

The Dynamics of Development

Greg Lindsay talks to Helen Hughes

From fifteen years at the World Bank to ten years at the National Centre for Development Studies, Helen Hughes has had a distinguished career in economics as both a practitioner and an academic. In 1985 she was awarded an Order of Australia in recognition of her services to international economics.

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Greg Lindsay: Can you tell me a little about the circumstances leading up to your family's departure from Europe, your life there and the environment in which you lived?

Helen Hughes: My family was a typical central European professional family. My father was a little atypical because he deserted from the Austro-Hungarian army on the Italian front toward the end of World War I to join the army of the newly emerging Czechoslovak Republic. He maintained a very strong interest in politics all his life.

I had a pretty normal life until I was about six when the shadow of Nazi Germany began to overwhelm Czechoslovakia. My mother appealed to a Rotarian colleague of my father's who was the Consul for Czechoslovakia in Melbourne in 1937 to help us to obtain an immigration visa to Australia. Thanks to Melbourne Rotarians we received the magic visa in 1938, but before we could leave, the Nazis marched into Prague and closed the borders. My parents found a corrupt SS officer who was selling exit visas. My father cashed in all his assets to bribe him. Thankfully he was an honest crook, and the exit visa was valid. We did not get hauled off the train that was winding its way through Germany to freedom. The best moment of my life was when a Dutch customs official stepped into our railway carriage.

GL: So you arrived in Melbourne?

HH: World War II broke out as we were on our way to Australia. The ship was blacked out but we arrived safely in Perth and then Melbourne. We started to work on

becoming Australians. My parents found work and I went to school. We learnt English. In my family, school was followed by university so as to acquire professional skills.

GL: You went to university to study what?

HH: History, because I won a State exhibition, and economics, because I wanted to know how the world worked. There was no teaching of economics at McRobertsons Girls' High School. They only had a bookkeeping teacher in those days when most girls became secretaries, but my teacher did her best to help me with what was a new subject for both of us.

GL: You sat the matriculation exam in economics, but you hadn't actually been taught it?

HH: Yes, and I did quite well.

GL: What triggered your interest in economics? Was it an abstraction or a social science? What set your intellectual interests going?

HH: The conditions of the 1930s set me off. Even in relatively developed Czechoslovakia, while we lived well, I saw dire poverty around me. Kids went hungry and had to leave school at 14. When the depression hit,

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unemployment deepened poverty. When my father had to sack workers, he had a heart attack at 44 years of age. So by the time I was four, family and social issues were one for me. That's what we talked about around the dinner table, when we weren't talking about the build up to World War II.

I also had an interest in production as my father had a textile factory and one of my cousin's husbands worked as an engineer for a steel plant. I spent some holidays with them and he took me around the steel plant. I was absolutely fascinated by how you produce and sell things. In my last year at high school in Australia I abandoned chemistry and physics for history and economics to start figuring out how the world worked.

GL: So you arrived at university and set out to do economics. Economics back in the 1940s was different from today. What were the intellectual currents? Who were the key people and events that were developing at that time?

HH: Communist ex-servicemen were the intellectual leaders at Melbourne University in the late 1940s. They were the people to be with. They ran the social and political debates. In marked contrast to Sydney University, there were few liberal ideas and few libertarians around.

The Economics Faculty was excruciatingly boring, so much so that we had to read the classics for ourselves to understand the principles of economics. Fortunately I was only a year behind a very bright group of students that included Peter Karmel and Max Corden. I learnt from them.

GL: The environment in economics was pretty much interventionist; politically were there Marxist leanings?

HH: Politically the Faculty of Economics was anti-socialist, but it was not particularly pro-market. By the time I was a student, Keynesian economics had become dominant. I did not find this very convincing intellectually. I did not start to learn economics until I went to the London School of Economics (LSE) to do a PhD in economic history.

In the early 1950s PhD degrees were still mainly for colonials. Local honours graduates were appointed directly

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to lectureships. The graduate students at LSE were mainly from the British colonies and Latin America. They made up the best club in London.

GL: So that started your interest in development? Was Peter Bauer there then or was he there later?

HH: He was there, but I didn't take any development courses. Studying economic history is the best training for economic development. I did it in depth, starting with the wool merchants in medieval England. Economic history grew, with the stimulus of discussion with my fellow students, into an interest in development.

GL: You graduated with a doctorate and came back to Australia?

HH: Yes, I worked in market research for a while, then got a job teaching economics at the University of New South Wales. After a couple of years, I went to Queensland and then to the School of Asian and Pacific Studies at the ANU.

WHY THE WORLD BANK SHOULD BE CLOSED DOWN

GL: When did you go to the World Bank?

HH: I went to the World Bank in 1968 on sabbatical, but stayed for 15 years until 1983.

GL: Why did you stay? You have now become quite a critic of international organisations and the World Bank in particular.

HH: The World Bank was making a positive contribution to the evolution of thinking about development in the 1970s. It led the intellectual case against 'developmental economics'—that is statism, protectionism and *dirigisme*—which until then had dominated development ideas and practice. This was the beginning of the turning away from central planning that culminated in the collapse of the communist states. The debates took place in academic and research institutions, within the World Bank, in other multilateral and international institutions,



and within industrial and developing countries. Having considerable resources to put into these debates, the World Bank made a marked contribution to ward liberal market-oriented development. It became evident that 'development economics' was responsible for slow growth and continuing poverty.

GL: Peter Bauer always said he only had one story and he was always right.

HH: Yes, Peter was and is right, particularly on the costs of aid, but he has not told the whole story. Because he took a relatively narrow view of development, he was not as influential in changing the understanding of development and of economic policies as others were. Ian Little, Bela Balassa, Jagdish Bhagwati, Harry Johnson and Anne Krueger were key to the debates for free trade. Other influential participants in the development debates were Charles Schultz (learning and human capital), Ron McKinnon (the key role of the financial sector) Al Harberger (shadow prices) and Mancur Olson (social and institutional factors). The World Bank played a key role in disseminating these ideas, so it made a positive contribution to the theory and practice of development until the 1980s.

GL: Now these outfits have become self-serving, bureaucratic elites that have adopted much of the *dirigisme* they eschewed. What's to be done?

HH: Not only have the multilateral institutions become self-serving, but by abandoning intellectual rigor in favour of their own survival, they have become counterproductive.

The World Bank is a large organisation employing some 10,000 staff, private consultants and non-government organisation staff. All of these people have a very considerable interest in maintaining their incomes and lifestyles by participating in the aid 'industry'.

GL: If you had a magic wand or whatever, what would you do with the World Bank?

HH: I would close it down. International capital markets lend freely to developing countries that run their economies sensibly. Countries that want to join the positive performers can put their past behind them.

GL: You have been very critical of UNDP's Human Development Reports. Why would an organisation like

that put out such reports that by all accounts are misleading and simplistic?

HH: Only because its staff and consultants want continuing financial support to maintain their lifestyles. A large body of research, starting with Peter Bauer's, has clearly demonstrated that aid flows have made little contribution to development and have often been counterproductive. Many UNDP projects are clearly counterproductive.

Micro finance is an example. It operates on the premise that small loans, not available commercially, 'empower' poor people by giving them, following Marx, access to 'the means of production'. Micro finance loans are made to members of groups chosen by lot. All borrowers have to contribute savings, but wait to take out loans until the initial borrowers' loans are repaid. Micro finance is the very antithesis of the market system. The pace is set by the least able borrowers rather than encouraging the most entrepreneurial ones. Loans are made at semi-commercial rates, that is with minor subsidies, but the bureaucrats that administer the systems are subsidised.

GL: The borrowers have to wait their turn?

HH: And he or she may never get a loan.

HOW CRONY CAPITALISM SURVIVED THE ASIAN 'CRISIS'

GL: Let's move on to Southeast Asia and parts of the world closer to home. You have written in *Policy* and elsewhere that there was no Southeast Asian crisis. What's happening there now, and are the institutions and the behavior of the people in these countries—or at least the political leadership—changing?

HH: Recovery has been fast because there was not a crisis, but a downturn. However, structural change is very, very slow. It is probably slower than in the 1980s. There are two opposing forces in Asia: crony capitalist forces—

GL: —just to stop there for a moment. How would you define crony capitalism?

HH: Crony capitalism is monopoly capitalism, with markets exploited by relatively few privileged, monopolistic firms that earn super profits or ‘rents’ because they enjoy regulatory benefits such as high import tariffs, restricted entry into an industry or monopoly access to land. Such firms usually have privileged entry to the financial sector. Many have benefited from the privatisation of public utilities. Interlocking political and commercial interests enhance privilege and encourage corruption. In industrial countries such as the United States and Australia, in contrast, markets are competitive. Some monopolies and cartels develop, and corruption surfaces from time to time, but the thrust of legal and administrative institutions is to enforce the rule of law and competition.

GL: What are the long-term dangers for that sort of structure?

HH: Crony capitalist economies do not grow. Jobs and skills do not increase and output does not grow. This is what happened in Italy, Germany and Japan in the 1930s, so that they had to go to war. Crony capitalism has dominated Latin American and Philippine economies with resulting low growth.

GL: Indonesia seemed to be a bad example of cronyism in the 1990s; hopefully, that is breaking down now.

HH: Indonesia had a strong liberal trend going back to the early Soeharto years, with reforms in the 1970s and 1980s.

GL: Why do you think that we went from an interventionist to a more liberal period in the 1960s and 1970s, and then back again to *dirigisme* in Southeast Asia in the 1990s when the free open view of things started to triumph everywhere else?

HH: Political development is much more difficult than economic development. Although political development in South Korea, Thailand, Malaysia and Indonesia was

moving, it was not moving fast enough. Changes in the institutional framework did not keep up. The crony capitalist pressures were unfortunately greatly strengthened in South Korea, Thailand and Indonesia by the IMF led ‘rescue package’ that injected \$US 1.4 billion into these economies to shore up crony firms. If some of the crony firms had gone bankrupt, restructuring would have taken place. By subsidising crony borrowers, the ‘rescue package’ made reform unnecessary. The crony firms are sitting comfortably in their old places. There has not been any pursuit of wrong doing through the courts.

GL: Okay, if that’s the case then, is the economic development of these countries descending into the stagnant state and less free patterns of say the Latin American countries in the 40 year period from the 1950s

to the 1990s?

HH: The short answer is likely to be yes in some cases. Unless there is a renewed effort to strengthen liberal trends, some Southeast Asian countries could be in serious difficulties. The Philippines appears to be in serious difficulty. The current government in the Philippines is giving so much support to crony capitalists that it is very difficult to see how the country could grow.

GL: They had a chance.

HH: Aquino and then Ramos tried, but not hard enough. If you don’t tax the rich, you are going to have a Latin American economy, a Filipino economy, or an Indonesian economy.

GL: So what you are saying is that the rich don’t pay anything?

HH: Yes. In countries like the Philippines, public servants pay and workers in the large enterprises pay tax—

GL: —But the cronies don’t pay tax—

HH: —although getting some wealthy people to pay their share of tax is a problem in countries such as Australia, compared to the Philippines or Indonesia the problem is very minor.

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GL: What about China now? It's a big player in the region, it's looking more open and outward-looking, but some people believe that it is descending into the same sort of pattern that we are worried about, namely cronyism, favouritism and fiddling.

HH: China is largely run for the benefit of some twenty million communist cadres. They can probably keep it that way for some time. After a brief period when income distribution improved as agricultural output rose, income distribution is now worsening. China does not have the essentials of a market economy. It does not have a financial system. Entrepreneurship is stifled. The only firms that can borrow money are state enterprises that do not service their loans and do not pay tax. What sort of an economy is that?

GL: What about what is happening in the southern parts of China? People are starting businesses there.

HH: Most businesses are started by communist party cadres. Otherwise loans are not available. Cronyism and corruption are inevitable. The firms that are operating are Taiwan and Hong Kong owned. They are keeping China afloat by exporting and providing a rotating system of jobs. Workers are coming from villages to work for two or three years in the factories, and then go back to be replaced by a new group. The Taiwan and Hong Kong entrepreneurs have parachuted to Canada, Australia or the US. There is serious concern about the state of the economy, but no evidence of policy change.

WHY OUR PACIFIC NEIGHBOURS ARE IN DIRE STRAITS

GL: A bit closer to home, you have been involved for a long period in policy debates in PNG. Why has its growth been so bad?

HH: PNG was very underdeveloped in 1975; but so were other countries such as Botswana. PNG has grown at 0.5% a year while Botswana has grown at over 7% a year. The difference between the GDP rise and the consumption fall has been siphoned away by crony rents and corruption.

Unfortunately PNG in 1975 took over the Australian institutional structure. Australia has spent 25 years reforming and changing that structure. PNG extended the unworkable institutional structure. For example, 19 provinces were created, public utilities followed Australian patterns, the industrial relations structure was copied, the kina was overvalued and high protection was introduced to create inefficient industries. Such high cost policies have meant that consumption has fallen by 1% a year.

GL: Do you think it will be possible for them to get some Asian-style growth or is it forever to be a stagnant backwater?

HH: Some reforms have taken place. The exchange rates have been freed up, with a considerable devaluation of the kina. In marked contrast to its predecessor, the present Morauta Government is making a serious effort to straighten out macroeconomic policies. A privatisation policy is in place to repay the public debt (some K1.5 billion) to the Reserve Bank and thus lower interest rates and end the annual subsidies (some K300-K400 million) to the public sector. This would free up funds for services such as education and health that rank among the lowest in the world.

GL: \$A300-400 million dollars is what we pay to the PNG government in aid?

HH: Yes, direct to the government—300 million, plus we gave them another 80 this year. So if they stop subsidising these enterprises, they will have more money for health and education.

GL: And infrastructure?

HH: Yes, privatisation in PNG is not only important from a financial point of view but also to improve products and services. Existing government enterprises are inefficient. For instance, cement is low quality and high in price. Sugar is three times the world price. Today, everybody who buys a soft drink or a pound of sugar pays three times the prices they should be paying. Fish canning—in a protein short economy—is highly protected. PNG does not have just tariffs or subsidies, it has both.

Industrial relations are another big problem for the economy, as its institutional structure was copied from Australia. The award structure includes long service leave that is unique to Australia, New Zealand and PNG. Wages and on costs are so high that formal employment has not risen in PNG for twenty years. A high proportion of private sector jobs is subsidised by tariffs and budget payments. The few workers who are employed in the formal sector either belong to the public or private sector union that wield strong political power. It has proved impossible to start a clothing industry because of the level of wages.

GL: Like in Fiji.

HH: PNG is a very small economy so that if, like Fiji, half a dozen clothing firms went into production, there would be an appreciable impact on the labour market.

GL: Australia and New Zealand have a huge interest in the whole range of small countries in our Pacific backyard. PNG, indeed most of them, seem to be forever dependent on us. Are there better solutions?

HH: Well, the best and quickest way would be to cut them off without a shilling.

GL: And then?

HH: Open our markets for goods, services and labour. They would have to qualify for immigration places with English and other skills.

Cutting off aid is the only way to sort out the Pacific mess. Western Samoa and the Solomons are also in dire straits. If we stopped aid flows they would have to adjust.

As micro economies, they could no longer pretend that they are fully-fledged states with embassies in every corner of the earth. Norfolk Island manages a very high standard of living without aid flows.

THINKING ABOUT AUSTRALIA'S FUTURE

GL: Let's come back to some local Australian issues. You mentioned immigration. Recently Premier Carr has been talking about controls on immigration for all sorts of reasons. One is that Sydney is too big and that immigration is environmentally damaging. What is your view generally?

HH: Immigration is a marginal component of environmental policies. If we have had poor environmental policies in the past so that salination has become a serious problem, then let us change environmental policies.

GL: Well, that is an issue of whether the market was working in the pricing of water.

HH: Markets now seem to work well in urban areas. We pay for water and energy, though we should probably be paying more for vehicle pollution. I also see the environment improving in the country. Much of the erosion

of my youth has disappeared and there has been a great deal of reforestation. The environment is extremely important, but with sensible policies it can continue to be improved though the population may grow.

I do not see that Sydney is too large or too small. People vote with their feet. We can live in the centre of the city, in the suburbs, on the outskirts, or move to Orange.

GL: There are a number of components to immigration policy. One is humanitarian and so forth. Should we try to attract certain types of people that we are unable to produce ourselves? Educated people like policy tried to do in the 1950s and 1960s? Do you think we would or should ever return to that sort of approach?

HH: We need a population rather than an immigration policy. Population policy would take not only environmental and spatial issues into account, but also national security and defence. So we need an informed debate on population policy.

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GL: And an open debate.

HH: A debate that is not captured by multiculturalism. Australia is one of the pleasantest countries to live in, partly because of its openness to migration over the last 200 years. The open attitude to migration has nothing to do with multiculturalism. It goes back to the Anglo-Saxon-Celtic mores of the bush where people had to help each other to survive. But Australia is also a closed society in the sense that when you go home and close your front door behind you, nobody interferes with what you do. You can speak whichever language you like, dress as you like, spend your leisure as you like. It is an open society because when you come out of that door, you are part of several civil groups at work, in sport and in cultural pursuits where you interact with a wider society. These are very good traditions to preserve.

An open debate on how we see Australia's population developing is needed. There are many extremists. Some think that we are not sufficiently Anglo-Saxon-Celtic. Some think that instead of having one national language we should have 75. Some think that cultural groups should not inter-marry to preserve what they think of as 'multiculturalism'. If you are Greek, you should—

GL: —marry a Greek. In economic terms, some people would argue that we have opened up too much, that globalisation is a bad thing, that too many jobs are going overseas, and that we ought to be making our own products. Dick Smith is promoting his own vegemite and his own matches. Is it all or nothing? Do we become part of the global community or can we somehow or other close selective doors?

HH: History suggests two conclusions. First, with global economies of scale in production and trade, we can all be much richer. We can have bigger houses and nicer cars and our children can have better schools and holidays. Countries that have opted for protectionism, such as the communist countries and the Latin American countries, haven't got big cars, big houses and a choice between three different types of vegemite.

GL: Unless you are one of the rulers.

HH: Unless you are one of the cronies. But they are small groups, not like the majority of Australians who are really well off. We have no choice but to be part of the global economy if we want to be rich. There are niches for people who do not want to be part of the world economy, albeit mostly at a relatively low standard of living. But it worries me that some Australians, notably teachers, journalists and others who seek to instruct the public, think that we have a choice. My granddaughter is being taught at school that the Australian economy is being taken over by foreign multinationals that are exploiting us. She is being told that we should buy Australian goods regardless of quality and price.

GL: You have spent most of your life teaching, and in related areas. For the last part of your career you have been working at a modest think tank like CIS. What role do you think organisations like this have in helping people to understand some of these very fundamental issues?

HH: The role of 'think tanks' is absolutely clear. I wish more people were concerned about fundamental issues. The parents whose kids are being taught this rubbish need CIS. We need outreach programmes for teachers. Economics is difficult because it is counterintuitive. For example, people think that if we protect industry, then there'll be more jobs. But if we are not going to import from the rest of the world, people won't import from us, and so on.

GL: I am an optimist. I think we will get it right. Wherever we get to in the next 20 years, the reforms of the 1980s protect us to some degree for the 2000s. Australia can be a leader in so many ways. I think we will get it right, and we need to get it right, and politics will have its way. Do you share that sort of optimism?

HH: Yes, I don't have to live in Australia. I could live anywhere in the world. But I want to live here.

GL: I'll bet it is the most free, pleasant and tolerant country in the world.

HH: Yes.

GL: We take it for granted, but we have to do more to make sure we keep it. ■