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La política urbana y el bienestar en el pensamiento económico de Lauchlin Currie¹

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It is a great pleasure and privilege to address this conference today, and I am most grateful to the Banco for the invitation.

I am also delighted to see Dr Arenas here today. My connections with him go as far back as September 1968. This was when I first came to Colombia. Dr Arenas was at that time the director of the Centro de Investigaciones para el Desarrollo (CID) at the Universidad Nacional, and I had a letter of introduction to give to him from Professor Currie (who was then teaching at Simon Fraser University in Canada where I had just completed my Master's degree). The letter asked Dr Arenas to help me get started on my PhD topic on the elasticity of supply of Colombian agriculture.

At that time the Universidad Nacional was abuzz with controversy over Currie's 1961 *Operación Colombia*, a proposal for an ambitious urbanisation programme that was much discussed by President Alberto Lleras's administration and was seen by Currie as the most effective way to modernise the country and provide the best solution, in both the short and long term, to widespread rural poverty. However, *Operación Colombia* was rejected. It was said that the cities could not cope with an accelerated inflow of campesinos. The people were needed in agriculture. Without

¹ Presented at the seminar/workshop, "El pensamiento económico de Lauchlin Currie", Banco de la República, Bogotá, D.C., 6 de febrero 2008.

them food production would fall and food prices would rise. Throughout the 1960s, and especially under President Carlos Lleras, all the talk was of colonización and “Reforma Agraria” as the solution to rural poverty.

Undaunted, Currie pressed the case for *Operación Colombia* and directed a number of quantitative studies that revealed the extent of disguised unemployment in the countryside and the huge potential for expanding Colombia’s towns and cities where labour could be far more productive and better paid, better housed, better educated and, paradoxically, also better fed than if they stayed in agriculture. These studies culminated in a book, *Accelerating Development: The necessity and the means* (1966) that won a prestigious international prize. This was written while he was the director of CID, and also conducting a study of *Alternativas para el desarrollo urbano de Bogotá* (1969) for the then alcalde, Virgilio Barco. Frustrated by political developments and repressive policies under Carlos Lleras, and anxious to reconnect with the influential academic communities of North America and Britain, he left Colombia in 1967 for university posts in the US, Canada and Britain where he completed a new book-length manuscript on development.

When in 1971 President Misael Pastrana appealed to him to return to Colombia as a special adviser to Dr Arenas, now the head of DNP, he hurried back. Within a few weeks he had reworked his manuscript into the form of a concrete national plan of development for Colombia, the famous *Plan de las Cuatro Estrategias*. This proved

no less controversial than *Operación Colombia* (which was *Las Cuatro Estrategias* in embryo) but it was courageously embraced by President Pastrana.

Dr Arenas will tell you more about this. But, in brief, you will recall that the first two of the four strategies involved promoting construction and exports as “leading sectors” that had hitherto been artificially repressed by interest and exchange rate controls in the face of high inflation. The third strategy involved raising agricultural productivity, though Currie believed this would largely come about automatically as the result of the greater effective demand that would accompany success with the first two strategies. The fourth strategy was a commitment to better distribution. This was to be accomplished through various tax reforms but especially from the hundreds of thousands of new jobs in the construction and export sectors. The four strategies thus formed an intellectually coherent interrelated whole. Its implementation required very strong political will on the part of the president and Dr Arenas in the face of scepticism or downright hostility in the Treasury and the Junta Monetaria and even amongst many technicians inside the DNP.

The most controversial part of the national plan was the birth, in September 1972, of a unique index-linked savings and loan system. This proved enormously attractive to savers who were given a much better deal than under the monopolistic BCH or the heavily subsidised ICT. Savings soared beyond most people’s (but not Currie’s) expectations, making available to borrowers a much larger volume of non-inflationary finance than the BCH and ICT had been able to capture. Yet, again to

the surprise of most commentators, applications for these funds grew at an even faster rate than the supply, despite the higher cost in real terms. The point was that the schedule of real repayments, as a proportion of borrowers' incomes, was far more evenly spread over the 15-year lifetime of the mortgage contract, hence was far more manageable and affordable. (With conventional BCH mortgages inflation that ranged between 5-25 percent a year in the 1960s necessitated high nominal rates of interest – around 16 percent – which in turn meant very high initial debt service payments that relatively few people could afford: the infamous front-end loading problem of unindexed long-term loans.)

There was no sub-prime mortgage problem in those days. The delinquency rate on the CAVs' large loan portfolio was lower than it had been for the BCH, and far lower than on ICT loans despite the large public subsidies for its 'social housing' programme.

It was a race against time, for Alfonso Lopez was due to assume office in August 1974, and his equipo económico had vowed to dismantle the new system once in office. Partly, the attacks were for purely political reasons; partly it was because they believed it would threaten the stability of the rest of the financial system; partly because they believed that housing was "unproductive"; and partly because they alleged the new system was the cause of accelerating inflation.

Fortunately the system expanded so rapidly, had financed so much new building, and had created so many new jobs – with “se necesita obreros” notices appearing all over Bogotá and other cities – that it became too big to dismantle. Instead, the new Lopez administration chose only to debilitate it. That has been the story for much of the ensuing 30 years. Eventually the index-linking was scrapped altogether in favour of variable rate mortgages due to pressure from borrowers. Borrowers loved the fact that they could get a mortgage but then naturally pressed for easier terms. But this was at the expense of savers, future borrowers, and the dynamism of a system upon whose health depended so many jobs, directly and indirectly.

When I was last in Colombia 5 years ago I engaged in a lively debate with Juan Carlos Echeverry who had recently published an influential book, *Las Claves del Futuro: Economía y Conflicto en Colombia*. Echeverry applauded the boost to housing finance in the 1970s and the contribution that the construction sector made to employment growth and as a contra-cyclical influence in the 1970s and 1980s. However, he claimed that in the 1990s, with “apertura” and the great influx of external credits and drug money, construction became a pro-cyclical speculative activity and a source of instability rather than growth.

Control of external hot money movements is of course a problem for the central bank who must try to prevent these from causing undesirable fluctuations in the money supply. But it would be wrong to blame housing finance for instability when its fluctuations are only a symptom rather than the cause of instability.

Currie understood this better than anyone. Ever since his time at Harvard and as adviser to the Governor of the Fed in the 1930s he had stressed the importance of monetary control. He was also extremely conscious of the importance of definitions. What is the money supply? It is the medium of exchange and its expansion facilitates further exchanges and determines the circular flow of money incomes and expenditures. He thus drew a sharp distinction between money and credit and money and savings. Antonio Hernandez may say more about this, but suffice it for me to say that there is a world of difference between an increase of money and an increase of savings.

An increase in money in the form of highly active bank demand deposits supports increased spending out of current income, settles debts directly, and will cause inflation if expanded faster than the real growth of the economy.

By contrast, an increase in saving in the form of time deposits is the act of not spending one's current income until much later. Thus in and of itself saving is a deflationary influence. When savings deposits are used to finance housing there is a transfer of buying power, not a net increase. The cause of inflation and instability lies elsewhere.

Both demand deposits and time deposits are deposits. When they are lumped together the cause of the rise is obscured. It makes a huge difference which of these

two types of deposit is rising. But semantic confusions such as this helped destroy the UPAC system. In 2002 the system lay in ruins, the victim of countless debilitating modifications. Construction had for the previous four years been leading the economy down instead of up. Many thousands had lost their jobs, both directly and as a result of the depressed state of the industries that supply the construction sector.

But Echeverry complained that construction is a sector that has been privileged and has diverted resources from traded goods. It also relies on unskilled workers whereas the future depends on skills and an allocation of resources more in tune with the market forces that Adam Smith emphasised. Let us rely on Smith, says Echeverry, not on protectionism and privileged “leading sectors”.

However, Currie, like his great Harvard mentor Allyn Young was profoundly influenced by Smith, especially by the opening chapters of *The Wealth of Nations* where Smith emphasised that the key to increased productivity was specialization or the division of labour. And the division of labour in turn depended upon the size of the market demand, or upon real reciprocal exchange.

Today demand management is generally associated with Keynesian policies to tackle short-run business cycles around a secular trend. These cycles are closely associated with interruptions to the flow of monetary incomes and expenditures (or monetary demand). But Currie and Young focussed on competition, openness, and the

mobility of labour to increase the underlying trend of real demand and market size, hence specialization, hence productivity.

This is where Currie’s vision of construction’s potential role comes in. As a “leading sector” it could help Colombia to break free of her historically slow, endogenous growth path. It is a leading sector because (a) it is an important direct and indirect component of GDP, so its growth has a significant effect on overall growth; (b) it moves independently of movements in the rest of the economy, and can be moved exogenously through discretionary policies; (c) it plays a vital role in promoting labour mobility; and (d) it is a sector with enormous latent demand that can be tapped not through inflation of the money supply but through a transfer of real incomes from savers.

The construction sector has another key role: it is an indispensable element in the labour mobility mechanism. This promotes not only faster growth but also better distribution. In Colombia there is still a great imbalance in the allocation of labour, notably between low-paying agriculture and high-paying urban activities. And in cities like Bogota there is urgent need for better balance between where people live and where they work, and for an improvement in the quality of the housing needed and/or demanded by all income groups. All this was covered by Currie in his work on “*taming the megalopolis*” through the “cities-within-cities” approach to urban planning, and in answering the question: “For whom should houses be built?”

Echeverry claims there is a conflict between investment in internationally traded goods and investment in housing. Yet in countries such as Singapore (which Currie visited), noted for spectacular export growth, investment in housing has also been enormous, and far greater than in Colombia. Despite re-housing almost the entire population within 30 years its construction sector still booms. There has been no saturation of demand.

As people's incomes have increased so Singaporeans have demanded better and better accommodation and related infrastructure. This has been aided by low inflation and large pension fund contributions that are released for housing finance at low rates of interest (but positive in real terms). Building is concentrated on well-built conventional high-rise blocks for the middle classes. As these families move into new homes lower-income families move into the ones they have vacated. This "filtration" or "escalation" process enables poorer families to enjoy far better accommodation than the type of subsidised "vivienda de interés social" (popular housing) that Colombia is desperately trying to provide today out of limited fiscal resources.

Housing and exports are complements, not substitutes. Both are capable of expanding on the basis of a stimulus to and redirection of real savings, rather than via inflationary finance or subsidies. Here are the real "keys to the future" – a future more stable, prosperous and equal, a future in which, in Currie's words in

the introduction to the Plan de las Cuatro Estrategias, Colombians can not only be better off but also feel better off and more comfortable with each other.