Drivers of Ethiopian Economic Growth: A Systematic Review

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Abstract- The main focus of this review is to identify the major drivers of Ethiopian Economic Growth. A deep literature review was done on 12 papers conducted in Ethiopia between year 2011 and 2015. The review result shows that Economic growth, as measured by GDP, is highly and positively influenced by human capital investment and export in both short and long run. In the same token, public expenditure (for productive sector), private investment, real exchange rate and household consumption are also important in determining economic growth, especially in the long run. The study finally recommends that Ethiopia should seriously work in sustaining the current progress in growth hemisphere. For this purpose the country need to promote private and public sector investment, human capital development and institutional capacity building.

Index Terms- Determinants and Economic Growth

I. Introduction

Economic growth is one of the most important issues in international political economy and one the major goals of all countries. It is the increase of gross domestic product. Therefore, it shows only the quantity of goods and services produced in a country in given period of time. It is a fundamental requisite to economic development. According to Nafziger (2005), economic development refers to economic growth gone with an improvement in the material well-being of the poor; a decline in agriculture's share of national output; increase in the output share of industry and services; an increase in the education and skills of the labor force; and technical advances originating within the country. The economic achievements lead to the improvement of the standard of life, adequate conditions of medical care, improvement of the educational system and a better redistribution of incomes (Haller, 2012).

Over the last 70 years the issue of economic growth has attracted increasing attention in both theoretical and empirical research. The long run economic growth is usually taken as the central issue of Economics science. As of World Bank (2015) world economy grew 2.6 percent in 2014 to reach $77 trillion in current prices, and growth is projected to accelerate to 3 percent in 2015. Developing economies grew an estimated 4.4 percent in 2014 and are projected to grow 4.8 percent in 2015. Growth in high-income economies has been updated from earlier forecasts to 1.8 percent in 2014 and 2.2 percent in 2015.

According to Ajide (2014), one of the most fundamental economic issues that have received due attention in the economic literature to identify the determinants of economic growth. In this regard various studies have been conducted in all corners of the world. Ng'ang' et al (2012), based on a panel data of 19 Sub Saharan countries for the years 1982-2000, identified the determinants of economic growth. The study found that physical capital formation, export and human capital significantly contribute to the economic growth among sub-Saharan countries. On the other hand, government expenditure, nominal discount rate and foreign aid significantly lead to negative economic growth.

As of Abala (2014) human capital, government expenditure and openness of the economy are vital for the growth of the economy in Kenya. Ekman (2009) also found that women did positively impact Tunisia's economic growth through increased labor force participation, increased working age population to total population ratio, and increased consumption. Khungwa (2007) identified that investments, terms of trade, openness and human capitals are the main determinants of growth in Malawi. These variables significantly affect growth both in the short run and long run. According to Ismaila and Imoughele (2015) the macroeconomics determinants of economic growth in Nigeria, under a stable inflationary rate, are: gross fixed capital formation, foreign direct investment and total government expenditure. In the same way, Kandenge (2010) stated that public and private investment, exports, imports, economic freedom, labor and human capital significantly and positively affect on short and long-term economic growth in Botswana. However, terms of trade and real exchange rate, are found to have a negative effect on short and long-term economic growth.

As we have seen it is difficult to draw a single conclusion regarding what determines economic growth of countries. What is important in one country may not be a big deal in other country. Even with in the same country the outcome might be different based on the nature of data, time and methodology used for analysis. International organizations, national governments, research institutions, academic institutions and communities have strong interest in knowing the factors affecting economic growth of a given country.

In Ethiopia various studies have been conducted to identify the drivers of Ethiopian Economic growth. There is, however, a lack of systematic review evidence on sources of economic growth. The central objective of this work is, therefore, to carefully review sample empirical studies conducted in Ethiopia and draw a reasonable conclusion. This review is expected to provide convincing and significant information for concerning body such as government, policy makers, and other institutions working to promote Economic growth and hence improving living standards of citizens. These bodies will be interested in recent evidence as the base for international, national and local decision-making process and policy development.

II. Description of Ethiopian Economic Growth

After the downfall of the imperial regime of Haile Selassie I in 1974, Ethiopia spent the next 17 years under a military junta known as the “Derg”. During that time, the national economy suffered tremendously, mainly due to policies designed to control the courses of social, economic and political development in the country. Above all, nationalization of land and others private properties (like land, extra houses, financial firms and industries) affected particularly the urban economy. Being one of the socialists’ governments of the time, Derg designed discriminatory monetary and fiscal policies that favored public sectors. The period witnessed deteriorating economic structure, dissatisfaction of people and strong resistance from opposition forces across the country and external economic shocking. Finally, Derg collapsed in 1991 joint military forces of opposition parties (Gada and Degefe, 2005).

The country has been undergoing market-oriented reforms following takeover by the Ethiopian People’s Revolutionary Democratic Force (EPRDF) in 1991. By 1992/93 the government began its first series of economic reform programs aimed at reorienting the economy from command to market economy, rationalizing the role of the state and creating legal, institutional and policy environment to enhance private sector investment. The performance of the economy during the 1990s showed that GDP and GDP per capita grew at an annual average rate of close to 5 and 2.4 percent during 1992/93-2000/01, respectively (MoFED, 2002).

The government of the Federal Democratic Republic of Ethiopia submitted an Interim Poverty Reduction Strategy Paper (PRSP) to the IMF and the World Bank in 2000 (Teshome, 2006). Ethiopia’s earliest version of PRSP is termed as ‘Sustainable Development and Poverty Reduction Program (SDPRP). It contained policy issues that need to be implemented to reduce poverty and bring economic growth, during the periods 2002/03-2004/05 (Abebe, 2012 and MoFED, 2006). According to MoFED (2006), the Ethiopian economy had registered encouraging but mixed results, with negative real GDP growth rate of 3.3% in 2002/03 as a result of drought, followed by strong positive performance of 11.9% and 10.6% in years 2003/04 and 2004/05, respectively. The average per annum real GDP growth of SDPRP period was 6.4%.

In the year 2005 government introduced the second phase of the Poverty Reduction Strategy Program (PRSP) process. The Plan for Accelerated and Sustained Development to end Poverty (PASDEP) is a five-year (2005/06-2009/10) strategic framework. According to MoFED (2010), during PASDEP implementation period sustainable economic growth (over 10 percent real GDP growth rate) was realized. Growth and Transformation plan I (GTP I) was the third phase of the Poverty Reduction Strategy Program (PRSP) process and was a second five-year development plan for the five-year period 20010/11-2014/15. Recent information, after implementation of GTP I, shows that the average rate of growth of GDP for the first four years of GTP was 10 percent (EEA, 2015).

Despite this all improvements, Ethiopia is one of the world’s poorest countries and still is vulnerable to shock. Ethiopia in the year 2013 ranks 173th out of 185 countries on the United Nations Development Program’s human development index (UNDP, 2014) and average per capita incomes are less than half the current sub-Saharan average. Therefore, growth registered so far is not enough put the country at the level of at least middle income countries. So, increasing the growth rate and hence improving the living standard of citizens’ would be one of the most important issues in post 2015 development agenda.

III. Methodology of the Study

The study area is located in the Horn of Africa. It was based systematic review that involved descriptive analysis. The primary data were systematically collected from 12 (twelve) studies conducted in Ethiopia between 2011 and 2015. The study used descriptive statistics (like frequency distribution tables) to analyze the macroeconomic factors affecting economic growth of Ethiopia in the last decades.

The review applied two stage screening process: title and abstract screening and Full-text screening. The researcher used hand searching method with key search terms from internet. Various papers were indentified with the same topic. Of these paper 12(twelve) studies were found relevant. The study assumed that dependent variable (Economic Growth) is a function of various economic variables. For this study, however, the main determinants of economic growth are: Household Consumption(C), Private Investment (PI), Government Investment and Expenditure (GE), Trade Openness (TO), External Debt (ED), Exchange Rate (ER), and Export (EX), Foreign Aid (FA) and Human Capital (HC).

IV. Results and Discussions

1.1. Description of Reviewed Literatures

This topic describes some of the general characteristics of literatures in terms of title, nature of data, and periods under study.

Table 1: Summary of Reviewed Studies

S,N	Authors	Title	Nature of Data	Years
1	Baylie (2011)	The Impact of Real Effective Exchange Rate on the Economic Growth of Ethiopia	Time Series (Annual)	1970-2009
2	Birara (2014)	The Relationship between Export and Economic Growth in Ethiopia	Time Series (Annual)	1975/76 - 2010/11
3	Gebrehiwot (2013)	The Impact of Human Capital Development on Economic Growth in Ethiopia: Evidence From ARDL	Time Series (Annual)	1974/75-2010/2011

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		Approach to Co-Integration		
4	Gebru (2015)	The Determinants of Economic Growth in Ethiopia: A Time Series Analysis	Time Series (Annual)	1974-2013
5	Girma(2015)	The impact of Foreign Aid on Economic Growth: Empirical evidence from Ethiopia (1974-2011) using ARDL approach	Time Series (Annual)	1974-2011
6	Jarra (2013)	Exports, Domestic Demand and Economic Growth in Ethiopia: Granger Causality Analysis	Time Series (Annual)	1960 -2011
7	Kassa (2014)	Does External Debt Cause Economic Growth? The Case of Ethiopia	Time Series (Annual)	1970/71-2010/2011
8	Mustefa (2014)	Private Investment and Economic growth: Evidence from Ethiopia	Time Series (Annual)	1970-2011
9	Shahir(2014)	The Impact of Public Final Consumption And Investment Spending on Economic Growth In Ethiopia: An Application of Vector Error Correction Model	Time Series (Annual)	1960-2014
10	Siraj (2012)	Official Development Assistance (ODA), Public Spending and Economic Growth in Ethiopia	Time Series (Annual)	1975 - 2010
11	Tadese (2012)	The Nexuses Between Public Investment, Private Investment, Trade Opennes and Economic Growth In Ethiopia: Co-Integrated VAR Approach	Time Series (Annual)	1970-2009
12	Wubu (2011)	The Impact of Foreign Capital Inflows on Economic Growth, Savings, and Investment In Ethiopia	Time Series (Annual)	1974/75 - 2008/09

Source: Reviewed literatures (2016)

All studies are conducted between Years 2011 to 2015 and used yearly time series data for their analysis.

1.2. Determinants of Economic Growth

Economic growth is one of the most important weapons in poverty alleviation. It shows the improvement in the productive capacity of the nation. Economic literatures show that economic growth is affected by various economic and non economic factors. This study, however, focused on economic determinants of Ethiopian economic growth. The sign (✓) shows that the variable has been found significant from reviewed literatures and the **(±)** shows the impact of a variable.

Table 2: Short Run Determinants of Economic Growth

S.N	**Authors**	**Variables**								
		GE/I	**PI**	**EX**	**HC**	**FA**	**ER**	**TO**	**ED**	**C**
1	Baylie (2011)						✓**(-)**			
2	Birara (2014)			✓(+)						
3	Gebrehiwot (2013)	✓(+)			✓(+)					
4	Gebru (2015)				✓(+)	✓(-)			✓(-)	
5	Girma (2015)					✓(-)				
6	Jarra (2013)			✓(+)						✓(+)
7	Kassa (2014)				✓(+)			✓(-)	✓(-)	
8	Mustefa (2014)	✓(-)	✓(+)							
9	Shahir (2014)									
10	Siraj (2012)									
11	Tadese (2012)	✓(-)	✓(-)					✓(-)		
12	Wubu (2011)					✓(+)				

Source: Reviewed literatures (2016)

Table 2, shows that export, human capital investment, household consumption unanimously positively contributes for Economic growth in the short run.

Table 3: Long Run Determinants of Economic Growth

S.N	Authors	Variables								
		GE/I	PI	EX	HC	FA	ER	TO	ED	C
1	Baylie (2011)	✓(+)					✓(+)			
2	Birara (2014)			✓(+)						
3	Gebrehiwot (2013)	✓(-)			✓(+)	✓(-)				
4	Gebru (2015)				✓(+)				✓(-)	
5	Girma (2015)					✓(-)				
6	Jarra (2013)			✓(+)						✓(+)
7	Kassa (2014)				✓(+)			✓(-)	✓(-)	
8	Mustefa (2014)	✓(+)	✓(+)	✓(+)	✓(+)					
9	Shahir (2014)	✓(+)	✓(+)		✓(+)					
10	Siraj (2012)	✓(+)	✓(+)							
11	Tadese (2012)	✓(+)	✓(+)		✓(+)			✓(+)		
12	Wubu (2011)					✓(+)				

Source: Reviewed literatures (2016)

As of table 3 private investment, export, human capital investment and household consumption are the factors that positively contributes for economic growth in the long run.
Human Capital investment, in the form of education and health investment, is the most influential driver of economic growth both in the short and long run. It leads to productivity improvement that increases output or national product. The role of export to economic growth is pivotal and properly stated in the studies of Birara (2014), Jarra (2013) and Mustefa (2014).
Private investment is another important factor that affects economic growth. In LDCs, increasing the growth rate of private investment would be a desirable target to achieve post 2015 development agenda. The role of private sector in the short run is unclear. However, in the long run as of Mustefa (2014), Tadese (2012), Shahir (2014) and Siraj (2012) private sector investment positively contributed to economic growth.

Public Investment/Expenditure is also another influential variables affecting economic growth either positively or negatively. The role of public expenditure is seen from two aspects. Public investment, in the form of human and physical investments, is an input to economic growth; however public expenditure on unproductive sector reduces the performance of the economy by reducing the amount of money available for productive investments. In the short run in two out of three studies, public expenditure is found that it negatively affects economic growth. According to Mustefa (2014) negative sign of public investment may be observed since public spending has a long gestation period. It creates a crowding out effect on growth in the short run. In the long run, however, studies favor the positive outcomes of public expenditures. This is in line with the endogenous growth models which states that fiscal policy can determine the national level of output (Mustefa (2014) and Tadese(2012)).

As regard to foreign aid, in both short and long, the average outcome shows that it inversely affects economic growth, improper usage of foreign aid might be the main reason. Exchange rate found that it is positively related to economic growth in the long run. According to Baylie (2011) this shows that devaluation or depreciation of domestic currency does not improve national output in the long run. In the short run, however, the result the outcome supports the view that depreciation in the value of the domestic currency promotes economic growth.

Trade openness is negatively associated with economic growth in the short run while the direction of influence is unclear in the long run. The short run result may be due to the failure of infant industries in competition with advanced foreign firms. External debt erodes economic growth both in the short and long run, improper management of external debt might be the reason. Finally, household consumption is positive both in the short and long run.

V. Conclusion and Recommendations

Economic growth is one of the most important issues in international political economy and one the major goals of all countries. It is the increase of gross domestic product and hence improving living standards of nations. Ethiopia, starting form the last decades, has been recording one of the fastest economic growths in the world. This study aims to carefully review sample empirical studies conducted in Ethiopia to identify the drivers of Ethiopian Economic growth. The review applied two stage screening process: title and abstract screening and Full-text screening. Twelve (12) studies were found relevant.

Human capital investment, in the form of education and health investment, is most influential driver of economic growth, followed by export, in both short and long run. Private sector promotion also leads to long run economic growth. The role of public expenditure is seen from two aspects. In the short run in two out of three studies, public expenditure is found that it negatively affects economic growth. In the long run, however, studies favor the positive outcomes of public expenditures. The average outcome of foreign aid shows that it is detrimental to economic growth. Exchange rate is positively related to economic growth in the long run but not in the short run. In the same token, household consumption is positive both in the short and long run. Trade openness is negatively associated with economic growth in the short run while the direction of influence is unclear in the long run. External debt erodes economic growth both in the short and long run.

Finally, the study recommends that in order to sustain the well performing economic growth due attention should also be given to effective and well designed economic policies which favors private sector, public sector investment; human capital development and institutional capacity building.

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