

# 1 Heaven Can't Wait

There were giants in the Earth in those days.

Genesis 6:4

## I Eagle Eyes

For more than half a century after World War II, first one American empire and then another dominated a territory larger than that imagined by King Solomon or Alexander the Great. The first lifted all boats; the second lifted all yachts. In one case, prosperity and growth were graced by Heaven. In the other, inequality and stagnation were squired by Hell. Whatever we can say about the rise and fall of American imperialism, it was not black or white, and it saw big changes. The new economic stars that are now forming in the firmament, constellations like China and India, will rapidly alter survival patterns here on earth.

Under the First American Empire, from 1950 to 1980, the world enjoyed an economic Golden Age. Growth in developing countries, whether Africa or the Middle East, soared. Nothing comparable had occurred before, nor has there been anything comparable since. The average growth in national income and income per head may have been faster than in any stage of colonial history. In terms of the betterment of its subjects, the First American Empire can take a deep bow.

Then, after 30 years, it was struck by lightning. It died at the hands of war (Vietnam), oil (price hikes), and cheap credit (Wall Street). As the 1970s passed, as news went from bad to worse, the plucky, prosperous era lasting from Franklin Roosevelt to Richard Nixon came to a halt. A Second American Empire arose in 1980, with the elections of Ronald Reagan and Margaret Thatcher. Soon a debt crisis convulsed poor countries, and for at least

the next 25 years the Second American Empire's orthodox medicines failed to revive them. Heaven slowly gave way to Hell. A Golden Age became enshrouded in darkness. Within influential circles, debate all but ceased, and the intellectual dimension of development grew silent. Only awesome Asia consistently moved closer to the world's technological frontier.

Whether or not an empire is morally responsible for its subjects, when they thrive, it thrives. The Second American Empire thrived all right, but its people didn't, creating a much more menacing challenge for "globalism."

The Third World's booms and busts are commonly explained as the result of its culture, because the process of modernization is always pulled and pushed by a people's history. According to one popular myth, Asia grew quickly under Confucianism because Confucius respected hard work. But Asia didn't always grow quickly, and when it grew slowly, in the 1950s, Confucianism was blamed just the same, on the grounds that Confucius held commerce in low esteem. If culture doesn't change but growth rates jump up and down, then culture is a poor predictor of growth. To make culture a meaningful predictor, its contradictions have to be taken into account. Every culture has a counterculture. One American says, "Nobody likes us." The other says, "Everybody wants to be like us, so they must love us." A culture is a set of beliefs, behavioral norms, organizations, and policies, while a counterculture is an opposite set.

The American Empire's own culture and counterculture made a deep impression on all developing countries. Cultural dominance flowed from U.S. power. After the Second World War, American per capita income and average Third World per capita income diverged, starting at a ratio of around 4:1 or 5:1 and growing, at the extreme, to around 40:1. The bigger the gap, the larger the area of imperial influence. Sometimes the influence is good for the developing world, sometimes it is a disaster.

From 1929 to 1980, an American counterculture, involving both Democratic and Republican presidents, was built on three pedestals—Knowledge, Inventiveness, and Experimentation. On top of this were the two drivers of development, Market and State. Then, balancing unevenly on these, at the very top, was American Foreign Economic Policy.

The historical root of American heterodoxy was "no ordinary time."<sup>1</sup> It starts with the fall from grace of free enterprise for its ignoble role in the Great Depression, followed by Keynes's economic experiment, the New Deal's attempt at industrial planning, wartime mobilization and demobi-

lization, the red revolution, the Green Revolution, and the electronics revolution. President Kennedy's close assistant and Pulitzer Prize-winning historian, Arthur Schlesinger Jr., described the United States as "a country for experiment." From all this came the greatest gift of the United States to the Third World—"use your own brains and run your own show." This version of laissez-faire might be summed up in the words of President Richard Nixon: "Nobody gave a damn."

Still, however golden an age, however experimental a generation's mindset, even the savants make stupendous mistakes. The Soviet Union was regarded as a tiger when, in reality, it was a paper tiger, while Vietnam was regarded as a paper tiger when, in reality, it was a tiger. The Cold War against the Soviets consumed billions of dollars and the Third World got almost nothing, not even when it tried to play Moscow and Washington off against each other. The one plum was Egypt's Aswan Dam. The war in Vietnam was catastrophic because the United States didn't know how to fight a people's war; the same happened again in the war in Iraq. America lacked the information, know-how, and experimentation it swore by, and without these it fell.

The Second American Empire arose on the embers of Vietnam and the hot coals of Japanese competition. If the motto of the First Empire was "Get smart," then the motto of the Second Empire was "Get tough." Financial services were becoming the largest single industry in the United States. To spread its wings, Wall Street demanded that the Treasury Department get Third World countries to deregulate their financial markets. No less vocal, multinationals wanted developing countries to practice free trade and drop all investment controls. Both Republican and Democratic presidents heard their pleas. Experimentation became cynical, as it had been under the British Empire; as J. V. Puryear writes, "In the early nineteenth century, the principle of free trade was introduced by the British into Turkey before it was accepted in Great Britain."<sup>2</sup> The Second American Empire first tried globalism in the developing countries before their sugar, rice, corn, and cotton could enter U.S. markets duty-free. As the Southern Hemisphere liberalized its manufacturing sector, the United States continued to protect its own manufacturers against Third World's specialties—machine tools, textiles, and steel. When financial markets crashed, deregulation had yet to be tested to see if it worked, but despite the desperation of millions of people, the United States never changed course.

A 1998 report by a Clinton appointee, the U.S. Trade Representative, conveys the demons behind deregulating and dismantling the state: "It is vital to the long-term prosperity and prestige of the United States . . . to take full advantage of our strong global position and *continue to push our trading partners for even more open markets and economic liberalization*. If we abdicate our strength, we risk missing a prime opportunity to advance those policies and values that have been so instrumental in making our economy the strongest and most efficient in the world."<sup>3</sup> This tough talk, a Hollywood version of the great economists Ricardo and Smith, takes for granted the win-win plot of the movies. The world's most competitive economies can tough out imports and thrive when weaker markets are opened. They have everything to gain from free trade. In theory, openness also helps the weak, despite the danger that imports will crush their infant industries. Instead, poor countries are saved by foreign investors. The industries of poor countries are built *and owned* by foreign investors. The market knows no ownership, but developing countries do not have everything to gain from liberalizing first.

After World War II, America's hippie counterculture, with its experimentation, outperformed America's orthodox culture, with its market mantras. *Why the unexpected performance of the two empires, especially since both are cut from the same cloth?* And why was Asia, alone among developing regions, blessed twice, growing rapidly no matter who was in power?

The sleuth that stars in this study, the author, sets out to solve these mysteries of economic life.

## II The Book of Numbers

How convincing is the case presented in this book that the effect of the United States on the developing world in the twentieth century is analogous to a fall from Heaven to Hell? Are the two American empires so different? Can't their initial differences explain most of their subsequent behavior (decolonization, the rise of Asia, the fall of Latin America)?

The weaknesses of the arguments cannot be denied. Although post-World War II American imperialism can be partitioned, the First and Second Empires have more in common than meets the eye. Throughout the postwar years, the United States has been a tough guy; even Third World governments that were democracies but hostile to America's economic

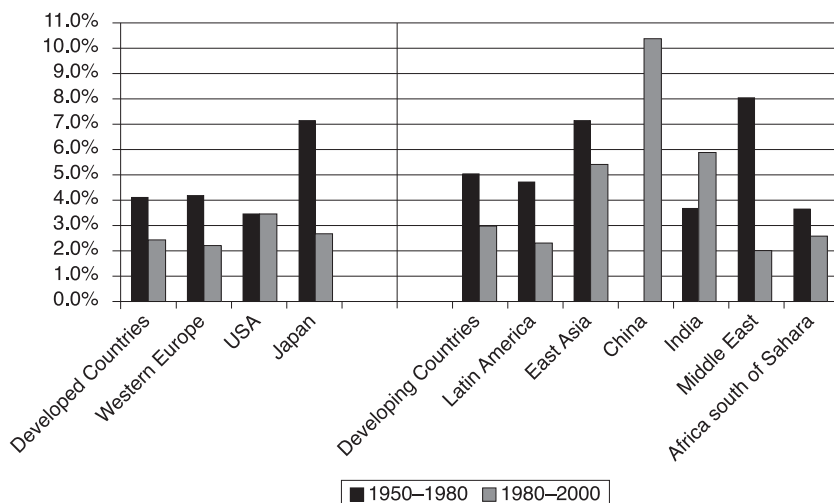
interests usually didn't survive for very long—witness Mossadegh in Iran in 1953, sitting on oil, and Allende in Chile in 1973, sitting on copper. For another, both empires were solicitous of American big business—part culture and part campaign donations. The First Empire was a great champion of decolonization, not least of all because it gave American industry a chance to penetrate markets previously monopolized by Britain and France. Development in both periods was dependent on massive technology transfers that were more difficult than anyone had imagined, because the expectation was widespread that Third World industrialization would be undertaken by *American* multinational firms. Markets, prices, and political control were the hallmarks of how America operated throughout the last half of the twentieth century.

Both empires lent little on soft terms to developing countries for the purpose of establishing modern industries, the heart of economic development. This stinginess undermined the effectiveness of foreign aid, although all donors tied roughly 80 percent of their aid to purchases from their own countries. Without investments in new plant and equipment to create jobs, foreign aid for water, sewage, roads, and education raised human welfare but not employment. Schooling was emphasized, but unemployed school graduates were ignored. Neither empire wanted the Third World to become a competitor.

Much more can also be said against the state interventionist model and the Third World strategy of import substitution (producing locally what was formerly imported). State intervention in many countries supposedly bred gross inefficiency and cancerous corruption. If a state picks winners, where does it get its wizardry? How can one talk about Heaven when that age harbored hippies and interventionist states?

Yet, whatever the weaknesses of the schema of two distinct epochs—one heaven-sent and the other hell-bound—all the numbers for the years after World War II strongly support it. Growth was faster, on average, under government intervention than under free markets, although, because of “retained” institutions, markets never became wildly free.<sup>4</sup> The most contentious market to be opened was for capital.

The striking difference in growth rates between the First and Second American Empires is shown in figure 1.1. In the Golden Age, between 1950 and 1980, income grew faster in developing countries than in developed ones—on average a little over 5 percent a year compared with 4



**Figure 1.1**

Growth in income: 1950–1980 and 1980–2000. Source: World Tables (World Bank, 1980, 1994); *World Development Report* Development Indicators (World Bank, 2002); and World Bank online data.

percent. This was a first in recorded history (according to World Bank data), a period of unprecedented expansion in living standards, per capita income, wages, and poverty reduction. Then the boom ended: inflation from rising oil prices and the Vietnam War led to monetarism at the Federal Reserve. A sharp cut in the money supply forced up interest rates on the loans developing countries had to repay, and made it more difficult for unemployed American workers to buy foreign goods. A new empire appeared with new policies. Then the average growth rates in the Third World plummeted and barely reached 3 percent for more than 25 years. The Middle East's decline was steepest, from about 8 percent to 2 percent, as savings and investment fell. Latin America and Africa also suffered high and chronic unemployment and a sharp slowdown: "Average annual growth rates in GDP per capita in Latin America and the Caribbean went down from 3 percent in 1960–1980 to 0.5 per cent in 1980–2002."<sup>5</sup> Whereas Latin America's income per head grew by 10 percent in the entire 25 years from 1980 to 2005, it grew by 82 percent in the 20 years from 1960 to 1980. According to the UN's *Human Development Report* (1990), a low-income country like Kenya had reasonably good growth in the 1960s and 1970s, when its income per head rose by about 3 percent a year. But like most African coun-

tries, it suffered negative growth in the 1980s, with per capita income falling by about 0.9 percent a year. The 1990s weren't much better.

The growth rate in the United States was unique—about the same in both periods. But income distribution became more unequal, approximating the huge gap between rich and poor in Latin America. American median family income (in 1996 dollars) barely budged from \$40,400 in 1973 to only \$43,200 in 1996, a mere 7 percent growth *over the entire twenty-three-year period!* While the top brackets captured more wealth, this stagnant median income occurred even as many families had to send two income-earners into the labor force to make ends meet, and many workers had to hold two jobs.<sup>6</sup> The 99.99th percentile of Americans enjoyed a 17 percent annual increase in income, with their absolute income averaging about \$6 million a year!<sup>7</sup> Something similar happened in Japan once it began to recover in 2005 after a long recession. There was national hand-wringing after a loss of egalitarianism which was attributed to “Reagan-esque” policies such as deregulation, privatization, spending cuts, and tax breaks for the rich.

Most economists studying developing countries have found that the more equal income distribution is, the more rapidly national income grows. How equality affects growth is unclear, and measures of equality vary, but all seem to point in the same direction. Many peasants were thrown off the land under colonialism, and land concentration led to high inequality in rural areas, where most people lived. The First American Empire started a movement in Asia toward greater equality by introducing land reform in Japan under the Supreme Commander of the Allied Forces in the Pacific, which also democratized education and decapitated the *zaibatsu*, or big business groups. In contrast, land reform fell into the dustbin of history under the Second American Empire even though huge numbers of peasants were still employed on the land. As the population shifted to urban areas, other distribution measures were studied, and most show inequality worsening. In Latin America, the share of employment in the “informal” sector rose from 52 percent to 58 percent in only seven years, from 1990 to 1997; it is better to be employed in the “formal” sector because the informal sector includes self-employed workers with very low incomes and bad working conditions. The share of national income (value added) going to wages instead of capital has also fallen: in six out of eight Latin American countries chosen for their data availability, the wage share fell. In

Mexico, the guinea pig of the “Washington consensus” (the Treasury, State Department, World Bank, and IMF), the wage share plunged from 37 percent in 1975–80 to 20 percent in 1985–92. The wage share stayed almost steady in Korea, Singapore, Indonesia, Malaysia, Thailand, and the Philippines. It fell—sometimes as much as in Mexico—in Ghana, Zimbabwe, Egypt, Morocco, Tunisia, and Turkey. Out of a sample of developing countries, real wages between 1975–1979 and 1987–1991 fell in 16 out of 24 cases. Generally the fall in equality, and wages, was greatest in Africa, Latin America, and the Middle East.<sup>8</sup>

Most Asian countries had very equal income distributions by world standards and a different model of capitalism from “Reaganomics” or neoliberalism. The ideology of free markets was taken with a grain of salt. The law of comparative advantage was obeyed on and off, as countries used their prewar manufacturing experience and state support to march into mid-tech industries like automobiles, petrochemicals, shipbuilding, and steel. China and India grew relatively slowly in the years immediately after World War II. Planning was too centralized in China, but the foundations of modern industry were laid, electricity reached almost all villages, education became nearly universal, and government R&D institutes accumulated human capital. India’s growth rate was faster than the average growth rate after 1980 for developing countries as a whole. India grew slowly because it took time off from industrialization to become self-sufficient in food and to succor small-scale firms. Then, after market reforms, protection of the old political constituency of Gandhi—the artisan and small producer—lost ground to big business—the favorite son of Nehru, India’s first prime minister. Output rose over time, soaring in the early 1990s even before market reforms began. Software services boomed in the remote region of Bangalore, which benefited from former government investments in electronics, telecommunications, aerospace, and a prestigious Indian Institute of Science. The military chose Bangalore as a center of science and technology because it was safe from Russian and Chinese attack. Soon the Bangalore region had more experienced engineers than any other part of India. When software services sprang up there, the contribution of government was invisible to the naked eye. Growth after 1978 in China was phenomenal, fueled by a 35 to 40 percent savings rate. Economic theory has never satisfactorily answered why savings rates (savings as a share of income) differ across countries, but other Asian countries also save a lot. The saving



rate in India rose to roughly 30 percent, while it rose to only 20 percent or less in Latin America.

After the fall of the Berlin wall, Russia let market forces rip, and its economy collapsed. China never experienced such a catastrophe and it never entirely retired its state-run system, the founder of modern industry. China adapted the model used by Japan, Korea, Taiwan, and Thailand, which combined not just market and state, but also subsidies and performance standards. Before being eligible for soft loans, science-intensive firms had to reach certain performance standards related to investments in R&D and new product development. The high *ideal* for government was to give nothing away for free. Still, the Gini coefficient for urban China rose from 16 in 1978, when market reforms began, to 28 in 1995 (the higher the Gini, the greater the inequality).

Capital formation and poverty alleviation went hand in hand; one created capable people and one created jobs to employ them. According to the Asian Development Bank, between 1960 and 2000 Asia's rate of poverty (people living at subsistence) fell from 65 percent to 17 percent, infant mortality was down from 141 per 1,000 births to 48, and life expectancy was up from 41 years to 67.

From Washington to Wall Street, Latin America in the 1990s was expected to become the next superstar. Because it had democratized politically and it had sounded a neoconservative wake-up call, Latin America was considered a good bet by the financial community. But in Mexico, Washington's laboratory for free trade, per capita income increased on average by 3.1 percent a year between 1935 and 1982 and then by a mere 0.02 percent a year between 1983 and 1999. In the same two periods, Mexico's minimum wage first rose on average by 1.4 percent a year and then fell by 6.9 percent a year. Financial crises became a recurrent feature of the Mexican scene and in Latin America at large. In Puerto Rico, a U.S. Commonwealth, GDP in the 1940s ran like a rabbit. From 1960 to 1970 growth was almost as fast as that of Asia's island economies: Singapore, 8.8 percent; Hong Kong, 10 percent; and Taiwan, 9.2 percent. Then from 1975 to 1984, under a new banking system, Puerto Rico's GDP growth plummeted, to 1.9 percent, while Asia's held firm (8.5 percent, 9.9 percent, and 8.0 percent respectively).<sup>9</sup> Argentina, one of the worst fatalities of the debt fiasco, recovered in the 2000s only by ignoring the IMF's advice (the same was true of Korea after the Asian financial crisis of 1997). A report on Bolivia

concluded, “the market-oriented changes that Washington long ago prescribed for Latin America have brought little or no prosperity to the average person, with some lands poorer than before.”<sup>10</sup> Bolivia’s president in 2005, Evo Morales, a former coca plantation worker, led the political party Movement toward Socialism as a way out of Bolivia’s woes. Despite its discovery of natural gas, Bolivia’s per capita income was lower in 2005 than 25 years earlier. The popular refrain in a Peruvian election in 2006 was “many have tired of the American-inspired free trade model.” Latin American trade improved after 2000, but mainly because it started exporting raw materials to China. Catfish exports to the United States were booming in Chile, Latin America’s favorite son. Few skilled, well-paying jobs were involved in either case.

The Second American Empire would ultimately incur the costs of not helping Latin America heal. Its economy sank as Asia’s soared.

### III Heaven Hails the Mind

Despite its much-debated spread of Western civilization, colonialism failed for the most part to increase the Third World’s collective income or income per head. After the Marines took control, Washington made the Philippines a paragon of education. But despite rich natural resources and human talent, the Philippines never took off. Cuba, another American colony, was in such bad shape after 60 years of U.S. rule that it was overrun by a small band of armed guerrillas led by Fidel Castro. Even the best-case growth rates under the British Empire were shockingly low. The jewel in Britain’s crown, India, saw its income grow from the mid nineteenth century to 1947 at something *just under one percent a year*. Egypt’s per capita income fell by roughly 20 percent between 1900 and 1945. Nigeria’s per capita income toward the end of British occupation in 1963 was officially estimated at £2, low even for the time.<sup>11</sup> The British Empire, not much different from the Second American Empire, is best remembered as a place where “the sun never sets and wages never rise.”

Bad publicity for colonialism and its chintzy diffusion of knowledge emerged only slowly. With the hindsight of history, we can see that *all* the countries that succeeded in entering the orbit of modern world industry after World War II had acquired manufacturing experience in prewar days, some in Latin America, most under colonialism. *But very*

*few of over 100 countries under colonialism had acquired manufacturing experience at all!* Without experience, it was hard to identify a marketable product, raise finance, build a firm, and produce to specification—all the factors of what we call entrepreneurship. Experience made it possible to guess what investments were “winners” with a reduced margin of error. Experience gave companies confidence that they could earn long-term profits, rather than make a killing through corruption. In turn, the profit-maximizing firm made it far more likely that government subsidies would be used productively. Manufacturing experience meant more effective government. But a “market” way of thinking emphasizes exchange, not production.

The great classical economists largely saw development in terms of market exchange, transactions, buying and selling, and the prices necessary to make transactions efficient. Prices are the economist's stock in trade. Knowledge about production and technology was taken as given, which is understandable since the technology of the time was virtually free. To produce pins, Adam Smith's brilliant example of the division of labor, manufacturers had only to look around and observe how pins were made; the technology was there for the having. But today, even a peeping Tom can't learn how to make a pin through sheer observation. What new materials is it made of? How does the machinery work? How are pins packaged? As big business arose and innovation became a matter of life and death, as corporate research and development laboratories became science-based and proprietary, knowledge became valuable and closely guarded. It became tacit rather than documented. The problem of development had changed, even if established wisdom hadn't.

Asian or Latin American companies, maneuvering to enter mid-tech industries like hard steel and health serums, were pressed to get the knowledge they needed to sell at minimum cost. They required new institutions to compete—to acquire, adapt, and master technology. They required state support as learning got under way, otherwise they would sink as foreign competitors “dumped” in world markets, as they leveraged their brand names and high quality, as they flexed their manufacturing muscles and marketing might. But because the Second American Empire let opening markets and “getting the prices right” crowd out acquiring technology and building institutions to exploit it, the developing world was doomed to Hell.

#### IV Heaven's Hippie Experiment

Whatever their shortfalls, Third World industrial policies under the First American Empire gave something to everyone: higher-paying industrial jobs to upwardly mobile workers; chances for small- and medium-sized enterprises to produce modern parts and components; employment for professional managers and engineers who had previously taken to emigrating; opportunities for the financial sector to lend to new firms; and chances for experienced entrepreneurs to make fair-sized fortunes. The idea was to industrialize by letting imports guide what was to be produced. This was safe and sound. After wartime shortages, a pent-up demand for imports exploded and endangered the balance of payments. Everyone in the tropics wanted air conditioners. Everyone wanted TVs. Everyone needed trucks or tractors, bicycles or scooters, machinery and medicines. "Import substitution" saved foreign exchange and was *demand-driven*: if something was imported, obviously locals were willing to pay for it, so the demand was there. The manufacture of TVs, for example, also enhanced technological know-how more than exporting copper and corn. Import substitution was learning-intensive. A worker on a TV assembly line was paid a pittance, but didn't have to face the dangers of a mine or back-breaking agricultural work.

But this counterculture was in violation of the law of comparative advantage, which dictates that markets be supply-driven. If a country has lots of labor, it should make only what requires a lot of labor to produce. According to a leading orthodox economist at the University of Chicago, a country can gain as much from producing potato chips as from making computer chips. Washington's advice became acerbic: "Don't produce what is imported, which might take an eon to learn and will almost certainly require protective tariffs. Produce what can already be exported, which has proven its worth. Produce more raw materials."

Comparative advantage was debunked after World War II by the United Nation's Latin American office. Raul Prebisch, an Argentine economist later vindicated by history, was the main advocate of import-substitution industrialization because he argued that prices of raw materials, which accounted for around 90 percent of Third World exports, had fallen over time relative to the prices of manufactures. Raw-material exporters had to give more and more just to stand still. They were also losing from technological change,

as synthetics substituted for natural rubber; as nylon substituted for silk, hemp, and sisal; as aluminum preempted pig iron; as saccharine supplanted sugar; and so on. The First American Empire satanized Prebisch, but its objections were brushed aside. Like the hippies, the Third World dropped out of orthodoxy and won the day.

Despite all the bad press, even the most efficient mature high-tech industries now practice import substitution. In Asia, assemblers of calculators, computers, and cell phones first buy hundreds of their parts and components from overseas, mostly from Japan. Then step-by-step they selectively import-substitute them. Protection never enters, but its equivalent does. The government provides assemblers with science parks, semiconductor design services, spillovers from government labs, cheap credit, and joint R&D.

Unexpectedly, import substitution in countries with manufacturing experience became the mother of mid-tech exports such as steel, cement, petrochemicals, automobiles, truck parts, TVs, and tires. An industry would start selling in the domestic market and then, with enough experience, would sell overseas. The whole idea that export-led growth and import substitution were at odds proved to be mismeasured and false.

## V Root of All Evil

Japan's black magic in manufacturing in the 1980s led to a massive restructuring of American industry. The share of manufacturing in national income declined, and with it, an American way of life. Trade unions became almost extinct, and manufacturing job shops in inner cities closed their doors. The service sector rose in importance, especially financial services. This industry became the favorite of the Treasury, comprising a dense network of stock exchanges, commodity brokers, investment banks, commercial banks, savings banks, nonbank financial intermediaries, and venture capitalists. The Third World was seen as an emerging *market*, a vacuum cleaner to absorb these services, rather than as an emerging *economy*, capable of supplying some of them itself.

The rise of the financial services sector, the triumph of the Treasury over the State Department in foreign economic affairs, and the plunge in Third World growth rates are all closely connected. The causality runs something like this, in rough order: first, there is deregulation of the Third World's financial markets, starting in some countries even before World War II

(the Treasury); then there is “loan pushing” to Third World borrowers (Wall Street); loan pushing leads to overborrowing to finance long-dreamed-of projects (the developing world); rising interest rates raise the costs of Third World loan repayments (the Federal Reserve); there is an outbreak of a deadly and contagious debt disease (the Third World, excluding Asia), and as a condition for raising money to repay overdue loans, the Third World must abandon state economic interventions (the Treasury, the Fed, the International Monetary Fund, and the World Bank). Because most developing countries, with a long history of prudently regulating their inflows and outflows of capital, were burned by “hot” money, this truly was Hell.

Now the Emperor has no clothes. It is undeniable that the Second American Empire’s attempts to restart Third World growth have failed. Populist governments are appearing in Latin America, unemployment is destabilizing urban life in Africa and the Middle East, and religious fundamentalism is spreading throughout the world. Excluding Asia, which has faithfully followed Japan and the First American Empire’s freelance approach, the engine pulling the rest of the Third World badly needs fixing.

How did a venerable culture of open markets fail to ignite development in so many countries?

## VI Heaven Wears Extra-Large

While *on average* Third World growth rates in the postwar years fell from high to low, averages sometimes hide a truth. During both a Golden Age and a Dark Age, Asia rose like a phoenix. It grew and grew, with Japan as mentor, the most creative catch-up case of them all. Growth first started accelerating in East Asia, in Japan’s former colonies of Korea and Taiwan. Then it spread to Southeast Asia, in countries such as Indonesia, Malaysia, and Thailand. It rose steadily in the city-states of Singapore and Hong Kong. Then it spread to South Asia, mostly India. As these countries rejected neoconservatism and orthodox *laissez-faire*, as they designed *unique mixtures of market and state*, their footprints became larger and larger. Soon, after a long sleep, there were giants in the earth. These were countries with low wages, huge populations, and a growing class of university students, professional managers, skilled workers, and experienced engineers. China and India awoke, having once been great empires

in their own right. Brazil, Indonesia, and Iran began warming up in the wings. Southern Nigeria and South Africa were stewing in the waiting room. These were smart and precocious giants, unlike those defeated in mythical Greece.

Edward Gibbon, the great Enlightenment writer on Rome, argued in the eighteenth century that the reins of power would always reside in Europe and its offshoots because that is where new technology was born. Power would merely shift from one advanced country to another, as in the past. In contrast, Oxford historian Arnold J. Toynbee argued in his twelve-volume world history, published beginning in 1934, that in the very long run, power would flow to countries with the largest populations (and the strongest religions).<sup>12</sup> Some developing countries today have huge populations dating from when they were empires in their own right, and also from colonial days, when they were stitched together from independent kingdoms by European powers such as Portugal (Brazil), the United Kingdom (India), and Holland (Indonesia). Holland couldn't conquer Aceh for almost 30 years, and then in 1908 it united it with Java, Bali, Celebes, and Madura to form a single colony, named Indonesia, under Dutch rule. Ironically, colonialists were responsible for creating many of the Third World giants that later cut them down to size!

With giants in the earth, not for a long time to come will an empire reign the way the United States reigned after World War II. With the awakening of giants, *global absolute power has become a relic of the past*. Absolutism cannot be preserved by the United States, nor can it be acquired by China. No longer can a single country enjoy it. What will empower an empire now is how "great" it is, meaning how much it promotes global economic development. Otherwise, the Vietnams, Afghanistans, and Iraqs of history will keep repeating themselves, and cutting down even the strongest empire at the knees.

China is larger than life because it does not stand alone. It is part of Asia, and if Asian economies continue to gallop away, so will China's economy, and vice versa. Regional trade, regional investment, regional manufacturing, and the regional exchange of ideas, fashions, music, and movies ("soft" power) have formed an Asian bloc that can be expected to rival the American states and the European Union. As unemployment jumps from one bloc to another, national obligations to create employment will rise. But with more competition, world welfare will also rise.

Asia has been thrown together through trade ties, but it has been diplomatically divided since the dinosaurs. Korea hates Japan, Japan hates China, and so on. Still, these sorts of divisions displease a new middle class. When Condoleezza Rice, the U.S. Secretary of State under George W. Bush, sounded a “cautionary note” about conferring with China, financial analysts in the Asian region said Rice’s notion seemed “passé.”<sup>13</sup> The dawn of the Asian century has eclipsed the dreary years of internal rivalry, and now Asia is set on competing against the West.

The United States has no equivalent regional relationship. The United States is Latin America’s best and worst friend. It imports almost half its oil from Latin America. American foreign investment south of the border is large, over 90 percent of Mexico’s exports go to American and Canadian markets, and Latino immigrants have changed the face of American cities. After falling into debt in the 1980s, Latin America became as ideological about free markets as Washington. Latin intellectuals are as Western as New Englanders, and as strong believers in the Enlightenment as Bostonians. At the same time, anti-American sentiment persists. The legacy of the Monroe Doctrine and President Teddy Roosevelt’s corollary to it—which stated that the United States, a “civilized” nation, had the right to stop “chronic wrongdoing” throughout the Western Hemisphere—still lingers. Between the end of the Spanish-American War and the Great Crash, American troops are estimated to have invaded Latin America at least 32 times. The overthrow of a popularly elected Chilean president in 1973 created widespread unrest. Following the failure of free markets to halt Latin America’s economic descent, “Yankee go home!” was again heard in countries ranging from Brazil, Argentina, and Venezuela, to Uruguay, Ecuador, and Peru. But the Yanks have not gone home.

The United States should be running a trade surplus with Latin America, Latin America should be running a trade surplus with Asia, and Asia should be (and is) running a trade surplus with the United States. But the United States can’t run a trade surplus with Latin America because Latin America’s industries are in shambles and its imports are weak.

*The rivalry between the United States and China will depend on the relative performance of Asia and Latin America. As of now, Asia is a plum and Latin America is a lemon. To do anything about this, the Second American Empire will have to become less ideological and pay Latin America its due: a modern Marshall Plan. Yet all this empire shows is an inability to change.*



## VII Democracy

Today's great empires no longer enjoy direct, formal political control over their subjects. Times have changed since India's Sepoy Mutiny in 1857 or China's Boxer Rebellion in 1900, when the fight waged against foreigners was a matter of liberty or death. But arguably, imperial power over the Third World today has *grown stronger* because differences in income between rich and poor countries have widened. Equating power with income, the global distribution of both has become more skewed than ever before. In the past, the per capita income of developed countries exceeded that of developing countries by a factor of four or five. Now, the gap may be as large as 30 or 40: for every dollar a poor developing country has, a developed country has 40 times more!

The developing world itself is sharply divided by income per head, with some countries (or regions within countries) being far more industrialized than others. In the beginning, countries were divided by population: dense in Asia, sparse in Africa, Latin America, and the Middle East. Foreign invaders worsened poverty in poor agricultural regions that were sparsely populated by the forceful creation of a low-wage labor force. Instead of obeying market rules and paying high wages for scarce labor to work in the gold, copper, and diamond mines of southern Africa, or the coffee, tea, and sisal estates of Kenya, colonialists concocted excuses to take away people's land, forcing them into paid employment at a pittance. Africans had no alternative means of support. Force was the origin of a low-wage economy in what were initially resource-rich, labor-scarce lands (Congo and Rhodesia in Africa; Colombia and Venezuela in Latin America; Indonesia and Malaysia in Asia) where, according to the law of supply and demand, wages should have risen, as they did in Australia, Canada, New Zealand, and the United States—white regions of "recent settlement."<sup>14</sup> The American South and Brazil went as far as using slavery to keep labor docile.

Divisions within the Third World widened over time due to a colonial inheritance—the presence or absence of manufacturing experience. The power of the manufacturing mind is illustrated by the Axis powers. Germany, Italy, and Japan all recovered after defeat in war on the basis of their memory—all physical infrastructure had been destroyed; only experience mattered.

On the eve of decolonization, manufacturing experience was greatest in Argentina, Brazil, Chile, China, Korea, Malaysia, Mexico, India, Indonesia, Taiwan, Thailand, and Turkey. Many of these countries had gained their manufacturing knowledge as a consequence of either Japan's preparations for war or inward emigration from Europe, China, and the United States. While not every country with prewar manufacturing experience succeeded (Argentina bombed), no country without it could create a diversity of advanced industries in the half-century after World War II.

Manufacturing experience implied the existence of entrepreneurs, managers, engineers, lawyers, accountants, an educated elite, a big student population, and a large working class in urban areas. These were the interest groups that typically took up the struggle for democracy. Students led the revolution for democracy in Korea in 1960 and 1987. Workers and students challenged Beijing's authority in Tiananmen Square in 1989 (the students wanting more political reform, the workers wanting less). Students "disappeared" in droves during Latin America's fight against tyranny in the 1970s. India, with one of the largest manufacturing elites, was extraordinary for democratizing as early as 1947. A big effort was soon launched to become self-sufficient in food. Certain industries were reserved for small- and medium-sized enterprise, with disastrous effects. China is the main exception, but even China developed activist grassroots politics. Rural countries may be democracies; the Ivory Coast was one for years. But if industry gets too small, if unemployment gets too large, and if upward mobility becomes blocked, democracy will be defeated (democracy in the Ivory Coast fell to tribal rivalries).

The manufacturing class has been weak in many Arab and African countries. In 1956, one estimate suggests there were only 143 local doctors and 41 engineers in Tunisia, a country with 4 million people. In Morocco, with 10 million people, there were 19 Muslim and 17 Moroccan Jewish doctors, and 15 Muslim and 15 Moroccan Jewish engineers. As more professionals were trained, more migrated for lack of good jobs, leading to a vicious circle of insufficient skills and hence insufficient investment in modern industry and services, and a weak lobby for political reform.<sup>15</sup> In the Arab world, only 4 countries out of 17 have multiparty electoral systems. In sub-Saharan Africa, the share is 29 out of 42.<sup>16</sup>

"Civilizing patterns" in Western countries typically went from political advance (the Magna Carta in England), to economic advance (the first In-

dustrial Revolution), to the welfare state. The sequence has been entirely different in the Third World. Here, the pattern has typically gone from paternalism (the Latin American *hacienda*), to economic development, to democracy. But as income distribution widens between the richest and the poorest countries, democracy in the Third World takes on a new imperative. It must include elections at home as well as transparency in the foreign economic policies that constrain them. Which is more difficult to achieve—democracy at home, or democratization of the U.S. Treasury, World Bank, IMF, and World Trade Organization? This is an open question.

### VIII Guns, Germs, and Steel

Jared Diamond examines early societies in terms of “guns, germs, and steel.”<sup>17</sup> In the ancient world that he masterfully analyzes, nothing existed that was close to what is now essential for survival: formal, institutional, national systems of innovation. The most successful latecomers started out with prewar manufacturing experience and then added layer after layer of all kinds of skills—production, project execution, managerial, technological, bureaucratic, and political. Skills had to be systematically strengthened to kill the germs, make the steel, and ward off the guns of the great powers.

Both Arnold Toynbee and Edward Gibbon saw empires dying from within: from “suicide” in Toynbee’s view and from “immoderation” in Gibbon’s. The First American Empire paid dearly for ignorance and immoderation; it died from a lack of understanding of a people’s war in Vietnam. Still, power was preserved by the United States after its fall. The Second American Empire is now in decline, possibly from immoderation but principally from a *lack of greatness*: it has made little contribution to economic development due to what may be described as a closed mind. Can its way of thinking be changed, or is it too late?

