

Classical Insights -- Emerging Markets

Global Investment Analysis Based on the Classical Economic Model

Classical Insights Emerging Market Bullet Points November 12, 2006

Western opinion leaders are finally turning against the policy of dumping economic aid on Africa in a way that takes individual Africans to be children incapable of entrepreneurship.

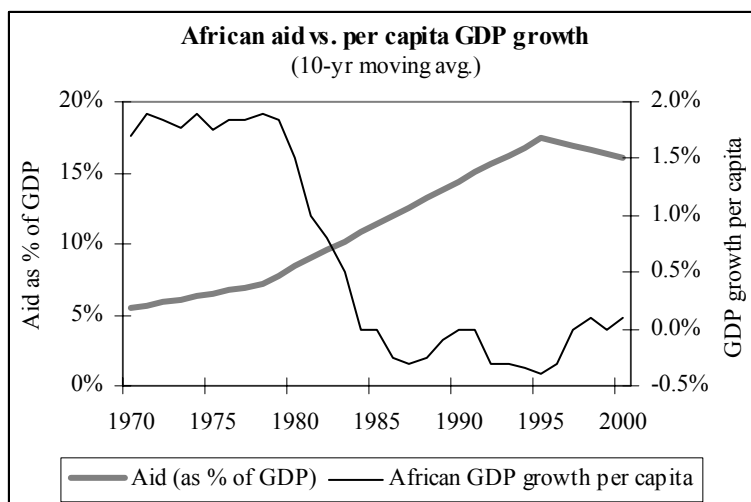
This is a big positive for African economies. Given the many other positives now at work in the region (global monetary tailwind, strong commodity prices, regional currency stability and regulatory improvements), it could be argued that the economic outlook for Africa is better than at any time in the last 40 years.

The intellectual shift on aid and development can be seen in many places:

- 1) William Easterly's *The White Man's Burden* (Penguin, 2006) demonstrated with extensive research and documentation that economic aid to Africa has totally failed to achieve its goals;
- 2) *New York Times* reporter Nicholas Kristof last month published a great [piece](#) in the *New York Review of Books* which arrived at the same conclusion as Easterly (i.e. top-down economic aid has failed). As a star left-leaning reporter, renowned for his portrayals of the world's poorest and most abused people, Kristof's views on this issue are likely to be taken seriously;
- 3) The 2006 Nobel Peace Prize was given to the "godfather of microcredit" Muhammad Yunus and his Grameen bank for, in the Nobel committee's words, "their efforts to create economic and social development from below." Of equal importance, the prize was *not* given to Bono or some other top-down aid proponent. Bono is becoming a symbol of the failed policies of the past;
- 4) *The New Yorker* last month ran a long positive [piece](#) on the exploding microfinance industry, which is attracting both philanthropists and private-sector players;
- 5) The Bill Gates foundation recently made the decision to put its money and energy into *health-care* aid to Africa, with an eye toward curing Malaria. Health-care aid is the one type of assistance that actually seems to work -- and the foundation's choice is unlikely to have been accidental;
- 6) Popular literature (fiction and non-fiction) has turned increasingly hostile toward African aid workers in the past three years. (More on that below.)

Of all these events, perhaps the most important has been the publication of *The White Man's Burden*, in which author Easterly uses a series of powerful charts and tables to dismantle the case for economic aid. Here are four of them:

From 1970-2000, foreign aid correlated *inversely* with GDP growth in Africa:



The countries receiving the greatest number of structural adjustment loans from the IMF and World Bank in the 1980s and 1990s had a combined growth rate that was *below* zero:

**Performance of countries with the most
structural adjustment loans from the IMF & World Bank (1980-1999)**

	Number of Loans	GDP per capita (annual) from date of first loan	CPI rate (annual) from date of first loan
Niger	14	-2.3%	2%
Zambia	18	-2.1%	58%
Madagascar	17	-1.8%	17%
Togo	15	-1.6%	5%
Cote d'Ivoire	26	-1.4%	6%
Malawi	18	-0.2%	23%
Mali	15	-0.1%	4%
Mauritania	16	0.1%	7%
Senegal	21	0.1%	5%
Kenya	19	0.1%	14%
Ghana	26	1.2%	32%
Uganda	20	2.3%	50%

Source: The White Man's Burden

Source for state failure: Richard Rotberg, 2002

There were eight cases of total state failure between 1977 and 1995 – and heavy IMF involvement preceded seven of them:

**The Eight Cases of State Failure Worldwide as of the 1990s
and their prior IMF programs**

	Approximate year of onset of state failure	Time under IMF programs in preceding 10 years (%)
Afghanistan	1977	46%
Angola	1981	0%
Burundi	1995	62%
Liberia	1986	70%
Sierra Leone	1990	59%
Somalia	1991	74%
Sudan	1986	58%
Zaire	1991	73%
Average		55%
Average for all developing countries 1970-1990		20%

Source: The White Man's Burden

The countries that grew the fastest in the 1980s and 1990s had little to do with the IMF:

Best and worst per capita growth rates 1980-2002

	Per capita growth 1980-2002 (%)	Aid/GDP 1980-2002 (%)	Time under IMF programs 1980-2002 (%)
Ten best per capita growth rates 1980-2002			
South Korea	5.9%	0.03%	36%
China	5.6%	0.38%	8%
Taiwan	4.5%	0.00%	0%
Singapore	4.5%	0.07%	0%
Thailand	3.9%	0.81%	30%
India	3.7%	0.66%	19%
Japan	3.6%	0.00%	0%
Hong Kong	3.5%	0.02%	0%
Mauritius	3.2%	2.17%	23%
<u>Malaysia</u>	<u>3.1%</u>	<u>0.40%</u>	<u>0%</u>
Median	3.8%	0.23%	4%
Ten worst per capita growth rates 1980-2002			
Nigeria	-1.6%	0.59%	20%
Nigeria	-1.7%	13.15%	63%
Togo	-1.8%	11.18%	72%
Zambia	-1.8%	19.98%	53%
Madagascar	-1.9%	10.78%	71%
Cote d'Ivoire	-1.9%	5.60%	74%
Haiti	-2.6%	9.41%	55%
Liberia	-3.9%	11.94%	22%
Congo	-5.0%	4.69%	39%
<u>Sierra Leone</u>	<u>-5.8%</u>	<u>15.37%</u>	<u>50%</u>
Median	-1.9%	10.98%	54%

Source: *The White Man's Burden*

Easterly's tables show a negative correlation between aid and growth, and this isn't coincidental. Kristof, in his New York Review of Books piece, argues (correctly) that foreign aid often has the same cancerous effect as huge oil revenues. In both cases, central governments get big piles of cash for doing basically nothing. This "free-money tap" makes control of national governments into a sort of "prize" to be won. Making matters worse, once control is achieved, rulers *have a direct interest in retarding grass roots growth, since it potentially threatens their power*. We can see just this dynamic now playing out in Russia and Venezuela. (Hugo Chavez would not exist without, say, \$45 oil, and oil production in Venezuela is actually declining because his administration is so bad.)

The IMF is a big part of the problem. IMF programs usually require tax-rate increases and currency devaluations on the (false) notion that risk-takers and entrepreneurs don't drive economic growth (so it doesn't matter how high tax rates are). The typical IMF program assumes growth won't change if marginal tax rates are raised to, say, 40% from 30%. The failure of this assumption is mirrored in the failure of Africa (and much of Latin America) to grow over the past 25 years (and also in the *success* of Eastern European countries, most of which have slashed tax rates since 2000).

Literature began turning against aid workers in 2003, and the trend appears to be gathering steam:

- In the movie version of John Le Carre's book *The Constant Gardener* (Scribner, 2000), the aid worker Tessa is portrayed as hotheaded, self-righteous and absolutist. It's not clear that Le Carre *himself* painted her that way in his book, but that's how the screenwriters portrayed her in 2006. Nominally the heroine of the movie, she is made to be (on balance) unlikable as a human being;
- Philip Caputo's *Acts of Faith* (Knopf, 2006), is essentially a re-make of Graham Greene's *The Quiet American* in which idealistic and naïve aid workers start a charter airline to carry relief supplies from NGOs to war-ravaged southern Sudan.
- In *Three Worlds Gone Mad Dangerous Journeys through the War Zones of Africa, Asia, and the South Pacific* (Lyons, 2003), author Robert Young Pelton meets aid workers in civil-war-torn Sierra Leone and describes them variously as drunken Italian party girls or conformist young American and European men, each wearing an item of local jewelry (like a bracelet) as a sort of uniform to convey solidarity with the local culture.

The harshest portrayal of aid workers to date is perhaps to be found in Paul Theroux's *Dark Star Safari – Overland from Cairo to Capetown* (Mariner, 2003). Theroux develops a serious dislike for aid workers as he travels the length of the continent. At the Ethiopia/Kenya border, a car Theroux had been riding in breaks down and he finds himself at dusk in a grim little town, in need of a lift across into Kenya:

Just then a white Land Rover went by. An idealistic slogan relating to hunger in Africa was lettered on the door, two faranjis [white westerners] inside.

"Could you give me a lift across the border?" I asked them.

"This isn't a taxi," one of the men said – a West Country accent.

"I was looking for a place to stay on the other side."

"We don't run a guest house," the other one said – a Londoner.

They drove away, leaving me by the side of the road. That was to be fairly typical of my experience with aid workers in rural Africa: they were, in general, oafish, self-dramatizing prigs, and often complete bastards.ⁱ

Once over the border, in Marsabit Kenya, Theroux meets two young British aid workers, Fiona and Rachel:

"We have a wet feeding tomorrow," Fiona said.

Rachel said, "Ninety underweight children, some of them malnourished, infants up to four-year-olds."

"What is a wet feeding?"

"That's porridge. Unimix for nutrition – maize, beans, oil, some sugar and fat. Americans call it Corn-Soy Blend."

"You are going to a village to dump Unimix in a trough for people to eat."

"I wouldn't put it that way," Fiona said.

I said, "We used to say, 'Give people seeds and let them grow their own food.'"

"The rains have been unreliable," Rachel said.

"Maybe they should relocate. If they relocated they might find work, and they might plant gardens if you weren't feeding them."

"We save lives, not livelihoods," Fiona said. ... "Why are you looking at me like that?"

"I don't know," I said. Something about 'supervising a wet feeding.' It sounds like something you'd do in a game park."

They looked at me, unhappy to be challenged.

I said, "And what would happen if you just sent the food?"

"Their parents would steal it and let the kids die."

In other words, natural selection. It was why the Samburu were so tough: the strongest survived, weak children died.ⁱⁱ

Curious about the food situation, Theroux goes to the local high school and talks with one of the teachers there, a Mr. Maina, who explains that there is more food than ever in the district

because the government is no longer supporting cash crops like coffee. As such, the farmers are planting more cabbage and maize for subsistence.

“Why doesn’t the government care [about the loss of the cash crops]?”

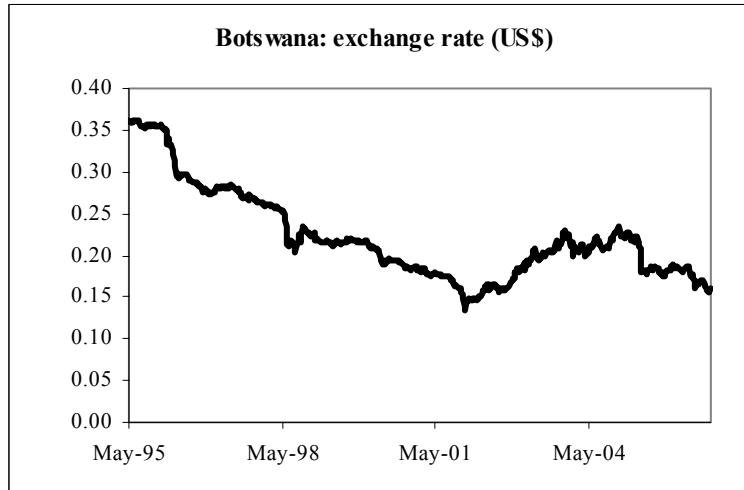
“Why should they care? They get money from the World Bank and the IMF and America and Germany and everyone else.”

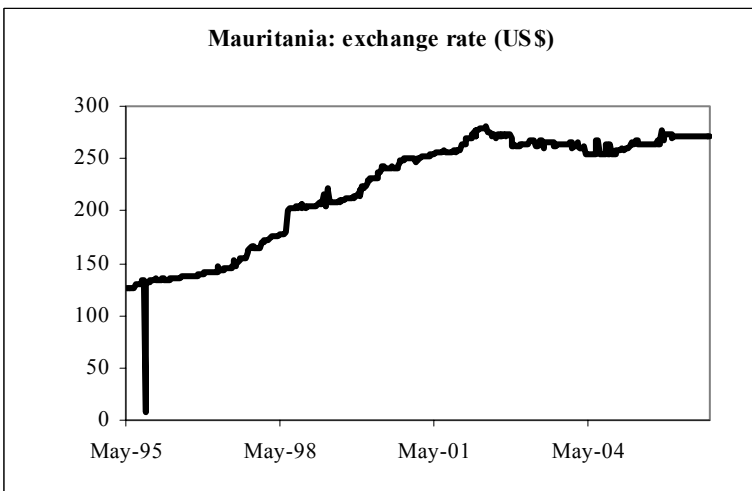
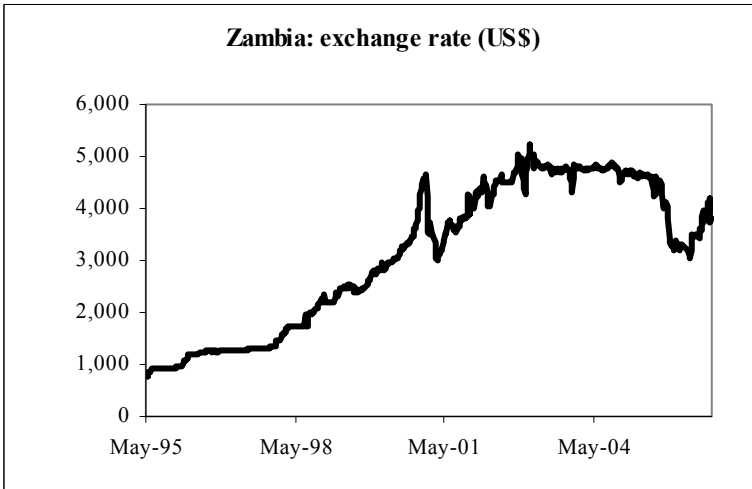
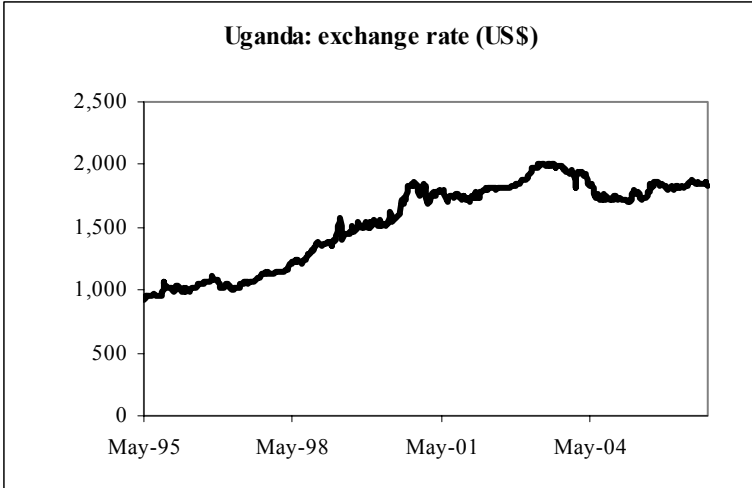
In a word, Kenya’s government too was dependent on its own version of Unimix, in the form of donor-country money. It was a proven fact that this money went into the pockets of politicians.ⁱⁱⁱ

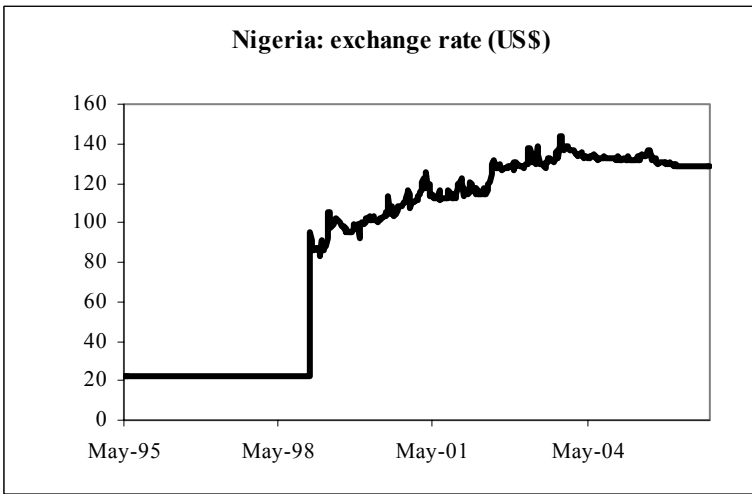
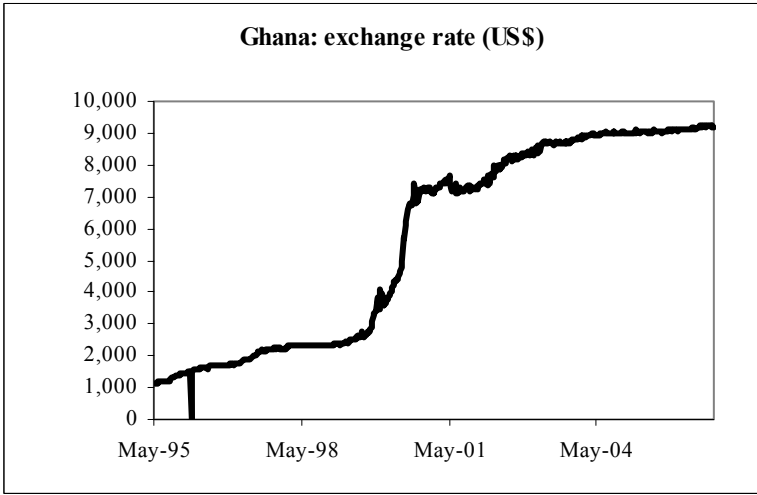
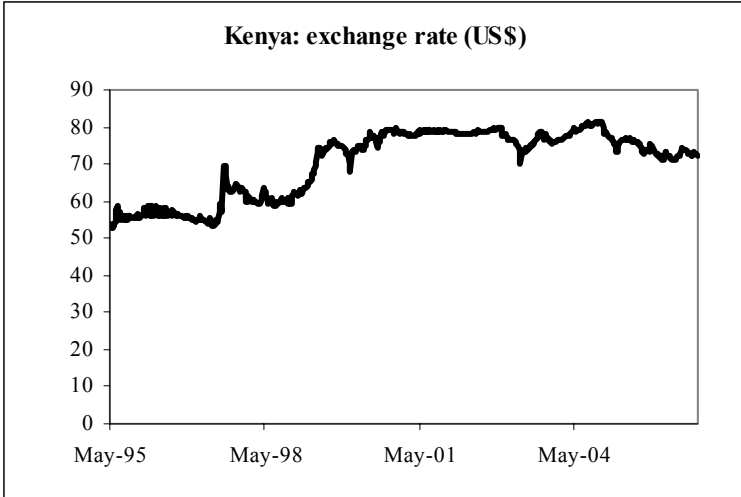
Eventually Theroux decides he prefers the deep-in-the-bush chunks of Africa. He finds people friendlier, more relaxed and more settled when not in the presence of aid workers, cities, relief programs and tourists. In these parts, Theroux senses a kind of equilibrium to life (albeit a monetarily poor one). Theroux theorizes that if all the aid workers just simply left, Africans would learn to do more things for themselves and larger chunks of Africa would reach such an equilibrium state.

A window has opened for new approaches to African development as the consensus realizes that traditional forms of foreign aid have failed. This is good time for experimentation because elevated commodity prices are providing many African governments with stronger tax-revenue streams and helping them maintain stable currencies. The runaway success of Eastern European flat-tax programs likely will exert some positive influence in Africa too. Also, several African countries have revised mining regulations in recent years (Burkina Faso and Zambia, in particular) to encourage more investment.

Sub-Saharan banks and consumer plays should be top beneficiaries of both elevated commodity prices and the declining clout of the IMF and World Bank in dictating policies. Moreover, key currencies have been holding their value in dollar terms (though not in gold terms) recently:







Zimbabwe has been the one major outlier in the region. Its program of land confiscation has led to hyperinflation. Hopefully, other countries will note this policy's failure and not follow it.

Mike Churchill

ⁱ Theroux, Paul. Dark Star Safari, p 146. (Mariner Books, 2003)

ⁱⁱ Safari, p. 157-158.

ⁱⁱⁱ Safari, p. 157-158.

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