UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

THEN AND NOW: REIMAGINING AFRICA'S FUTURE

Catalysing Investment for Transformative Growth

UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

THEN AND NOW: REIMAGINING AFRICA'S FUTURE

Catalysing Investment for Transformative Growth

UNITED NATIONS
Geneva, 2015

NOTES

The contents of this report are based on the *Economic Development in Africa Report 2014: Catalysing Investment for Transformative Growth in Africa*, launched on 3 July 2014.

All references to "dollars" are United States dollars.
Sub-Saharan Africa: unless otherwise stated, this includes South Africa.
North Africa: Sudan is classified as part of sub-Saharan Africa, not North Africa.

UNCTAD/OSG/2015/1
UNITED NATIONS PUBLICATION

CONTENTS

ABBREVIATIONS

FDI	foreign direct investment
GDP	gross domestic product
ODA	official development assistance

1. MEETING AFRICA'S DEVELOPMENT CHALLENGES

Africa continues to grow at a moderately rapid pace, despite weaker global growth

Africa entered the twenty-first century with promising economic prospects. Over the past decade, most African countries have enjoyed good economic growth relative to the continent's historical growth performance and the average growth rate for the global economy. The average annual growth rate of real output increased from 1.8 per cent between 1980 and 1989 to 2.6 per cent between 1990 and 2000 and 5.3 per cent between 2000 and 2010. Furthermore, 12 countries had an average growth rate above the developing-country average of 6.1 per cent from 2000–2010, and two countries (Angola and Equatorial Guinea) had double-digit growth rates. Unlike its performance in the 1980s and 1990s, Africa's average growth rate since the turn of the millennium has also been higher than the average growth rate of the world economy. The continent experienced a significant slowdown in growth due to the global financial and economic crisis of 2008–2009 (UNCTAD, 2014). Nevertheless, its average growth rate in the post-crisis period (2008–2012) was about 2 percentage points higher than that of the world economy.

Internal and external factors have contributed to Africa's relatively impressive growth performance over the past decade. Better macroeconomic management, high domestic demand and a relatively more stable political environment are some of the internal factors that supported growth in the continent. On the external front, favourable commodity prices, stronger economic cooperation with emerging economies, more official development assistance (ODA) and an increase in foreign direct investment (FDI) flows contributed to the growth process. Rising agricultural production and public investment in infrastructure, and growth in African retail, telecommunications, transportation and financial services fuelled a forecast rise in regional gross domestic product (GDP) from 4.6 per cent per annum in 2014 to 5.2 per cent in 2015 (World Bank, 2014).

Responding to emerging sustainable development challenges

Despite Africa's recent growth performance, there are indications that countries on the continent are experiencing the wrong type of growth in the sense that joblessness is still widespread and growth has not led to significant reductions in poverty. One of the reasons for jobless growth in Africa is that it has not gone through the normal process of structural transformation, involving a shift from low- to high-productivity activities both within and across sectors. In the normal process of economic transformation, economies begin with a high share of agriculture in GDP and as incomes rise, the share of agriculture declines, and that of manufacturing rises. This process continues until the economy reaches a relatively high level of development where both the shares of agriculture and manufacturing fall and that of services rise. The structural change observed in Africa has not followed this process. Over the past three decades, the continent has moved from a state in which agriculture has had a very high share of output to one in which the service sector, particularly its low-productivity activities, dominates output. This transition has taken place without any significant manufacturing development, which is critical to creating employment. It is therefore not surprising that Africa has experienced jobless growth over the past decade.

Although Africa has enjoyed relatively strong economic growth over the past decade, many of its countries are grappling with several development challenges ranging from food insecurity, Ebola, high unemployment, poverty and inequality, to commodity dependence, lack of economic transformation, environmental degradation and low integration in the global economy. Since the dawn of the new millennium, African Governments and the international community have adopted various initiatives aimed at addressing these development challenges and improving living conditions. At the continental level, African Heads of State and Government adopted the New Partnership for Africa's Development, which emphasizes African ownership of the development process and outcome, and calls for interventions in the following priority areas: agriculture and food security, regional integration and infrastructure, climate change and the environment, human development, economic governance, capacity development and women's empowerment. At the international level, world leaders adopted the Millennium Development Goals, which called for, among others, a halving of the proportion of people living in poverty by 2015. There are also ongoing efforts by the international community to delineate and finalize the broad contours of the post-2015 development agenda within the framework of sustainable development. While Africa has made some progress in achieving the goals set out in existing development frameworks, overall it has yet to realize the broad vision set out in these initiatives. It is still wrestling with extreme hunger and poverty, and unemployment and inequality have increased over the past decade (Economic Commission for Africa and Organization for Economic Cooperation and Development, 2013). Reversing this trend is a challenge that African policymakers have to address effectively in the short to medium term to enhance the likelihood of achieving the African Union's vision of an integrated, prosperous and peaceful Africa. Finally, in 2015, the international community will convene in Addis Ababa for the third International Conference on Financing for Development to assess progress made in the implementation of the 2002 Monterrey Consensus and the 2008 Doha Declaration on Financing for Development, address new and emerging issues and reinvigorate and strengthen financing for development. For Africa, this will mean addressing three key interrelated issues: enhancing domestic resource mobilization, plugging leakages to tackle illicit financial flows and enhancing flows of ODA. At the international level, it will be necessary to consider more rigorous compliance criteria in meeting existing ODA commitments. Clearly, catalysing investment will be essential in reinvigorating and strengthening finance for development in Africa.

Another reason why Africa's recent growth has not had a profound impact on either poverty reduction or employment creation is that it has not gone hand in hand with the development of productive capacities, which is crucial for generating decent jobs and reducing poverty. These structural issues, associated with recent growth, raises the question of how African countries can achieve the high, sustained and transformative growth necessary to reduce poverty. UNCTAD (2012) identified investment as one of the main drivers of structural transformation. Furthermore, research studies suggest that for African countries to make significant progress in reducing poverty, they would have to sustain growth rates of about 7 per cent and above in the medium to long term, and this would require investment rates of 25 per cent of GDP and above. Currently, investment rates in Africa are well below this threshold. They are also low relative to what is observed in rapidly growing developing countries. Boosting investment is therefore of strategic importance in achieving the broad development goals of African countries. It is also imperative if the continent is to achieve sustained growth and be a pole of global growth in the twenty-first century. Against this background, this report explores how investment might be used to support economic transformation and sustained growth in Africa. The term "investment" as used in the report refers to total investment in the economy, which includes public and private investment. Private investment in turn consists of investment by local private investors and FDI. The focus of the report on total investment reflects the fact that all components of investment matter for growth and development; therefore, the focus of policy should be on how to exploit the complementarities among the various components, rather than promoting one component at the expense of another. Simply increasing the quantity of investment will not be sufficient to achieve transformational growth; the productivity or quality of investment and ensuring that it goes to strategic and priority sectors of an economy, such as infrastructure, agriculture and manufacturing, are key.

2. CATALYSING INVESTMENT FOR TRANSFORMATIVE GROWTH

Investment is a major determinant of long-run growth

In the growth and development literature, capital accumulation is regarded as a key determinant of an economy's long-run growth (Turnovsky, 2011). This strategic role of investment in the development process has been confirmed by recent empirical studies based on data for African countries. For example, using cross-country data, Mijiyawa (2013) finds that investment, credit to the private sector, government effectiveness, exports and the share of agricultural value added in GDP are significant growth determinants. Ghazanchyan and Stotsky (2013) also find some evidence that investment boosts growth. The cross-country evidence on the predominant role of investment for long-run growth has been supported by country-level analysis indicating that there is a positive association between investment and growth in African countries. In the case of South Africa, for example, Eyraud (2009) provides evidence linking investment to growth in South Africa (box 1). Fedderke et al. (2006) also find strong empirical evidence that investment in infrastructure is not only positively associated with economic growth, but that it actually drives growth. In sum, both cross-country and country-level evidence indicates that investment is critical for accelerating growth in African economies.

Box 1. Sluggish investment undermines growth in South Africa

The development experience of South Africa over the past few decades provides a good example of the link between growth and investment. The country has abundant human, financial and natural resources. It also has very good infrastructure compared with other countries on the continent. In the 1980s and 1990s, South Africa had average growth rates of 1.4 and 2.1 per cent, respectively. Over the past decade, there has been a significant improvement in economic growth performance, with an average growth rate of 3.9 per cent for the period 2000–2010. Nevertheless, this is still below that of fast-growing developing countries and, above all, it is well below that of the continent, which was about 5.3 per cent over the same period. Investment ratios in South Africa have not changed very much over the past few decades. Between 1990 and 1999, the average investment ratio was 16.3 per cent and between 2000 and 2011, it was about 17.9 per cent, compared with the continental average of 18.7 per cent and the world average of 21.7 per cent.

Eyraud (2009) presents evidence indicating that South Africa's investment rate is low compared with that of fast-growing developing countries, and that sluggish investment undermines growth in the country. Furthermore, he argues that investment in South Africa has been hampered largely by low private savings due to structural factors such as the high dependency ratio and increased urbanization. High real interest rates have also been found to have a negative impact on investment in South Africa. In particular, when real interest rates increase by 1 percentage point, real investment growth falls by 7 percentage points after a year.

There are structural problems with Africa's pattern of growth both on the demand and the supply sides of the economy

On the demand side, the current pattern of growth has not been accompanied by significant improvements in investment rates (defined as the ratio of gross fixed capital formation to GDP). As discussed earlier, investment is one of the main determinants of an economy's long-run growth rate and productivity and is thus crucial for achieving sustained growth and development. Over the past two decades, the investment rate was either unchanged or declined in 28 African countries. In Angola, for example, it fell from 28 per cent to 13 per cent between 1990–1999 and 2000–2011. In Eritrea, it fell from 25 per cent to 18 per cent, and in Guinea-Bissau, from 20 per cent to 10 per cent. At the continental level, the investment rate was 17.7 per cent between 1990 and 1999 and 18.7 per cent between 2000 and 2011. There was a marked increase in the average growth rate of investment between 2000 and 2011. However, output and other components of demand grew as well; therefore, the share of investment in GDP has not changed significantly over the past two decades. Household consumption is the dominant component of demand in Africa. With an average growth rate of 5 per cent and a 62 per cent share of GDP, it made the largest contribution to output growth between 2000 and 2011 (UNCTAD, 2014).

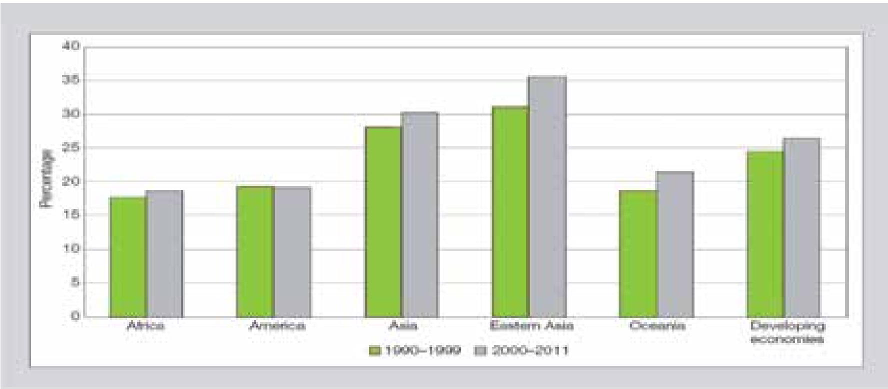
Although consumption is an important source of domestic demand and has been the dominant driver of growth in Africa over the past decade, a consumption-based growth strategy cannot be sustained in the medium to long term because it often results in overdependence on imports of consumer goods, which presents challenges for the survival and growth of local industries, the building of productive capacities and employment creation. Furthermore, it causes a deterioration of the current account balance that would have to be corrected or reversed in the future to maintain external sustainability. Experience has shown that reversals of such current account imbalances often require drastic reductions in consumption that have a severe negative impact on growth. While investment booms can also erode the current account, recent evidence suggests that current-account deficit reversals caused by investment booms that increase the production capacity for tradable goods are associated with better growth performance than those driven by consumption booms (Klemm, 2013). Hence, the need to enhance the role of investment in the growth process, particularly given the low investment rates observed in Africa relative to investment requirements.

There are also structural problems with Africa's recent growth from a supply or sectoral perspective. For example, it has not been transformative. Despite the continent's high and steady growth over the past decade, many countries have yet to go through the normal process of structural transformation characterized by a shift from low- to high-productivity activities, as well as a declining share of agriculture in output and employment, and an increasing share of manufacturing and modern services in output. Available data indicate that the share of manufacturing in total value added has declined over the past two decades. It fell from an average of 14 per cent between 1990 and 1999 to 11 per cent between 2000 and 2011. Furthermore, the service sector is now the most dominant sector of African economies. Its share of total value added from 2000–2011 was about 47 per cent, compared with 37 per cent for industry and 16 per cent for agriculture. In terms of dynamics, the service sector over the same period had an average growth rate of 5.2 per cent, agriculture, 5.1 per cent and industry, 3.5 per cent (UNCTAD, 2014). Given that the service sector has the highest growth rate and has a higher share of total value added, its contribution to growth has been higher than that of other sectors. This pattern of structural change differs substantially from what one would expect, since the continent is still in an early stage of development. At that point, the service sector does not generally play such a dominant role in an economy. Furthermore, the dominance of the service sector should be of concern because it is driven mostly by low-productivity activities such as informal and non-tradable services. This suggests that Africa's recent growth is fragile and is unlikely to be sustained in the medium to long term if current trends continue.

Africa has low investment rates relative to the average for developing countries and to what is considered necessary to achieve development goals

From a comparative perspective, Africa has low investment rates relative to the average for developing countries. On an annual average basis, the investment rate was about 18 per cent between 1990 and 1999, as opposed to 24 per cent for developing economies. Similarly, between 2000 and 2011, the average investment rate for Africa was about 19 per cent, compared with 26 per cent for developing economies (figure 1). As shown in figure 2, its investment rate over the past two decades has been consistently below those of developing countries.

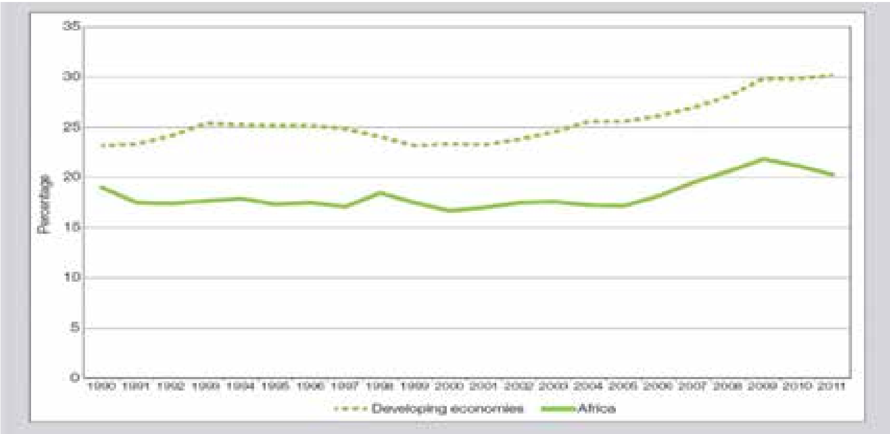
Figure 1. Investment rates across developing-country groups
(Percentage of gross domestic product)



Source: UNCTAD.

The average investment rates described above hide substantial cross-country variation. High investment rates in the range of 25 per cent and above are rarely sustained in Africa. Over the past two decades, only a small set of African countries have sustained investment rates of 25 per cent and above. These are Algeria, Botswana, Cabo Verde, the Congo, Equatorial Guinea, Guinea, Lesotho, Sao Tome and Principe, and Seychelles. Equatorial Guinea exhibits unusually high investment rates, with annual averages of 68 per cent for 1990–1999 and 43 per cent for 2000–2011. Low investment rates are especially prevalent in a broad range of African countries. For example, between 2000 and 2011, the following countries had average investment ratios below 15 per cent: Angola, the Central African Republic, the Comoros, Côte d'Ivoire, Guinea-Bissau, Liberia, Libya, Nigeria, Sierra Leone, Swaziland and Zimbabwe.

Figure 2. Trends in gross fixed capital formation, 1990–2011
(Percentage of gross domestic product)



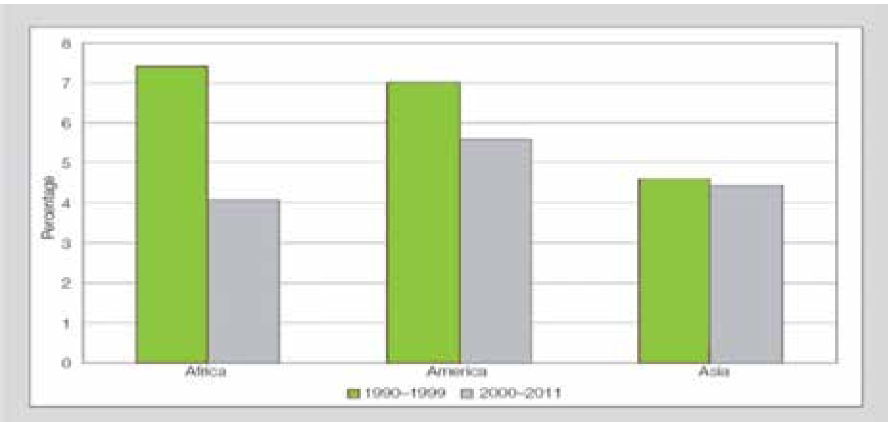
Source: UNCTAD.

Research studies also suggest that Africa's investment rates are lower than optimal levels in the sense that they are below what is needed to sustainably reduce poverty and achieve international development goals such as the Millennium Development Goals. National as well as international development frameworks for developing countries have always emphasized the role of investment for stimulating growth, which in turn is viewed as a prerequisite for achieving the ultimate development goals of poverty reduction and other dimensions of social development. For example, one of the key targets under the Programme of Action for the Least Developed Countries for the Decade 2001–2010 was to achieve an annual investment–GDP ratio of 25 per cent. Similarly, the Programme of Action for the Least Developed Countries for the Decade 2011–2020 considers an investment rate of 25 per cent necessary for achieving the target growth rate of 7 per cent in least developed countries. Regarding the Goals, research by the Economic Commission for Africa suggests that an investment rate of 33 per cent is required for African countries to be able to reach the growth rate of 7 per cent that was estimated to be necessary to meet the Goals, especially reducing poverty by half by 2015 (Economic Commission for Africa, 1999). Few African countries have been able to meet the targets set by the Brussels Programme of Action and Istanbul Programme of Action on a consistent basis, let alone the target established by the Economic Commission for Africa. It should be noted that one of the reasons the target investment rates from both sources differ is that the estimate for least developed countries includes non-African countries, while that for the Goals covers African countries only.

Africa has experienced an increase in the productivity of capital over the past two decades

The discussion so far has focused on the quantity of investment. But the efficiency or productivity of investment also has an impact on an economy's growth and development. To examine the extent to which capital has been productive in Africa, the incremental capital–output ratio has been computed. This ratio measures the degree of inefficiency in the use of capital in an economy. An economy with a higher incremental capital–output ratio has lower efficiency or productivity of capital. Figure 3 shows that the productivity of capital increased significantly between 1990–1999 and 2000–2011. Between 1990 and 1999, the incremental capital–output ratio in Africa was about 7.4, while between 2000 and 2011 it fell to 4.1. Compared with other developing-country groups, the productivity of capital between 2000 and 2011 was much higher in Africa than in America and slightly higher than in Asia. This is a big change from the 1990s when the productivity of capital was lower in Africa than in the other developing-country groups.

Figure 3. Incremental capital–output ratios across developing-country groups



Source: UNCTAD.

Within Africa, there is a wide variation across countries in terms of the productivity of capital (UNCTAD, 2014). A comparison of the last two decades shows that some of the countries that have made significant progress in enhancing the productivity of capital include Angola, the Congo, Guinea-Bissau, Liberia, Sao Tome and Principe, and Zambia. However, countries where capital had very high productivity between 2000 and 2011 were Angola, Equatorial Guinea, Ethiopia, Liberia, Mozambique, Nigeria, Rwanda, Sierra Leone and the Sudan. While there has been a significant improvement in the productivity of capital at the aggregate level, it should be noted that there were 22 African countries where the productivity of capital either did not change or declined between 1990 and 1999, and 2000 and 2011. Furthermore, there is some evidence indicating that public investment efficiency is low in sub-Saharan Africa (Dabla-Norris et al., 2011). The low efficiency of public investments in Africa tends to weaken the link between public and private capital. It also reduces the returns on private investments, making it more challenging to attract such flows. Therefore, although there has been an improvement in the efficiency of total investment, more work needs to be done, particularly in the area of public investments, to reduce waste and achieve maximum impact.

Composition of investment matters for growth in Africa

A relevant question to pose at this stage is whether the composition of investment matters in the investment–growth nexus. It is important to consider the composition of investment – that is, the distribution between private and public investment – for two reasons. First, from a policy perspective it is helpful to know how to focus interventions aimed at boosting investment for stimulating growth. For example, conventional market-based economic reform policies promote a reduction in the role of the public sector in favour of private sector activity. From that perspective, priority is given to private investment. The question then is whether the empirical evidence supports this view. In other words, is private investment more important than public investment in the growth process, or are both complementary? Second, if the distinction between public and private investment matters for growth, then there is a need to understand the linkages between them. Furthermore, if both types of investments are complementary, then from a policy perspective they are not mutually exclusive choices; therefore, government efforts aimed at stimulating investment should accord attention to both types of investment.

The relative contributions of private and public investment to the growth process have been examined in the empirical literature, although most of the studies focus on developed countries. In general the evidence is mixed. Some studies find that public investment tends to crowd in (increase) private investment, while others find that it has a crowding-out effect. Nevertheless, studies based on African data do show that public investment has a positive effect on growth by raising the effectiveness of private investment. In other words, public and private investments are complementary. For example, Samake (2008) found that public investment crowds in private investment and that both types of investment have a significant impact on growth in Benin. Similar evidence has also been provided for Cameroon (Ghura, 1997). Other studies have found that public capital is generally productive and boosts output at the sectoral or national level. An example is the study on South Africa by Fedderke et al. (2006). Additional supportive empirical evidence on the role of public investments in the growth process in Africa can be found in Fosu et al. (2012). These findings confirm the strategic role of public investment in the growth process. It is difficult to imagine strong economic performance in Africa in the absence of the supply of adequate quantity and quality of infrastructure, and this is one area where public investment plays an important role.

Public investment rates have declined relative to the 1980s and are currently below optimal levels

In analysing investment, it is important to pay attention to its distribution to private and public investment. The long-term trends of investment in Africa show a dramatic decline in public investment since the beginning of the 1980s (figure 4). Following a steady rise from 1970 (5 per cent) to a peak of 11.5 per cent in 1982, public investment has since declined to about 5 per cent in 2012. Today, public investment is at about half its peak level of the early 1980s. In the second half of the 1970s, public investment rose as private investment declined; this trend was reversed in the early 1980s with public investment falling and private investment rising. While there was a significant reduction in public investment in the 1980s, it was relatively more stable in the 1990s and 2000s at the continental level. The average public investment rate between 1990 and 1999 was 7.6 per cent; between 2000 and 2012, it was 7.5 per cent. However, these stable investment rates observed at the aggregate level mask the significant decline in public investment rates experienced by 23 African countries over the past two decades.

Figure 4. Gross fixed capital formation in Africa
(Percentage of gross domestic product)

Source: World Development Indicators.
Abbreviation: GFCF, gross fixed capital formation

It is important to identify the causes behind the decline of public investment in Africa that began in the early 1980s. The timing of the decline is historically pertinent. It occurred during the period in which African countries were hit by the external debt crisis. As Governments ran out of financing while attempting to meet their debt obligations, it appears that public investment became the victim of the severe budget cuts that ensued. Thereafter, African countries underwent structural adjustment reforms, which promoted austerity and a diminished role of the State. Therefore, the decline in public investment can be attributed to public expenditure compression mandated by debt distress and perpetuated by structural adjustment programmes. The degree of dependence on public investment varies widely across African countries. For example, between 2000 and 2012, the share of public investment in gross fixed capital formation exceeded 50 per cent in Angola, Eritrea, Ethiopia, Guinea-Bissau, Libya, Mozambique and Rwanda. Furthermore, in the Central African Republic, Chad, Djibouti, Egypt, Ghana, Madagascar, Malawi, the Niger, Sierra Leone and Zambia, there was a significant shift in the composition of investment between 1990–1999 and 2000–2012. In these countries, there was a marked decline in the share of the public sector in investment, resulting in a higher share of the private sector (UNCTAD, 2014).

The general decline in public investment rates relative to the 1980s should be of concern to African policymakers because recent studies suggest that public investment rates in Africa are below optimal levels. For example, Fosu et al. (2012) find that growth in African countries has been hampered by public underinvestment in the sense that actual public investment has remained below the optimal level required to reach high growth (or the growth-maximizing level of public investment). Simulations of growth models run by these authors show that the public investment rate that maximizes consumption is between 8.4 per cent and 11 per cent, depending on the discount rates used. However, the average public investment rate in Africa between 2000 and 2012 was about 7.5 per cent. The decline in public investment has important implications for growth prospects in African countries. Given the complementarity of public and private investment, the low rate of public investment erodes the potential impact of private investment on growth. This result is important for strategies to boost investment. It implies that the public sector has a crucial role to play in accelerating investment in Africa. While it is important for Governments to enact policies that incentivize private investment, it is clear that the first priority must be to substantially increase allocation to public investment.

External finance continues to play an important role in financing investment but its contribution has declined significantly over the past two decades

African countries have historically used external finance such as FDI, debt, remittances and ODA to complement domestic resources for investment (box 2). This is evidenced by the continent's positive investment–savings gap of the past few decades. For example, between 1980 and 1989, the investment–savings gap as a percentage of GDP was 1.2 per cent. More recently, it has fallen significantly. In particular, for the period 2000–2011, Africa had a negative investment–savings gap of about minus 2.8 per cent, reflecting the fact that more investment is financed through domestic sources. The ratios of the traditional sources of finance to investment provide an insight to the role of the source of financing investment in Africa (see table). Variations over time and across countries, differences between oil and non-oil African economies, and how African countries compare with other developing countries are indicated.

Box 2. The growing role of remittances

While FDI, ODA and debt have historically been the main sources of external finance in Africa, the importance of remittances has increased in recent years. In 1990, Africa received only about $8.9 billion in remittances, representing about 11 per cent of global flows and 26 per cent of flows to developing countries. However, in 2012, it is estimated that the continent received $62.4 billion, which is 12 per cent of global flows and 17 per cent of flows to developing countries. Remittances are also attracting more attention from policymakers in Africa because they tend to be a less volatile source of finance than ODA and FDI, and as is well known, volatility has negative consequences for investment and output. Although remittances are often associated with brain drain, they also have a positive impact on development. In particular, they play an important role in poverty reduction and human capital development. Furthermore, available evidence suggests that, contrary to the perception that remittances are only used to finance household consumption, they also have a significant effect on investment and saving (UNCTAD, 2012). In a study on African countries, Baldé (2011) finds that although remittances may be quantitatively smaller than official aid in most countries, they have more positive impact on investment and saving, and consequently on growth. In this context, African countries should pay more attention to remittances as a potential source of stable and non-debt-generating finance.

The table presents the ratios of gross domestic saving, ODA, FDI and external debt to investment, as well as the ratios of ODA and debt to public investment, and the ratio of private debt to private investment. The table sheds some light on whether countries are able to finance investment with their domestic saving. The data show that African countries are able to cover a relatively smaller share of their investment through domestic finance compared with non-African developing countries. Between 1970 and 2012, the ratio of domestic saving to investment was 48.4 per cent for Africa, compared with 61.4 per cent for non-African developing countries. Over time, however, Africa has been able to close the gap. For the period 2000–2012, the ratio was 52.6 per cent for Africa, compared with 59.9 per cent for other developing countries.

Oil-rich African countries exhibit a substantial surplus of saving over investment, with a ratio of 158 per cent for 2000–2012. In contrast, non-oil-rich African economies have a low ratio of saving to investment. They had a ratio of 17.2 per cent over the same period. The ratio of saving to investment has increased substantially for oil-rich countries, especially since the 1980s, spiking during oil boom episodes.

African countries also depend on ODA to finance investment more than their other developing-country counterparts. The ratio of ODA to investment between 2000 and 2012 was 68.8 per cent for Africa, compared with 23.1 per cent for other developing countries. The gap is even larger for public investment: 239.3 per cent for Africa, compared with 84.3 per cent for other developing countries. However, African oil-rich countries appear to rely less on ODA, with a ratio of 34.9 per cent between 2000 and 2012, as opposed to 78 per cent for non-oil-rich countries. African countries also exhibit higher ratios of debt to gross capital formation compared with other developing countries. There are less distinguishing patterns regarding the FDI-to-investment ratio. Oil-rich countries exhibit slightly higher ratios, consistent with the tendency for resource seeking observed in FDI flows to African countries. It is important to note that the evidence presented in the table is only indicative of possible sources of financing for investment. Therefore, high domestic saving does not necessarily imply correspondingly higher investment rates. While there can be a correlation between the level of saving and other forms of financing on one hand and investment on the other, it is not possible to infer causality. There are other factors that influence investment decisions that may also influence the relationship between investment and these potential sources of financing for investment.

Selected sources of investment financing by country category

Category	Domestic saving/ GCF	ODA/GCF	FDI/GCF	Debt/GCF	ODA/public investment	Net public debt/public investment	Net private debt/ private investment
Averages for the period 2000–2012							
Non-oil Africa	17.2	78.0	24.0	620.4	251.4	22.0	2.2
Oil-rich Africa	158.8	34.9	27.8	449.9	202.7	[2.8]	[3.3]
Non-Africa	59.9	23.1	18.8	231.4	84.3	23.6	6.6
Africa	52.6	68.8	25.0	581.6	239.3	16.3	0.7
Averages over the period 1970–2012							
Non-oil Africa	27.6	81.2	11.5	541.9	225.7	42.8	0.4
Oil-rich Africa	110.1	35.3	15.5	547.1	171.7	30.1	[0.7]
Non-Africa	61.4	25.5	12.4	249.0	88.0	34.8	4.8
Africa	48.4	70.7	12.5	543.2	211.2	39.6	0.0

Source: Computed based on data from *World Development Indicators*.
Abbreviation: GCF, gross capital formation.

3. RECOMMENDATIONS

An analysis of Africa's economic growth over the past two decades suggests that it is fragile, owing largely to the structural nature of the growth. Against this backdrop, it can be argued that sustaining growth for employment and poverty reduction in Africa in the medium to long term requires structural transformation and that investment is a major driver of transformation. One of the main messages of the *Economic Development in Africa Report 2014* is that achieving sustained and transformative growth in Africa requires broadening its sources of growth on the demand and supply sides of the economy. On the demand side, this means balancing the contributions of consumption and investment to the growth process. On the supply side, it involves inducing a shift from low- to high-productivity activities both within and across agriculture, manufacturing and services.

A second message of the Report is that enhancing the contribution of investment to growth in Africa requires increasing the quantity of investment, improving the productivity of existing and new investment, and ensuring that it is directed to priority and strategic sectors. There is a need for more public investment in Africa, particularly in infrastructure, to catalyse private investment. In this context, public and private investments are complementary; therefore, the focus of government policy should be on how to exploit these complementarities rather than promoting one at the expense of the other.

The Report also stresses that African Governments have to adopt a more coherent approach to promoting investment if it is to play an effective role in economic transformation in Africa. In particular, macroeconomic policies should not result in prohibitive interest rates that hinder investment, and interest rates on government securities should not be so high that they incentivize banks to hold excess reserves and reduce lending to the private sector. Furthermore, African countries should change their approach to promoting FDI because it discriminates against local investors and has negative consequences for local entrepreneurship and investment. African Governments offer generous incentives to foreign investors that put local investors at a disadvantage and go against efforts to promote domestic entrepreneurship and investment. In this regard, there is a need for coherence between policies to promote FDI and those aimed at developing local entrepreneurship.

In addition, the Report makes specific policy recommendations on how to catalyse investment for transformative growth in Africa. Some of the policy recommendations addressing issues at the national and regional levels are highlighted below.

Boosting the level and rate of investment

There is a need for African countries to increase the level and rate of investment. This would require the adoption of a more coherent macroeconomic policy framework that, for example, balances the objective of maintaining price stability with that of promoting growth and employment. It is also necessary to reverse the policy bias against public investment, which has been prevalent in Africa since the 1980s, because public investment, particularly in infrastructure, is urgently needed to catalyse private investment. In this regard, African Governments are encouraged to strengthen efforts to enhance domestic resource mobilization to create fiscal space to boost public investments in infrastructure, particularly in energy and transport where it has been very challenging to attract private sector investment. Some of the policy measures for enhancing domestic resource mobilization include broadening the tax base by exploiting the potential to increase tax revenue through property and environmental taxes, improving tax and customs administration, developing and strengthening the financial system and ensuring better management and use of natural resource wealth.

Addressing imperfections in credit markets that make it difficult for enterprises to access loans at affordable interest rates is crucial to boost investment in African countries. In several of these, access to credit is difficult, and commercial banks tend to hold excess reserves rather than lend to the private sector. Furthermore, bank loan rates are so high that they hinder investment. One way to reduce the incentives that banks have to hold excess reserves in the form of government securities is to ensure that the returns on such securities are not very high. Reducing information asymmetry between lenders and borrowers by strengthening support for the establishment of private credit bureaux and movable collateral registries will also help. The establishment of partial guarantee schemes can also play an important role in encouraging banks to finance private sector investments. Further, there is a need to enhance access to long-term finance by establishing and strengthening development banks at the national and regional levels. However, if these banks are to succeed, they must have a flexible mandate and operational autonomy, adhere to sound governance and management practices, and have a credible mechanism for assessing performance on a regular basis. Capital market development also has a potential role in enhancing access to long-term finance in Africa. For example, it can facilitate the channelling of long-term savings from pension funds and insurance into long-term investments. Given the small size of

African economies, however, capital markets are more likely to be effective if they are developed at the regional level.

Reducing risk and uncertainty facing local and foreign investors is also crucial to boosting investment on the continent. Political instability, macroeconomic volatility and policy reversals are all sources of risk and uncertainty in Africa, with negative consequences for investment. For example, macroeconomic instability can lead to large fluctuations in real interest rates and make lending and investment challenging. Addressing the issue of risk and uncertainty will require reducing the incidence of policy reversals, making more efforts to ensure that information on government policies is widely disseminated to the public, reducing macroeconomic instability, and maintaining peace and security. In addition, reducing uncertainty in monetary policy by, perhaps, tying interest rate changes to movements in real variables such as real output growth or employment, can also enhance transparency, reduce uncertainty and encourage firms to invest in long-term projects. Better information on regulations and rules governing investment, as well as investment opportunities, will also diminish uncertainty and contribute to promoting investment. Although the primary responsibility to provide information rests with the Government, the media can also play an important role.

Investment demand depends on the policy and investment environment, as reflected for example by the availability and state of infrastructure. Firms have an incentive to invest if they know that infrastructure is available and of good quality. The state of infrastructure also affects the incentives for banks to lend to the real sector. For example, in countries with severe power outages, banks are reluctant to finance projects in agribusiness and manufacturing because the likelihood of non-performing loans in these sectors will be high. Public investment in infrastructure is therefore important in boosting investment. Other policy recommendations for achieving higher investment include reducing inequality in the distribution of income and assets, and strengthening regional integration and the development of regional production networks.

Ensuring that investment goes to strategic and priority sectors of the economy

There are certain activities and sectors that are critical to building productive capacities and achieving sustained and transformative growth. These include infrastructure and production activities in the agriculture and manufacturing sectors. The national development plans, visions or frameworks of most African countries identify these as strategic or priority sectors. However, commercial banks and financial institutions in Africa are generally reluctant to finance projects in these sectors, preferring to lend to the non-production sectors. In this regard, one of the challenges facing African Governments is how to promote investment in the strategic or priority sectors by redirecting financial resources into these sectors. Industrial policy has an important role to play in achieving this goal. For example, central banks can encourage lending to strategic sectors by adopting a refinancing (discount) policy that favours lending to these sectors. The policy involves setting a differentiated discount rate that is lower for bank advances dedicated to financing investment in strategic sectors or activities. Another way to redirect investment to the strategic sectors, particularly in the case of small and medium-sized enterprises, is to encourage financial institutions to use the flow of remittances as collateral for those that seek finance for productive investments. The establishment of partial credit guarantee schemes can also increase the flow of funds to strategic sectors and groups such as small and medium-sized enterprises. There are also non-financial measures that Governments can take to promote investment in the strategic sectors, one of which is the provision of market information and investment opportunities available in those sectors.

Boosting the productivity of investment

Enhancing the contribution of investment to growth and transformation is not about increasing the quantity of investment alone; it is also about improving the productivity or quality of existing as well as new investments. While there is some evidence that at the continental level the productivity of investment in Africa has improved over the past two decades, it is also true that there are many African countries where the productivity of investment either did not change or declined over the same period. Against this backdrop, there is a need for African Governments to strengthen efforts to enhance the productivity of investment. Developing workforce skills, providing good infrastructure, enhancing access to affordable credit and reducing the high costs of factor inputs are ways to enhance the productivity of private investment. With regard to enhancing the productivity of public investment, particularly in infrastructure, the following recommendations are suggested: better project selection and delivery, maintenance of assets to get more value out of existing infrastructure and more targeted public investment, which could be achieved by refocusing public investment in areas such as energy and transport – some of the binding constraints to boosting investment in Africa.

While the responsibility for catalysing investment to transform Africa lies with national Governments, there are issues with an international dimension that have a bearing on their ability to achieve their development goals. These include FDI, capital flight, aid and international trade. Policy recommendations in each of these areas are discussed below.

Strengthening linkages between local and foreign enterprises

African countries have experienced a significant increase in FDI flows over the past decade but there are concerns that the developmental impact has been limited due in part to weak linkages between foreign and local enterprises. The lack of adequate infrastructure and skilled labour, low absorptive capacity, policy incoherence and the lack of a vibrant domestic private sector are some factors responsible for the weak linkages between local and foreign enterprises. It is recommended that African Governments create and strengthen linkages by developing and improving workforce skills as well as raising the absorptive capacity of local firms, for example, through the imposition of technology transfer requirements on FDI. There is a need to promote joint ventures between local and foreign enterprises and make FDI policy consistent with the promotion of domestic entrepreneurship. In this regard, it would be advisable that African Governments promote FDI in a manner that does not discriminate against local investors. Furthermore, if incentives are to be used to promote FDI, they should be used mainly for attracting new investments in activities where a country cannot attract investors without such incentives. For example, in most cases, incentives are not necessary to attract FDI in the extractive industry because such investments will take place regardless, given the high demand for resources and investor interest in the sector.

Stemming capital flight to boost investment

Africa loses significant amounts of resources each year in the form of capital flight; therefore, it is necessary to address that problem to release more resources for investment in Africa. For example, efforts are required at the international, regional and national levels to curb capital flight. International cooperation is required to prevent tax evasion and the illicit transfer of capital across borders. Some measures were taken recently at the regional and international levels to address this issue. In 2013, for example, the Group of Eight countries made a commitment to fight tax evasion at the national and international levels. They also committed to introducing rules to ensure that multinational companies do not shift profits across borders to avoid taxes. At the continental level, African regional organizations set up the High-level Panel on Illicit Financial Flows from Africa to advise Governments on the nature and magnitude of these flows and offer insights on how to tackle the challenge. Importantly, African Governments need to improve tax and customs administration, ensure transparency in management and use of natural resources, and rethink their FDI promotion policy to ensure that multinational corporations that receive incentives do not contribute to illicit financial flows.

Using aid to stimulate investment

As put forward in the *Economic Development in Africa Report 2014*, aid can have a more positive impact on development in Africa if it is geared more towards, for example, stimulating investment by using it as a guarantee mechanism to reduce the risks faced by lenders and investors. Banks are often reluctant to lend to investors because of the risks involved. The use of ODA to provide partial guarantees to banks will encourage them to lend, thereby increasing investment. There is a need for more aid to be channelled to the production sectors to build productive capacities. In addition, development partners should be encouraged to use more aid to lift infrastructure constraints, particularly in energy and transport, as was recently done by the United States of America through the Power Africa initiative.

Stimulating investment by fostering international trade

African countries can also boost investment by fostering international trade. Access to a larger market through trade will allow African countries to exploit economies of scale associated with producing for a large market, thereby enhancing their competitiveness and stimulating investment. In this regard, it is important for the international community to grant African countries more market access, particularly in areas such as agriculture, where they currently have a comparative advantage. But enhanced market access will be of benefit to African countries only if they have the productive capacity to take advantage of the opportunities arising from such market access. Therefore, it is essential to build productive capacities in Africa for better information sharing on available market access opportunities so that African entrepreneurs can take more advantage of these opportunities. As high international trade costs have a negative impact on trade and investment in Africa, the international community should provide financial and technical support to African countries to enable them to implement the Agreement on Trade Facilitation adopted by members of the World Trade Organization in Bali in December 2013. There is also a need for African Governments to have a more coherent approach to the various trade negotiations and agreements they are engaged in to ensure that the outcomes are mutually supportive of economic transformation and development on the continent.

REFERENCES

Baldé Y (2011). The impact of remittances and foreign aid on savings/investment in sub-Saharan Africa. *African Development Review*. 23(2):247–262.

Dabla-Norris E, Brumby J, Kyobe A, Mills Z and Papageorgiou C (2011). Investing in public investment: An index of public investment efficiency. International Monetary Fund working paper WP/11/37. Washington, D.C.

Economic Commission for Africa (1999). Economic Report on Africa 1999: The Challenges of Poverty Reduction and Sustainability. Addis Ababa.

Economic Commission for Africa and Organization for Economic Cooperation and Development (2013). The Mutual Review of Development Effectiveness in Africa: Promise and Performance. Economic Commission for Africa. Addis Ababa.

Eyraud L (2009). Why isn't South Africa growing faster? A comparative approach. International Monetary Fund working paper WP/09/25. Washington, D.C.

Fedderke JW, Perkins P and Luiz JM (2006). Infrastructural investment in long-run economic growth: South Africa 1875–2001. *World Development*. 34(6):1037–1059.

Fosu AK, Getachewb YY and Ziesemer T (2012). Optimal public investment, growth, and consumption: Evidence from African countries. Centre for the Study of African Economies working paper WPS/2011-22. University of Oxford. Oxford.

Ghazanchyan M and Stotsky J (2013). Drivers of growth: Evidence from sub-Saharan African countries. International Monetary Fund Working Paper WP/13/236. Washington, D.C.

Ghura D (1997). Private investment and endogenous growth: Evidence from Cameroon. International Monetary Fund working paper WP/97/165. Washington, D.C.

Klemm A (2013). Growth following investment and consumption-driven current account crises. International Monetary Fund working paper WP/13/217. Washington, D.C.

Mijiyawa A (2013). Africa's recent economic growth: What are the contributing factors? *African Development Review*. 25(3):289–302.

Samake I (2008). Investment and growth dynamics: An empirical assessment applied to Benin. International Monetary Fund working paper WP/08/120. Washington, D.C.

Turnovsky SJ (2011). *Capital Accumulation and Economic Growth in a Small Open Economy*. Cambridge University Press. Cambridge.

UNCTAD (2012). *Economic Development in Africa Report 2012: Structural Transformation and Sustainable Development in Africa*. United Nations publication. Sales No. E.12.II.D.10. New York and Geneva.

UNCTAD (2014). *Economic Development in Africa Report 2014: Catalysing Investment for Transformative Growth in Africa*. United Nations publication. Sales No. E.14.II.D.2. New York and Geneva.

World Bank (2014). Africa's pulse: A n analysis of issues shaping Africa's economic future. No. 10. Washington D.C.