Cayman Financial Review

Lessons from winners and losers

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January 23, 2018

The good news for 2018 is that world economic growth is accelerating after a decade of sluggishness. And history shows that any country can grow rapidly and achieve a high-income level, if it follows the correct set of policies.

Sixty years ago, Singapore, New Zealand, Estonia, Ireland, Finland, Bulgaria, Panama, and Honduras were considered relatively poor countries. Now, the first five are rich countries, Bulgaria and Panama are middle-income countries, and Honduras remains poor. The accompanying table shows the per-capita income of selected small countries along with their rank on the Index of Economic Freedom. These countries, with the exception of Honduras and particularly Venezuela (with the world's largest oil reserves), lack much in the way of natural resources. Some have warm climates, and some have cold, especially Finland.

For measure of relative economic well-being I have used the conventional IMF numbers as a measure of per-capita income on the basis of a purchasing power parity (PPP), and rounded off to the nearest thousand dollars. There are many flaws in such a measure but it does a reasonable job in showing relative well-being.

The standout country for economic progress is Singapore, whose current per-capita income is now roughly twenty times what it was in 1960, and a good deal higher than the U.S. More than any other country, Singapore has employed the classic limited-government model, wherein government spending only accounts for 17 percent of GDP. In contrast, total government spending in the U.S. net of intergovernmental transfer payments is about 37 percent of GDP. Singapore has little government corruption and a competent and honest judiciary. It has a very high degree of economic freedom, including free trade. It has a stable government (despite many ethnic and religious differences among its people), and property rights are well secured.

The lesson from Singapore is that economic freedom works, and that a country does not need a large government to ensure that its citizens are well cared for, including health needs (it has the 3rd highest life expectancy in the world at 83.1).

Switzerland has long been the poster child for good governance, economic prudence, and stability. Despite three major official languages and religious differences, there is little conflict, in part, because most governance occurs at the local level. The Swiss have little corruption, a very sound judicial system, with very strong protection for property rights. They have effective measures to control the size and growth of government. All of these have resulted in Switzerland being a magnet for money, and the country is regarded for good reason as the ultimate safe-haven.

Switzerland is an improbable success. It is landlocked with at times very unruly neighbors – yet for two centuries it has overcome these obstacles to provide its citizens with one of the world's highest standards of living and a very civil and attractive society. Countries that are struggling to find their way could do no better than adopt the Swiss political and economic model.

The lesson from Switzerland is that with the construction of proper institutions and polices, language and religious differences, and lack of natural resources are impediments that can be overcome to provide a very high standard of living for the populace.

Little Estonia has also been an improbable success. Like all of the other countries in the late Soviet Union, it was poor and corrupt. When it obtained its freedom in 1992, it, more than any other former communist country, embraced the free market. As its reformist Prime Minister Mart Laar said at the time, the "only economics book I ever read was Milton Friedman's "Free to Choose." It sounded good, so we went ahead and did it." One of Laar's greatest innovations was the creation of "e-government," which is the short hand for doing as many government functions over the Internet and electronically as possible. The system was designed to both reduce the cost of government and eliminate much of the potential for corruption, by reducing face-to-face contacts with government employees and having a full electronic record of all interactions with government. The Estonians have been so successful with this model, they now have a number of firms which are selling e-government products and technologies to governments around the world.

The Estonian lesson is that new technology properly utilized can go a long way in destroying corruption, and moving rapidly to free markets from statism provides better results than a more gradual approach.

Finland is a quiet success, like its people. Finland claims to be the safest country in the world with the least organized crime and the most personal freedom. Finnish banks have been ranked as the soundest in the world. Finland ranks in the top three when it comes to the protection of property and the rule of law. It also has the lowest risk to natural disasters in the world – if you don't count bitterly cold winters. The OECD ranked the Finnish education system as the best in the world with highest level of literacy. The country ranks near the top in innovation, research and development, and digital knowledge on a per capita basis. It has the lowest infant mortality rate in the world. And its capital, Helsinki, has been ranked as the most honest city in the world.

Finland is also an oddity in that it is successful even though it has a very high level of government spending (55 percent); but unlike almost any other place on the planet, the people actually get a lot for their money. It is also arguably the most homogenous country in the world, and before Finland entered the EU, it was not open to immigration. Most Finns are descended from a small tribe of people who lived in a harsh climate for thousands of years where they were mutually dependent for survival, and had relatively few interactions with the outside world. The close bond and high trust among Finns even today may well explain why their government works so well. Their unique history does not serve as a path for other countries. In fact, a good case can be made if their government was smaller, their real incomes would be higher, particularly given all of the Finns other constructive attributes.

The lesson from Finland is that a high-trust society with exceptional honesty makes everything work better. Unfortunately, these qualities are very difficult to transplant to other societies.

Bulgaria is in many ways the opposite of Finland – a low-trust society with poorly developed civil institutions. But it is neither a great success nor a big failure. At the end of the communist era in 1990, Bulgaria was poor, and it took a number of years, unlike Estonia, to institute many of the necessary reforms. It is now a thriving democratic free-market state, but is plagued with lingering corruption in the courts and government, which has undermined economic growth. Bulgaria has a stable currency fixed to the euro, relatively little debt, and a flat ten-percent income tax on both individuals and corporations.

The main lesson from Bulgaria is that relatively good monetary and fiscal policy cannot fully offset corruption and repeated failures in the rule of law.

As the old adage goes, "no one is totally useless, they can always serve as a bad example." It is equally true of countries. Greece is the bad example when it comes to fiscal mismanagement. The question is often asked, how much debt can a country manage as a percentage of GDP before it is sucked into a downward spiral. For decades, the Greeks lived beyond their means by borrowing more and more from their EU neighbors, but finally the bill came due. Greece has gone through a succession of bailouts, but the situation continues to get worse. The politicians failed to cut spending as much as would be necessary to stabilize the situation. Instead, they keep increasing taxes in an attempt to get back to balance, but it only makes the situation worse. The tax increases cause the economy to shrink at a faster rate than the higher rates can produce revenue (they are on the wrong side of the Laffer curve). The Financial Times reports: "Unemployment is at 23 percent, and 44 percent of those aged 15 to 24 are out of work." Greece was a developed European country but is rapidly becoming a less developed country as it continues to consume capital rather than invest it. The government has increasingly resorted to seizing property of those who are in tax arrears. It has now reached the point where more than half the taxpayers are behind in their payments. Those who still have some wealth are fleeing the country, further eroding the tax base. Economic output is now lower than it was in 2005. At some point, the legal economy will collapse and the only goods and services that will be provided will be by the black economy. This situation occurred in Eastern Europe and the Soviet Union at the end of the 1980s and early 1990s. The people suffered greatly until a new market economy was established with fiscally responsible governments.

The Greek lesson is that government debt does matter, and once the debt becomes more than the populace is willing to service, a downward spiral becomes self-fulfilling until painful collapse and hopefully ultimately renewal.

Honduras is a country that should be rich. It has both Caribbean and Pacific ports, which could, if developed, service both Asia and the Americas. The highlands have a pleasant climate, and the country has many natural attractions. But Honduras has never had a core of far sighted leaders to create an economic and social renaissance. The country suffers from a high degree of lawlessness and corruption, and property rights are not secure. One can only imagine what the country could look like if the Swiss had been in charge for the last half century. As an optimist, I expect sooner or later some of the ruling elite will decide to make the necessary changes to make Honduras prosper.

The lesson from Honduras is without strong and visionary leadership like Singapore with Lee Kuan Yew, little progress will be made if the country is poor.

Venezuela is the best current example of what not to do. For many years, it was democratic and the most prosperous country in South America. However, all too much of the prosperity was based on oil exports. The government increasingly spent much of the oil revenue to feed friends of the government leaders as a way of buying political support, and engaged in a variety of socialist experiments. The dependence on oil revenue had the side effect of not developing a broad economic base which could have been a cushion during periods of low oil prices. As socialist and other irresponsible governments often do, when the revenue bowl runs dry, the Venezuelans started printing money, leading to very high rates of inflation.

A long-time observer of Venezuela and international monetary expert, economist Steve Hanke, recently wrote in Forbes: “Venezuela has had a long history of producing junk. Venezuela began central banking in 1939, when the Banco Central Venezuela was established. Back then, the exchange rate was 3.35 old bolivars per U.S. dollar. Today, it takes 103,000 to fetch a greenback. That’s equal to 103,000,000 old bolivars.” The government now has a new scheme to issue commodity-backed currency, but would anyone trust the corrupt and incompetent government to honor a currency redemption pledge, when it has reneged many of its other pledges?

The lesson from Venezuela is that no matter how rich a country is in natural resources, socialists and the corrupt can drive it into poverty.

There are many reasons for optimism as the new year unfolds. In most countries, real incomes are rising as a result of more market friendly policies. The danger is the know-nothings and the historically ignorant will continue to push for socialist and other statist policies which always end the same way – more misery.