

The Impact of the rule of law on economic growth of the East Africa Community countries: An Empirical Analysis

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Abstract: Economic integration and cooperation were of the major objectives for establishing the East African Community in 1967. Initially, it consisted of Kenya, Uganda, and Tanzania, and later expanded to include five more countries, namely Rwanda, Burundi, the Democratic Republic of Congo, South Sudan, and Somalia. The intergovernmental organization acknowledges that the rule of law is an indispensable basis for reaching its economic objectives. Despite the region experiencing steady economic growth, it falls far behind its potential. On average, the region scores poorly on the rule of law index, one of the factors acknowledged by many economists to influence economic performance. The research investigates the extent to which the rule of law affects the economic growth of the East African Community countries. The data sample used spans twenty years from 2003 to 2022. The data for the two variables was sourced from the World Development Indicators (World Bank) database to examine the relationship, and Ordinary Least Squares regression was conducted to analyse the impact of the rule of law on economic growth across the EAC countries. The results revealed that the rule of law has a weak positive impact on the economic growth of the EAC countries. This shows that increased adherence to the rule of law can lead to increased economic growth. The study recommends that governments strengthen institutions to guarantee higher and steadier economic growth. The study also recommends consistency in the implementation of intra-trade policies and the guarantee of property and contractual rights.

Keywords: Economic growth, Rule of Law, ordinary least square, EAC.

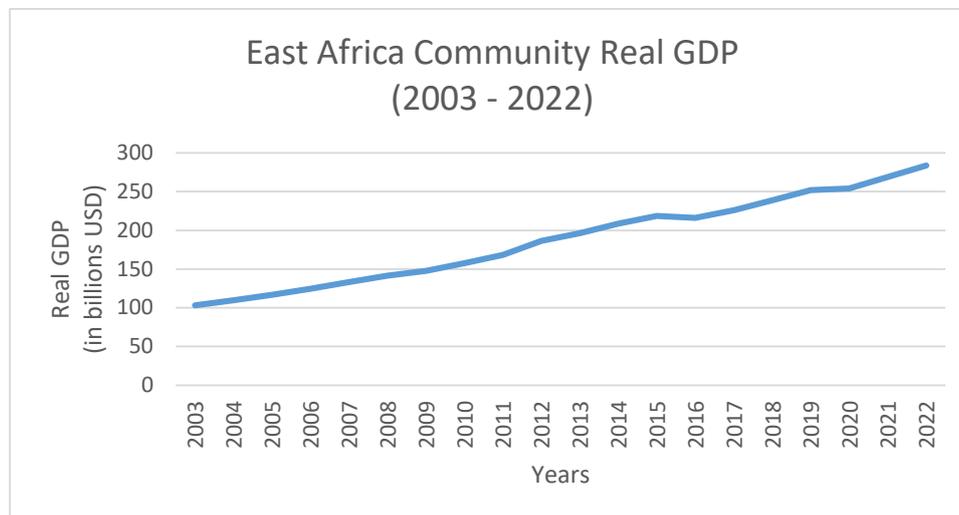
1. INTRODUCTION

Governance is a critical factor in determining the growth an economy. The differences in the rates of economic growth lies in the differences in state capacities to govern. Governments which govern more efficiently and effectively often experience high economic yields (Khan, 2007). The World Bank (2005) enumerates six factors it considers the indicators of governance and the Rule of Law is one of them. It is a multidimensional indicator with different aspects. The World Bank mentions these aspects to include: property rights, contract enforcements, the courts, the police, crime and violence. Although appearing distinct, these aspects of the rule of law are not mutually exclusive but rather complementary. It is therefore difficult to distinguish the individual impact of each one of them on the economic output without linking it to another whether methodologically or theoretically (Haggard & Tiede, 2011). In this paper, we look at it wholesomely without much focus on the individual aspects. High income countries have relatively higher rule of law index compared to developing economies especially in the Sub-Saharan Africa (Ozpolat, Guven, Ozsoy & Bahar, 2016).

The treaty of the East African Community (EAC) which is composed of eight member states namely Kenya, Uganda, the United Republic of Tanzania, Rwanda and Burundi, the Democratic Republic of Congo, South Sudan, and Somalia recognizes that the rule of law is a precondition for achieving economic growth and development (EACJ, 1999).

Despite the steady growth of economic output of the East Africa Community countries, their economic performance is far below the potential. Several factors including poor adherence to the rule of law are suspected to stunt the growth.

Graph 1



Source: World Bank

2. LITERATURE REVIEW

The rule of law, as defined by the US Courts (2019), is the principle which obligates all individuals, institutions and entities to adhere to laws that are publicly promulgated, equally enforced, independently adjudicated and consistent with international principles of human rights. The World Bank (2015) states that the rule of law refers to the measurement of the perception of the extent to which people have confidence in the rules of their society and abide by them. More specifically, the rule of law can be viewed through property rights, crime and violence, contractual rights, the police and the courts. The effectiveness of the legal system of a country, according to Kaufmann & Kraay (2023) is judged by its capacity to uphold contractual and property rights. The World Bank developed a system for ranking the legal systems of countries based on rule-based governance and effective protection of property rights. The scale runs 1 to 6, with 1 indicating the lowest rating and 6 the highest.

Economic growth is a general indicator of the health of the economy. Callen (n.d) stated that people are more interested in whether the economy is increasing or decreasing. In order to check that, we look at the changes that happen in the economic output otherwise called the real GDP. An increase in the real GDP indicates an increase in economic growth.

The IMF defines GDP as the monetary market and also non market value of all the final goods and services produced within the borders of a country in a given period of time. The services that the government provides including education and defense are considered the nonmarket production.

Numerous literature draw a nexus between economic growth and rule of law. Kaufmann & Kraay (2023) found that among the factors that determine economic growth is abiding by the rule of law and protection of contractual and property rights. Van (2020) argued that the two main factors that enable the high income countries to produce and develop fast are the rule of law and property rights. In his empirical study on the impact of the rule of law and property rights on the economic output in Africa, he used a multiple regression model and found that poor scores on these two fronts (rule of law and property rights) inhibit economic growth of Africa. Collier, Hoeffler & Söderbom (2008) investigated the impact of conflict and violence on economic growth in Africa and they discovered that whenever there is a conflict like a civil war, economic growth becomes volatile. They concluded that violence is an important determinant of economic performance while also acknowledging that economic development helps to rebuild post conflict era. Butkiewicz & Yanikkaya (2006) used empirical growth model to examine the relationship between institutional quality and economic growth in developing nations. They found that upholding the rule of law promotes growth. Ohnesorge (2007) also found that the rule of law is a crucial determinant of economic growth and development.

Ozpolat, Guven, Ozsoy & Bahar (2016) utilized the Generalized Method of Moments (GMM) to analyse the data they collected to investigate the impact of rule of law on economic growth in developed, developing and under-developed countries. The results revealed a positive correlation between the rule of law and economic growth in high income countries. However, the results revealed that there was not statistically meaningful correlation between the two variables in developing and underdeveloped countries.

Common Market For Eastern And Southern Africa (COMESA) whose member states include: Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe stated that respecting the rule of law is a prerequisite for achieving economic objectives (Charles, 2012).

The Southern African Development Community (SADC), a regional economic block comprising of fourteen countries (the Republic of Angola, Botswana, the Democratic Republic of Congo, Lesotho, Malawi, Mauritius, the Republic of Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe) acknowledges that the rule of law has an impact on economic growth and development (SADC, 2011).

The Economic Community of West African States (ECOWAS) was established in 1975. It is an economic bloc consisting of fifteen countries. They include: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo. Its Protocol on Democracy and Good Governance admits that without adhering to the rule of law to provide good governance, it would be impossible to achieve economic growth and development (Cowell, 2011).

El Naggat (2021) investigated the factors that contribute to regional economic integration in the Arab Maghreb Union (sometimes referred to as North African Arab countries). His study revealed that adherence to the rule of law contributes to regional economic cooperation which leads to improved economic output.

3. METHODOLOGY

Prior to doing the OLS regression, the data series underwent stationarity testing via the augmented Dickey-Fuller (ADF) test to prevent false regression outcomes, confirming that both variables were stationary. The OLS model subsequently assessed the impact of the rule of law on GDP growth rates among the EAC countries, designating GDP growth as the dependent variable and the rule of law index scores as the independent variable. The model's coefficients demonstrate a moderate positive correlation, indicating that enhanced rule of law is associated with increased economic growth. The report advocates for the protection of institutional frameworks within the EAC to strengthen the rule of law, hence facilitating sustained economic growth throughout the region.

The model specification is as follows:

$$\text{GDP_Growth}_{it} = \alpha + \beta \text{Rule_of_Law}_{it} + \varepsilon_{it}$$

where:

In this model, GDP_Growth_{it} denotes the economic growth rate for country i at time t , while Rule_of_Law_{it} represents the rule of law index score for country i at time t . The intercept term, α , represents the baseline level of economic growth, while the coefficient β indicates the influence of the rule of law on economic growth. The error term, ε_{it} , represents any unaccounted fluctuation in economic growth.

The augmented Dickey-Fuller (ADF) test was performed to verify the stationarity of the time series data, hence ensuring data dependability and avoiding false regression outcomes. The computed β coefficient signifies the magnitude and orientation of the correlation between the rule of law and economic growth in the EAC nations. Research indicates a moderate positive correlation, highlighting the necessity of reinforcing the rule of law to foster economic development in the region.

Table 1: Average GDP growth rates of the East Africa Community countries (2003 - 2022)

Country	Av. GDP growth rate (2003 – 2022)
Burundi	2.475855551
Congo, Dem. Rep.	5.912137111
Kenya	4.66588832
Tanzania	5.993477048
Uganda	5.93996379
South Sudan	-4.925337978
Rwanda	7.023552689
Somalia	5.449960997

Source: The World Bank

Table 2: Average Rule of Law index of the East Africa Community countries (2003 - 2022)

Country	Rule of Law Index (2003 – 2022)
Burundi	-1.241252545
Congo, Dem. Rep.	-1.666457832
Kenya	-0.698835731
Tanzania	-0.454088368
Uganda	-0.39196867
South Sudan	-1.834307949
Rwanda	-0.252259791
Somalia	-2.337427497

Source: The World Bank

Table 3: Average GDP growth rates and the Rule of Law Index of the East Africa Community countries (2003 - 2022)

Country	Av. GDP growth rate	Av. Rule of Law Index
Burundi	2.475855551	-1.241252545
Congo, Dem. Rep.	5.912137111	-1.666457832
Kenya	4.66588832	-0.698835731
Tanzania	5.993477048	-0.454088368
Uganda	5.93996379	-0.39196867
South Sudan	-4.925337978	-1.834307949
Rwanda	7.023552689	-0.252259791
Somalia	5.449960997	-2.337427497

Source: The World Bank

4. RESULTS

Table 4: Descriptive Statistics

	AVERAGE_GROWTH_RATE	AV__RULE_OF_LAW
Mean	4.885363	-1.072327
Median	5.285863	-1.059378
Maximum	7.176812	-0.972081
Minimum	-0.788296	-1.183809
Std. Dev.	2.013032	0.047067
Skewness	-1.743139	-0.550085
Kurtosis	5.452942	3.714453
Jarque-Bera	15.14255	1.434012
Probability	0.000515	0.488212
Sum	97.70726	-21.44653
Sum Sq. Dev.	76.99364	0.042091
Observations	20	20

Source: EViews 12

The descriptive statistics for the Average Growth Rate of the East Africa Community (EAC) countries show a mean of approximately 4.89%, with a median slightly higher at 5.29%. This indicates that, on average, these countries experienced modest economic growth during the study period. The maximum growth rate recorded was 7.18%, suggesting that at least one country saw strong growth in a given year, while the minimum was -0.79%, indicating that some countries experienced negative growth or economic contraction during certain periods. The standard deviation of 2.01% highlights the variability in growth rates across the countries, with a left-skewed distribution (skewness of -1.74), meaning that lower growth rates were more common. The high kurtosis value of 5.45 suggests that the growth rates had heavier tails, indicating the presence of more extreme values than would be expected in a normal distribution.

For the Rule of Law variable, the mean was -1.07, with a median of -1.06, showing that the rule of law across the EAC countries tended to be weak during the study period. The values ranged from -0.97 (better rule of law) to -1.18 (weaker rule of law), with a minimal standard deviation of 0.047, indicating that the rule of law scores was relatively consistent across the countries. The skewness of -0.55 suggests a slight leftward skew, meaning that more countries had lower (worse) rule of law scores. The kurtosis value of 3.71 is close to a normal distribution, implying that the data did not have extreme outliers, and the Jarque-Bera probability of 0.488 suggests that the rule of law variable followed a nearly normal distribution.

Table 5: Correlation

	AVERAGE_GROWTH_RATE	AV__RULE_OF_LAW
AVERAGE_GROWTH_RATE	1	0.1339791075869871
AV__RULE_OF_LAW	0.1339791075869871	1

Sources: EViews 12

The correlation between the Average Growth Rate and the Rule of Law is approximately 0.134, indicating a weak positive relationship.

Table 6: Regression analysis

Dependent Variable: AVERAGE_GROWTH_RATE				
Method: Least Squares				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
AV__RULE_OF_LAW	5.730216	9.989974	0.573597	0.5733
C	11.03003	10.72231	1.028698	0.3172
R-squared	0.017950	Mean dependent var		4.885363
Adjusted R-squared	-0.036608	S.D. dependent var		2.013032
S.E. of regression	2.049547	Akaike info criterion		4.367754
Sum squared resid	75.61158	Schwarz criterion		4.467327
Log likelihood	-41.67754	Hannan-Quinn criter.		4.387192
F-statistic	0.329013	Durbin-Watson stat		1.916612
Prob(F-statistic)	0.573338			

Source: EViews 12

This study's findings indicate a little positive albeit statistically insignificant association between the Rule of Law and economic growth in East African Community (EAC) nations. The value of 5.73 indicates that enhancements in the Rule of Law could positively influence economic growth rates. The elevated p-value (0.573) and diminished t-statistic (0.574) signify that this correlation is statistically insignificant, implying that alterations in the Rule of Law may not independently influence economic growth in this region. The R-squared value of 0.018 emphasizes that the Rule of Law accounts for merely 1.8% of the variation in economic growth within the sample.

These results indicate the intricate nature of economic growth, wherein several structural, political, and social elements interact with institutional quality. Although the Rule of Law is essential for establishing a stable business environment and promoting long-term economic growth, factors such as infrastructure, political stability, trade policy, and the investment climate may exert a more substantial influence on growth within the EAC context. The weak statistical significance may indicate that enhancements in the Rule of Law alone might only produce substantial economic effects with simultaneous reforms in other domains.

Based on these findings, EAC nations should enhance their institutional frameworks comprehensively, tackling all aspects of governance and economic policy to foster sustainable growth. Subsequent research could enhance the model by incorporating supplementary factors, such as investment rates, trade openness, and political stability, to gain a deeper understanding of the circumstances under which the Rule of Law may exert a more significant impact on economic outcomes. Additionally, the negative Adjusted R-squared value of -0.037 suggests that the model does not accurately fit the data. The Durbin-Watson value of 1.917 indicates a lack of substantial autocorrelation in the residuals. However, the regression model does not offer compelling evidence to establish a significant impact of the Rule of Law on economic growth in the EAC member.

5. CONCLUSIONS AND RECOMMENDATIONS

This study aims to examine the influence of the Rule of Law on economic growth in the East African Community (EAC) nations from 2003 to 2022. The emphasis was on assessing whether enhancements in the Rule of Law characterized by compliance with concepts such as legal transparency, accountability, property rights protection, and equitable judicial processes correlate with elevated economic growth rates in these nations. The results demonstrate a little positive correlation between the Rule of Law and economic growth; nevertheless, this association is statistically insignificant, indicated by a high p-value of 0.573 and a low t-statistic of 0.574. The R-squared value of 0.018 indicates that the Rule of Law explains merely 1.8% of the variation in economic growth among EAC members.

The statistical insignificance of this association may indicate numerous underlying reasons. Although the rule of law is a fundamental pillar for cultivating a secure and predictable environment, it may not be the only thing that propels economic progress. Economic growth frequently arises from a confluence of factors, including capital investment, infrastructure, labor market conditions, political stability, trade policy, and human capital, which interact in intricate manners. The restricted explanatory capacity of the Rule of Law in this context implies that absent simultaneous advancements in these domains, the advantages of a robust legal framework may not completely convert into enhanced economic performance.

An alternative interpretation of the findings may pertain to the problems in implementing the Rule of Law in the region. Despite the existence of legal frameworks in EAC nations, the actual compliance with these principles may fluctuate considerably, thereby undermining the anticipated good effect on economic progress. Corruption, inadequate judicial capability, uneven law enforcement, and political intervention may impede the efficacy of the Rule of Law in fostering economic stability and prosperity. Thus, the mere existence of legal frameworks may be inadequate; strong enforcement and institutional reforms are essential to realize the potential advantages.

These findings highlight the necessity for a comprehensive strategy for economic development within the EAC. Although the enhancement of the Rule of Law is crucial, policymakers must also prioritize complementing domains that are equally vital for economic advancement. Enhancing governance, upgrading public infrastructure, fostering human capital development, and preserving political stability could create a more conducive climate for the Rule of Law to flourish and significantly influence prosperity.

Furthermore, regional integration initiatives among EAC nations may augment the impact of the rule of law on economic results. By synchronizing legal norms, protecting transnational property and contractual rights, and unifying regulatory frameworks, EAC member states might establish a more integrated and stable market that attracts investors and promotes commerce. This regional alignment may enhance accountability and uniformity, thereby ensuring that legal improvements provide concrete advantages.

In conclusion, although the Rule of Law possesses the potential to augment economic growth in the EAC, it must be integrated into a comprehensive strategy that considers several growth determinants. Future studies may investigate the interacting effects of the rule of law with other variables, like governance quality, education, and infrastructure, to yield a more nuanced comprehension of the determinants of sustainable growth in the region.

Limitations

The study faces constraints that may have affected the outcomes. Primarily concentrating on the Rule of Law as a singular independent variable may neglect other critical determinants influencing economic growth, like infrastructural quality, political stability, and human capital. Moreover, data limitations restricted the research to a rather small sample size over two decades, which may have influenced the reliability of the findings. The application of an OLS model may inadequately represent the dynamic interactions between the Rule of Law and economic growth, indicating a necessity for more research employing more sophisticated econometric methods.

Policy implications

Policymakers in the East African Community (EAC) must emphasize the enhancement of the Rule of Law as an essential element of a comprehensive economic development strategy. While the Rule of Law may not immediately stimulate economic growth, it establishes an essential framework for further reforms. Countries can enhance investor trust, promote business stability, and attract foreign direct investment (FDI) by creating a predictable and transparent legal framework, which is essential for sustainable economic development. Instances from both within and outside the EAC demonstrate the beneficial effects of reinforcing the Rule of Law on economic development.

Moreover, enhancing legal transparency is crucial for fostering confidence among investors. Rwanda has achieved notable progress in improving legal openness and diminishing corruption, thereby transforming its economic environment. Through the optimization of legal procedures, the implementation of transparent policies, and the enforcement of anti-corruption measures, Rwanda has emerged as a premier investment destination in East Africa. These reforms have facilitated persistent economic growth, and Rwanda frequently achieves excellent rankings on the World Bank's Ease of Doing Business Index. The nation's initiatives to reinforce the Rule of Law illustrate how legal clarity may stimulate economic advancement and enhance investor trust.

In addition, the protection of property rights is essential for fostering investment, as it guarantees investors the security of their investments. Kenya serves as a relevant case within the EAC. In recent years, Kenya has enhanced property registration and the enforcement of land rights, favorably influencing economic growth by promoting real estate and industrial investments. Enhancing property rights has diminished land conflicts and enabled businesses to invest with increased assurance, fostering long-term investments. Moreover, in foreign contexts like South Korea, reforms in property rights have been associated with swift industrialization, highlighting the essential function of property protection in promoting economic progress.

Equitable judicial procedures significantly contribute to economic stability. In Uganda, for example, the judicial system has seen significant improvements in the arbitration of commercial disputes, which has strengthened confidence among domestic and international businesses. The advent of commercial courts in Uganda and an enhanced emphasis on judicial efficiency have fostered a more stable business environment. Fair and efficient judicial processes protect investors from arbitrary or delayed rulings, promoting a stable market that is conducive to economic growth. Likewise, Singapore's focus on an effective court and prompt resolution of commercial disputes has established it as a global business center, illustrating that a dependable judiciary is essential for economic competitiveness.

Aligning legal and economic policies among EAC nations can foster a more cohesive, stable, and appealing regional market. The European Union (EU) exemplifies effective regional integration via standardized policies. The EU has established a unified market that draws international investment by unifying legal frameworks, enforcing cross-border property and contractual rights, and harmonizing trade laws. EAC countries can draw lessons from this model by working toward unified legal standards, particularly in areas such as intellectual property rights, tax regulations, and labor laws. A harmonized legal environment can reduce barriers to trade, encourage cross-border investments, and create economies of scale, making the EAC an attractive regional market.

For example, Tanzania and Kenya have cooperated on joint infrastructure projects, such as the Northern Corridor Transport Improvement Project, aiming to facilitate cross-border trade. By aligning their policies, these countries have created a more predictable environment for investors, enabling projects that benefit the entire region. If EAC member states expand this cooperation into legal frameworks, the benefits of shared infrastructure could be further enhanced by legal protections that encourage greater investment.

Finally, Effective anti-corruption measures are equally essential to the Rule of Law, as corruption undermines legal transparency, property rights, and judicial fairness. Efforts in Botswana serve as a strong example outside the EAC, where strict anti-corruption policies and government accountability have promoted economic growth. Botswana's low corruption levels attract investors who are assured of a fair business environment. Within the EAC, Kenya has also initiated anti-corruption reforms to reduce bureaucratic inefficiencies and improve accountability. While these reforms are ongoing, greater consistency and dedication to anti-corruption initiatives can further enhance the Rule of Law and economic growth.

Overall, Strengthening the Rule of Law, through examples such as improving legal transparency, protecting property rights, ensuring judicial fairness, and harmonizing policies, can be instrumental in fostering economic growth in the EAC. These reforms create a foundation that promotes investor confidence, business stability, and regional cooperation. As these examples illustrate, a robust Rule of Law combined with targeted reforms has the potential to transform the EAC into a more integrated, stable, and competitive economic bloc. By drawing on the successes and challenges of regional and global counterparts, the EAC can build an environment where the Rule of Law contributes meaningfully to sustainable economic growth.

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