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Similar Problems, Similar Solutions

by Richard W. Rahn

NATIONS LARGE AND SMALL CAN DODGE ECONOMIC DISASTER WITH PRO-GROWTH POLICIES

SAN PEDRO, BELIZE

The world financial and debt crisis can, at times, be better understood by looking at a small entity that is suffering from the same diseases as the major countries. The small Central American-Caribbean nation of Belize is, in many ways, a microcosm of Europe and the United States in that its debt has grown to a level where it cannot be serviced without doing great damage to the rest of its economy.

Also, the courts in Belize, like those in the U.S., give too much deference to government, which is undermining civil liberties, the rule of law and property rights. All too many judges succumb to the pressures of the political branches of government.

I am here in Belize to discuss with representatives of the government and business community changes in policy that should lead to higher rates of economic growth. Belize is about the size of West Virginia but has a population of just 330,000. The budget is in millions, rather than billions or trillions of dollars, so one can still get a sense about how much is being spent and on what.

On June 29, Belizean Prime Minister Dean Barrow presented the new proposed budget, which, like budgets in the U.S., many European countries and elsewhere, shows a debt-to-gross-domestic-product (GDP) ratio approaching 100 percent. In Belize, the debt service cost is about the size of the expected deficit. Also, its debt service cost, as in Spain and Italy, is much higher than in the U.S. The U.S. dollar, for the moment, is still the world's reserve currency and is viewed as less risky than many other currencies. Thus, many foreign governments, institutions and individuals are still willing to hold dollars, which helps keep U.S. interest rates low.

Assume you are the prime minister of Belize. What would you do, knowing that you are facing a fiscal cliff within the next couple of months? It is going to be difficult to borrow more money to make up the projected deficit because it is obvious to all that it is unlikely that the country will be able to pay it back. Thus, any additional monies you borrow from private sources will have very high interest rates.

You could try to cut expenditures, but this might require a cut as much as 15 percent. Any government finds it tough to make real cuts, particularly in a democracy where you have a razor-thin majority, as does the ruling party in Belize.

You could default on the interest payments to your private creditors. This option might buy you a year, but it will drive away foreign investors, make borrowing more difficult and expensive in the future, and put your government at risk for seizures of any assets outside the country, plus other unpleasant side effects, such as depressing domestic property prices.

You could try to negotiate with your existing foreign creditors for better terms - lower interest rates, extending maturities, or a "haircut" on the amount of loans. The creditors will, of course, want something in exchange for agreeing to any of these measures. What are you willing to give them?

This leads us to the last option, which is the high-growth option. Belize, like the United States, has been growing at barely 2 percent per year. A country in its stage of development should be growing at 7 percent to 10 percent a year or even more. Like most countries, Belize has created many unnecessary regulatory, tax and trade policies, and procedures that impede growth. It has done many things that have had the effect of greatly impeding foreign investment. (The U.S. is doing the same thing with many of its new international tax regulations.)

Belize should embark immediately on a program of economic reform, with the goal of achieving 10 percent real growth per year. This could be done by removing unnecessary regulatory impediments, implementing pro-growth tax and trade reform, and reforming the central bank and judicial system. Recently nationalized industries could be reprivatized, which, if done correctly, would remove a big contingent liability. The government could provide grants for charter or free cities, as neighboring Honduras has done, to serve as demonstration projects and engines of economic growth.

Creditors would welcome a pro-growth privatization plan and thus be willing to give better debt terms because they understand that high growth leads to a rapid increase in tax receipts and other revenues, which greatly reduce the debt problems.

Hint to U.S. policymakers: The same formula also works for developed countries, as Ronald Reagan and Margaret Thatcher proved a generation ago.

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