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# Policies for Growth and Poverty Reduction in Africa: How to Reach the Millennium Development Goals





African Union

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# Contents

Acronyms	v
1. Introduction	1
2. New International Initiatives	3
3. The Diversity of African Economies	5
4. Prospects for African Countries to Achieve the MDGs	6
5. Africa's Progress towards the MDGs	7
6. The Growth-Distribution-Poverty Nexus	9
7. Policies for Poverty Reduction	14
7.1 Geographic structure	14
7.2 Some informal sector issues	15
7.3 Economic and political governance	15
7.4 Macroeconomic environment	17
7.5 Export orientation	17
7.6 Business environment	18
7.7 Human resources	19
7.8 Physical infrastructure	19
7.9 The PRS process and development financing	19
7.10 Broad participation and redistribution policy	19
8. The Way Forward	21
References	22



## Acronyms

APRM	African Peer Review Mechanism
BOP	Balance of Payments
CfA	Commission for Africa
CFA	Central Africa Franc
CPIA	Country Policy and Institutional Assessment
CSO	Civil Society Organization
DAC	Development Assistance Committee
EC	European Commission
ECA	Economic Commission for Africa
HIPC	Highly Indebted Poor countries
IDA	International Development Association
IEO	Independent Evaluation Office (IMF)
IFI	International Financial Institution
IMF	International Monetary Fund
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MTEF	Medium-Term Expenditure Framework
NEPAD	New Economic Partnership for Africa's Development
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
OED	Operations Evaluations Department (World Bank)
ODI	Overseas Development Institute
PEAP	Poverty Eradication Plan (Uganda)
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PRS	Poverty Reduction Strategy
SGPR	Second Generation Poverty Reduction Strategy
SPA	Special Partnership with Africa
SSA	Sub-Saharan Africa
SWAP	Sector-wide Approach
PRSP	Poverty Reduction Strategy Paper
UNMP	United Nations Millennium Project



# 1. Introduction<sup>1</sup>

In September 2000, the United Nations Millennium Summit endorsed the Millennium Development Goals (MDGs) and what was called the Millennium Declaration. The main objective of the Millennium Summit was to set quantifiable and time-bound global development goals to end human suffering from hunger, destitution and diseases found mainly in developing countries. Since their establishment, the MDGs have been embedded in several international and regional initiatives and have increasingly influenced the policy debate throughout the developing world. The MDGs consist of 8 goals and 18 targets that were agreed upon by 180 member States of the United Nations (Box1).

## **Box 1: Millennium Development Goals to be reached by 2015 Endorsed in the Millennium Declaration, September 2000**

1. Eradicate extreme poverty and hunger:
  - Halve the proportion of people with less than a dollar a day;
  - Halve the proportion of people who suffer from hunger.
2. Achieve universal primary education:
  - Ensure boys and girls alike complete primary schooling.
3. Promote gender equality and empower women:
  - Eliminate gender disparity at all levels of education.
4. Reduce Child Mortality:
  - Reduce by two thirds the under-five mortality rate.
5. Improve maternal health:
6. Reduce by three quarters the maternal mortality ratio.
7. Combat HIV/AIDS, malaria and other diseases:
  - Halt and reverse the spread of HIV/AIDS;
  - Halt and reverse the spread of malaria and tuberculosis.
8. Ensure environmental sustainability:
  - Integrate sustainable development into country policies and reverse loss of environmental resources;
  - Halve the proportion of people without access to potable water;
  - By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.
9. Develop a global partnership for development:
  - Develop further an open, rule-based predictable, non-discriminating trading and financial system including a commitment to good governance, development, and poverty reduction - both nationally and internationally;
  - Address the special needs of the Least Developed Countries (LDCs);
  - Address the special needs of landlocked and small island developing countries;
  - Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term;
  - In cooperation with developing countries, develop and implement strategies for decent and productive work for youth;
  - In cooperation with the pharmaceutical companies, provide access to affordable drugs in developing countries; and
  - In cooperation with the private sector, make the benefits of new technologies available, especially information and communications.

The MDGs are the culmination of several international initiatives that took place in the 1990s sponsored by the United Nations and other agencies,<sup>2</sup> adopting a multidimensional notion of poverty that includes health, education and other basic entitlements. While the MDGs obey the general rules of target setting by being specific, measurable, relevant, and time-bound, achievability has become a serious concern, particularly in Sub-Saharan Africa (SSA). Most studies conducted on the resource implications of MDGs have come up with figures well beyond the reach of the countries in SSA, and this has turned the debate on the development problem of the continent to development finance.

In this context, one observes the following developments in Africa. First, the MDGs have helped African governments to commit to targets, which are long-term in nature. Until now, policy frameworks, including the PRSPs, have often formulated anti-poverty

1 This draft benefited enormously from the contributions of the Poverty Team at ESPD at various stage of the draft. Specially, the comprehensive comments given by Professor Augustin Fosu, written contributions of some sections of this draft by Adrian Gauci, Elizabeth Woldemariam, Alem Abraha, Workie Mitiku is highly appreciated. Thanks for comments are due to Kwabena Gyimah-Brempong and other participants in the ECA workshop in Addis Ababa.

2 The most notable are: UN Conference on Environment and Development, Rio de Janeiro, Brazil, 1992; UN International Conference on Population and Development, Cairo, 1994; Fourth UN World Conference on Women, Beijing, 1995; Copenhagen UN World Summit for Social Development, 1995.

programmes without the help of long-term development or growth strategies.<sup>3</sup> Second, addressing such basic human needs as those set in the MDGs has proved to be extremely challenging and has put SSA in a position that calls for new policy initiatives. Finally, in Africa, in addition to country level harmonization of policies with the MDG targets, the regional development initiative New Partnership for Africa's Development (NEPAD), has placed them firmly at the centre of Africa's development vision for the coming decade.

The rest of the paper is organized as follows: Section 2 presents the reports of the UN Millennium Commission and the Commission for Africa. Section 3 describes the diversity of the development challenge in different African economies, and Section 4 presents the key questions raised in this paper. Section 5 provides a brief overview of the status of each MDG in Africa. The evidence so far suggests that on the whole Africa, particularly SSA, is falling behind the pace required to achieve most of the goals.

Aggregation, however, hides striking diversities across countries. This section therefore also highlights some of the encouraging performances recorded in recent years among individual countries. Section 6 discusses how economic growth and changes in income distribution affects the path of extreme poverty. It offers some insight into the implications of different combinations of growth and inequality reduction for the achievement of Goal 1. Particularly it discusses the role of the growth pattern for poverty reduction. Section 7 discusses what policies that African countries should pursue to halve poverty by 2015, while Section 8 provides brief final remarks.

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3 There are a few exceptions to this. For example, Ethiopia, Uganda, and Tanzania have referred to long-term strategies as well as the PRSPs.

## 2. New International Initiatives

After the Millennium Declaration, there has been an upsurge of international commitment to Africa's development. Two major initiatives have recently culminated in comprehensive reports analysing Africa's development constraints and suggested policy interventions and dramatic increases in aid to Africa to make it possible for Africa to reach the MDGs by 2015.

The first of those is the United Nations Millennium Project (2005) coordinated by Jeffrey Sachs. This calls for a "Big Push" of investment supported by a huge increase in foreign aid. The emphasis is on investment in core infrastructure, human capital, and governance to lay the foundation for economic development and private sector-led growth. It is noted, though, that the aid should be structured according to the specific country constraints, since absorptive capacity varies across countries. It is also argued that there are certain quick-win interventions that should be launched immediately.

Sachs et al (2004) argue that Africa is caught in a poverty trap, and therefore small changes are not enough to break out of the poverty trap unless large-scale foreign assistance is injected into the system. What is needed is an investment strategy alongside international changes in policies and governance structures. Sachs does not accept the notion that the poor African performance is due to poor governance. He argues that this is in itself an effect of poverty and that poor countries are poorly governed because of lack of resources and skills. He argues that African countries are not worse governed than other poor countries, but that it is caught in a poverty trap. Since savings in Africa is low, the continent tends to get stuck in a low level equilibrium.

This is a classical argument from the early writings in development economics. What is needed, according to Sachs, is a "Big Push" to propel the economy to a high-level equilibrium. Sachs identifies three reasons for the poverty trap. First, savings are too low, since people are too poor to save enough. Second, they have large household size, with high dependency ratio. Third, capital has a threshold level below which it is not productive. Investments are lumpy. At the macroeconomic level, the poverty-trap models suggest that African countries need to attain a threshold income level from which they can then "take off".

The second report comes from the Commission for Africa (2005), initiated by Prime Minister Blair of the UK, to gather support for an international initiative to boost African development. Like the Sachs report, this report argues that there are interlocking vicious circles that need to be tackled simultaneously, that is, with a "Big Push" on many fronts. This study puts stronger priority on the need for improved governance. The report recommends that donors should support attempts to enhance Africa's capacity and to build efficient government systems and staff these. African leaders must improve accountability by broadening participation and strengthening institutions. They need to build transparent and accountable budgetary processes, to limit corruption. African States also need to build systems that can manage and prevent conflicts. Aid should be used to tackle the causes of conflicts.

Like the UN report, this one puts high priority on investment in people via the development of good systems for education, health delivery, and water and sanitation. There are particular needs to combat the spread of HIV/AIDS. It is noted that private and public sectors need to work together to create a climate that unleashes entrepreneurship, generates employment, and encourages individuals and firms to invest. The investment climate thus needs to be improved and there is a need for massive infrastructure investments to integrate African economies.

It is also noted that poor groups must be included in the development efforts, and this suggests that development strategies should focus on agriculture and the development of small-scale enterprises. African countries need to enhance their capacity to trade, while the rich countries must reduce barriers to African exports, particularly for agricultural goods. The quality of aid is crucial and it requires good governance on the part of the recipient countries and improved aid quality on the part of the donors (bilateral as well as multilateral). Complete debt cancellation is recommended for the poorest countries.

The G8 Summit at Gleneagles considered the Commission's report (July 2005), and made key decisions on aid, trade and debt in Africa, committing, among other things, to a doubling of aid to Africa by the year 2010. Specifically, the G8 Summit in Gleneagles promised to increase levels of aid to Africa from about \$12 billion in 2004 to \$25 billion per year by 2010. In addition, the G8 summit also agreed to cancel all outstanding debts of eligible HIPC countries to the IMF, IDA and African Development Fund. This position was subsequently endorsed by the UN General Assembly World Summit in September of 2005.

So are there problems with a massive scaling-up of aid to Africa? In recent years African economies have certainly changed many of their policies in a sensible direction, but the problem of revamping the administrative machinery is a task of a much larger order. The main question concerning a large aid injection is therefore how the new or expanded programmes are to be managed. How can one reach a situation where governments have incentives and possibilities to deliver efficient administration? Both commissions assume that the efficiency in service delivery can be upheld. There are some areas where this is true such as science-intensive regional public goods, including basic research in health and agriculture, as well as debt relief. A massive and externally funded scaling up of country public service delivery is more problematic.

Pritchett and Woolcock (2004) point out that many of the MDG services are both transaction intensive and discretionary. Unlike many macroeconomic reforms, the delivery of many health and education services requires the collaboration of multiple indi-

viduals who make highly discretionary choices in an environment where many key actions are unobservable. A few politically protected technocrats cannot deliver such services. They are subject to deep incentive problems. The empirical link from spending on health and education to outcomes is notoriously weak (World Bank, 2004c). So the great challenge with regard to the new initiatives (provided that the rich countries really pay up) is to get the system of governance in shape.

### 3. The Diversity of African Economies

The most ambitious study trying to explain African economic growth, or rather the lack thereof, has been undertaken by the African Economic Research Consortium (AERC) (O'Connell, 2004, Collier, O'Connell, 2005). The project has attempted first to identify the growth opportunities and constraints and then to explain the success or failure of countries in seizing the opportunities. The study characterizes opportunities for growth along two structural dimensions. The first dimension divides countries into three geographical categories, namely coastal countries, landlocked countries, and resource rich countries (irrespective of location). The second dimension is the degree of polarization in the society, from not polarized to moderately polarized and highly polarized countries.

After having defined the opportunities, the study goes on to investigate how governments have shaped the growth environment in the various countries covered. Four different types of anti-growth syndromes are identified from the case studies (see also Fosu, 2005a). First, there is the regulatory syndrome, which refers to excessive government interventions in markets. Second, there is the redistributive syndrome, where efficiency-reducing resource transfers play a dominant role in the formulation of government policy. Third, there is the intertemporal syndrome, which redistributes resources from the future to the present via for example looting by the elite or unsustainable government spending booms. Such episodes are generally followed by sharp adjustments. Fourth, there is the State breakdown syndrome, as a result of civil wars or severe political instability. Finally, there are also some countries that are characterized as syndrome free. The empirical analysis shows that an absence of syndromes increases the growth rate by almost 2 per cent per year.

When looking globally at the performance of landlocked countries, Collier and O'Connell (2005) find strong evidence that resource-scarce landlocked economies have dramatically worse opportunities for growth, and that there were two basic mechanisms behind this. First, being landlocked implies high constraints on market access, which has the effect of precluding significant entry into the global market for manufactures. Second, without high-value resources, landlocked countries are left dependent upon agriculture. There is no example of any such developing country experiencing rapid growth during the period 1960-2000.

O'Connell further notes that growth accelerations in Africa have often tended to evaporate. One reason suggested is that growth in the early stages is not real. For example, most of the government component of GDP is measured at cost, and thus increases with the growth of government wages. Since government wages often exceed the opportunity cost of government workers, the resulting increase in measured real GDP is partly illusory. If the government expansion proves unsustainable, it is generally hard for the government to lay off workers, and instead other types of expenditures will be cut, with negative supply-side effects. Overspending booms are often followed by economic declines.

The main conclusion of the AERC study is that African growth has faltered due to dysfunctional political-economic configurations or syndromes. Africa's poor growth performance is not the product of a uniform phenomenon but due to interaction different syndromes with different effects in different countries with different opportunities. It is noteworthy, though, that in the 1990s the landlocked natural resource scarce countries were the most successful ones in breaking free of the syndromes.

Collier and O'Connell believe that because of the small upside potential for land-locked countries such as Uganda, these countries may be more resilient to policy errors and predation. For example, peasant farmers have the option of retreating to subsistence farming to protect their incomes, if the government tries to exploit them. These types of countries may therefore be less prone to the syndromes than what otherwise would have been the case.

The conclusion that can be drawn from this study is that the policy packages to be applied need to be tailored to the set of constraints and to the policy syndromes that apply to the specific country. The first-generation PRSs have been too uniform.

## 4. Prospects for African Countries to Achieve the MDGs

This section explores the challenges and prospects for Africa to achieve the MDG targets stipulated. Despite the fact that the weight of existing evidence suggests that the MDGs are elusive targets for SSA, this paper takes the view that it is possible with the right mix of policies to make significant strides towards the MDGs. To illustrate this point, the section analyzes the target of reducing extreme poverty by half in great detail by examining its determinants as well as identifying the range of actions that need to be taken for its realization.

The choice of Goal 1 of MDGs is based on a number of considerations. First, its realization depends on a complex set of factors which are difficult to track over time and involve a great deal of effort on the part of policy makers to identify potent policy reducing policy instruments with complex effects on growth and inequality.<sup>4</sup> Second, there is a strong synergy across the targets in the MDGs so that progress in one target is both a result and cause of progresses in other targets.

For example, access to basic health and education services explain only a part of the high mortality and low primary enrolment rates in Africa. A significant proportion is also explained by hunger, malnutrition, and low level of income. High drop out rates from schools due to bouts of famine and epidemics of diseases related to malnutrition contribute significantly to low primary completion and high child mortality rates.<sup>5</sup> It follows that income growth is needed as much as the delivery of basic social services for maximum impact on human development.

This suggests that factors determining income poverty are relevant for other targets too. In addition, among the MDGs, the way to achieve Goal 1 is the most contentious issue among academics, policy makers and development partners. Thus, focusing on Goal 1 provides an opportunity to explore MDGs within the broader context of the fundamental challenge that Africa currently faces.

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4 See for example, Lopez (2004a) and Page and Lopez (2004), for discussion on the difference between pro-growth and pro-poor growth policies. The case for pro-poor growth in Africa is also discussed in Bigsten and Fosu (2004)

5 For example see Bourguignon, Bussolo, Lofgren, van der Mensbrugge (2004) for the illustration of the MDG synergy for Ethiopia.

## 5. Africa's Progress towards the MDGs

The MDGs have reshaped the way the United Nations and also its specialized agencies address development issues. Their centrality is reflected in a number of key reports and reiterated in the World Social Summit, Brussels Programme of Action (BPoA) and others. Regionally, the New Partnership for Africa's Development (NEPAD) and the African Peer Review Mechanism (APRM) use the MDGs as benchmarks for their strategic vision.

The progress of SSA towards the MDGs has been poor between 1990 and 2000. Nearly all measures of the targets have either remained unchanged or showed little progress (table 1). Despite problems of data reliability and a huge diversity among individual countries SSA still remain off the MDG track.

**Table 1: Status of Selected Targets of MDGs in Sub-Saharan Africa**

	1990	2000	2015**
MDG1: People living on less than 1\$ (PPP) a day (% of population)	45	46	22
MDG2: Primary Completion Rate (% of relevant age group)	57	55	100
MDG3: Promotion of gender equality and empowerment of women	79	82	100
MDG4: Under-five Mortality Rate (per 1,000 births)	187	174	62
MDG5: Maternal Mortality Rate (per 1000,000 live births)	920*	917	230
MDG7a: Access to an improved water source	54*	58	77
MDG7b: Access to improved sanitation facilities (% of population)	55*	54	77

Source: www.developmentgoals.org, \*United Nations Database, \*\*Targets.

Given the variation in economic growth rates across African countries, it is important to track progress being made by individual countries, in order to give a better picture of the trends towards achievement of the MDGs.

Goal 1: Eradicate extreme poverty and hunger. Goal 1 of the MDGs states that by 2015 extreme poverty should have declined by half in each country. In 2000, the percentage of population living on less than one dollar a day in Purchasing Power Parity terms in SSA was 46% (annex table 1), which, in comparison to 1990, was an increase by one percentage point. In absolute numbers, the poor population increased from 217 million to 290 million. This shows that even if the rate of poverty remained more or less unchanged, the number of the poor may increase considerably.

Despite the enormous challenge Africa faces to reach Goal 1, there are some country experiences that raise hope. Using the head-count ratio for two periods for countries where data are available and calculating the percentage of annual reduction in poverty, one would expect that poverty could be reduced by half by 2015 in North African countries and in eight SSA countries including Burkina Faso, Botswana, Ghana, South Africa and Uganda. This is if the current trends persist during the remaining 10 years.<sup>6</sup> Unfortunately, most countries in SSA have not shown much progress and will not achieve the goal by 2015 if the current trends continue (see annex table 1 for details).

Goal 2: Achieve Universal Primary Education. Using recent data, the average primary completion rate for SSA is slightly above 50%, while the net enrolment rate is 62% (tables 2 and 3). In order to achieve the goal by 2015, African countries need to register an uninterrupted annual growth of 3.9 percentage points in net enrolment between 2000 and 2010. On average, the observed growth rate is much less but about 10 countries from SSA and 3 from North Africa are likely to achieve the goal if the current trends persist (see table 2 for details).

<sup>6</sup> The computation is based on a simple assumption that the rate of reduction in poverty between two observed periods prevails until 2015.

**Table 2: Annual growth in net primary enrolment rates required for achieving Universal Primary Education and the historical trends (Percentage changes)**

Region*	Enrolment Rate (2000)	Required (2000-10)	Observed (1991-99)
Central Africa	71.00	2.86	0.03
East Africa	53.99	4.6	0.07
North Africa	82.83	1.72	0.22
Southern Africa	75.27	2.47	0.01
West Africa	44.66	5.53	0.21
SSA	61.18	3.88	0.54

**Source:** UNESCO and ECA Computations. \* Regional averages are calculated as population-weighted means of country data for countries with sufficient data.

**Table 3: Annual growth in primary completion rates required for achieving Universal Primary Education and the historical trends (Percentage change)**

Region*	Required (2000-10)	Observed (1991-99) %	Number of countries
Central Africa	3.78	1.2	1
East Africa	2.02	2.23	8
North Africa	0.61	2.45	5
Southern Africa	2.07	-0.57	8
West Africa	2.34	-0.71	9
All regions (Africa)	2.16	3.01	31

**Source:** UNESCO and ECA Computations. \* Averages for countries for which data are available.

**Goal 3: Promote Gender Equality and Empower Women.** During the last decade, there has been limited progress towards gender equality in primary education, although the trend has been better in secondary education. A linear projection to 2015 showed that, in primary education, SSA as a whole will not achieve the goal, but North, West, and Central Africa could achieve it. In secondary education, North African countries have already achieved the goal.

**Goal 4: Reduce Child Mortality.** The progress in reduction of the under-five mortality rate between 1990 and 2002 shows that countries in East and West Africa have not progressed at the required pace, while North African countries' progress has been remarkable. The Southern African subregion has not shown any progress, while child mortality in the Central African region has actually increased. Progress in SSA was, thus, insignificant, while it was substantial in North Africa. While it is unlikely that SSA will meet the goal, North Africa almost certainly will.

**Goal 5: Improve Maternal Health.** A reduction of maternal mortality by three-quarters seems unlikely for most countries in SSA, as the reduction was only 4-16% over the last decade, while it was required to be 75 %. In Southern Africa countries, maternal mortality actually increased by 15% over the same period. However, North African countries, Botswana, Cape Verde and Mauritius can achieve the goal.

**Goal 6: Combat HIV/AIDS, Malaria and other Diseases.** The possibility of halting the spread of HIV/AIDS is constrained by the low level (below 50%) of condom use in most countries of Africa. Prevention practices to reduce the prevalence of malaria are at an infant stage (only 5-15% of the population uses insecticide-treated bed nets). The prevalence rate of tuberculosis increased in 34 SSA countries from 2000 to 2002, aggravated by the high rate of HIV/AIDS infection. Its treatment with DOTS is also below 50% in most countries of Africa.

**Goal 7: Ensure Environmental Sustainability.** Deforestation, an indicator of environmental loss, has increased by as much as 25-30 % in some countries during the 1990s. On the other hand, forested areas have increased in Cape Verde, Gambia, Swaziland, and North African countries. CO<sub>2</sub> emission is not currently a problem on the continent except for Libya and South Africa. The progress made so far with regard to access to safe drinking water is not adequate, however. The target for urban areas can be met in most African countries, but in rural areas only a few countries will be able to meet it. Access to sanitation showed little progress (from 32 % to 36%) between 1990 and 2002.

**Goal 8: Develop a Global Partnership for Development.** Official Development Assistance (ODA) inflow to Africa as a whole decreased from 25 billion to 15.4 billion (constant \$US) during the period 1990 to 2001. In terms of per capita, ODA inflow for 51 African countries was \$US91 in 1990, falling to \$US38 in 2001. The average share of ODA as percentage of donors GNI was far below that agreed at the Monterrey Consensus. Market access to products (particularly to agriculture) is also limited. As a result of the enhanced HIPC initiative, debt service to export ratio (%) for African countries declined from 20.6% in 1990 to 15% in 2001.

## 6. The Growth-Distribution-Poverty Nexus

The attainment of the MDGs in Africa rests primarily on the pace and character of economic growth. Rapid and sustained growth generates resources necessary to deliver social services for the attainment of MDGs. However, growth alone is not sufficient to meet the MDGs. The pattern of growth also matters for the speed of the process of reducing poverty, hunger and diseases. That is, while economic growth is a sure way to increase a nation's pie, it does not guarantee that it is shared broadly. In fact, poverty is closely associated with the nature of changes in income inequality as well as average rate of growth of the economy.<sup>7</sup>

The key to reducing poverty by half therefore lies in formulating and implementing a growth strategy that recognizes the constraints and opportunities to induce and sustain growth as well as the need to contain the dampening effects of a deteriorating income distribution on poverty reduction. The delineation of such a growth strategy requires analysis on the underlying causes of growth and the link between economic growth, income distribution and poverty in the African context.

The target of reducing income poverty by half by 2015 can be achieved through a wide range of growth paths with different rates of inequality change.<sup>8</sup> The extent to which income inequality matters for the achievement of the target of halving extreme poverty is difficult to evaluate in the African context given the paucity of data on the evolution of income distribution and poverty over time.

Preliminary results based on limited information on income distribution and poverty over the last decade provide some insights into the orders of magnitude involved and on the role of income distribution in the attempts to achieve Goal 1 of the MDGs in Africa. To begin with, the weight of evidence on the state of income distribution indicates that Africa is the second most unequal continent in the world, next to South America (table 4).

**Table 4: Median Values of Gini Coefficient by Region**

Region	1960s	1970s	1980s	1990s
Eastern Europe	22.76	21.77	24.93	28.60
South Asia	31.67	32.32	32.22	31.59
OECD and High Income Countries	32.86	33.04	32.20	33.20
East Asia and the Pacific	34.57	34.40	34.42	34.80
Middle East and North Africa	41.88	43.63	40.80	39.72
Sub-Saharan Africa	49.90	48.50	39.63	42.30
Latin America	53.00	49.86	51.00	50.00

**Source:** Deininger and Squire (1998), p. 263.

Simulations for 26 selected African countries of the cumulative growth and reduction in income inequality required for reducing poverty by half show interesting results. The first point is that the median cumulative reduction in income inequality required to achieve the target of reducing extreme poverty by half by 2015 without growth is 10.4%. If the span of the target period is 10 years (say between 2005-2015), then the annual reduction in income inequality needed to halve poverty by 2015 is about 1.0%, on the assumption that per capita growth is zero throughout this period. On the other hand, in a situation where income inequality is held constant at the current level, the median cumulative growth in per capita income needed to achieve goal 1 is 22.8% or an annual rate of growth of about 2.1% (see table 5). If we add the average rate of growth in population observed over the last decade for Africa, we get approximately a 5% growth in GDP for a typical low income African country to achieve Goal 1 of the MDGs.

In other words, whether African countries follow a pattern of growth that reduces income inequality, or a pattern that manages to contain it at its existing level, has large implication for the rate of economic growth that is required to halve poverty in Africa. It is, therefore, often argued that there should be pro-poor growth. There are two main interpretations in the literature of the concept of pro-poor growth (see survey in Ravallion, 2004). The first one says that growth is pro-poor if the incomes of the poor grow faster than total per capita income, that is, income distribution improves during the process (Kakwani and Pernia, 2000).

The critique against this concept is that even growth that benefits the poor a lot but where the rich benefit even more would not be considered pro-poor. Because of this others have argued that pro-poor growth should be taken to mean that the absolute

<sup>7</sup> ECA (2004a) analysis based on data for a fairly large number of African countries showed that the responsiveness of poverty to economic growth is strongly and positively correlated with initial per capita income and negatively with initial income inequality. This empirical regularity has also been documented by Ravallion (2001), Bourguignon (2002), and Lopez (2004).

<sup>8</sup> This is due to the fact that, by definition, income poverty declines with per capita income and rises with inequality. As a result, poverty reduction can be addressed through economic growth as well as reduction in income inequality. For a discussion of this issue in this context, see Fosu (2002), Bourguignon (2002, 2004), Kakwani and Pernia (2002).

income of the poor increases (Ravallion and Chen, 2003). The rate of pro-poor growth according to Ravallion and Chen is the mean growth rate of those characterized as poor. The latter type of change is what one typically means when talking about poverty reduction.

**Table 5: Growth or Inequality Reduction Required 2005-2015 in Selected African Countries, to Achieve Goal 1**

Country	Year (latest)	Mean per income (1985PPP)	Gini (%)	Reduction in Gini required to reduce poverty by half without growth (%)	Growth rate in per capita GDP required to reduce poverty by half without change in Inequality (%)
Burundi	1992	926.00	33.33	8.31	15.63
Botswana	1986	4023.00	54.21	4.60	20.75
Burkina Faso	1994	971	48.85	13.97	23.26
Cote d'Ivoire	1993	10970	37.11	8.91	14.84
CAR	1993	1306	61.33	22.73	58.82
Ethiopia	1995	583	40.01	46.30	27.62
Ghana	1989	1303	36.74	3.70	9.51
Guinea	1991	2657	46.87	6.69	42.02
Gambia	1992	1312	47.69	10.37	26.88
Kenya	1994	1215	44.68	10.50	24.39
Lesotho	1993	2215	57.94	6.18	31.25
Madagascar	1993	888	43.46	18.12	25.91
Mali	1994	854	50.69	27.93	37.59
Mozambique	1996	1003	39.61	10.42	18.18
Mauritania	1995	1399	39.14	5.77	16.34
Morocco	1984	3242	39.18	2.03	6.99
Namibia	1993	4541	74.3	1.89	21.65
Niger	1995	880	36.2	11.01	15.53
Nigeria	1997	1072	50.56	15.38	29.76
Rwanda	1984	1108	29.12	35.21	18.25
Senegal	1994	1498	41.28	3.83	11.90
South-Africa	1993	7233	61.06	3.28	29.24
Tanzania	1993	553	38.4	65.79	33.78
Uganda	1993	788	39.02	20.00	22.42
Zambia	1996	836	49.86	27.03	37.88
Zimbabwe	1990	2948	5683	7.40	22.42

**Source:** ECA computations

It is clearly the case that the impact of a certain rate of growth of poverty will vary by the degree of initial inequality. For a country with low to average inequality, one may argue that the main thing is to accelerate growth, while for a high inequality country growth by itself will only reduce poverty slowly. When discussing the emphasis of strategy in a certain country one thus needs to take the starting position into account. To devise poverty reduction policy it is important to understand the sources of inequality. These are, for example, access to human and physical assets and to public goods. Changes in income distribution are also crucial. This is related to the geographical and sectoral pattern of growth, and particularly important in Africa is the extent to which growth occurs in the rural sector.

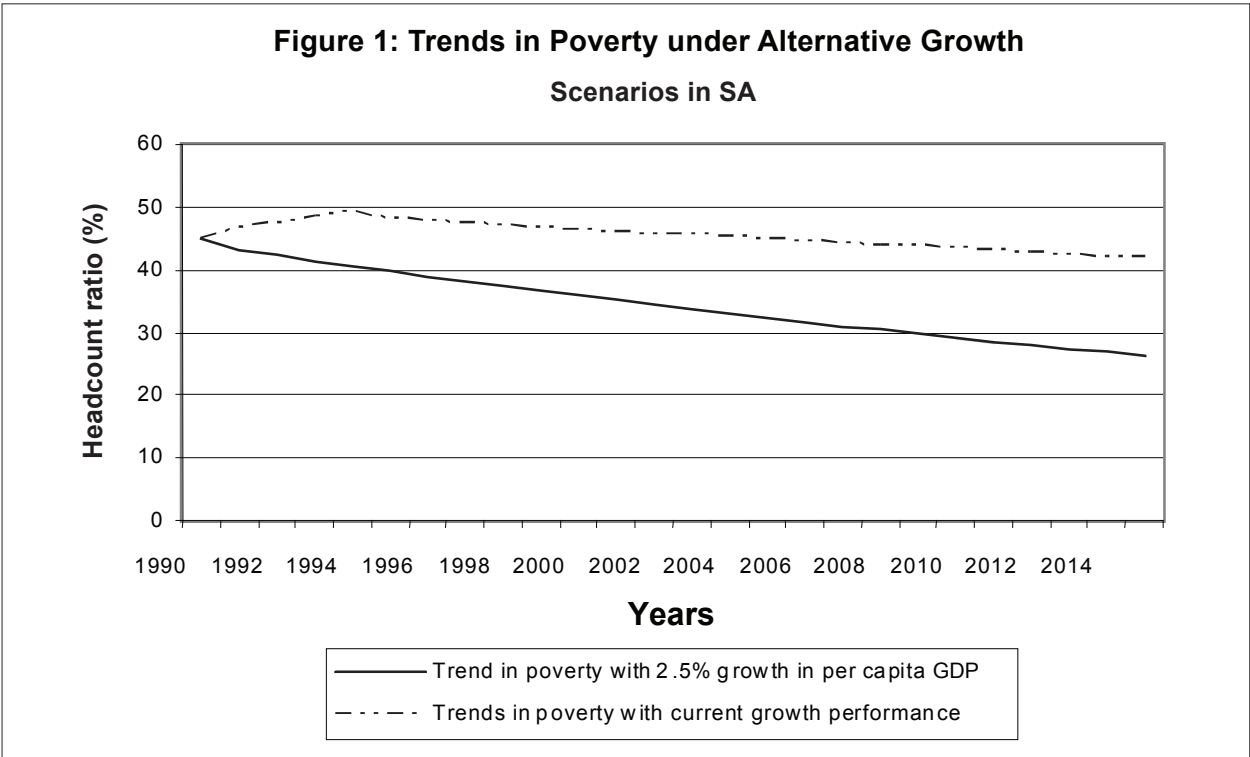
An attempt was also made to compare the actual rate of per capita growth recorded between 1990 and 2001 with the cumulative growth required to achieve goal 1 with neutral pattern of growth (no change in income inequality). The results, as shown in Figure 1,

show that for the sample of countries considered in the simulations, the median rate of actual growth in per capita income between 1990 and 2001 was 0.46%. This is an indication of the stagnation that characterised African economies in the 1990s.

However, for some countries, such as Uganda, Namibia, Botswana, Mozambique, and Ghana, the actual growth in per capita GDP exceeded that of the rate of growth required to halve poverty by 2015, suggesting that these countries even can afford some increase in income inequality if they can sustain the historical growth rate up to 2015. For most others, long-term growth was either negative or so small that they only can attain goal 1 of the MDGs by either accelerated growth and/or a reduction in income inequality.

Figure 1 reports the order of magnitude involved in the reduction of inequality required to achieve Goal 1 if current trends in per capita GDP growth prevail. Such countries as Botswana, Ghana, Mozambique, and Uganda can afford a moderate increase in the measure of income inequality in the coming years, while achieving goal 1 over time. So, unless the state of income distribution deteriorates significantly in these countries, current growth rates, if maintained, is sufficient to achieve goal 1.

Countries such as Ethiopia, Mauritania, Gambia, Lesotho, and Tanzania need, apart from maintaining the current pace of economic growth, a slight reduction in inequality to achieve Goal 1. Significant reductions in income inequality or a strong acceleration of growth is needed for those countries whose growth rate has been close to zero or negative.



Income inequality in Africa showed a substantial decline between the 1960s and 1980s, but it is still high relative to other regions, except for Latin America (table 4). It must be noted, though, that during this period, per capita income did not change much. For seventeen countries for which relevant data is available, we observe large changes in the measure of income inequality in a span of short periods (table 6) suggesting that income distribution patterns are not stable (with reservations for the data quality, though), and that they are subject to significant variations in response to changes in the fundamentals of the economy. In a number of cases, income inequality actually declined following decline in per capita income (Easterly, 2000).

The discussion suggests that the target of reducing poverty by half in 2015, and other targets in the MDGs in principle can be achieved through a combination of rapid and sustained growth and improved income distribution. Examples from the recent experiences of Uganda, Ethiopia and Mozambique demonstrate the importance of containing income distribution in the course of economic growth to significantly reduce poverty. Uganda saw income distribution improve until 1999, speeding up poverty reduction. Inequality did increase again between 1999 and 2002 according to recent estimates (Ssewanyana et al, 2005).

In Mozambique, poverty declined by only 9 percentage points in spite of rapid economic growth throughout the 1990s.<sup>9</sup> Similarly, in Ethiopia poverty reduction would have been larger as the country registered strong recovery in the early and mid-1990s had it not been for a worsening of income inequality.<sup>10</sup>

9 See ECA (2003)

10 See Bigsten et al (2003)

**Table 6: Response of Poverty to Growth and Changes in Income Distribution for Selected African Countries**

Country	Years	Percentage change in Head-count ratio <sup>1</sup>	Percentage change in Mean per capita income	Percentage change in the Gini coefficient	Elasticity of poverty with respect to per capita income <sup>2</sup>
Gambia	1991 V 1992	-12.69	-3.53	-15.10	3.60
Ghana	1992 v 1997	-0.58	0.93	-0.56	-0.62
Ghana	1993 v 1997	-0.74	0.72	-0.49	-1.03
Guinea	1991 V 1994	-21.47	0.93	-4.82	-23.03
Kenya	1992 v 1994	-14.17	-0.25	-11.82	57.58
Mauritania	1993 v 1995	-15.06	-1.12	-11.57	13.39
Niger	1992 v 1995	0.16	-0.86	0.00	-0.19
Nigeria	1991 V 1997	2.35	-0.38	2.01	-6.13
Nigeria	1992 V 1997	4.09	0.88	4.21	4.64
Nigeria	1993 V 1997	3.10	3.37	3.02	0.92
Senegal	1991 v 1994	-9.60	-2.11	-8.63	4.55
Tanzania	1991 v 1993	-14.35	-1.76	-19.38	8.15
Uganda	1992 v 1993	-9.21	3.96	-4.32	-2.33
Zambia	1991 V 1997	3.12	-4.62	2.67	-0.67
Zambia	1993 V 1997	2.03	-2.84	2.54	-0.72

**Source:** ECA's computations

1 The headcount ratio represents the percentage of the population living below one dollar a day.

2 The elasticity values reported in this column refer to the combined effects of both income growth and change in income inequality on poverty.

There are two major concerns for Africa in this regard: how to turn around the economy from stagnation to a path of acceleration of economic growth on a sustained basis, and to ensure that the benefits of such growth translate into highest conceivable reduction of poverty. From Table 7, it is possible to infer that long-term growth in Africa has been anaemic and as a result, poverty remained very high in 2000 (see annex table 1). Overall, average per capita incomes fell through the 1980s and the first half of the 1990s. From the middle of the 1990s, there was some modest growth recovery.

Still, to meet the MDGs, Africa needs to accelerate the pace of economic growth and to make growth efficient in reducing poverty. It is possible to get a better sense of what would happen to poverty in the future if Africa continues to grow slowly and its impact is moderate on poverty by looking at the growth-poverty link in the subregions.

**Table 7: Average Real Per Capita GDP Growth Rate in Africa: 1960-2002**

Region	1961-70	1971-1980	1981-1990	1990-1994	1995-2002
West Africa	1.86	1.05	-1.48	-0.53	0.68
Central Africa	0.13	1.34	0.97	-4.13	1.66
East Africa	0.32	-0.06	-0.23	-3.22	0.52
Southern Africa	2.21	0.94	-0.46	-1.68	1.77
North Africa	2.45	3.08	1.08	0.54	2.33
SSA	2.57	0.76	-1.12	-2.02	0.73

**Source:** ECA computations based on African Development Indicators CD-ROM, 2004.

Based on alternative measures of the elasticity of poverty<sup>11</sup> with respect to income, it is possible to show that the number of years it would take for Eastern and Western Africa to meet the MDGs is more than a century if the growth rate recorded in late 1990s and early 2000 prevailed throughout. For Southern and Central Africa, the situation is slightly better, where 35-40 years

11 See ECA (1999), Hanmer and Naschold (1999, 2000). The figure is based on a constant elasticity of poverty with respect to growth, so that regional income inequality is held constant over these periods.

are required to reduce poverty by half if current growth rate is assumed to prevail over this period.

On the other hand, if SSA were able to grow as it did in the 1960s for the period 1990-2015, the headcount ratio in SSA would decline by 19 percentage points between 1990 and 2015. If current growth rates persist,<sup>12</sup> poverty would still remain pervasive in SSA in 2015.<sup>13</sup> The message of this analysis is that Africa should strive for rapid and sustained growth with a good distributional profile.

In addition, an important dimension with respect to extreme poverty is the effect of growth volatility on poverty. Existing evidence suggests that the transitory component of over all poverty is quite large in many parts of Africa and that it is driven by the variability in income. It follows that managing variability in growth can contribute to the reduction of poverty. The point is that different types of temporary or recurring negative income shocks force a substantial number of people into poverty despite the fact that such people can live above the poverty line on the basis of their long-term income.

A recent study on Ethiopia<sup>14</sup> showed that the contribution of transitory poverty due to variability of income to total poverty is as much as 20%-35%. Addressing income shocks can lead to substantial reductions in poverty. There are a number of underlying factors that contribute to growth variability in Africa. The major ones are price fluctuations, particularly, terms of trade shocks, weather variability and political instability.<sup>15</sup> These facts, along with the slow growth that characterises African economies, beg for an understanding of the deeper factors that made Africa to grow slowly and unpredictably.

A key finding of the discussions in the preceding paragraphs is that the pattern of growth in the African case makes a great deal of difference as far as the issue of achieving Goal 1 of the MDGs is concerned. This implies that if the central objective of policy makers is to reduce poverty, then they need to consider the impact of policies on both growth and income inequality. But the question then is, of course, how they can find the appropriate policy mix? This will be discussed in the next section.

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12 The relevant growth rates are taken from table 7 in the text.

13 This result is based on the assumption that a 10% growth in real per capita GDP reduces poverty by 9.3%, or the elasticity of poverty with respect to growth (corrected for possible changes in income inequality) is around 0.93 (see ECA, 2004, 1999 for details).

14 Shimeles (2004)

15 Geda and Weeks (2003)

## 7. Policies for Poverty Reduction

In recent years, there has been extensive empirical research on Africa's growth problems, mainly based on information on macroeconomic aggregates.<sup>16</sup> A wide range of factors has been considered as being responsible for the general economic stagnation and decline observed in the continent. These include macroeconomic instability (caused by several external and domestic shocks) and the set of initial conditions, such as geography (Sachs and Warner, 1997), ethnic fractionalization and conflict (Collier and Hoeffler, 1998), political instability (Fosu, 2002), bad policies (Sachs and Warner, 1997; Collier and Dollar, 1999; Easterly, 2000), poor governance (Barro, 1997), weak institutions (Acemoglu et al 2002; Rodrik et al, 2002), and low level of human capital.

During the last few years, most African countries have pursued a development policy within the framework of some form of PRS for achieving the MDGs. They are now in the process of assessing the outcomes so far and drawing up plans for the new PRSs. We will here briefly discuss policy issues that we feel are important for African countries to consider when they are rethinking their development strategies. We have already noted that there is a great variation in the character of constraints and in the initial policy environment for African economies, and this means that one must let the policy mix vary accordingly. Here we will only have room for a general discussion.

In addressing appropriate policies to reduce poverty, the policy implications of some structural features of African economies must first be discussed, and then crucial policy areas have to be reviewed. The conclusion is a discussion about the importance of a broad-based development strategy, touching briefly on issues that obviously need to be part of the future strategy.

### 7.1 GEOGRAPHIC STRUCTURE

A feature of many countries in Africa is the existence of geographic poverty traps essentially caused by adverse agro-climatic conditions, weak institutional and infrastructural developments, including road, rail and air transport, and fragmented domestic markets. Evidence available on spatial poverty in Africa shows that interregional or intra-country poverty differences are much more pronounced than inter-country poverty differences.<sup>17</sup> Obviously, income inequality arising out of regional differences, could contribute an important part of overall inequality.

In addition, spatial differences are much more severe with respect to other forms of deprivation such as health and education, which makes geographic poverty- traps important dimensions to deal with in a policy to achieve the MDGs<sup>18</sup>. Location and climate have large effects on income levels and income growth through their effects on transport costs, disease burdens and agricultural productivity among other channels.<sup>19</sup> Furthermore, high fertility rates and low mobility further create stress on scarce resources such as land and forest.

The combined effects of agro-climatic conditions and remoteness create extreme vulnerability to shocks in weather conditions, prices, and policy. Recent evidence (Shimeles, 2004) based on a micro data set from Ethiopia shows the extent to which vulnerability matters for poverty traps. Households that reside in remote areas and persist in adverse agro-climatic conditions suffer from frequent shocks with long-lasting effects on poverty and wellbeing. The elements of shocks and its effect on long-term welfare should be as much a policy concern as the issue of raising average incomes. Among the most important factors that can reduce vulnerability to shocks are reductions in family size (low fertility rates), access to basic infrastructure, and access to productive assets, including human capital such as better education.<sup>20</sup>

Thus, education and health interventions are not only desirable in their own right to meet the MDGs, but they are also crucial for reducing vulnerability and poverty traps in the long term. A decomposition of income inequality as measured by the Gini coefficient for rural Ethiopia covering the period 1994-2000 shows that location explains about 31% of the variation in income distribution.<sup>21</sup> This implies that connecting geographic locations by efficient means of transport, communications, and other supports can meaningfully deal with income growth as well as income distribution.

The large difference in poverty across geographic areas in Africa is a reflection of the complex factors underpinning economic underdevelopment that requires huge investment in infrastructure as well as targeted interventions to make maximum impact on poverty.<sup>22</sup> Investment in infrastructure can help integrate the economy by linking up fragmented domestic markets for goods

16 One of the important contributions in this area comes from case studies conducted by AERC.

17 ECA (2004)

18 E.G Sahn and Stifel (2003) reported that asset-based inequality as well as capabilities-based inequality is much higher in rural Africa than in urban areas, suggesting how remoteness causes huge inequality in access to basic services.

19 Sachs and Mellinger (1998)

20 Shimeles (2004)

21 Similar results are also reported for other areas. For this and the methodology of decomposing inequality see Morduch and Sicular (2002)

22 See for example Fofack (2000) and Sachs et al (2004) for details of such interventions.

and services as well as factors of production, such as labour. In addition, the investment on infrastructure development leads to capital deepening, which is essential for raising productivity.

## 7.2 SOME INFORMAL SECTOR ISSUES<sup>23</sup>

In devising policy and analysing outcomes it is important to take the sectoral structure of the economy into account. African economies can broadly be broken down into four sectors, urban formal, urban informal, rural formal (largely large-scale agriculture), and rural informal (mainly smallholder agriculture but also some handicraft and small-scale trading and the like).

The formal sector employs about 10% of the labour force; the informal sector including smallholder agriculture employs about 80%, leaving 10% of the labour force unemployed (ILO, 2004). The policy emphasis must be different for these different sub-categories.

The most difficult aspect of policy making in Africa concerns the treatment of the informal sector, so before embarking on the general policy discussion we will consider some special issues relating to this sector and its role. The informal sector absorbs a lot of labour, so it helps with the unemployment problem. Still, incomes are often low and the main emphasis of policies aimed at the informal sector should thus be to increase its productivity. This will immediately help reduce poverty and contribute to economic growth.

Moreover, for African countries to take off into self-sustaining growth, they need to achieve higher investment rates and increased exports. This can only be realized by the formal sector. Investments in informal firms are generally modest, and the sector hardly exports at all. Also for the economy to grow faster, publicly provided goods and services such as infrastructure, education, and law and order must be delivered. Apart from relying on foreign aid, this can only be done if the government is able to increase tax revenues. And these can only be collected from the formal sector. Therefore, it is argued that long-term policy must aim to speed up the absorption of informal firms or informal sector labour into the formal sector.

What does this imply for policy making? First, on the macro-level there is a need to bring about a shift to a policy that is credible to domestic as well as foreign investors. Formal firms have been confronted with all kinds of problems in dealing with the governments such as regulatory red tape, corruption, and lack of security. Thus, part of a policy to bring about a shift of firms to the formal sector is to clean up the way the government deals with formal sector firms to reduce the incentives for firms to take shelter in the informal sector.

To bring about informal sector growth and absorption into the formal sector the government needs to design its general policies so that they are relevant also for informal firms, and design specific programmes targeting informal firms. The skill level and policy environment of informal firms need to be improved to make it possible for them to graduate to the formal sector. Informal sector projects by donors and governments in Africa have so far focused on the important issue of immediate poverty reduction, but this strategy needs to be complemented by support to the informal firms, so they can graduate into the formal sector.

Capacity-building efforts have largely neglected the needs of informal firms, but we think curriculum as well as targeting should be thoroughly evaluated. Infrastructure such as roads, electricity, and water supply is often poor, and in its efforts to improve infrastructure the government should also take the needs of the small informal firms into account.

Informal firms have difficulties in accessing to the formal credit market. This is due to their uncertain legal status, lack of proper accounts, and lack of credit rating procedures relevant to informal firms. The small size of the loans required by these small firms also means that alternative procedures for the provision of credit to such firms are desirable.

The government should also try to link up informal firms with the formal economy through, government contracts, which could be used as an incentive for informal firms to formalize operations. Measures to stimulate demand for informal sector goods and services from the private sector could also be considered. One could try to stimulate the formation of supporting networks among informal African entrepreneurs themselves, as well as between them and formal sector organisations and informal networks. Since the ultimate aim of the policy is to absorb the informal firms into the formal sector, there is need to work on several fronts that have potential for bridging the gap between the sectors. This kind of policy emphasis would have a pro-poor character and could contribute significantly to poverty reduction.

## 7.3 ECONOMIC AND POLITICAL GOVERNANCE

The role of good economic and political governance has attracted immense interest in the recent literature as one of the key determinants of long-term economic growth and, to a certain extent, also of the pattern of income distribution.<sup>24</sup> In general, the growth loss associated with bad policies, instability and poor governance are considered to be huge.<sup>25</sup> In the case of Africa, the subject of governance has taken several meanings in the minds of many so that it covers a vast terrain difficult to track

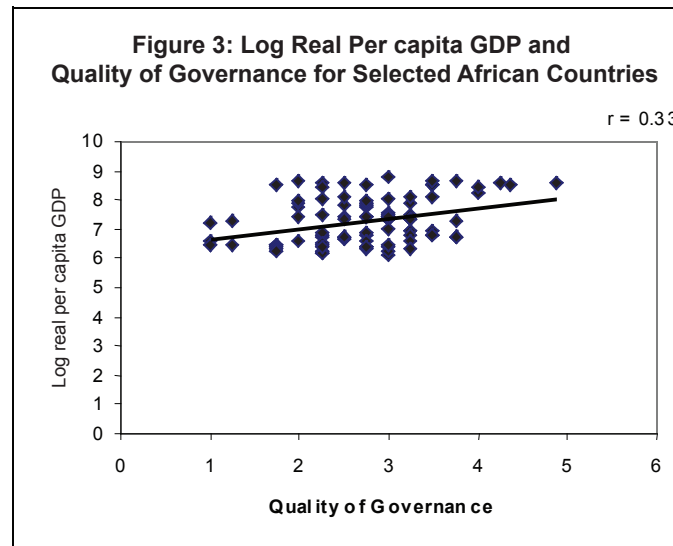
23 This section is based on Bigsten, Kimuyu, and Lundvall (2004).

24 See. Barro (1996, 1997), Alesina, et al (1996), Easterly (1993), Hall and Jones (1999)

25 Olson et al (2000)

for policy purposes, but researchers do not agree fully on the nature and degree of association between economic growth and governance in Africa.<sup>26</sup>

One possible reason is that the data used to measure the quality of governance come from different sources and cover a wide range of issues so that aggregation hides notable differences in some aspects of governance. Still, some components of governance can be more important and relevant than others for economic growth in the context of Africa. Variations in results also are due to differences in the setting up the channels through which good governance affects economic growth. A better understanding of the details of the institutional structures is important because it allows a clearer interpretation of the empirical results and the mechanisms through which governance affect economic growth.



The quality of economic and political governance determines the extent to which a country is able to exploit fully its growth potentials by affecting the incentive structure and allowing an amicable resolution of conflicts of interest among members of society. The difficulty remains, however, that institutions in general and governance in particular are hard to measure.<sup>27</sup> By taking into account the existence of high correlations among the governance indicators and after some data filtering exercises, the indicators used here are democratic accountability, control of corruption, law and order, and policies towards private investment.

Figure 3 provides the correlation between the average of these governance indicators and the log of real per capita GDP for selected African countries for the period 1984-2000. It is observed that levels of per capita income and indicators of political as well as economic governance are strongly correlated. This fact, however, does not warrant causality.<sup>28</sup>

Figure 4 is based on the analysis of a panel of 31 African countries that attempted to explain cross-country differences in productivity growth through the quality of governance following the recent contributions of Olson et al (2000).<sup>29</sup> The results as shown in figure 4, indicate that the quality of governance is positively correlated with the overall changes in productivity of each country.<sup>30</sup> The suggestion is that countries with better indicators of governance have higher productivity growth in the period under study.

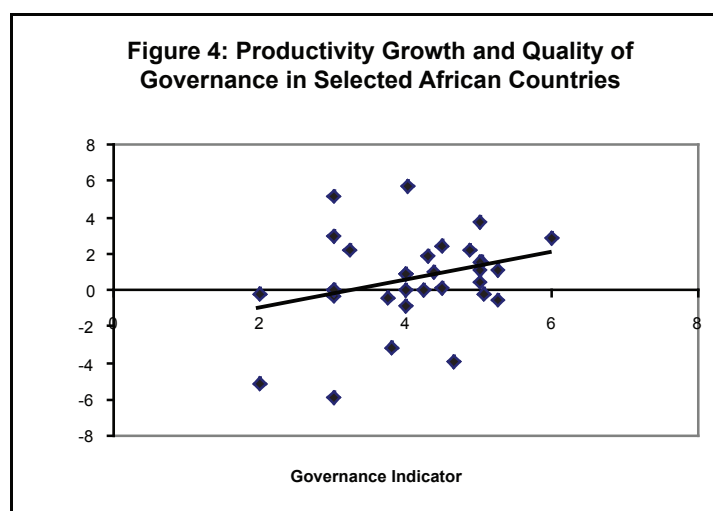
26 See Sachs et al (2004) for the arguments on the limited scope that governance has to promote growth in Africa.

27 One of the popular sources of data on economic and political governance used in the empirical literature as well as in this report comes from the International Country Risk Guide generated by a private firm mainly to assess investment climate and risk in a given country. The data go as far back as 1984 for most countries in the world and covers economic, political, social and other aspects of governance divided into twelve components such as the quality of the bureaucracy, democratic accountability, peace and security, law and order, government stability and investment climate

28 There are at least three possibilities that may arise out of this correlation. First is that economic governance causes higher long-term growth, given other factors. Second, it is also possible that sustained growth leads to improvements in economic and political governance. Or third, the correlation above is spurious in the sense that there is a third variable that drives both per capita income and governance indicators in the same direction, so that the two may not be correlated at all.

29 The idea is that there are a few African countries that are performing well in terms of growth, and a large number are either regressing or stagnating in the last four decades. Using a growth model in the tradition of growth accounting, we first estimated the contributions of capital and labour growth to growth in real GDP with a dummy for each country in the study. The dummies for each country are calibrated in such a way that they measure the contribution of improvements in overall productivity growth to economic growth. Then, these estimates of productivity growth are correlated with the average of the quality of governance that prevailed in each country for the period covered in the study.

30 The result on the link between governance and total factor productivity is based on a generic neo-classical growth model where growth in real per capita GDP is a function of rate of growth in labour force, capital and overall increase in factor productivity. Using panel data for the period 1984-2000 for 31 African countries, an index of total factor productivity for each country was estimated. This was correlated with the average governance index for the same period.



Today, a large number of countries in Africa, particularly those in the SSA, are in the midst of economic and political transition. These reforms need to deepen to secure a stable political system, rule of law, and peace to improve economic performance directly through their impact on economic growth and indirectly through reducing investment risk, and macroeconomic distortions.

## 7.4 MACROECONOMIC ENVIRONMENT

Sound fiscal and monetary policies are prerequisites for successful development, and the stabilisation efforts in most countries in Africa have become increasingly successful. Budgets are under reasonable control and the central banks have generally sustained a fairly responsible monetary policy keeping inflation under control. The basis for the forthcoming PRSs must continue to be a macroeconomic policy that is credible to domestic and international investors. Uncertainty is a major factor in explaining low investments in Africa, so efforts to maintain stability are very important for investment.

One should also observe that countries in Africa are unusually vulnerable to economic shocks (Gunning, 2004), and one type of intervention that donors should consider is some form of insurance mechanism against for example terms of trade shocks. It has been shown that aid is particularly effective when protecting recipient countries from the effects of shocks.

## 7.5 EXPORT ORIENTATION

Most African countries have small and fragmented economies. For example, the average size of an African economy is about \$US8 billion, as compared to \$US50 billion in other developing regions. A few of the larger economies, such as Nigeria and South Africa, account for more than half of the region's GNP. Efforts have been underway to integrate economies such as the Economic Community of West African States (ECOWAS) in West Africa and the Southern African Development Community (SADC), but most subregional integration efforts have not shown much progress towards economic integration. Many African countries suffer from landlockedness, which increases transport cost as well as the delivery time for goods.

One important indicator of how far a country has moved towards economic take-off is whether it is internationally competitive in areas outside traditional commodity exports. There have been some breakthroughs in Africa, for example, in horticulture, but there has been limited progress in manufacturing. Still, results on African manufacturing exports reported in Bigsten et al (2004) suggest that there are important productivity effects from exporting.

There has been some shift towards a policy for international economic integration, although Africa is still the continent with the highest tariffs. Whether a producer will enter the export market depends on the level of the entry barriers, and their cost efficiency. It is generally costly for a firm to enter into the exports market, but once they enter they tend to remain in the exports market. By reducing the entry costs one could increase the number of firms that find it profitable to enter the export market. The second factor that determines whether a firm will export is its cost efficiency. To improve this, policies need to work over the whole spectrum of factors that affect productivity and costs.

If firms are to be able to export they have to be competitive.<sup>31</sup> The quality of the investment climate is a central factor. Reforms to improve market institutions such as laws, courts, business associations, lobbies, quality control, and protection of property rights and enforcement of contracts have begun, but the process has been slow. Financial institutions that provide insurance, hire-purchase/leasing of equipment and vehicles, merchant banking services, letters of credit, bonds, hedging instruments, etc. are weak. Commercial and business services, e.g. in the provision of warehousing, transport, utilities, auditing, marketing, market prospecting, export promotion, product design and maintenance need to be developed.

<sup>31</sup> This discussion follows Bigsten and Söderbom (2005).

The list is long, but all reforms need not be done at the same time. Production costs need to be reduced for firms to become competitive, but this can be achieved with the help of some reforms and innovations. First one needs to identify what improvements can be introduced at lowest local cost. Initial interventions can for example be focused on some specific sector and/or a specific location to save money. This makes it more likely that productivity will be increased enough to make firms competitive.

## 7.6 BUSINESS ENVIRONMENT

One of the problems faced by the private sector is high transaction costs. In addition, there is a serious problem with the institutional setup and rules governing business in Africa. Development of formal private sector requires a level playing field with rules that are enforced fairly. Various estimates, such as the World Bank's "Cost of doing Business", show that African countries rank very low in various indicators of a business environment conducive for formal private sector activity. For example, the World Bank's "Cost of Doing Business" survey estimates that starting a business requires \$US5, 531 in Angola (more than eight times the per capita income) and about \$US28 in New Zealand (far less than 1% of the per capita income). Cumbersome entry regulations are directly correlated with lower productivity.

Functioning financial markets are important for the business climate, but African financial markets are the least developed in the world due to imperfect information, poor contract enforcement, and lack of competition among lenders (Bigsten and Söderbom, 2005). There has been some progress in efforts to create a more diversified and reliable financial system, but the sector is still fragile and prone to abuse. Moreover, even if the financial market problems are sorted out, there may still be too few projects that are sufficiently lucrative to be able to cover the credit costs including the risk premium. If the latter can be reduced by the creation of a more stable environment investment could increase.

If the aim is to pursue a growth strategy that includes the poorer segments of society, it is particularly problematic that banks in Africa are generally not ready to lend to SMEs because small-scale loans bear high transaction cost and risk, while the return for the bank is relatively low. Also supervisory and capital adequacy requirements often discourage serving small borrowers who lack traditional forms of collateral. To handle this market failure on the credit market, specialized microfinance institutions have emerged as institutions capable of developing innovative products and mechanisms for broadening access to credit by SMEs and the poor.

In many developing countries, microfinance institutions (MFIs) have achieved wider outreach and profitability by developing mechanisms and procedures to lower transaction cost and risk and increase loan collection rates. They receive various types of government support that helps them grow. However, small informal lenders who dominate the microfinance (MF) sector in Africa cannot fully meet demand for loans or provide necessary non-financial services for SMEs to develop. MFIs need support to be licensed and to upgrade their services to modern banking levels.

Many African countries are now in the process of trying to create an enabling business environment for enhancing private investment. Some have opened up investment promotion offices, but these have not been effectively followed up with the easing of the required administrative and bureaucratic procedures. In line with the constraints that the private sector in Africa faces, priority areas need to be identified for the development of the sector. Such exercises have been started. In the main development-planning document of the continent, the PRSPs, priority areas for the development of the sector are outlined. A summary of these priorities indicates that improving macroeconomic stability, supporting SMEs and improving infrastructure are the top three priorities for the development of the sector (see table 8).

**Table 8: Priority Areas for Improving the Investment Climate: Percentage of PRSPs Identifying These Priority Areas**

Improving macroeconomic stability	94
Supporting SMEs	78
Infrastructure	81
Governance and corruption	78
Improving the regulatory environment	72
Promoting FDI	66
Trade policy	63
Finance	72
Improving legal systems	72

*Source: IMF (2003)*

## 7.7 HUMAN RESOURCES

Human capital development is crucial if growth is to be sustained. Investment in human capital may be an example of a win-win situation, to the extent that it is good both for growth and equity. The first round of PRSs focused a lot of attention to these kinds of social sector activities, and the new set need to sustain and deepen those efforts. Although the required policies are largely in place, progress is impeded by human and financial constraints.

In the area of education there has been considerable progress in several countries, while technical skills are scarce. Apart from a lack of engineering competence, African countries lack entrepreneurial capacity to run big modern firms, integrate into the modern world of technology and financial sources and the experience to do business on a large scale. Many businessmen still hide assets and revenue from tax officers, feel uncertain due to political instability, and do not know how to deal with currency depreciation and external shocks or sudden and radical policy reversals.

At present, health care services do not reach more than a small portion of the population, and also this is an area where there is need to continue the efforts that are in the first-generation PRSs, as well as interventions suggested in the new global initiatives described earlier.

## 7.8 PHYSICAL INFRASTRUCTURE

Collier and Gunning's (1999) review of studies of growth determinants in Africa indicates that the lack of infrastructure impacts greatly on poor growth performance. Compared to other regions, public expenditure as a share of GDP has been higher in Africa, while service provision has been worse. Poor infrastructure constrains firms producing for the whole of the domestic market, but it is also a severe constraint for exporters. The problem is aggravated by delays in customs, unreliable telephone connections, frequent power outages, etc. For African firms to be able to take advantage of international trading opportunities and to engage actively in the emerging system of outsourcing, there must be a reliable and cheap infrastructure.

Poor infrastructure and high utility costs hold back competitive production and drive up costs, thus undermining the potential for the output expansion. Excessive regulations result in entrepreneurs forming very small and informal firms rather than formal organizations that have export potential and contribute to tax revenues.

## 7.9 THE PRS PROCESS AND DEVELOPMENT FINANCING

The IFIs have evaluated the implementation of the PRGFs in several countries (IMF-IEO, 2004, World Bank, 2004b). Four main results have emerged:

- The emphasis in the future should be more on establishing a good process rather than to produce good documents. That is, implementation is the key at this stage;<sup>32</sup>
- It is also noted that feedback is still very weak, which is unfortunate, since this input is needed for the improvement of forward budgeting;
- It is also clear that the underlying analysis is weak in many instances and needs to be strengthened; and
- The partnership is weak in some areas, particularly in relation to prioritization and costing of interventions.

The PRS process is sensible, that is, budgeting is done to achieve desired ends. The demands on the system are high and, to make the process more realistic, much more training is needed further down in the hierarchy of planners. Moreover, there is also a serious concern about incentives. Even if people know what to do, they may choose not to do so because the incentives are weak. Administrative reforms are underway in many places, but these will require a very drawn-out process.

The main thing is to get the process right. It has worked well for the production of reports, but it has been weak when it comes to implementation. The financial monitoring, which is required by donors if they are to give budget support, has been significantly improved in many countries. The central planners also need physical tracking, as an input into policy making and budgeting activities. While the first PRSPs were largely expenditure focused, it would be desirable for the new ones to shift more towards serious analysis of supply issues.

## 7.10 BROAD PARTICIPATION AND REDISTRIBUTION POLICY

There has been, in recent years, an extensive debate on the consequences of redistribution for growth. It is suggested that redistribution of wealth is less distortionary than that of income. However, such redistributions, for example land reform, are hard to do except in exceptional circumstances, often involving political violence. Income transfers are easier to undertake, but they are

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<sup>32</sup> A key recommendation from the IMF-IEO (2004) evaluation is to "shift the emphasis of the initiative from the production of documents to the development of sound domestic policy formulation and implementation processes."

more problematic from a growth point of view. By reducing returns to both human capital and physical capital income, taxation reduces savings and investment incentives.

Still, income transfers may be desirable in some instances, if the beneficiaries choose to invest more in human and physical capital when they are better off. Transfers may also have an insurance element that protect the poor from negative shocks and make it possible for them to avoid dissaving when they are hit by a shock. Such dissaving may, for example, be taking children out of school

Traditionally economists have been concerned about the risk that an egalitarian situation will be detrimental to growth. It was assumed that the rich were the savers, and that shifting incomes towards the poor would reduce the national savings rate. This may well be a concern, but there are also factors that work in the opposite direction. The most widely cited example relate to the credit market. If there are credit market failures, the poor particularly will lack access to credit, which will mean that large segments of the population may fail to realize their economic potential. It has also been argued that inequality increases the risk for macroeconomic instability and makes it less likely that the government can undertake reforms that require cooperation and social trust. The econometric evidence on all these issues is somewhat mixed, but there is no longer a clear view that equality hampers growth. On the whole, the extent to which it does depends on how it is achieved.

Most types of distributional policies are politically controversial and to be able to do them there normally needs to be support from powerful and wealthy groups. One could argue that it is in the interest of the elite to see a middle class emerge, so that one might expect them to support a policy for broad-based education. This would be good for growth, which would be in their interest, but it could, at the same time, undermine their power positions.

On the other hand, the emergence of a middle class could reduce social tensions and reduce the risk of expropriation. In conflict-ridden countries, it seems clear that broad-based education or other measures that help broad segments of the population, tend to give them a stake in society, that is, makes them middle-class. These are important measures to reduce the risk of genocide. There is thus an extra dimension to distribution policies in countries that have experienced civil wars.

Azam (2005) argues that:

- a) The political geography of poverty is important for growth, not just the overall size distribution of income;
- b) Redistribution to regions with low income and low opportunity cost of violence may improve growth by avoiding conflict;
- c) Regionally based redistribution of assets at the margin (i.e., of new investment, public and private) is a particularly effective strategy where there is a 'shadow of conflict', because it buys the peace in the short run while also undermining the roots of conflict over time; and
- d) Broad-based or shared growth may help defuse policy stalemates and build support for an export-led strategy, and contribute to lowering the current and future cost of human capital for potential domestic and foreign investors in the manufacturing sector.

It is often a concern that policy makers are more interested in redistribution issues than growth issues. Some types of redistribution measures may be essential for the ruling group to stay in power. However, sometimes there may also be a situation where even redistribution measures negative for growth may be necessary to stabilize an unstable situation or to buy peace. The outcome of seemingly inoptimal transfers may be better than that of a counterfactual with civil war. The situation in Rwanda for example seems to be a case where the need for stability and peace will have to be high on the agenda for policy makers. Still, one may also note that sustained growth should lead to upward social mobility, leading to reduced social tensions and, thus, less pressure for populist measures.

Existing PRSPs have attempted to identify and cost anti-poverty programmes to achieve some intermediate development targets, most of which are coincidentally consistent with the MDGs and with financing strategies that reckon largely on borrowing and foreign assistance. This exercise is restrictive in a number of ways. In the first instance, the exercise of costing of anti-poverty programmes in the PRSPs has not been matched with a consistent macroeconomic framework that could provide realistic assessment of alternative financing strategies, including domestic resources. This forced a large proportion of the resources required to finance anti-poverty programs to be considered as residuals to be met from external sources. Second, confronting the costs of meeting predetermined targets with some kind of consistent macroeconomic framework allows for a realistic assessment of the growth constraints, opportunities and priorities that a country has to reach the targets, thus providing a basis for a coherent growth strategy. This is particularly important in the context of MDGs, since the overall resource requirement to meet the targets in SSA is much larger than the current budgets of governments in these countries. As a result, it is important that governments place these targets within the context of a consistent macroeconomic framework and formulate long-term strategies on that basis to reach said targets.

## 8. The Way Forward

The review in the preceding sections of the nature of Africa's challenge to meet the MDGs is illustrative of the diversity across countries and specificity of the causes leading to the scourge of overall economic stagnation and human underdevelopment that besieged a large part of the continent. However, some of the lessons that can be drawn from the experiences of African countries as we look towards the next generation of PRSs may be summarized as follows:

- The prerequisite for successful development is the reign of peace, stability and continuity of political and economic systems. The experience of African countries has shown that state failure, political instability and conflict have been a major set back in realizing Africa's growth potential in recent decades<sup>33</sup>;
- Functioning institutions, including markets, are key to the implementation of growth strategies; and
- Genuine ownership of growth strategies improves the chances of their being comprehensive, sensitive to local circumstances and implemented.

Against this background, the task awaiting the policy makers in Africa as well as its development partners is to rise to the challenge by establishing a new alliance and partnership around the MDGs. The policy choices to spur and sustain growth have to be adapted to local circumstances, constraints and opportunities. Although it is impossible to make generalizations, a few suggestions can be made based on the cross-country comparisons with regard to the growth, distribution and poverty nexus.

The first lesson is that economic growth needs to be the central theme of the next generation of PRSs. Second, to the extent it matters for the reduction of poverty, the role of income distribution has to be addressed in context. For instance, some countries can accelerate the pace of poverty reduction better if they address both income distribution and growth issues, or in other words, if they follow pro-poor growth strategies. For others, even a slight increase in income inequality is tolerable provided that they can sustain a high growth.

To achieve a sustainable process of growth, African countries need to create an environment that stimulates investment by private economic agents in both human and physical capital. A system that empowers poor people can generate growth, which also increases the incomes of the poor. The next generation of PRS in each country need to spell out clearly the sources of growth and identify possible engines of growth that could lead the way to long-term prosperity based on these sources of growth. It is also important to identify the sources of income and wellbeing inequality, mainly to ensure social cohesion, consensus on key development priorities and improved social justice. Finally, efforts to meet the MDGs, besides building the stock of human capital, offer room to reduce inequality in opportunities and capabilities significantly.

In this sense, the growth-focused strategy will be reinforced by actions directed towards meeting the MDGs. Apart from the political economy factors, African economies are severely constrained by inadequate development finance. The paper has pointed to the existence of geographic poverty traps in many parts of Africa mainly due to the poor state of basic infrastructure, slow technological diffusion and the stagnant pace of structural transformation of African economies. In this regard, many countries in Africa need critical support from their development partners, to revitalize such core sectors as basic infrastructure and skilled human resources.

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33 See also Bates (2005) and Fosu (2005b) for a summary and synthesis of the havoc that political insecurity and State failure have brought on Africa's development and the difficult lessons learnt in rebuilding the economies.

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**Annex Table 1: Change in poverty based on \$ 1 a day and national poverty lines during the 1990s**

Country	P0 (Survey year)	P0 (survey year)	Annual percentage Change
Botswana	33.4(1986)	23.5 (1993)	-4.23
Burkina Faso	61 (1994)	44.9(1998)	-6.6
Cameroon	33.4(1996)	17.1(2001)	-9.76
Ethiopia	31.3(1995)	26.3(2000)	-3.19
Kenya	26.5(1992)	23(1997)	-2.64
Lesotho	43.11(1993)	36(1995)	-8.25
Madagascar	49(1993)	49(1999)	0
Mauritania	28.6(1995)	25.9(2000)	-1.89
South Africa	11.5(1993)	7.1 (1995)	-19.13
Zambia	63.7 (1993)	63.7(1998)	0
Cote d'Ivoire	12.3(1995)	15.5(1998)	6.88
Malawi*	54(1991)	65(1998)	2.4
Egypt*	22.9(1996)	16.7(2000)	-9.28
Zimbabwe*	25.8(1991)	34.9(1996)	5.2
Tunisia*	7.4(1990)	7.6(1995)	0.52
Tanzania*	41.6(1993)	35.7(2001)	-2.06
Uganda*	44 (1997)	35(2000)	-6.82

\* National poverty line is used instead of 1US\$ a day.

**Source:** World Development Indicators CD-Rom, 2003 & World Development Report 2000/01

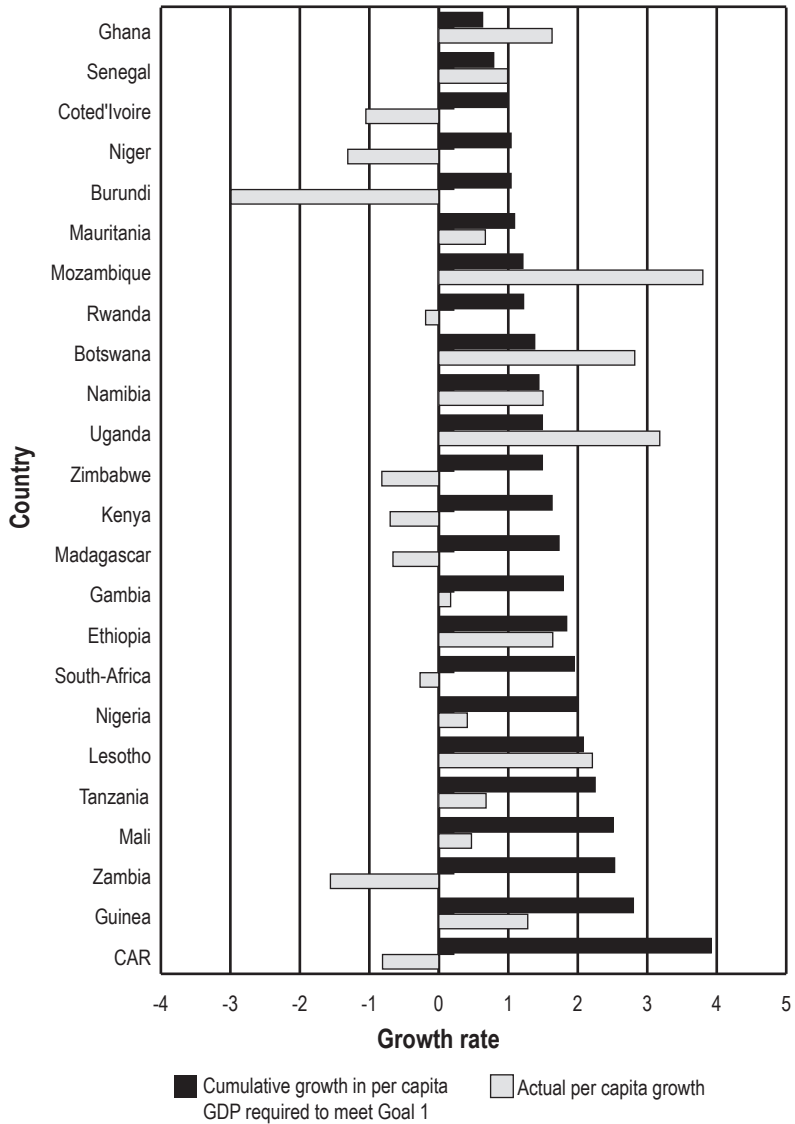
**Annex Table 2 Timely Enrolment in School in Africa (2000/2001)**

	Share over-aged	Gross intake rate	Net intake rate
<b>North Africa</b>			
Morocco	38	106	66
Tunisia	15	105	89
Egypt	12	98	86
Algeria	7	87	81
<b>Sub-Saharan Africa</b>			
Mozambique	81	110	21
Botswana	80	115	23
Mauritius	74	97	25
Ethiopia	73	95	26
Lesotho	70	183	54
Mauritania	70	92	28
South Africa	68	116	37
Ghana	66	86	29
Chad	66	82	28
Zimbabwe	63	106	39
Côte d'Ivoire	60	68	27
Eritrea	59	64	26
Burundi	59	76	31
Togo	58	111	47
Zambia	56	86	38
Burkina Faso	55	47	21
Rwanda	48	125	65
Namibia	44	103	58
Djibouti	36	42	27
Niger	33	46	31

Annex Table 3: Profile of Poverty in Africa

Country	Year of survey	Poverty incidence (head count) (Percentage of total)			Estimated Population of poor (2003) (Millions of people)			Population (millions)
		Rural	Urban	National	Rural	Urban	National	National
<b>West Africa</b>								
Senegal	2001	80	51.5	53.9	4.19	2.5	5.44	10.09
Mali	1998	75.9	30.1	63.8	7.03	1.13	8.29	13
Gambia, The	1999	73	28	69	.73	.12	.99	1.43
Niger	1993	66	52	63	6.52	1.08	7.54	11.97
Guinea	1996	52	24	40	3.27	.52	3.39	8.48
Burkina Faso	1998	51	16.5	45.3	5.57	.34	5.89	13
Cote d'Ivoire	1998	42	23	33.6	3.99	1.64	5.59	16.63
Nigeria	1993	36.4	30.4	34.1	28.11	14.22	42.29	124.01
Ghana	1999	36	17.3	27	4.83	1.3	5.65	20.92
Benin	2002	33	23.2	29	1.27	.67	1.95	6.74
Estimate		44.4	29.5	38.1	65.5	23.5	87	226.27
<b>Central Africa</b>								
Cameroon	2001	49.9	22.1	40.2	4.02	1.76	6.44	16.02
Chad	1996	67.0	63.0	64.0	4.47	1.22	5.5	8.6
Estimate		56.9	29.1	47.6	8.5	3.0	11.9	24.62
<b>North Africa</b>								
Mauritania	2000	61.2	25.4	46.3	.75	.42	1.34	2.89
Algeria	1995	30.3	14.7	22.6	4.41	2.53	7.19	31.8
Morocco	1999	27.2	12.0	19.0	3.76	2.01	5.81	30.57
Egypt	2000	21.2	10.7	16.7	8.74	3.28	12.01	71.93
Tunisia	1995	13.9	3.6	7.6	.52	.21	.75	9.83
Estimate		24.4	11.7	18.4	18.2	8.5	27.1	147.02
<b>East Africa</b>								
Djibouti	1996	86.5	..	45.1	.09	..	.32	.70
Madagascar	2001	74.9	50.	69.6	9.54	2.62	12.11	17.4
Burundi	2000	68.7	68.2	68.7	4.27	.42	4.69	6.83
Rwanda	2000	67.9	22.6	64.1	5.9	.13	5.38	8.39
Kenya	1997	53	49.0	52.0	11.82	4.76	16.63	31.99
Tanzania	1991	49.7	24.4	51.1	14.21	2.04	18.9	36.98
Ethiopia	2000	45	37	44.2	26.87	4.06	31.24	70.68
Estimate		52.8	40.3	51.7	72.7	14	89.3	172.97
<b>Southern Africa</b>								
Zambia	1998	83.1	56	72.9	5.43	2.39	7.88	10.81
Mozambique	1997	71.3	62	69.4	9.62	3.33	13.09	18.86
Swaziland	1995	70.6	45.4	65.5	.57	.13	.71	1.08
Malawi	1991	66.5	54.9	54	7.1	.79	6.54	12.11
Lesotho	1993	53.9	27.8	49.2	.75	.11	.89	1.8
Zimbabwe	1996	48	7.9	34.9	4.18	.33	4.5	12.89
Estimate		66.3	43.9	58.4	27.7	7.1	33.6	57.55

**Annex Figure 1: Annual Growth in Per Capita GDP and Neutral Growth Required to Achieve Goal 1.**



Annex Figure 2: Reduction in inequality required to achieve Goal 1 if current trend in growth rate prevails

