The Heritage Foundation Backgrounder

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The Center for International Economic Growth

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WHY ASIA GROWS AND AFRICA DOESN'T

INTRODUCTION

In the 1960s, as the countries of Sub-Saharan Africa gained independence from their colonial rulers, their economic futures looked bright. Free of problems associated with imperialism, and many rich in natural resources, these new countries seemed on the road to inevitable economic progress. At the same time, Asia seemed an economic backwater, holding no special promise.

Today, Sub-Saharan Africa is the economic backwater. Living standards in many African countries have declined. The misery and suffering of their people, compounded by famines (part of which are man-made), disease and political repression, continue to rise. By contrast, Asia has been setting the global pace for economic development. This is true particularly for those nations variously called the Four Tigers or the Newly Industrialized Countries (NICs): Hong Kong, the Republic of Korea, Singapore, and the Republic of China on Taiwan. By and large they have eliminated the hunger and diseases associated with Third World poverty, while Hong Kong and Singapore per capita income equal that in a number of European countries.

Money No Answer. American policy makers correctly are saddened and disturbed by Africa's tragic situation and are seeking ways to reverse its plight. Usually such plans rely on more money for that continent, for food, increased numbers of medical care personnel, or other worthy goals. The trouble is that after nearly three decades of pouring aid into Africa, there is little indication that more money is the answer to the continent's problems. Tanzania, for example, has received more funds per capita over the past two decades then almost any other less developed country. Its economy, however, is in shambles. In fact, it appears in worse shape than it was a quarter-century ago.

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Asian Lesson. The answer for Africa is not simply more foreign aid; it is economic growth. The comparison with Asia dramatically illustrates this point. If between 1965 and 1985, their economies had grown at the same rate as the four Asian NICs, the countries of black Africa today would have a combined gross domestic product of $648.3 billion rather than the actual $211.8 billion. This $436.5 billion in additional wealth would go very far to eliminate hunger, increase people's life expectancy, and raise living standards.

The Asian example offers another lesson for Africa. The four Asian NICs pursued free market oriented policies. All had lower levels of inflation and sounder banking systems than Africa. Prices generally were established by the market. Taxes were kept low. Hong Kong and Singapore have markets opened almost totally to imports.

Economic growth which results from free markets, with minimal government control and maximum incentives for private entrepreneurs to be productive, is the only means by which Sub-Saharan African countries can pull themselves out of their economic quagmire. Foreign aid simply cannot provide the amounts of assistance that Africa could create for itself with the right economic policies. The U.S. and its Western allies therefore should promote economic growth as the ultimate solution to Africa's poverty. America's Agency for International Development could help by placing a greater emphasis on policy reforms and monitoring programs in African countries toward a number of free market goals. These goals should include:

♦ ♦ Guaranteeing the right of all citizens to own property, to use it as they choose, and to have these rights protected by their governments.

♦ ♦ Establishing the freedom of farmers to grow whatever crops they choose and to sell them to whomever they wish and at whatever price they can obtain.

♦ ♦ Opening markets to imports, which raise living standards, and foreign investment, which creates jobs.

♦ ♦ Privatizing state-owned enterprises by selling shares to the workers, the general public, and foreign investors.

THE FAILURE OF AID TO AFRICA

The economic plight of Sub-Saharan Africa usually comes to the attention of the American public through pictures on television screens of starving children in Ethiopia or the Sudan, of AIDS-ravaged villages in Uganda or of teeming urban slums in Nigeria or Zaire. American policy makers respond in fits and starts. Famine relief is sent to help the hungry. A special African Development Foundation is created by Congress to funnel aid to that continent. The foundation seeks $10.2 million for fiscal 1991. Further, America's Agency for International Development (AID) seeks $565 million for the Development Fund for Africa in its 1991 budget. A Global Poverty Reduction Act would require AID to set specific goals for reducing absolute levels

of poverty and infant mortality and for raising levels of female literacy in less developed countries, especially in Africa. The humanitarian instinct driving these programs is commendable. But little fundamental is accomplished because little fundamental is changed.

In addition to America's assistance to Africa, other democratic, industrialized countries have supplied aid. The British and French have tried to help their former colonies. The Scandinavian countries took special interest in Tanzania after its then-President Julius Nyerere declared his intention in 1968 to transform his country into a model of African socialism.

Western Budget Problems. The U.S. has transferred almost $12.5 billion to Sub-Saharan Africa during the last three decades. Over the last four decades the U.S. has transferred some $400 billion in foreign assistance to the less developed world, less than the amount that Africans themselves might have created with economic growth. Given the budget problems of most Western countries today, it will be difficult to sustain current levels of assistance much less meet the new economic demands of Africa. Economic growth offers the only solution to Africa's difficulties.

Yet the economies of most of the Sub-Saharan African countries continue to stagnate. Foreign aid has failed to overcome the adverse effects of flawed economic policies. There is no way for the West to provide enough funds to pull Africa out of its quagmire of poverty. That must be done by the Africans themselves, through growth-oriented free market policies that will allow them to create the wealth that constitutes a prosperous society.

THE BENEFITS OF GROWTH

A lesson for Africa can be found in the four Asian NICs, Hong Kong, the Republic of Korea, Singapore, and the Republic of China on Taiwan. Like most African countries, Hong Kong, Singapore, South Korea, and Taiwan had colonial pasts. South Korea and Taiwan were Japanese colonies from early in this century until the end of World War II. Singapore was ruled by London from 1819 until 1965. Hong Kong remains a British colony until Beijing becomes its ruler in 1997.

None of the four NICs had particularly promising economies in the 1950s. Hong Kong and Singapore had suffered brutally under Japanese military occupation during World War II. The Korean War left South Korea in shambles, and in the early 1960s, the U.S. cut off development assistance to South Korea, declaring it to be in too poor condition economically to benefit from further aid. During the 1950s, Taipei was concerned foremost with defending Taiwan against a possible attack by the communist armies from the Chinese mainland; little attention was paid to the economy.

As African countries gained their independence in the 1960s, their economic conditions appeared no worse than the Asian countries'. In some ways Africa was in better shape. Some African countries had large deposits of mineral resources like copper and oil. Others had fertile land, especially in

British East Africa. In many cases the colonial powers left infrastructure necessary for economic growth, like roads and power plants.

Table 1 Economic Growth in Asia (billions of $)			
Four Asian NICs	**1965**	**1985**	**Percent Increase**
Gross Domestic Product*	$50.5	$269.9	434
Per Capita Income	$1,080	$3,948.7	266

*In terms of purchasing power parity. Data from the U.S. Agency for International Development.

Comparing what happened in the subsequent years is instructive. In 1985 the total gross domestic product (GDP) of the Asian NICs was $269.9 billion in terms of purchasing power parity, which attempts to measure real buying power and adjusts for inflation. This is a 434 percent increase over the GDP of these countries in 1965. (See Table 1. Raw data in Appendix.) The per capita income of these countries stood at $3,948.7 in 1985, 266 percent higher than in 1965.

Table 2 Economic Growth in Africa (billions of $)			
African Nations	**1965**	**1985**	**Percent Increase**
Gross Domestic Product*	$121.4	$211.8	74
Per Capita Income	$503	$505	0

*In terms of purchasing power parity. Data from U.S. Agency for International Development.

In Sub-Saharan Africa, by contrast, GDP in 1985 was $211.8 billion, only 74 percent above the 1965 level. Per capita income was virtually unchanged. (See Table 2) Some countries had particularly poor records. A recent World Bank report,[1] for example, finds that between 1965 and 1987 Zaire's average per capita income shrank at an annual rate of 2.4 percent. In contrast, per capita income in Singapore grew during this period at an annual rate of 7.2 percent.

This comparison confirms the importance of economic growth. (See Table 3) If, since 1965, the Sub-Saharan African countries had grown at the same rate as the four Asian NICs, in 1985 they would have had a total GDP of

1 *World Development Report 1989*, issued by the World Bank, Washington, D.C., Table 1, Basic Indicators, p. 164-5.

$648.3 billion, an additional $436.5 over the actual amount. If per capita income had grown at the same rate as in the Asian countries, each individual African would have had $1,841 in annual income, or $1,336 more than they actually had.

Table 3
If African Nations' Growth Rates Matched Those of Asian NICs (billions of $)

	1965 Actual	1985 Projected	Growth Dividend
Gross Domestic Product	$121.4	$648.3	$436.5
Per Capita Income	$503	$1,841	$1,336

The extra income resulting from higher economic growth would have allowed African governments to deal with many of their social and economic problems. More bridges, roads, schools, power stations, and hospitals could have been built. With more money in their pockets, individual Africans could have afforded food, better housing and consumer goods.

PRODUCTIVITY AND DEVELOPMENT

The rising economic productivity needed by a country to grow and prosper is attained when such factors of production as manpower, land, capital, and raw materials are employed as efficiently as possible. This requires an economic system to be flexible enough to allow these factors to be allocated or redistributed quickly from less to more profitable and productive ventures. For this, the primary economic actor is the individual. Thus an economic system must allow those individuals who are best at providing goods and services to meet public demand to profit directly from their actions.

This, by and large, is what the four Asian NICs have done. The result of their relatively free market economies is increased economic productivity and prosperity. They have allowed market forces to operate and protected the property rights of their people. This contrasts dramatically with the socialist systems of most African countries. There, governments rather than markets have been allocating resources. Often, corrupt politicians and bureaucrats pocket revenues. The result: there are usually few incentives for individuals to work hard and to be as productive as possible.

A report issued by AID in March 1987 outlined the consequences of such policies. **First** it found that production was discouraged, new savings and investments were reduced, and what investments were made were relatively unproductive.

Second, the AID report found that government policies shifted income from poorer groups, mainly small farmers, to better off urban dwellers.

Third, the study found that by diverting investment funds to usually money-losing capital intensive industries and away from the labor intensive sectors, African governments created high unemployment.

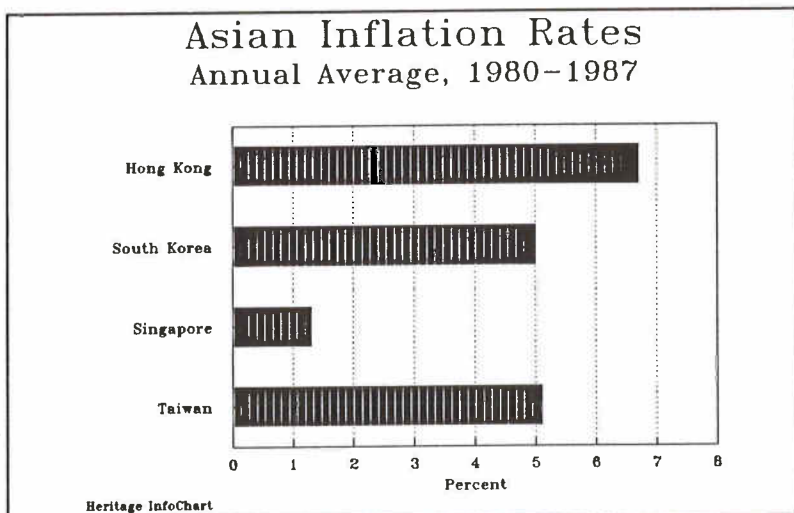
Finally, the study found that "The more control government has on economic life, the more it uses administrative means to ration resources rather than the market, the greater the opportunity for extortion and bribery and corruption of all kinds."[2]

Thus while Africa has pursued policies of government control and regulation, the four Asian NICs limited government and promoted free-market policies. A number of examples illustrate the different outcomes of the policies of Africa and Asia.

INFLATION

Money, usually in the form of paper currency, acts as a medium of exchange to facilitate economic transactions, and as a store of value for those who save for future investments or consumption. A country's central bank usually provides the paper currency. To promote economic growth a country's money supply must remain relatively stable, expanding only slowly to meet market needs. If a central bank prints paper money far in excess of actual economic growth, the currency's value will drop and prices for real goods and services will be higher. This will make currency less useful as a medium of exchange or a store of value. People will be reluctant to accept currency if its value is shrinking. This inflated currency will discourage economic transactions and thus will lower a country's productivity.

Chart 1



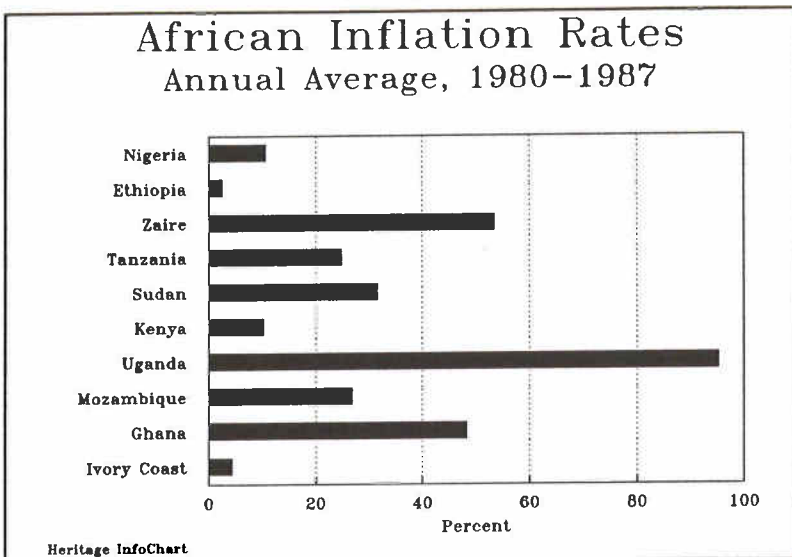
Figures from *World Development Report 1989*, issued by the World Bank, Table 13. Money and Interest Rates, p. 188-189. Taiwan figure from *Taiwan Statistical Data Book 1989*, p. 181. Figure given for average annual increase of the consumer price index. The World Bank does not keep figures on Taiwan.

2 Stephen M. Haykin, *Policy Reform Programs in Africa: A Preliminary Assessment of Impacts* (Washington, D.C.: Bureau for Africa, Office of Development Planning, Agency for International Development, March 1987), p. i.

A comparison of the four Asian NICs with Sub-Saharan Africa illustrates the destructive effects of inflation. Between 1980 and 1987 the average annual inflation rate in the four NICs was well below 10 percent. (See Chart 1)

The 10 most populous African countries, however, which include nearly 70 percent of the continent's people, have had high rates of inflation. (See Chart 2)

Chart 2



Figures from *World Development Report 1989*, issued by the World Bank, Table 13. Money and Interest rates, p. 188-189. Population order from Table 1. Basic Indicators, p. 164-165.

The two African countries with inflation rates below 10 percent further illustrate the point. Ethiopia is listed by the World Bank as the world's poorest country; AID's figures place it among the poorest. As a Marxist dictatorship with a completely centrally planned and controlled economy, Ethiopia strictly limits price increases, which are the usual measure of inflation. But, while prices are officially low, there is virtually nothing to purchase openly with money. The goods that are available are so only through unofficial and even illegal transactions – on the "grey" or "black" markets. There prices are very high. Thus in Ethiopia, the inflation is "hidden," meaning that to actually obtain various goods would requires substantially more than the official prices. There are no good figures on real costs.

The Ivory Coast, by contrast, has a comparatively strong economy by African standards. The Ivory Coast, for example, has invited foreigners to invest in such economic activities as agricultural production and manufacturing. The Ivory Coast also has tended to protect private property rights.

COMMERCIAL BANKING

The commercial banks provide a place for individuals and businesses to deposit savings and to obtain loans. Banks in African countries are often owned by the governments. Governments strictly regulate those that are not, setting interest rates and dictating lending practices. Interest rates are often held below the level of inflation. This means that savers lose money. Savings thus is discouraged.

Where funds exist, governments decide where they are to go. Often, governments force banks to fund inefficient government-owned and managed industrial and manufacturing sectors. As the public sector becomes unable to compete, loans go bad and banks loose money. Many Sub-Saharan banks fail and are prevented from merging with other institutions to diversify the losses. As a result, banks in Africa are in terrible shape. Examples:

> **Ghana.** The banking system here had a negative net worth in 1988. The reason was the great number of loans made to the publicly owned sector of the economy because of government pressures. The businesses failed and the loans went bad.[3]
>
> **Kenya.** Most banks in Kenya started in the mid-1970s have failed, including several major banks, because of bad loans.[4] Government corruption involving banks and regulation of lending is in large part responsible
>
> **Madagascar.** By 1988, some 21 percent of all loans were considered difficult to collect and another 25 percent were considered uncollectible. This made the entire banking system insolvent. Here too the cause of such losses were the government targeted loans to huge public sectors.[5]
>
> **Tanzania.** Some 85 percent of the credit in this country goes to the state sector. Half of this goes to government-owned agricultural marketing boards. And 42 percent of this sum simply goes to cover these boards' debts.[6] Tanzania's banking losses in 1987 totaled nearly 10 percent of their entire Gross National Product because of bad loans.[7]

By contrast, the Asian NICs have had more open banking systems. Hong Kong is a major world banking center. And even though public sectors exist in these countries, especially in South Korea and Taiwan, banks have been free to lend money to companies that they feel would make good investments.

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3 *World Development Report 1989, op. cit.*, p. 71.

4 *Ibid.*

5 *Ibid.*

6 Figures from the Tanzanian Chamber of Commerce, from meeting between Edward Hudgins and Chamber's President, Mr. Mwapachu on June 27, 1989.

7 *World Development Report 1989, op. cit.*, p. 72.

When a banking crisis does occur, the free market allows banks to merge and prevent the entire collapse of larger banks. For example, in South Korea, 78 banks merged between 1986 and 1987, preventing $5.9 billion worth of assets from being lost.[8]

CAPITAL MARKETS

Capital markets, in which stocks and bonds are bought and sold, provide investment opportunities and help businesses raise funds for productive activities, expansion, and innovations. The four Asian NICs gradually have increased their equity, bond, and stock markets. African countries continue to have very small capital markets. Hong Kong has a major world stock market. In South Korea, in 1987 the average of the total value of listed stock made up 19 percent of the GNP. South Korea even offers special tax credits to encourage corporations to offer stock. But in Nigeria, the most populous African country and a major oil exporter, the listed stocks made up only 4 percent of GNP. (In the United States and Japan, the averages can be as high as 80 to 90 percent.) Developing larger money and capital markets help to provide the necessary sources of capital to fund economic growth.

PRICING

Most developed nations rely on market forces to set the prices of goods and services. Many less developed countries are suspicious of or even hostile to the market and thus allow government to set prices. Prices set below the costs of production and that do not respond to the forces of supply and demand, create shortages of some items and massive surpluses of others.

Africa has a history of economically destructive price controls. Example: In Benin, government price controls caused otherwise efficient cement plants to operate at a loss. Example: In Sierra Leone, state-owned transport enterprises were forced to absorb cost increases without timely price increases, again creating losses.[9] Example: In Zambia farmers had to pay more than a dollar for fertilizer for every dollar's worth of food produced.[10] A 1989 report by the World Bank and the United Nations Development Project finds that price controls continue to harm many Sub-Saharan countries says the report: "Where producer prices are fixed...high domestic inflation in some

8 World Development Report, *op. cit.*, p. 71

9 John R. Nellis, *Public Enterprise in Sub-Saharan Africa* (Washington, D.C.: World bank Discussion Papers, November 1985), pp.21-21.

10Haykin, *op cit*, p. 1.

countries (Sierre Leone, Somalia, Sudan, and Tanzania) continues to erode the purchasing power of producers' income despite agricultural price policy changes."[11]

MARKETING BOARDS

Although never used extensively by Asian countries, marketing boards have been used throughout Africa over the last two decades. In many African countries, farms are collectively owned or the rights of the farmers severely restricted. For example, farmers might be required to grow only crops approved by the government. Governments usually regulate agriculture through marketing boards. Farmers are required to turn over their crops to these boards, which pay them a price well below world market rates. The government board then might either export the crops and keep the profit or sell the crops cheaply to urban dwellers who tend to be the bureaucrats and political supporters of the government.

Farmers often are required to send their crops to distribution centers using government transportation, which is often inadequate and fails to deliver crops where they are needed. Marketing boards usually are the sole legal distributers of such farm inputs as fertilizer and seed.

Marketing boards and state control of agriculture have harmed African farmers and led to agricultural disaster. In Cameroon, for example, in 1986 the coffee marketing board paid farmers only $150 per ton for their crops while the world market price was between $2,250 and $4,500 per ton.

Disastrous Results. Tanzania, for example, in the 1960s and 1970s wholeheartedly imposed marketing boards on its mostly agrarian economy. Ten state agencies were put in charge of buying, processing, and marketing 42 products. The results have been disastrous. Prices declined rapidly and it thus no longer paid for farmers to plant more crops than were needed for farming self-sufficiency. The result: agricultural output fell and food shortages occurred. Further, in late 1987 Tanzanian government officials cracked down on informal sector distribution of crops, stranding some 300,000 tons of crops in the field, since the government distribution system could not handle the cargo.[12]

A report by the U.N. Food and Agriculture Organization in 1985 found that while in Asia marketing costs accounted for about 20 percent of the value of agricultural products, in Africa these costs accounted for 55 percent. This inefficiency usually leads to black markets or informal sectors. Example:

11 *Africa's Adjustment and Growth in the 1980s*, the World Bank and the United Nations Development Project, Washington, D.C., 1989. p.21-22

12See Melanie S. Tammen, "The Failure of State Agriculture in Sub-Saharan Africa,"unpublished draft, 1988.

In the mid-1980s Kenya monoplized the marketing of corn. The poorly integrated distribution systems led to an informal sector that offered farmers better service at cheaper rates.

TAXATION

The Asian NICs have had a neutral, workable tax structure that promoted economic growth. A report by Alvin Rabushka, a Senior Fellow at the Hoover Institution, finds that:

> Responsible officials in Hong Kong, Taiwan, Korea, Singapore, and Malaysia (the latter until 1970) got the basics right. They were therefore able to utilize either the model of a neutral, broad-based, low-rate tax system or that of selective incentives coupled with light taxation of capital to propel their nations from the ranks of low-income developing nations to upper middle-income advanced status in the short span of one generation.[13]

African countries, by contrast, have had very high marginal tax rates. In Ghana, for example, cocoa farmers were taxed at a top marginal rate of 90 percent.[14] In their attempts to squeeze the last amount of wealth out of their citizens, the African countries have removed much of the incentive for productive economic activity. The top marginal tax rate for the lowest income tax bracket in Hong Kong is 5 percent,[15] for South Korea, 7.1 percent, and for Singapore, 3.6 percent. These rates would be paid by the poorest citizens. The lowest tax rate in Tanzania, however, is 20 percent.

Lower Top Rates. The top tax rates in Asian countries tend generally to be lower than in Africa and are applied only to the highest incomes. For example, the top rate in Hong Kong is 25 percent[16] which applies only to incomes over $5,128.[17] The top rate in Singapore is 40 percent but applies only to incomes over $340,909, far below the $7,940 average per capita income. South Korea's top rate is 70.12 percent. But this applies only to incomes over $68,976, compared to a per capita income of $2,690.

13Alvin Rabushka, "Tax Policy and Economic Growth in Advanced Developing Nations," Hoover Institution, Stanford University, California, 1987. p.6

14Haykin, *op. cit.*, p. 1.

15Figures from the Gerardo P. Sicat and Arvind Virmani, "Personal Income Taxes in Developing Countries," *World Bank Economic Review*, Vol. 2, No. 1, 1988 p.128-9.

16Rates from Bruce Bartlett, "The International Tax Revolution," unpublished paper. Rates as of 1985.

17These per capita income figures are in terms of real incomes, not purchasing power parity. What is important here is the level at which the tax rates apply, not the real buying power of the these incomes. Figures are for 1987 from *World Development Report 1989, op. cit.*, Table 1. Basic Indicators, p. 164-165.

In Kenya, on the other hand, the top rate of 65 percent is levied on income over $730, in a country with a annual per capita income of only $330. Ghana's top rate of 60 percent affects people making at least $250, in a country with a per capita income of $390.

The African countries use their tax code to punish the the productive efforts of their citizens. It is little wonder that these countries are not productive.

CONCLUSION

Well-meaning policy makers in the U.S. and in other democratic, industrialized countries see Africans' suffering as the tragedy that it is. Yet the billions of dollars of development assistance donated in the past decades to Sub-Saharan Africa have done little to end or relieve this suffering. If anything, the situation has deteriorated.

Africans, to be sure, need continued foreign aid. But this will not do much good unless African nations adopt free market-oriented policies that encourage individual farmers and entrepreneurs to create wealth.

Fuel for Progress. It has been economic growth, not foreign aid, that has fueled the four Asians NICs' dramatic economic and social changes. It is this that has raised their citizens' standards of living, health, education, and consumption.

The lessons taught by the Asian success can be learned by Africans: Individuals must be free to pursue their own economic good in the free market, to have secure private property, to freely trade with their fellow citizens, and to benefit directly from their own economic activities. Only when individuals have positive economic incentives to produce will the productivity of a country rise.

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APPENDIX

Per capita Gross Domestic Product
Using Purchasing Power Parity[18]

Asian countries	1965	1985
Hong Kong	2,704	8,972
South Korea	808	3,082
Singapore	1,753	9,791
Taiwan	1,133	3,581
Average	1,080	3,948.7

African countries	1965	1985
Angola	1,008	609
Benin	633	552
Botswana	530	1,987
Burkina Faso	287	359
Burundi	263	331
Cameroon	55	1,138
Central African Republic	463	441
Chad	496	254
Congo	841	1,189
Ethiopia	320	304
Gabon	1,286	3,313
Gambia	510	497
Ghana	361	527
Guinea	452	450
Ivory Coast	889	919
Kenya	453	592

18Purchasing Power Parity takes into account currency devaluations, exchange rates, and inflation rates.

Lesotho	310	795
Liberia	557	588
Madagascar	614	477
Malawi	254	347
Mali	327	337
Mauritania	527	526
Mozambique	864	528
Niger	340	311
Nigeria	569	590
Rwanda	152	373
Somalia	396	348
Senegal	800	756
Sierre Leone	411	474
Sudan	729	548
Tanzania	256	295
Togo	550	486
Uganda	333	374
Zaire	305	197
Zambia	854	629
Zimbabwe	680	990
Average	503	505