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ABSTRACT

Asia and Africa: Towards a Policy Frontier

by

Michael Roemer

March 1994

The unprecedented, rapid economic growth of countries in East and Southeast Asia since 1965 has been proposed as a model for other developing countries by development economists and practitioners. In a recent book, *Asia and Africa: Legacies and Opportunities in Development*, edited by David Lindauer and Michael Roemer, the contributors identify the policies that were, and were not, essential to rapid growth in Asia, and assess the Asian legacy for countries in Africa. This summary paper graphically depicts in a few pages a picture of the important policy differences in policies between Asian and African countries.

The book and the paper examines the Asian model under three categories: Governance and Economic Strategy, Factor Endowments, and Components of Development Strategy. It deals mainly with the quantifiable policies addressed in the latter part of the book, but summarizes policies in the other categories as well.

The paper concludes that there is no single Asian *model* of development, but that it is possible to find four common elements in the economic policies of all seven rapidly growing Asian economies as follows:

- Exchange rates were managed to provide constant and rewarding incentives to exporters.
- Budget deficits--and the need to finance them--were kept small in relation to national income.
- Economies were outward-looking, in the sense that exporters had access to inputs and could sell their outputs at close to world market prices, despite protection for home-oriented industries.
- Labor and credit markets were kept flexible enough to direct resources to the most rapidly growing industries.

The author believes African policy has fallen short in these crucial respects. He also predicts it will take several years for reforms to generate growth in African countries, where poor policies have prevailed for one or two decades, and determined reforms have not yet begun.

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Asia and Africa: Towards a Policy Frontier

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ASIA AND AFRICA: TOWARDS A POLICY FRONTIER[1]

MICHAEL ROEMER
Harvard Institute for International Development
March 1994

The unprecedented, rapid economic growth of countries in East and Southeast Asia since 1965 has been proposed as a model for other developing countries by development economists and practitioners. In a recent book edited by David Lindauer and Michael Roemer,[2] contributors identify the policies that were, and were not, essential to rapid growth in Asia and assess the Asian legacy for countries in Africa. This paper summarizes the policy conclusions of that volume.

The device used here is a "policy frontier," which graphically depicts differences in policies among a set of countries. This technique has the advantage of providing in a few pages a picture of many of the important policy differences between Asian and African countries. It has the disadvantage of focusing only on those policies that can be quantified, omitting some crucial but qualitative policy differences; and of reducing policies to simple measures that miss important nuances and interactions.

The countries most often cited as models for others are South Korea, Taiwan, Hong Kong, and Singapore, which we call the "East Asian" countries (despite the location of Singapore in Southeast Asia). In addition, the contributors to *Asia and Africa* focus on three countries of Southeast Asia: Indonesia, Malaysia, and Thailand. These members of ASEAN[3] started their rapid growth in the 1960s with natural and human endowments and forms of government resembling those in Africa far better than did the countries of East Asia. The Southeast Asian coun-

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[1] This paper is a result of research sponsored by the United States Agency for International Development under the Consulting Assistance for Economic Reform Project, Contract PDC-0095-A-00-9053-00. The views and interpretations in this paper are those of the author and should not be attributed to USAID. I am grateful to Markus Goldstein for producing the graphs for this paper and to David Lindauer for his comments on an earlier draft.

[2] *Asia and Africa: Legacies and Opportunities in Development*, David L. Lindauer and Michael Roemer, editors (San Francisco: ICS Press, forthcoming in 1994).

[3] Association of Southeast Asian Nations, which includes Brunei, Philippines, and Singapore as well.

tries consequently chose development strategies deemed more appropriate for Africa.

For the most part, the data on policy outcomes cover several years of the 1980s. These policy indicators may not, therefore, fully reflect policy reforms that have been undertaken more recently in such African countries as Ghana, Kenya, Tanzania, and Zambia.

In the opening chapter ("Legacies and Opportunities") of *Asia and Africa,* David Lindauer and I discuss the Asian model under three categories: Governance and Economic Strategy, Factor Endowments, and Components of Development Strategy. The latter deals with most of the quantifiable policies that are summarized in this paper. But all categories offer policy lessons for countries aspiring to accelerated development and it is worthwhile summarizing those policies here.

Governance and Economic Strategy

The first requirement for a cohesive development strategy is a stable government. Asian countries, with the exception of Thailand, are noted for political stability. But many African countries also have had long-lived governments without sustaining rapid economic growth over 25 years, including Cote d'Ivoire, The Gambia, Kenya, Senegal, Tanzania, Zaire, Zambia, Zimbabwe.

A second political requirement for rapid growth is that governments give economic policy primacy over rent-seeking by insulating economic policymakers from political pressure. In Southeast Asia as in Africa, politics is characterized by clientelism and rent-seeking. Nonetheless, all three ASEAN governments installed economist-technocrats in powerful positions for long spells and adhered to their prescriptions whenever the political considerations or rent-seeking threatened to reduce growth. African governments have been less successful at walling off economic policy from the depredations of rent-seeking.

The choice of economics over politics is also manifest in policies to treat entrepreneurially talented ethnic minorities as welcome investors, rather than to penalize them as oppressors. Ethnic Chinese minorities in Southeast Asia have spearheaded modern industrial growth. Ethnic Indians in East Africa, Lebanese in West Africa, resident Europeans in many countries, and even minority indigenous groups have faced inconsistent and often hostile attitudes towards their participation in African economies.

Factor Endowments

All countries of East and Southeast Asia followed the dictates of comparative advantage as determined by their factor endowments. East Asian countries began their growth spurts as labor-abundant, resource- and capital-poor countries and initially exported labor-intensive manufactures. Southeast Asian countries are better endowed with land and natural resources, so that primary exports played a major role in their early development and continue to do so. As gains in agricultural productivity released labor to the cities, these countries followed the East Asian exporters into world markets for textiles, footwear, electronics, and other labor-intensive manufactures. In all Asian countries, upgrading of technologies and products has moved in step with the accumulation of physical and human capital. In Southeast Asia, primary export earnings helped to finance the investment and imported inputs needed to industrialize.

Countries such as Botswana, Cote d'Ivoire, and Kenya also invested productively in agriculture, but other African countries turned away from their primary export base. In contrast to Southeast Asia, foreign exchange shortages hampered industrialization efforts. Because protection and other policies insulated manufacturing from the disciplines of markets, it was possible to start industries and employ technologies that were not always closely related to the resource and factor endowments in Africa.

The upgrading of human skills is one of the more important long-term components of a strategy to develop through evolving comparative advantage. Two indicators of governments' education policies are shown in Figures 1 and 2: government spending on education and average years of education per adult over 25, a measure of the stock of human capital. In terms of government expenditure, African performance in 1990 was indistinguishable from Asian results, as Figure 1 shows: African and Asian budget shares on education are interspersed throughout the range, from a low of 2% in Zaire to a high of 26% in Ghana.

The stock of education achieved by these expenditures, Figure 2, reveals a different picture. The educational stock in Asian countries in 1960, before their growth spurts began, looked quite similar to those in African countries in 1985. But Asian countries made great strides during the intervening 25 years and even the least educated country in our sample, Indonesia, ranked above all African countries in the sample, except Zambia and Zimbabwe, in 1985. This suggests that, although Africa starts today without a clear disadvantage compared to Southeast Asia of three decades ago, Africa also has to make massive and effective investments in education to support the rapid growth over the next two decades.

Figure 1: Spending on Education, 1990

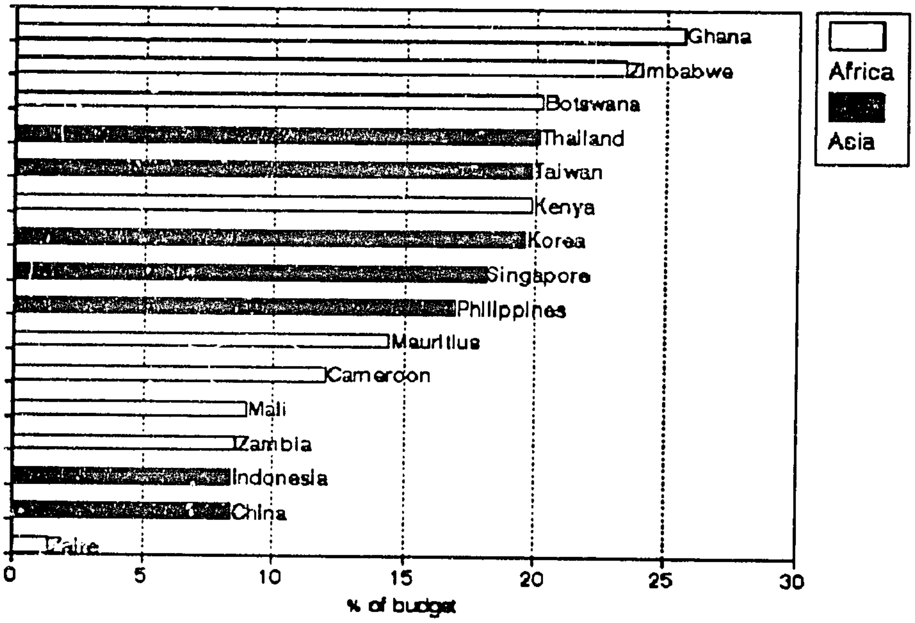
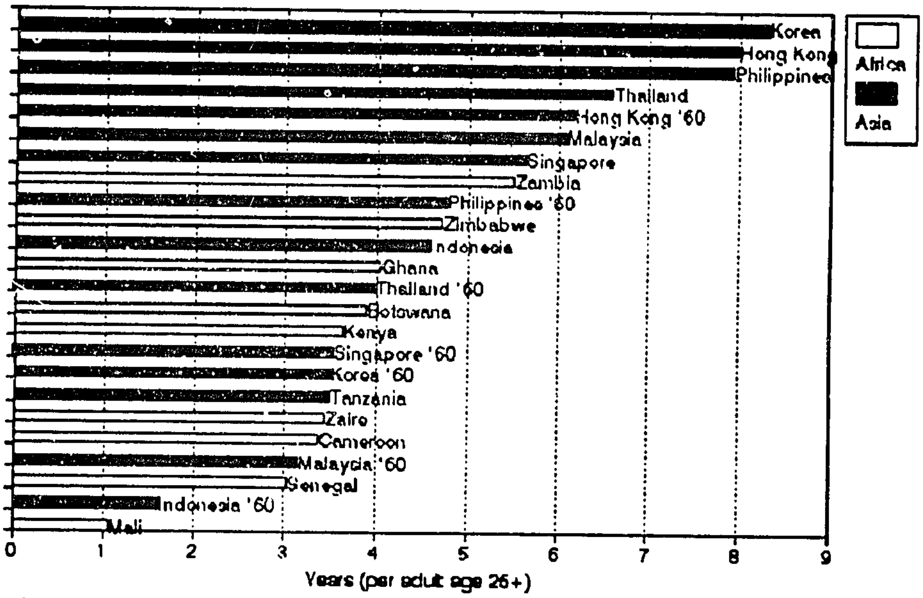


Figure 2: Average Years of Education in Asia (1960) and Africa (1985)



Source: World Bank, unpublished data.

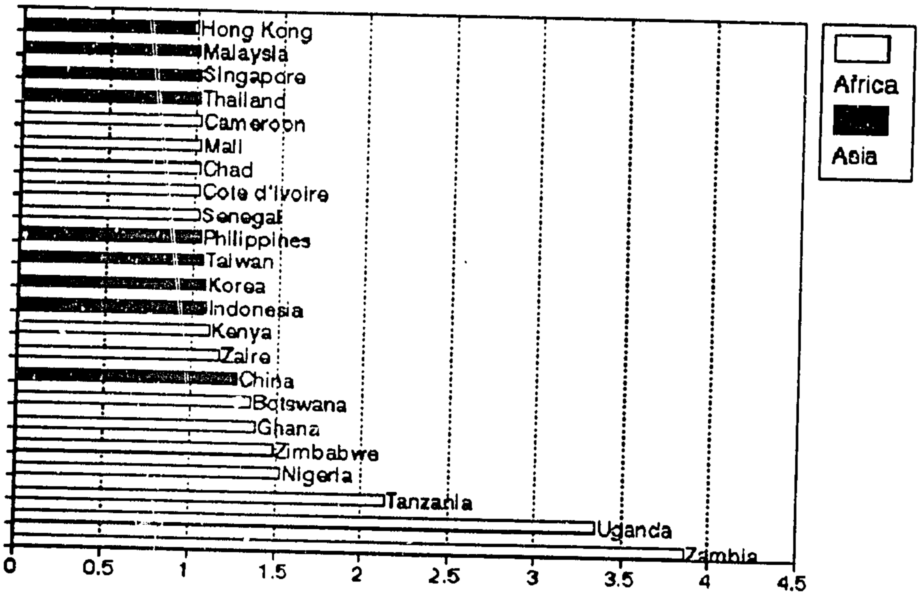
Components of Development Strategy

Three features of development strategy are considered central to Asia's development legacy: macroeconomic management, industrial strategy, and flexible factor markets.

Macroeconomic Management[4]

Sound management of the macroeconomy, the maintenance of both external and internal balance, has been a hallmark of development in both East and Southeast Asia. **External balance**--rapid export growth and balanced external payments--have been supported by nominal exchange rates that were kept close to market-clearing levels. Figure 3 illustrates this characteristic of exchange rate management by showing the average ratio of the parallel market exchange rate to the official rate from 1986 to 1991.

Figure 3: Ratio of Parallel to Official Exchange Rate, 1986-1991



Source: Africa and Asia, Chapter 4

[4] Much of the data in this section come from Jeffrey Lewis and Malcolm McPherson, "Macroeconomic Management: To Finance or Adjust?" Chapter 4 of *Asia and Africa*.

All seven rapidly growing Asian countries shown in Figure 3 have ratios no higher than 1.1 (a 10% premium in the parallel market). The franc zone countries of West Africa also have low premia, but this is a result of their unique fixed rate regime, backed by France, rather than a reflection of external balance. Other African countries shown in Figure 3 had higher free market premia than any of the seven Asian countries (excluding China, which is not a model for Africa; and Philippines, which has not performed well). Zimbabwe, Nigeria, Tanzania, Uganda, and Zambia had grossly overvalued exchange rates with premia from 50 to almost 300%.

A second important aspect of good exchange rate management, once a market-clearing exchange rate has been established, is to maintain the real value of this rate, i.e. the real returns to exporters, over long periods. This is not so easily captured on a one-dimensional policy frontier. Three patterns, shown in Table 1, have been notable:

TABLE 1: MOVEMENTS IN REAL EXCHANGE RATES

	Low Volatility	High Volatility
Constant real rate	HONG KONG SINGAPORE TAIWAN Cote d'Ivoire Senegal (Other franc zone)	INDONESIA Tanzania Zaire
Gradual depreciation	MALAYSIA THAILAND S. KOREA Kenya	

Constant real rates with low volatility have supported rapid export growth in the Asian countries because rates have not been overvalued. But in the franc zone, rates have become increasingly overvalued in markets other than France and have not supported rapid export growth. Gradual appreciations have also been consistent with rapid export growth in Asia. Indonesia's **high volatility** came from devaluations that successfully overcame Dutch disease from rising oil revenues. Tanzania and Zaire, in contrast, suffered from severe overvaluation (see the high premia in Figure 4) before taking drastic steps that may not have fully overcome the problem.

A more controversial aspect of Asian exchange rate policy has been **currency convertibility**. Only Korea and Taiwan of the Asian countries in our sample did not allow convertibility. The Southeast Asian countries opened their capital accounts and have managed convertible currencies for two decades or more. In Africa, the franc zone had convertibility because the CFA was backed by France, but it had no flexibility to adjust the rate, so exports suffered. Outside the franc zone, African countries had strict currency controls. The advantages of convertibility in Asia have been a credible discipline on macroeconomic policy and greater ability to attract foreign investment. But a glance at Table 2 shows that it is rate flexibility, rather than convertibility, that distinguishes the rapidly growing countries from the others. Recent reforms in The Gambia, Ghana, Kenya, Zambia, and other countries have moved towards both exchange convertibility and rate flexibility.

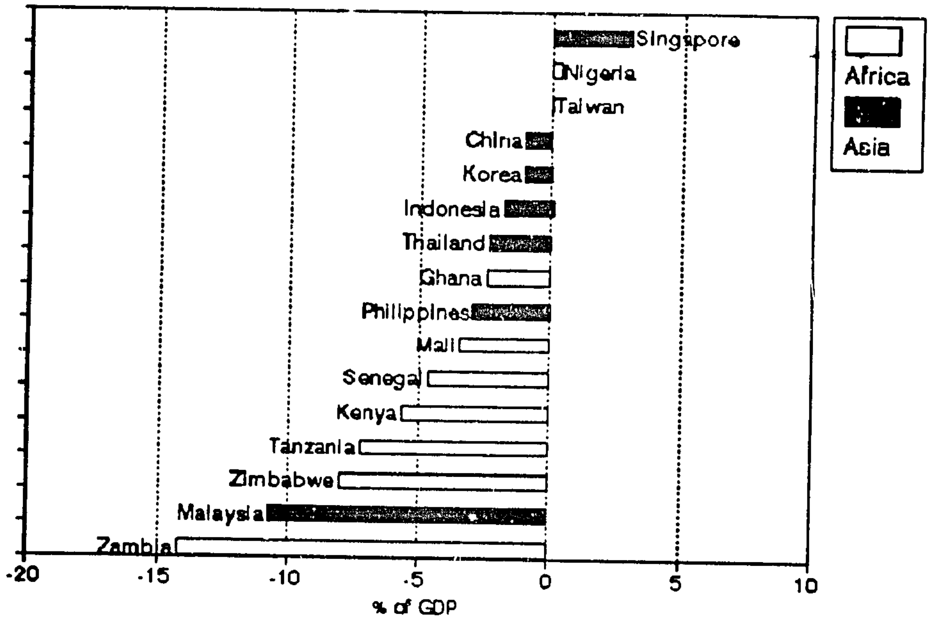
TABLE 2: EXCHANGE RATE CONVERTIBILITY AND FLEXIBILITY

	Convertibility	**Foreign Exchange Controls**
Exchange Rate Flexibility	HONG KONG INDONESIA MALAYSIA SINGAPORE THAILAND The Gambia (post-85)	KOREA TAIWAN Kenya
Fixed Exchange Rate	Franc zone countries	Most other African countries

Internal balance--low inflation, low budget deficits, and moderate money growth--is the other side of sound macroeconomic management. Economists have reached a consensus that internal balance centers on budget deficits that are consistent with aggregate demand and are financed in ways that avoid excessive money creation.

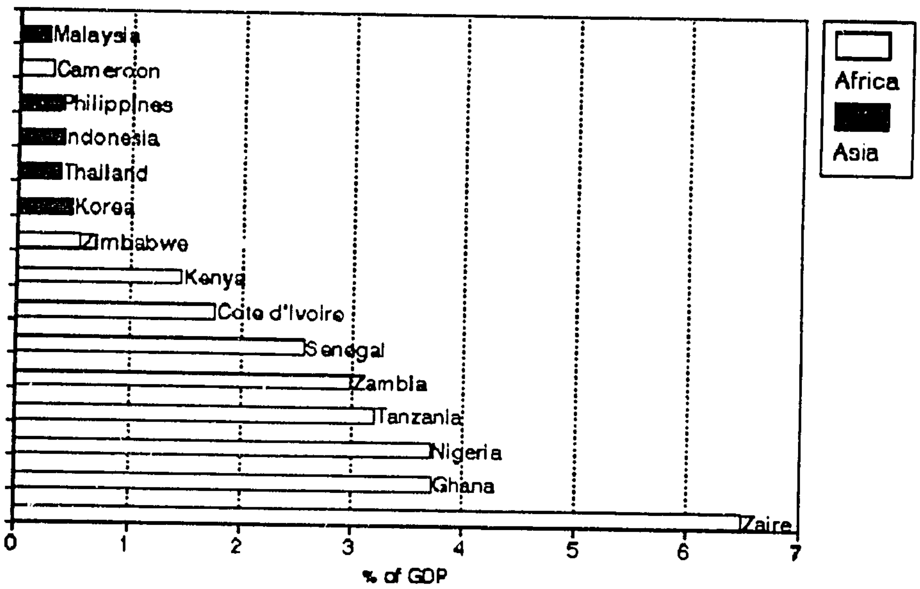
Figure 4 shows that, for the most part, Asian countries kept their deficits considerably lower than African countries during the 1980s. Nigeria is the only African country with budget balance or a surplus, standing with Singapore and Taiwan. Ghana ranks just below Korea, Indonesia, and Thailand with a deficit just exceeding 2% of GDP. Other African countries show larger deficits, ranging from about 3.5% of GDP (Mali) to 14% (Zambia). Among Asian countries, only Malaysia ran large deficits (over 10%), but Malaysia, with saving rates well above 30%, could finance such deficits without inflationary consequences.

Figure 4: Budget Balance, 1980-1990



Source: Africa and Asia, Chapter 4.

Figure 5: Deficit Financed by Central Bank: 1980-1990



Source: Africa and Asia, Chapter 4.

The latter point is brought home by Figure 5, which shows the share of GDP represented by **central bank funding of the government deficit** (the increase in central bank obligations to government) from 1980 to 1990. Malaysia and the other Asian countries have very low ratios, less than half a percent. In Africa, only Cameroon and Zimbabwe are in that zone. In all other African countries shown, central bank funding of government ranges from 1.5 to 6.5% of GDP. In these cases, government deficits have contributed to rising inflation. All Asian countries in our sample had lower inflation in the 1980s than during the previous decade, indicating that these countries had stabilized their economies despite the economic shocks of the 1980s. Six of the African countries had higher inflation during the 1980s; for Ghana, Nigeria, Tanzania, and Zambia the rate was over 20% a year.

Industrial Strategy

Two components of industrial strategy have attracted the most attention from students of East Asian industrialization: the extent of government control over, rather than market allocation of, investment and credit; and the degree to which domestic prices have reflected world prices.

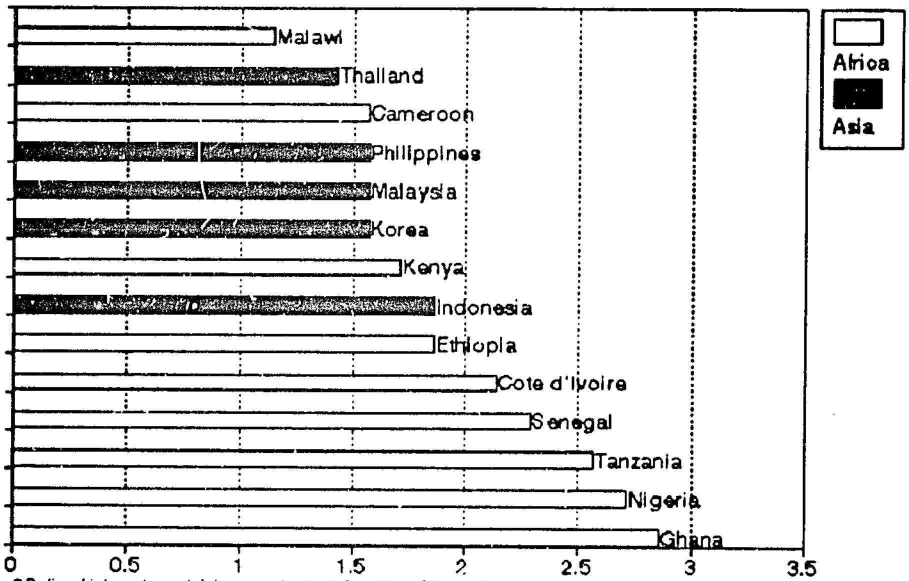
It is difficult to characterize the extent of **controls** in quantitative terms. The revisionist literature on Korea and Taiwan, which has become the new orthodoxy, is that government did intervene to allocate credit and direct investment, but such interventions were disciplined to promote exports as the single overriding objective. The Southeast Asian countries tried nothing so ambitious. Government intervention was sporadic and inward-looking for the most part; exports were not a target of intervention and were affected only by the high costs generated by inward-looking industries and public enterprises. African interventions were also inward-looking, perhaps related as much to rent-seeking as to economic strategy. In two cases, Malaysia and Tanzania, intervention was motivated also by social goals.

In the neoclassical paradigm of development, an outward-looking economy is characterized by internal prices that reflect world prices. **Price distortions** from this ideal are caused by import controls, tariffs, internal taxes, subsidies, credit allocations, public monopolies, and other government interventions. With the likely exceptions of Hong Kong and Singapore, for which we have do not have comparable data, none of the Asian economies were notably outward-looking in this respect, as Figure 6 shows. The price distortion index[5] for Thailand, Malaysia, Ko-

[5] The index is the coefficient of variation of actual domestic prices from purchasing power parity levels based on United States prices (as a proxy for world prices). An index of 1.5, for example, says that one standard deviation of observations (68% under a normal distribution) lies between *plus* and *minus* 50% of the mean.

rea, and Indonesia is higher than for Malawi and comparable to those of Cameroon, Kenya, and Ethiopia. Other African economies in Figure 6 were, however, far more distorted.

Figure 6: Price Distortions,* 1983
(Coefficient of Variation)



* Ratio of intervals containing one standard deviation of domestic prices compared to world price standard.

Source: Asia and Africa, Chapter 7

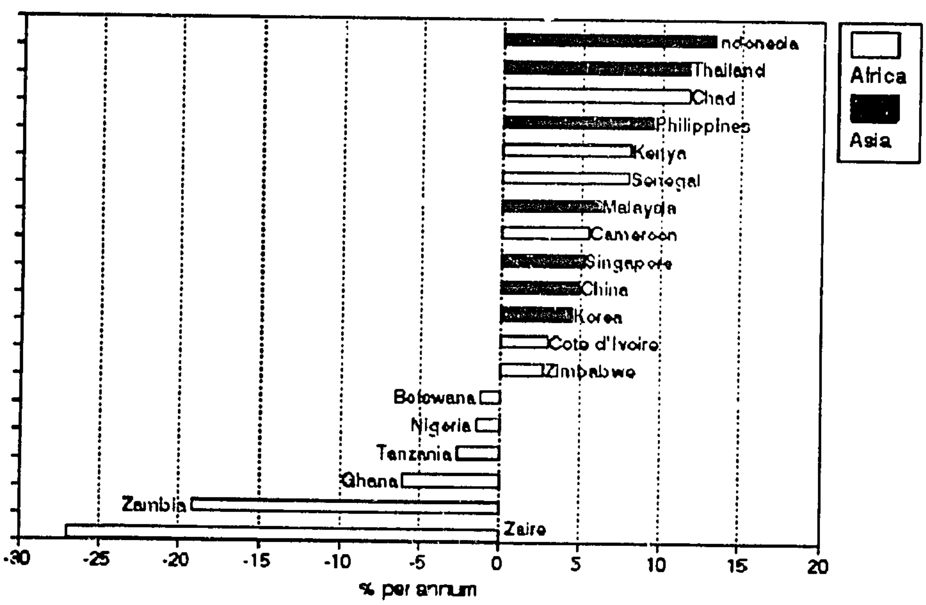
How did Asian countries manage to generate rapid export growth in the face of such an imperfect set of industrial policies? Macroeconomic stability and flexible management of the exchange rate probably played the major roles. But the Asian countries also insulated their growing export industries from price and other distortions. Korea used an elaborate set of interventions with the combined effect of allowing export firms to import their inputs and sell their output at close to world prices. Taiwan and Malaysia used export processing zones. Taiwan, Indonesia, and Thailand exempted exporters from import duties and import licensing. Some African countries tried similar devices. But these were ineffectual in the face of overvalued exchange rates, uncertain macroeconomic policies, and unenthusiastic implementation of export promotion schemes.

Flexible Factor Markets

Rapid economic growth requires factor markets that generate appropriate price signals and allocated resources to their most productive use. In Asia, wages were determined by **labor markets** rather than by government regulation. Because growth has been rapid, markets have also generated rapidly increasing real wages. African wages rates have been affected more by strict labor codes that affect the larger employers. Despite this, it is not clear that African labor markets have failed to reallocate labor when there was a demand for it. In the large informal sector, wages are determined entirely by market forces.

There is a greater difference in the performance of financial markets. Asian markets have, until recently, been marked by government controls over interest rates and the allocation of credit. But, as Figure 7 shows, interest rates have been kept positive in real terms, a sign that efficient allocation of credit has been a policy goal. The highest real rates in that table belong to Asian countries plus Chad, Kenya, Senegal, and Cameroon. Several African countries have negative real rates; in Zambia and Zaire interest rates are so negative that they can have little allocative role.

Figure 7: Average Real Interest Rate
On Loans



Source: Asia and Africa, Chapter 4.

Before they were reformed, Asian financial markets had important safety valves for credit needs not satisfied in the domestic formal sector. Korea and Taiwan have large and efficient curb markets that have been important financers of export firms. And the open capital accounts of the ASEAN three plus Hong Kong and Singapore offer access to foreign finance to the largest firms. Africa has neither of these safety valves.

Most Asian countries have by now established a momentum towards reform of their financial markets that has been a factor in attracting foreign capital. Some African countries--The Gambia, Ghana, Kenya, and others--are moving in that direction. Given the lack of large informal credit markets or of access to world financial markets, African financial reform may be more urgent that in Asia.

Conclusions

There is no single Asian "model" of development. But it is possible to find four common elements in the economic policies of all seven rapidly growing Asian economies:

- Exchange rates were managed to provide constant and rewarding incentives to exporters.
- Budget deficits--and the need to finance them--were kept small in relation to national income.
- Economies were outward-looking, in the sense that exporters had access to inputs and could sell their outputs at close to world market prices, despite protection for home-oriented industries.
- Labor and credit markets were kept flexible enough to direct resources to the most rapidly growing industries.

It is in these crucial respects that African policy has fallen short. Botswana and Mauritius have had productive policy regimes for several years. Economic reforms in The Gambia, Ghana, Kenya (only recently), Nigeria (until recently), Tanzania, and Zambia have improved the policy environment in those countries. The recent devaluation of the CFA franc may be a start to reform in Francophone Africa. But reforms may take several years to generate growth in economies that suffered from poor policies for one or two decades, and in most countries in Africa determined reforms have not yet begun.

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