THE NEW BAZAAR

August 12, 2021

EPISODE 1: THE GREAT TURNAROUND

Peter Blair Henry with a new look at old-school macroeconomic policies

---

CARDIFF GARCIA: Hi, I'm Cardiff Garcia and this is The New Bazaar. Coming up on our first episode.

PETER BLAIR HENRY: Whether countries grow or not determines whether people eat or don't eat.

CG: Economist Peter Blair Henry with a new look at old school macroeconomic policies. Welcome everybody to the inaugural episode of The New Bazaar. Aimee and I, that's Aimee Keane, my business partner who produces the show, the two of us are so grateful that you're here. And I wanna say a quick word before we get started on the show's format. Every week I interview a new guest about how the economy shapes our lives and I start each episode with an essay that introduces the show and the guest and then afterwards there's a long form interview with the guest.

That's it. Pretty simple, but also we know that not everybody digs the long introduction by the host thing. So if you wanna go straight to the interview, mash that 30 seconds ahead button until you hear music that sounds like this and that's how you know that the interview is about to start. Stick around for the credits of this episode for a quick preview of topics we'll cover in future shows, but for now, let's get to the episode itself.

There is something about the way economic policy debates play out these days that drives me a little crazy, but let me start with this. If you're listening to this podcast, there's a decent chance that you're familiar with debates about inequality in the US and Europe and other rich countries. And even if not, there's at least a good chance that you know that income inequality has gone up in these countries in recent decades, because it has. Here's the fact you might be less familiar with, since the late 1980s for the first time in two centuries, global income inequality has actually fallen.

So if you look at inequality across the whole world, as opposed to just inequality within a specific country, for the first time since the industrial revolution, it has gone down. And the reason it has gone down is the incredible progress that's been made by poor developing countries in catching up to the rich economies of the world. So what's behind that? And also what could be more important than figuring that out, how a poor country becomes more prosperous lifting people out of poverty so they can avoid hunger and educate their kids, giving people a choice for what to do with their lives.

Today's guest, Peter Blair Henry, has dedicated his career to finding answers to that question and his latest research does offer a few answers, but there's a twist. The policies that he finds have worked, the policies in other words, that developing countries have used to accelerate their economic growth were once considered pretty basic sound macroeconomic policies, but now those same policies have become controversial in economic debates that take place in rich countries. The same countries that once encouraged those policies and let's face it, once foisted those policies onto the developing countries in the first place.

Now we go through each of these policies in our chat, but the controversy over them is mainly about whether they are too market-friendly, whether they limit too much the role of government in steering the economy to make sure that the benefits of economic growth reach everybody. And so what ends up happening, and this is the part that drives me nuts, is that debates about things like free trade, foreign investment, privatization, get caught up in these partisan or ideological squabbles, where people start throwing around words like neoliberal or technocratic or capitalist or socialist or progressive like epithets. So people end up taking a side and the debates about these policies turn real unproductive, real fast.

The nuances of why these policies work and the nuances of how these policies should be applied to different countries with different circumstances, get lost. It happens all the time. It is maddening and Peter Blair Henry has no time for this. [laughs] He really doesn't. You'll even hear him get kind of fired up about it on the show. And one of the reasons I wanted to talk to him is that his own work is so consistently non-ideological, nonpartisan. So you'll hear him praise market-friendly policies, of course, but also praise things like Joe Biden's antitrust agenda, a fair tax code, more infrastructure spending, and you definitely cannot accuse him of running away from nuances even if you disagree with him.

Some quick background before we start the show. I refer a few times to Peter's book called *Turnaround*, where he writes about developing countries, and we also discuss his recent paper called “The Baker Hypothesis”, which Peter wrote with his coauthors, Anusha Chari and Hector Reyes. That paper is named after a famous speech by Secretary of State James Baker in 1985, where he, Secretary Baker, proposed some of the very policies that Peter and his coauthors have just analyzed. And by the way, if there is one piece of new economic research that I would wanna elevate right now, it is “The Baker Hypothesis”. And so with that, my interview with Peter Blair Henry. Here it is.

CG: I kind of interpret a lot of your intellectual project as reminding policymakers about this [intruality 00:05:41] of economic growth when talking about policies in developing countries. And it seems vital to mention this because there has been a kind of like intellectual trend, intellectual fashion, for the concept of de-growth or at least deemphasizing the importance of growth in recent years. Sometimes citing worries about, you know, climate change, the environment or inequality sometimes just citing the kind of connotation with like greed or something like that. So let me just start with that. What's been your response to that trend and how would you sort of reemphasize the importance of economic growth to developing countries?

PBH: Economic growth is really, it is central to developing countries. And I think that it's been easily forgotten because, if you think that the last really 40 years, and I'm not exaggerating, when I say 40 years, there's been a remarkable thing that's happened, which is that we've seen more, uh, more uniformity of economic growth than we've ever seen around the world. And in particular, we're seeing it in developing countries that didn't have it systematically prior to really the, the late 1980s and early 1990s.

And the ironic thing is that developing countries are now growing, you know, putting, you know, the COVID shock aside. It's been a really on average and outstanding, a couple of decades for developing countries, that growth has happened because of policies that the developed world, you know, have been pushing on developing countries, which used to be called third world countries for, for decades. And it wasn't until the, um, late 1980s, early 1990s, that developing countries actually started listening.

And so now we find ourselves in a situation, developing countries are finally growing and you use a phrase that, you know, Gilda Radner, uh, used to use on Saturday Night Live, I'm dating myself here, but Gilda Radner used to say, “Just kidding.” Right? [laughs] And so all of a sudden the developed countries are saying, “Just kidding.” Right? Just, just kidding about free trade and we know we told you guys that free trade is a good thing, but actually no, we wanna close our borders now because we're upset because we, the developed countries, have not handled internally very well, uh, adjustments to trade.

Or gee, you know, growth is kind of boring so let's just, let's, let's only focus on redistribution now, you know, forgetting about the fact that in order to have something to re- redistribute, you've gotta have a bigger pie. And so it's, it's, I think it's a problem because, um, developing countries are finally reaping the benefits of growth and develop countries, I think policymakers have gotten a little, a little confused. And it's deeply, deeply unfair and it's also bad for the developed countries, by the way.

CARDIFF GARCIA: Of course, of course. I mean, it's a, it's a global economy. Um, the, there's a quote from *Turnaround*, uh, that cites this kind of historical note, which I think is really important too. I'm just gonna read it here: “Never in the history of the world has a country sustainably reduce poverty without significantly increasing its population's average overall standard of living.” And to be clear, the average overall standard of living is another way of saying, without economic growth, without increasing economic growth.

And the point you made about going from zero sum to positive sum, where if you want to redistribute things, then you first need for the overall pie to grow. This seems to be sort of the crucial point that you're making, right? That economic growth is consistent with redistribution and with more infrastructure spending and with a bigger safety net, uh, it's not mutually exclusive to those things.

PBH: Absolutely. And even, and even more importantly and is always Cardiff, human nature is such that let's, let's, let's take a really simple example. Let's say that there, there's a pie and Peter and Cardiff have to share the pie. And, um, if I just say, “Cardiff, I want more of your pie but guess what, you're gonna have to have a less pie.”

CG: Mm-hmm [affirmative].

PBH: That's not such an easy thing for you to agree.

CG: That sucks. [laughs]

PBH: That sucks, right? [laughs]. Whereas if I say, “Cardiff, okay, um, I need some more pie, but guess what, you're gonna have more pie too.” Right? But the history of the world has never been an example where this pie has stayed the same. And we found a way, or governments have found a way to give more of the pie to other parts of the population without shrinking the pie. And there's, there's never been a way to transfer pie from Cardiff to Peter without increasing the size of the pie that hasn't eventually either shrunk the size of the pie or Cardiff and Peter ended up, ended up basically, you know, at fisticuffs, at war with each other.

CG: Yeah.

PBH: So that's just, that's just, that's the reality. That's just the reality.

CG: Yeah. This often becomes subject to a kind of partisan debate about, you know, traditionally on the right, pursuing a more kind of free markety laissez-faire approach, on the left an approach to, you know, higher taxes, higher spending and those categories have been kind of, you know, switched around and, and have become more complicated in recent years. But it's interesting to me that in a lot of your work, you're sort of, I mean, not, not just, you know, uh, consistently, but I would say aggressively non-partisan about this. I mean, you make the point that laissez-faire, hands-off everything, is not the way to go and neither is an agenda that interferes with the kinds of economic reforms that do include a lot of market mechanisms and that lead to more economic growth.

PBH: Yeah. I like, I like the term aggressively non-partisan. That's, I think it's a good way of describing, um, my, my, my views on these things, aggressively non-partisan and I'll tell you why. It's, for me, it's personal, okay? So I have what I would call a nondescript, you know, American accent. [laughs]

You can't really tell where I'm from but I'm from Jamaica originally, okay? And the reason I have a nondescript American accent is because my family left Jamaica when I was nine years old. Why? Because Jamaica was in the middle of an economic tailspin that was brought about by policies that basically wanted to bring about a complete redistribution of the pie by essentially taxing the wealthy, closing Jamaica's borders to trade, and engaging in a wide range of what you would call them, sort of, you know, strongly left-leaning economic policies for lack, lack of a better term, basically non, let's call them non-market friendly policies, okay?

And, and, and to be clear, my fam- I didn't come from a wealthy family. We weren't poor by any stretch of the imagination. My parents were, well, both my parents were scientists. All right. Um, but because the Jamaican government under Michael Manley in the 1970s, decided that the way to address to make his legitimate, you know, there were legitimate concerns about inequality in Jamaica coming out of its colonial history, but rather than growing the pie, Michael Manley decided he was gonna take pot from the rich and give it to the poor. And even, you know, made a famous speech about it in 1974 or '76 or something like that. Something, somewhere, somewhere out there in the early '70s, he made a speech saying Jamaica has no room for millionaires.

CG: Is that when he told everybody to go to Miami?

PBH: Exactly. And guess what? A bunch of people left and went to Miami and, and the people that left for Miami are the people who could afford to go to Miami, people who were mobile. So the people who own businesses, the people who, you know, were scientists like my parents, were doctors. And so a bunch of the driving force of the economy left. So all that to say, I'm aggressively non-partisan about, you know, about policies on the left that are too far the left. They just, they just don't, they don't work. The economy shrinks. On the other hand, yes, we need the employment market friendly reforms, but market friendly reforms, things that introduce real competition are not the same thing as policies that are just friendly to the wealthy.

It has to be very, this is where the nonpartisan point comes in, because I think what happened with the, let's call it the, the revolution of harnessing the market for the good of the order, okay? Harnessing the market to lift masses of people out of poverty, okay? That is the right agenda, okay? Or the correct, if you will, [laughs] to my, to my view, economic agenda. That, that agenda, I think, got hijacked, um, in the mid '80s, into the '90s, by what, um, others have called capitalists, you know, special interests masquerading in capitalists clothing, okay?

So think about the pro-competition agenda that the Biden administration has just put in place. I think it's a very healthy agenda, right? Because we want more competition as opposed to saying, because markets are good for lifting people out of poverty then how, somehow trying to extend that argument in a, in a specious way to say that we don't need taxes or that the government shouldn't be involved in any aspect of people's lives in terms of providing social safety net, that's just nonsense.

We know that we need, we need governments to do some things well. If you look at the Growth Report, which was, which was a report that was produced by the World Bank around 2006, it was commissioned by the World Bank and headed by Nobel Laureate Michael Spence. And the Growth Report found that the countries that had grown at 5% or more per year, uh, for 20 or more years. There are only 13 examples of those countries in the post-World war II period. And everyone of those countries had to some extent relied on market forces to deliver goods and services, everyone of those countries at a stable environment, meaning that reduced inflation and everyone of those countries had good leadership.

But all those countries also, they use that good leadership to put in place the infrastructure that they needed to grow, to educate their citizens, um, to have a fair and efficient tax system. So policies that have caused countries to grow by 5% or more for extended periods of time are not the same thing as policies that just completely leave government out of the picture and just allow those who have by, um, by some matter of fortune and also, um, their own hard work accumulated wealth to just allow them have a free ride. It's just not the case.

CG: Okay. Peter, I now wanna turn to the Baker Hypothesis, which was the paper that you recently finished with Anush Chari and Hector Reyes. Your coauthors, the three of you studied four specific economic reforms that are part of this agenda to spur economic growth in developing countries. And I wanna just go through each of the four and we'll talk about whether or not they worked. And we'll talk about some of the nuances in how they should be applied. First up inflation stabilization, and to be clear by that, we just mean reducing inflation from, you know, a very high rate of inflation to a lower rate of inflation.

PBH: When inflation is low, stable and predictable, so let's, less than 10% per year and it doesn't move around a lot, it's easy for consumers to plan, uh, their purchases and for businesses to plan their investment and their pricing. When inflation is 200% per year, things are a mess. No one knows exactly what prices are gonna be in the future. Uh, prices start rising even more rapidly, when they're at that level. And they start rising in ways that are very different across different categories of goods. And so the, the product, the price of the product you're selling may, uh, rise less quickly than the prices of the products that you're using to produce, you know, shirts or shoes and so all of a sudden you're unprofitably. It creates a lot of uncertainty. So high inflation, that is, high, inflation is high, unstable and unpredictable undermines economic growth.

CG: I wanna get into a little bit of nuance here because there's a part of your book *Turnaround* that talks about the difference in a developing country going from super high inflation, above 40% to then going below 40% for a couple of years. When it reduces inflation that way, really quickly, that can be a boost to economic growth, but it's not necessarily the case that if inflation say is already down to 15%, that going from 15% to below 10%, let's say all the way down to 5%, that if it does that too quickly that that can actually be a problem, a hindrance for economic growth because it might suggest that it slowed its economy down too quickly and, and too much. This is really intriguing because it sort of shows that even though in general, reducing inflation is a good idea when it's too high, the same idea doesn't apply the same way in every different country.

PBH: In every different country and, and every different circumstance. So as an empirical fact, yeah, if, going from 50% inflation to, you know, 15% inflation, that, that seems in the data, that when countries do that, it improves their economy, but just to make it really tangible, I mean, that's, so an example of that would be, you know, kind of Brazil going from, you know, uh, inflation in, you know, in the triple digits, in the early 1990s to where, when Brazil was actually pretty good economic shape in the early 2000s, you know, it would be a good example of that.

And a developed country example would be, just think about the United States right now. We're having a major kind of, I would say, public hang ringing contest over whether inflation being above 2% for a couple of months is going to lead us into being where Brazil was in, in the 1990s and Jay Powell and the Fed have basically said, “Listen, we're in a different inflation targeting regime. We're gonna look at an average inflation over an extended period of time and we're not gonna freak out because inflation, you know, went up to 5% for, for the last couple of months 'cause we're coming out of COVID, everybody, everybody, all of a sudden wants a rental car.” [laughs] Right?

So what the research from *Turnaround* sorta suggests, um, without trying to overstate the case is that it may be quite reasonable for Jay Powell to say, “Look, I don't need to raise interest rates right now to drive inflation down from, you know, 5% to 1%, 'cause it might be overkill.”

CG: Okay. Let's go to the next reform that you and your coauthors studied, which is, a developing country opening its economy to global trade, removing barriers to trade effectively. And again, you found that it works. Countries that allow more trade ended up growing more quickly. And I think Peter, a lot of people understand the common argument in favor of trade, which is that it allows a country to make more of the products that it specializes in so it can then sell those abroad. And then of course the country can import the products that it is not as good at making. But you also emphasize something else, which is that a country exposing itself to trade can also help that country to upgrade its own domestic technology and to bring in new managerial ideas for how to make certain products. So tell us about that angle?

PBH: Imagine if you said we don't make our own laptops and so we're gonna close our borders until we figure out how to make our own laptops because we wanna be able to be a world leader in laptops. Well, if you do that, that's gonna hurt your country for a while, right? You might eventually develop your own laptop industry, uh, but in the meantime, you're losing out on, on the benefits of using those computers directly, but also, you know, you're, um, being kind of networked into all of the technological externalities that we know exist from being part of the information economy. So again, another kind of extreme example, but it really is the case that, uh, locking yourself out of the market for free trade it means you're also effectively locking yourself out of the market for ideas. And ideas are vital to economic growth, even more vital than, um, than capital or just as vital as capital and labor.

CG: And I wanna ask you about something that I think has been controversial, not just in development economics, but just in economics generally for a really long time, which is, what role should protectionism play or, you know, um, putting in place tariffs or other things that restrict imports. What role should that play in a developing country going from being, you know, a poor country to a richer country? And I bring it up because there is kind of a long tradition of developing countries, including at one point, you know, in the 1800s, the US, later on Germany, later on Japan, later on, you know, South Korea and, and some of the east Asian economies.

These countries would at times restrict imports in the higher tech industries that they wanted to develop domestically, which is very different from restricting imports for the entire economy. And so this seems like it's a big part of the so-called East Asian economic miracle. And I guess I'm, I'm curious to know how you address that particular nuance, that particular complication in this idea that developing countries should expose themselves more broadly to free trade?

PBH: Yeah. So there can be a theoretical case for, for tariffs, but as a practical matter, tariffs should be small, judicious and rare, right? And so you think about the cases where tariffs have actually helped in economic development. They're far outweighed by the cases where they, where they did damage. And even take a country like South Korea, which is often cited as, you know, it's kind of a favorite example on the left of, um, a country that ended up sort of market driven policies. But if you look even at South Korea free trade policy, it's true that a lot of import restrictions, but they grew in large part by removing those import restrictions.

You know, they did it fairly slowly, but they realized that in order to, uh, to grow, they needed to import goods, imported goods, such as, uh, colored televisions is a great example. So before, South Korea became a leading producer of colored televisions, um, before it had, uh, it had a domestic, uh, broadcasting system in, in color, because by importing those colored televisions they basically figured out how to, you know, if you will kind of reverse engineer [laughs] and build those, those televisions themselves.

So even the case where you're, you know, importing, importing to learn how to export is one example of, of basically using imports to learn how to take advantage of the, of the, of the outside world. Because South Korea, they slowly removed tariffs, but even as, even when they had tariffs in place, I guess is the point that I'm making, but they were importing a lot of goods. And if you look at the history of South Korea over the, the two decades in which they had their kind of highest period of economic growth, which is from kind of the late 1970s, mid or mid 1970s, um, up until the Asian Crisis, South Korea, during that entire period, almost every year, they ran a trade deficit. I think that's, that's not a well known fact.

So people tend to think of, you know, South Korea as being, you know, this country that, you know, felt, that, that followed a non kind of market path. But South Korea actually, um, was important quite a bit, even as it was growing as, uh, uh, as an exporter. And that's the point, you know, a growing economy, uh, you would expect it to actually, it's important to be growing as well.

CG: Yeah.

Peter, let's go to the third plank of economic reforms that you and your coauthors studied. And this one's fascinating to me and it's, allowing more foreign investment into a developing country. And the reason this is so interesting is that a lot of times this is an idea that people worry will lead to a big economic bubble inside of that developing country because an amount of money from foreigners abroad, foreign capital, that might not be a lot relative to all the money sloshing around the global economy could be huge as a share of all the money inside that developing country.

And the worry is that you end up with a huge bubble, either in asset prices or in the price of some goods, the currency sometimes of the developing country will become really, really strong. And eventually when the bubble bursts and a lot of that money turns around and flows right out, it exacerbates the economic downturn in its wake. Um, but you found that actually allowing in more foreign investment ends up leading to a lot of subsequent economic growth, that it can have really beneficial effects. What's going on there?

PBH: So the key thing when thinking about foreign direct, foreign investment in a developing country is to make the distinction between debt and equity. So debt investment, if I'm lending money to let's say, I don't know, let's say Indonesia, if Indonesia has, has some projects and these projects in, in Indonesia get financed through a debt contract, which means no matter what happens to the projects, the people who borrowed the money have got to pay back the lenders, you know, they have to service that debt. Then, you know, if Indonesia falls on economic hard times, um, it's gonna have a really, may have a really hard time servicing that debt in particular, if it borrowed in US dollars. And let's say there's a devaluation of the currency then the value of the debt that's gotta be paid back is even higher. And so the, the situation just gets exacerbated.

Whereas if those projects in Indonesia, uh, are financed through equity like stocks. Then in that case, equity is basically an agreement that says when things are going well and the Indonesian companies are doing well, then they'll, they pay dividends to the, the foreign equity holders. When things aren't going so well, dividends they'll get paid out or dividends get reduced. And so in the real world the, the examples are a little more complicated than that, but that's the basic point.

Developing countries that, that rely too heavily on debt financing found themselves in times of economic distress and even worse circumstances because the debt they took on exacerbated the economic downturn. Versus countries that opened their stock markets to foreign investment to allow this kind of equity investment. Following those equity market liberalizations, uh, you do tend to see higher, uh, higher investment and not just higher capital flows going to those economies, but actually real physical investments.

So as a result of money flowing into the stock market, which reduces the cost of, uh, the cost of equity financing for projects, you actually see more physical capital investment. And by the way, because that's not a zero sum game increasing the amount of investment that goes into, let's say, building new factories, you know, increases the productivity of workers. Their wages tend to rise as well. And so you can get a beneficial self-reinforcing cycle of investment, higher wages, higher growth that's good for the economy, but the debt equity distinction is really, really the critical one.

CG: Yeah. And I, I think I would make a couple of points in response too, one which you highlight in your book is that the reason that a lot of developing countries end up with so much debt is that actually the legal and regulatory landscape has skewed things in that direction so that debt is privileged in a way, debt is favored and it ends up becoming a real problem. You know, the other thing I would note though, is that a lot of even multilateral institutions that traditionally were sort of hesitant to embrace the idea that some countries should have some capital controls so not across the board, but that there are limited circumstances where capital controls that limit inflows might be appropriate.

Um, they've changed their minds on this, you know. It's not like the IMF is now saying capital controls are awesome, but I think over the years, they've softened their stance, which used to be very strongly against any kind of capital controls. And I have a feeling that this is what they had in mind that, you know, the idea that certain types of debt end up leading to these just economic catastrophes for these developing countries. Henry, so what do you sort of think about how things have changed, you know, over the last couple of decades when it comes to certain types of capital inflows versus other kinds?

PBH: I think the change in thinking on capital flows is a good example of, um, things moving, I think generally in, in favor of less partisan direction. So at one point the view was there were lots of, uh, kind of wealthy interests in the United States that just wanted to be able to invest in the developing world in whatever form they could. And so that was an argument for basically, you know, this is why we should, we should lift all capital controls. And without thinking about this distinction between debt and equity. And then we had some crises, uh, that happen in particular, the Asian Crisis in the 1990s.

And then you had folks on the left, people like Joe Stiglitz, coming to mind, you know, this knee jerk reaction saying, “We told you so, lifting capital controls is a bad idea." And that was, things swing too far in, in the other direction, in the wrong way, when really the right answer was, yes, what we've learned in textbooks is really right. Opening up to capital flows in some form is going to allow countries to be more productive 'cause it's, a lot of capital flows from countries that have a lot of capital to countries that don't have much capital, but I think the IMF, the World Bank, and others have not been very sharp in making this distinction between debt and equity, 'cause that is really, that's the central point.

You know, everything else is sort of details, but once you recognize that every financial crisis you can think of in the last three decades or four decades, going back to the third world debt crisis, the Asian market crisis, the Mexican crisis, uh, the LTCM Russian crisis, and the Great Recession, these were all crisis precipitated by excessive leverage. There, the, none of these crisis originated in the stock market per se, right? And so if I would, I would love to see the, the international institutions just get sharper about this point.

CG: Yeah, and Peter, the first three reforms that we discussed, inflation stabilization, opening up to trade, and allowing in more foreign investment, you found in your paper that these all worked quite definitively and quite clearly-

PBH: Mm-hmm [affirmative].

CG: In your conclusions, that they led to a subsequent period of economic growth for the countries that tried them. This last reform had a more mixed finding, which was privatization. So the idea of privatizing certain industries that were previously owned and run by the government. So why don't you kind of give us a sense of when privatization is likely to work and when it doesn't, because the paper does list a number of nuances here?

PBH: If you privatize state-owned companies in an industry that's already pretty competitive, there are a lot of occupants to that industry, industry. That's much more likely to result in lower prices and better products for consumers than if you privatize a set of companies or a company that has a complete monopoly on, on it, in an industry.

CG: Is it in just going from one monopoly to another, you're just going from the state-

PBH: Exactly. Exactly.

CG: To some rich oligarch or something.

PBH: Exactly. If I just basically transfer a monopoly for mo- from the private, from the public sector to the private sector, I'm just, as you said, likely to create a rich oligarch, okay? And so that's a great example of needing to understand the nuance of the economic landscape to, to determine whether policies like that to be effective or not. And also good example of how to distinguish between what's gonna be good for the country as a whole versus what's gonna be good for in this case, a handful of people who might be lobbying for privatization, why? Because they stand to, to be the ones to, to be able to make the first bid on this, on this state on asset.

And we know the privatization went awry certainly in the, in the former Soviet Union. Uh, the, the initial conditions, as it were, were not thought about as carefully or to put it less delicately, there were forces, there were, there were special interests that really stood to benefit very, very strongly from being the sole or one of few competitors for the assets that were, were gonna be privatized.

CG: Okay.

PBH: Yeah. There, there are more details, but that's a big part of the issue.

CG: So Peter, that's the Baker Hypothesis and I got to tell you, what's kind of interesting about it is that if you look at these policies, you know, stabilizing inflation, exposing yourself to more free trade, allowing in more foreign investment, you know, privatizing when going about it the right way, these are ideas that I think a few decades ago would have just simply been considered, you know, sound macroeconomic ideas. And in this paper where you find that these ideas actually work because the intellectual landscape across economics has kind of changed in the last few decades. It's really interesting to me that your findings are almost contrarian, at least in some circles.

And I'm a little bit surprised to be honest that your paper hasn't gotten a little bit more attention and I know it's just about to be published now as we're speaking. So maybe it will, but it's just fascinating to me how the ideas themselves, which really do seem to work and were once just considered bog standard, you know, good economic ideas for generating growth, uh, now have this kind of flavor of contrarianism not because the ideas themselves necessarily changed, although they do have, you know, different wrinkles nuances as we learn, but because economics has become, I guess, a more complicated, you know, intellectual area, what do you think about that?

PBH: So I'd say a couple of things. I think one, first of all, it was a famous thing, I forget who it, who it's attributable to, but you know, everyone's entitled to their own opinions but not their own facts. So in this paper we said, “You know what, let's take that serious, let's, let's take that seriously and let's just try to see what the facts are.” Because my own view is I think economics has become a little obsessed with cuteness and cleverness, at least macro to some extent. I think we've forgotten that ultimately why do we care about macroeconomics? We care about macroeconomics and macroeconomics is the biggest scale business in the world. Whether countries grow or not determines whether people eat or don't eat. And for me, I'd never lost sight of that fact because I came from a, I come from a poor country.

So in the United States, we can have clever arguments about whether the inflation rates should be 2% or 4%. And that's, that's an argument over splitting hairs, okay?

Whether inflation rate is 40% or 10% determines whether the kids go to school or not. And so I guess, I mean, I don't wanna sound self-righteous here but, you know, it's just a function of where I come from. When I, when I, when I took my first international economics class when I was in college, it was the fall of 1989, the Berlin Wall had just fallen. I remember actually walking across campus to class and people like running and scream about the Berlin Wall having fall. I was like, "What are you talking about?" And I got the class and I learned the Berlin, the Berlin Wall actually had fallen.

Of course the falling of the Berlin Wall was a sea change in terms of the view about state, the state versus markets and economic policy and more generally, it really turned the tide on these ideas surrounding the Baker Hypothesis. And I thought when I took that first international economics class in college, I thought, "Okay, now I'm gonna finally learn how, how the IMF ruined my country." Right? Because I grew up believing the supporters of Michael Manley, who said that the IMF had ruined Jamaica and Manley had just agreed to the policies that would have worked if it weren't only for the IMF.

And I spent the rest of my life kind of investigating that because that class really made me scratch my head and said, "You know what, I'm not so sure that, uh, Michael Manley was right and their supporters are right." The world is complicated. And the more I've looked into it, the more I've realized that when countries actually change their policies, when they stable countries reduce inflation to stable, low and predictable level, and by the way, should you credit, the Bank of Jamaica, I think brilliantly coined that phrase, low, stable and predictable inflation is the key to economic growth. When countries open to free trade, those two things first and foremost are non-negotiables in growth. And countries do that. They grow faster than before they did that. Our paper found that, the Growth Report found that.

On foreign direct investment, the distinction between debt and equity is really critical. And in privatization, shakier ground, but still beneficial in certain circumstances. And so I think by clinically just going through what had an ideological minefield. We're able to bring some facts to bear but they're really the, we think the facts are really important because unlike in the US where the economic debates we're having are not so much about life and death, um, in developing countries, they are.

And we're really concerned that we've lost sight because we're so worried about causality and, and other issues, which are really important scientifically, but we're trying to write more and more clever papers and come up with, you know, clever theories about, you know, why the kind of basic bread and butter economics isn't right that we lose sight of the bread and butter. And if you've ever, and if you, and if you've lived in a country where people can't get access to bread and butter, you're like, no stop. [laughs]

CG: Yeah, that point about the higher stakes, I think, has really been driven home in the last couple of years. Because for example, I was looking at some numbers from Pew Research and about an additional hundred and 30 million people in the year

2020, because of COVID went from living above $2 a day to below $2 a day. And most of these people were concentrated in Sub-Saharan Africa and in south Asia.

And this was roughly a 20% increase on the prior year and it had reversed what had been continual progress, you know, in, in prior decades. And it, just to me showed that like, you know, when you're living that close to subsistence, a hit to your economy can put you right back below that level, that poverty level, that global poverty level. And it also just shows that like the stakes, when it comes to economic growth are different in countries outside the developed world of the US, Europe, Japan, and, and, and a few other places. That this is not a sort of cute semantic debate here.

This actually is in some places, the difference between life or death, or at least between, you know, whether you go hungry or whether you have enough to eat, whether you can afford to buy, you know, textbooks for your kids so they can go to school and those kinds of things. It's just a, it's a completely different debate and it really does seem sometimes like economics exists on two completely different dimensions when we're talking about developed countries versus developing countries, and maybe that's appropriate. The circumstances really are different, but it's important to highlight that when we're talking about various policies and, and their potential effects.

PBH: Absolutely. Because otherwise you are basically exporting, you know, clever ideas [laughs] from the rich world that, um, that you're sort of, you know, playing with in your rich laboratory that are gonna be absolutely detrimental to the poor countries. And by the way, when I say, you know, it's not right, it's not me saying it's not right for many logical perspectives, it's me saying, we look at the data and the data are telling us, right? This is why, this is why we wanna, we take this clinical approach and just looked at and see, what did the data have to say about, you know, the effect of these policies and growth. And if these policies raise growth and the data just kept throwing this at us, then it's just not right to obscure that fact.

CG: Yeah, of course.

PBH: You know, I, I talked to my students, students all wanna know about climate change and climate change is really important. And my students will say, “Well, shouldn't we be moving to de-growth.” And, you know, I just have to remind people that, you know, what does de-growth mean? You just said it really well, Cardiff. De-growth in poor countries since it started COVID has been 130 million people are in poverty that were in poverty before. Now, of course the key here is we want growth and a livable planet, but the point is you can't just say to countries that haven't had it be able to taste the fruits of prosperity don't grow.

CG: Yeah.

PBH: And oh, by the way, we grew for a century yourself and polluted the heck out of the planet. We're not gonna do the same thing and we're not, but, and by the way, we're not, we're not willing to pay any price or make any trade-offs just so, that, that's not a real conversation. And so the real conversation is how do we, how do we recognize what it is that helps poor countries grow, recognize what it is that we need to maintain the livability of the planet and have a real conversation about how we find a middle ground in order to get there with zero net emissions.

CG: Yeah. And I, I know you've spoken before about how one of the paths to getting there is through more infrastructure investment in the developing world. What exactly do you mean by that?

PBH: There are roughly a billion people who have ac- don't have access to electricity and other billing people roughly you, um, live more than, uh, more than a few kilometers away from an all season road. So the lack of electricity and roads in poor countries is a huge obstacle to growth, particularly in Sub-Saharan Africa. And by the way, um, the, the opportunity to invest in infrastructure in poor countries, uh, is also potentially is a big part of the solution to getting us out of the low interest rate environment we've been in for the last couple of decades. And this what's called the global savings club.

Now the Biden administration recently announced its Build Back Better World initiative, this B3W initiative, and part of that initiative, which didn't get as much attention as I think it should have gotten, um, is an initiative to bring more financing of infrastructure, private financing of infrastructure in the developing world. So here we are, again, talking about capital flows, right? So in principle, there is a big opportunity to have more capital flow from rich countries like the United States and countries in Western Europe to finance the building of roads and electricity in places like Nigeria and other, uh, poor countries in Sub-Saharan Africa and Indonesia and elsewhere.

Um, and why is this so important? Well, one there's the growth part of it, okay? It could finance higher growth in the developing world. So basically by bringing people out of unemployment and you do that by building roads, electricity, you allow for more productive economic, economic activity, okay? But the more sustainable environment part comes in because you think about the biggest growth opportunity in the developing world is actually gonna be cities. So the, the, the, the UN population survey tells us that between the year 2000 in the world, and the year, I believe it's 2040, the world's urban population, in other words, the number of people that live in cities, it's gonna go from that, it was two billion to four billion.

So we're in the middle of a doubling of the world's urban population. And virtually a hundred percent of that increase in the world's urban population, which is basically a migration from rural areas into cities is taking place in the developing world. And so either we're gonna get, we're gonna get clean green livable cities or we're gonna get, cities are gonna generate a ton of carbon emissions.

CG: Peter, do you have a simple story for why all of the excess savings in the rich world has not been reached channeled to the developing world to invest in things like roads and other infrastructure projects, because I often see that cited as a failure of the financial system to channel money from where it is to where it could best be put to use, uh, what's going on there?

PBH: So a couple of failures, right? So the first failure I would point to, and I'll, I'll say this, I've just written another paper about this. I don't wanna be self-serving here, but I've thought a lot about this. The first failures of the World Bank, because the first, the first thing you need in order to figure out how to finance infrastructure in developing worlds, got to figure out where it's profitable to do so and where it isn't, where it's potentially profitable.

And so we have very little data, very little publicly available data that would tell us what is the economic rate of return to a road in Indonesia or Egypt or Nigeria or India. And the World Bank is the one place in the world that should be a central clearinghouse for those kinds of data. What we would say is the social rate of return to, to building roads or electricity, okay?

So the World Bank in the year 2000 commissioned a major study called the social rate of return to infrastructure in developing countries or the, it was called just the social rate of trend infrastructure. It was written two, in the year 2000. It was based on data from 1985 and the World Bank hasn't updated the data since then. So essentially we've got 35 year old data on the rate of return on infrastructure in the developing world. I'm exaggerating a little bit, but not much.

CG: Wow. It's hard to convince somebody to invest in something if you have such a paucity of data on just [laughs] how well their investments are gonna pay off.

PBH: Exactly. And it gets worse. The World Bank then in, in 2015 issued a major communique joint with the IMF and the multilateral, other multilateral investment banks and institutions like the, like the African Development Bank that called for billion, going from billings to trillions in infrastructure. It was a, there's a tagline billions to trillions, um, trying to motivate the private sector to think about how to invest in the developing world and again, no data. No new systematically provided data, okay? So that's the first failure.

So if we have those data, that's what I did, so based, so using the, using the data that we, do exist, that's now old. And I went back and actually looked at the rate of, rate of return to investment infrastructure and compared it to the rate of investment in private projects, let's say the United States. In other words, if the rate of return infrastructure in Nigeria is higher than the it is, where Indonesia is higher than it is to private financing United States, you've at least got a chance of convincing capitalists in moving their money, right?

And so when we did this, we actually found that the countries for which data actually exists, there are 53 of them that were in that original World Bank report. Um, so contrary to the claim that the World Bank made of us needing to go from billions to trillions, which basically implies that there's lots and lots of investment opportunities out there just waiting to happen. It turns out that in less than, less than a third of the countries that, for which there is data, uh, is it both publicly efficient? In other words, it's good for the countries if they do these better infrastructure investments and also privately profitable, meaning that rich countries could actually make money by moving money into infrastructure and poor countries.

So you need both of those things to happen in order for infrastructure investment, to make sense, you know, to do well and do good. And in less than a third of the countries in that, um, initial World Bank report, would you have been able to make the case of their tagline? So the question now is, if given this framework that we layout, what, what did the data tell us now? And, and if I were, if I were, you know, running things for president Biden at the, [laughs] at the treasury, uh, international affairs at the treasury, I would be, I'd march over to, to my colleagues at the World Bank and tell them, and say, “Hey guys, how about producing some data that will allow, will actually allow the private sector to make some sensible decisions.”

CG: Yeah, yeah. That's a great point. Uh, Peter, I have one final question as, as we've run out of time, um, you have an origin story that I actually buy. And what I mean by that is that I'm often sort of, sort of suspicious of, you know, somebody saying, “Well, you know, these things happened to me in childhood and therefore that's why I became an actor or whatever.” Right? I think, I think motivation is a really difficult psychological thing to untangle, but in your case, there's such a direct relationship between your quite, you know, quite dramatic experiences as a kid growing up in Jamaica, uh, and what you sort of dedicated your career to doing that it just seems clear that there's a relationship there.

So you've talked about Michael Manley's sort of, you know, well-intentioned economic disaster, right? In other words, that he pursued these policies, which were meant, um, to boost the countries, you know, worst off and ended up having kind of the exact opposite effect and it sort of torched Jamaica's, you know, growth prospects for multiple generations, you know. But you also talked about, you know, some of your own childhood experiences before all that came to pass, before you left the country, and I'd love for you to just tell us the story of your grandmother and a woman named Miss Mama?

PBH: Yeah. So my, my grandmother known to her former students as a Miss Gem, my dad's mom was a teacher. So when I used to spend time at my grandmother's house, as a kid in Kingston, Jamaica, I was always reading and doing various things on her, on her front porch. And we'd always have conversations about the things that I read during the course of the day, the atlas, encyclopedias, countries around the world, all manner of, manner of things that were going on beyond the shores of Jamaica. And our, our afternoon sessions were frequently punctuated by visits from a lady named Miss Mama who had come knocking at my grandmother's gate. And I always found it, you know, at the time it was just kind of odd as a kid, I was probably six, seven years old.

This woman, Miss Mama, would come to the gate. She had, you know, her hair was matted, uh, her teeth were scraggly, she was barefoot most of the time, and she had a big protruding belly. And, and invariably, my grandma would ask, you know, said, “Miss Mama, are you hungry?” And she would say yes and she would sit down on the porch and my grandmother would go in the kitchen and get, uh, some milk, like a big tumbler of milk and a big hunk of bread and bring it out. And Miss Mama would eat it and they chat for a little bit and, and, and then Miss Mama would leave.

And I remember one day I asked my grandmother, I said, I said, I said, “Grandma, you know, Miss Mama has a big belly. Why is she always hungry?” You know, very naively. And my grandmother said to me, “Some people have big bellies 'cause they eat too much. Other people have big bellies 'cause they can't get enough to eat.” And that was my first encounter, obviously with, you know, someone having a distended belly from hunger.

And so the point is that, you know, being, growing up in Jamaica, I was not, I did not grow up in poverty, never been close to poverty. I was born on third base, both my parents have PhDs, a story for another day. Uh, how they got to the states, you know, it's kind of elements and globalization, but growing up in Jamaica, I was never far from poverty and it really stuck with me, Miss Mama stuck with me. It really stuck with me.

You know, when we lived out in the country in Jamaica, the middle of nowhere, just all the kids that I used to play with on a daily basis who worked, uh, for the folks who, um, who helped out at our house, you know, didn't have much. Then I got to the United States and we moved to suburban Chicago. You know, in 1978, not a lot of people came, you know, knocking on our door [laughs] asking for bread. [laughs] Growing up in the suburbs of Chicago. It's a totally different place, right?

You know, if you don't, you don't do well in school in Jamaica, you know, life's really hard. You grew up in, in Wilmette, Illinois, you don't do well in school, your dad gets you a job at a hedge fund. [laughs] I'm exaggerating a little, but you know what I mean? And that's, that, those differences are real. When you're, when you're coming from Jamaica as a kid in the '70s, like you.

CG: Yeah.

PBH: And you, then you're having at the next couple of decades, you're like, you're just seeing this stuff and it affects you. You know, when I got to college, I really wanna understand why, you know, I took my first economics class and I said, “Wow, some countries are rich and some countries are poor and here's the discipline that actually that has something to say about that.” And so I spent the rest of my life, you know, kind of chasing down this answer, why is, why is, why is Jamaica rich and the U, and the US, sorry Jamaica poor and the US rich?

And you know, for a while I thought it was the IMF that made Jamaica poor. If you believe Michael Manley, that was the answer. It turns out that's not the answer. And so one of the things I think I've learned most since I wrote *Turnaround*, uh, actually is that, you know, Jamaica actually, before COVID hit, had actually made some real, real economic changes to kind of start moving in the right direction and I hope those will continue. And so I get really, I get really fired up about, um, about economic policy because it's, it's how you help Miss Mama, you know, um, it's how you help people help themselves.

CG: Peter Blair Henry, thank you so much.

PBH: You're welcome. Thank you, Cardiff.

CG: And that's a wrap on the first episode of The New Bazaar. Hopefully the first of many. You can find links to “The Baker Hypothesis” and to Peter's book *Turnaround* in the show notes for this episode. The New Bazaar is a production of Bazaar Audio, the new company founded by executive producer Aimee Keane and me. And let me say a word on Aimee on this first ever episode of The New Bazaar.

My career as a podcast host would never have been possible if Aimee and I had not first partnered at the Financial Times, seven years ago. She is just an unmitigated joy to collaborate with and also a monster, monster talent. And I promised her by the way, that I would not embarrass her with enthusiastic praise in the credits [laughs] but I lied and I don't care. I think she deserves it and I absolutely will keep finding new ways to embarrass her in the credits in all future episodes. So keep tuning into the show if only, just to hear me refer to Aimee as a soft serve ice cream cone with sprinkles on a summer afternoon, whatever else I can come up with.

By the way, what goes into making a podcast is not universally well understood. So you should know that it involves a group of crucial people who never get enough credit. So special thanks to Adriene Lilly, a sound engineer who wields magic and has found ways to make me sound like a smoother conversationalist than I actually am. Special thanks also to Rob Byers, Johnny Vince Evans, and Michael Raphael of Final Final V2 for helping guide us on how to record episodes remotely under the challenging circumstances of podcasting in a pandemic. And finally, our awesome theme music is an original composition by Scott Lane and DJ Harrison of Subflora Studios. Check those dudes out seriously. They're based in Richmond, Virginia and they are fantastic AF. I mean, listen to the sound that they constructed from scratch after all we did was tell them what kind of vibes we like. Just great to work with.

We have a ton in store for the inaugural season of The New Bazaar. In just the first couple of months, future topics are gonna include immigration, the psychological effects of living through a crisis, a vicious financial battle over a casino, the economic policies that extend our lives, and even how poker can teach us to make better economic decisions. It's gonna be a lot of fun.

So please follow or subscribe to The New Bazaar on your app of choice and if you enjoyed today's show or even if not actually, but you're just feeling generous, leave us a review or tell a friend. That is so important for a podcast that's just starting out. If you wanna get in touch I'm on Twitter at, @CardiffGarcia, or you can email Aimee and me at hello@bazaaraudio.com, that's hello@bazaaraudio.com. Thanks so much for checking us out and hopefully we'll see you next week.