The Washington Times May 1, 2018

Allocating Global Capital

by Richard W. Rahn

People are more careful in spending their own money than they are in spending other people's.

Even though this core principle about human behavior has been understood for thousands of years, many taxpayers seem to be perfectly comfortable with turning over a significant portion of their wealth to politicians and government bureaucrats to spend their hard-earned money. Then they are shocked when they learn that much of it has been wasted, stolen, or spent on foolish things.

Economic growth is largely dependent upon savings being invested in more and better plant and equipment and new technologies (i.e. capital formation). The higher the rate of productive investment the higher, the rate of economic growth. The necessary capital investment comes from domestic and/or foreign saving. Countries that have the rule of law and strong protections for private property are more attractive to foreign investors than those that have weak economic institutions.

In the 19th century, the U.S. was an attractive place for foreign savers to put their money. English investors in particular underwrote the development and expansion of U.S. railroads. Some of this investment was wise, and some foolish because the projects were mismanaged or poorly thought out — which are the normal risks of doing business. But the foreign investors could rely on the U.S. courts to fairly uphold their claims, and they had few worries about the government seizing their property — which was not true in many countries.

As information more freely flows among countries, it would be logical to expect that the risks of foreign investment would be diminishing rather than increasing. Sadly, this is not the case. Foreign (and domestic) investors are now faced with ever increasing complexity in tax, anti-money laundering and anti-terrorist finance and securities laws which add both to costs and uncertainty.

Many of the laws are vague and arbitrarily enforced, so that financial actors cannot know with certainty when they are in compliance. This has caused both financial institutions, their executives, and individual investors to "de-risk," which means they are investing less in places where the returns could be most attractive.

The laws and regulations that unnecessarily interfere with the proper allocation of global capital have the effect of reducing world economic growth, and job and income growth. That is, they are making the world poorer than it should be.

Ironically, international institutions which have been established to promote more productive investment in poorer nations are having in many cases the opposite effect. Institutions like the World Bank, the International Monetary Fund, the Organization for Economic Cooperation and Development and the European Bank for Reconstruction and Development now create negative value.

The IMF and the World Bank have been around for three-quarters of a century, and the Organization for Economic Cooperation and Development for more than half of a century. How many more decades will they need to complete their tasks? The European Bank for Reconstruction and Development was formed in 1991, now more than a quarter of a century ago, to help finance the transition of the former Eastern European and other countries of the Soviet Union.

Most of these countries are no longer poor, but middle income. So why do we still have a European Bank for Reconstruction and Development, other than as the lobby for those who get unnecessary subsidized loans, etc., and the 3000 employees with high tax-free salaries?

The fact is there is no evidence that European Bank for Reconstruction and Development made much difference. Those countries that were quick to put in the rule of law and protect private property rights did much better than those who lagged in reform. As the late great development economist Lord P.T. Bauer often noted, if countries have the right policies and institutions, they will attract all of the capital they need, and if they don't, no matter how much money they are given, it will be wasted.

The U.S., Canada, and Europe, and more recently, Singapore, Hong Kong, etc., did not become rich because of subsidies from development banks. They became rich because at the time of their most rapid development they had the rule of law and protected private property. It was only after they became rich they had the luxury of fiddling with a welfare state.

The European Bank for Reconstruction and Development has devolved into an increasingly politicized crony capitalist institution that is subsidized by U.S. and European taxpayers. It clearly no longer serves any necessary purpose — and probably never did. It is time to pull the plug. Most of the staff and international bureaucrats who attend their splendid dinners in great locations are probably clever enough to find other sources for free meals. Some might even get real jobs in the private sector and become productive.

As President Reagan used to say, "a government bureau is the nearest thing to eternal life we'll see ever on this earth." International institutions are prime examples as they keep reinventing themselves as an excuse to milk the productive global economy. They all should be given fixed terms and then erased.

Richard W. Rahn is chairman of Improbable Success Productions and on the board of the American Council for Capital Formation

https://www.washingtontimes.com/news/2018/apr/30/allocating-global-capital/