THE NEW WORLD ECONOMY

BY **JEFFREY D. SACHS**

Money makes the world go round

The key to economic development and ending poverty is investment. Nations achieve prosperity by investing in four priorities. Most important is investing in people, through quality education and healthcare. The next is infrastructure, such as electricity, safe water, digital networks and public transport. The third is natural capital, protecting nature. The fourth is business investment. The key is finance: mobilizing the funds to invest at the scale and speed required.

In principle, the world should operate as an interconnected system. Rich countries, with high levels of education, healthcare, infrastructure and business capital, should supply finance to poorer countries, which must urgently build up human, infrastructure, natural and business capital.

Money should flow from rich to poor countries. As emerging-market countries become richer, profits and interest would flow back to rich countries as returns on their investments.

That is a win-win proposition. Rich and poor countries would benefit. Poor countries become richer, and rich countries earn higher returns than if they invested only in their own economies.

Strangely, international finance does not work that way. Rich countries invest mainly in rich economies. Poorer countries get only a trickle of funds, not enough to lift them out of poverty. The poorest half of the world — low-income and lower-middle-income countries — produces about US$10 trillion per year, while the richest half of the world — high-income and upper-middle-income countries — produces about US$90 trillion.

Financing from the richer half to the poorer half should be about US$2 trillion to US$3 trillion per year. In reality, it is a small fraction of that.

The problem is that investing in poorer countries seems too risky. This is true in the short run. Suppose that the government of a low-income country wants to borrow to fund public education. The economic returns to education are very high, but need 20 to 30 years to realize, as today's children progress through 12 to 16 years of schooling and only then enter the labor market.

However, loans are often for only five years, and are denominated in US dollars rather than the national currency.

Suppose the country borrows US$2 billion today, due in five years. That would be fine if in five years, the government can refinance the US$2 billion with another five-year loan.

With five refinance loans, each for five years, debt repayments are delayed for 30 years, by which time the economy would have grown sufficiently to repay the debt without another loan.

However, at some point along the way, the country would likely find it difficult to refinance the debt. Perhaps a pandemic, a Wall Street banking crisis or election uncertainty would scare investors.

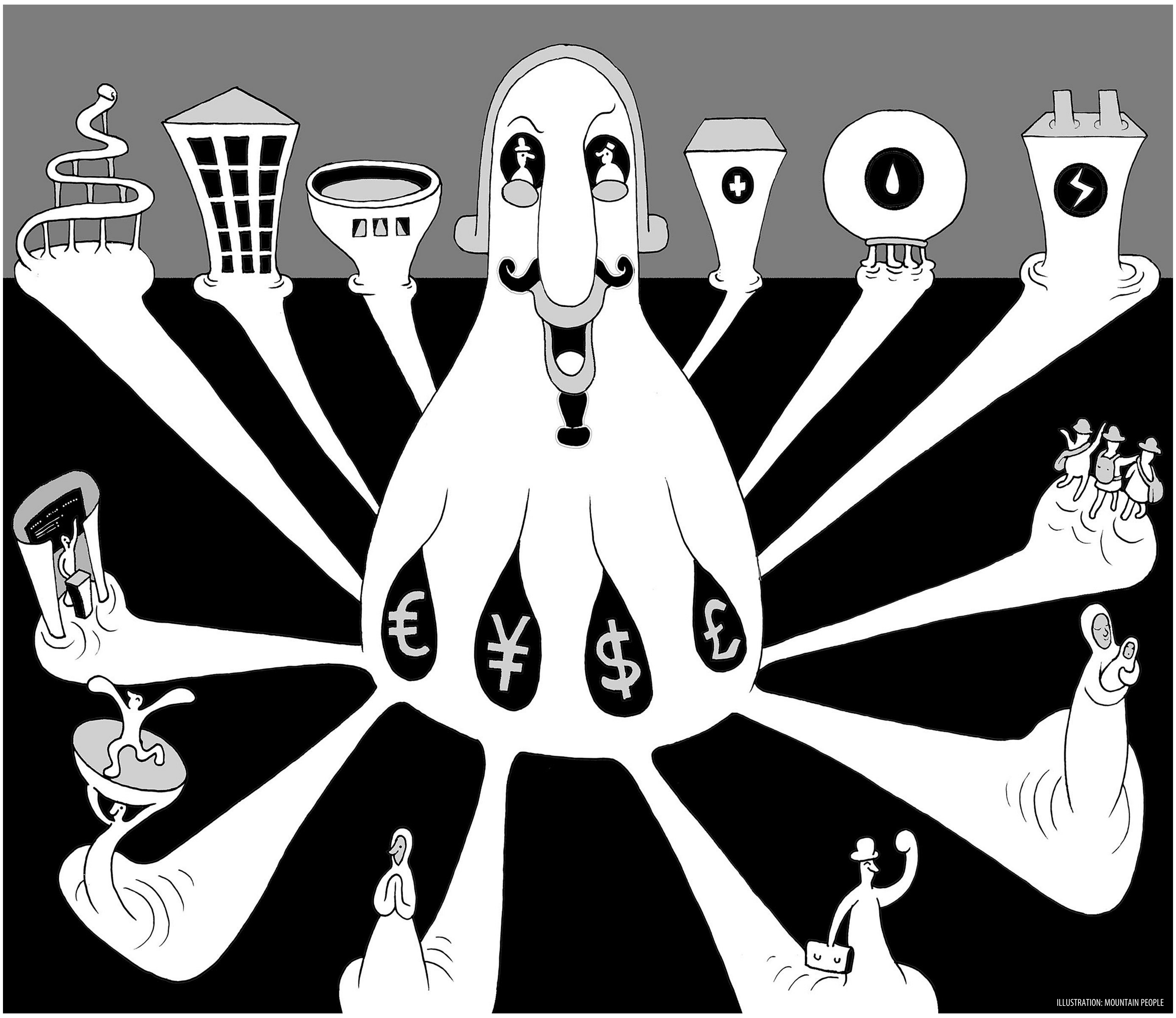
ILLUSTRATION: MOUNTAIN PEOPLE

When the country tries to refinance the US$2 billion, it finds itself shut out from the financial market. Without enough money to hand, and no new loan, it defaults, and lands in the IMF emergency room.

Like most emergency rooms, what ensues is not pleasant to behold. The government slashes public spending, incurs social unrest and faces prolonged negotiations with foreign creditors. In short, the country is plunged into a deep financial, economic and social crisis.

Knowing this in advance, credit-rating agencies such as Moody's Investors Service and S&P Global give the countries a low credit score, below "investment grade."

As a result, poorer countries are unable to borrow long term. Governments need to invest for the long term, but short-term loans push governments to short-term thinking and investing.

Poor countries pay very high interest rates. While the US government pays less than 4 percent per year on 30-year borrowing, the government of a poor country often pays more than 10 percent on five-year loans.

The IMF advises the governments of poorer countries not to borrow very much. In effect, the IMF tells the government that it is better to forgo education — or electricity, safe water or paved roads — to avoid a debt crisis. That is tragic advice. It results in a poverty trap, rather than an escape from poverty.

The situation has become intolerable. The poorer half of the world is being told by the richer half: decarbonize your energy system; guarantee universal healthcare, education and access to digital services; protect your rainforests; ensure safe water and sanitation; and more.

However, they are somehow to do all of this with a trickle of five-year loans at 10 percent interest.

The problem is not with the global goals. These are within reach, but only if the investment flows are high enough. The problem is the lack of global solidarity. Poorer nations need 30-year loans at 4 percent, not five-year loans at more than 10 percent. They need much more financing.

Poorer countries are demanding an end to global financial apartheid.

There are two ways to accomplish this. The first is to expand about fivefold the financing by the World Bank and the regional development banks — such as the African Development Bank. Those banks can borrow at 30 years and about 4 percent, and on-lend to poorer countries on those favorable terms. Yet their operations are too small. For the banks to scale up, G20 countries — including the US, China and EU nations — need to put a lot more capital into those multilateral banks.

The second way is to fix the credit-rating system, the IMF's debt advice and the financial management systems of the borrowing countries. The system needs to be reoriented toward long-term sustainable development.

If poorer countries can borrow for 30 years, rather than five years, they would not face financial crises in the meantime. With the right kind of long-term borrowing strategy, backed by more accurate credit ratings and better IMF advice, poorer countries would access much higher flows on much more favorable terms.

The major countries have four meetings on global finance this year: in Paris in June, Delhi in September, the UN in September and Dubai in November.

If big countries work together, they can solve this. That is their real job, rather than fighting endless, destructive and disastrous wars.

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Reconsidering the dilemmas of deterrence

BY **JOSEPH S. NYE**

We live in a world where geopolitical stability relies largely on deterrence, but how can we prove that deterrence works?

Consider the war in Europe. Beginning in December 2021, US President Joe Biden warned Russian President Vladimir Putin that Russia would face severe sanctions if he invaded Ukraine, to no avail. Then, when the US and its European allies thwarted Russia's plans by providing arms to Ukraine, Putin brandished the nuclear option.

However, Western aid continued unabated.

Did deterrence fail or succeed? Answering this question poses a challenge because it requires assessing what would have occurred in the absence of the threat. It is hard to prove a negative. If I put a sign on my front door that says: "No Elephants," and there are no elephants in my house, did I deter them?

It depends on the likelihood of literate elephants entering in the first place.

The Ukraine war demonstrates how risk reduction is not a black or white choice, but often a matter of degree.

Perhaps Putin, counting on a flimsy Western alliance, believed the sanctions would fail.

However, he has refrained from striking supply lines in NATO countries. While the West has continued to arm Ukraine despite Putin's nuclear saber rattling, it has been reluctant to provide longer-range missile systems or modern warplanes.

Credibility is essential for deterrence to work: Threatening a maximum response to defend a minor interest strains credulity. This is particularly true when a nuclear power promises to extend its umbrella to defend a distant country.

During the Cold War, the US and the Soviet Union credibly extended their nuclear deterrence to Western and Eastern Europe respectively. While some analysts were skeptical that the US would risk New York to defend the isolated enclave of West Berlin, the threat worked, partly because of the US troops stationed there.

While the so-called Berlin Brigade was too small to defend against a Soviet invasion, it ensured that a nuclear strike on the city would result in US casualties. At the same time, US forces in Europe — nuclear and conventional — were not a credible deterrent for Soviet military intervention in Hungary in 1956 or Czechoslovakia in 1968.

This history is relevant to the current situation in Korea, where North Korea has nuclear weapons and South Korea remains bound by the Non-Proliferation Treaty. A recent poll found that more than 70 percent of South Koreans were in favor of their country developing a nuclear arsenal.

However, when South Korean President Yoon Suk-yeol met with Biden last month, they agreed that the US would station a nuclear-armed submarine near the Korean Peninsula and deepen consultations with South Korea on nuclear and strategic planning, similar to US engagement with NATO allies during the Cold War.

The credibility of US-extended deterrence in this instance, much like in the Berlin example, is reinforced by the presence of 28,500 US troops in South Korea. The countries are locked in a "community of fate," because North Korea cannot attack South Korea without killing Americans.

Forward bases in Japan offer the same guarantee. That is why former US President Donald Trump's frequent musings about the withdrawal of troops from places such as Japan and South Korea were so damaging.

Trump's presidency highlighted the ineffectiveness of nuclear intimidation and bribes. When North Korea successfully tested an intercontinental ballistic missile in 2017, Trump threatened "fire and fury like the world has never seen," to no effect.

Next, he tried direct diplomacy. After meeting with North Korean leader Kim Jong-un in 2018 — a long-sought foreign-policy goal for the North — he brashly predicted the swift demise of the country's nuclear-arms program. To no surprise, North Korea did not disarm. As Kim sees it, his reputation and the fate of his dynasty depend on nuclear weapons.

The case of Taiwan shows how changing circumstances can test tried-and-true deterrence strategies. When then-US president Richard Nixon and then-Chinese leader Mao Zedong (毛澤東) met in 1972 to restore relations between the US and China, they did not see eye to eye on Taiwan's status.

Ultimately, the two sides designed a formula to postpone the matter: The US would recognize "one China," the People's Republic, but only acknowledge that people on both sides of the Taiwan Strait were Chinese. The US provided weapons to Taiwan in accordance with the Taiwan Relations Act, but did not recognize it as a sovereign country.

For many years, the US refused to say whether it would defend Taiwan. When I visited Beijing as a Pentagon official during then-US president Bill Clinton's administration, my hosts asked if our countries would go to war over Taiwan.

I said that no one could know, adding that even though then-US secretary of state Dean Acheson failed to include South Korea in the US' defense perimeter in his Jan. 12, 1950, speech, the US entered the Korean War only six months later.

Relying on what deterrence theorist Thomas Schelling called "the threat that leaves something to chance," I warned the Chinese against testing us.

What some call a policy of "strategic ambiguity" might better be described as "double deterrence," designed not only to prevent China from using force against Taiwan, but also to dissuade Taiwan from declaring *de jure* independence.

Some analysts worry that this strategy is eroding as China's military might grows and US lawmakers visit Taiwan in greater numbers. On four separate occasions, Biden has stated that the US would defend Taiwan, only for the White House to follow up each time with a statement reaffirming adherence to the "one China" policy.

Steering a path that avoids projecting weakness or provoking escalation would be decisive for avoiding all-out war.

History is a reminder that assessing a deterrent's success can be difficult. There are some factors, such as credibility, that are crucial to achieving the desired outcomes.

However, as dilemmas of deterrence evolve and multiply, studying the strategy's limits is equally important for finding an approach that works.

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