employment generation, equitable wealth distribution, and strategic use of foreign investments. By addressing these issues, the region can work toward a more balanced and prosperous future for all its citizens.

5.3 Recommendations

From the findings stated above, some recommendations to policy makers can be made, through which the inequality can be addressed effectively in the countries under study:

Employment Generation: Emphasize employment generation, targeting sectors with a high employment potential such as agriculture, manufacturing, and services. These are programs on employment that would benefit the vulnerable groups so that growth may go on to translate into increased equity.

Equitable Distribution of Economic Growth: Strategies should be targeted at ensuring a more equitable distribution of the benefits of economic growth. This can be achieved through progressive taxation, social safety nets, and policies encouraging SMEs to promote local economic participation.

Targeted FDI Policies: Governments have to draft policies in such a manner as to ensure that not only is FDI attracted but there are positive contributions made by foreign investments to the local economy. This includes responsibility or policies which require foreign firms to engage in local hiring and community development initiatives.

Monitoring and Evaluating Policies: There is a need to continuously monitor and evaluate economic policies with respect to their effects on inequality. Data-driven approaches will help in identifying those areas of strategy that work and allow for timely adjustment of policies.

Regional Collaboration: One may consider regional collaboration approaches wherein best practices and resources are shared among countries to deal with the issue of inequality better. Regional frameworks reinforce national policies and further strengthen regional economic integration.

5.4 Concluding Insights

This paper showed how various economic variables interact in creating inequality. While economic growth is important, it is not a panacea for achieving all goals. Inclusive reduction of inequality needs to be sought along multiple dimensions; hence, employment and equitable distribution would be the key to this sustainable progress. By embracing these recommendations within this chapter, policymakers can then set a path toward ensuring that economic growth is translating into an inclusive economy for one and all.

The results emphasize the importance of employment creation as a consistent factor in reducing inequality across most countries, particularly in Kenya, DRC, and Uganda. Policies aimed at fostering job growth and ensuring equitable distribution of economic benefits can help mitigate inequality. Additionally, the lack of significant short-term effects of FDI and GDP

growth in some countries suggests that economic growth alone may not be sufficient to address inequality, and targeted interventions are necessary.

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