THIRD WORLD DEBT: LEGACY OF DEVELOPMENT EXPERTS

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> In the future, we should try to move toward a common recognition of aid to underdeveloped countries as a collective responsibility for the developed countries, the burden of which should be shared in an agreed fair way, amounting to *an approach to a system of international taxation.*
>
> —Gunnar Myrdal[1]

Debt and Development: The Crowding-Out Effect

Four decades ago, in the wave of the internationalism ushered in by two world wars and coincident with the beginning of large-scale decolonization, the West found itself confronted with a new entity that was to become known as the Third World. The terms "underdeveloped countries" and "less developed countries" were coined to take account of these nations and our perspective of them, and the field, development economics, was crystallized to address the problems that these new nations faced.

Today, many of these nations are still underdeveloped by Western standards. In addition, some nations that once seemed on the way up now find themselves statistically grouped with nations that are many generations their juniors. It would be almost farcical to refer to many of these nations as "developing" in the optimistic lexicon of the past. Instead, they are now more commonly known as the "debtor countries."

This revision in taxonomy is not mere whimsy or rhetoric. Latin American debt is now approaching $400 billion. Sub-Saharan Africa

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[1]Myrdal (1970, p. 365).

has foreign debts exceeding $50 billion. The focus of attention has shifted to the inability of Third World countries to make good on their debts—debts that are said to be crippling their respective economies.

The debt problem elbowed its way to attention in 1982, when Mexico announced that it could not pay its debts. The problem was seen as a political one. The multilateral lending agencies and Western governments stepped between the original principals in the loans, private banks on one side and Third World governments on the other. This culminated in a process of lending money to pay interest while pushing for economic policies to facilitate debt servicing in debtor nations that generate large trade surpluses. Somewhere along the way economic development was crowded out by debt.

The Rule of Experts

The crowding-out process began when Third World development was placed in the hands of Western academics, Third World governments, and international bureaucrats. From the beginning, "development planning," as it was called, substituted foreign loans for foreign and domestic equity in order that the investment process could be controlled by the government's development plan. Consequently, economic life in developing countries was politicized from the start, with markets taking a back seat to governments. Peter T. Bauer, whose skepticism of the wisdom and benevolence of government rivaled development economists' skepticism of markets and private investment, doubted that development planning would succeed. He was wont to remind his colleagues (Bauer 1972, p. 73):

> The state cannot create new additional productive resources. The politicians and civil servants who direct its policy dispose only of resources diverted from the rest of the economy. It is certainly not clear why overriding the decisions of private persons should increase the flow of income, since the resources used by the planners must have been diverted from other productive public or private uses.

Others, however, were confident that only planning would bring development. Gunnar Myrdal (1965, p. v), an eventual Nobel laureate, described the extent of the faith in planning in the 1960s: "In the under-developed countries outside the Soviet Union, national economic planning is almost everywhere a commonly acclaimed ideal." Earlier Myrdal (1956b, p. 201) wrote, "All special advisers to underdeveloped countries who have taken the time and trouble to acquaint themselves with the problems, no matter who they are . . . all recommend central planning as a first condition of progress."

Myrdal (1956a, p. 65) did not decry this mistake. He wrote, approvingly:

> But *the alternative to making the heroic attempt is continued acquiescence in economic and cultural stagnation or regression which is politically impossible in the world of today;* and this is, of course, the explanation why grand scale national planning is at present the goal in underdeveloped countries all over the globe and why this policy line is unanimously endorsed by governments and experts in the advanced countries.

Not all development economists were ideological advocates of planning. A committee of leading development experts, in a volume sponsored by MIT's Center for International Studies, simply believed that "there are limits to the effectiveness of the private market institutions, especially where development must be accelerated. It may be necessary to plan out in advance the key pieces of a general development program (Millikan and Blackmer 1961, p. 64)." Columbia University professor Ragnar Nurkse (1953, p. 84) believed that "private foreign enterprise in the past has not done much to spread industrial development to the backward agricultural countries, but has concentrated rather on primary production for export to the advanced countries."

Other economists were more strident in their beliefs. Stanford professor Paul Baran (1962, pp. xxviii) wrote: "If what is sought is *rapid* economic development, comprehensive economic planning is indispensable." He then explained (p. xxix): "No planning worth the name is possible in a society in which the means of production remain under the control of private interests which administer them with a view to their owners' maximum profits (or security or other private advantage)." Baran (1962, pp. xl–xli) cast aside the history of economic development with a wave of the hand:

> To conclude: the dominant fact of our time is that the institution of private property in the means of production—once a powerful engine of progress—has now come into irreconcilable contradiction with the economic and social advancement of the people in the underdeveloped countries and with the growth, development, and liberation of peoples in advanced countries. That the existence and nature of this conflict have not yet everywhere been recognized and fully understood by the majority of people is one of the most important, if not the decisive, aspect of this conflict itself. It reflects the powerful hold on the minds of men exercised by a set of creeds, superstitions, and fetishes stemming from the very institution of private property in the means of production which now desperately needs to be overthrown.

The above passage, from a widely used textbook by an internationally renowned development expert, exemplifies the basic problem of the development field. Development economics asserted that private property was incompatible with progress. By telling this to the Third World, we exposed a lack of belief in our own institutions and undermined the role of private equity in the development process.

Bauer's Reply to the Planners

Peter Bauer disputed the notions used to justify central planning. In an argument similar to Nurkse's, Baran (1962, p. 177) claimed: "The economic surplus appropriated in lavish amounts by monopolistic concerns in backward countries is not employed for productive purposes. It is neither plowed back into their own enterprise, nor does it serve to develop others." Bauer's (1984, p. 22) response was straightforward: "This statement is patently untrue. In the less developed world large industries such as the oil, copper, tin, rubber and coffee industries, to mention but a few, have been financed through reinvested profits."

Likewise, the general argument that the manufacturing industry was the key to a developing economy, and thus requires a government plan to ensure its even development, was disputed by Bauer (1972, p. 142): "This argument is again irrelevant: the development of manufacturing industry does not depend on comprehensive central planning; and development does not depend on the enlargement of the manufacturing sector."

The endowment of governments with extensive control over their economies set up conditions exactly opposite to those required for economic growth. Individual initiative and independence gave way to manipulation of government connections. Bauer (1984, p. 27) wrote:

> In closely controlled economies, the decisions of politicians and civil servants take the place of private decisions in production and consumption. Economic life is extensively politicized. Official directives replace voluntary transactions. The decisions of the rulers largely determine people's incomes and employment opportunities. Indeed, these decisions often determine the economic or even the physical survival of large sections of the population. In such conditions, who has the government becomes all-important for large numbers of people.

Western insistence on development planning helped to saddle poorer nations with easily corruptible economic and political systems. Today Professor George Ayittey (1986) damns the "kleptocrats (armed government looters) and incompetent bureaucrats" who have squan-

dered and stolen billions of dollars of development resources from the people who could least afford to lose them.

Economic planning in the Third World came to mean much more than government bureaus channeling loans, approving licenses, and applying tariffs and subsidies. Planning entailed state ownership of industries, including the nationalization of enterprises owned by foreign companies. Third World nations have been little concerned with the effect of outright confiscation on the flow of private investment, because, as Myrdal (1965, p. 183) noted, "There is a widespread feeling that the direct attraction of private investment from abroad is too costly a way of inducing capital inflow."

Disregard for Property Rights

The disrespect for private property in the Third World not only impaired the ability of underdeveloped nations to attract private investment from abroad; it led also to a loss of massive amounts of capital from domestic sources. A sampling of 18 Third World countries by Morgan Guaranty Trust Company (1986, p. 13) revealed that these nations suffered $198 billion in capital flight from 1976 to 1985. Mexico alone lost $53 billion.

It is remarkable that in our own hemisphere, despite the example of American capitalism, the state dominates so many economies. After "the largest privatization campaign" in Brazilian history, there are still over 340 state-owned companies in Brazil. It has been estimated that "in 1980, 70 percent of all capital investments went to state-owned companies" in Brazil (*Infobrazil* 1985).

In Argentina an estimated 60 percent of the economy is state owned, with the rest subject to all forms of government regulation. A member of the Argentine Chamber of Deputies related an especially poignant example of government inefficiency: the annual interest on the debt of the Argentine coal mines amounting to more than $80 million, compared with annual sales of less than $30 million (Alsogaray 1984).

Mexico, which expropriated its private banks in 1982, is now selling back 34 percent of the banks' shares. This meets privatization demands of creditors without freeing the banking system. To secure its latest debt bailout package, Mexico also promised to "modernize, merge or close about 300 of its 500 state-owned corporations" (Pine 1986). Some nations find it harder to deprogram themselves of the fear of private enterprise drummed into their heads by so-called development experts. One would think that Peru, unwilling or unable to service its debts, would be encouraging private investment. This was hardly the message sent out by Peruvian President Garcia in

August 1985, when the foreign oil company, Beloc, was confiscated by the government, with no compensation paid for its book assets of $400 million (Graham 1986).

Bias Against Private Investment

Third World distrust of foreign private enterprise, called by the MIT committee "a convenient symbol of the external domination from which such a society seeks to liberate itself," led in many countries to an outright blockage of direct private investment (Millikan and Blackmer 1961, p. 65). This sort of policy was urged by Baran (1962, p. 184), who wrote:

> It is very hard to say what has been the greater evil as far as the economic development of underdeveloped countries is concerned: the removal of their economic surplus by foreign capital or its reinvestment by foreign enterprise.

Baran (1962, p. 184) complained of "the pronounced paucity of the direct benefits derived by the underdeveloped countries from foreign investment." Countries wishing to finance the planned development prescribed by experts were advised not to depend on private investment (domestic or foreign); instead, they borrowed and relied on foreign loans to finance their pet projects. As Nurkse (1953, p. 89) advised, "Foreign loans for capital expenditure by public authorities have the advantage that they can be used for domestic economic development in accordance with a coherent over-all programme." This program, of course, devised and implemented by government bureaucrats, was by definition the best use of resources, and it would easily pay back the debts incurred, or so it was thought.

Some Western observers realized the danger of leaving to chance the ability of underdeveloped nations' governments to borrow the necessary resources. They proposed stepped-up lending by Western governments. In his famous report to President Truman, Gordon Gray (1950, p. 13) asserted, "Under present conditions a heavy reliance on public lending must be recognized as essential for an aggressive development program." Gray (1950, p. 63) explained:

> The probable inadequacy of the total volume of private foreign investment available for most areas is not the only reason for this conclusion. Economic development requires funds for the construction of facilities which are ordinarily not attractive to private capital and therefore in most cases must be financed by public funds.

The argument for loans tied to projects was undermined to a degree by Nurkse (1953, p. 96), who argued, "The desire of the lending or giving country to tie its aid to specific investments is understandable,

but this procedure by itself cannot assure the desired effect. There is no substitute for comprehensive planning and budgeting of natural resources." In this reasoning, the projects themselves took a back seat to the existence of a central investment plan, which determined the priority of investments.

In other words, development experts were claiming either that private investment was evil and should not be allowed, that private investment was inadequate and public aid was necessary for certain projects, or that public aid was necessary regardless of the projects. No matter what line was taken, private property took a bashing.

Debts Gone Sour

Bauer was suspicious of public aid and insisted on introducing alien concepts into the discussion: such notions as "productive," "market demand," and "motivations." Noticeably absent from the development plans was the idea that what the people of the underdeveloped country wanted actually mattered. Moreover, there was an almost supernatural belief that government investments would generate the wealth to pay back the debts incurred despite these investments not being guided by any market sense of profitability or productivity. The fact that private investment does not flow into these uses on its own implies that the projects would not generate the wealth necessary to service the loans that finance the projects. Separating the projects from the only objective measure of their worth resulted in declining economic performance and rising political instability. It is no accident that the reliance on planning and borrowing has culminated in the debt crisis. These twin beliefs of the development creed placed resources in unaccountable government hands.

The matter was compounded when Western banks, forgetting the laws of capitalism to which they owe their existence, made large loans to socialist Third World governments. By discounting the likelihood that enough wealth would be generated to pay back the loans, banks removed the last market condition from the process, virtually ensuring that the loans, and the entire development process, would sour.

By following the development creed, Third World leaders found themselves with vast amounts of resources at their fingertips for use at their discretion. As we should know by now, entrance into government does not magically transform human nature. It cannot be surprising that Third World leaders are among the richest people in the world.

The approach taken to the debt crisis has worsened economic and political conditions in debtor countries. The loans that have been used to prevent technical default have increased the debtors' indebtedness. Total debt has risen 25 percent over the past four years, from $809 billion to $1.01 trillion. Long-term debt has grown by more than 37 percent from 1982 to 1986 (World Bank 1986, p. xi). These statistics can hardly be viewed favorably, and the growth of debt hardly constitutes a solution to the debt problem.

Western policymakers still have not shaken off the reliance on debt. Treasury Secretary James Baker's plan, laudable in its attempt to force privatization in the debtor countries, offers the carrot of more loans. The Mexican bailout of July 1986 is primarily a mechanism to furnish Mexico with $12 billion in new loans. The World Bank seeks to "nearly double its loan authority for Third World aid by 1990," increasing its loan level to $21.5 billion (Rowen 1986). Proposals to reduce the debt have been attacked because development is still believed to depend on loans. Unfortunately, more loans are probably the last thing these nations need.

The Failure of Austerity Programs

The other cornerstone of the debt "solution" has been the adoption of austerity programs in debtor countries under the advisement and monitoring of the International Monetary Fund (IMF). Typically, these programs entail cutting government spending and raising taxes to balance the budget; slowing monetary growth and freezing wages and prices to slow inflation; and devaluing the currency and raising taxes further to cut domestic demand. This mishmash of policies is designed to facilitate debt payment in the short run, but it hurts it in the long run by damaging the economy and adding to political instability. The combination of wage freezes, tax increases, and import restrictions destroys the incentives of workers and drives the most enterprising citizens into the underground economy or out of the country.

The wrenching austerity plans are not out of character with the original thinking of some development planners. Myrdal (1957, p. 84), for example, wrote, "There is no other road to economic development than a forceful rise in the share of the national income which is withheld from consumption and devoted to investment. This implies a policy of the utmost austerity."

Today the populace of many Third World nations finds itself in the position of enforced poverty in order to pay for the mistakes of development planners. The per capita gross domestic product of debtor

countries that have accepted austerity in exchange for a rescheduling of their debts is now on average about 10 percent below the precrisis level. For many countries, such as Peru, Venezuela, and the Philippines, the decline has been about 20 percent, with Mexico, Chile, and Uruguay experiencing even larger declines. It is a dangerously destabilizing situation that breeds resentment toward the West. Even relatively responsible politicians often have no recourse but to point their finger at the West. In Argentina, the workers occupied the factories when President Alfonsin first agreed to an IMF austerity plan. Strikes and protests in Panama forced the government to repeal its austerity plan. Violent riots greeted the announcement of plans in Jamaica and Dominican Republic. The most dramatic addition to the unemployment rolls due to IMF austerity was Sudan's former leader, Nimeri, who was deposed in a 1985 coup while in Washington conferring with the IMF.

Institutionalized Barriers to Development

Bauer (1972, p. 78) has stressed the attitudinal basis of economic development. "What is not in doubt," he wrote, "is the presence in many underdeveloped countries of long-standing and interrelated attitudes, beliefs and cultural traditions uncongenial to material advance, and often also a comparative weakness of personal capacities which favour it." Foremost among these unfavorable attributes he listed: "lack of initiative, self-reliance and a sense of personal responsibility for the economic fortune of oneself and one's family." It is a cruel irony that development planning institutionalized these barriers to economic development in the social systems of Third World countries.

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