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DRIVERS OF ECONOMIC GROWTH IN AFRICA

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This Occasional Paper establishes that African countries need to pursue economic diversification and structural transformation vigorously using appropriate policies and institutions that address inclusive growth priorities. In addition, good governance and a committed national leadership with a developmental vision are crucial ingredients. Any capacity building interventions have to be crafted taking these priorities into account as well as the contextual factors that determine a particular country's economic direction.

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DRIVERS OF ECONOMIC GROWTH IN AFRICA: Opportunities, Financing, and Capacity Issues

PREFACE

According to Agenda 2063, African people aspire to “a prosperous Africa based on inclusive growth and sustainable development.” Countries are aware that the “Africa rising” discourse needs to lead to wider access to sustainable socioeconomic opportunities for the majority—while protecting the vulnerable—in an environment of fairness, equality, and political plurality.

Many African countries have enjoyed strong economic growth since 2000. After Asia, Africa has been the second-fastest growing region in the world over the past decade. But higher economic growth has not translated into better living standards, lower poverty rates, or higher employment rates. Poverty is still a scourge in many African countries. Unemployment is rising even as these countries achieve higher growth rates and greater investments and trade volume. Why? What capacity building is required to develop, sustain, and share the benefits of higher economic performance in Africa?

The ACBF has produced this paper under its supported Strategic Studies Group to provoke discussion, encourage further investigation, and define the critical capacity challenges to tackling the growth-equality disconnect in Africa.

The paper shows that investment, human capital formation, debt, and overseas development assistance drive Africa’s economic growth. It recommends paying attention to capacity, which is critical to making Africa’s growth sustainable and inclusive. Continental, regional, and national long-term growth plans require stronger capacities to improve economic governance, align national and subnational institutions, coordinate planning and financing ministries, and cultivate a culture of committed leadership to stir economies when times are hard and execute recovery plans without policy reversals.

In addition to establishing think tanks and policy institutes and strengthening individual and institutional capacities throughout the continent, generating knowledge will enhance evidence-based policymaking processes. Building the capacities for policy analysis and economic management remains a priority. We hope that stakeholders and development partners will join us to continue strengthening human and institutional capacity for sustainable development in Africa.

Professor Emmanuel Nnadozie
Executive Secretary
The African Capacity Building Foundation

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The paper was produced as part of the African Capacity Building Foundation (ACBF) Strategic Studies Project, which aims to provoke discussion and raise awareness about strategic issues of importance to Africa and its development agenda. Strategic studies topics were selected through a consultative process by members of the Policy Institutes Committee and the Strategic Studies Group. Special thanks to members of both networks. In addition, we thank the Strategic Studies Group for its critical review of the manuscript.

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About the African Capacity Building Foundation

The African Capacity Building Foundation (ACBF) is Africa's premier institution in capacity building. Established in February 1991, ACBF builds human and institutional capacity for good governance and economic development in Africa. The Foundation has empowered governments, parliaments, civil society, private sector, and higher education institutions in more than 45 countries and six regional economic communities. It supports capacity development by way of grants, technical assistance, and knowledge generation across the continent. ACBF's vision is that of an Africa capable of achieving its own development.

About the Strategic Studies Group

The Strategic Studies Group (SSG) is an ACBF network of global development experts and practitioners made up of the ACBF Policy Institutes Committee, selected development partners, international development specialists, and the ACBF-supported training programs and university partners. The SSG assists the Foundation in identifying key policy and emerging issues requiring the attention of the Foundation and its stakeholders.

The SSG works with the ACBF to identify research themes and advises the Foundation on strategic and pertinent issues that need special attention. It also serves as a "review panel" that shapes, examines, and evaluates the high-level studies undertaken by the Foundation.

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ABBREVIATIONS

ACBF	African Capacity Building Foundation
FDI	Foreign direct investment
FE	Fixed effect
GDP	Gross domestic product
GMM	Generalized method of moments
HIPC	Highly Indebted Poor Countries
IMF	International Monetary Fund
MDRI	Multilateral Debt Relief Initiative
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
SAP	Structural adjustment program
SDG	Sustainable development goal
UNDP	United Nations Development Programme

All dollar amounts are U.S. dollars unless otherwise indicated.

EXECUTIVE SUMMARY

Africa's economic, social, and political history largely determines its current economic development. The externally imposed structural adjustment programs and reform initiatives of the 1980s and 1990s failed to promote productivity, employment, and poverty reduction. Since 2000, most African countries registered remarkable growth, but this growth failed to reduce inequality. Some African countries have strong development states that organize economic activities and regulate the private sector and other development actors such as civil society organizations. Economies' growth is driven by large public investment in infrastructure and other growth-enhancing sectors but with visible urban bias and ever greater borrowing.

Despite encouraging gross domestic product expansion over the last 15 years, many African countries do not perform well on human development, as recent United Nations Development Programme (UNDP) reports show. So we must investigate whether this growth is inclusive and sustainable given its reliance on debt. For policy and research purposes, we must examine the drivers of Africa's recent growth, recognizing the diversity of the continent's institutional quality, income growth, geographical location (such as having coastal access or not), and resource endowment (such as mineral- or oil-rich versus mineral-poor or non-oil economies). Using longitudinal data on a large dataset, this study provides the following:

- A detailed discussion of African countries' growth performance—focusing on economic, social, structural, and political changes. The study underscores the importance of using the continent's potentials (such as arable land and young population) for its structural transformation. Africa's growing economic and geopolitical importance gives it the opportunity to make the most of its partnerships—used by many African countries for infrastructure development, technology transfer, trade, and curbing of illicit financial flows. There are also outstanding challenges to Africa's growth—such as declining aid, youth unemployment, dysfunctional institutions, income inequality, poor economic governance, unfavorable global trading arrangements, development planning devoid of nationally developed macroeconomic frameworks, and rising external debt from non-concessional sources.
- Evidence of various financing sources (such as debt, savings, revenue, and foreign direct investment) and their future projections based on current trends. Debt, savings, and tax revenue are important development finance sources. For growth sustainability, debt is critical because most governments get non-concessional finance to fund their development needs in the face of declining grants and aid from traditional development partners.
- Information on Africa's substantial growth determinants using panel data from 1980 to 2013 for 52 countries. Past growth, human capital, trade openness, foreign direct investment, and overseas development assistance have huge, positive impact on growth. African governments failed to make the most of the debt relief from Highly Indebted Poor Countries and the Multilateral Debt Relief Initiative. Debt finance needs to be channeled to growth-enhancing sectors (such as infrastructure) to improve long-term growth.
- Information on key capacity needs that will contribute to development policymaking and economic growth. In Africa, institution capacity needs to be reinforced to build on the recent economic governance improvements in some countries. And focusing on long-term capacity issues, such as human capital development, will make the bureaucracy

more efficient and facilitate technology acquisition. Given the well-recognized role of development states, it is important to build capacity of development planning commissions or ministries so that they will have the necessary skills to domesticate continent-wide development visions such as the African Union Agenda 2063. Equally, local capacity should include the capacity of planning officials to align national development objectives with objectives at the sub-national level. To plan, monitor, and track progress, data are critical. So capacity in data collection, compilation, management, and harmonization needs the support of multilateral institutions such as the African Development Bank, the United Nations Economic Commission for Africa, and the ACBF. The data issue needs coordination at all levels and prioritization among capacity issues.

CHAPTER 1. INTRODUCTION

Background

African countries have pursued many economic development models and policy regimes over the last five decades. Choosing one is a complex process influenced by Africa's economic, political, and historical evolution. The models pursued so far include the two-sector model or the surplus labor model of growth developed by Arthur Lewis in the 1950s; the import substitution or inward-looking industrialization of the 1960s credited to Prebisch and Singer (used by Ethiopia, Ghana, Kenya, Mali, Nigeria, and Zambia); and the growth-with-equity paradigm of the 1970s. They also include the neoclassical model of development in the 1980s and early 1990s through the structural adjustment programs (SAPs) designed by major international financial institutions such as the International Monetary Fund (IMF) and the World Bank. SAPs made African countries abandon the development planning of the 1970s, which was generating decent growth in gross domestic product (GDP). After the SAP era of the 1980s and 1990s, characterized by deindustrialization in much of Africa, countries have pursued mixed economic planning combining state-controlled/regulated development initiatives with private sector expansion. Many countries now have long-term visions and five-year development plans, such as Ethiopia's Growth Transformation Plan I for 2010–2015 and a second plan for 2016–2020.

Development planning's attractiveness is growing as countries that have plans with strong political commitment behind them have been sustaining their growth over the last 15 years. In recent years, the New Partnership for Africa's Development was designed to eradicate poverty and help the continent participate in global partnerships in the 21st century. Because previous attempts to transform African economies have not brought the desired outcomes (Ewang 2013), careful empirical attention is needed to understand the drivers of Africa's growth (Jerven 2015). When countries are fragile and suffer from shocks (such as conflict and epidemics), capacity to pursue growth-enhancing policies is compromised. But structural capacity challenges must be tackled to transform African economies. Therefore, prioritizing economic and policy governance as well as institution building and data are essential for durable growth. Establishing a strong development state with peace and stage building (with tax administration and collection ability) and gender-sensitive initiatives are also required (Jones 2013).

Empirical studies show that growth reduces poverty (Dollar and Kraay 2002). The last decade witnessed impressive growth rates for many African countries, but structural transformation has been slow. Right now, optimistic research and media headline phrases such as "Africa rising," "Africa's extraordinary boom," and "middle class rising" proliferate. According to African Economic Outlook 2015, the continent's GDP growth was expected to strengthen to 4.5 percent in 2015 and 5 percent in 2016 after limited expansion in 2013 (3.5 percent) and 2014 (3.9 percent) (AfDB, OECD, and UNDP 2015). The March 2, 2013, issue of the Economist refers to the continent as "Aspiring Africa" and "The world's fastest-growing continent," much in line with the 2010 McKinsey Global Institute report that described African economies as "lions on the move" (Roxburgh et al. 2010). Seizing the moment, presidents and high-level officials have cited Africa's encouraging growth trends when addressing audiences. The July 2015 speech delivered by Barack Obama at the African Union Commission during his visit to Ethiopia is a case in point. Academics and policy researchers also examine and debate the sustainability of Africa's growth (Anderson and Jenson 2014).

But Africa's historical economic performance must be understood to identify what works in different contexts. Africa's diversity complicates the search for alternative growth models, as heterogeneous growth trajectories must be followed for optimal economic and human development outcomes in different countries (Collier and O'Connell 2007). A better understanding of the drivers of Africa's growth based on recent data and with an appropriate analytical framework is essential to shed light on a viable path.

Africa experienced a growth tragedy in the 1980s and 1990s, with the highest poverty rate and lowest human development indicators in the world. Africa was the slowest growing region for many decades except in the last 10 to 15 years (ECA 2015b). According to the UN classification of the world's poorest countries, 33 are in Africa, 15 in Asia, and only 1 in Latin America. Despite the growing optimism about the continent, 32 of the 40 that rank lowest in the UN human development index are in Africa. Looking at the 2013 inequality-adjusted human development index, 24 of the 25 worst performers are African countries (UNDP 2013). So from a global comparative outlook, the continent still has a long way to go to improve its residents' welfare.

A growth model for resource-rich countries does not apply to resource-poor countries. Equally, an export competitiveness model for coastal countries has different implications for landlocked countries that experience excessive trade costs. The same logic applies when examining the growth trajectory of fragile and non-fragile or post-conflict societies. The continent's great diversity should be reflected in the diversity of proposed analytical findings, prescriptions, and economic growth models (Aryeetey et al. 2012).

The last decade's fast growth rate is encouraging, but is this growth inclusive and sustainable (Kedir 2012)? Some quarters recognize the importance of public investment in infrastructure, but this investment is often financed by excessive borrowing, with many African countries diversifying their sources of loans (from concessional and non-concessional sources). So we must determine whether this debt-financed growth is sustainable and what mechanisms should be in place to support the encouraging growth trajectories.

"Growth with Depth" is the theme of the 2014 African Transformation Report, published by the Accra-based African Center for Economic Transformation (ACET 2014). Arguing that Africa needs more than growth, the report emphasizes the inclusive and sustainable dimensions of growth, which are complementary and mutually reinforcing. For instance, the principle of inclusive green growth recognizes the importance of environmental and climate change impacts of growth for development planning. It strives to meet the current generation's needs without compromising those of future generations. Many African countries, following heterogeneous growth models, have tried to make growth inclusive and sustainable. Almost all these countries registered fast growth over the last decade. A few have attended to inclusive growth through social protection initiatives and job creation. We can learn from those few.

Africa can also learn from countries beyond its shores. An article titled "You Can't Eat GDP Growth" shows how shared growth in Africa can be sustained, using examples from Latin American social protection programs (Norbrook et al. 2014). But comparing Africa with Asia or Latin America is problematic given these continents' divergent economic, political, institutional, and social histories. This study focuses on a comprehensive discussion of relevant economic growth paths and models tailored to Africa's diverse realities and unique characteristics. It also includes projected figures to 2020, assuming current trends continue.

Study's structure

This study has four parts. This first part concentrates on Africa's growth performance, recognizing each region's characteristics and growth patterns (such as geography, resources, and institutions) (Eyong and Foy 2006). Focusing on economic, social, structural, and political changes, the paper discusses how Africa's future path will be better charted by unlocking its potential and harnessing current and emerging partnerships. The first part also touches on Africa's outstanding challenges and growth opportunities. For example, partnerships with emerging economies are growing despite persistent governance problems (Shaw 2015). The paper provides evidence on growth financing sources (such as savings, revenue, and foreign direct investment) and their future projections assuming current trends prevail. Since some African countries have pursued public investment-driven growth—with debt as a driving force—the discussions focus on whether debt-fueled growth is sustainable.

Part two identifies substantial growth determinants using a dynamic generalized method of moments (GMM) estimator based on longitudinal/panel data from 1980 to 2013. The key data sources for African countries are the recent World Development Indicators published by the World Bank, International Country Risk Guide, and Country Policy and Institutional Assessment.

Part three focuses on promoting growth. In recent years, fast-growing African countries have been receiving more non-concessional and concessional loans from multilateral financial institutions such as the World Bank, the IMF, and the African Development Bank to fund public investment and other development projects. Academic researchers and policymakers debate whether this debt-driven growth is sustainable. The paper puts forward critical views on debt-financed growth, reinforced by the insights from regression results presented in part two.

Part four discusses the outstanding poverty challenge, lessons, and capacity issues for inclusive and sustainable growth. The conclusion reflects on a viable path that would lead Africa to sustainable and inclusive growth.

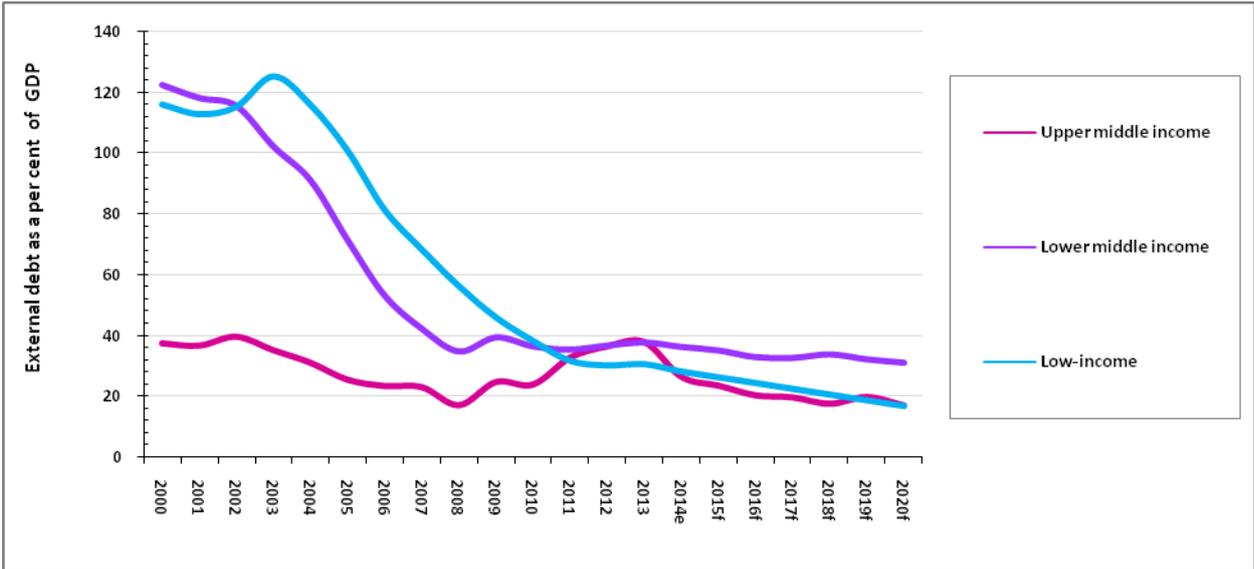
Africa's development, potential, and role in global partnerships

African economies have grown at least 5 percent in the last 15 years. Confidence in and evidence for the sustainability of this growth is rising (Andersen and Jensen 2014).

Many countries are implementing sound macroeconomic policies, improving governance and regional business environments, and experiencing greater global demand, with commodity price booms and progress in regional integration (ECA 2015b). The economic growth is easing infrastructure constraints; increasing trade and investment ties with emerging and advanced economies by taking advantage of recent natural resource discoveries (such as gas and oil); and boosting financial inflows (through remittances, sovereign bonds, foreign direct investment, and so forth; see appendix) (Bodomo 2013).¹ Part of this growth was made possible by lower indebtedness. For instance, external debt as a proportion of GDP is falling because of debt relief, expansion of countries' GDP, and GDP rebasing leading to larger economies in at least 10 percent of countries, including Ghana, Kenya, Nigeria, Uganda, and Zambia. Indebtedness declines in all countries whether they are disaggregated by development level or by region (ECA, 2015d).

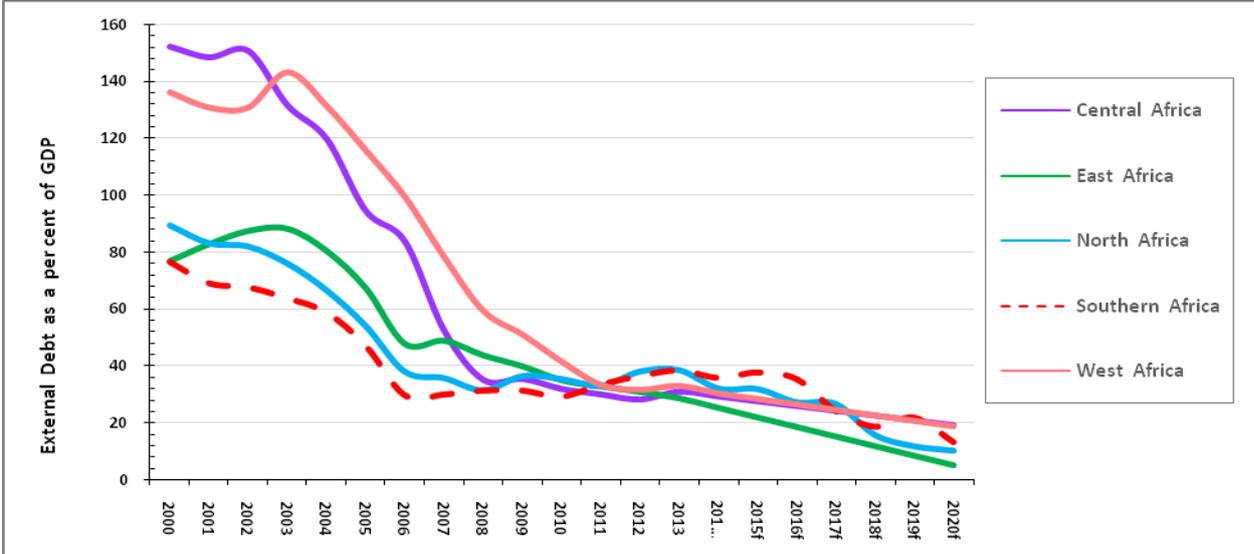
¹ Remittances are now larger than ODA. But evidence indicates that they are often allocated to consumption expenditure items, so it is not clear how available they are for development purposes through entrepreneurship.

Figure 1.1 External debt by development level



Source: IMF 2015.

Figure 1.2 External debt by subregion



Source: IMF 2015.

Sectoral value added statistics show that the share of the modern sector (manufacturing and services) in Africa’s GDP is higher than that of agriculture. But because most of the African population is still engaged in agriculture, agricultural productivity must be emphasized for growth to be inclusive (ECA, 2015b).

Social and political dimensions of Africa’s growth

Despite persistent challenges in material mortality and gender inequality, the social dimension has seen important progress. The foundation for Africa’s future transformation relies on the continent’s capacity to provide compulsory and inclusive high-quality basic education (primary schooling) that will lead to a productive workforce, economic prosperity, and social stability. The commitment of governments to universal primary education has paid off, and private and public higher education is proliferating. But literacy and numeracy levels are not as impressive as expected, even at the primary level. Also, lack of funding at the secondary level makes the focus on the primary and tertiary level of education misguided. On the positive side, African

countries have addressed enrollment and gender imbalances in primary education, which then extends to other education levels. For instance, the overall youth literacy rate for the population aged 15 to 24 years has improved in Africa through increased access to universal primary education, observed since 2000 (Kedir 2015).

On the political front, governance, public financing management, and transparency are improving (Kedir et al. 2015). Governments have taken steps to provide the enabling environment, infrastructure, and regulatory framework to guide economies to fast growth trajectories. The various development visions underscore the increasing growth orientation of many African governments and political elites. Armed conflict in the 1970s and 1980s hampered the continent's growth (Durbach and Fettweis 2014). The peace dividend has translated to strong growth for over a decade, but risks may reverse progress in some areas (such as Burundi, Democratic Republic of Congo, and South Sudan).

Challenges to Africa's growth

Despite promising changes setting a foundation for robust future growth, outstanding challenges remain, including a huge infrastructure gap of \$93 billion a year; inadequate human capital development, as reflected in health and education; and a weak technological base and low agriculture productivity (AfDB 2010). One key threat to Africa's growth—capital flight—costs the continent billions of dollars every year. Since the 1970s, capital flight has robbed the continent of about \$700 billion, making Africa a net creditor to the rest of the world (Ndikumana and Joyce 2013). If this money had been invested in the continent, it could have addressed key economic and human development challenges. Tackling this problem is at the heart of sustainable growth for the continent. Other challenges include poor service delivery, limiting tax collection efforts. Policymakers and researchers are aware of the need for equitable basic social services (Adedeji, Du, and Opoku-Afari 2013; Manda and Mwakubo 2013). Other challenges include natural resource mismanagement (ACBF 2013), inequality, climate change, global price fluctuations, youth unemployment, de-industrialization, and recurring conflict (such as in Burundi) (ECA 2015b).

The impact of these challenges on economic performance is compounded by slow progress to unlock the continent's development potential. Africa has abundant arable land, an economically active youth population, and large deposits of natural resources, as discoveries in the last 10 years reveal (Jayne, Chamberlin, and Headey 2014). Africa has the potential to be the next frontier destination, with unprecedented economic opportunities.

Opportunities for Africa's growth

Many areas can sustain Africa's growth, such as natural resources, domestic resource mobilization (through savings and tax revenue), and emerging and strengthened trading and investment partnerships. The continent has abundant natural resources. New discoveries of gas and oil make the outlook bright. There is a huge market potential as incomes rise and the middle class keeps growing. Youth and women are a huge resource for labor-intensive development initiatives and foreign investment projects. A World Bank study provides evidence supporting the role of an increase in the share of working-age population, capital accumulation, and total factor productivity for sustaining growth in Africa, excluding North Africa (Cho and Tien 2014).

Africa's trade partners are expanding and diversifying. China is the largest trading partner, followed by the United States (surpassed in 2009) and the EU. Other emerging partners are India, Korea, Brazil, and Turkey (African Economic Outlook 2011). Investors are attracted to Africa because of higher returns to investments (ECA 2015b). Investment is not restricted to

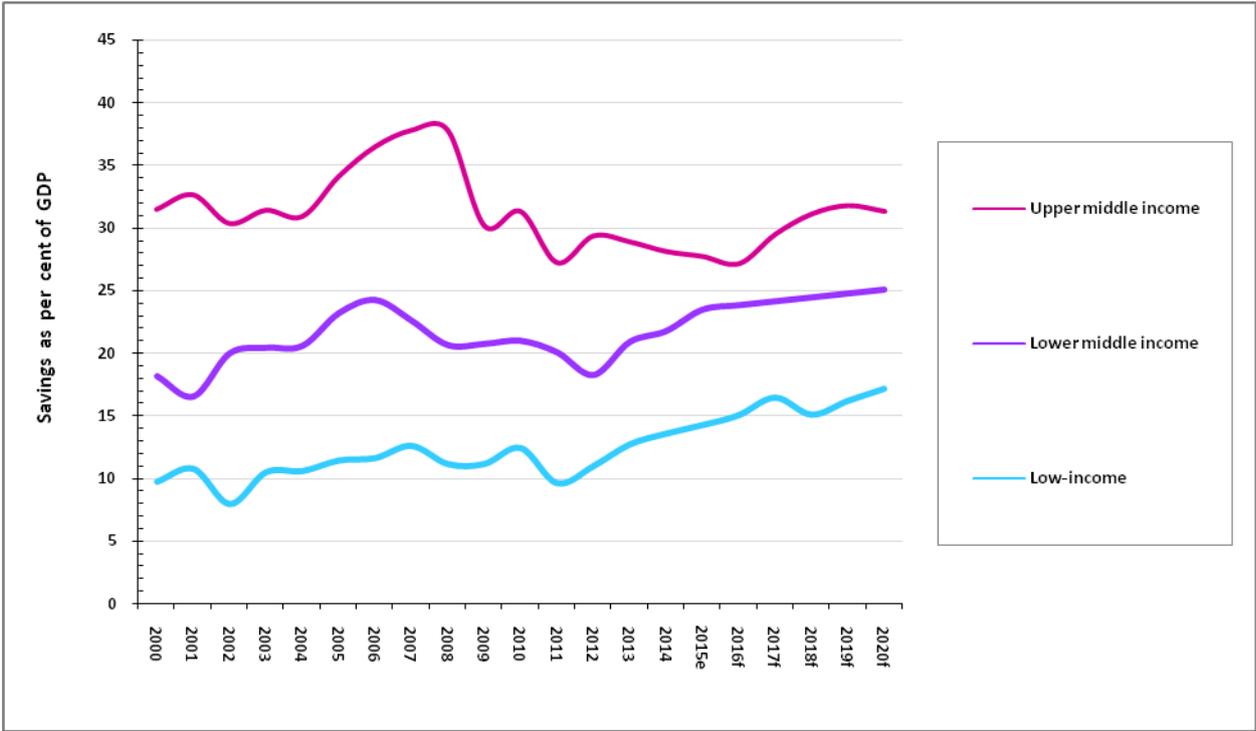
the extractive industry, with emerging partners working in areas such as textiles (Turkey) and agro-business (Brazil). Collaborations for technology exchange and other productive capacity-building initiatives can be created and harnessed with countries with huge grain production and agricultural technology experience. Traditional Organisation for Economic Co-operation and Development (OECD) partners are also expanding their presence. The improving investment climate is attracting foreign direct investment (FDI) inflows into the continent. African governments are lowering the cost of doing business and regularly revising commercial laws and investment codes. Trade and FDI ties will facilitate technology transfer and innovation and add value to African products for export. Africa's global partnerships play a critical role in its future growth and in the inclusiveness and sustainability of this growth. The partnership can be bilateral or multilateral, and engagement strategies can vary across countries. For instance, China is working at the continental level with the African Union and locally with various governments on infrastructure and other development projects. Africa's leadership and the technocratic elite must ensure that global partnership configurations align with national development priorities.

Domestic and external sources of development finance for Africa's growth are vital vehicles. First, partnerships are useful to raise the much-needed financing for the upcoming sustainable development goals (SDGs) established in September 2015 through official development assistance (ODA), sovereign bonds, remittances, and FDI.² But the primary responsibility for securing development finance rests on the continent through domestic resource mobilization and innovative financing mechanisms (tax revenue, savings, private equity, pension funds, blended finance, and so forth). Savings and tax revenues are rising steadily and are expected to continue doing so (ECA, 2015d). Projections here reflect the growing consensus that developing countries are expected to raise development finance themselves rather than from outside sources.³ The encouraging trend in Africa indicates the continent's potential to raise development finance by itself. ODA is still relevant, but should play only a complementary role, with domestic resource mobilization taking center stage.

² The Third International Conference on Financing for Development, held in Addis Ababa in July 2015, discussed in detail the mechanisms and processes for mobilizing domestic and external finance for development in the next 15 years (2016 to 2031).

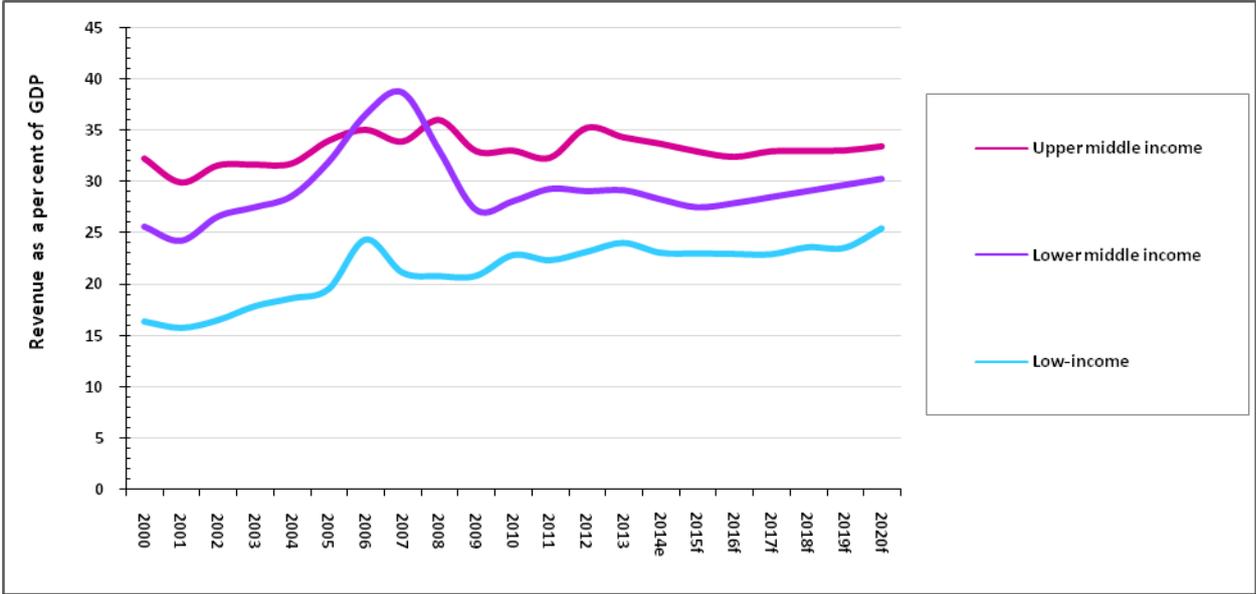
³ For instance, a study in preparation for the July 2015 Third International Conference on Financing for Development emphasizes the need for domestic resource mobilization to finance the post-2015 development agenda, or sustainable development goals, which were finalized in September 2015 in New York (Sachs and Schmidt-Traub 2014).

Figure 1.3 Savings by development level



Source: IMF 2015.

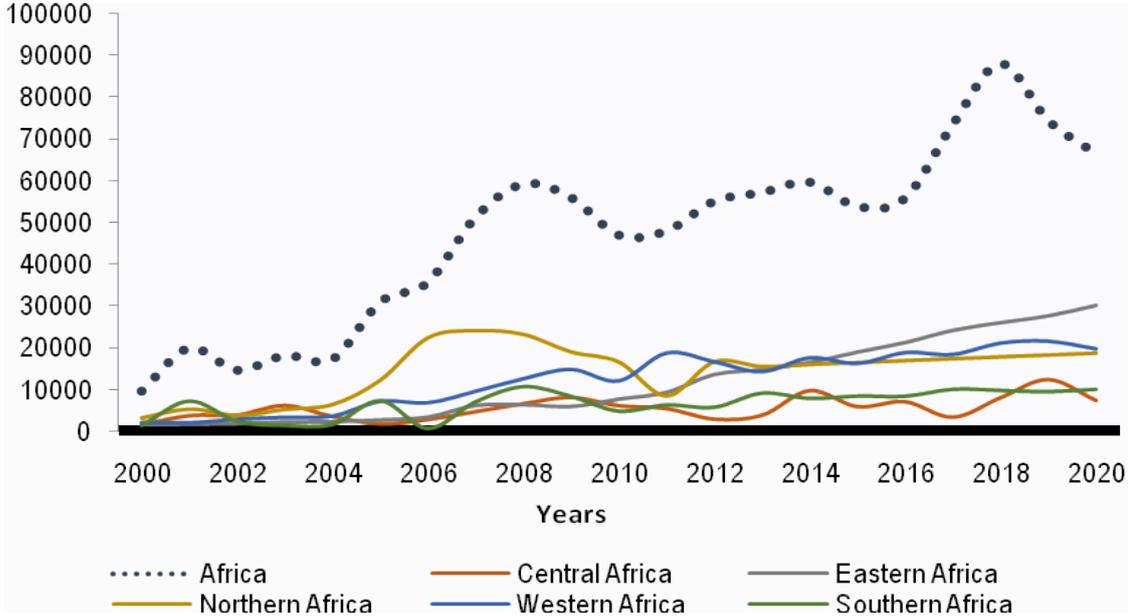
Figure 1.4 Tax revenue by development level



Source: IMF 2015.

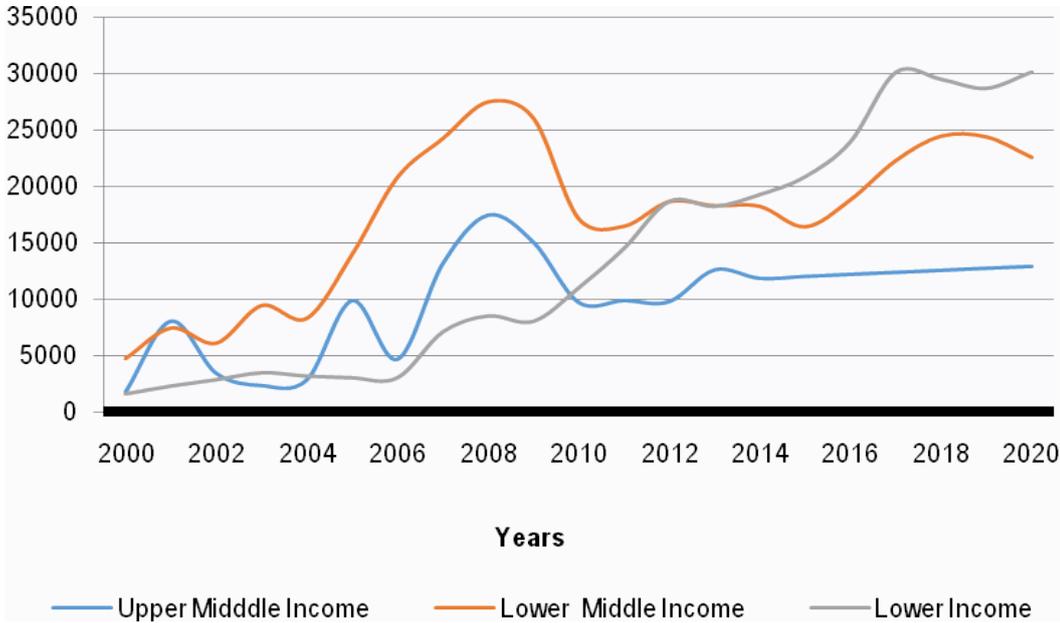
Africa will continue to attract capital from traditional and emerging partners because of its improved business environment and rising positive corporate sentiment ratings. Mineral and oil discoveries across the continent also attract foreign capital. FDI is the largest source of external private finance, followed by remittances. Between 2014 and 2015, FDI is expected to rise by 10 percent to \$89 billion according to computations based on UNCTAD data (ECA, 2015d).

Figure 1.5 Foreign direct investment (net inflows) to Africa by subregions, 2000–2020 (\$ million)



Source: Calculations based on UNCTADstat.

Figure 1.6 Foreign direct investment (net inflows) to Africa by development level, 2000–2020 (\$ million)



Source: Calculations based on UNCTADstat.

Partnerships for infrastructure and technology transfer and to curb illicit finance flows

Africa’s growth will not be sustainable and inclusive if investment supports soft infrastructure, weak technology adoption frameworks, food insecurity, and rampant corruption and capital flight facilitated by multinational companies’ tax evasion practices. Partnerships can help not only to raise development finance but also to provide regional or cross-border infrastructure. For instance, over the last decade, Africa’s partnerships, particularly with China, changed the face of Africa’s infrastructure with the construction of roads and railways. This focus contrasts

sharply with that of previous partnerships with OECD countries on social sector projects such as education and health (Wenping 2013). Regional transport projects with emerging partners will help sustain growth by providing the solid foundation for private investment to thrive. One example is the East African Standard Gauge Railway, linking cities in four countries such as Mombasa, Nairobi, Kampala, Juba, and Kigali. Other projects include the Trans-Sahara road and fiber optic cabling project running from Algiers to Lagos and the proposed gas pipeline from Nigeria, through Niger and Algeria, up to Europe (The Africa Report 2014).

Partnerships can also help overcome collective challenges such as illicit financial flows, estimated to cost about \$50 to \$60 billion a year (ECA 2015c). Illicit financial flows are an international crime, so transparent international partnerships are essential. International rhetoric and, in some cases, a practical crackdown on tax evasion by some G20 member countries are a step in the right direction. International and regional attempts to enforce tax information exchange require further work. Many African countries are expected to sign and implement the Extractive Industries Transparency Initiative and to avoid granting unreasonable tax holidays, underestimated royalty payments, and unfair deals in natural resource extraction arguments. There is a huge capacity development need in these areas. For instance, many countries do not have the required skilled labor to negotiate natural resource contracts with potential investors and end up having an unfavorable deal (Ajayi and Ndikumana 2015).

For structurally transformed economies and sustainable development, partnerships can focus on technology transfer. Based on economic reports published since 2013, the United Nations Economic Commission for Africa argues that Africa can industrialize (ECA 2015b). For instance, there is more intra-Africa trade in manufactures than with the rest of the world, pointing to the potential for value addition and further expansion in manufacturing. No advanced economy can avoid industrialization. The future growth trajectory of African countries should focus on industrialization with reinforced backward and forward linkages with critical sectors such as agriculture. There is scope to add value to products leaving production lines in Africa, but without technology transfer through development-oriented partnerships and transformation of the means of production, the chance to join global value chains will be severely limited. So trade and investment ties with partners need to focus on growth-enhancing technology adoption.

Finally, Africa's partnerships must contribute to solving formidable challenges such as food security. In Africa, despite structural change, the agriculture sector has stagnated. Partnerships can improve agricultural productivity through technology exchange (such as with Brazil).

CHAPTER 2. DRIVERS OF AFRICA'S GROWTH

Africa has registered positive growth for more than a decade (Shaw 2015). But what is driving this growth? As discussed earlier, Africa's growth is an outcome not only of a commodity boom. Since the second half of 2014, commodity prices have fallen in international markets because of the global economic slowdown, and African economies continue growing with a marginal impact on GDP figures. For instance, based on IMF primary monthly commodity price data, the oil price decline increased the GDP of oil-importing and mineral-rich countries by 0.01 percent and 0.02 percent, respectively (ECA 2015d). On the other hand, GDP fell 0.17 percent for oil-exporting countries. So non-commodity price factors—such as investment, infrastructure, trade, sound macroeconomic management, improvement in governance, relative peace, and prudent fiscal policies—are important drivers of growth.⁴ The econometric evidence discussed below corroborates this conclusion. The empirical approach used here adopts static and dynamic panel models for robustness. First, a baseline fixed effect (FE) model is adapted for static analysis. This is followed by the dynamic system generalized method of moments (GMM) specification proposed by Blundell and Bond (1998).

This paper contributes to the current growth literature through its comprehensive data, its focus on the link between growth and debt, and its use of robustness checks to verify the results. The analysis covers 1990 to 2013, and the sample includes 52 African countries. (A recent IMF study focused on only 42 Sub-Saharan African countries, covering 1999 to 2011 [Ghazanchyan and Stotsky 2013]).

Fixed effect model

Two approaches are used in growth literature. The first is based on convergence theory, and the second applies growth theory framework to specify and estimate growth equations. This study follows the second approach in modeling growth determinants. Various studies have identified investment (such as FDI in Lensink and Morrissey 2006), human capital formation, openness, and the policy environment as key growth determinants. This paper controls for these variables and highlights others that are often missed, such as gross public debt or external debt. The theoretical framework draws on an augmented Solow growth model.

To explore the effect of growth drivers on economic growth among African countries, first a fixed effect estimation technique is adopted. The estimating equation is given as follows;

$$Growth_{it} = \alpha + X'_{it}\beta + u_{it} \quad (1)$$

where $Growth_{it}$ is the annual GDP growth rate for country i at time t , and α is the constant term. X_{it} stands for $1 \times k$ vector of k variables such as gross government debt (Debt) as a percentage share of GDP, gross fixed capital formation (GFC) as a percentage share of GDP used as a proxy for domestic investment in physical capital; secondary school enrollment as percentage share of gross enrollment used as a measure of investment in human capital accumulation (HC); net foreign direct investment (FDI), official development assistant (ODA) and international remittances (Remittances) inflows measured as percentage share of GDP; rate of inflation (INF) proxied by the rate of change of annual consumer price index, trade openness measured as the sum of export and import, and general government final consumption expenditure (GFCE) as a percentage share of GDP, population growth (PG) and institutional factor index (IFI) a proxy for transparency, accountability and corruption in the

⁴ Why Africa Is Becoming Less Dependent on Commodities," The Economist, January 11, 2015.

public sector rating (1=low to 6-high). Here the error term contains fixed effects (both country/time-invariant effects and time varying effects) and the idiosyncratic shocks. Note that the error term has familiar error component structure with zero mean and constant variance.

Dynamic panel system generalized method of moments estimator

The above static specification leads to biased results caused by the potential state dependence in growth, which introduces endogeneity. This problem will arise when the classical ordinary least squares, two-stage least squares, or static panel estimation techniques (fixed effects or random effects) are considered because of the dynamic nature of economic growth. The preferred estimation framework needs to address this potential bias and endogeneity problem. The process of adjustment in economic growth to a change in its factors may depend on the passage of time, which necessitates the inclusion of lags and past values of the economic growth variable (annual GDP growth rate).

All the estimation problems in this context are conventionally handled by adopting a dynamic panel estimation technique (preferably the system GMM) proposed by Blundell and Bond (1998). The problem of potential endogeneity is much easier to address in the dynamic panel system GMM estimation framework than in the static models that do not allow the use of internally generating instruments from past dependent variable values. An underlying advantage of the dynamic system GMM estimation is that variables from the regression not correlated with the error term (including lagged and differenced variables) can be used as valid instruments (Greene 2008).⁵ Furthermore, in the longitudinal/panel dataset, 52 countries (N) were observed from 1990 to 2013, constituting the latest official data on the key variables listed above. Thus, there are more countries (N) than years (T). Many authors argue that the dynamic panel system GMM estimation procedure is specially designed for a situation where T is smaller than N in order to control for dynamic panel bias (Bond 2002). Last, system GMM estimation approach is more appropriate than difference GMM because time-invariant variables would disappear if the difference GMM approach were used. This does not wash away country-specific features that may explain the certain economies' growth dynamics (Bond 2002; Roodman 2006; Baum 2006; Baltagi 2008). In other words, differencing variables within groups will remove any constant variable, including country- and region-specific fixed effects. Thus, the estimation results will be based on system GMM instead of difference GMM.

The two-step system GMM estimating equation is given as follows:

$$Growth_{it} = \beta Growth_{it-1} + X'_{it}\theta + Z'_{it}\delta + (\mu_i + v_{it}) \quad (2)$$

where, $Growth_{it-1}$ is lagged value of economic growth (i.e. annual growth rate of GDP) and is endogenous in this specification. X_{it} is a matrix of predetermined regressors (*GFC, HC, Debt, PG and Inflation*) while Z_{it} is a vector of exogenous control variables (*FDI, ODA, Trade, Remittances, IFI*). In this study, therefore, the lagged value of growth is considered as a regressor along with other explanatory variables such as human capital accumulation, gross fixed capital formation, debt, inflation rate, annual population growth. Besides, lagged values of the variables that are not correlated with the error term are potentially used as valid instruments.

The empirical analysis is based on the latest annual panel data of 52 African countries from 1990 to 2013. Except for gross government debt, sourced from the IMF World Economic Outlook,

⁵ Instruments should not be correlated with the variable that they are instrumenting and with the estimating equation's error term. These are often referred to as the orthogonality conditions.

variables are obtained from the latest edition of the World Bank's World Development Indicators.

Table 2.1 Summary of descriptive statistics

Variables	Mean	Std. Dev	Min	Max	Number of observations
GDP growth rate (%)	4.17	4.23	-15.70	19.20	1,021
Gross government debt (% of GDP)	61.29	39.96	0	199.8	717
Human capital formation	40.38	27.61	5.20	122.20	610
Gross fixed capital formation (in millions of USD)	21.38	10.65	2.10	108.60	986
Population growth (%)	2.41	0.99	-7.60	10.30	1,021
Trade (openness)	72.66	35.27	10.70	199.40	1,021
Foreign direct investment (inflows in millions of USD)	3.87	6.57	-8.60	85.40	1,011
Official development assistance (% of GDP)	11.17	13.29	-0.30	181.2	969
Remittances	3.90	8.08	0	78.60	822
General government final consumption expenditure (millions)	15.07	6.67	2.10	47.2	975
Inflation (annual % change)	14.98	49.06	-11.70	948.80	1,021

The average GDP per capita growth rate for the continent is more than 4.17 percent, with huge variation across time and country (table 2.1). This average figure masks the heterogeneity in growth performance. For instance, the lowest average growth rate at country level was -15.7 percent in Chad, while the highest average registered over the 24 years covered was 19.2 percent for Cape Verde. Gross government debt as a percentage of GDP ranges from 0 in Algeria and Libya to 199.8 in Seychelles. Liberia had received the continent's highest official development assistance (ODA) at 181.2 percent of its GDP. Because of the Ebola outbreak in the 1980s, Gabon had faced net outflow of FDI, -8.6 percent in 1986. Finally, the mean inflation rate in the region is 14.98 percent, ranging from -11.7 percent in Gabon in 1991 to 948.8 percent in Angola in 1994.

Econometric evidence

Even though the static panel model (FE) regression result is reported in this section as a baseline (table 2.2), the empirical analysis and conclusions are based on dynamic panel system GMM model estimates. According to the baseline results, gross government debt, gross final consumption expenditure, and external debt are negatively and significantly associated with the rate of annual economic growth. But when the FE model is specified by including only the external debt, trade openness shows a positive and statistically significant coefficient. This is consistent with the argument that trade can be an engine of growth, as is often the case when smart trade policies are coupled with strategic sectoral investment and development (such as promoting industrialization through trade).

Table 2.2 Fixed effects (FE) estimation results

	(1)	(2)
Variables	Total debt (debt from external and domestic sources)	External debt (debt only from external sources)
Gross government debt	-0.0228*** (0.00720)	-0.0197*** (0.0071)
Human capital formation	-0.0181 (0.0236)	-0.00854 (0.0214)
Gross fixed capital formation	0.0298 (0.0287)	0.0205 (0.0295)
Foreign direct investment	0.0501 (0.0399)	0.0722 (0.0438)
Official development assistance	0.0394 (0.0537)	0.00535 (0.0507)
Trade	0.0105 (0.00963)	0.0213** (0.0103)
Remittances	-0.0167 (0.0472)	-0.0602 (0.0493)
General government final consumption expenditure	-0.145** (0.0592)	-0.225*** (0.0607)
Inflation	-0.0934*** (0.0275)	0.0209 (0.0242)
Population growth	0.0715 (0.119)	0.0680 (0.249)
Constant	7.798*** (2.234)	6.154*** (1.974)
R-squared	0.27	0.21
Number of observations	391	483
Number of countries	52	52

Note: Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

To get reliable parameter estimates and allow dynamic specification accounting for endogeneity, the paper uses the Arellano-Bond System GMM estimator. Table 2.3 shows the estimated results together with serial correlation and some significant specification tests. Accordingly, the extended set of moment restrictions is not rejected by the Sargan test of overidentifying restrictions. In this specification, the overidentifying restrictions or instruments included in the regression to control for endogeneity are valid. AR(1) and AR(2) are consistent with the standard assumptions.

Table 2.3, in its first column, reports the estimated results when economic growth is regressed on its lagged values, gross government debt, human capital accumulation, and gross fixed capital formation (percentage of GDP). It excludes indicators of development finance or international financial inflows (such as foreign direct investment, official development assistance, remittances, and trade openness) to avoid potential multicollinearity among the variables included in the right side of the estimated equation. But these variables are included in the second column. And the final column includes key variables to capture the influence of domestic macroeconomic situations (such as inflation and government final consumption expenditure) and demographic shifts as captured by annual rate of population growth.

The result reveals state dependence in growth. Growth in one year has a strong, positive effect on growth the following year. This phenomenon is robust across the three specifications,

although the impact of past growth is not too strong in the last column (0.101) compared with the second column (0.221).

Another robust result relates to the gross government debt. In empirical macro literature, the relationship between debt and growth is not clear in developing countries. A dearth of research evidence links these two variables for Africa. Regardless of the specification adopted, higher gross government debt as a share of GDP is associated with a lower GDP growth rate among African countries. More important, the estimated coefficient on gross government debt as a share of GDP is not only negative but also statistically significant. The negative association between gross government debt and GDP growth might be because higher debt-service (particularly external debt) repayments may hamper GDP growth by exhausting the public resources that could have been allocated for growth-enhancing activities such as infrastructure. Human capital accumulation and investment in physical capital have a positive and statistically significant impact on GDP growth, pointing to the need for future growth endeavors to focus on this area. It is hard to defend a case for development that excludes sustained investment in public infrastructure provision and human capital.

FDI, trade, and ODA have a positive and significant impact on GDP growth. But the estimation result reported in the second column implies that GDP growth is adversely affected by remittances, while trade has an insignificant effect. This is consistent with microevidence showing that the probability of those receiving remittances engaging in entrepreneurship is negative. Unless remittances can be channeled to productive use, their impact on development and growth might not bring the desired result. So, in development discourse, remittances as a key source of development finance should not be romanticized for their potential development impact. The use of diaspora bonds by the Ethiopian government for the construction of its hydroelectric power plant, the Grand Renaissance Dam, is one innovative way of mobilizing remittance-related income for development purposes.

External sources of development finance such as FDI and ODA are important positive drivers of Africa's growth. So, even if domestic resource mobilization and innovative sources of finance are important for financing the post-2015 development agenda or the SDGs until 2030, the external financial flows need to be maintained and used as complementary financing mechanisms.

The last column of table 2.3 includes government final consumption expenditure, population growth, and inflation rate (measured as annual change in consumer price index). As expected, inflation and government final consumption expenditure have a negative and statistically significant impact on GDP growth in Africa. The negative effects of the latter may reflect growth-hampering or unproductive government expenditure.

One growth determinant that proved statistically significant under various specifications relates to the debt variable. Gross and external debt are linked to growth. From a technical point of view, to check the robustness of the results reported in table 2.3, regressions were run by disaggregating the gross government debt variable between domestic debt and external debt. Also, it was important to understand growth drivers by dividing the period into distinct policy regimes that have been followed by African countries. For instance, instead of considering 1990 to 2013 as one block, it can be split into 1990 to 2001 and 2002 to 2013 because Africa has registered impressive growth since 2002. The robustness check results are reported in the appendix in tables A.1 to A.4.

Table 2.3 Dynamic panel two-step system GMM estimation (1990–2013)

Variables	(1) Growth	(2) Growth	(3) Growth
Lag of growth	0.261*** (0.0117)	0.221*** (0.0149)	0.101*** (0.0143)
Gross government debt	-0.0108*** (0.000656)	-0.0237*** (0.00276)	-0.00953*** (0.00254)
Human capital formation	0.0174*** (0.00162)	0.0313*** (0.00651)	0.0290*** (0.00457)
Gross fixed capital formation	0.127*** (0.00518)	0.0542*** (0.0116)	0.0182*** (0.00539)
Foreign direct investment		0.116*** (0.0235)	0.0171 (0.0117)
Official development assistance		0.150*** (0.0133)	0.0677*** (0.0129)
Trade		0.00261 (0.00221)	0.00221 (0.00220)
Remittances		-0.0288*** (0.00950)	0.0236*** (0.00862)
Government final consumption expenditure			-0.0297** (0.0121)
Inflation			-0.00788* (0.00442)
Population growth			1.112*** (0.0887)
p-value Sargan test	0.46	0.66	0.58
p-value AR(1) test	0.004	0.02	0.02
p-value AR(2) test	0.31	0.18	0.23
Number of instruments	87	67	73
Number of observations	446	413	386
Number of countries	52	52	52

Note: Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

There is no consensus on the definitive list of growth determinants because of each country's idiosyncrasies. But investment, human capital formation, debt, and ODA are relevant and significant drivers of Africa's growth (Jaunky 2013; Mijiyawa 2013; IMF 2012; Ghazanchyan and Stotsky 2013).

A key development finance source for Africa's growth has been debt (both domestic and external). The next section will investigate the sustainability issue associated with debt financing of Africa's growth. Over the last decade or so, ODA has declined and there is an increasing recognition that African governments can no longer rely on it for their economies' transformation. Along with aggressive actions to mobilize domestic resources through savings mobilization and improvements in tax administration, they are accessing concessional and non-concessional finance (such as by issuing sovereign bonds in financial markets) to raise the required funds for the various infrastructure- and development-oriented investments they are committed to. Because of unfavorable terms countries face in the private debt market, African heads of state at the African Union Commission's January 2015 summit expressed concern about potential debt distress hampering economic growth.

CHAPTER 3. IS DEBT-FINANCED GROWTH SUSTAINABLE? SOVEREIGN DEBT AND SOVEREIGN BONDS

Debt can be a heavy burden, and debt servicing limits fiscal space. Due to strains in many African countries caused by the debt crisis of the 1970s and 1980s, international arrangements were put in place and debt relief initiatives were undertaken. The debt relief helped many countries to sustain their positive growth. According to the December 2014 Highly Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) statistical update, only African countries are still to benefit—economies characterized by weak macroeconomic management, debt arrears, and political instability.⁶ A large volume of development finance, including external borrowing, is required for Africa's structural transformation. It is underpinned by investment, infrastructure, industrialization, skills development, resilient health systems, improved agricultural productivity, and better regional integration. Accountable and transparent public finance management needs to be in place to ensure that external debt finance is allocated to development projects with long-term social and economic returns.

Another important trend is for African governments to issue sovereign bonds. This trend is rising as the sources of concessional loans dry up. But does issuing bonds guarantee sustainable growth?

Total and net external debt

Total external debt as a percentage of GDP is declining in Africa. There has been a sharp decline since the Monterrey consensus, particularly from 2002 to 2008, driven by debt relief, sustained GDP growth, and economic expansion induced by GDP rebasing. There has also been a corresponding robust GDP growth since 2000. But a recent study on 52 countries shows the negative association between total debt and growth in Africa, suggesting the need to use loanable funds for growth-enhancing projects (Kedir et al. 2015; Ncube and Brixiova 2014).

The net foreign debt for Africa is low because of the oil-exporting countries' high international reserves, which can quickly shrink in the face of declining oil prices. Despite a declining trend in total foreign debt, the share of net foreign debt in some countries is not negligible. Mineral-rich and oil-importing countries have positive net foreign debt. And the average hides extreme cases such as Cape Verde (59 percent of GDP), Ghana (28 percent of GDP), Sudan (55 percent of GDP), Mauritania (52 percent of GDP), Mozambique (28 percent of GDP), São Tomé and Príncipe (117 percent of GDP), Senegal (25 percent of GDP), Seychelles (90 percent of GDP), Tunisia (50 percent of GDP), and Zimbabwe (338 percent of GDP) (ECA 2015b).

Sovereign bonds

Africa's public investment-driven growth momentum fuels the sovereign debt appetite. So fast-growing economies such as Ethiopia are moving toward market-based loans in addition to concessional loans. Optimistic views by international credit agencies (such as Moody's) enabled countries to borrow from riskier sources. Other countries that issue Eurobonds include Gabon, Ghana, Ivory Coast, Mozambique, Namibia, Nigeria, Republic of Congo, Rwanda, Senegal, the Seychelles, South Africa, Tanzania, and Zambia. According to Sy (2015), 14 countries have issued international bonds, up to at least \$15 billion. The debt problem will be exacerbated in countries with weak fiscal discipline and those who overborrow and pay little

⁶ The countries that require urgent attention are Chad, Eritrea, Somalia, Sudan, and Zimbabwe.

attention to repayments. Along with potential global effort to manage debt distress, individual African governments should be held accountable.

The debt burden and macroeconomic situation of countries that go through shocks such as disease outbreaks and conflict (such as Guinea, Liberia, Sierra Leone, and South Sudan) keep them vulnerable to external shocks such as the sharp recent declines in commodity prices. Macroeconomic fundamentals such as volatility of terms of trade affect sovereign debt spread substantially (Hilscher and Nosbusch 2010). So a global framework on sovereign debt restructuring is essential. Globally, there are huge legal and political bottlenecks to be tackled. Current arrangements are driven by laws in advanced economies such as the United States, whose courts often rule in favor of vulture funds. So international agreements to prevent a potential debt crisis should seek to solve such impasses in the international financial architecture.

During the 24th AU summit in January 2015, it was pointed out that African sovereign debt losses may reach \$10.8 billion, 1.1 percent of the region's GDP (ODI 2015a, 2015b). Sovereign debts are riskier options for investment even if they have better terms than concessional loans. IMF proposed a sovereign debt restructuring mechanism more than a decade ago, but there is no international agreement so far. There is a consensus that current rules are too creditor-friendly. But a push for an international agreement that is too borrower-friendly might not be the way forward. Global agreement should strike the right balance (ECA 2015b).

Sound macroeconomic management to limit the risky rush to borrow

Foreign asset holding in the form of debt depends on a variety of factors, such as the country's development level, future prospects, and absorptive capacity. Unsustainable debt might also result from poor macroeconomic management and structural economic malfunction. If a country that benefits from a commodity boom is prudent, it will follow a counter-cyclical fiscal policy by amassing the revenues allowed by the boom. And it will use them when times are hard (such as when oil prices fall). Countries that failed to do so often request a bailout from a major lender (such as the IMF) with conditions such as fiscal consolidation by downsizing the public sector. A bailout loan by a major lender may encourage private lenders to provide loans because of a rise in investor confidence triggered by the willingness of a major lender such as the IMF to offer a bailout package. This increases the country's potential future indebtedness. If many economies fail to have a sound macroeconomic management in place, this vicious cycle of debt stress might lead to a systemic breakdown, because ill-discipline amplifies the impact of exogenous shocks. The commodity price cycle in 2014 demonstrates this reality.

As some African countries fail to follow a counter-cyclical fiscal policy or demand management (such as through commodity stabilization funds), they face currency depreciation, low foreign reserves, and more demand for loans. Resource-poor countries, which lack the option of saving from a commodity price boom, rely on sovereign borrowing. Thus, debt sustainability is crucial for them and their fiscal situation. A broader, comprehensive look into African macroeconomic management is essential for debt sustainability. This cannot be emphasized enough, as the continent is experiencing a structural change with an increasing commitment to transforming its social and economic landscape (Nissanke 2013).

Also, optimistic rating agencies' outlook and GDP rebasing reinforce the need for risky borrowing. For instance, Ethiopia and Ghana were rated B1 by Moody's, which feeds into investor confidence. Recently, both issued \$1 billion worth of sovereign bonds. Ghana, for instance, raised the money in dollar bonds before the last quarter of 2014. In February 2015, the IMF agreed to lend Ghana \$933 million, which will boost investor confidence (Dzawu 2015). In

turn, this might fuel further borrowing from other sources, such as bond issuance, potentially exacerbating the debt situation. Debt-to-GDP ratios decline as more countries rebase their economies, which might alleviate sustainability concerns.

The following focuses on what Africa needs to do, as well as what development partners can do, about external debt. The suggestions are based on an analysis of external debt since 2000 and on a preliminary empirical analysis of the association between total debt and growth.

- External debt (concessional and non-concessional) can be an important source of development finance, but it is helpful only if Africa uses debt finance for growth-enhancing projects. For instance, the econometric evidence shows the negative association between gross government debt (the sum of domestic and external debt) and Africa's growth from 1990 to 2013 (see appendix).
- Following counter-cyclical fiscal policy during commodity booms and building foreign reserves is essential to avoid a future debt crisis.
- Since Monterrey, total external debt has been falling as a percentage of GDP, expanding the opportunities to access various loans and ensuring debt sustainability (figure 1.1). But net foreign debt caused by extremes observed in some African countries highlights the need for caution.
- Most African countries benefited from initiatives such as HIPC and MDRI, made possible by the sensible policies pursued by the beneficiaries. Thus, continuing sound macroeconomic management in addition to sustained growth will lead to debt sustainability.
- African countries can engage more with South-South partners in addition to traditional bilateral and multilateral lenders.
- To circumvent the crippling impact of potential debt distress, countries can pursue growth bonds, whereby they need to respect repayment terms only if they grow. Equally, governments should be transparent and allow independent debt audits to avoid irresponsible use of funds.
- Because of their robust growth record for over a decade, African governments are accessing new forms of loanable funds, such as sovereign bonds. African governments need to weigh the mix of long-term bond issues in local and foreign currencies to reduce their exposure to risks of currency volatility. This should also hold for other forms of debt, which again should be split between or among various currencies.
- In line with the Monterrey Consensus, creditors often located in advanced economies can share responsibility with the sovereign debtor to resolve potential future debt crises. This can be done through credit-worthiness assessment prior to lending and debt relief in case of extreme distress.
- There should be follow up on the recent resolution of the UN General Assembly (A/RES/69/247) as a priority to establish a multilateral legal framework for sovereign debt restructuring. This ensures the international financial architecture's stability. Other debt crisis international mechanisms not in place should also be pursued.
- Based on experience after Monterrey, there is a concern that potential future debt relief might lead to ODA reduction. This should not be ignored in the next round of engagement with development partners.

CHAPTER 4. WHY IS AFRICA'S GROWTH NOT INCLUSIVE? CAPACITY ISSUES AND THE WAY FORWARD

Impressive African growth is not reducing poverty. How should Africa tackle poverty and inequality in the next round of SDGs? One issue is poverty measurement. For instance, compared with conventional poverty estimates based on expected utility theory, prospect theory insights reveal a different degree of association between GDP growth and poverty reduction (Jäntti et al. 2014).

The measurement problem emanates from African governments' poor statistical capacity (Jerven 2009). For instance, when Ghana corrected the methods it used to calculate its GDP, the figure grew by 70 percent. This affects the accuracy of the debate on the translation of GDP growth figures into poverty reduction. As Fields (2012) argues, poverty measurement and data anomalies are at the heart of the debate on the link between growth and poverty, and there is need to ascertain data validity to boost confidence in the translation of growth into poverty reduction. Other possible channels to explain the growth-poverty link include inflation, inequality, high fertility, resource mismanagement, trade liberalization, poor statistical capacity, and churning when there are household movements in both directions of the poverty line (Jerven 2013). The discussion of transmission channels is of utmost importance because it helps us to understand whether growth has translated into poverty reduction and welfare improvement.

Redistribution through social protection programs (such as safety nets) is a short-term measure to share the proceeds of growth and can be unsustainable. Labor markets are important to promote shared growth. Labor is the surest factor endowment and income source for the poor. A study using 10-year household panel data from Ethiopia showed the importance of self-employment/informal sector work, the number of working adults, remittances, assets, and inequality in poverty reduction (Kedir, Alemu, and Endale 2011). The informal sector absorbs a large portion of labor in Africa, but it is starved of capital (Aryeetey 1998).

There are various policy attempts to make growth inclusive and sustainable. Social protection and other redistributive measures are important, but their effectiveness and sustainability are a huge problem for many countries. Development planning is taking center stage for structural transformation of economies, as many countries have developed different development and growth strategies or visions that extend 20 or 30 years. The lessons of development planning in Africa, Asia, and Latin America since the 1960s show that the market alone cannot fix development problems. Planning should be consultative to make development inclusive. This consultation should be at all levels (national and subnational) and embrace all societal groups (children, youth, women, the elderly, and those with disabilities) and sectors (private, civil society, and public sector, as in Mauritius). Africa has various long-term visions, articulated in the African Union's Agenda 2063, the details of which need to be domesticated at the national level. And consultation and coordination at the national level play a critical role. Development plans need to be anchored on macroeconomic frameworks suited to heterogeneous contexts without imposing a macro framework borrowed/imposed from other settings. For transformative development planning, the importance of building the capacity of individuals and institutions has been underscored (Acemoglu and Robinson 2012). Development-oriented planning should be left in the hands of the committed leadership of development states and be complemented by marrying fast growth with sustainable development principles or green growth principles (Nnadozie, Jerome, and Keita 2012). Building the capacity of inclusive

institutions is slow and requires a gradual dismantling of extractive economic and political institutions that undermine progress.

Inclusive development planning cannot work in a vacuum, and data management plays a critical role. There is need to go beyond designing a good development plan, since implementation and follow-up using various monitoring and evaluation frameworks are essential. To do so, various countries have attempted medium-term expenditure frameworks to match resources with plans and expenditure tracking. These require data and many countries in Africa lack timely, high-quality data for monitoring and evaluation and medium-term expenditure framework exercises. Thus, the data harmonization efforts by the African Development Bank and the African Centre for Statistics of the United Nations Economic Commission for Africa should be complemented by regular data on capacity-building initiatives such as the ACBF's African Capacity Indicators, which help point out capacity shortcomings. Without solving critical data capacity issues, little can be done to set growth benchmarks and track progress sustainably. This capacity problem is not restricted to having data, but necessitates properly staffing statistical offices, building the necessary data infrastructure, and setting up internationally accepted harmonization and data-sharing arrangements.

CHAPTER 5. RESULTS AND INTERPRETATIONS

Based on a comprehensive dataset from many African countries, this paper showed the significant drivers of Africa's growth and focused on the importance of prudent use of funds borrowed from public and private sources for growth sustainability. With a call for inclusive and sustainable development in most current global development discussions, most researchers and policymakers are focusing (at least in the SDGs negotiations) on inequality, because current growth trends were found to reduce poverty while neglecting equity. This emphasis on inequality is a recourse to the growth-with-equity paradigm of the 1970s. African governments have more leverage on policy ownership than before because of increasing pressures, including a concerted effort by Africans to ensure they have the policy space to chart the future of their development without excessive outside interventions and falling into debt crisis as ODA declines. In the wake of the Great Recession of 2007 and 2008, the economy cannot be left to the free will of the market. A state-led and regulated market economy seems to work better (such as China and Ethiopia). For instance, in Mauritius, industrialization has developed through a long-term collaborative engagement between the state and the private sector, pointing to the importance of exploiting partnerships across sectors and nations for sustainability of sectoral and nationwide growth.

Future growth pathways in Africa should recognize the key complementary role the state can play in the economy and include the following elements:

- Allocate debt finance in activities that can promote growth, as experience so far shows that debt has been detrimental to growth. There is need to focus such debt finance on erecting new infrastructure, such as power stations, roads, railways, telecommunications, education, and health, and repairing current infrastructure.
- Develop investment ties in areas that enhance growth, with fair terms for Africa (with careful review of the tax holidays) and without dislocating investments by local investors in small and medium enterprises.
- Exploit untapped human, natural, and physical resources. For example, the continent has a large youth population—the 15–24 year olds are at 200 million and projected to hit 400 million in 2045. There also are new natural resources and vast underutilized arable land.
- Seize opportunities of technology transfer from elsewhere and adapt it to Africa's conditions. Coupled with the presence of vast arable land in Africa, current agricultural technologies can be harnessed to boost irrigation and agricultural productivity, which will lead to job creation and food security. Building capacity for enhancing agricultural productivity and diversification is critical in stopping the unreasonably high cost and volume of food imports in much of Africa, while most of the same imports can be produced and sourced within the continent.
- Capacity is critical to sustain Africa's growth and make it inclusive. Given the proliferation of long-term growth visions, there is a capacity need to align national and sub-national goals; coordinate planning and financing ministries (to match planned development priorities with financing resources); improve economic governance (fighting corruption, tax evasion, and capital flight); and cultivate a culture of committed leadership to stir economies when times are hard and to execute recovery plans without policy reversals. For efficient bureaucracy, human development (health and education) is essential (Findley, Nelson, and Sharman 2014). More important, data provision in a timely fashion

with appropriate quality checks is of paramount importance. To assess growth, set benchmarks, plan the future, and track progress sustainability (achievement of SDGs), the capacity of institutions in the economic planning chain should be strengthened.

APPENDIX. ROBUSTNESS CHECK FOR THE ECONOMETRIC EVIDENCE

Table A.1 Dynamic panel two-step system GMM estimation (Only external debt: 1990–2013)

	(1)	(2)	(3)
Variables	Growth	Growth	Growth
Lag of growth	0.216*** (0.00824)	0.119*** (0.0149)	0.0713*** (0.0137)
External debt	-0.0229*** (0.00144)	-0.0207*** (0.00224)	-0.0171*** (0.000672)
Human capital formation	0.0248*** (0.00274)	0.00408 (0.00407)	0.0164*** (0.00182)
Gross fixed capital formation	0.149*** (0.00801)	0.0949*** (0.00688)	0.0446*** (0.00435)
Foreign direct investment		0.0941*** (0.0126)	0.0284*** (0.00951)
Official development assistance		0.108*** (0.00925)	0.0745*** (0.00579)
Trade		0.0149*** (0.00326)	0.00863*** (0.00167)
Remittances		-0.0713*** (0.00785)	0.0110** (0.00453)
General government final consumption expenditure			-0.0432*** (0.0105)
Inflation			0.0381*** (0.00738)
Population growth			0.917*** (0.0375)
p-value Sargan test	0.65	0.24	0.69
p-value AR(1) test	0.01	0.04	0.04
p-value AR(2) test	0.11	0.14	0.15
Number of instruments	87	67	52
Number of observations	553	413	465
Number of countries	52	52	52

Note: Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table A.2 Dynamic panel two-step system GMM estimation (1990–2013)

Variables	(1) Total debt (debt from external and domestic sources)	(2) External debt (debt only from external sources)
Lag of growth	0.101*** (0.0143)	0.0713*** (0.0137)
Gross government debt	-0.00953*** (0.00254)	-0.0171*** (0.000672)
Human capital formation	0.0290*** (0.00457)	0.0164*** (0.00182)
Gross fixed capital formation	0.0182*** (0.00539)	0.0446*** (0.00435)
Foreign direct investment	0.0171 (0.0117)	0.0284*** (0.00951)
Official development assistance	0.0677*** (0.0129)	0.0745*** (0.00579)
Trade	0.00221 (0.00220)	0.00863*** (0.00167)
Remittances	0.0236*** (0.00862)	0.0110** (0.00453)
General government final consumption expenditure	-0.0297** (0.0121)	-0.0432*** (0.0105)
Inflation	-0.00788* (0.00442)	0.0381*** (0.00738)
Population growth	1.112*** (0.0887)	0.917*** (0.0375)
p-value Sargan test	0.58	0.69
p-value AR(1) test	0.02	0.04
p-value AR(2) test	0.23	0.15
Number of instruments	73	52
Number of observations	386	465
Number of countries	52	52

Note: Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table A.3 Dynamic panel two-step system GMM estimation (1990–2001)

	(1)	(2)
Variables	Total debt (debt from external and domestic sources)	External debt (debt only from external sources)
Lag of growth	-0.574*** (0.0450)	0.0379 (0.0446)
Gross government debt	-0.134*** (0.0124)	0.0826*** (0.00919)
Human capital formation	0.0723** (0.0298)	0.186*** (0.0144)
Gross fixed capital formation	0.240*** (0.0476)	-0.250*** (0.0192)
Foreign direct investment	0.0298 (0.0824)	0.0748** (0.0334)
Official development assistance	0.739*** (0.0968)	0.0530 (0.0562)
Trade	-0.0223* (0.0122)	-0.0295*** (0.00460)
Remittances	-0.146*** (0.0546)	0.319*** (0.0206)
General government final consumption expenditure	0.152* (0.0892)	-0.211*** (0.0335)
Inflation	-0.0341 (0.0371)	-0.0212 (0.0219)
Population growth	1.382*** (0.285)	-0.168 (0.408)
p-value Sargan test	0.86	0.73
p-value AR(1) test	0.14	0.07
p-value AR(2) test	0.76	0.36
Number of instruments	40	40
Number of observations	112	198
Number of countries	52	52

Note: Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table A.4 Dynamic panel two-step system GMM estimation (2002–2013)

	(1)	(2)
Variables	Total debt (debt from external and domestic sources)	External debt (debt only from external sources)
Lag of growth	0.171*** (0.0294)	0.340*** (0.0239)
Gross government debt	-0.000766 (0.00481)	-0.00119 (0.00739)
Human capital formation	0.0169 (0.0186)	0.00889 (0.00852)
Gross fixed capital formation	0.0311 (0.0284)	0.0671** (0.0296)
Foreign direct investment	0.0285** (0.0123)	0.0330 (0.0287)
Official development assistance	0.0359* (0.0202)	0.0457 (0.0366)
Trade	0.00267 (0.00550)	0.0109 (0.00741)
Remittances	0.00989 (0.0228)	-0.0210 (0.0185)
General government final consumption expenditure	-0.00720 (0.0240)	-0.0343 (0.0220)
Inflation	-0.0107 (0.0180)	-0.263*** (0.0525)
Population growth	1.004*** (0.0923)	1.026*** (0.188)
p-value Sargan test	0.07	0.27
p-value AR(1) test	0.01	0.02
p-value AR(2) test	0.12	0.17
Number of instruments	37	28
Number of observations	248	241
Number of countries	52	52

Note: Standard errors in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

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