Government of Rwanda
Ministry of Finance and Economic Planning

Economic Commission for Africa | Commission économique pour l'Afrique
1958 - 2018

22nd Meeting of the Intergovernmental Committee of Experts
Sub-regional Office for Eastern Africa (SRO-EA)

Implementing the African Continental Free Trade Area in Eastern Africa: From Vision to Action

Concept Note for the Ad Hoc Expert Group Meeting:
Balance of Payments Constraints on Economic Growth in Eastern Africa and its relevance to the AfCFTA

21 – 22 November 2018

Kigali Convention Centre

Rwanda

I. Background

Since the late-1980s, there has been an outpouring of literature and research into the macro-determinants of economic growth, attempting to understand and explain the differences in the rates of growth and per capita incomes across countries of the world (e.g. Barro, 1991; Barro and Sala-i-Martin, 1995; Easterly et al., 1997).[1] Historically, countries that have achieved and sustained high growth rates were able to finance their growth without running against what Thirlwall (1979) refers to as the balance of payment constraint, which postulates that "*no open economy can grow faster, in the long run, than the rate consistent with balance of payments equilibrium on current account unless it can finance ever-growing deficit*s." In addition, such countries also maintained high domestic saving rates.

The relevance of much of this work for African countries has been less clear (Jerven, 2015). Mostly developed within a framework known as 'endogenous growth theory', the large cross-country time series models have focused principally on a set of variables - initial per capita income (to see whether 'convergence' has occurred with higher income countries), savings/investment ratios, population growth, education (as a proxy for human capital), government consumption, political instability, monetary and fiscal variables, trade variables and inflation. Increasingly, too, these models have incorporated variables to capture the quality of governance (e.g. Easterly and Levine, 2003; Acemoglu and Robinson, 2001).

Perplexing, however, despite the increased sophistication of the models and methodologies, this empirical work has failed to explain the growth performance of the African continent, with much of the earlier work focusing on the perceived failure of Africa simply by incorporating an 'African dummy'.

In the background study for this AEGM,

[1] For summaries and discussion of this earlier work, see Agenor (2004) for an orthodox review, and Thirlwall (2011) for a more heterodox approach.

a) We explore the main drivers of the balance of payment constraint in the region, specifically focusing on the Keynesian approach as motivated by Thirlwall.

b) We construct an econometric model to help explain growth in East Africa, borrowing from the aforementioned endogenous growth literature, but *focusing specifically on the way in which growth has been financed*. There are several reasons for this approach:

    - Despite still low average per capita incomes, in terms of growth performance, East Africa has been performing strongly since the early 2000s – far above the global and African averages, and not far short of the most dynamic economies of East and South-Eastern Asia (e.g. China, Vietnam). This makes it a good case study of the determinants of sustained economic growth in a low income setting.
    - In an important contribution to the literature, Prasad et al. (2007) find that the more a developing country finances its investment through its domestic savings, the faster it grows. Conversely, the more external financing it relies on, the more slowly it grows. While enjoying a strong overall growth trajectory, East Africa has generally struggled to mobilize sufficient resources from domestic sources and has been thus been forced to rely quite heavily on foreign inflows (principally, ODA, remittances and, increasingly, FDI) to finance that growth process. As a consequence, most countries in the region continue to sustain large current account deficits, indicative of low domestic savings. How this impacts on growth has implications for the sustainability of the growth process in Eastern Africa
    - Finally, much of the literature cited earlier on the causes of economic growth in Sub-Saharan Africa actually uses data prior to the growth spurt in the 2000s. Determinants may have subsequently changed. This study uses data spanning the whole of the fast growth period since 2001-2, and beginning in 1990.

II. Objectives of the AEGM

Participants will be invited to provide inputs to the discussion and to review the following questions;

a) What are the economic causes and consequences of Balance of Payments constraint in our sub-region?

b) What does the empirical analysis reveal about the determinants of the funding gap for regional growth and development?

c) What policy measures can be implemented to address the persistent trade deficits which afflict the region?

III. Provisional Programme

Wednesday 21st November 2018

After an initial presentation by Andrew Mold and Laura Naliaka (UNECA), the session will proceed with panel discussions. Participants may be asked to make short presentations based on the experience of their respective countries.

Presentations and Panellists:

- Andrew Mold, Acting Director, Office for Eastern Africa, ECA
- Monique Nsanzabaganwa, Deputy Governor of the National Bank of Rwanda
- Brad McDonald, Deputy Chief, External Policy Division, IMF
- Mulu Gebreeyesus Gebreyohaness, Senior Researcher Fellow, Ethiopian Development Research Institute
- Anthony Mveyange, Research and Impact Director, TradeMark East Africa
- Enock Nyorekwa Twinoburyo, Senior Economist, SDG Center for Africa

IV. Participation

The AEGM will gather experts – economists, econometricians and policymakers - from Eastern African countries, as well as representatives of the private sector, civil society organizations, and other relevant institutions. For further information and clarification, please contact Mr. Andrew Mold, mold@un.org

References

Acemoglu, D. and Robinson, J. (2001). *The Colonial Origins of Comparative Development: An Empirical Investigation*. The American Economic Review, 91 (5), 1369-1401

Barro, R. (1991). *Economic Growth in a Cross Section of Countries*. The Quarterly Journal of Economics, Oxford University Press, 106(2), 407-443

Barro, R. and Sala-i-Martin, X. (1995) *Economic Growth*. McGraw-Hill, New York.

Easterly, W., Loayza, N. and Peter, M. (1997). *Has Latin America's Post Reform Growth Been Disappointing?* Journal of International Economics, 43 (3-4), 287-311.

Jerven, M. (2015). *Africa: Why Economists Get It Wrong*. London: Zed Books

Prasad, E., Rajan, R. and Subramanian, A. (2007). *Foreign Capital and Economic Growth*. NBER Working Paper No. 13619

Thirlwall A. (2011). *Balance of Payments Constrained Growth Models: History and Overview*. PSL Quarterly Review, 64 (259), 307-351

Thirlwall, A. (1979). *The balance of payments constraint as an explanation of international growth rate differences*. BNL Quarterly Review