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Publications

U.S. AND WORLD ECONOMY

The Four Horsemen ride again

Why have some countries gotten relatively rich while others sink deeper into poverty? History and culture have something to do with it, but rotten economic policies are the biggest villain

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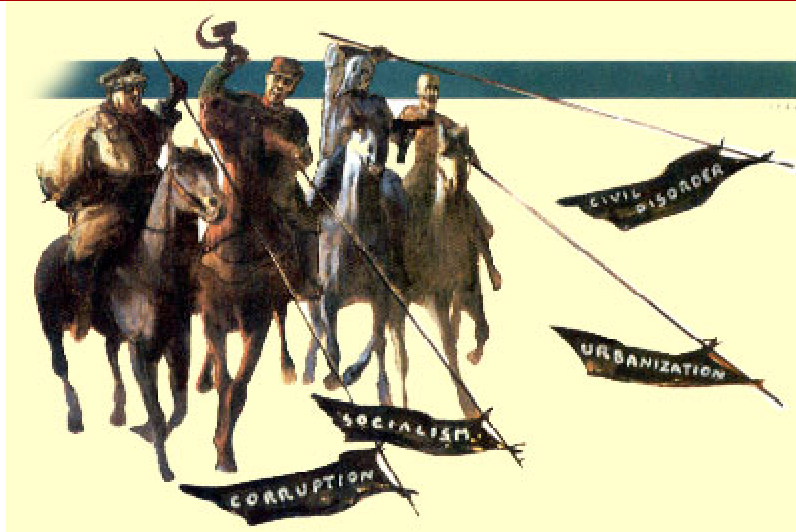

IN BUENOS AIRES hotel lobbies, Brazilian purchasing agents do deals to buy cheap, high-quality Argentinean leather to make shoes in Brazil and export them to the U.S. Why aren't the Argentineans, who badly need both the dollars and the jobs, using the good leather to make and export the shoes themselves! Because Argentina's economy is such a mess that it can no longer function in the world economy save as a producer of raw materials.

Argentina is not starving *(see box, p.102).* Its people are much better *off* than hundreds of millions of others in Africa and Latin America whose very survival is threatened by lack of capital, shrinking exports and cities that grew too big for the economies they feed on.

The Four Horsemen of this particular Apocalypse are natives of the countries they afflict. They are socialism, excessive urbanization, corruption and civil disorder.

Who or what unleashed them? Flint-hearted bankers, determined to extract their pound of flesh? That myth has lost its power even for Third World politicians struggling to avoid blame for their own shortcomings. If the bankers are at fault, it is because their loans too often enabled governments to continue bad economic policies.

Capitalist imperialism to blame? If that were true, the Soviet-bloc developing countries would be better off than the noncommunist developing nations. The opposite is true: Pro-Western South Korea booms, while Marxist-Leninist-Maoist North Korea, in addition to being horribly repressive of human rights, is economically dreary and stagnant. Communist North Korea's per capita income is scarcely half that of capitalist South Korea's. Cuba exists solely on Soviet subsidies. Soviet-bloc developing countries stagnate under the heavy hand of totalitarian bureaucracies that repress human initiative.

By and large, even the poorest of the noncommunist developing nations fares far better than most of the Soviet-bloc developing nations. But why do the noncommunist Third World countries show such uneven development? Why are South Korea and Taiwan booming and Brazil developing fast while many other Latin American and African countries are running

downhill? Because the successful ones, like South Korea and Taiwan, have submitted to the discipline of free markets; where Taiwan and South Korea have intervened in the economy it has been to push private industry toward - greater efficiency and an export orientation. The less successful developing countries have used state intervention to create useless jobs and for ideological reasons. Take Peru. As many as half of all Pew's salaried workers are employed by the government. This may help keep governments in power, but it drains rather than feeds the economy. Money that ought to go for job creation goes instead to maintain economically unproductive bureaucrats. People who could be making shoes or processing food are instead shuffling pieces of paper. Because so many developing countries have chosen the path of bureaucracy rather than of market discipline, the worldwide transformation in mortality—which has halved death rates in poor countries since 1950—is threatening to reverse. The blunt truth is that conditions in large parts of the world are deteriorating.

Never before in history have living standards risen so far as in the four decades since World War II. In many poor countries, people have been linked in new networks: roads, airports, telephones, electricity, radio, TV. But now much of this is crumbling.

According to the World Bank, features of modem society to which many Africans have been exposed are withering. Trucks no longer run because there are no spare parts and roads have become impassable; airplanes no longer land at night in some places because there is no electricity to light the runway. Even where foreign donations of food and medicines flow in, they become less and less useful as the internal distribution system deteriorates.

In Africa and Latin America, governments built impressive hospitals in the big cities that fed the job boom in the health care industries. But local currency can only pay salaries. Fast dwindling is the foreign exchange needed to buy medicines and instruments.

Visit the big hospital in the squatter settlement of Collique, on the outskirts of Lima. It lacks X-ray plates, thread for suturing, serum tubes and injection needles. Razor blades are used for small surgeries. The new 150-bed wing is filled in the summer with children dehydrated by chronic diarrhea and in the winter with others suffering from bronchial and lung diseases At a police office in the lobby, mothers and newborn babies are fingerprinted to make it easier to identify abandoned infants.

Peruvian mothers abandon their babies today because the country's economy no longer can sustain further population increases in squatter communities like Collique. Peruvian real per capita income has returned to 1965 levels, wiping out the gains of two decades. Since 1975 per capita consumption of wheat and fat products has fallen sharply, even though a large part of Peruvian demand is covered by foreign donations and concessionary sales. A soapmaker says sales of his products also are falling because "people have less clothes to wash."

Peru is typical of many overpopulated poor countries throughout the world, where cities are swelling out of control without an infrastructure, an industry or an agriculture sufficient to support them. In sub-Saharan Africa urban populations are growing by 6% yearly, one of the fastest rates at any time or place in history. Cities like Lagos and Nairobi and Kinshasa have absorbed modem technologies of consumption much faster than the technologies of production.

How do the uprooted rurals survive in the cities? In Peru's Collique, the only productive activity in sight is people building more shacks. Outside the shrinking world of the formally employed, there has been a swarming of street-sellers. Youths eke out a living by stealing sewer caps and selling them as scrap iron, or by roving in bands at night, carrying empty flour sacks from U.S. Food for Peace donations, to steal the crops from the small truck farms at the edge of Lima, just beyond the squatter settlements. It is no different in many other Latin American and African cities.

Having become much more efficient at absorption than they are at production and distribution, the Third World cities grow not only because of high birth rates but because—

thanks to modem transportation—they are easier to reach today, and because they provide access to cheap goods and services (from schools and hospitals to foreign food donations) that cannot be had in a stagnant and forgotten countryside.

Mexico City's population has grown in this century from 344,000 to 18 million, pushing Tokyo-Yokohama to become the world's biggest metropolis.

In 1950 all but four of the world's ten biggest cities were in the richer countries. Today all but two are in less-developed countries.

In 1907 Nairobi, now the capital of Kenya, then the capital of British East Africa, had only 4,737 inhabitants. It was a mere outpost. By 1950 the population grew to 130,000, and it is 1.2 million today. But there is insufficient industry to support the city. It lives off hinterland agriculture and foreign loans and charity.

Jeffrey Sachs, an economics professor at Harvard, suggests that one of the reasons for the big differences in economic performance between Asian and Latin American countries is that Asia is much less urbanized. Among the most economically successful countries in Asia have been ones like Malaysia—with 38% of its people in towns and cities—whose economy grew by an average of 7% yearly over the past two decades, or Thailand—20% urban—with economic growth at 7% since 1965. The countries in deepest trouble have from one-fourth to one-third of their populations piled into a single city like Santo Domingo, Mexico City, Santiago or Buenos Aires. (By contrast, Brazil has ten cities of more than 1 million people.

These miserably poor cities, unproductive in nearly every sense, drain resources needed for development and goods that could otherwise be exported. They require sewers and roads and water supplies and clinics, but produce nothing to pay for these amenities. Lower urbanization levels in Asia made it possible for Asian countries to achieve much higher levels of capital formation than Latin America. In 1982 gross domestic fixed investment averaged 25% of GDP in five Asian nations (China, India, Indonesia, Korea, Taiwan)—more than doubling since 1950—while investment in Latin America went down, from 23% to 20%.

Why are some Third World countries raising themselves by their bootstraps, as Brazil and South Korea, say, are doing, while others, Ilke Nigeria and Mexico, sink daily lower? Why are the sprawling cities of Seoul and Taipei economic assets, while Mexico City and Lagos are dumps of human misery? Why is Argentina productive only in such raw materials as beef and bides, while South Korea produces 256K RAM chips!

"You have to have an exporting mentality," says Elvio Baldinelli, a Buenos Aires trade expert. Here he puts his finger on the policy differences that seem to separate the rising Third World countries from the falling ones.

Says Baldinelli: "You have to seek opportunities and design your shoes for foreign markets. You must have an exchange rate that makes it possible to export profitably, not a historically overvalued currency that protects inefficiency and unproductive concentrations of people in the cities. Argentina despised its export industries and taxed them very heavily, yet lived off them very well until markets closed and prices fell." You can sum up Baldinelli's explanation in a sentence: To succeed in the modem world, a country needs economic policies that encourage, not hamper, economic initiative. You must submit your economy to the disciplines of the marketplace. This is politically difficult but economically essential.

"In the big hotels of Seoul and Taipei, the lobbies are full of U.S. purchasing agents bringing samples of pans and finished products to order cheap copies from Korean or Taiwanese manufacturers," says Frank Veneroso, an international financial consultant. Few purchasing agents haunt hotel lobbies in Nairobi or Lagos or Lima.

In Africa and Latin America, governments consistently have hurt exporters by overvaluing exchange rates to protect and enlarge the consumption levels of the people in the cities.

Here's how the bad policies worked in the glaring case of Mexico:

On the eve of its 1982 debt crisis, the Mexican government was holding the peso at a greatly overvalued rate—29 to the dollar—thus keeping imports of food and other consumption items relatively cheap but so seriously penalizing Mexican exports that almost nothing but oil was exportable. The dollar was so artificially cheap that wealthy and middle-class Mexicans happily changed pesos into dollars, which ended up back in the U.S., but in private Mexican names. Now Mexico can't pay its debts.

In Mexico and throughout much of Latin America, people foolish enough to save have been robbed systematically. Anyone foolish enough to leave $1,000 (U.S.) worth of Peruvian currency in a Peruvian savings account since 1970 would have had only $150 left by June 1985. The situation in Mexico was worse in some ways. To encourage Mexicans to keep dollar assets at home, the government permitted them to maintain dollar deposits in Mexican banks. But when the peso collapsed, the government repudiated the dollar deposits, settling them in pesos at a substantial loss to depositors. It will be another generation before Mexicans will trust their own government again.

While small savers were frequently penalized, insiders were raking it in. Private and government banks lent money to business partners and political insiders at negative rates. Banks usually lost lots of money from bad loans and from lending at below-inflation interest but were bailed out by the government printing press. Says a former Peruvian Economics Ministry official: "Industrial profits were spectacular during the 1970s, with abundant government credit for industry at negative interest, If you owned a factory, you could buy dollars from the government at special cheap rates to import machinery, parts and materials. You could then move the cheap dollars out of the country by overbilling machinery imports by 200% or 300%. We know of imported factories that produced fortunes for their owners without the machinery ever being taken out of the crates. They're still in warehouses waiting to be assembled." So much for state subsidies.

In South Korea the state also was deeply involved in development efforts. Its government bankrolled new industries with cheap credit. But, unlike Mexico and Peru, it always had its eye on prices and standards of the world economy. It did not try to insulate its own economy from the marketplace.

As a Japanese colony until after World War II, Korea loped a strong educational system and valuable commercial experience as part of the prewar Japanese export machine. So when Korea started developing on its own, it had the skills to do better than the Mexicans and Peruvians. It's not only what you do but how you do it.

Governments always have promoted economic development. They did it in ancient China and 18th-century Germany and prewar Japan. After World War II, they were deeply involved in development efforts throughout the Third World. The efforts that succeeded were those showing the greatest sensitivity to market forces.

Take Brazil, one of the most successful of the developing countries. Although its industries were protected from foreign competition, they had to keep prices low in markets of low-income people. This cost discipline, together with government export subsidies, enabled Brazil to raise manufactured exports by roughly 30% yearly from 1970 to 1982, about as fast as Korea and Taiwan. Last year Brazil exported $3.2 billion in cars, trucks and pans, enough to cover nearly 30% of the $10.4 billion in interest paid on its huge foreign debt.

On the other hand, African governments have done so badly that few people today remember that Africa once showed quite remarkable economic progress. In Ghana in the lB9Os there were no roads, and only 3,000 children were in school. Goods were carried along jungle paths on the backs of porters- By the time Ghana gained independence, in 1957, the British had built a network of railways and roads, and more than half a million children were in school. Ghana's cocoa exports rose from 1,000 tons in 1900 to 300,000 tons in 1950. Nigeria's exports of palm kernels went from 52,000 tons in 1900 to 347,000 tons in

1951. Back-country towns that had been slave markets became centers of the groundnut trade by the 1 930s. Trade in these commodities was largely in the hands of highly competitive small merchants and farmers.

And then came independence. Independence was not the problem. The chosen economic policies were the problem. Ghana adopted bastard socialism, bred first by British socialists and then expanded by African nationalists. The British started the trouble with government monopoly of export of all major crops, licensing of commercial activities, and state enterprises that used subsidies to spawn big bureaucracies that paid below-market prices to peasant farmers. Farmers stopped producing and started moving to the cities. As independence neared, Ghana's Cocoa Marketing Board became the cash cow for the political ambitions of Kwame Nkrumah, Ghana's first president. Since the mid-1960s, Ghana's cocoa production has fallen by half while its urban population has tripled.

Swelling with pride that they were no longer in thrall to foreigners, many countries ignored the fact that they were cutting the arteries that bound them economically to the rest of the world; they were seceding from the world economy. Most of the state companies that took over from foreigners were geared to one or a few traditional product lines—tin, copper, oil. This drastically reduced the capacity of many countries to respond to changes in the outside world. Each state enterprise has a vested interest in its own product. Conditions change—the U.S. now uses 30% less metal per unit of production than it used a decade ago—but the metal-producing nations missed the signals because the economic sensors were cut. They went on producing senselessly, just as the squabbling members of OPEC are doing in oil today.

"Until 30 or 40 years ago, foreign businessmen influenced decisively the orientation of Latin American economies," explains a senior World Bank economist. "This insured a reasonable consistency between what was being produced and what was being demanded by world markets. Then governments took the place of foreigners. They created many production bureaucracies in state corporations that were created when private investors were nationalized in extractive industries like mining and oil."

Why not shut down copper mines or tin mines until supply catches up with demand? Why give the stuff away? Because these countries need foreign exchange earnings at almost any cost, and because workers at these nationalized industries need their jobs for survival in a shrinking economy. There is no longer a market-clearing mechanism at work to align production with levels of consumption. Instead, enormous amounts of resources and credit-creation are employed wastefully to sustain and expand excess capacity.

In declaring last year that his country could no longer fully service its foreign debt, Peruvian President Alan Garcia paid ritual obeisance to anti-gringo myths, but then spoke bluntly to his country: "If we must denounce the unjust origins of the debt, we also must accept that as a people we have not had sufficient strength or courage to change the direction of our history." The real problem—as Garcia well knows-is that fewer than 10% of the public-sector loans to Peru in 1970-85 were invested productively. Much of the rest went for food imports and for buying French Mirage fighter planes and Soviet military hardware. In 1983-85 foreign loans provided one-third of total government spending.

As the foreign loans dry up, too few new exports arise to replace the foreign exchange that loans once provided. In Africa, governments make desperate pacts with the IMF for spending cuts and currency devaluations to improve the official balance of payments and to get a little more loan money to ward off financial collapse.

But human needs and human aspirations thwart these belated attempts at discipline. According to an article in London-based *South Magazine,* which focuses on developing countries, Nigeria is the source of contraband oil bound for Europe, as well as of textiles, detergents, spare parts and tape recorders smuggled into the back country of Togo, Benin, Ghana, Niger, Chad and Cameroon. About a fifth of Ghana's cocoa crop is smuggled out of

the country in 30-kilo sacks carried through the bush on the backs of young men to the ports of the Ivory Coast and Togo. The young men carry back to the bush TVs and stereo sets, building materials, perfumes, watches and jewelry. These exchanges build on both ancient intertribal trade and the extensive systems, involving many African intermediaries, commanded in colonial times from the ports by European and Arab import-export firms.

Peru's overvalued exchange rate today is wiping out the country's role as a major minerals exporter. Meanwhile, **it** survives in the world economy by smuggling coca paste to the cocaine trade, which brings in more foreign exchange than petroleum, its biggest official export.

In Bolivia, the bulk smuggling trade extends to a wide range of products: tin concentrates stolen from nationalized mines, coca paste from the jungle valleys of the Chapare, gasoline, alpaca wools and foreign food donations. Most passengers on Bolivia's creaking railroads are the *hormiga* ("ant") smugglers carrying bundles from the border towns of Peru, Argentina, Chile and Brazil.

Maybe the saddest thing of all is this: While the contraband trade is surprisingly efficient in providing consumer goods (especially if it circulates part of the proceeds from export smuggling of high-value products like coca paste or gold or diamonds), it does poorly in supplying technology and capital goods needed to keep the modern sector of a country's economy running. Dope and smuggling help keep stomachs filled but don't help with the long-term problem of jobs and production.

In this threatening climate, with the Four Horsemen threatening to ride down the helpless masses of so many countries, there's lots of talk in the media about corruption. But what is corruption? It is a market of favors, usually official favors. The more government control, the more government dominance of the economy, the greater the opportunity for and demand for the buying and selling of official papers. (With a totally government-dominated economy, the Soviet Union looks to many observers as the most corrupt society in the world.) In places where people can't live from production, they live by granting and receiving favors. Most Third World corruption is not a mark of national character but a by-product of poverty and socialism. The challenge is to make the market for production more important than the market for favors.

What are the chances for reversing the policies that have impoverished so much of the world? For both rich and poor countries, two important developments have taken place recently to begin correcting these distortions.

First, governments are finding it harder to subsidize uneconomic capacity. This difficulty is behind such events as last fall's collapse of the London tin market and this year's breakup and privatization of the moneylosing Japanese National Railways.

Second, rich and poor governments are adjusting their currency exchange rates. The outstanding example is the depreciation of the dollar since last September. But even more dramatic are the efforts of the poorest nations of sub-Saharan Africa to arrest their economic decline with radical devaluations prescribed by the IMF and the World Bank. In late 1985 Zambia started auctioning the foreign exchange needed for most trade transactions. Within three weeks, the value of the kwacha fell by two-thirds. In Zaire the effective exchange rate fell by 75% after the zaire was floated. Guinea, Ghana, Gambia, Madagascar and Mauritania are pursuing similar schemes.

These devaluations, imposing sacrifices on long-favored city populations, often air accompanied by increases in producer prices to farmers aimed at generating more a-ports and more self-sufficiency in food.

These new policies, while essential, will be hard to carry out. Once granted, economic goodies arc hard to take back. Democratic or autocratic, socialistic or capitalistic, governments cannot redistribute wealth that doesn't exist.

What can the richer countries do? They can back the brave efforts of those developing countries that take the hard necessary steps. But the capital these countries need cannot be bestowed as a gilt or created by political edict. It can be raised in only two ways: by less consumption at home, and with policies that attract foreign investment. This, unfortunately, means even lower standards of living—but that is happening anyhow. The slide can be stopped only with firm political determination. Without it, there is little the richer countries can do to help save the poor countries from the Four Horsemen.

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