

FIGHTING
THE **WAR OF IDEAS** IN

LATIN AMERICA



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NATIONAL CENTER FOR
POLICY ANALYSIS

FIGHTING THE WAR OF IDEAS IN LATIN AMERICA

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The contents of this book represent the views of the authors alone.

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WINNING THE WAR OF IDEAS IN LATIN AMERICA

John C. Goodman

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INTRODUCTION

As this book goes to press, Latin American politics are undergoing dramatic and radical change. This change has been largely unnoticed by the North American news media — perhaps because it is overshadowed by the collapse of communism in Eastern Europe. But a radical shift toward freedom and free enterprise (one which parallels the change in Eastern Europe) is occurring throughout Latin America. It is a change that appeared all but impossible only a few years ago.

Consider the following:

- In Brazil, a pro-free enterprise candidate for the presidency recently defeated a traditional socialist candidate by drawing considerable support among low-income voters.
- In Peru, the leading candidate for the presidency is a former socialist who now strongly endorses free markets.

- In Guatemala, an advocate of laissez-faire capitalism is a credible candidate for the presidency.

Even in countries where forces traditionally hostile to free enterprise have assumed control of the government, political leaders are turning to private property and free markets as a solution to economic problems.

- After the Peronists regained power in Argentina, the new president almost immediately announced a program of massive privatization.
- Even though a center-left coalition won the recent election in Chile, the new president has announced his desire to retain the dramatic free market reforms of the Pinochet dictatorship.
- Although the presidency of Mexico remains in the hands of the pro-statist PRI, the new president seems committed to a program of privatization and liberalization and the largest opposition party is openly committed to free enterprise.

This is not a book about politics or economics. It is a book about ideas and how ideas cause change. It presents a novel perspective on what is happening in Latin America and what the United States can do about it.

All too often U.S. attitudes toward Latin America range from the view that “the situation is hopeless” to the view that we can “buy the allegiance of Latin American countries with foreign aid dollars.” When foreign aid fails, we invariably turn to sending weapons. At no point has serious consideration been given to engagement in a war of ideas.

Throughout most of the twentieth century, the left (mainly communist) has been actively involved in ideological warfare in Latin America. The U.S. has not. Although we have been able to “buy” the temporary allegiance of certain politicians, at no point have we made a concerted effort to convince Latin Americans of the virtues of freedom and free enterprise.

Like other people around the world, most Latin Americans

want an improvement in their well-being. They want a higher standard of living, better health, better economic opportunities, and longer lives. The communists promise that this will be accomplished through collectivized agrarian reform, redistribution of wealth, and state control of production. Yet the history of communism in Russia and China and recent events in Eastern Europe have taught us that communism falls short of attaining these goals. The U.S. has been the showcase of history. Yet we fail to export the fundamental ideas of economic freedom and political freedom — the foundation of the America's success.

Not only have we not engaged the opponents of freedom and free enterprise on the intellectual battlefield, U.S. foreign policy all too often has undermined the very values most Americans believe in. Our foreign aid dollars frequently have been used to set up state-owned corporations, which often are in direct competition with private companies. U.S. foreign aid and grants from private foundations in the U.S. have been used to encourage centralized planning and collectivization of Latin American economies.

In short, money from the U.S. is being used to undermine capitalism and freedom, to solidify the power of politicians who are actively hostile to free enterprise, and to support widespread corruption among public officials. Among advocates of freedom in Latin America there is a growing consensus: U.S. money does more harm than good.

Mistakenly, Americans have been led to believe that Latin America faces only two choices: corrupt dictatorships or communism. Either we support the former with money or we fight the latter with weapons. U.S. citizens desperately need to understand that there is a different and better way.

Although most people in the United States are unaware of it, a war of ideas is raging in Latin America. It is a battle between those who believe in various forms of collectivism and those who believe in freedom and free enterprise.

LATIN AMERICA'S CLASSICAL LIBERAL HERITAGE

During the nineteenth and early twentieth centuries, many Latin American countries were heavily influenced by classical liberal

ideas that came mainly from the United States and Europe. For example, one of the leaders of Argentina's early efforts to gain independence from Spain was Mariano Moreno, an ardent advocate of free speech and free trade and a strong opponent of the economic policies of mercantilism. Moreno was familiar with the writings of Rousseau, Adam Smith and Thomas Jefferson. On the proper role of government, he wrote "Reason and the famous Adam Smith ... who is undeniably the apostle of political economy, show that governments in laws directed to the general good, should limit themselves to the removal of obstacles."

As in the case of the United States, classical liberal ideas not only formed the rationale for wars of independence, these ideas also were the basis for the foundation of a new political order. For example,

- Simon Bolivar, the "George Washington of Latin America," was an intellectual who was heavily influenced by classical liberal thought from France and who wrote a model constitution incorporating these ideas.
- Argentina's 1853 constitution was virtually copied from the U.S. Constitution. Its principal author, Juan Bentiste Alberdi, was an admirer of Adam Smith, Jean Baptiste Say, Alexis de Tocqueville, John Locke, David Hume, James Madison, and the authors of the *Federalist Papers*.
- The Central American Congress Constitution of 1824 and the Mexican Constitution of 1864 also were patterned after the constitutions of the United States and France.

Under the influence of a political philosophy that respected property rights and free markets, many Latin American countries experienced considerable economic growth. For example,

- Between 1853 and 1925, Argentina experienced the highest rate of foreign investment per capita and the second highest rate of economic growth in the world.
- By 1925, the real wage in Argentina exceeded that of Switzerland, Germany, France, Italy, and Spain, and its exports were on a par with Canada and Australia.

Argentina is not alone. Throughout Latin America, the most prosperous periods of economic growth occurred during the periods of greatest economic liberty.

THE RISE OF COLLECTIVISM IN THE TWENTIETH CENTURY

Just as the United States and Europe have experienced the rise of collectivism in the twentieth century, so has almost every country in Latin America. Within the last several decades this trend has accelerated at an alarming rate. For example:

- Every five years Peru elects a president with “dictatorial” powers. Peru produces 27,000 laws a year, mostly by Presidential Executive Orders.
- In the last 13 years, the president of Venezuela has issued Executive Orders governing economic activity at a rate of at least 3,000 per year.
- The ruling party in Mexico (the PRI) also has increasingly assumed dictatorial powers. The Mexican Constitution has been changed 316 times in 68 years, with 37 changes in just the last few years — more than all of the changes that have ever been made in the U.S. Constitution.

One of the consequences of the growing power of the state, and the accompanying instability in political-economic institutions, is capital flight, declining investment, and declining rates of economic growth. Take Mexico, for example:

- It is estimated that over the last ten years as much as \$60 billion in private capital has flowed out of Mexico into the United States.
- At least another \$8 billion of private Mexican capital has gone into Swiss banks.

Just how quickly political instability and the erosion of capitalist institutions can lead to an erosion in economic prosperity is illustrated by comparing Argentina with Australia.

- Argentina was first settled by the Spanish in the sixteenth century, while Australia was settled by the British in the eighteenth century.
- In the early part of the twentieth century, Argentina was more developed than Australia and had a higher standard of living.
- Yet today, Australia has a per capita GNP four times that of Argentina.

THE POLICIES OF NEO-MERCANTILISM

The strongest force in the world today is not communism; it is nationalism. Nationalism finds its economic expression through the policies of neo-mercantilism. And nowhere in the world today are the policies of neo-mercantilism practiced more blatantly than in Latin America.

Throughout Latin America, governments use all of the classic tools of mercantilistic policy: tariffs and quotas, exchange rate controls, and the use of regulation and licensing powers to create monopoly privileges for the favored few. More recently, there has been a movement to combine mercantilism with socialism — first by nationalizing existing firms and industries and then through the creation of state-owned enterprises. Ironically, much of this activity would have been impossible without the assistance of international loans and foreign aid.

Regulatory Barriers to the Operation of Free Markets.

What do these trends mean in terms of the ability to start businesses and compete for customers in the marketplace? Take the case of Peru:

- In order to start a new manufacturing business in Peru, the owner must spend about \$9,300 to obtain all of the necessary government authorizations and approvals. Yet the per capita income in Peru is only \$1,500 per year.
- Once a business is started, the costs of regulatory requirements frequently are even greater than the burden of taxes. A survey of small businesses in Lima found that an average of 44 hours per month was spent complying with government regulations.

The Growth of State-Owned Enterprises. Throughout Latin America, there is an increasing tendency for government to own, rather than merely control, the means of production. Take Mexico, for example. In 1982 President Lopez Portillo nationalized all private banks. Along with the banks, the government obtained hundreds of private companies that were connected to the banks. Studies by the U.S. Treasury and the Mexican private sector show that the government and/or PRI-affiliated labor unions currently own or control about 70 percent of the Mexican economy. Not only has the state expropriated all the banks, it also owns supermarkets and hotels and controls the sale of supplies to agricultural communes. At one point, the government even owned a night club in Mexico City.

International Loans. Much of the growth of socialism in Latin America would have been impossible without foreign loans. All too often, loans from the “capitalist” developed countries are used by Latin American governments to start new businesses or subsidize the losses of existing state-owned enterprises (SOEs). The private sector economy is hurt in several ways. First, SOEs drain capital and labor from the private sector and drive up input prices for private industry. Second, SOEs borrow in the local private capital market to finance further expansion or cover operating losses — thus diverting funds from their more productive private uses. Third, SOEs often are in direct competition with the private sector enterprises that subsidize them. Finally, governments must ultimately tax the private sector in order to acquire the funds to pay back the loans.

SQUANDERING RESOURCES

Latin America is rich in natural resources. Argentina, for example, is one of the most richly endowed countries in the world. Its 200,000 square miles of pampa has extraordinarily rich soil, and it has substantial oil and gas. Brazil has sizable amounts of arable land and great mineral wealth. Chile has copper, Bolivia has tin, and even many of the smaller countries have mineral resources such as gold in Nicaragua and the Dominican Republic, and bauxite in the Dominican Republic and Haiti.

Venezuela is one of the world’s major oil-producing nations. When international oil prices rose to historic levels in the 1970s, Venezuela was one of a handful of countries outside the Middle East with the opportunity to derive great benefits from the OPEC cartel. Rising oil prices increased the value of Venezuelan wealth and gave

the country a rare opportunity to accelerate its economic development. Yet ironically, the Venezuelan economy performed far better during the ten-year period of 1964-73 than it did during the oil bonanza years of 1974-83. Specifically,

- Even though oil revenues were five times higher in the decade following 1973, the growth rate of Venezuela's gross domestic product declined for the country as a whole as well as in all nonpetroleum sectors of the economy except the service sector.
- Although employment grew at an annual rate of 4.6 percent during the six years before the oil boom, it grew by only 3.7 percent from 1974 to 1978, by only 2.8 percent from 1979 to 1982, and in 1983, total employment actually dropped.
- During the period 1976 to 1985, average real family income declined by 73 percent, and it is still declining.

Venezuela was not alone in being unable to turn high oil revenues into a solid, stable growth and development. Mexico, another oil-rich country, experienced similar failures during this period. For example, between 1973 and 1980 Mexico saw its rate of economic growth cut in half and was experiencing double digit unemployment by 1982. What explains the failure of these two countries to take advantage of the gift they were given by the international oil market? With the unexpected, extraordinary increase in petroleum revenues, both countries immediately increased public expenditures and increased the size of government. For example,

- In Venezuela, government spending as a percent of Gross Domestic Product (GDP) varied between 30 and 35 percent from 1962 to 1972. Yet by 1984, government spending had climbed to 57 percent of GDP.
- In Mexico, public spending grew to 61 percent of GDP.

Not only did these countries use oil revenues to fund increased government spending, but they also increased government borrowing for the same purpose. The rationale behind these government policies was the belief that public spending would create and distribute wealth. In each case the opposite occurred. As resources were diverted from the productive private sector to the inefficient

public sector, the economic consequences were devastating. In many cases, the increased spending took the form of acquiring, expanding, or starting government-owned enterprises. Invariably, these firms incurred losses which required even more government subsidies. As the subsidies to inefficient state-owned enterprises grew, efficient, private-sector companies were starved for capital. If the politicians had let the private market sector take its natural course the private sector would have expanded, creating jobs which would have directly benefited people. A healthier economy with reduced unemployment would have been the result.

RESPONSE TO NEO-MERCANTILISM: THE EMERGENCE OF THE INFORMAL ECONOMY

A common myth about Latin America is that its cultural and religious institutions are not compatible with a capitalist economic system. Both historical data and recent surveys show that nothing could be further from the truth. Where they have been allowed to do so, Latin Americans have demonstrated that the entrepreneurial spirit is alive and thriving. In an increasingly collectivist political environment, however, these activities frequently are conducted in the “underground,” “black market,” or “informal” sector of the economy — where they escape official scrutiny and ignore costly government regulations.

The most extensive research on the informal economy has been done in Peru. Under the direction of Hernando de Soto, researchers at the Instituto Libertad y Democracia (Institute for Liberty and Democracy) estimate that,

- About 48 percent of the population of working age is involved in the informal sector of the economy.
- The informal economy accounts for 61 percent of all man-hours worked and 38 percent of Peru’s gross domestic product.

The informal economy is a thriving, bustling marketplace. It has developed despite numerous legal obstacles, with virtually no access to credit, and without foreign aid. Overall, the informal economy assembles cars, manufactures precision tools, builds furni-

ture, and repairs buses. For example, in Lima, the informals carry on 90 percent of the clothing construction business, 75 percent of furniture construction, 60 percent of housing construction, and 95 percent of public transportation.

Peru is not alone. The informal economy is a general phenomenon throughout Latin America, although rigorous estimates of its size have been made in only a few countries. Using different methodology from that used by researchers in Peru, the Instituto De Estudios Contemporaneos (Institute for Contemporary Studies) in Argentina estimates that 38.5 percent of Argentina's gross domestic product is produced by the informal economy, and more than half of Argentina's working population has its principal job in the informal economy.

Just as there is a black market in goods and services, there is in many countries an astonishing black market in currency. Argentina is a country in which the government actively manipulates exchange rate controls to influence foreign trade and domestic production and as a source of revenue. These controls are so extreme that a black market in dollars of staggering size has developed. Even though very few Argentine citizens have investments in the United States, the Institute for Contemporary Studies estimates that,

- The total value of dollars in Argentina is approximately equal to the total value of Argentine currency.
- Put another way, the typical Argentine is holding one dollar for every dollar's worth of australes.

Researchers at Venezuela's Instituto Libertad Democracia (Institute for Liberty and Democracy) also have made estimates of the size of the informal economy in that country. According to their estimates,

- The Venezuelan informal economy grew from less than three percent of non-oil GNP in 1973 to more than 20 percent in 1985.
- Currently, the informal economy is providing income to more than 42 percent of the country's labor force.

RESPONSE TO NEO-MERCANTILISM: PRIVATIZATION

Privatization, as a response to neo-mercantilism, is a favored goal of the newly enlightened international lending community. In some countries, however, privatization is occurring because the government has decided that it is good policy — not because international lenders insist on it. In Latin America, Chile has taken the lead.

Although Chile experienced the longest period of democratic rule of any country in South America, from 1973 to 1989 it was ruled by a well-publicized military dictatorship. Despite its authoritarian political system, by almost any measure, Chilean economic reforms have been a resounding success. Chile's privatization efforts rival those of Britain; and, outside of Britain, there is probably no other government in the world that has announced its official intention of selling virtually every state-owned company to the private sector.

Chilean privatization also has achieved other important goals:

- Overall it is estimated that 100,000 Chileans who had never before owned a share of stock now own shares of stock in privatized companies.
- More than 400,000 housing units (about 18 percent of the total houses in the country) have been transferred to their tenants.
- About 150,000 titles to farms (representing about 47 percent of the total farmland of the country) have been transferred to small farmers.
- Although Chile was the first nation in the Western Hemisphere to adopt a social security system, it also is the first nation in the world to dismantle a public social security system through sweeping privatization.

FIGHTING THE WAR OF IDEAS

Neo-mercantilism in Latin America is a political-economic system in which countries once relatively free are now ruled by politicians who use the power of the state to dispense economic favors to their friends and supporters. Neo-mercantilism is opposed by the vast majority of Latin Americans who have been closed out of the formal sectors of their economies and who generally see the state and the ruling class as their enemy.

Neo-mercantilism has imposed an enormous cost on the economies of Latin American countries. It has led to the squandering of precious natural resources, to economic stagnation, and to incredibly burdensome international debts. Moreover, neo-mercantilism and the governments that support it are inherently unstable. There is probably not a government in all of Latin America that can survive in its present form. The only question is: What kind of political system will replace them?

The rise of collectivist ideas and attitudes in the United States and Europe in the twentieth century was mirrored by similar developments throughout Latin America. As the governments of Latin America asserted more and more control over their nationalized and monopolized educational systems, their colleges, universities, and schools became increasingly dominated by Marxist and socialist thinking. Indeed, until recently it was virtually impossible for students in many Latin American countries to find a single Spanish- or Portuguese-language book explaining liberal classical ideas.

Yet there are reasons to be hopeful. Today, books, monographs, and articles by Milton Friedman, Henry Hazlitt, Friedrich A. Hayek, Ludwig von Mises, and many other advocates of freedom and free enterprise are being translated into Spanish and Portuguese, republished, and distributed throughout Latin America. Private independent schools in Guatemala and Argentina are serving as beachheads for the transmittal of classical liberal ideas to the rest of the intellectual community. Independent research organizations are sponsoring conferences, briefings, and seminars for journalists, teachers, businessmen, and political organizers. New political parties are forming for the express purpose of advancing classical liberal political policies. And a new breed of intellectual is emerging in Latin America — exceptionally capable scholars who are applying the concepts of freedom and free enterprise to the institutional and cultural environments of their own countries.

Developing a Free Market Constituency. The discovery that there are large underground or informal economies in Peru and other Latin American countries has astonishing implications for political change. The pro-free market Institute for Liberty and Democracy in Lima has purchased newspaper advertisements declaring that participants in the informal economy deserve property rights in their homes, their land, and their buildings, and deserve the right to conduct business under the protection of Peruvian courts. The politicians have responded. Today, all major political candidates actively court the votes of the informals, promising them more and more concessions.

Without intellectual leadership, it is probable that the participants in the informal economy will become just one more special interest group to which politicians appeal. *With* intellectual leadership, the informal economy can become the basis for a capitalist revolution. Right now these people are engaged in capitalism without the benefit of the institutions of capitalism, e.g., secure property rights, a common law, access to a formal legal system that enforces contracts, etc. Were they to have these benefits, they would be wealthier and far more productive.

In other words, capitalism is in the direct, perceivable economic self-interest of the majority of the Latin American people. With increasing frequency, they are recognizing this fact.

Winning the War of Ideas. As in the U.S., in universities throughout Latin America many leftist intellectuals are still repeating the slogans of the past. But by and large, in Latin America as elsewhere the left is intellectually bankrupt. When fresh, new ideas are injected into the intellectual marketplace, they find a ready constituency — particularly among students and young professors. And with few exceptions, all of the fresh, new ideas are coming from conservatives and classical liberals.

Indeed, in a few countries it appears that the tide has turned and those espousing economic freedom have won some major battles.

- In Argentina, even the Marxists no longer recommend the establishment of more state-owned corporations.
- In Peru and Venezuela, former Marxists are now advocating capitalism for the informals.

- In Venezuela, 91,728 volumes of pro-free enterprise books have been sold in the last four years — mainly to university professors and students.
- Guatemala's pro-free market Universidad Francisco Marroquin is now recognized as the best university in the country and its former students are actively sought by other universities in Guatemala and in other Latin American countries.

Participants in the War of Ideas. This book is about the battle of ideas in Latin America as seen primarily through the eyes of the combatants. The Latin American contributors to this book are heavily involved in this war of ideas. Their involvement is considerably diverse. They are authors of best-selling books, presidents of universities, publishers of books and magazines, directors of research institutes, and organizers of educational programs. Some are involved in the theoretical and intellectual struggle at colleges and universities. Others are involved in educational programs for journalists and businessmen. Others are actively attempting to influence public opinion. All believe that freedom and free enterprise is the best solution for improving the economic and social well-being of people everywhere.

Funding for the War of Ideas. None of the institutes described in this book accepts money from the government of the country in which it resides, although a few have accepted money from agencies of the U.S. Government. Some of the institutes receive support from U.S. foundations and international corporations. But support from multinational corporations (fearful of offending those who exercise political power) is rare. Most Latin American institutes receive their only support from small businesses and independent entrepreneurs.

The funding sources appear to depend upon the tactics being used to fight the war of ideas. In general, large corporations seem willing to support institutes that promote capitalism in the abstract (e.g., republishing books on the virtues of the free market, teaching economic theory, etc.) But those institutes which are fighting specific public policy battles usually find that no support is available from large corporations, either foreign or domestic.

Almost invariably, institutes seeking specific political change get no help from the rich and the powerful. Their support comes from

the new capitalist constituency — small businesses and entrepreneurs who find capitalism in their economic self-interest and who are closed out of the power structure of the country in which they operate.

The National Center for Policy Analysis is honored to be the publisher of this book — giving those who are actively involved in the battle of ideas in Latin America an opportunity to tell their story to the rest of the world. It is a story that needs to be told.

2

THE WAR OF IDEAS IN PERU

EDITOR'S INTRODUCTION

When Albert Einstein was young he asked a simple question: “What would it be like to ride on a beam of light?” In seeking an answer to that question he revolutionized modern physics. When Hernando De Soto was young he also asked a simple question: “Why are some countries rich and other countries poor?” In seeking an answer, De Soto revolutionized the theory of economic development.

De Soto’s parents were in the Peruvian diplomatic corps, and in his youth he attended school and socialized with the children of diplomats from countries around the world. He observed that the children from different countries were quite similar. Yet the countries from which they came represented huge extremes in wealth. Differences in the wealth of nations, he concluded, are not primarily due to differences in people, so they must be due to differences in institutions.

One of the things that puzzled De Soto on his return to Lima was the continual improvement of living standards in the poor districts on the outskirts of Lima. His observations led him to doubt three assumptions widely held about poverty in Peru: (1) that shantytowns, slums, small-scale industry, and illegal activities represented only poverty and subsistence activities; (2) that the culture of Peru’s rural areas was incompatible with entrepreneurship and capitalism; and (3) that the problems of Peru were caused by external forces rather than internal, Peruvian institutions.

De Soto's doubts led him to an extensive study of Peruvian institutions. What he learned from examining the underground or "informal" economy of Peru had international significance and, indeed, is fully applicable to other Latin American countries, many African countries, and most of the less-developed world.

De Soto's work, and his ability to communicate his ideas, propelled him into the international limelight. It is probably no exaggeration to say that he is the "Milton Friedman of Latin America" — and probably no coincidence that Milton Friedman was one of his mentors.

The work of Hernando De Soto and his Institute for Liberty and Democracy (ILD) are important for four reasons.

First, De Soto's study of the Peruvian informal economy has fundamentally changed our view of how the economies of less-developed countries operate. Economists have long known that the institutions of capitalism (the common law, a court system to adjudicate disputes, rights to private property, etc.) evolved along with free exchange in an open marketplace. De Soto discovered that the development of the institutions of capitalism is more than a matter of historical curiosity.

In Peru and other Latin American countries, the vast majority of people have been denied full access to formal sectors of their economies through laws and government regulations designed to confer special advantages on the privileged few. In response, less-privileged Latin Americans participate in an extensive informal market economy. They reap the benefits of specialization and exchange in a marketplace that might be described as "capitalism without capitalist institutions." These people are systematically excluded from a formal legal system that enforces contracts, defines and punishes torts, defines and enforces property rights. Their informal market is, after all, illegal.

The informal market in Peru is of enormous economic importance. The total volume of goods and services produced informally is equal to 38 percent of Peru's "official" gross domestic product (GDP). Its potential is still higher. If the informal sector were "legalized" and the informals accorded the right to take advantage of capitalist institutions, the GDP of Peru would be 54 percent above its current level.¹

¹See Robert Litan, Luis Morales-Bayro and Jorge Fernandez-Baca. "Internal Structural Reforms in Peru: A Promising Road Out of the Debt Crisis," *Journal of Economic Growth*, Vol. 1, No. 2, 1986, pp. 28-36.

Second, the work of De Soto and the ILD has fundamentally changed our view of what is possible in Latin America. Forgetting that in the early part of this century Argentina and Chile were at the same level of economic development as the U.S. and much of Europe, many development “experts” have concluded that Latin Americans are not culturally suited to capitalism. The newer economic theory, however, recognizes that the cultural hostility to capitalism in Latin America exists at the top of the ladder of income and privilege, not at the bottom. It is the ruling elite that remains hostile to capitalism — the group which receives international loans and U.S. foreign aid money. By contrast, in the informal sector one finds a teeming, bustling marketplace — characterized by far more entrepreneurial activity than one finds in the U.S.

Third, De Soto has discovered that the participants in the informal economy form a natural constituency for capitalism. It is probably no exaggeration to say that not a single government in Latin America can survive the economic and political pressures continuing to evolve. Change is inevitable. The only question is, how will these countries change? Many U.S. conservatives will be surprised to learn that a natural constituency for capitalism exists among those who have the most to gain from it — those born without advantage or privilege who seek economic opportunity.

Finally, De Soto and the ILD have shown themselves masters at communication. The ILD has used many enterprising techniques to galvanize public opposition to the expansion of state power and public support for proposals to roll back that power.

One example of these activities is the ILD’s role in generating public opposition to President Alan Garcia Perez’ plan to nationalize Peruvian banks and other financial institutions. In 1987, Mario Vargas Llosa, Peru’s most famous novelist, told a rally of 25,000 people in Lima:

A totalitarian threat is hovering over our country If the government takes control of the financial life of this country, it is going to have such untrammelled power that democracy will become completely unstabilized.²

²Quoted in *Critique*, September 18, 1987.

Vargas Llosa is a former socialist whose political views have changed, due in large part to Hernando De Soto. Moreover, Vargas Llosa is now running for president of Peru and represents a credible electoral threat, with a pro-free enterprise platform.

Over the long run, De Soto's most effective vehicle for communicating ideas around the world is his book, *El Otro Sendero* (The Other Path).³ Called "the greatest challenge to Marxist thought in recent years," *El Otro Sendero* is breaking all sales records as its pro-free enterprise message sweeps across Latin America, fostering intense interest and debate. Some highlights:

- The book has sold more copies than any other nonfiction commercial book ever published in Peru.
- It has quickly climbed to the top of the best-seller list in every Latin American country where it has been introduced.
- It has been lauded by the Secretary General of the United Nations and praised by U.S. politicians spanning the political spectrum, including Ronald Reagan, Jim Baker, Bill Brock, and Bill Bradley.
- It has inspired more than 800 articles in the world press, including feature pieces in the *Wall Street Journal* and the *New York Times*.

What follows is a brief summary of De Soto's research and the activities of the ILD in Peru.

THE ROLE OF THE INFORMAL ECONOMY IN PERU

Hernando De Soto

Peru is the classic example of a Latin American country whose economic policies are unsound and whose political system lacks respect for the private sector and free enterprise. Inflation averaged more than 52 percent per year for the ten-year period between 1973 and 1983. Burdensome government regulations and controls thwart the ability of the private sector to produce goods and services efficiently. As a result, economic growth is stifled.

³Hernando De Soto, *El Otro Sendero* (Lima, Peru: Editorial el Barranco, 1986). The book was recently published in English as *The Other Path* (New York: Harper & Row, 1989).

In response to a government bureaucracy that is increasingly unresponsive to the needs of the private sector, the people of Peru have turned to illegal means of taking advantage of the economic benefits that a private marketplace confers on its participants.⁴ The result is an underground or “informal” economy that has grown to staggering dimensions.⁵ Our research indicates that:

- About 48 percent of the population of working age is involved in the informal economy.
- The informal economy accounts for 61 percent of all man-hours worked and 38 percent of Peru’s gross domestic product.

These statistics illustrate why the current economic and political system in Peru is unstable. Change is inevitable. At the Institute for Liberty and Democracy, my colleagues and I are attempting to insure that this change is in the direction of freedom and free enterprise.

THE INSTITUTE FOR LIBERTY AND DEMOCRACY

The intellectual and political high ground in Latin America has long been occupied by the political left, which argues that government intervention is necessary to protect consumers and workers, redistribute wealth, and promote industrialization. Twenty years ago, candidates from the extreme left received about 4 percent of the total vote in the national elections. They received nearly 25 percent in the last presidential elections, and about 30 percent in the last municipal elections. El Sendero Luminoso (The Shining Path), a Marxist-based terrorist group, is growing in strength.

⁴For the most part, these activities are not “criminal” in the sense of violating the rights of others or harming the general welfare. To the contrary, they are attempts to circumvent barriers to productive economic activities, and in general they advance the welfare of society as a whole.

⁵Editor’s note: What in Peru is called the “informal economy” is commonly called the “underground economy” in the U.S. In other countries, it is variously referred to as the “subterranean economy” the “black economy” and the “black market economy.” In this chapter, the terms “informal” and “underground” are used interchangeably.

But the Marxists have no solutions which will contribute to economic development. The current political systems in Peru and in other Latin American countries are not working either. Throughout the continent, governments of the right and the left impede individual initiative, perpetuate privilege, and stifle market forces. Although we are rich in natural resources, we remain underdeveloped.

Because no institute was engaged in rigorous research to find solutions to underdevelopment in Peru, I founded the Institute for Liberty and Democracy (ILD) in 1980. For the first two years the staff consisted of a secretary and myself, working evenings and weekends only. Our initial work focused on the economic activities of the urban poor in Lima. The data we collected from interviews and visits to slums, informal businesses, and industries had astounding implications. I began to understand that the informal economy was the response of Peru's poor to a mercantilistic system. Economically locked out of the formal or legal economy, they created their own market-based economy.

In late 1981 I organized a symposium on "Development and Dependence." Peru's President Fernando Belaunde, along with Milton Friedman and Elliot Richardson from the United States, were among the speakers. The conference was a huge success. The fees we collected were used to set up an office, and to hire a clerical staff and consultants.

Our foremost task was to measure and explain the mechanisms of Peru's informal economy. As our knowledge of it grew, we began to understand why Peru remained underdeveloped. The initial goal of documenting the extent of the informal economy evolved into the larger goal: to provide the research data and intellectual arguments necessary to move Peru from a mercantilist to a market economy — from an elite, semi-democratic society to a modern, pro-free enterprise nation. Our strategy is to build public support for reform — exposing the adverse effects of government policies on the lives of our citizens, documenting the reasons for these effects, and proposing practical programs for change.

The results of our two-year study of the informal economy were published in November 1986, in a book titled *El Otro Sendero* (The Other Path). We are also trying to put other issues, including property rights and deregulation, on the national agenda. In what follows, I will present some of the findings presented in *El Otro Sendero* and explain their implications for political and economic

change. I also will describe some of the ways we are attempting to influence Peruvian politics, and I will present the evidence of our thus-far modest success.

PERU'S UNDERGROUND ECONOMY

The results of ILD's two-year study confirmed my initial impression that the informal economy is a thriving, bustling marketplace that holds important lessons for the country. It has developed in spite of numerous legal obstacles, with virtually no access to credit, and without foreign aid. Overall, the informal economy assembles cars, manufactures precision tools, builds furniture, repairs buses, and manages thousands of street-vending operations. The extent of these activities is summarized below.

The Size of The Informal Economy

Retail Trade. The most visible sign of the informal economy is the tens of thousands of vendors in Peruvian cities, selling everything from tropical fruit to handmade jewelry to posters of Sylvester Stallone. We estimate that, in Lima alone, there are 91,455 street vendors.

- Informal businesses employ 42 percent of the labor engaged in retail trade.
- In addition to other products, they distribute about 60 percent of all the food, clothing, and furniture purchased in Lima.

In Peru, as in other Latin American countries, much retail trade is conducted in market centers, which may be thought of as hybrids between U.S.-style farmers' markets and modern shopping centers. Their distinguishing characteristic is that numerous independent sellers share common facilities. Market centers which are part of the formal economy are government-established, but many more have been established by street vendors and remain part of the informal economy. For example,

- Over the last 20 years, the informal economy has established 12 market centers for every one established by the government.

- Today, there are 274 informal and only 57 formal market centers.
- Market centers in the informal economy employ 40,000 individuals and are valued at \$41 million.

One of these informal market centers — the largest commercial center in Lima — is equipped with cold-storage facilities, parking lots, and most of the other conveniences found in modern U.S. shopping centers.

Manufacturing. A substantial amount of Peru’s manufacturing also takes place in the informal economy. According to our estimates,

- About 52 percent of all manufacturing firms are part of the informal economy.
- They employ 34 percent of all manufacturing workers and account for about 18 percent of the value-added production in the manufacturing sector.

Transportation. The vast majority of all transportation in Peruvian cities is provided by the informal economy.

- Underground buses account for 80 percent of the seating capacity and 85 percent of all bus riders.
- If taxi rides are included, the informal sector furnishes 95 percent of all mass transportation.

Interestingly, while informal buses are allowed to operate on Peruvian streets, their fares are restricted to ten cents per ride. This compares with an average of about \$1.50 per ride in most of the world’s major cities⁶ on systems that usually are subsidized by government. Nonetheless, the informal bus sector has flourished while public-sector buses have incurred large losses.

- For-profit informal bus companies carrying 85 percent of all Lima’s bus passengers are estimated to have assets worth \$620 million.

⁶The population of Lima is approximately six million.

- Another \$400 million has been invested in repair garages, spare parts companies, service stations, and other infrastructure facilities.
- By contrast, the government-owned bus system, carrying only seven percent of the passengers, has managed to accumulate a \$120 million deficit.

Housing. Construction of new houses is another area in which business is booming in the informal economy. We estimate that,

- About 42 percent of all the housing units in Lima, sheltering 47 percent of the population, have been constructed by the informal economy.
- The value of these houses is approximately \$8.3 billion — an amount equal to about half of Peru's external debt.

Most houses built by the informal economy are built for the poor — those least able to cut through bureaucratic red tape and build their houses legally. Thus, it is interesting to compare housing production in the informal economy to housing built by the state for the poor.

- In the last 20 years, while the informal marketplace has constructed \$8.3 billion worth of houses, the government has constructed only \$174 million worth.
- In other words, the amount of public housing for the poor is only 2.1 percent of the amount of housing constructed in the informal economy.

That so much of Peru's population has deserted the formal economy is a sure sign that its institutional structure is restraining economic progress. The ILD estimates that the informal economy produced 26.9 percent of Peru's total gross domestic product in 1979, growing to 32 percent of GDP in 1984, and 38 percent of GDP in 1986.

The Importance of the Underground Economy

The informal sector dates from the 1940s and the first mass migration from the countryside into the city. Since then, its ranks

have swelled as people have been driven from their subsistence farms by floods, droughts, or the lure of a better life. Many have settled in the arid government-owned land surrounding Lima, building make-shift huts. Most are Indians or mestizos (of mixed blood) from rural villages in the Andes. They have no technical training, little money, and no hope of getting credit. They have no police protection in the slums where they live. Getting legal title to land, obtaining a house permit, or registering a business are beyond their financial means and their understanding of and tolerance for bureaucratic red tape. Out of desperation, they have followed another path.

As the informal economy has grown in size, a set of extralegal property rights has evolved. People have taken “ownership” of tiny plots of land through squatters’ rights and built huts for their families. They have set up small businesses in the streets, in their homes, and in office buildings. They have developed their own legal code, with contracts, property rights, and courts. A professional class of urban planners has now evolved, employed to stake out and design new settlements in the underground economy.

The spontaneous marketplace economy of the poor is a more sensible and effective economic option than any government plan. This path, taken intuitively and through necessity by the underprivileged, is a solution to many of the problems of less-developed nations. In countries like Peru, the problem is not the informal economy but the government itself. The informal sector is a spontaneous and creative popular response to the inability of the government to satisfy the most elemental aspirations of its people.

Bureaucratic Obstacles Faced by the Underground Economy

There are obvious benefits to operating in the formal, legal sector of the economy. These include access to the courts to enforce contracts, secure property rights to pledge as collateral for loans, and other advantages conferred by a formal system of laws and courts. The fact that such a large portion of the Peruvian population operates in the informal sector of the economy suggests that the costs of access to the formal sector must be considerable. At the ILD, we have made a major effort to document these costs.

Establishing a Business. In 1983 the ILD went through the procedures necessary to obtain the official licenses required to

operate a clothing workshop with only two sewing machines in Lima, Peru and Tampa, Florida. In Lima, the ILD followed strict legal channels and paid only two of the 10 bribes solicited by Peruvian bureaucrats to facilitate the paperwork. We paid the two bribes because not doing so would have stopped the process completely. It took four full-time people (including one lawyer) 289 days to file the forms and obtain the authorizations to register the workshop. Approval was required from 11 different government offices.

When all of the required documents were laid end to end, they measured 33 yards. Including expenses and lost wages, the registration procedure cost \$1,231. At the time this was equivalent to thirty-two months of labor at the minimum wage. Obviously, the process of legal registry for even a very small business is too costly for a person of modest means.

By contrast, in Tampa it took only one person working three and one-half hours to legally register and establish the business.

Establishing a Market Center. The ILD has calculated that it takes even longer for street vendors to organize a formal market or commercial center. On the average,

- Informal street vendors have to wait 17 years from the moment they decide to construct a market center until they can legally do so.
- Of this time, nine years and eight months are consumed by the bureaucratic procedures related to getting permission to establish the center.
- The rest of the time is spent in waiting to become a fully licensed, formal business.

Transportation. The case of transport is even more dramatic. The state simply does not permit legal access. It only sporadically grants informal invaders of transportation routes formal recognition. If legal access were permitted, the red tape would take three years according to our best estimates.

Housing. Because of their poverty, many Peruvians cannot afford developed residential property. Their only alternative is to seek undeveloped land which is owned by the government. The

problem is similar to that faced by nineteenth century U.S. settlers, who sought land from the government in the western states, and by individuals who today want to acquire land from the government in Alaska. But there the similarity with the U.S. experience ends.

By following the actual trail of documents, the ILD discovered that an individual attempting to acquire a plot of undeveloped government land in Peru faces a complex web of municipal, provincial, and federal regulations. On the average,

- To obtain vacant land from the government on which to build a house, applicants must meet 207 different administrative requirements, administered by 48 separate public agencies.
- This takes three years and seven months and costs approximately \$2,156, some 56 times the present monthly minimum wage.

The only recourse for poor people seeking housing is the illegal economy. For example,

- During 1985, 282 illegal housing developments were constructed on public and private lands.
- During the same year, only three legal transfers of public land were made for the purposes of constructing housing.
- Most illegal seizures of public land eventually will be legitimized by the government. But, on the average, squatters face about 20 years of bureaucratic red tape before they can expect to acquire legal title to their property.

The irony is that these squatters have received constant organizational support from the Marxists. Thus, the movement to transfer property from the state to the people primarily has not been led by those who claim to believe in free enterprise but by those who advocate socialism.

STIFLING EFFECTS ON ECONOMIC GROWTH

Despite the advantages of the informal economy, Peru would be far wealthier today if these activities were legalized. The perpetu-

ation of a dual economic system — one formal, the other informal — has had serious side effects that have discouraged economic growth in Peru. In general, credit is not allocated to the most productive investments; total investment in the economy is less than it otherwise would be; labor productivity is lower than it otherwise would be; and a defective tort system fails to make people bear the burden of costs they impose on others.

Access to Credit. Because they lack legal property rights, informal businesses have little collateral with which to obtain credit from formal lending institutions. They also are at a disadvantage in a financial system in which loans often are made on the basis of politics rather than economics.

- About 85 percent of all credit in Peru's financial system is offered by institutions controlled partially or completely by the government.
- Often these loans are made on the basis of political influence, and frequently they are made at subsidized rates of interest.
- On the average, the informal sector receives only 0.2 percent of all credit.

Something similar happens with the external debt. The oppressive weight of the debt is the direct result of an institutional structure that has permitted the government and the state-owned companies to negotiate large loans from foreign banks and contractors. Now that the debt is too heavy to be supported by these entities, the rest of Peru must pay the price. The government may either limit its repayment of the debt — thereby discouraging new capital investments in the country — or begin to pay the debt — thereby draining funds from productive investments that would promote economic growth.

Investment Decisions. When property rights are secure, the owners of land, housing, equipment, and business enterprises have an incentive to invest in order to increase their property values. People invest less, however, if there are substantial risks that their property will be expropriated by government or by other people. As a consequence, in the informal sector many economically rational

investments simply are not made because property rights in the investment are unprotected and insecure.

Take housing, for example. An early ILD study compared two neighboring settlements in Lima, Mariscal Castilla and Daniel Alcides Carrion. The two were built in the same period and inhabited by people with almost identical socioeconomic characteristics. The only difference between the two settlements was their legal status. In the former, residents had legal title to their houses. In the latter, residents lacked legal title.

- The ILD found that the value of houses in the settlement where people had legal title to their property was 41 times greater than where legal title was lacking.
- A subsequent ILD study of 37 settlements found that, on the average, housing values in settlements with property titles were nine times greater than housing values in settlements without.

Labor Productivity. Like informal “homeowners,” informal business people cannot use the courts to enforce contracts and protect their property. As a result of inadequate access to credit and lack of formally protected property rights, informal businesses typically are under-capitalized and too small to enjoy full economies of scale. This renders the firms less efficient than they would be if they were operating formally. In fact, we estimate that labor productivity in the informal economy is only one-third that of the formal sector.

The implication of this finding is that the economic gains to the country as a whole would be huge if the informal economy were legalized. There unquestionably would be substantial increases in labor productivity and a consequent boost in the country’s output of goods and services. For example,

- If labor productivity in the informal economy were increased to the level of the rest of the economy, Peru’s gross domestic product (GDP) would increase by 54 percent.
- If labor productivity in the underground economy were increased to one-half the level of the rest of the economy, Peru’s GDP would increase by 27 percent.

These changes could not occur overnight. But even if they were achieved over a ten-year period, Peru's annual rate of economic growth would increase between 100 and 200 percent.

Tort Law. Informals are also denied access to a legal system that adjudicates torts. An important function of civil law is that it can repair or prevent the negative effects of people's actions on others — actions which are not foreseen in specific contracts. To achieve this result, the formal society establishes a system of torts that requires compensation to those who have been hurt.

In Peru, the extralegal system of the informal economy is incapable of generating a system of tort law, and informality creates negative externalities that are not compensated. For example, Lima experiences 15 times more transportation deaths than does Western Europe, and the street vendors leave behind garbage, cause congestion, and often sell food products not subject to sanitary control.

All of this means that our society is not taking advantage of its opportunities, and has not discovered its potential. The value of production has not been maximized and the cost of transactions is clearly greater than it would be under an efficient juridical system. This lack of facilitative law explains, perhaps, why Peru lacks the institutional conditions under which individuals pursuing their own interests also serve those of others.

SECURING PRIVATE PROPERTY RIGHTS

In the summer of 1985, the ILD began a campaign to publicize the economics of free enterprise—to gain government support for private property rights and bring about deregulation. Private ownership of homes and businesses was a major focus. We wrote articles about housing that focused on the extent to which Peruvian law deprives the poor of secure property rights. For example,

- Almost half of Lima's homeowners lack title to their houses and their land.
- Only 20 percent of the poor in Peru have title to the land on which they live.

In his 1985 electoral campaign, President Garcia paid scant attention to the issues of housing and deregulation. The ILD's efforts, however, resulted in public pressure for reform.

In early 1986 the ILD convinced the constitutionally independent Office of the Attorney General to activate its Defender of the People function for the first time. The Attorney General has the power to use this office to identify inefficient regulations and bureaucratic practices. As Defender of the People he may receive citizens' complaints about the bureaucracy and direct such complaints to the proper authorities. By law the Peruvian Ministries must take action on suggestions for reform.

The ILD encouraged people with housing complaints to make them known to the Attorney General. Within one month complaints from 300,000 people had been received. On March 22, 1986 the ILD, bolstered by popular support, publicly called for a major initiative to deal not only with the issue of securing titles but also with the legal and bureaucratic problems underlying the current system.

The ILD proposed that the government address the following issues: the creation of secure rights to private property, the granting of title to private property, the deregulation and simplification of housing and related legislation, and access to information that would enable citizens to influence their government.

The campaign hit a responsive political cord. The granting of property titles to almost a third of the population of Peru was an opportunity President Garcia could not pass up. A month after the ILD/Defender of the People campaign, President Garcia proposed a new property title law, which was approved by the lower house of Peru's parliament shortly thereafter.

Unfortunately, the President's proposal was ill-conceived. It granted title to squatters regardless of whether they had invaded private land, archeological land, or unused government land. It did nothing to simplify the process of obtaining title. And it placed restrictions on property rights, forbidding titleholders to sell or rent their property for at least five years.

ILD published its own draft of a property title law, pointing out the weaknesses of the President's proposal. As a result, the ILD was called to testify before the Senate Committee that was revising

President Garcia's proposal. Several of the Institute's suggestions were incorporated into the Senate version. Several Senators stated that although the President's proposal would have to be passed, they would like ILD's help on a more comprehensive future proposal. In addition, after the law was passed, the ILD pointed out that restrictions on the sale of property were unconstitutional and succeeded in having that section of the law abolished.

DEREGULATION OF BUSINESS ENTERPRISE

Although no one knows the exact number of laws, regulations, decrees, and executive orders regulating business activity in Peru, we estimate that they exceed 500,000. Parliament enacts only one percent of these laws. The other 99 percent emanate from the executive branch and range from executive orders to departmental regulations. In effect, every five years Peru elects a president with dictatorial powers. About 27,000 laws are introduced every year — mostly by presidential executive orders.

Laws proposed in Parliament are publicly discussed, the media report on the debates, and their victims or beneficiaries may be able to influence the final form of the law. This is not possible with the majority of our regulations, which are promulgated at such a rate that not even the lawyers who write them can keep abreast of them.

An ILD study of small businesses found that administrative employees spent an average of 44 hours per month meeting government regulations. The cost of regulatory compliance was more than seven times higher than their tax burden and more than five times greater than their after-tax profits. These prohibitive costs drive many enterprises underground, despite the benefits of legality.

In July of 1986 the ILD made a proposal to deregulate the economy. It was designed to reduce the costs that Peru's inefficient, excessive, and inflexible public administration imposes on its citizens and business institutions. The response from the private sector and the media was excellent. Officials of the National Institute of Public Administration (INAP), the Supreme Court of Justice, and the Justice Ministry called ILD personnel to discuss the proposal and its relationship to current laws.

As a result of ILD efforts, politicians of virtually every political persuasion now recognize the potential power of the underground-economy voting bloc. Indeed, they actively court the votes

of the informals. No serious candidate for public office would dare suggest that the government jail or fine those who operate in the underground economy, or confiscate their property.

DEREGULATION OF LABOR MARKETS

Peru, like a number of other Latin American nations, has passed laws aimed at providing employment stability. A major consequence of these laws has been to raise the cost to employers of employing their workers. This, in turn, has led to substantial unemployment.

Permanent employment has been seen as a worker's right — the right to be protected against “the abuses of the capitalists.” Unfortunately, many applicable government regulations have been gravely misguided. It is impossible for any law to reverse the effect of fallen demand for a product or to combat an acute shortage of supply. Nor can any law make an unproductive worker more productive. It is impossible for an employer not to suffer serious negative financial consequences when he is prohibited from laying off employees, especially in cases where the layoffs are for purely economic reasons.

Prior to 1970 government intervention aimed only to reduce the negative effects of job loss. As early as 1902, employers were required to give an employee three months' notice before dismissal or pay three months' severance after dismissal. An unemployment compensation system enacted in 1924 further attempted to compensate for an individual's lack of income during the period after being fired.

Until 1970 the government appeared to understand that the reasons for layoffs were varied. Then an abrupt turnabout occurred. A regulation enacted that year stated that the individual worker, once past a three-month test period, could not be fired without proper proof that he had committed a grave infraction. Recently the system has been converted into one of “absolute stability” for virtually all workers: freedom from firing for the first three months and “employment stability” for life for every worker who is employed beyond three months.

The effects of these regulations will make labor a fixed cost of doing business. There are a number of ways for a business to

respond to such regulations. Using less labor and more capital is one way. Increasing the number of part-time workers who are not covered by the regulations is another. Reducing labor costs by decreasing the real value of nominal wages and salaries are others. There is evidence that businesses are utilizing all of these options. Currently there is less demand for labor, an unwillingness to grant raises, and an increase in part-time labor through the rotation of day-workers and outside contractors. But since "absolute job stability" is perceived as desirable, the number of people seeking employment can be expected to grow. The result will be a rising official unemployment rate. Moreover, a significant number of excess laborers will be expelled into the underground economy.

There is one legal loophole. Regulations allow any enterprise to establish an extra shift of workers for additional production and to contract temporary personnel as many times as may be necessary to work the shift. Throughout the contract, employees get all of the government benefits they would be entitled to if they were full-time, regular employees. At the same time, employers can adapt to market conditions without assuming fixed labor costs during periods of reduced production. This loophole may help businesses which can create new shifts to handle the problem of expanding and contracting their work force to meet changing market conditions, but it does not help those which cannot.

The ILD believes that one viable alternative to the present system could take shape along the following lines. First, the negative effects of layoffs could be eliminated or reduced through adequate unemployment insurance, administered by private companies. Second, the judicial system could be used to eliminate or reduce arbitrary firings.

An unemployment insurance system, whereby an employee is given a three-month notice or three pay checks, is one suggestion. This would be similar to the pre-1924 system in Peru. An alternative is a system similar to that established in 1924, granting fired employees compensation based on their length of employment.

To explore the possibility of such a system, the ILD conducted a poll among industrialists. Of the 62 interviewed, 58.6 percent favored the freedom to lay off workers with a payment the equivalent of six months' salary plus fringe benefits and taxes. The poll suggests that such a system might be workable, although the six-month period might overburden certain businesses.

The following figures illustrate how a private unemployment insurance system might be funded. In 1981 the total value of annual wages for workers and employees in the industrial sector reached 362.99 billion sols.⁷ If the same amount (5 percent) that employers currently pay into the government's workmen's compensation fund also had been set aside for unemployment insurance, the fund would have had 18.15 billion soles. This amount would have been enough to pay the minimum wage for one year to practically all of Peru's unemployed population (some 47,000 persons) or to pay them twice the minimum wage for six months. Alternatively, it would have been enough to pay the unemployed population 1.5 times the minimum wage for six months, keeping the rest to fund a retraining program that would improve labor skills.

Economic freedom is the counterpart of political freedom. Only when the two exist simultaneously can they function effectively. Economic freedom, like political freedom, existed in Latin America only on paper until the poor of our countries, overwhelmed by the discrimination of the legal system, began to put it into practice. They were able to do so because they were excluded from the political system. The ILD's research found that many would prefer the options and protections of the legal economy if they could afford them. One can only imagine what our economy would look like if all the productive energy of the informal sector were channeled into an authentic market economy in which the people were protected and stimulated instead of being harassed by the state.

IMPLICATIONS OF ILD RESEARCH FOR THE THEORY OF ECONOMIC DEVELOPMENT

In Peru and throughout Latin America a number of theories have been advanced to explain the lack of economic growth and development. These theories are wrong. What follows is a brief summary of the fallacies in light of ILD findings.

⁷Editor's Note: According to the International Monetary Fund, the average value of a sol in 1981 was .42 to \$1 (U.S.). *International Financial Statistics Yearbook*.

Cultural Theories. Many theories, ranging from anthropological to political, are based on the premise that Latin American culture, particularly that of the Indian and mestizo, is basically anti-entrepreneurial. The result is a widespread belief that a Western-style democracy and a market economy are not natural components of Latin American culture.

The ILD's research into the informal sector disposes of this argument. Our findings describe the incipient market economy and democratic systems spontaneously generated by the informals. We believe that one of our major contributions is the description of the extralegal norms, or common law, created by the informals once they arrive in the cities. We have found no dictatorships or organizations. Rather, we have found individual or family ownership and rules that attempt to create fair competition through extralegal norms in the areas of property law, contract law, and the law of torts. When large and primarily indigenous segments of the population have set up participatory democratic structures and a market economy, it is wrong to consider these structures alien to Latin American culture.

Marxist-Leninist Theory. All variants of Marxism teach that capitalist society is a system of domination and subordination with economic roots deriving from control over the means of production. Market relationships, particularly those between laborers and the employers who contract for their services, are never relationships among equals; they conceal domination and exploitation. The political system, including the laws and institutions, is merely a reflection of unjust domination and exploitation.

The ILD's findings undercut Marxism-Leninism in two ways. First, they make clear that the economic system in Peru today is not modern market capitalism, but mercantilism. We oppose the same control by special interests that the Marxists object to. Second, the ILD's research demonstrates that a large part of the society in Peru is not proletarian but is entrepreneurial in its interests and world view. Its primary objective is to secure rights of property — a bourgeois rather than proletarian objective in Marxist terminology.

Dependency Theory. Beginning around 1950, the United Nations Economic Commission for Latin America began to develop its structuralist theory of economic underdevelopment. It held that the world capitalist economy embodies an international "division of labor" that is structurally biased against the interests of the developing countries. Such bias, its said, takes the form of "unfair" terms of

trade, “monopolization” of capital and technology by multinational firms, and so on. The remedy: that underdeveloped countries withdraw from the world economy and implement an inward-looking strategy of industrial promotion.

Starting in the early to mid-1960s, leftists found a way to combine this theory with Lenin’s ideas about the inherently imperialist nature of capital on a world scale. Lenin argued that certain internal “contradictions” of the capitalist system required the systematic colonization and exploitation of the less-developed by the developed countries. In this new paradigm, the domination was organized and led by the United States. And whereas Lenin had relatively little to say about the details of the “exploitation,” it assumed the features identified by the structuralist theory. This marriage of Leninism and structuralism became known as “dependency theory.”

The dependency idea has acquired an ideological appeal quite independent of its failures as theory. There are three reasons for this. The first is that it is an eminently nationalistic ideology. In fact, it is the characteristic form assumed by Latin American radical nationalism. Nationalism, not Marxism, has consistently proven to be the most attractive political ideology of modern times. Second, dependency theory enables Third World political leaders — and the oligopolistic, privileged corporate elites who associate closely with them — to shift the blame for their policy failures onto the shoulders of an international system for which they cannot be held responsible. Finally, the apparently radical features of dependency theory give the leaders who cater to exacerbated nationalism a way of coopting local Marxists and/or appealing directly to the Marxists’ ideological constituency.

Today the evidence is overwhelmingly weighted against every one of the core dependency propositions. Likewise, the policies that emanated from it — such as import substitution industrialization, the favoring of foreign borrowing over foreign investment, subsidization of urban consumers at the cost of undermining agricultural production — have proved to be counterproductive, particularly when implemented by a mercantilist state.

Most of the “distortions” in Latin American countries can be corrected by purely local measures that have nothing to do with the world economy. The ILD has identified these measures and recommended domestic implementation of policies.

This is not to say that the international economic system is necessarily just and free from bias against the Third World. Rather, there are steps Third World countries can take, irrespective of the international economic system, which will improve the condition of their people.

As noted above, the ILD's research to date suggests that much, or most, of the informal sector is entrepreneurial rather than proletarian. What it needs are opportunities to create more jobs rather than confrontations between the proletarian and entrepreneurial classes.

One strength of dependency theory is its nationalist appeal. For the negative nationalism based on opposition to the United States, the ILD is working toward a positive nationalism based on indigenously developed institutions and incorporating much that is distinctly Peruvian.

Liberation Theology. Twenty-odd years ago there arose a Latin American variant of European political theology. It first took institutional form as "Cristianos por el Socialismo" in Chile during the Allende period, although its best-known current embodiment is the Sandinista "Iglesia Popular" in Nicaragua. More generally known as liberation theology, its views constitute both a political ideology and a movement that is particularly influential in Peru and Brazil, where two of its major proponents (Gustavo Gutierrez and Leonardo Boff, respectively) reside. It has gained strength at surprisingly high levels of the church hierarchy and among the priests and laity. It also enjoys a considerable following in the United States, especially within the priestly and monastic orders that operate programs in Latin America.

Without deviating from the church's long ideological tradition, liberation theologians maintain that a solidaristic, cohesive society is God's plan for humanity. They fault the capitalist system and its underlying individualistic ideology for impeding the realization of God's plan. And, like the earlier Catholic corporatists whose lack of a political strategy ended in overt support for fascism, they offer no assurance that their new political order will be more just than the old one.

The proposals of the ILD are by no means out of tune with the moral thrust of liberation theology. The ILD, too, identifies structures in the existing system which embody special privilege, are

biased against the poor, and must be overcome through direct political action. The ILD stresses the self-organization of informals as the key to successful reform.

We believe that the ILD's work does not undermine the social concerns expressed by liberation theology. The IDL opposes, however, any political ideology — even if disguised as theology — which insists that the only way to improve the lot of the poor is all-out revolution and the elimination of entrepreneurship.

Since we are not theologians, we have no desire to interject ourselves into a theological debate. But as concerned lay persons we know of no basis in Catholic doctrine for opposing a system based on widespread entrepreneurship per se, if it can be fair and just — as we believe it can. In fact, the ILD's case studies should challenge Catholic social thinkers to reconcile the aspirations of individual human initiative with the goal of a just society.

IMPLICATIONS OF ILD RESEARCH FOR THE POLICIES OF DEVELOPED COUNTRIES

The External Debt. There is a growing consensus that the austerity programs imposed on debtor countries by the International Monetary Fund (IMF) are not having the desired results.

This is not surprising. Conditional loan programs demand that the debtor countries subordinate major portions of their economies to the criteria set down by foreign governments and multilateral institutions. Reforms are executed from the top down, without consideration for the political consequences. Most of the reforms — fewer restrictions on foreign investment, reduction of tariffs, elimination of exchange controls — risk offending powerful local interest groups and appear unconnected to the interests of the poor. Thus, the governments of the debtor countries are understandably hesitant to adopt them even though they could help alleviate the debt. This clearly was what led to Peru's announcement that it was limiting payment of its debt to 10 percent of its export earnings. While this action may not have won friends for President Garcia in the international banking community, it helped to shore up his internal political support. When they ignore internal political climate, the outside forces of reform can have only limited success.

More importantly, conditional loan programs ignore the vital

role of microeconomic institutional reform. As the ILD research has demonstrated, countries such as Peru lack many of the institutional prerequisites of economic growth. A legal system that does not guarantee the fundamental rights of property, contract, legal process, and commercial organization to the majority of its citizens cannot maximize incentives to innovate, invest, and produce. This same legal system imposes excessive charges on the private sector through red tape and regulation, discourages private initiative, and increases the costs of goods produced. In this setting, traditional prescriptions for reform are doomed because they do not get at the heart of the problem: a mercantilist structure that limits competition, functions on favoritism, and represses entrepreneurship.

The ILD argues that although informality signals an institutional problem, it contains the germ of a solution. Once the informals understand that they are victims of government interference, and that they would benefit enormously from market-oriented reforms, it should be possible for them to provide political support for the necessary reforms.

Foreign Policy and Assistance Programs. Developed countries have faced two problems in achieving consistency between their basic values and their foreign policy and assistance programs. First, they often have confused mercantilists with modern market systems and democratic elections with full-fledged participatory democracy. Yet as the ILD's research has shown, the mercantilists are not really capitalists and democratic elections do not guarantee real democracy.

Second, the West has stressed stability, believing it crucial to economic growth and thus to Western interests. Because in many Latin American countries stability supports the existing mercantilist structure, efforts to change it have come primarily from the left. This has given the West an ideological reason to help maintain the status quo. Yet as the ILD's research has demonstrated, the status quo inhibits economic growth and political democracy. And since the majority of the population — do not support the status quo, Western policies are identified with the oligarchy.

These misconceptions explain why Western foreign assistance often has failed to bring about the desired results. It has promoted the state by concentrating funds and, therefore, power. It has strengthened the business elite, mistakenly identifying them as competitive entrepreneurs. It has helped create and maintain a labor

elite that has become part of the mercantilist structure. And it has provided charity to the poor which, while admirable in humanitarian terms, has not helped them to change the institutional structures impeding their progress.

In addition, by supporting or appearing to support special interests, Western developed nations have played into Marxist hands. The Marxists have identified themselves with the interests of the proletarians, whom they have redefined to include the poor and oppressed. They have appeared to stand for change while the West has appeared to revere the status quo.

By identifying the ruling structure as mercantilist (anti-democratic and anti-market) and proving that it is the poor majority who supports and practices democracy and accessible markets, the ILD's research enables the West to place itself squarely on the side of democratic participation and economic opportunity. The effort required to move from a mercantilist to a democratic, market-based society is primarily local. But foreign governments through their policy and assistance programs can either slow the process or encourage it.

CONCLUSION

The poor are living an economic and political revolution that offers an alternative to that advocated by the Marxists. The record-breaking sales of *El Otro Sendero* indicate Peruvians' intense interest in learning about the ILD's free market solution and suggestions for transforming Peruvian society. Six thousand printed copies were sold in Lima in the first four days of the book's release. It is also interesting to note that:

- The Ministry of Foreign Affairs ordered 250 copies.
- The National Society of Business ordered 250 copies.
- Scala, a leading department store, gave the book as a Christmas gift to all of its executives.
- Numerous businessmen, trade unions, and associations of informals have assisted in marketing the book.

At this writing, *El Otro Sendero* is in its sixth printing. About 40,000 copies have been sold in Peru, 20,000 in other Latin American

countries. It is the largest selling nonfiction book ever published in Peru and Colombia. Its recent release in Mexico was heralded by an eight-part national television series. It also has received considerable attention in the U.S., including a major article in the *New York Times Magazine* and coverage in other metropolitan newspapers. The English translation enables the book to reach a wider American audience.

The publication of the book and other ILD activities have persuaded a number of previously leftist thinkers of the virtues of the free enterprise system. The foreword to *El Otro Sendero* was written by Mario Vargas Llosa, a world-famous novelist who is a former socialist and one of Latin America's foremost literary figures. Many ILD workers were formerly involved with the political left. Leading socialist politicians have cooperated in ILD campaigns, among them the former communist mayor of San Martín de Porres, a suburb of Lima with a population of 500,000.

If reforms are to come, they must come quickly. The terrorist organization El Sendero Luminoso (The Shining Path) and its cries for violent revolution are dangerous — in large part because neither the political parties nor the intellectuals of the right or the left have responded effectively. Their responses have been based on perpetuation of the existing mercantilist structure — even though Peru's current approach to private property, its excessive regulation, and its labor stability laws are clearly counterproductive.

The ILD is attempting to explain how and why these policies are counterproductive, and to mobilize popular support for change. And as we push for change, ILD carefully outlines the fundamental reforms necessary to convert Peru into a market economy.

3

THE WAR OF IDEAS IN VENEZUELA

EDITOR'S INTRODUCTION

Although Venezuela has been a stable democracy for only 30 years, it is one of the oldest democracies in Latin America. This statistic is important because it is indicative of the political turmoil Latin America has undergone since the end of Spanish domination.

Although Simon Bolivar, Venezuela's most famous native son, was considered a classical liberal, there are very few political or intellectual leaders today who share his philosophy. Politics and economics are dominated by a strong leftist, collectivist culture. Government regulation and control over the economy has skyrocketed in the last 15 years. As Jesus Eduardo Rodriguez points out, although the legislative body is the branch of government empowered with lawmaking, the executive body issued 107 executive orders and laws between 1972 and 1983, compared with 21 executive orders in the previous 20 years. Some of these laws limit free speech and the press. Some restrict private property rights. Others limit contractual rights.

During this period of government encroachment, the economic well-being of Venezuelan citizens has plummeted. The average real monthly family income decreased dramatically between 1976 and 1985. This decrease is especially shocking given the sharp rise in oil prices, which reached almost \$30 per barrel before declining rapidly in the fall of 1985.

The failure of the citizenry to prosper when a country is awash in petrodollars suggests serious political and economic problems. The government used its oil revenue to increase its size and its

expenditures and as leverage for obtaining foreign loans, which were also used to increase government spending. When oil prices fell, the country was left with a bloated bureaucracy and a huge foreign debt. While Venezuela has been able to reduce its debt dramatically, and the government is cutting some subsidies — the basic economic problems remain unsolved.

An unhappy citizenry is demanding changes. As in other Latin American countries, the most systematic and influential policy ideas are being proposed by the political left. It has become increasingly clear, however, that the ideology of the left does not work well in practice. Collectivization and central control do not consistently advance the well-being of individuals and families.

In this chapter, Jesus Eduardo Rodriguez explains how he first became acquainted with the free enterprise system as a potential solution to Venezuela's problems. Of note is the influence that programs of various institutes in the United States and Latin America have had on him and his work. Hernando de Soto, founder of Peru's Institute of Liberty and Democracy, has been especially influential.

Rodriguez tells a fascinating story of how he and his college friends began a movement to advance the economic and political ideology of classical liberalism as a realistic solution to the country's economic predicament. They are utilizing various strategies to present free market ideas to their fellow Venezuelans. They have developed an impressive newspaper program, plus an economics education program featuring seminars and economics classes, and they are translating and producing books.

Although it is difficult to measure the impact of such efforts, Rodriguez offers examples that point to a growing interest in classical liberalism as an alternative to collectivism.

One such example is the dramatic increase during the past four years in the amount of newspaper space devoted to articles with a classical liberal underpinning — a direct result of the efforts of Rodriguez and his group. Another is the number of scholars at Venezuelan universities who are willing to associate with pro-free enterprise institutes. In 1982 there were none. There are now more than 40 scholars associated with these institutes. In 1982, there were only four books on free enterprise available in Spanish for Venezuelan students. Rodriguez and his group have increased that number to

more than 300 by translating and publishing important works in economics and political economy.

Venezuela's intellectual climate appears to be slowly changing.

MARKETING IDEAS IN VENEZUELA

Jesus Eduardo Rodriguez

Teresa Sosa de Bocaranda

Vilma Clavier

Venezuela has had a dramatic and passionate history. It is a country that was born out of the struggle for freedom. First we fought for our independence from Spain, then we fought for the independence of other South American countries (Colombia, Ecuador, Peru, and Bolivia) under the leadership of "El Libertador," Simon Bolivar. Bolivar's intellectual role in Venezuela's history was that of a classical liberal thinker. The wars of independence were followed by a period of continuous struggle for national unity as one authoritarian government replaced another. Indeed, it was not until 1958 that Venezuela officially established a permanent democratic form of government.

Since its beginning as a nation, Venezuela has had large numbers of citizens who believed in and struggled for economic and political freedom, and their spirit has passed from generation to generation. The battle to strengthen the principles set forth in our 1961 constitution continues to this day.

OIL AND POLITICS

Venezuela is rich in natural resources and ranks among the world's major oil-producing nations. When international oil prices rose to historic levels in the 1970s, Venezuela was one of a handful of countries outside the Middle East with the opportunity to derive great benefits from the OPEC cartel. Rising oil prices created the potential to increase the value of Venezuelan wealth and gave the country a rare opportunity to accelerate its economic development.

We did not, however, take advantage of this opportunity. In fact, the Venezuelan economy performed far better during the ten year period of 1964-73 than it did during the oil bonanza years of 1974-83.

- Even though oil revenues were five times higher in the decade following 1973, the growth rate of Venezuela's gross domestic product declined for the country as a whole and in all non-petroleum sectors of the economy with the exception of the service sector.
- Although employment grew at an annual rate of 4.6 percent during the six years before the oil boom, it grew by only 3.7 percent from 1974-78 despite a government decree mandating full employment, and by only 2.8 percent from 1979-82. In 1983, total employment actually dropped.
- During the period 1976-85, the average real family income declined by 73 percent, and it is still declining.

The oil bonanza obviously did not produce positive economic results. Many private-sector companies faced huge debts and potential bankruptcy. Numerous public companies found themselves in even worse straits; they operated at a loss and the government borrowed heavily to cover their losses.

Venezuela was not alone in its inability to turn high oil revenues into solid, stable growth and development. Other oil-rich countries — including Mexico, Holland, Norway, and England — experienced similar failures during this period. Each also experienced rising unemployment and declining real growth rates. For example,

- In Holland, unemployment grew from 2.3 percent in 1973 to 17 percent in 1982, and its rate of economic growth actually declined in the late 1970s.
- In Britain, the unemployment rate doubled between 1973 and 1980 and soared to double-digit levels thereafter, while its rate of economic growth was cut in half.
- Mexico also saw its rate of economic growth cut in half and was experiencing double-digit unemployment by 1982.

What explains the failure of these countries to take advantage of the gift they were given by the international oil market? In all five cases, two major policy errors were committed: the public sector was allowed to grow, relative to the private sector, and the local currency became artificially overvalued.

The Growth of Government. With the unexpected, extraordinary petroleum revenues, all five countries immediately increased public expenditures and the size of government. For example,

- In Venezuela, government spending as a percent of GDP varied between 30 and 35 percent from 1962 to 1972; yet government spending climbed to 57 percent of GDP by 1984.
- During the oil boom in Mexico, public spending peaked at 61 percent of GDP and in Holland it reached 62 percent.
- In Norway and Great Britain, the figures were 48 percent and 46 percent respectively.

Not only did these countries use oil revenues to fund public projects, but they increased government borrowing for the same purpose. Despite expanding income from the sale of oil, all five countries experienced ten consecutive years of deficit spending. In Mexico — the worst case — the government deficit reached 17 percent of GDP. In Venezuela the internal debt grew from \$1.6 billion in 1975 to \$9.0 billion in 1985, while the external debt increased from \$1.4 billion to \$19.6 billion in this same period.

In all five countries, the rationale behind these government policies was the belief that public spending would create and distribute wealth. In each case the opposite occurred. As resources were diverted from the productive private sector to the inefficient public sector, the consequences were devastating. In many cases the increased spending took the form of acquiring, expanding, or starting government-owned enterprises. Invariably, these firms incurred losses, which required even more government subsidies. As the subsidies to inefficient state-owned enterprises grew, efficient companies in the private sector were starved for capital.

Overvalued Currencies. If a country's currency value is tied to the value of its oil, the currency will become overvalued for non-petroleum activities when the price of oil is high. One immediate consequence is that non-petroleum producers will find their export market diminishing and their competition with imports increasing. The exchange rate discourages exports by making them relatively more expensive to buyers, and it encourages imports by making them cheaper.

In the case of Venezuela, the increase of imports brought on by the bolivar's overvaluation was viewed as a way of supplying citizens' basic needs at a reasonable cost while containing inflation. Furthermore, it was thought that a well-designed system of tariffs and export incentives would shield national producers from the noxious effects of the bolivar's overvaluation. Unfortunately, the opposite occurred. Local producers were undermined.

Government revenues grew steadily because of the 1973 and 1979 increases in oil prices, yet government debt grew to more than \$28 billion (U.S. dollars) by 1984. The number of government employees grew from less than 300,000 in 1973 to more than 1.3 million in 1984, although the overall unemployment rate in 1984 was close to 15 percent. Politicians blamed these developments on the "capital flight" that began in 1981, forgetting the policies they had enacted.

According to the Venezuelan Central Bank, investment in the private sector has dropped precipitously — from a high of almost \$3.5 billion in 1977 to below zero in 1983, the biggest year for capital flight. It has improved very little since.

THE LEGACY OF MERCANTILISM

Venezuela today retains much of our legacy from Spanish mercantilism. In addition, the country is dominated by a strong leftist-collectivist culture. These two factors have created a climate favorable to the growth of big government.

In addition to a loss of economic freedom, Venezuelans increasingly have been losing political freedom. One way this has been happening is through the growth of presidential executive orders used to bypass the legislature and create new laws. For example, in 1974 the government's political party ordered its con-

gress to transfer, for one year, legislative power to the president, despite the fact that the legislative body is the branch of government empowered with lawmaking. In the decade prior to this transfer, between 1961 and 1972, the executive branch dictated only 21 executive orders related to economic activities. Since that time, however, the number of executive orders has soared, averaging more than 3,000 per year during the last 13 years.

Some of these laws limit freedom of speech and the press. Some restrict private property rights. Others limit contractual rights and undermine the judicial system.

LEFTIST CULTURE

The leftist culture of Venezuela is a mixture of Marxism, populism, Keynesianism, "Cepalism,"¹ liberation theology, and the state paternalism which has permeated the whole society. According to Emeterio Gomez, a leading Venezuelan economist, the leftist culture is dominated by three beliefs: government provision of free goods and services, redistribution of wealth, and the permanent conflict between capital and labor. Economic concepts such as opportunity cost, competitiveness, scarce resources, productivity, and transaction costs are generally not understood.

The concept of wealth redistribution by means of low-cost housing, free education and health services, although morally acceptable, is economically disastrous. Free goods and services might accomplish certain goals in the short run, but in the long run they create more poor people. In Venezuela, the welfare state is responsible for the creation of the belt of slums which surround the major cities and are now home to more than 60 percent of the population.

The leftist culture promotes economic planning, nationalization, limitations on freedom of speech, erosion of private property rights, conformity in education, and a welfare state. This culture values security and personal comfort more than freedom and justice.

¹Editor's note: CEPAL (United Nations Economic Office for Latin America) propagated the view (developed principally by Argentine economist Raul Prebisch) that the gap between rich and poor countries would widen if prices were set in the international marketplace and that the gap can be narrowed only through active intervention (through tariffs, quotas and exchange rate controls) by third world governments.

As Wilhem Roepke wrote in his book, *A Humane Economy*, “The individual means less and less, mass and collectivity more and more. The center of gravity of decisions keeps shifting upwards: from the individual, the family, and the small, compact group to anonymous institutions. The power of the state grows uncontrollably.”

GROWTH OF THE INFORMAL ECONOMY

As in the case of other less-developed countries, a growing governmental bureaucracy in Venezuela has had the effect of preventing large numbers of people from enjoying the advantages of the free enterprise system. In increasing numbers these people are turning to the underground economy to reap the benefits denied them by the formal, legal system. As in the case of Peru, the growth of the informal economy has been staggering:

- The Venezuelan informal economy grew from less than three percent of non-oil GNP in 1973 to more than 20 percent in 1985.
- Currently, the informal economy is providing income to more than 42 percent of the country’s labor force.

Citizen discontent is growing. The real danger is that many of the political solutions currently proposed will exacerbate the harmful effects of the policies that the government had in place during the oil-boom years. The ideologies of the left have not worked in the past. Their views of managing the economy differ, but their desires for a strong central government do not. It is time to try a different approach, one which gives individuals the freedom to exercise their creative and innovative abilities in building a better society.

REBIRTH OF AN OLD PHILOSOPHY

When I was living in California in 1980, I met Antony Fisher, a successful businessman who strongly advocates the free enterprise system. Fisher had been influenced by Friedrich Hayek, the Nobel Laureate renowned for his work in Austrian economics. He explained to me Hayek’s beliefs about the importance of ideas and how they can influence the course of political events.

Upon my return to Venezuela in 1982, I met with a group of college friends who were worried about the government’s increas-

ingly interventionist policies. We identified and contacted a number of people who shared these concerns and wanted to do something to change things. The response was overwhelming. One hundred seventy businessmen, most of them young, got together and produced a document diagnosing problems in the Venezuelan economy and proposing alternative solutions.

We presented the document to top leaders of the country, politicians and businessmen. In general they were receptive. In 1984, however, when the new government took office, many individuals who previously had agreed with our proposal would not admit publicly that it was feasible.

At that point, we changed our tactics. We became a public opinion group attempting to influence key political and business leaders. We also aimed our message at a new group: union leaders. In 1984 we published *A Proposal to the Nation*, which is a detailed economic plan for the government. It is conceptually based on libertarian ideas with feasible solutions designed for short-, medium- and long-term implementation. The fact that it was still on the list of the nation's ten best-sellers three years later is evidence that Venezuelans are interested in an alternative to present policies.

Meanwhile, our group incorporated a think tank called Grupo Roraima to counter the leftist ideas put forward by congressmen and government officials. Its main activities have been sponsoring seminars and publishing books and papers.

Grupo Roraima sponsored more than 200 seminars throughout the country between 1983 and 1986. As a result, more people are aware of and concerned about the activities of the government. If a new executive order is being considered, for example, Venezuelans in record numbers voice their opinions. At times this has caused change.

In 1987, Grupo Roraima published *More and Better Democracy*. Distributed by the Center for the Promotion of Economic Education (CEDICE), this book became a national best-seller. It is an analysis of what has happened politically in our country during the last two decades and how the growth of the leftist culture has contributed to a reduction of our freedom. It discusses how decisions are made and how to promote citizen participation in building a stronger, freer society.

Grupo Roraima's seminar on privatization, attended by key leaders, was particularly successful. We followed it up by publishing a book titled *How to Improve the Administration of State-Owned Corporations*. It was designed as a first step toward privatization.

Unfortunately, the strategies of channeling citizen participation through publications and presenting proposed solutions to decision makers have not had the impact we would like. Collectivist and statist ideas continue to dominate. However, in the midst of our despair at this realization, we found an ally — the National Council of Chambers of Commerce and Services (CONSECOMERCIO). CONSECOMERCIO sold books about freedom and free enterprise. Its meetings often are devoted to analyzing the nation's political and economic problems.

We approached some of the people in CONSECOMERCIO who shared our ideas and met with them to plan what could be done to defend and strengthen our democratic system. We found we shared two beliefs: 1) that translating, publishing, and distributing books written by classical liberal economists is important, and 2) that public opinion had to be influenced through an effective use of the mass media.

CEDICE: A NEW ORGANIZATION WITH A NEW DIRECTION

On November 21, 1984, we founded the Center for the Promotion of Economic Education (CEDICE), a nonprofit, nonpartisan volunteer organization. Its mission is to promote freedom, a market economy, individual liberty, and a strong sense of civil rights. We are carrying out this mission by increasing the coverage of free market ideas in the press, by teaching economics courses and conducting seminars, and by publishing, promoting, and distributing books and other materials espousing individual liberty and democratic political systems.

Press Coverage. Since 1974 the government has maintained that it is the only entity which can promote the general well-being of its citizens. We decided to counteract this propaganda by promoting the role of the small business entrepreneurs through the press. We persuaded *El Diario de Caracas* (the Caracas Daily News), a leading daily newspaper, to donate one page per week² to

²Editor's note: One page in *El Diario de Caracas* has 130 inches of press space and cost (in 1984) the equivalent of \$1,467 U.S. dollars.

publish a story about an entrepreneur. Our next task was to find a journalist to write the articles. Given the leftist culture that has prevailed in our universities for the last three decades, this was not easy. We eventually located a professor at Andres Bello Catholic University in Caracas who shared our ideas, and she in turn found a journalism student to whom she could entrust the job. The student devoted a month to reading works by Ludwig von Mises, Friedrich Hayek, Henry Hazlitt, George Stigler, and others.

Our first publication promoting the free market system appeared on February 11, 1985, and featured an interview with a Venezuelan entrepreneur who spent two years trying to get a license to sell fresh fruit juice. It also contained two articles on Mises' classic work, *Human Action*. The response was enthusiastic: There were numerous calls to the newspaper for additional information.

In October 1985, CEDICE began teaching a basic economics course for university journalism students. Readings and lectures cover ideas developed by Ludwig von Mises, Friedrich von Hayek, Henry Hazlitt, Milton Friedman, Michael Novak, Ayn Rand, Alberto Benegas Lynch, Gordon Tullock, James Buchanan, and others. The students interview people and write articles related to principles of freedom and the free market system. These articles are submitted to the national daily press, national business and economic magazines, and economic bulletins. By November 1989, 76 students had completed the economics course.

The impact of this course has been remarkable.

- In February 1985, there were only 236 column inches of news coverage in all Venezuelan newspapers related to economic freedom, a free market economy, and similar ideas. The average was only ten articles a month in the entire country.
- By July, just five months later, there was an average of 96 articles per month totaling 3,300 column inches of new coverage.
- By August 1986, there was an average of 338 articles consisting of 9,917 column inches per month — published all over the country in more than 35 daily newspapers.

- The volume was more than 400 times that of 17 months earlier. The market value of this space exceeds \$100,000 per month.

Although column inches of articles about economic freedom and free enterprise may be an imprecise measure of CEDICE's effect on public opinion, it is an excellent indicator. Another measure of our input is the number of articles addressing similar topics and expressing similar viewpoints, but written by persons not affiliated with CEDICE. In 1985-86 the number of column inches written by others exceeded that written by CEDICE-sponsored authors!

In 1987 we changed our measuring unit. We now measure only the articles written by university students and published in newspapers and magazines, because so many more people are writing for the media that it is hard to analyze all the articles. By August 1987 our average was 98 articles per month, published in nine daily newspapers and totaling 2,888 column inches.

Seminars on Economic Topics. CEDICE conducted its first seminar in the summer of 1985. More than 150 people attended. The next four seminars also were very well-attended, with university students and young professionals making up the bulk of the participants. They were keenly interested in solutions to current Venezuelan economic problems. Students and professors have requested more seminars and books — a pleasant surprise as we originally had targeted mainly businessmen because of the prevalence of the strong leftist culture in Venezuelan universities. Our strategy has since changed and we currently target the future leaders of the country — college students — and their professors.

In addition, we regularly bring internationally acclaimed speakers to Venezuela. Among them have been Hernando de Soto from the Institute for Liberty and Democracy in Peru; Miguel Boyer, the president of Spain's Exterior Bank; Gordon Tullock from the Center for Study of Public Choice in the United States; Luis Pasos of the Iberoamerican Integration Institute of Mexico; Martin Schwab from Argentina; and Enrique Ureña, a Jesuit priest from Spain who is critical of the Catholic Bishops Letter and of liberation theology; John Goodman, president of the National Center for Policy Analysis in the United States; and many others.

ADDITIONAL CEDICE PROGRAMS

Thirty-five short monographs by well-known political economy experts have been published by CEDICE. The idea of publishing monographs no longer than 30 pages came from the Fraser Institute in Vancouver, Canada. More than 39,000 copies of the following essays have been distributed throughout Venezuela:

1. Friedrich A. Hayek, *Our Moral Heritage*
2. Fernando Salas Falcon, *Keynesianism and Monetarism: Two Exaggerations?*
3. Sven Rydenfelt, *Capitalism and Economic Crisis*
4. Carlos A. Ball, *Economic Liberty*
5. Carlos Rangel, *Time to Know Liberty*
6. Pascal Salin, *The Tramp of Co-Administration*
7. Hernando de Soto, *Informal Economy*
8. Emetrio Gomez, *Leftist Culture*
9. Jesus Eduardo Rodriguez, *Poverty or Marginality: Cause or Effect?*
10. Fernando Salas Falcon, *The Fundamentals of Neo-Liberalism*
11. Luis Pazos, *Press Regulation in Mexico*
12. James Buchanan, *Politics without Romanticism*
13. Carlos Ball, *Regulation vs. Freedom*
14. Mario Vargas Llosa, *Underdevelopment and Mercantilism*
15. Joaquin Sanchez-Covisa, *Inflation: General Concepts*
16. Adan Celis, *An Experience*

17. Eddo Polessel, *Freedom*
18. Los Sistemas Economicos Contemporaneos, Fernando Salas F.
19. La Economia de Mercado en Alemania, Ludwig Erhard
20. El Ocaso de una Gran Potencia, Robert Kriebel
21. El Desafio de la Teologia de la Liberacion, Armando de la Torre
22. Conquistar La Libertad, Marcel Granier
23. Carlos Rangel y la Mitologia Populista, Leandro Cantó
24. La Funcion Social del Empresario, Juan Marcos De la Fuente
25. La Necesaria Coherencia de la Politica Economica, Ruth Krivoy
26. ¿Como Generar Empleo?, Juergen Donges
27. Convocatoria al Pais para Vencer La Inflacion, Enrique Auvert
28. Seguridad Juridica y Desarrollo Economico, Luis Pazos
29. El Subdesarrollo Pensante, Emeterio Gomez
30. Los Empresarios: Explotadores o Explotados, Edgar Mason
31. El Instinto de la Libertad, Mario Vargas Llosa
32. Privatizacion, Roberto Dubuc
33. Una Opinion Disidente, Carlos Rangel

CEDICE promotes books about classical liberalism by Venezuelan authors by providing them with editing, printing, distribution, and promotion. In addition, CEDICE has begun to translate some of these works into English in order to introduce Venezuelan authors and their ideas about political economy to people in English-speaking countries.

Another CEDICE project is our human resources bank. Based on a model developed by the Heritage Foundation in Washington, DC, we set up a directory of Venezuelan “free market” experts. To our surprise we found more specialists and believers in freedom and a free market economy than we had anticipated. The directory enables members of the press and others to locate free market experts throughout the country.

We established a bookstore as a bridge between the general public and other classical liberal Latin American institutions. With the support of 17 bookstores throughout the nation, we have sold more than 91,728 books and donated more than 46 collections containing libertarian ideas to universities. Authors include Friedrich Hayek, Ludwig von Mises, Henry Hazlitt, James Buchanan, Gordon Tullock, and George Stigler. This program has opened university doors to our ideas.

We also operate a public library. We are attempting to acquire a coherent and systematic selection of national and international books, documents, and publications about classical liberal ideas. To offset the rising cost of books, we also are trying to make them easier for the public to obtain.

An unanticipated consequence of our success has been the invitation to members of CEDICE from the Senate Economic Advisory Committee to participate in the discussion and writing of proposals on economic issues of interest to the government.

We are pleased with what CEDICE has accomplished in creating a constituency of free market-oriented citizens and in provoking interest, curiosity, doubts, and questions about the present economic policies of our government. CEDICE is providing an opportunity for citizens to work for change.

While at times we feel that we are fighting the war of ideas by ourselves, we are not alone. Allies such as CONSECOMERCIO are active in the fray, and new organizations are springing up.

One example is the Institute for Liberty and Democracy of Venezuela (ILDV) formed in 1986. Modeled after Peru’s Institute for Liberty and Democracy, the ILDV is in the process of measuring Venezuela’s informal economy and its causes. It also is researching poverty. Results of this research are being disseminated, and they are

helping citizens to understand why the informal economy exists, what their duties and rights are, and how they can participate in the process of creating a genuine free market in Venezuela.

Some idea of how quickly change is occurring can be gained by considering the following:

- When I returned to Venezuela in 1982, there were only four books on free market ideas translated into Spanish and accessible to Venezuelan readers.
- Today there are at least 340, and more than 91,728 volumes on free market ideas have been sold within the last 48 months.
- In 1982 there were no scholars at Venezuelan universities who were known to be willing to associate with pro-free enterprise institutes. Today there are at least 50, and professors and students at the universities are the biggest group of consumers of free market literature.

In formal education, Cedice had not been able to enter major universities and colleges, until 1989 when courses on Leadership, Participation, Ethics, Market economics and Liberty started to be taught at five universities: Universidad Metropolitana, Universidad Catolica Andres Bello, Universidad Central de Venezuela in Caracas, the College of the United Kingdom for Agriculture in Barinas and Universidad Tecnologica del Centro in Valencia.

CONCLUSION

Venezuela's fragile democratic system is under assault by statist, leftist, and collectivist politicians, the educational elite, and other leaders. We believe that the survival of our democratic system depends upon action that can be taken now and that will give immediate results.

In Venezuela, voluntary citizen groups are becoming a powerful, positive force for change. Perhaps the most striking feature of these groups is their relative freedom from constraints and the resulting pluralism in our society. Within the bounds of the law,

people can advance any idea or social program they wish. CEDICE is a good example.

Successful voluntary action encourages individual involvement and keeps alive the sense of personal caring and concern that is essential in a humane society based on private property and freedom of choice. The positive impact of CEDICE's efforts in marketing its ideas on free enterprise, liberty, and individualism and in generating active public support, organization, and participation suggests that change is possible. This gives us faith, hope, and the energy to continue our work.

4

THE WAR OF IDEAS IN MEXICO

EDITOR'S INTRODUCTION

With more than 83 million inhabitants and an area three times the size of Texas, Mexico is the thirteenth largest economy in the world. It is the third largest trading partner of the United States. In the mid-1980s Mexico was the world's fourth largest oil producer. The Green Revolution in agriculture began in Mexico, and between World War II and the pre-oil boom of the 1970s the nation's economic growth averaged 6 percent per year.

Despite its abundant natural resources and its industrialization after 1949, Mexico's economy has turned into a nightmare. The country is stranded in a web of bureaucratic red tape and plagued by what is sometimes called a "pervasive atmosphere of corruption."

Runaway inflation is eating up the earnings and savings of its citizens. Mexicans' lack of faith in their government and economy has resulted in a tremendous outflow of capital in the last ten years. An estimated \$60 billion in private Mexican money has poured into the U.S. and at least another \$8 billion has been identified in Swiss bank accounts.¹ What went wrong? How is it that a country extraordinarily rich in natural resources, with a history of relatively steady economic growth, is in dire economic straits? How did this country, with an initial constitution modeled on that of the U.S., evolve so differently?

¹John A. Gavin, "Mexico, Land of Opportunity," *Policy Review*, Vol. 39, 1987, pp. 32-35.

Several twentieth century political events have had an enormous effect on the economy of Mexico. These include the constitution of 1917, the establishment of an official party, the Institutional Revolutionary Party (PRI), the expropriation of private property, and the expansion of the public sector.

The 1917 constitution was a radical departure from those preceding it, embodying new notions of social and economic justice, proclaiming hostility to organized religion, granting rights to labor unions, and establishing the national government's inalienable claim to the land as well as to the subsoil.² Ultimately this constitution ushered in an era of government economic planning that has had disastrous results for the economic well-being of most of the country's citizens.

President Plutarco Calles established the PRI in 1929 to eliminate political competition, a goal that was attained through extensive fraud and violence.³ Calles reorganized the party in 1933 when he feared that regional *caudillos* were becoming dangerously powerful. The reorganization concentrated authority at the national level, transferring candidate selection from the public domain to the PRI nominating conventions.⁴

In 1938 President Lázaro Cárdenas again reorganized the PRI, giving it essentially the structure it retains today. Based on then-current European models of populist corporatism, Cárdenas divided the citizenry into peasants, labor, and popular sectors, the last including government workers and the military. The clergy and organized business groups were purposely excluded.

Each sector is organized at the local, state, and national level. Communication is supposed to flow from the bottom up, reflecting the revolutionary myth of a government of the masses that Cárdenas and past and current presidents have nurtured. In fact, policy is determined at the national level, often in unpublicized meetings, and the decisions are sent down the line for implementation.⁵

²Evelyn P. Stevens, "Mexico in the 1980s: From Authoritarianism to Power Sharing," H. J. Wiarda and H. F. Kline, eds., *Latin American Politics and Development* (Boulder, Colorado: Westview Press, 1985), p. 406.

³*Ibid.*

⁴*Ibid.*

⁵Stevens, p. 419.

People behave differently when they feel secure in their rights to what they own than they do when those rights are insecure. One basic difference is in investments to increase the value of their property. People are less willing to make such investments if they fear that government will expropriate the fruits of their labor. The more insecure property rights are, the greater the likelihood that people will invest their money outside the country. Probably the most widely known case of expropriation was Cardenas' nationalization of the petroleum industry in 1938. Cardenas' intervention and protectionist measures created other economic disorders. For example, although other presidents had redistributed land, Cardenas redistributed more than all previous presidents combined. Under the *ejidal* system, 49.4 million acres of land were expropriated from owners and divided into small parcels which were rented to 776,000 members of *ejidos* (collective landholdings).⁶ This system proved very inefficient and marks the decay of Mexican agriculture. Many land plots are so small that the peasants cannot eke out a subsistence living, let alone produce food for sale. President Luis Echeverria's massive expropriation of land in 1976⁷ led to a further deterioration of Mexican agriculture.

In 1982 President de la Madrid nationalized all private banks. Along with the banks the government obtained hundreds of private companies that were connected to the banks. U.S. Treasury studies and Mexican private sector estimates show that in 1987 the state or PRI-affiliated labor unions owned or controlled about 70 percent of the Mexican economy.⁸ In no successful economy in North America, Asia, or Western Europe does state control even begin to approach this percentage. In addition to the banks, the state owns supermarkets and hotels, dominates the sale of supplies to agricultural communes, refines sugar and at one point even owned a nightclub in Mexico City.

One of the hallmarks of both mercantilism and socialism is central government planning. Monopoly franchises, regulations, trade barriers and other policies designed to guide industry and commerce result in large profits for favored firms but do not truly build a wealthy nation. A 1983 study for the World Bank reported that countries with little government interference in the economy grew an average of 7 percent per year compared to the average annual growth

⁶*Ibid.*

⁷Bruce Babbit, "Mexico Could Use a Good Neighbor," *Wall Street Journal*, July 2, 1986.

⁸Gavin, "Mexico, Land of Opportunity."

rate of about 3 percent (less than half!) for countries with heavy governmental controls.⁹ In 1987 Mexico's industrial production grew at a rate of 1.7 percent; its Gross Domestic Product, 1.4 percent.¹⁰

The expansion of the Mexican government in the last decade and a half has been phenomenal. Between 1975 and 1983 the population grew by 25 percent but the bureaucracy grew by 85 percent! In 1983 more government offices were created than in the previous six years combined.¹¹ Only 25 million of its 83 million inhabitants are economically active. Of this 25 million, six million are unemployed and four million are bureaucrats.

As government grows, public spending increases. In 1970 public spending accounted for 26 percent of the Gross Domestic Product. This figure was 35 percent in 1976 and over 50 percent in 1982.¹² Expanding the money supply and borrowing appear to be the principal means used to finance these expenditures. The debt has grown so large that 56 percent of the 1988 federal budget was allocated to servicing it.¹³

Increasing oil prices in the 1970s allowed Mexico to borrow heavily. First the government borrowed to develop oil production and then it borrowed to support other programs. The bust in oil prices left it with a debt of over \$82 billion in 1982.¹⁴ Mexico's foreign debt grew to \$107 billion by mid-1988.¹⁵

Government policies have taken their toll on the Mexican citizenry. Real wages declined 45 percent in 1982 and an additional

⁹John Semmens, "Laissez-Faire as a Development Policy," *The Freeman*, Vol. 37, No. 5, 1987, pp. 182-185.

¹⁰"Business Outlook Mexico," *Business Latin America*, May 16, 1988, p. 156.

¹¹Luis Pazos, "The False Austerity Policies of the Mexican Government," *Journal of Economic Growth*, Vol. 1, No. 1, 1986, pp. 29-31.

¹²*Ibid.*

¹³*Budget of Federation Expenses: Presidency of the Republic.*

¹⁴William Cline, *International Debt and the Stability of the World Economy*, Institute for International Economics, Washington, DC, September 1983, p. 17.

¹⁵Matt Moffett, "Mexican Politics Seem Forever Transformed by Close 3-Way Vote," *Wall Street Journal*, July 11, 1988, pp. 1 & 14.

40 percent in the last 6 years. Infant mortality rates are high (53 per 1,000 deaths in 1982) and 40 percent of the population suffers from some form of malnutrition. The population continues to expand at the rapid rate of 2.5 percent per year, which means that it will double in 29 years, and that every year almost a million new workers will enter the labor market.¹⁶

President Miguel de la Madrid inherited an oversized public sector where corruption and mistrust were pervasive. Although de la Madrid took strong measures, including privatization of a number of government-owned companies, entry into the GATT, and the gradual floating of food and fuel prices toward their real costs, his economic measures did not turn Mexico's economy around. Certain prices and salaries remain fixed, with the expected result: continued dislocation in the economy. Record inflation and diminishing per capita income continue.

Results of the 1988 elections were indicative of widespread dissatisfaction. Speculation about reasons for the largest voter abstention rate in almost 30 years were rampant, with the PRI's history of electoral fraud in the forefront. Amidst allegations of electoral fraud, Carlos Salinas de Gortari, the primary author of de la Madrid's economic policies and a Harvard-educated economist, received the smallest proportion of votes (50.4 percent) ever received by an official PRI presidential candidate. Cuauhtemoc Cardenas, the son of former President Lazaro Cardenas, a leftist and influential former PRI member, received 31.2 percent, and Manuel Clouthier, the National Action Party (PAN) candidate, received 17.1 percent.¹⁷ The following year (1989), the PRI suffered an even greater setback when the PAN candidate won election as governor in Baja California Norte.

Without greater economic freedom and a reduction in government expenditures, economic conditions are almost certain to get worse. This concern has been voiced by John Gavin, former United State Ambassador to Mexico, who wrote:

¹⁶Karen Elliot House, "Mexico's President-Elect Should Retain His No-Pain, No-Gain Plan on Economy," *Wall Street Journal*, July 19, 1988, p. 19.

¹⁷"Reading Mexico," *Wall Street Journal*, July 15, 1988, p. 16. See also, "Mexico's Apparent New President Faces a Series of Challenges to His Legitimacy," *The Wall Street Journal*, July 13, 1988, p. 15. These election figures are from the Mexican government (the PRI). Many Mexicans are skeptical of these percentages.

The crisis in Mexico today is not primarily its staggering debt of \$100 billion. Nor is it the precipitous drop in the price of oil. The deeper crisis is that there are Mexicans, from all stations of life, who declare they are losing confidence in their country's political and economic institutions. This crisis can only be overcome if the rulers of Mexico hear the voices of disaffected Mexicans and act on their concerns.¹⁸

As this book goes to press, there is mounting evidence that President Salinas is serious about free market reforms — that he favors real reform, not merely cosmetic changes designed to appease international lenders. For example, of 1,155 state-owned enterprises that existed in 1982, only 392 remain in the public sector and 185 of those are in the process of being closed or privatized.

Among the most important privatization victories, the government privatized Aeromexico in 1988 and partially privatized (government's equity share was reduced to 40 percent) Mexicana de Aviacion (its largest airline) in 1989. The government also sold the National Hotel group (Mexico's largest five-star hotel chain), several large capital goods companies, several industrial concerns and 19 sugar mills. Among companies which the government has allowed to be liquidated are a major steel mill employing 8,000 workers.¹⁹ According to the government's announced intentions, "everything ... is open to privatization" except the railroads, the electric power plants and the extraction and trade of oil and uranium.²⁰

Among other developments, the Salinas government has slashed the government budget, reduced tariffs and eliminated import licenses, cut subsidies on food and gasoline, liberalized foreign investment restrictions and opened financial markets. For example, foreigners are now permitted to own up to 100 percent of businesses in industries such as agriculture and livestock, building and construction, magazines and newspapers, air navigation, and legal

¹⁸John A. Gavin, "Mexico, Land of Opportunity."

¹⁹Guillermo Ortiz, "Mexico's Been Bitten by the Privatization Bug," *Wall Street Journal*, September 15, 1989.

²⁰Nathan P. Gardels, "Perestroika Goes South: Auctioning Off the National Patrimony," *New York Times*, November 12, 1989.

and financial services. In many areas, Mexico is now less protectionist than the United States.²¹

The Salinas government is taking a self-proclaimed “supply-side” approach to economic policy. When the corporate income tax rate was lowered from 42 percent to 36 percent, government revenues actually increased in those sectors where rates went down. In 1988, individual income tax rates were lowered by 12 to 15 percentage points on middle-income wage earners (those earning about four times the minimum wage).²²

It is not known whether these reforms will continue. If they are to continue, the war of ideas will be critical in Mexico. Free market economics and increased political freedom offer an alternative to the disastrous politics of the past. In their chapter, Luis Pazos and Carolina Bolivar provide more detail about this battle.

ECONOMICS, POLITICS AND CULTURE IN MEXICO²³

LUIS PAZOS
CAROLINA BOLIVAR

The ideological war presently being waged is an international phenomenon with two possible destinies for humanity: bondage or liberty. Most of the free world, Mexico included, suffers the pressure of this ideological war, the outcome of which will determine which system is to prevail worldwide in the future: centralized socialism or freedom and democracy.

Socialism has crept up on the Western world, weakening traditional values and undermining the institutions and political-economic systems that have made possible development and prosperity. In most countries, individualism is being replaced by collectivism, autonomy by submission, democracy by dictatorship, free enterprise by centrally-planned economic systems.

²¹*Ibid.*

²²David Asman, “La Perestroika Mexicana,” *Wall Street Journal*, October 5, 1988.

²³Translated by Anna P. de Fusoni

Despite its importance, this global cold war receives little publicity. It is far more dangerous than an armed conflict because the enemy attacks indirectly, secretly, with deceit and hypocrisy. It should be considered the Third World War of the present century. The economic, political, and social breakdowns we are witnessing are generally interpreted economically, although they are really philosophically based. In general, people are unaware of wars until bombing, maiming, and death occur. They do not realize that wars begin in the human mind. The most powerful arms of the enemy in the cold war are ideas, and since ideas are intangible, few people recognize the imminent danger of the loss of autonomy and liberty facing free societies.

Julius Caesar said that ideas must be fought with ideas, arms with arms. Arms can kill enemies, overthrow governments, liberate countries from tyrannical dictators. But they can never transform the philosophy of a people, and this is what ultimately counts. A country convinced that socialism is the solution to its poverty will never evolve towards democracy nor will it accept a free market economy.

Many explanations have been put forth for the present crisis which engulfs so many less-developed countries. Some historians postulate the cyclic theory, affirming that all splendor is inevitably followed by decadence. Others blame postwar problems; still others the impact of technology. All these factors may be partly to blame, but the fundamental cause is the penetration of socialist philosophy.

Victory over free and strong nations in open warfare would have been, and still is, an impossibility for the Soviet Union. The strategy has been far more subtle and astute. Marx himself, in the *Communist Manifesto*, suggested that the takeover of societies and countries should begin with the gradual undermining of their basic philosophies and the penetration of their institutions. He viewed this as a long-term strategy.

From the intellectual point of view, the socialist strategy has been resoundingly successful. Utilizing textbooks, essays, scholarly journals, novels, magazines, and newspapers, Marxist philosophy has reached all levels of society. The Western world is awash in ideological confusion because truth has been distorted, history falsified, and information manipulated. Educational systems are being slowly and systematically penetrated. Many educational programs and teachers extol the benefits of socialism while condemning democracy and free market economies. In most schools and universities,

students are being indoctrinated in the docile acceptance of subjugation. This is particularly true in Mexico.

Western moral values are under socialist attack. The loss of traditional values, a prevailing hedonism and mind-altering drugs are destroying contemporary youth, the very generation upon which the future of free nations depend. A corrupt youth, without self-respect and without pride, without either principles or clear ideas, is easy prey.

Politically, socialism also has achieved much. Governments have been infiltrated by indoctrinated politicians who have brought about the necessary transformations to set nations on the socialist path. Many Latin American constitutions no longer embody the original spirit of liberty and justice intended to protect the citizenry from state domination. These constitutions have been converted into governmental justification for dominating individuals and usurping their natural rights and liberties. Governments of this type have gained increasing control over the economies of their countries, gradually converting free market systems into central planning. Through legislation, high taxation, and expropriation of private property, these governments are usurping private capital and exerting control over their countries' economies.

A number of dedicated people are aware of the danger and are battling it. A few years ago, mention of an army of moralists and intellectuals struggling for liberty would have sounded like fiction taken from an Ayn Rand or Morris West novel. Today it is a cause for real optimism.

Active libertarian²⁴ groups have appeared spontaneously and begun working independently. Often they are unaware of each other and probably do not realize the value of their seemingly insignificant activities. They act out of a sense of moral obligation to right the wrongs they perceive in their immediate spheres. Meanwhile, most of humanity slumbers in apathy and passivity. It must be shaken out of its complacency soon, for the libertarian struggle must enlist many warriors if the battle is to be won before it is too late.

²⁴Editor's note: In this chapter the term "libertarian" is used as a synonym for "classical liberal."

To understand the struggle in Mexico, knowledge of its different institutions is essential. Mexico is in great danger, but as we shall see popular reaction to the present situation is encouraging.

MEXICO'S POLITICAL CLIMATE

The most important political and social analysts agree that Mexico is on the verge of a possible rupture of the social order. The country today has characteristics similar to those which preceded the 1910 Mexican Revolution. Many symptoms lead the analysts to believe that the last half century of social peace is coming to an end.

The Partido Revolucionario Institucional political party, or PRI, was created in 1929. This party has presided over a long period of stability through a more or less democratic political system. The PRI did not demonstrate a clear and definite ideology in the past, but rather one that changed according to the president in power and the political pressures he faced. Political stability allowed Mexico to enjoy sustained economic development. While this development was not as successful as it could have been, at least it placed the country on the path of progress. The country, in many ways, became the leader of Latin America.

Unfortunately, the PRI changed its tactics, beginning in 1970 with Luis Echeverria's government. He decided to accelerate socialist gradualism. Since then, the PRI has adopted Echeverria's ideology and imposed many statist measures. After the 1968 student conflict, which severely repressed the socialist movement, the PRI suffered a metamorphosis. Socialist strategy no longer involved open opposition but rather active cooperation with the government. Some socialist leaders joined the cabinet; others became advisers to Luis Echeverria. Since then the ideology of the party has been deeply influenced by the left. In 1972, when Reyes Heróles became leader of the PRI, a close relationship between the Socialist International and the Mexican government began. The PRI is not an official member of this organization, but participates in all its meetings and is considered a guest member.

Mexico's present crisis derives from the political-economic policies adopted by the governing party. Government intervention in all areas of the economy has resulted in chaos, which is evident in high inflation, unemployment, bankruptcies, capital flight, and huge internal

and external debts. Instead of the economic growth and accelerated development which the government had expected, the country now has plunged into the worst crisis in its history.

Other factors also are causing antipathy toward the government. These include the severe deterioration in education, the overbearing behavior of many public servants, and general corruption. Discontent is evident not only among the citizenry but also inside the government. Not all politicians agree with the excessive interventionism and many are ashamed of the corruption. A majority of citizens believe that the PRI no longer represents the will of the Mexican people or understands their special character. They feel that Mexico needs a more democratic structure, one which will return to the people the rights and liberties taken by the government. Thus, many no longer vote for the PRI.

In 1983 President de la Madrid declared that municipal elections in Chihuahua, one of the richest states of the country, would be fair and democratic. The results astonished the PRI. The principal opposition party, PAN (Partido de Accion Nacional), was conservative in character and had enjoyed scant success. Yet PAN won majorities in the municipal councils of seven cities and its candidates were elected mayors of the state capital and the important city of Ciudad Juarez.

This experiment put an end to the PRI's good intentions. Its desire to maintain total control of the country led to the suppression of democratic reforms. Reverting to outright electoral fraud, the PRI has become increasingly unpopular. By contrast, the PAN, ineffectual in the past, has become the choice of disappointed voters who abandon the PRI.²⁵ New blood is giving life to the old PAN. Many businessmen, workers, and intellectuals are joining the activists in building neo-PANism, which probably will be responsible for a new, healthier democratic system. The neo-PANists have influenced the political platform of the party to include the following political goals:

- Privatization of the land
- Reprivatization of the banks

²⁵Editor's note: At that time, PAN was the only credible alternative to the PRI.

- Pluralist education
- Democratization of the electoral system
- Free market system
- Reduction of the public sector

Transcendent changes in Mexico have always begun in the northern states, the wealthiest and most productive part of the country. Recent elections have demonstrated that the north is supporting the PAN. Many important northern businessmen have joined the PAN's political struggle, using nonviolent Gandhian tactics of civil disobedience, antifraud campaigns, hunger strikes, and political speeches.²⁶ They are awakening civic conscience. The 1988 election results reported by the government are completely different from those reported by private entities. The actual voting was a clear demonstration of antigovernment sentiment. Those presently in power will have to reverse policies if they wish to remain in office.

Enrique Krautze in his book *Por Una Democracia sin Adjetivos* (For A Democracy Without Qualifications) accurately defines the general attitude to the present situation:

The country has an overwhelming and legitimate grievance. Its origin is the irresponsibility with which the government disposed of enormous wealth between 1977 and 1982. People are aware that the government had in its hands a unique opportunity for development, which no other Latin American country had enjoyed. They feel that with the loss of this opportunity the possibility of sane, harmonious progress, capable of mitigating ancestral problems, has also vanished. They admit that error is human, but not of this magnitude.

²⁶Editor's note: The strategy of civil resistance is similar to that used by supporters of Corazon Aquino to obtain power in the Philippines.

MEXICO'S POLITICAL PARTIES

PDM (Partido Democrata Mexicano)	Christian Democrats
PAN (Partido de Accion Nacional)	moderate right
PARM (Partido Autentico de la Revolucion)	moderate left
PSUM (Partido Socialista Unificado de Mexico)	radical left
PRIT (Partido Revolucionario de los Trabajadores)	radical left
PMT (Partido Mexicano de los Trabajadores)	left (revisionist)
PRI (Partido Revolucionario Institucional)	left *
PPS (Partido Popular Socialista)	left **
PST (Partido Socialista de los Trabajadores)	left **
PLM (Partido Laboral Mexicano)***	left **
PSD (Partido Social Democrata)***	moderate left

* The PRI has not openly recognized its leftist tendency but its programs and policies place it in the left wing.

** PRI's protégé parties.

*** Not a registered party.

Although the overall situation has caused anxiety, we believe there are grounds for optimism. As we have said, an important sector of the population has become aware of the crisis and many people link

socialism with the unpopular government. This awareness tends to neutralize the intense socialist propaganda which inundates Mexico. Therefore there is less interest in socialism and an increasing interest in classical liberalism, which represents something new for the majority. A free market, democratic system is beginning to be seen as the only possible alternative for the future.

THE JURIDICAL CLIMATE

Since Mexico gained its independence from Spain, it has had several constitutions. The first was approved in 1824 when the republic was instituted. As noted above, its articles were very similar to those of the U.S. Constitution. It was short-lived, however, and was changed by President Benito Juarez in 1857. Juarez introduced a new constitution which was federalist in character and initiated the “liberal movement” in Mexico — rooted in some socialist and anti-clerical tendencies.

Since then other presidents have created new constitutions, and followed an increasing tendency to ignore constitutional restraints. An ambivalent and complex system was installed which still persists. What is stated in the constitution is one thing, what is done is another. The system almost defies explanation and bewilders both Mexicans and outsiders.

This contradictory state of affairs has given Mexican presidents great flexibility in the exercise of power. Porfirio Diaz, who governed from 1876 to 1910 and whose ideology was not consistent with Juarez’s ideas, is an example of this. He governed the country in a spirit of economic freedom which inspired confidence and encouraged investment. He respected private property and welcomed foreign investors, especially French, English, and American. During the Porfirian era the country’s most important railroad network and highway systems were built. Ports were constructed, and great importance was given to education. A period of economic growth, prosperity, and intellectual achievement resulted. Diaz gave the country the infrastructure necessary for its future development.

Unfortunately, Diaz made the mistake of insisting on perpetuating his power instead of moving the country toward a system of electoral democracy. The last eight years of his government

were marked by the political repression that led to the Mexican Revolution of 1910.

In 1917 a new constitution was adopted and is still in force, though hardly recognizable, as it has been amended 318 times in 69 years. By comparison, the U.S. Constitution, which is more than 200 years old, has been amended only 26 times.

Between 1917 and 1972, Mexico experienced alternate periods of prosperity and difficulty. One of the difficult periods occurred under the presidency of Lazaro Cardenas, who gave a great boost to the movement toward socialism. One of the most important measures of his government was the agrarian reform, leading to the era of the *ejidal* system. Land was expropriated and divided into small parcels called *ejidos*, which are still rented to the peasantry. Because the small peasant farms could not benefit from economies of scale, the system proved inefficient and led to the major agricultural problems the country faces today. Cardenas's populist measures in other fields also created serious economic disorders. These have been exacerbated by the protectionism and interventionism of the last three presidents.

On the whole, however, the period from the 1940s to the 1960s was one of steady development, thanks to government policies which encouraged economic expansion. Mexico became a leader of Latin America. In 1972, however, the juridical climate began to deteriorate. From Luis Echeverria's presidency to the present, the constitution has been so transformed that certain of its fundamentals are now similar to those of the Russian and Cuban constitutions. Consider the following examples:

“The State will plan, conduct, coordinate, and guide national economic activity ...”	paragraph 2 of article 25 of the Mexican constitution modified on February 3, 1983.
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“... the State organizes, directs and controls national economic activity in accordance with its sole development and socioeconomic plan ...”	paragraph from article 16 of the Cuban constitution.
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“The State will organize a system of democratic planning and national development ...”	paragraph of article 26 of the Mexican constitution modified on February 3, 1983.
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“The direction of the economy is based on State plans for economic and social development”

article 16 of the Russian constitution.

The juridical order expressed in a constitution reflects the way in which a country is to be governed and, up to a point, regulates the social contract. The recent changes which encroach upon private property and other individual rights clearly demonstrate the intent to turn Mexico into a totalitarian country. The present government continually demands the return of Mexican capital from abroad while it simultaneously transforms the constitution, violates civil rights, and undermines public confidence. In 1982 Lopez Portillo expropriated Mexican private banks and with them many of the country's most prosperous companies. The public anxiety and distrust this caused has increased with subsequent constitutional changes.

THE ECONOMIC CLIMATE

The Mexican government today intends to become the absolute director of the Mexican economy. These plans have not been fully implemented because of the chaotic state of the country's economy. Economic pressures have forced the government to reverse many of its programs. However, as a consequence of the implementation of centralist policies, Mexico has suffered severe economic deterioration. The fundamental reason for Mexico's problems is and has long been its political-economic system. During the past fourteen years the situation has worsened because socialist measures have been adopted at an accelerated rate. Luis Echeverria, Jose Lopez Portillo, and Miguel de la Madrid have all pressed for a socialist economy.

Had the government not received foreign financing, it would have been forced to abandon many of its socialist plans and Mexico would be better off today. Loans to the government, refinancing of the external debt, and other forms of economic aid are considered by many Mexicans to be a crass error and even a betrayal of the people. The external debt, depicted in Table I, is a somber burden for many citizens who believe it compromises Mexico's autonomy and dashes their hopes in the future. The political left interprets the debt as

collusion between the PRI and the U.S. designed to subject the country to the interests of foreigners. Through anti-American statements the government tries to pin responsibility and blame for the present state of affairs on the U.S.

Many in Mexico legitimately question the irresponsibility of lending those huge amounts of money without closer scrutiny of the people the lenders were dealing with. They question the shortsightedness of foreigners in general, and North Americans in particular, in their continued financing of this type of government.

Outsiders apparently do not understand that the future success of Mexico is vital to the United States. If things continue as they now are, relations between the people of Mexico and the United States will deteriorate. The United States has made these same mistakes many times in recent history, but still has to learn from its errors. Undesirable governments such as those of Batista, Somoza and Marcos, among others, received financial help from the U.S. — which kept them artificially in power with harmful consequences. We trust that Mexico will not tread the same path.

TABLE I

PUBLIC AND PRIVATE DEBT (Millions of dollars)			
Year	Public Debt	Private Debt	Total Debt
1982	\$66,800	\$18,000	\$84,800
1985	81,500	18,000	99,500
1986	85,635	17,065	102,700
1987 estimates	91,800	16,500	108,300

Source: Secretary of the Treasury

The government now manages as a monopoly the country's oil, electricity, railways, airlines, telephones, and banks. State-

owned companies control 60 percent of the production of steel, 70 percent of the sugar, 30 percent of the distribution and sale of seafoods, and 50 percent of the coffee. An important percentage of the distribution of corn, beans, and milk is controlled by state companies. The Mexican government is the country's main industrialist and largest trader. It is also its only banker and its principal importer and exporter.

In 1970 there were 86 state companies and organizations. Now there are close to 1,000, and most are operating with losses. These losses are covered by collecting more taxes, inflating the money supply, and increasing the government debt.

Most loans made by U. S. and Japanese private banks, as well as by the World Bank and the International Monetary Fund, have not contributed to the development of Latin American countries, since they have been channelled largely to the creation or expansion of state companies. Paradoxically, the same international banks which now condition the renegotiation of Latin America's foreign debt to privatization helped to make possible the concentration of economic power in the hands of those governments.

The figures in Table I demonstrate that Mexico's debt has been incurred mainly by the government, and that the proportional difference between the public and private debt progressively widens to the detriment of the private sector. In 1982 the Mexican government seized all private banks and with them a high percentage of the most prosperous Mexican enterprises.

In 1970 spending by the federal government was 26 percent of the gross domestic product. In 1976 the figure had reached 35 percent. From 1982 to this date it has remained around 50 percent of the GDP. This increasing role of the state in the economy, together with the 1982 banks expropriation and the 1983 constitutional changes — which introduce central planning and a state "leadership" of the economy as features of the constitution — place Mexico's present political and economic system farther down the road to socialism than Francois Mitterrand's France or Felipe Gonzalez' Spain.

The recent reduction by the government in the number of state-controlled enterprises has led some people to assume that Mexico has begun a program of privatization and decentralization of power. Many are not aware that this apparent decrease in the number

of state-owned enterprises is due to the fact that many companies have been merged, and others that appear to have been sold existed only on paper. The government has been obliged to shut down or sell a number of state-owned companies because it could not continue subsidizing large losses. Although the government acted out of necessity, not out of conviction, the actions permit a certain optimism.

Tables II and III present data about the number of state-owned companies and the profits and losses of several of the major state-owned companies.

TABLE II

NUMBER OF STATE-RUN COMPANIES			
1970	1976	1982	1986
86	783	1165	765

TABLE III

COMMERCIAL BALANCE OF MAJOR GOVERNMENT COMPANIES (1985)	
Profits	Losses
Azufrera Panamericans 4,773 million pesos	Conasupo 360,000 million pesos
Banco Internacional 3,156 million pesos	Banco Internacional de Credito Rural 3,136 million pesos
Aseguradora Hidalgo 399 million pesos	Dina Autobuses 1,063 million pesos
Exportadora de Tabacos Mexicanos 177 Million pesos	Consejo de Recursos Naturales 1,719 million pesos

Source: Secretaria de Minas o Industria Paraestatal (Secretary of Mines and State-owned Industries).

In Mexico, as in Brazil, Argentina, Peru, and other Latin American countries, the government subsidies used to compensate the losses of state firms are a primary cause of inflation. Mexico's ruling clique found in the state's control over the economy a profitable business. Many of them see state economic interventionism as a means to create state firms and jobs for political patronage. These companies and employment positions are inflationary because they generally require the issue of new money. One consequence of this expanding state role is an inflation rate which was near 130 percent a year by mid-1987. Interest payments also are financed largely by new issues of money. This method of government financing worked for awhile. However, the ever higher interest rates which accompany inflation make the debt even harder to service.

How will this end? So far there are no signs of a significant change in Mexico's economic policies. In all probability, confiscatory measures will increase, the cost of services will multiply, the public internal and external debts will expand, and the inflation and unemployment rates will continue to rise. But it is also possible that these crises will trigger the beginning of a new economic system and a more democratic political system.

THE EDUCATIONAL CLIMATE

The influence of socialists in the PRI is clearly evident in the so-called "Sole Education System" — a universal, compulsory public education system that was imposed 14 years ago on the whole country. Since 1917 the government has shown a desire to become the ruler of education, and this tendency has escalated since Luis Echeverria's presidency.

About 96 percent of the primary schools belong to the state while only 4 percent remain private. In the past, most of the education was private and many schools were run by the clergy, which is not strange considering that 92 percent of Mexicans are Catholics. The monopoly of education which some bureaucrats would like to impose is the fundamental basis of socialist plans for Mexico. To force Marxist-Leninist ideas on the minds of children and adolescents has been the main purpose of the so-called "Sole Education System."

Official textbooks have been created and imposed in almost all schools. The Mexican Bar Association says that this imposition is illegal, anticonstitutional, and against the cultural interests of the

Mexican people. According to Article 26 of the United Nations Charter of Human Rights, the imposition of a single system and of a single and obligatory textbook is a violation of the right to free and good education.

The government's educational program is divided into five sections: Mathematics, Spanish, English, Natural Science, and Social Sciences. For each there is a single textbook which covers the totality of this discipline. For example, the natural sciences book includes physics, chemistry, biology, and physical geography. Because so many subjects have been compressed into a single book, and because students do not have the opportunity to study authors other than those imposed by the government, there has been a great impoverishment of education. Special training is being given to teachers for the appropriate use of the textbooks, but the books are so poor that not even their embedded socialist ideas have much impact.

A recent study by Jorge Carpizo, Dean of the Universidad Nacional Autonoma de Mexico (National University of Mexico) demonstrated the results of the "sole educational plan" on the current generation. He stated that students from public schools (that is the great majority) lack the necessary academic skills to enter the university. Carpizo made an emergency appeal to the nation, asking that this educational problem receive immediate attention, stating that if things continue as they are the consequences will be catastrophic. This declaration provoked generalized uneasiness, and parents and students feel defrauded by the public education system.

Students from private schools are also required to use these books but continue the old system of a plurality of sources with satisfactory results. Getting teachers is becoming difficult, since the government efforts to seize private training schools for teachers has almost eliminated them. Individuals interested in teaching will soon be forced to study in government training schools. Legislation aimed at eliminating the 4 percent of private schools left has been stopped in court by civic associations, especially the Union de Padres de Familia (Union of Parents). We reproduce some sentences from one of the official textbooks so the reader will have an idea of their content:

Explaining capitalism to children:

The owner of the means of production is known as a capitalist or bourgeois. The capitalists, in order to produce, hire other men

called workers or proletarians, who sell their work potential for a salary.

The capitalists join together to form monopolies to fix prices and obtain larger profits.

Riches are in the hands of a privileged few — the capitalists bourgeois.

Unemployment is advantageous to the capitalist as it lowers the cost of labor.

Explaining socialism:

Production is controlled by the State for social benefit.

The State controls commerce. There is no commercial competition as the state determines the price of all products.

Science and technology are used for public benefit under state direction.

The state permits religious freedom.

All the areas of study transmit similar ideas, many times giving only half-truths or giving facts out of context.

HOW IS THE BATTLE BEING FOUGHT?

In Mexico, the desire for change is pervasive. In response to the serious and difficult crisis which confronts the country, many who were passive have become combative. Mexican reaction has been different from that in other countries, reflecting its distinct personality and unique problem-solving approach.

Writers and Their Effect. During the past 14 years, books, magazines, and newspaper articles have been changing public opinion. The writers have been committed and courageous, particularly in view of the risk involved in opposing government policies in any dictatorship, including a one-party dictatorship as in the case of Mexico. These publications serve all levels of society, so that the

blue-collar worker, the housewife, the professional, and the intellectual all have access to new information and unorthodox opinions.

Weekly and monthly magazines are taking part in the ideological war. Intellectuals versed in classic liberalism write in some of these publications, communicating important ideas and criticism. *Impacto* (a review for a wide range of right-wing opinion) was unfortunately seized recently by a minority shareholder with government help. *Vision, Proceso, Siempre, Accion, Vuelta, Tiempo, Negobancos*, and *Diario de Diarios*, among many others, have helped to awaken the country's conscience. Not all these publications favor a free market system. In fact, some are frankly socialist. However, all influence public opinion and expose inconsistencies and contradictions in government policies and in the behavior of public officials.

Exposés by courageous former government insiders have had an especially important impact. Books such as *Lo Negro del Negro Durazo* (The Black Record of Durazo),²⁷ written by one of his former aides, and *A Calzon Quitado* (With All Sincerity) by Irma Serrano bring to light the crimes, repressions, and dishonesty of highly-placed officials. Sensationalism rather than true interest in politics has attracted some of these open critics of the status quo. However, their iconoclasm has fostered a loss of confidence in the government which is reflected in ballots and in public commentaries.

Not long ago *Excelsior*, one of the country's leading newspapers, published the results of a poll in which people were asked whether they believed government statements that the country is overcoming the financial crises; 88 percent answered negatively. Another question asked was whether the next elections would be fair and the results respected; 55 percent answered no.²⁸

On a different intellectual level, publication of novels such as those of Luis Spota, which describe the Mexican reality in fictional terms, are increasingly widely read. Among them are *Los Dias Contados* (Numbered Days), *Paraiso 25* (Paradise 25), *Dias de Poder* (Days of Power), and *Lo de Antes* (Former Times). Books such as *La Ultima Llamada* (The Last Call) by Mauricio Gonzalez de la Garza; *Mexico Negro* (The Dark Side of Mexico), and *Que la Nacion*

²⁷Editor's note: Durazo was the former Chief of Police of Mexico City.

²⁸Editor's note: This poll was taken prior to the 1988 elections. This chapter was also written before that time.

me lo Demande (Let the Nation Ask Me) by Carlos Loret de Mola; *Exaltacion de Ineptitudes* (The Glorification of Ineptitudes) by Rafael Ruiz Harrell; *Ya con Esta me Despido* (With This I Say Farewell) by Roberto Blanco Moheno; *Los Presidentes* (The Presidents) by Julio Scherer Garcia; *Mexico en Crisis* (Mexico in Crisis) by Armando Ayala Anguiano; and *Mexico Operacion S.O.S.* (Mexico Operation S.O.S.) are examples of the many books which are influencing public opinion.²⁹

Intellectuals, including the internationally known Octavio Paz, are openly critical. Books by Paz such as *Tiempo Nublado* (Stormy Weather), *Posdata* (Postscript), and *El Ogro Filantropico* (The Philanthropic Ogre) analyze Mexico's problems as well as those of Latin America in general. Enrique Krautze has recently published *Por una Democracia sin Adjeticos* (For a Democracy Without Qualifications), in which he examines the country from many perspectives. Edgar Mason in *Crisis y Super Crisis* (Crisis and Super Crisis) exposes present economic conditions. Gabriel Zaid, Jorge Castaneda, Alfredo Farrugia Reed, and Nilda Morell are thinkers who influence public opinion. Their activity is not solely limited to writing. Some take part in television programs, roundtable discussions, and debates on Mexican and world problems.

Television and Theater. A critical spirit is evident also in television and theater productions, especially the theater, which is less subject to censorship. Many comedies have been staged which satirize the government; sometimes the audience has been astonished. Lately, television programs have called for a change of attitude and greater civic participation. Criticism of government and bureaucratic shortcomings, though basically political, is presented comically in order to avoid censorship.

Civic Associations. In the past few years numerous civic associations have emerged, due both to an increasing awareness of Mexico's problems and to a sense of moral responsibility in the face of terrible nationwide corruption. Groups of concerned citizens comprise several million individuals, all struggling to rescue the country. Since 1982 many different groups have been created for the

²⁹Editor's note: Throughout Latin America, novelists have focused on social problems. In the past many of the great novelists were leftists. That appears to be changing as more novelists become critical of government. Stephen Schwartz addresses the issue in the chapter on "Literature and Freedom in Latin America" in this volume.

same purpose: to defend freedom and individual rights. Most groups work independently, though a strong social network is being created.

During the earthquake of 1985 the Mexican public demonstrated its capacity for spontaneous volunteer action in the face of catastrophe. Something similar is happening in the country's culture. People from all sectors are joining to fight for the preservation of the fundamental principles of democracy, the right to free education, to private property, to free trade, to fair elections, to honesty in government.

Some groups are working in the field of ethics; some are struggling against drug addiction and alcoholism. Some groups are giving economic help and technological advice to the rural population. Others are working in the religious field through the Catholic church, which is also facing the penetration of socialism among its own members. There is deep interest in preserving the family through traditional moral values. We believe that a country with strong family ties is not easy prey.

Among the most important of these groups is the Union de Padres de Familia (Union of Parents) which, since 1917, has been monitoring government activities in the educational field. Its function is very important in the ideological war and its position on liberty is unequivocal. It has achieved much in preventing harmful educational reforms and in lessening the pro-socialist message of the government's obligatory textbooks. The Union of Parents now has more than one million members and its voice is heard even though it faces an uphill struggle.

It would be impossible to mention all the groups, but one must be singled out because of its outstanding organization: the 60,000 member Asociacion Nacional Civica Femenina (National Feminine Civic Association), whose influence in Mexico is important because of the moral stature of its members and the courage and forcefulness with which it defends human rights and ethical principles. Some of its members have entered politics and are active participants in the Chamber of Deputies.³⁰ There is also the Asociacion de Madres por Mexico (Mothers Working for Mexico), whose work is essentially ethical with neither political or religious influence. It enjoys prestige and respect for its main task, which is to educate individuals in firm

³⁰Editor's note: Comparable to the U.S. House of Representatives.

moral principles and knowledge of the personal value of liberty. Civilizacion y Libertad, Pro-Mexico, Pro-Vida, Dhial, the Junior League, the Rotary Clubs, Gente Nueva, the Movimiento Familiar Cristiano, Guias de Mexico, Accion Catolica, Opus Dei, and many other groups are fighting the good fight for ethics and liberty.

The response of young libertarians and their anxiety for the country is moving and inspiring. A youth assembly organized at the Universidad Intercontinental last autumn brought together ten thousand enthusiastic young people who rallied to the slogan "The Twenty-first Century is Ours."

The convention rooms and auditoriums of hotels, clubs, and institutions are continually occupied by civic associations discussing and analyzing the present crisis. This phenomenon is new in Mexico and its existence indicates the country's widespread desire for change.

The Economic Defense. Something similar is happening in the economic world. The public is becoming interested in subjects which previously had no appeal. The defense of economic liberty began in the 1940s, when intellectuals were obliged to face the crisis created by the Lazaro Cardenas government's erroneous policies. At that time Luis Montes de Oca, Agustin Navarro Vazquez, Gustavo Velasco, Salvador de Madariaga, Guillermo Guajardo Davis, Gustavo de Anda, and other libertarians began the economic battle. They introduced ideas from the Austrian School of Economics. They founded newspapers and magazines, invited foreign speakers, and contributed to policies which resulted in four decades of continued development and growth for the country.

Although these ideas were not widely disseminated, they produced a harvest of intellectuals. These individuals now head well-run organizations and carry out economic research using modern methodology. Others are editors, teachers, financial counselors, and headmasters, and some have gone into politics. They are not very numerous but their influence is beginning to be felt.

The Instituto de la Integracion Iberoamericana (Institute for the Integration of Latin America) has been in existence for more than fifteen years. It offers courses and edits studies on economic policy, trains speakers, distributes books, and organizes seminars with local and foreign personalities. Its teachers take part in television debates and some have radio programs. Thanks to its efforts, professors,

media writers and commentators, and a body of young people now appreciate the market process.

Many books published by the Institute have become best-sellers. For example, the works of Luis Pazos have sold more than 1.5 million copies. Some of these, such as *Donde Vivir Mejor* (Where The Living is Best), *Como Salir de tu Crisis* (How to Solve Your Crisis), and *El Rey Populachero* (The Common Man King) are illustrated volumes which simplify complex ideas, making them intelligible to all. Others like *Respuesta al Plan de Miguel de La Madrid* (Answer to Miguel de La Madrid's Plan), *Mitos y Realidades del Petroleo Mexicano* (Myth and Realities of Mexican Oil), *La Nacionalizacion de la Banca* (The Nationalization of the Banks), and *Democracia a la Mexicana* (Mexican-Style Democracy) analyze government policies and propose appropriate changes. Several of them, such as *Ciencia y Teoria Economica* (Science and Economic Theory) and *Marxismo Basico* (Basic Marxism), are used by teachers as textbooks.

The Centro de Estudios en Economia y Educacion (Center for Studies in Economics and Education), founded by Rolando Espinosa in 1982 in Monterrey and later in Mexico City, has worked very successfully in the field of economic journalism. Espinosa has assembled a large group of economic commentators who meet periodically to listen to respected intellectuals, scholars, or book reviewers. His institute also publishes research materials and gives young students scholarships and instruction in economic theory.

The Centro de Investigaciones Sobre la Libre Empresa (Free Enterprise Research Center) is another relatively new institution founded by Luis Pazos in 1983. Its main task is to promote highly qualified intellectuals and to publish their work. The Ludwig von Mises Award, founded by Carolina Bolivar in 1983, is one of the institute's projects. It was created to encourage intellectuals to study in depth the works of prominent libertarian thinkers. Participants in this annual contest enter essays on the subject, the best of which are published.

Economics in One Lesson by Henry Hazlitt was the theme for one of the contests. This book, until then practically unknown in Mexico, sold more than 4,000 copies in one year and was adopted as a textbook by some universities. *Law, Legislation and Liberty* by Friedrich Hayek was the 1987 theme. People from nearly all the Latin American countries participate. More than 400 have taken part in the

contest and so far 80 have demonstrated superior intellect — the type required for closing the ideological gap which persists in Mexico and Latin America.

Private educational institutions such as the IPADE, Instituto Panamericano en Alta Direccion de Empresas; the Universidad Panamericana; the Instituto Tecnologico de Monterrey; and the ITAM, Instituto Tecnologico Autonomo de Mexico, have adopted a definite pro-liberty posture, which is having considerable influence in the country.

There is much to be done in the world of ideas. Paradoxically, the institutions that defend economic liberty have virtually no resources. Entrepreneurs and certain institutions which could and should provide funding have yet to understand the importance of ideas. Donations are occasional and sparse.

By contrast, the CIDE, Centro de Investigaciones y Docencia Economica (Center for Economic Education and Research), which publishes books opposed to the free market, has an annual budget of one hundred million pesos.³¹ State universities and socialist publications receive large subsidies.

Importing, editing, and marketing books is fundamental in the war of ideas. Each book fosters liberty. Many private universities wish to include libertarian literature in their programs and libraries but are unable to do so either because the volumes are unavailable or because there are no Spanish translations.

CONCLUSION

There is hope for Mexico and for the world. Throughout history evil has had its victories. It has prevailed at certain times but it has never won a total war against right and truth. In the past the effort, tenacity, fortitude, and faith of certain individuals restored to their countries liberties which had been lost. There is no reason why our destiny should be any different.

The outcome of the war of ideas, the victory or defeat of liberty, will depend on each of us, on our faith and our convictions.

³¹Editor's note: About \$42,000.

We must realize that we are running out of time, that the efforts made in peacetime are insufficient in times of crisis. No one country, however powerful, can win the war alone. The international efforts of organizations and individuals will have to be combined, with each contributing as much as possible.

The struggle for liberty and human rights makes no distinction between cultures, peoples, religions, languages, economic strata, or technological advances. Liberty has the same meaning in all countries and at all times, for it is a universal principle. Liberty's conservation has the same importance for the American as for the Russian or the Frenchman, for the Nicaraguan or the Cuban. Some of these people have already lost it. There is no guarantee that we are not next on the list.

Where liberty has been lost it was through apathy, incredulity, lack of perception. Or it was because people who believed in liberty underestimated the enemy, or thought that other nations would come to the rescue. Many who aided the enemies of liberty believed that socialism offered an improvement over democracy and free market economy.

We Latin Americans, who should have strengthened our economies, have preferred feudalism, protectionism, and central planning to industrialization, free competition, and autonomy. We have blamed others for the sorry condition, poverty, and suffering of our countries, instead of admitting that we are solely responsible for this state of affairs.

So far, we have failed in the defense of our liberties, and have spent little time taking part in the public administration of our countries. We have allowed governmental castes to perceive themselves as our unquestioned masters. We have become complacent and docile. We have abandoned our countries to the domination of the enemy and the incompetent. We have no right, therefore, to blame others, or to be astonished at the present situation.

You Americans, as you proudly call yourselves, need to be reminded that America is an old continent and you are the latest arrivals. We Latin Americans witnessed your arrival from Europe a scant few centuries ago. We watched as you built your beautiful skyscrapers while our own splendid pyramids and lovely temples had long since been devoured by the jungle. When you began a new civilization, we were already living the second phase of our history.

The integration of ancient and elaborate civilizations, pre-Columbian and Hispanic, was taking place in Peru, Ecuador, Central America, and Mexico. Other countries were welcoming pioneers from Spain and Portugal who were to enlarge the Spanish Empire.

Many North Americans look upon us as distant neighbors, although we are the nearest. Few North Americans learn Spanish, not realizing that our language is the key to Latin America. This key unlocks a very rich world — rich not in the material sense but in the far more important spiritual sense. Few have shown interest in our music or understood the singing of our souls. Few know our novelists and our poets, the voices of our intellect and our deepest emotions. Few have bothered to study our history, which is the story of our lives, the explanation of what we are. Many Europeans, however, have seen and found in our cultures what the majority of North Americans have not. No wonder you feel so distant, no wonder your Latin American policies so often fail.

We have also failed in allowing others to classify our countries as “underdeveloped.” Underdeveloped in what way? Because our material wealth is not as great as yours, because our services are not up to your standards, our sciences and technology less advanced? Are these the parameters by which countries are to be assessed? Is a man to be evaluated by the car, the house, or the clothes he owns? Or by his human qualities, by his virtues, his habits, his values?

Latin America has its own cultures, which are certainly dissimilar to those of North America. They are by no means inferior, merely different. These cultures must be respected and admired by you, not despised as has too often been the case. We have been remiss in not expressing warmly enough our gratitude for American generosity in difficult times. We also have been remiss in not sooner calling a halt to irresponsible government borrowing which has brought our countries to the brink of disaster. We feel that in this matter the responsibility is mutual.

In spite of our differences we have a common goal: liberty. The libertarian war is a war for justice, honesty, honor, fairness, integrity, and the sovereign rights of peoples. It is a war of peace. We must join forces to prevent other nations of our hemisphere from following in the footsteps of Cuba and Nicaragua, and to eradicate Soviet influence from these countries.

In order to close the information gap, the translation, editing and publication of libertarian literature must be a prime strategy in the war of ideas. We libertarians and classical liberals who are dedicating our lives to this struggle will exit this world knowing that we have done our duty. Our hope is that humanity will find our message compelling.

5

THE WAR OF IDEAS IN CHILE

EDITOR'S INTRODUCTION

Among Latin American countries, Chile is an enigma. Although it experienced the longest period of democracy of any country in South America, from 1973 through 1989 it was ruled by a well-publicized military dictatorship which systematically suppressed political and civil liberties. Yet in the economic sphere, Chile has expanded freedom of choice and individual decision-making to a greater degree than virtually any other country in the world.

Chile thus raises a perplexing question with profound implications: Can any Latin American country create a society that guarantees *both* political freedom and economic freedom? All the contributors to this book agree that in the long run economic freedom is incompatible with political dictatorship. But now that Chile has liberalized political freedom and civil rights and held the first free and democratic election since 1973, the future of the Chilean economy is in serious doubt. Will the newly elected Christian Democrat president Patricio Aylwin be forced to reverse the pro-free enterprise economic reforms of General Augusto Pinochet's military government? Or will Chile follow the path of Southeast Asian countries and enter the 1990s with a solid foundation for sustained economic growth? It is worth noting that the new government's publicly announced intentions are to maintain the free enterprise reforms that the Pinochet government put in place.

That Chile has made enormous economic gains under military rule is undeniable:¹

- While most of its neighbors face triple-digit inflation, Chile's inflation rate is now 20 percent — well below the 1,000 percent inflation rate of the Allende years.
- While most of its neighbors' economies are stagnating, since the 1982-83 recession Chile has averaged a 5 percent annual real rate of economic growth.
- While most of its neighbors face heavier and less manageable international debts, Chile has reduced its external debt from 115 percent of GNP in 1986 to 83 percent today.
- While Chile's neighbors experience growing internal government debts, Chile now has a budget surplus.
- While Chile's neighbors practice flagrant protectionism, Chile has a uniform, across-the-board 15 percent tariff — making it the freest trading nation in all of Latin America.
- While other Latin American countries see private investment as a tempting source of tax revenue, in Chile the income tax rate on domestic investment first was reduced to a rate of 10 percent, and now has been completely eliminated.
- While most other Latin American countries moan about sagging exports, Chile's trade liberalization has led to a surge that has increased exports at a rate of 22 percent per year for the last three years.
- While job creation is sluggish almost everywhere in Latin America, in the past two years Chile has created 543,000 new jobs — twice the number created in the U.S. on a per capita basis.

¹See Everett G. Martin, "Chile at the Crossroads: A Hot Economy Once Again," *Wall Street Journal*, December 29, 1987; Daniel Gressel, "Chile at an Economic Crossroads," *Wall Street Journal*, March 10, 1989; and "Going to Market", *Wall Street Journal*, December 19, 1989.

By far the most important aspect of the Chilean economic success story is its program of privatization. Chile's privatization efforts rival those of Britain, and outside of Britain there is probably no other government in the world that has announced its official intention of selling virtually every state-owned company to the private sector.

The privatization of the Chilean economy began in 1974 with the return to their owners of 202 companies expropriated by the Allende government. Between 1975 and 1976, the government sold most of its bank stock, and by 1983 it owned stock in only one bank. Overall, the number of state-owned companies was reduced from 620 in 1973 to 76 in 1981.

Following the recession of the early 1980s, the privatization effort regained momentum. Since 1985, ten major companies have been wholly privatized, including the steel company, the sodium nitrate company, the two most important power supply companies, the computer company, the telex company, and the explosive materials company. The total or partial privatization of 15 other major companies including the telephone company and the national electricity company is also underway. Overall, it is estimated that 100,000 Chileans who never before owned stock now own shares in privatized companies.

Chilean privatization also has achieved other important goals:

- More than 400,000 housing units (about 18 percent of the total houses in the country) have been transferred to their tenants.
- About 150,000 titles to farms (representing about 47 percent of the total farmland of the country) have been transferred to small farmers.

By far the most interesting privatization is that of the Chilean social security system. Chile was the first nation in the Western Hemisphere to adopt a social security system, establishing its program in 1924. Chile also is the first nation in the world to dismantle a public social security system through sweeping privatization.²

²See John C. Goodman and Peter Ferrara, "Private Alternatives to Social Security in Other Countries," NCPA Policy Report No. 131, National Center for Policy Analysis, April 1988, pp. 22-31.

Workers previously participating in social security were given the option of choosing between the private and the public system. All new workers entering the labor market are required to be in the private system. Under the new system, workers make deposits to the Chilean equivalent of an IRA account as an alternative participation in social security. The program has been enormously popular, and 90 percent of all Chilean workers now participate in the private system.

Under the private system, participants are required to make a monthly tax-deductible contribution equal to 10 percent of wages to an individual pension savings account. Participants can voluntarily make additional tax-deductible contributions equal to another 10 percent of wages. Workers are also required to contribute 3.5 percent of wages to buy life and disability insurance from approved private insurance companies of their choice. In addition, they are required to contribute 6 percent of wages for health insurance coverage.

The government has authorized 12 private investment companies to administer and invest the individual private pension funds. Workers are required to place their accounts with one of these 12 companies, although they can switch to another company on short notice. The system has a uniform retirement age of 65 for men and 60 for women. At that point, workers can either purchase an annuity from an insurance company to finance their retirement benefits or keep their accounts with the investment company and make periodic withdrawals.

In the following chapter, Arturo Fontaine and his colleagues compare the Chilean economic miracle with the privatization revolution taking place in Britain under the leadership of Margaret Thatcher. As the authors make clear, economic liberalization does not have widespread popular support. In both countries a strong leader is, in effect, dragging an unwilling populace kicking and screaming into the post-Industrial Age.

There is an important difference between the two countries, however. In Britain, Margaret Thatcher clearly has taken the intellectual high ground. In Britain, the case for the free market is broadly understood, though not all agree with it. In Chile, by contrast, the intellectual battle has not been won. The Pinochet regime has made little effort to market its programs and policies, apparently assuming that the economic benefits of these policies are argument enough. Patricio Aylwin says he wants to continue the economic programs

begun under Pinochet, but his understanding of the programs and his commitment to them remain to be seen.

DEMOCRACY AND DICTATORSHIP IN CHILE

Arturo T. Fontaine

Harold Beyer

Eduardo Novoa

The recent liberalizing reforms of the Chilean economy have their own Achilles' heel: they were imposed by force. However, it is impossible to understand the Chilean economic liberalization without placing it in a historical context. Chile's democracy was one of the oldest and most respected in the world. But it collapsed in 1973 amidst a weakening, and then a virtual extinction, of classical liberal ideas and of faith in democratic institutions. Marxism had grown and spread since the 1930s, emanating from the intellectual centers and from the leadership of trade unions, corroding the value of "bourgeois democracy."

THE CHILEAN WAY TO SOCIALISM

The 1918 fall in the price of sodium nitrate, then Chile's main export, followed by the 1929 Great Depression, precipitated two "crises of identity" which undermined Chilean confidence in classical liberal views. Those who believed in free markets were left without intellectual leadership and were put in the role of reacting to initiatives proposed by those who favored greater government intervention in the economy.

From the 1930s to the 1950s, the country was governed by social democrats, mainly of the Radical Party. An extensive welfare state developed with substantial economic regulation and intervention by the government. Because of protectionist tariffs and the small size of the domestic market, industry became monopolistic. By the early 1960s, disillusion with government was widespread, and economic development disappointing.

During those years, a shift in thinking among "liberals," mainly represented in Chile by the Christian Democratic Party,

resulted in a greater tolerance for the positions of the Marxist-Leninist-oriented left. The shift to the left did not reflect an increase in the number of Marxist party members, but rather a rapprochement with those who promoted communitarian socialism and “noncapitalistic” development. In the 1958 presidential elections the Unidad Popular Marxist coalition led by Salvador Allende received only 43.9 percent of the votes. They received 38.7 percent in 1964, dropping to 36.3 percent in 1970. The 36.3 percent plurality, however, was sufficient to win and Allende’s 1970 election was verified in the Chilean Senate and Chamber of Deputies by a left-wing coalition. Over the next few years, this congressional support eroded as anti-Allende electoral sentiment grew. Demonstrations, civil disruptions, and labor strikes were evidence of this discontent. The Christian Democrats and the conservatives became allies as they began to perceive the totalitarian character of Salvador Allende’s regime.

Allende’s program included the creation of “Areas of Social Ownership,” which included nationalizing “key sector” companies, and strengthening the Agrarian Reform Process.³ The concept of “social area” was ambiguous. The government never made clear what areas were to be nationalized even to its own party followers, who kept pressing for nationalization of smaller economic units. Thus Allende’s government did not even spare farms having 40 or fewer hectares.⁴ The most publicized means of increasing the “social area” was violent occupation by workers supported by the government’s regulatory institutions.

On August 22, 1973, after the totalitarian nature of the Allende regime had become apparent, Congress passed a resolution stating that the government had violated the Constitution:

“It is a fact that the present government, from the beginning, has attempted to seize total power, with the evident purpose of subjecting everyone to the

³The Unidad Popular program, published on December 17, 1969, specifically incorporated a number of sectors into the “Area of Social Ownership,” but its boundaries were not clear. One of the points of this program reads as follows: “In general, those activities conditioning the economic and social development of the country, such as production and distribution of electric power; air, water, and railway transportation; communications, oil production, refining, and distribution, including liquified gas; siderurgy, petrochemistry and heavy chemistry, cellulose and paper.”

⁴Editor’s note: A hectare is 2.47 acres.

most rigorous economic and political controls and of achieving by this means the installation of a totalitarian absolutely opposed to the system of representative democracy that the constitution upholds.”⁵

The Chamber of Deputies called on “...the armed forces and Carabineros⁶ ...[to] participate in the government ... in order to reestablish the rule of constitution and law... in order to guarantee stability, civil peace, security, and development.”⁷ This political backing made the military coup possible.

THE CRISIS OF ALLENDE’S SOCIALISM

How did this crisis come about? What methods did the Allende government use to acquire and consolidate power? Although there were strong tactical differences within the Unidad Popular and there was no comprehensive coherent strategy, it is possible to identify at least some key government goals. The strategies used to achieve these goals were increasingly perceived as totalitarian.

First, there were the labor unions.⁸ Through persistent effort, the Communist Party had succeeded in controlling the major Chilean trade unions and with them the Central Unica de Trabajadores (Labor Union Federation), or CUT, whose goal was to unite all Chilean workers into a single bargaining unit. With Marx’s ideas in its declaration of principles, CUT sought a monopoly of Chile’s labor unions. For that purpose, it was aided by Chilean labor law, which made union membership and payment of union dues compulsory. The CUT was so powerful that, because of its pressure, government-controlled companies increased from 282 to 526 in a single day.⁹

⁵Robert Moss, *Chile's Marxist Government* (Newton Abbott [England]: David & Charles, 1973), p. 197.

⁶Editor’s note: National Police.

⁷*El Mercurio* (International Edition), August 23, 1973, pp. 6-12.

⁸See Andres Benavente, “Partido Comunista y Sindicalismo Politizado,” in *Revista del Centro de Estudios Publicos*, No. 20, 1985.

⁹See Francisco Orrego Vicuña, ed., *Chile: the Balanced View*, University of Chile, Institute of International Studies.

Second, the Government significantly increased its control of the media. This was accomplished both through illegal occupations and through government control of newsprint and advertising. With a smaller private sector and a policy of placing public sector advertising decisions in the hands of the government or of its supporters, nongovernmental press, radio and television were gradually stifled. Eventually the government gained direct control over two of the four television channels, 68 radio stations, 10 important newspapers and 27 magazines. The above corresponds to the idea stated in 1970 by the Communist Party deputy and CUT president, Luis Figueroa: "Only a society where the mass media are 'socially owned' may guarantee an authentic freedom of speech."¹⁰

Third, the government exerted progressive control over the business sector and moved toward a government monopoly of the means of production. Through illegal occupations, violent occupations, expropriations, and other means, the government extended its control over private enterprises. It is estimated that by October 1972 the government controlled 90 percent of the mining production, 85 percent of all banks, 60 percent of large-scale trade, 52 percent of manufacturing, 84 percent of construction, and 75 percent of the cultivated agricultural land.¹¹ It is not an exaggeration to say that almost all of the country's private sector felt in danger of expropriation by Salvador Allende's government.

In March 1972, Sergio Ramos, a member of the Communist Party Technical Committee, said: "Chile's transition to socialism shall necessarily pass through, and be inaugurated by, the dictatorship of the proletariat ... The Leninist need to destroy the bourgeoisie's state apparatus in order to create a new one ... is as valid in today's Chile as it was in 1917 Russia to build up the socialist society."¹² Whether or not such a statement represented the personal intentions of many of the leaders of Unidad Popular, the fact is that a large part of the country viewed issues in these terms and the people were either in favor of these goals or against them. It is true that President Allende often repeated his commitment to democracy; so did the other Marxist-Leninist leaders of both the Socialist Party and the Communist Party. But, in turn, President Allende declared that "the Soviet Union is Chile's older brother" and received a machine gun as a

¹⁰November 1970, Workshops of Social Responsibility to the Media.

¹¹See Robert Moss, *Chile's Marxist Government*, p. 197.

¹²"Chile, ¿una economía en transición?," ed. CESO.PLA.

personal gift from Fidel Castro, who visited Chile for about two months. The supporters of the government made frequent use of “revolutionary violence,” claiming that “bourgeois legal order” was in itself a form of “institutionalized violence.” At the same time, hundreds of young men and workers wearing helmets paraded along the streets, and armed brigades were organized within the political parties and elsewhere. Weapons of foreign origin were sometimes found in the possession of these groups.

These circumstances prompted the President of the Supreme Court of Justice to denounce “the illegal attitude of the administration . . . its open and continual rebellion against judicial order . . . which signifies a crisis of the rule of law and the imminent breakdown of the juridical structure of the country.”¹³ Likewise, the Chamber of Deputies stated in 1973 that “. . . the Government has not engaged in isolated violations of the Constitution and the law, but rather that this has become its permanent type of behavior.”

It is important to note that the economic stagnation brought about by the political and economic policies of the Unidad Popular was not apparent at first. Indeed, some economic indicators appeared favorable. In 1971, industrial production grew by 8.3 percent; agricultural production grew by 5.3 percent; and unemployment dropped to record lows. However, beginning in 1972, obvious signs of trouble appeared. Industrial production that year grew by only 1.4 percent, investment fell by 8.5 percent; real wages decreased by 9 percent, and the annual inflation rate reached 180 percent. By 1973, economic chaos prevailed. The annual rate of inflation reached 1,000 percent;¹⁴ the fiscal deficit grew to 25 percent of GDP; 88 percent of all internal credit was concentrated in the hands of the government; more than 30 percent of the workers were on strike; and price controls applied to more than 3,000 products.

By 1972 the severity of the crisis had led to widespread shortages which gave rise to a large-scale black market. The Juntas de Aprovechamiento y Precios, or JAPs (Price and Supplies Boards), were created to distribute basic consumer goods. The 1973 distribution of rationed food by more than 1,500 JAPs increased the level of

¹³See Francisco Orrego, “Chile: The Balanced View.”

¹⁴This figure is a widely accepted estimate; the official figure was 512 percent.

government control.¹⁵ The use of JAPs was not the result of economic ignorance or mismanagement. Concerning this point, the Secretary of Economy, Carlos Matus, stated, "If we consider it from a conventional economic approach, we are in a state of crisis. If, for example, the former government had been in our situation, that would have been the end of it. . . what is a crisis for some is a solution for us."¹⁶

The possibility of civil war was in the air. Opposition conservatives and liberals faced a critical juncture. Many felt uncertain about whether the 1976 elections would be honest. Such uncertainty was well grounded. Most people knew that they were living in a "revolutionary period." A major leader of the government coalition, the Secretary General of the Communist Party, had declared that if Allende's opponents won the elections the transfer of power to the opposition would have to be rethought since "the point is to carry on the process, to make it irreversible."¹⁷

On September 11, four military commanders, General Augusto Pinochet Ugarte, whom Allende had just appointed Commander in Chief of the Army; General Gustavo Leigh Guzman, the Air Force chief; Admiral Jose Toribio Merino Castro, the acting Navy commander; and General Ceasar Mendoza, the national policy chief, demanded that Allende resign. He refused, and went on nationwide radio urging workers to occupy factories and resist the coup.¹⁸ Allende was photographed at a window, a few hours after that broadcast, holding the machine gun presented to him by Fidel Castro.

The coup and the new government had considerable political support. Former President Frei, whose victory was virtually assured in the 1976 elections, supported the military government of September 11, 1973, headed by General Augusto Pinochet. The new Pinochet government was initially supported by both liberals and conservatives.

¹⁵See "The Political Economy of the Allende Regime," by Alec Nove, included in *Allende's Chile*, edited by Phillip O'Brien, University of Glasgow.

¹⁶Appearing in an interview given by Carlos Matus to *Der Spiegel's* correspondent.

¹⁷See Labarca, Eduardo: "Corvalan 27 Bhoras," Quimantu, 1972.

¹⁸Lester A. Sobel, *Chile & Allende*, (New York: Facts on File, Inc. 1974), p. 141.

THE POLICIES OF THE MILITARY GOVERNMENT

The first objective of the new government was the restoration of public order and the military defeat of the Marxists. For this purpose, it set up a legal framework granting itself wide powers and, under these powers, took severe repressive measures. These included thousands of arrests without formal charges, incarceration for indefinite periods, exile with a ban on reentry for about five thousand Chileans, restrictions on freedom of speech, and the prohibition of political parties and labor union organizations. The new government viewed a Marxist as a military enemy in wartime. The general opinion is that thousands suspected of having participated in—or possessing information about—revolutionary organizations were systematically tortured. Some 800 individuals “disappeared” after their arrests. It is impossible to understand the current Chilean political situation without considering the wounds these actions created.

The anticommunist character of the new regime and the chaos created by the socialist policies of Salvador Allende’s government led the military rulers to try a different economic strategy. They looked for “technicians” who could reshape the economy of the country and solidify their political-military power. The depth of the Chilean economic crisis and the slowness with which the new policies led to improvement contributed to a long-range “foundering spirit.”

As is well known, the key policy technicians of the military regime were conservatives trained at the economics and business administration departments of U.S. universities — Harvard, Columbia, and especially the University of Chicago. The nucleus came from the School of Economics and Business Administration of the Catholic University of Chile. Some had maintained ties with *El Mercurio* newspaper since the mid-1960s.

The military initially turned to Eduardo Frei’s former Secretary of Finance, Raul Saez, to direct government economic policies. Saez was soon replaced by Jorge Cauas, former Vice President of the Central Bank under Frei’s administration, who in March 1975 fully implemented a liberalization policy for the Chilean economy. Despite ups and downs, this is the policy General Pinochet’s government has maintained up to the present.

MACROECONOMIC POLICIES

The Pinochet reforms tended on the one hand to reestablish the country's macroeconomic stability and, on the other, to privatize its economy. The elimination of price controls in October 1973 was the first step in reestablishing macroeconomic stability.¹⁹

In 1975 the exchange rate was unified for the whole economy²⁰ and import tariffs were lowered and made more uniform to encourage international trade and trade diversification. This encouraged a substantial expansion of exports, especially agricultural produce. While exports grew at an average annual rate of 0.8 percent between 1963 and 1973, from 1973 to 1985 they grew at a 10.3 percent rate. This occurred despite the substantial fall of the terms of trade between 1970 and 1984, which on the average dropped 5 percent for Latin America, while decreasing 66 percent for Chile.²¹

Inflation was gradually reduced to an annual rate of 20 percent or lower. Historically, inflation in Chile had been about 25 percent since the 1940s. Although it had reached 1,000 percent in the last year of Salvador Allende's government, by 1986 it was 17.4 percent. The reduction in the rate of inflation was made easier because of the reduction in the government deficit, from 25 percent of GDP in 1973 to 2.1 percent of GDP in 1986.²²

Under the military government, the country underwent two severe economic recessions which raised unemployment to very high rates. From 1970 to 1973, unemployment had averaged 3.3 percent. It rose to 14.9 percent in 1975, gradually fell until 1980, then rose again in 1981 and reached 20 percent by 1983. Another 10 percent of the labor force worked in emergency or make-work programs. Moreover, between 1981 and 1985 the monthly family income in Santiago fell 37 percent. If to this we add a dramatic increase in the real interest rate — about 40 percent in 1981—the public riots which shook the nation during this period can be partially explained. In

¹⁹Price controls for 20 products were maintained for some time.

²⁰Editor's note: The practice of maintaining multiple exchange rates is common throughout Latin America.

²¹Source: ECLAC.

²²For a relationship between fiscal deficit and inflation, see Larroulet Cristian, "El Estado Empresario en Chile," *Estudios Públicos*, No. 14, 1984.

response, the government eased political restrictions, allowing more freedom for the press and the political parties.

Chile's external debt grew substantially under the military government, totaling more than \$19 billion by 1986. To lessen the debt burden, the Central Bank of Chile implemented a mechanism for purchasing external debt notes, provided that the product of such purchase was to be invested in the capitalization of companies. It was believed that this policy would decrease the external debt by \$2.5 billion by the end of 1987.

PRIVATIZATION

The privatization of the Chilean economy began in 1974 with the return to their owners of 202 companies expropriated during the Unidad Popular government. Between 1975 and 1976 the government sold most of its stock in the country's banks. By 1983 it held shares in only one bank. In addition, it implemented a general plan to increase the operating efficiency of the remaining public companies. The number of government-owned companies was reduced from 620 in 1973 to 76 in 1981.

Since the 1981-84 recession, the privatization of public sector companies has continued. Ten important companies have been wholly privatized. These include the steel company (CAP), the sodium nitrate company (SOQUIMICH), the two most important power supply companies in the country (CHILMETRO and CHILQUINTA), the computer company (ECOM), the telex company (TELEX CHILE), and the explosive materials company (ENAEX). The total or partial privatization of another 15 companies very important to the Chilean economy is underway.²³ The capital of the state-owned companies acquired by the private sector was distributed as follows: 40 percent was sold to the workers of the respective companies; 22 percent was sold in the stock exchange; 27 percent was bought by the Pension Fund Associations (AFP); and the remaining 11 percent was sold to other buyers. As many as 100,000 Chileans who had never before owned stock are shareholders today as a result of this privatizing effort.

²³The privatization of the Telephone Company and of the National Electricity Company are to be announced as this paper is being written.

In addition, wider distribution of property ownership has been promoted in other ways. More than 400,000 government-owned houses have been privatized, accounting for 18 percent of the total houses in the country. About 150,000 small farms have been privatized, accounting for 47 percent of the total farmland of the country. One-third of the newly privatized farmland consists of holdings which were expropriated by the governments of Eduardo Frei and Salvador Allende but were not distributed to the workers.

Private sector participation also has been important in the supply of goods and services for education, housing, and health. In the field of education, the government grants a subsidy (the equivalent of a voucher) to each student, who is free to move from one school to another. This practice assures freedom of choice and makes the system competitive. Private education is on the increase as well. In 1973, 21.5 percent of primary school children went to private schools. By 1986, this figure had risen to 35 percent. The trend for secondary school students is similar, with 43 percent attending private schools by 1986. This contrasts sharply with the Unidad Popular goal of creating an Escuela Nacional Unificada (National Unified School System) under the Ministry of Education — a project that was indefinitely postponed due to opposition spearheaded by the Catholic church.

In the health sector, a similar move toward privatization and competition is underway. In the past, people could use the government system which was of poor quality and offered few choices, or they could turn to the small, private medical marketplace. At present, about 15 percent of the population has opted out of government-provided health insurance and contributes to ISAPRE (Private Health Insurance Companies), where they are able to choose among various health plans.

Government subsidies are available for housing. Qualification for these subsidies is based on income, and the program permits people to choose among the different options offered by the private sector, including construction.

Perhaps the most significant social welfare program change has occurred in the social security system. Until 1981, benefits were largely unrelated to individual contributions. The social security system was actually many systems in which workers in separate sectors of the economy had separate retirement systems. For example,

there was a Caja Nacional de Empleados Publicios (National Fund for Public Officials), a Caja Nacional de Periodistas (National Fund for Journalists) and so on. The main features of the new system are: (1) Individual accounts whose value is directly dependent on one's own contributions (savings are compulsory). This mechanism links present efforts to future benefits. (2) Private administration of the accrued funds. (3) A competitive structure at the level of Social Security Institutions. (4) The worker's freedom to choose the AFP (Pension Fund Associations) with which they want to affiliate. In 1980, there were 2,226,000 people in the social security system. In only eight months, more than 1.5 million of workers moved to the private system.²⁴ By March 1987, the new system had 2.67 million contributors with 480,650 million pesos accrued in the retirement funds.

Taxation is, of course, a crucial issue for the growth of the private sector. In 1973, the tax system was extremely complicated, often treating people with similar incomes in very different ways. Taxes also fell heavily on high incomes. Tax reform simplified the system so that similar types of income are taxed at the same rate. Additionally, new tax brackets were established both for taxes on wages and for taxes on income received from different sources.²⁵

The last reform, which is still being implemented, will reduce the highest marginal tax rate to 50 percent from the 65 percent level that prevailed in March 1974. At the same time the minimum income which is tax-exempt has been raised to such an extent that 70 percent of the labor force pays no income tax. Retained company earnings also have lower tax rates so as not to discourage investment.

One of the most controversial government reforms drastically changed the framework of collective bargaining and the features of trade unions. Collective bargaining for entire sectors of the economy is prohibited, and is allowed only at the company level. On the other hand, there is a right to work law — workers may decide whether or not to affiliate with a trade union. The new policy also allows more than one union to represent employees of the same company. The law requires unions to elect their leaders by secret and

²⁴Movement into the new system was encouraged by reducing the tax burden for its members so that their salaries increased by 15 percent.

²⁵Editor's note: Internal investment was previously taxed at 10 percent. Now the tax rate is zero.

free ballots and to consult with members before forming federations or confederations, calling strikes, or imposing extraordinary dues. The compulsory unionization which applied to Chilean workers until 1973 has come to an end. The right to strike is limited; if workers do not return to work after a maximum of 60 days, they may be fired.

THE POLITICAL IMPORTANCE OF THE FREE MARKET EXPERIENCE IN CHILE

General Pinochet's steady privatization efforts over the years must be understood as a part of a political agenda adopted by the Chilean armed forces when they took power. That agenda is to lay the foundations of a social order which, unlike that of the 1950s or 1960s, cannot be taken over by Marxist organizations. Economic development, eradication of extreme poverty, establishment of free market and capitalistic institutions, and resulting social mobility are crucial to the success of this political agenda.

The military models for the government have been that of Franco in Spain and General Park in South Korea. Moreover, General Pinochet's authoritarianism, though foreign to the Chilean democratic tradition, belongs to a "caesarist" intellectual trend, which became popular in Chile as a result of the 1918 and 1929 crises. Some Chilean historians and essayists such as Alberto Edwards and Francisco Encina argued that the nineteenth-century Chilean democracy was basically "caesarist" and that the introduction of parliamentary checks and balances weakened the government by weakening the president. These concepts were also advanced by *Estanquero*, a magazine produced by Jorge Prat in the 1940s and were present in the presidential campaigns of General Carlos Ibanez and Jorge Alessandri in 1952, 1958, and 1970. At that time the Chilean political conservative movement, lacking a coherent economic theory, held onto the idea that a strong president (and — alas! — the right man) would solve the nation's problems. Even presidents Eduardo Frei and Salvador Allende blamed the Congress for the difficulties their governments faced, and urged reforms to strengthen the president's power. Chilean economic institutions needed dramatic reform based on a workable economic theory, yet the view that a democratic political system could not make such reforms gained wide currency.

The tacit or expressed popular support General Pinochet's government has had for many years is due less to his economic

policies than to the intellectual and political support for a “strong man” and the general discredit of political parties. Particularly for conservatives, the crisis of leadership preceded the military coup. The novelty in General Pinochet’s government was the merging of a strong executive with a free market system engineered by apolitical experts.

A 1980 constitution approved by plebiscite established presidential and congressional elections for 1989 and 1990, respectively.²⁶ But according to the constitution, in 1989 commanders-in-chief of the armed forces were to choose the candidate to be approved in a plebiscite. Should this candidate win, he would be the next president; should he be defeated, there would be a second, open, competitive election. In both cases, the parliament would be democratically elected. This mechanism was probably designed to facilitate the election of General Pinochet and to legitimize his government, once its fruits could be perceived by the people. The broad support of the government by conservatives must be understood in this context. In a country with a strong democratic tradition the validation of a de facto government by popular vote is of the utmost importance. However, Pinochet was defeated in the 1988 plebiscite and the election of a new president was scheduled for December 14, 1989.²⁷

Recent opinion polls do not show general public support for the economic liberalization that has occurred. For example, 55.5 percent of the people support price controls; 52.2 percent have a greater confidence in the old government’s social security system than in the new privatized system; and 38.2 percent believe that big companies should be owned by the government even though 48.3 percent think that the state-owned companies are less efficient. Apparently many people believe that the state control of companies is justified for political reasons, despite the economic consequences. Nevertheless, 66 percent of the people believe that foreign investment is advantageous for Chile; 59.8 percent prefer private over public education; and 66.1 percent favor allowing private television channels.²⁸

²⁶Editor’s note: This plebiscite, or ballot by citizens, approved the political constitution.

²⁷Editor’s note: This chapter was written before the election of Patricio Aylwin as president on December 14, 1989.

²⁸The current system prohibiting this, except for some universities, was established in the 1960s during the Christian Democratic Administration of Eduardo Frei.

The opinion polls also reveal that economic issues, unemployment and inflation in particular, have absolute priority over other issues. Further, the polls show an absence of political polarization, despite the fact that before the 1988 plebiscite 54.5 percent predicted that General Pinochet would continue in power beyond 1989. From these answers, it could be concluded that there is a leadership vacuum. Lack of leadership options probably accounts for dispersed opinions and a high percentage of “do not know” answers.

The popularity of economic policies is tied to concrete outcomes. Compared to developing nations around the world, the open economy in Chile has brought excellent results. But when Chile’s current economic situation is compared to its earlier status, the results are poor. For example, in 1987 per capita income was almost equal to that of 1970. This, along with the authoritarian and repressive style of the government, makes it difficult to market the free market. Nevertheless, the economic improvement of the last two years is being felt by the citizenry. The improved economic well-being has increased the prestige of the free market policies and cooled political temperatures while discouraging political extremism. Tranquility and great optimism pervade the domestic economic environment.

Notwithstanding the economic progress, what makes the institutions and policies of Chilean liberalization vulnerable is the absence of early popular support. Economists and their supporters, in closed-door meetings with General Pinochet and his advisors, and with no justification other than the approval of the conservative press,²⁹ determined the policies that were imposed by the military.

Unlike what transpired in Britain, conservative economic thought did not ripen through open intellectual debates before it was imposed. It was cultivated as a technical exercise, without values or connections to overall social concerns. Once in power, conservative economists relied on the force of the military and the political will of General Pinochet to enforce their policies. The government has privatized and liberalized almost without marketing or soliciting popular support. Chile is a case of an “enlightened dictatorship” at

²⁹Note the influential *El Mercurio*, the evening paper *La Segunda*, and the magazine *Economía y Sociedad*, edited by Jose Pinera, an influential former minister of the regime.

the close of the twentieth century. However, given the secular spirit of the times, the demands on "the prince" are different. Rather than a display of talent for sponsoring the best musicians and educators, today he must be able to choose the most suitable economists.

If free market supporters are rejected by popular vote and domestic policy trends are reversed, the chances of democratic capitalism in Latin America will be diminished and the link between capitalism and political dictatorship will be reasserted. However, the dismantling of the institutions of Chile's open economy will be more difficult than its opponents believe. They do not appreciate the social and economic depth of the transformation which has taken place in Chilean society in these fourteen years. For example, the infant mortality rate has declined dramatically and life expectancy has risen. As a consequence, the general death rate has declined. Decentralization has enabled different private institutions to grow, and interest groups depend upon them. The strength of the new system, if threatened, remains to be seen.

It is possible that if politicians who favor statism and government control take power, they will be compelled to make adjustments and reforms instead of radical changes.

Over the next three or four years of potential transition to democracy, the most important player in Chilean politics will be the armed forces. But at a deeper and more permanent level, the intellectuals and journalists may determine the destiny of Chilean society. Although the war of ideas will be hard-fought, there are clear indications that democratic capitalism has powerful appeal at the intellectual level and is beginning to permeate the rest of Chilean society as well.

6

THE WAR OF IDEAS IN ARGENTINA

EDITOR'S INTRODUCTION

There was a time, not long ago, when Latin Americans looked to the United States for ideas rather than foreign aid. The U.S. was held up as the model to be emulated — for its political institutions and its commitment to classical liberal values.

For example, one of the leaders of Argentina's early efforts to gain independence from Spain was Mariano Moreno, an ardent advocate of free speech and free trade and a strong opponent of the economic policies of mercantilism. Moreno was familiar with the writings of Rousseau, Adam Smith and Thomas Jefferson. On the proper role of government, he wrote "Reason and the famous Adam Smith ... who is undeniably the apostle of political economy, show that governments in laws directed to the general good, should limit themselves to the removal of obstacles."¹

As in the case of the United States, classical liberal ideas not only formed the rationale for wars of independence, these ideas also were the basis for the foundation of a new political order. For example, Argentina's 1853 constitution was virtually copied from

¹Ellen Garwood, *The Undying Flame: Mariano Moreno of Buenos Aires* (Washington, DC: American Studies Center, 1986), p. 84. The quote is taken from Moreno's famous belief in favor of free trade, *La Representacion de los Hacendados*.

the U.S. Constitution. Its author, Juan Bentiste Alberdi, had read the *Federalist Papers* and admired Thomas Jefferson and James Madison. As a result, Argentina's original political institutions were conducive to economic development, and by 1900 that nation's economic well-being was on a par with that of North America and Europe. For example:²

- Between 1853 and 1925, Argentina experienced the highest rate of foreign investment per capita and the second highest rate of economic growth in the world.
- By 1925, the real wage in Argentina exceeded that of Switzerland, Germany, France, Italy, and Spain, and its exports were on a par with those of Canada and Australia.

The intense economic progress that began in the early 1800s and brought Argentina such prosperity ended when the Peron government came to power in 1945. The change in political ideology caused an economic decline from which Argentina has never recovered. Just how quickly political instability and the erosion of capitalist institutions can undermine prosperity is illustrated by comparing Argentina with Australia.³

- Argentina was first settled by the Spanish in the sixteenth century, while Australia was settled by the British in the eighteenth century.
- In the early part of the twentieth century, Argentina was more developed than Australia and had a higher standard of living.
- Today, Australia has a per capita GNP four times that of Argentina.

Argentina now has a hopelessly regulated mercantilist economy. State-owned companies, often monopolies, are notoriously inefficient. About 353 enterprises are owned by the government. Entel, the state-owned telephone company, employs more people

²Ezequiel L. Gallo, "La Argentina del 80 al Centenario," paper delivered July 16, 1982, at the Instituto Popular de Conferencias de (La Prensa), Buenos Aires.

³Lawrence E. Harrison, *Under-Development is a State of Mind: The Case of Latin America* (Lanham, Maryland: Center for International Affairs, Harvard University and the University Press of America, 1985), p. 104.

than Nippon Telephone and Telegraph in Japan, although Argentina has one-third the population of Japan. Newspapers regularly print letters from people who have waited as long as 15 years to acquire a telephone from the government-monopoly telephone company and 20-year waits for phones are common. State-owned enterprises also lose money.⁴ The rail system loses \$3 million a day.

Virtually every industry is regulated and the regulations reflect a complex web of special interests. In fact, so Byzantine are the laws and regulations governing economic activity that it is doubtful the Argentina economy could function if the laws were always obeyed. Fortunately for consumers, they are not. As in the case of Peru, Mexico, and almost every other Latin American country, Argentina has a thriving informal economy — one that has flourished since the days of Perón.

Researchers at the Instituto de Estudios Contemporaneos (Institute for Contemporary Studies) estimate that 38.5 percent of Argentina's gross domestic product is now produced by the informal economy, and that more than half of Argentina's working population has its principal job in the informal economy.⁵

Argentina also is one of the countries in which the government actively manipulates exchange rate controls to influence foreign trade and domestic production, and as a source of revenue. These controls are so extreme, with buying and selling prices differing as much as 40 percent, that a huge black market in U.S. dollars has developed. Even though few Argentine citizens have investments in the United States, Argentina's Institute for Contemporary Studies estimates that the total value of U.S. dollars in Argentina is approximately equal to the total value of Argentine currency.⁶ Put another way, the typical Argentine is holding one dollar for every dollar's worth of australes.

Tariff protection is another area in which ingenious Argentines skirt onerous regulations. Under current law, importers are required to obtain permission before they import a product competitive with one produced domestically. Yet the paper work is so involved and the

⁴Richard Cooper, "Argentina at the Crossroads," *The Freeman*, December 1989, pp. 488-489.

⁵Monica Maturano, "The Informal Activity in Argentina," Buenos Aires, Instituto de Estudios Contemporaneos, 1987.

⁶*Ibid.*

process so costly that often importers do not bother. One readily available 84-page weekly lists thousands of items of illegally imported goods which may be ordered by telephone.⁷

Fortunately, an intellectual counterrevolution is underway. As Alberto Benegas Lynch, Jr., explains in the following chapter, its roots go back three decades, and it is now gaining momentum.

Much of the credit for counterrevolution belongs to the *Centro de Estudios sobre la Libertad*, CESL (Center for the Study of Liberty), the country's pioneer free market institute. A small group of Argentine libertarians seeking to explain and disseminate free market economic theories has provided funding, and the Center has hosted lecturers from all over the world.

The spread of classical liberal ideas has been further enhanced by other CESL endeavors. The center has published close to 50 books and issued 49 editions of a magazine which reaches 3,500 readers. CESL also has a scholarship program. Close to two dozen intellectuals have been sent to the United States to study under the leading economists of the Austrian School of economics.

The creation of many additional institutes in the last two decades is proof of CESL's influence and vision. Most free market think tanks were started or are staffed by people associated with CESL. In 1975 several CESL members created the *Escuela de Educacion Economica y Filosofia de la Libertad*, ESEDEC (School of Economic Education and the Philosophy of Liberty). Its president, retired Navy Admiral Carlos Sanchez Sanudo, is a founding member and director of CESL. ESEDEC organizes economic seminars and publishes books and transcriptions of conferences and lectures.

Similarly, in 1975 a group of CESL associates and other pro-free market individuals founded the *Circulo de la Libertad* (Freedom Circle). The organization holds monthly dinners with renowned libertarian speakers and attracts extensive media attention. The *Circulo* has ten branches and at least eight of its directors are members of CESL.

In 1975 Alberto Benegas Lynch, Jr. took a major step forward by starting a graduate School in Economics and Business

⁷Asman, "Liberation Argentine Style," *Wall Street Journal*, December 14, 1989.

Administration (ESEADE) in Buenos Aires. Benegas Lynch studied Austrian economics at New York University, spent some time at Guatemala's Francisco Marroquin University and is Argentina's leading free market intellectual. Although ESEADE is relatively young, it has had tremendous impact. Most of the leaders of the growing movement toward classical liberalism are graduates of the school.

In 1985 another institute was formed: the Instituto de Estudios Economicos y de Etica Social, or IEEES (Institute of Economics and Social Ethics). The principals of IEEES are Dr. Enrique Loncan of the Argentine National Academy of Economic Science, and Professor Luisa Zorraquin de Marcos; both received CESL scholarships.

The Instituto de Estudios Contemporaneos, or IDEC (Institute of Contemporary Studies), created in 1984, has had an impact as well. Unlike the other think tanks, which focus on educational activities, IDEC devotes its attention to the marketing of ideas. Directed by Marcos Victorica, it publishes research by intellectuals associated with other free market institutes. Dr. Eduardo Helguera, associated exclusively with IDEC, is renowned for his brilliant and well-documented articles, some of which have appeared in the *Wall Street Journal*. Trained in Buenos Aires and at the University of Colorado and Harvard, Dr. Helguera also received a scholarship from CESL.

IDEC's activities are not limited to economics. Its first major symposium and book analyzed the Argentine political system and the attitudes and ideas of voters, and received extensive media coverage. Its study of Argentine black markets calculated that three out of five Argentines work full-time or part-time for the informal sector and that half of all new investment stems from this sector. One of IDEC's most impressive feats was its international conference on privatization in 1987. Participants included Sir Alan Walters, former economic advisor to Margaret Thatcher, and Dr. Raymond Barre, ex-prime minister of France, as well as leading experts from Canada, Spain, and Italy.

Several additional centers are devoted to free market research. The Centro de Estudios Macroeconomicos de Argentina, CEMA (Argentine Center of Macroeconomic Studies) is a post-graduate school. Most of its faculty identify with the Chicago School of Economics. Its technical papers have been highly influential in

academic circles. Its director, Dr. Carlos Rodriguez, recently was elected to the National Academy of Economic Science, and Dr. Roque Fernandez, another CEMA economist, writes a column for *Mercado*, Argentina's most influential business publication.

The Instituto de la Economia Social de Mercado (Institute of Social-Market Economy) also promotes free market ideas. It is closely tied to Argentina's largest free market political party and the party's president, Congressman Alvaro C. Alsogaray, whose prolific pen, clarity of thought, and extensive knowledge have made him a veritable one-man free market think tank.

The influence of free market ideas on former left-leaning institutes is a good indicator of the success of the free market movement. For example, the change that has taken place in the philosophical outlook of the Instituto Torcuato Di Tella (ITDT) clearly demonstrates the force of classical liberal ideas. At one time the ITDT was monopolized by social democrats and Keynesians. Some bright young members of Alfonsín's administration are former ITDT researchers. In the last decade, however, a dozen of its most prominent members have adopted a more classical liberal outlook. Historians Roberto Cortes Conde and Ezequiel Gallo, social scientists Francis Korn, Manuel Mora y Araujo, and Oscar Cornblit are leading a transformation that perhaps one day will affect scholars in the institute's economics department. Already, their influence has changed the thinking of thousands of university students.

Although all of these institutes are located in Buenos Aires, where more than 40 percent of the Argentines live, the free market revolution is spreading. In the northern province of Tucumán, the Fundación del Tucumán follows the Chicago School tradition. Dr. Valeriano García, the founder of the foundation and former dean of Tucumán University, is now at the World Bank, advising other Latin American countries. Free market organizations also have developed in the important cities of Rosario and Mendoza.

While they share the same objective, the institutes have followed distinct paths, used diverse methods, reached different markets, and thus intensified the power of free market ideas. Some institutes are better at marketing. Others are better at research. Some are more scholarly than others. The competition results in better research, stronger articles, and greater impact. Op-ed articles produced by institute members appear in Argentine newspapers almost daily.

As in other countries, the proliferation of institutes also has increased the resources devoted to free market ideas, although funding for these activities is quite small. The total combined budget of all the institutes is approximately \$1 million — minute when compared to the hundreds of thousands of individuals who have been reached by the institutes' work.

An intellectual revolution is taking place in Argentina today, especially among the young, and is shifting public opinion toward classical liberal ideas.

REDISCOVERING FREEDOM IN ARGENTINA

Alberto Benegas Lynch, Jr.

The Argentina Constitution was basically copied from the U.S. Constitution. Juan Bautista Alberdi, principal author of the document, was very familiar with the works of Adam Smith, David Hume, Jean Baptiste Say, Benjamin Constant, and James Madison. Our constitution, approved in 1853, was adopted and its principles were enthusiastically adhered to until approximately 1920. Although it is still in force, our governments have not followed or even understood its philosophical foundations since the rise of populism in the twentieth century.

THE CLASSICAL LIBERAL PERIOD

The adoption of the constitution meant that government power was limited to the protection of individual rights. This policy made Argentina one of the most progressive countries in the world.⁸ At the beginning of the twentieth century, by most measures, Argentina ranked as one of the most advanced of civilized nations. For example,

⁸This fact is also recognized by many who do not share the classical liberal point of view, including professors Alejandro Bunge and Carlos Diaz Alejandro.

- In 1910 our currency was considered the third most stable in the world — after the U.S. dollar and the British pound — and the volume of our exports was greater than that of Canada or Australia.
- From 1880 to 1908 we enjoyed the third highest rate of industrial growth in the world.
- From 1892 to 1913 the wages and income in real terms of our rural and industrial workers were higher than those of Switzerland, France, Germany, Spain, or Italy.
- From 1880 to 1910 the annual growth in GNP averaged 6.6 percent.
- Foreign investment, principally British, grew at the rate of 25 percent per year and the domestic savings rate was 24 percent.

Before our constitution was adopted, we were importers of wheat, corn, and linseed; yet by 1908 we were the second largest exporter of wheat and corn and the largest linseed producer in the world. In 1909 we also ranked second in the world in the number of sheep and third in the number of cattle. From the adoption of our constitution to World War I, the total mileage of railroad tracks increased by a factor of 15, the amount of freight carried grew by a factor of 40, and we were second in the world (after the U.S.) in telephones per capita. The Argentine Industrial Association was set up in 1887 with 850 members from important industries such as metallurgy, textiles, sugar refining, and wine making. The high rate of economic growth induced huge migrations, and the population doubled every ten years. Between 1871 and 1914, for example, six million immigrants reached our shores.

Members of the French Academy who visited Argentina in 1910 compared our parliamentary sessions with the debates that took place in the Academy itself, in terms of the stature of our learned members of Congress. Our political leaders clearly understood classical liberal philosophy,⁹ and there can be no doubt that they saw Argentina as a nation in which the power of government was strictly limited to the protection of individual rights. For several decades

⁹Editor's note: The term "liberal" in Latin America usually refers to classical liberal, and that usage is adopted in this chapter.

their vision prevailed, and our people were free to pursue spiritual and material values without government interference.

This remarkable state of affairs led some to assume that freedom, and the resulting cultural and material progress, would be permanent. Many avoided academic and political affairs and limited their activities to business. Thus, the supporters of a free society began to neglect the study and expression of ideas.

THE RISE OF STATISM

The vacuum was filled slowly but steadily by Marxists, socialists, Keynesians, Marcusians and, later, by what we might call the CEPAL ideology — led principally by Raul Prebisch.¹⁰ In the 1930s some of these ideas appeared in the political arena, and in the mid-1940s changes that had begun in academia emerged with great force in the politics. From then on, supporters of statism, populism, and all forms of state interventionism became increasingly popular. Their collective force became a kind of avalanche which seemed impossible to stop. Under both civilian and military governments:

- Public expenditure began to rise, as did taxes.
- Major corporations were nationalized.
- As the rate of inflation rose, controls were imposed on prices, wages, interest rates, and exchange rates.
- A fascist system governed the organization of the trade unions.
- Pensions and medical insurance were nationalized and incorporated into the public sector.

¹⁰Editor's note: CEPAL (United Nations Economic Office for Latin America) propagated the view (developed principally by Argentine economist Raul Prebisch) that the gap between rich and poor countries would widen if prices were set in the international marketplace and that the gap can be narrowed only through active intervention (through tariffs, quotas, and exchange rate controls) by Third World governments.

- Legislation affecting foreign investment — based on a xenophobic nationalism—erected a virtual barrier against the entry of foreign capital.

These policies brought about drastic reductions in the national standard of living and led to periodic labor strikes and interruptions in the supply of basic services. Since money plays such an important role in the economy, it is perhaps useful to point out that in 1946 two pesos could buy one dollar in the free market. In 1987, a dollar still could be bought in the black market for two pesos. The only difference was that we had removed nine zeros from our currency. In other words, but for the change in the official accounting unit, a dollar today is worth two billion pesos.

THE REBIRTH OF LIBERAL PHILOSOPHY

Despite these dismal developments, since the beginning of the 1970s a renewed interest in classical liberal ideas has emerged in the academic world. Numerous scholars have influenced this development, but none have been as influential as the economists of the Austrian School. A great many of their works, principally those of Ludwig von Mises and Friedrich Hayek, have been translated into Spanish. Both men lectured several times in Buenos Aires. The writings of Milton Friedman also have exerted great influence. More recently, the publication of works on law and economics, property rights theory, and public choice have had a major impact in our intellectual world. The works of James Buchanan, who has visited us in Argentina, have been especially important. It also is important to mention that since Argentina is a largely Catholic country, Michael Novak's recently translated books and his lectures here have had a major impact. The teachings of these men and, to a lesser degree, works by local professors, have completely changed the nature of the debate in academic circles, particularly among young people.

Discussions today are substantially different from those which took place before the classical liberal ideas of this generation's efforts have been fruitful. A different vision for Argentina is emerging, one that contrasts sharply with the current political system. Privatization, for example, is a favorite political topic, although little is being done about it yet. Still, the new intellectual ferment has revised the language of politics and forced politicians to modify their announced agendas. If we persist in these educational efforts,

Argentina will once more return to the liberal path we never should have left.

A GRADUATE SCHOOL IN ECONOMICS AND BUSINESS ADMINISTRATION

My father (Alberto Benegas Lynch, Sr.) was the first Argentine of this era to attempt to revive classical liberalism. He invited Ludwig von Mises and Friedrich A. Hayek to Argentina for the first time, and he founded the Centro de Estudios sobre la Libertad (Center for the Study of Liberty), which produced the magazine *Ideas sobre la Libertad* (Ideas on Freedom). This institute was inspired by his close friend Leonard Read, then President of the Foundation for Economic Education at Irvington-on-Hudson, New York.

In 1977 I proposed to a group of distinguished Argentine businessmen a Graduate School in Economics and Business Administration based on the Austrian tradition. The project was adopted and a four-story building was bought for that purpose. The institute is based on the philosophy of limited government, free markets, and private property. It has an Advisory Council presided over by Nobel Laureate in Economics, F.A. Hayek, and consists of eight members from the National Academy of Economic Sciences, three from the National Academy of Law, and three from of the National Academy of Moral Sciences.

ESEADE (Graduate School in Economics and Business Administration) is a nonprofit private institution financed by 60 corporations, the Argentine Chamber of Commerce, the Buenos Aires Stock Exchange, and the Argentine Society of Agriculture. It is completely independent of government. This gives us the necessary freedom in program design, professional appointments, relationships with other educational institutions, research, and methodology. At present, ESEADE is developing the following seven academic programs:

1. **Master's Degree Program in Economics and Business Administration.** This program is devoted to university graduates from different disciplines and graduates of the military academies. It consists of four academic semesters and has 22 full professors and 27 associate professors.

2. **Undergraduate Program in Social Sciences.** This is a one-year program devoted to university students from different disciplines.
3. **Research Department.** The goal of this department is to train graduates in the social sciences and to support the other programs.
4. **Ph.D. Programs in Economics and Economic History.** These degrees are granted by the International College of the United States (California). The program was developed by two professors of ESEADE who act as tutors and members of the Thesis Examination Board.
5. **Short Seminars.** Open to the public, these seminars seek to further an understanding of the principles of a free society.
6. **Libertas.** This is a biannual, 250-page academic journal in which ESEADE publishes papers on economics, history, philosophy, and law.
7. **Video-Lectures.** Videotaped lectures are made available for use at academic institutions throughout the country.

Our graduates have become very influential as journalists, business leaders, professors, and economic consultants to political parties. Most of the leaders of the very important liberal student movement at the local university are from our graduate school. The revival of classical liberalism in Argentina today expresses itself through the extraordinary intellectual revolution taking place among the young — a revolution which has already produced a shift in public opinion.

OTHER FREE MARKET INSTITUTES

At various locations throughout Argentina, small but energetic institutes are also espousing the philosophy of freedom. The most important are the Fundacion del Tucuman (Tucuman Foundation), headed by Valeriano Garcia and Severo Caceres Cano in the Province of Tucuman; the Fundacion para el Orden Social de la Libertad

(Foundation for Liberty and Its Social Order), headed by Rogelio Ponton and Garardo Bongiovani in the Province of Santa Fe; the Centro Carlos Becker (Carlos Becker Center), headed by Francisco Navarro Vilches and Carlos Murgo in the Province of Mendoza; the Centro de Estudios Sanjuaninos (Center for San Juan Studies), headed by Osvaldo Maurin Navarro; the Instituto de la Economía Social de Mercado (Social Market Economy Institute), headed by Alvaro L. Alsogaray in Buenos Aires; the Centro de Estudios Macroeconomicos (Center for the Study of Macroeconomics), headed by Roque Fernandez; the Escuela de Educacion Economía y Filosofía de la Libertad (School of Economic Education and the Philosophy of Liberty), headed by Carlos Sanchez Sanudo in Buenos Aires; and the Circulo de la Libertad (Circle of Liberty), headed by Rodolfo Vinelli, also in Buenos Aires.

THE HARMFUL EFFECTS OF INTERNATIONAL LOANS

The responsibility for what has happened to the Argentine economy is ours alone. Our country's basic problem is a lack of general understanding of the importance of a political system that limits the use of government force to the protection of individual rights. The institutional framework of a free society must prevent the use of force and allow people to decide how they will manage their lives and property.

Nonetheless, an external element has also harmed Argentina as well as the countries of the so-called Third World. This enormous harm is inflicted through the multimillion-dollar international loans granted to our governments. These loans do nothing but strengthen socialism.¹¹ They divert private capital from the citizens of the lending countries to projects that would otherwise not have been privately funded. Such institutions as the World Bank and the International Monetary Fund are largely to blame.

At this point in the twentieth century, it is no longer plausible to claim that this loan policy enables the United States to "gain friends" in the Third World. Every time a U.S. delegation visits these

¹¹This point has been made by others, mainly by Peter Bauer, Karl Brunner, and Melvin Krause.

countries, the reaction is hostile — systematically the American flag is burned, and U.S. delegates are insulted. Cutting off credit to the governments of the Third World would be a great step forward. These governments would be challenged either to change their institutional frameworks to ensure private property and a free market or to remain socialist — and rely for financial help on Moscow, Havana, and Managua.

7

THE WAR OF IDEAS IN GUATEMALA

EDITOR'S INTRODUCTION

Although Guatemala has many natural resources, it remains relatively undeveloped. Except for brief spurts, there has been little economic growth. This is not surprising, since economic and political freedom and stability are necessary to spur economic growth, and Guatemala has experienced neither freedom nor stability. The ranks of prominent people from which leadership might be expected to emerge have been thinned by assassination. And a heinous legacy of violence affects every sector of Guatemalan society.

THE LEGACY OF THE PAST

As in most other Latin American countries, the political history of Guatemala was largely the struggle between “conservatives” and “liberals” until the second decade of the twentieth century. The conservatives were the heirs of those with power, position, and land under Spanish rule. They fought to conserve the privileges, advantages, and monopolies that they believed were inherently theirs. The liberals, inspired by the writings of Rousseau, Montesquieu, Locke, Voltaire, and Paine, fought to establish a system of government that

would guarantee individual rights. Many Guatemalan liberals shared a political philosophy with the founders of the United States.

After the declaration of independence from Spain in 1821, what is now Guatemala became part of the Mexican Empire. In 1823, Central America united and declared its independence from Mexico. The Central American Congress modeled its constitution after that of the United States. It provided for a president and a congress to be housed in Guatemala City, and for state governments in each province. Slavery was abolished, but religious freedom was proscribed. Catholicism was made the state religion, and people were forbidden to publicly practice any other.¹

There was tremendous conflict in that period between the conservatives, who drew their strength from the clergy, the monastic orders, landowners, and rich merchants, and the liberals, who were mostly professionals. The federation of the Central American provinces failed, perhaps because there were no experienced leaders or tradition of self-government to withstand the pressures of powerful interest groups such as the landowners and the clergy.

With few exceptions, following the breakup of the Central American federation the governments of Guatemala were dictatorships for the next 100 years. One of the more notable dictators was Justo Rufino Barrios. Although there was a period of great economic progress during his presidency from 1873 to 1885, the economic system of Guatemala persisted as a mercantilistic economy, not a market economy.

For example, during the Barrios regime land and labor policies forced Indians off their lands and onto the coffee plantations. In 1876 Barrios ordered all political chiefs at the local level to ensure that “Indian villages in your jurisdiction be forced to give the number of hands to the farmers that the latter ask for.”² In addition, a law passed in 1877 allowed for the confiscation of Indian land.³

Jorge Ubico y Castaneda, one of the most controversial figures in Guatemalan history, became president in 1931. Ubico’s

¹Mario Rosenthal, *Guatemala* (New York: Twayne Publishers, Inc. 1962), pp. 108-109.

²Justo Rufino Barrios in *El Guatemalteco*, May 7, 1877. Cited in La Guardia, *Pensamiento*, pp. 204-205.

³Jim Handy, *Gift of the Devil: A History of Guatemala* (Boston: South End Press, 1984), pp. 65-69.

regime, popular until its waning years, spanned the Great Depression and World War II. Ubico presided over the construction of a highway system that provided the nation with a comprehensive transportation network. When Ubico took office the entire nation had only 2,200 kilometers of highway. By 1943, the total had reached 10,200 kilometers (almost five times as much) and included over 300 new bridges.⁴ Ubico also devoted considerable resources to the construction of public buildings and service facilities, including communications facilities. He also successfully courted foreign investment, including the United Fruit Company. The new infrastructure enabled remote parts of the country to become part of the national economy.

THE REVOLUTION OF 1944

Ubico's economic policies created new political power blocs and gave impetus to the realignment of some of the old ones. Guatemala's economic modernization benefited the domestic oligarchy the most. The uneven benefits fostered resentment, especially against foreign capital and the oligarchy. The social revolution which ousted Ubico in 1944 was led by a middle class seeking a restoration of constitutional rights and limits on government authority.

Ubico resigned on July 1, 1944, and appointed a junta to succeed him. But Major Francisco Arana and Captain Jacobo Arbenz soon seized power in a successful coup. The new government set up a new constitution, repealed oppressive laws, dissolved the secret police, exiled numerous members of the old guard, and held the first free election since 1891. Dr. Juan Jose Arevalo Bermejo was elected overwhelmingly. He is said to have received over 85 percent of the votes.

Arevalo, a self-described "spiritual socialist," is noted for the country's first Social Security Law, and for the Labor Code of 1947. The Labor Code guaranteed the right to form trade unions, to bring labor disputes to court, and to strike, and it opened the way for a small but active labor movement, closely tied to the success of the Arevalo

⁴Kenneth Grieb, *Guatemalan: The Regime of Jorge Ubico* (Athens, Ohio: Ohio University Press, 1979), pp. 126-140.

government.⁵ Arevalo also suspended constitutional rights, shut down newspapers, and exiled his enemies.⁶

THE COUP OF 1954

Jacobo Arbenz, a former army captain and a leftist, succeeded Arevalo in a fraudulent election of 1950. His succession was assured because his prime opponent, Colonel Arena, was conveniently assassinated. The Communist Party came into the open shortly after Arbenz's inauguration and proceeded to exert pressure at many levels of government, including the Congress.⁷

Land reform was one of the aims of the 1944 revolution. On June 17, 1952, Arbenz signed a law which was closely modeled after the Red Chinese experiment. It provided for the expropriation and distribution of lands that were not used in "the best interests of the nation." Decisions made under the law were to be "incontestable" and appeals to the Supreme Court were denied.⁸

An example of the disregard for private property and due process, and of the heavy hand of those in power, occurred when the Supreme Court voted 5 to 4 to hear an appeal challenging the expropriation of certain properties. The night of the vote, Congress convened in a special session and the five judges who had admitted the appeal were summarily dismissed for "notorious bad conduct, negligence, and incapacity."

Civil rights were abridged. The communists, who by now dominated the Congress, weakened the 1945 constitution. Opposition political parties were discredited. A demonstration of 20,000 anticommunists was used by Arbenz as grounds for reprisals. "Wholesale imprisonment of anticommunists commenced; hundreds were tortured, shot, or disposed of in some manner, with no pretense of legality."⁹ In his March 1, 1953 message to Congress, Arbenz labeled opposition to his policies as traitorous and subversive.

⁵Peter Calvert, *Guatemala: A Nation in Turmoil* (Boulder, Colorado: Westview Press, 1985), p. 76.

⁶Rosenthal, *Guatemala*, p. 225.

⁷*Ibid.* pp. 244-267.

⁸*Ibid.* p. 245.

⁹*Ibid.* pp. 245-6.

Arbenz built up a large military force. Guatemala had in excess of 10,000 troops at a time when Honduras had an estimated 2,000, Nicaragua 3,000, El Salvador 5,000, and Costa Rica with no regular army about 1,500.¹⁰ When Arbenz tried to purchase fighter planes, armored cars, and other military equipment, the U.S. banned weapons shipments to Guatemala from the West. On May 15, 1954, a Swedish freighter delivered 15,424 cases of military weapons loaded in Poland and shipped from Czechoslovakia.

It is not clear why Arbenz was so intent on arming. The arms shipment, a closely guarded secret, was sufficiently large that it could have been used to take on all of Central America. Concurrently, the Communist Party in Guatemala was organizing laborers into civilian militias. It is quite possible that Arbenz, who had an uneasy relationship with the army, was planning to undermine it. In June, Arbenz appointed a high command for the militia made up of men “intimately identified with communism and for the most part *persona non grata* to the military.”¹¹ This sent a signal to the military that Arbenz was plotting to oppose them.

During this time General Miguel Ydigoras Fuentes (who had fled Guatemala when Arbenz was elected president) and Colonel Castillo Armas set up a liberation army in Honduras. These 300 troops, under the command of Armas, marched into Guatemala City on June 18, 1954, with the backing of both the CIA and the United Fruit Company. If the military had followed Arbenz’s orders to stop the insurrection, the troops could have been repelled easily. The military refused. Arbenz resigned and fled to the Mexican embassy after making his successor, Colonel Carlos Enrique Diaz, promise that he would not negotiate with Armas.

There is considerable confusion about the extent of U.S. involvement in the takeover. Apparently the CIA had sent arms to the exiles in Honduras and may have helped to train them. CIA support also consisted of a radio station, two or three fighter planes, and two DC3’s. The radio station was a psychological factor: it broadcast several clandestine programs a day. None of the aircraft were involved in the fighting, although about a half-dozen bombs (which apparently missed their targets) were dropped from the DC3’s above

¹⁰*Ibid.* pp. 246-248.

¹¹*Ibid.* pp. 246-248.

the military airfield and barracks.¹² Nonetheless, Diaz could not repel the rebels and by July 9, 1954, Armas was in control.

THE LEGACY OF KIDNAPPINGS AND VIOLENCE

In 1957 Castillo Armas was assassinated. In the fraudulent election that followed, the National Democratic Movement (MDN) party (the ruling party) candidate was declared the winner. Major disturbances broke out in the capital and new elections were held. This time General Miguel Ydigoras, the National Democratic Reconciliation party candidate, secured a narrow plurality over the MDN candidate.

Ydigoras's five years in office were noted for patronage, corruption, and incompetence. For example, shortly after election he raised the presidential salary to \$150,000 annually and established a million-dollar presidential pension fund.¹³ Because the United States made it a precondition for aid, he attempted to push through a progressive income tax, against considerable opposition. He was overthrown in 1963 before he was able to accomplish this, but the bill was passed by the subsequent military government.

The notorious terrorist kidnappings and killings in Guatemala began during Ydigoras's short presidency. A group of rebellious young officers led by Lt. Luis Turcios Lima and Captain Marco Antonio Yon Sosa took to the mountains to begin their guerrilla warfare in the eastern part of Guatemala. To finance their operation they plundered and kidnapped. The first victim, Jorge Samayoa, was kidnapped on the day Ydigoras was toppled by the military. The new government headed by Col. Peralta would not support Samayoa's family because of his father's association with the Ydigoras government. The family paid the ransom and the son was released.

Kidnapping of the wealthy became an increasingly common way to raise money. But kidnappings were not the only terrorist actions. Yon Sosa and Turcios Lima led a small and often brutal revolutionary movement throughout the 1960s. It was backed by a group of leftist intellectuals, many of whom were eventually eliminated by the government.

¹²Calvert, *Guatemala*, p. 79; and other sources.

¹³Handy, *Gift of the Devil*, pp. 152-3.

The guerrillas had their greatest success during the Peralta years, which also saw the emergence of small right-wing groups which later became known as “death squads.” These groups threatened or killed suspected “enemies of the state.”¹⁴ One of those killed was Mario Mendez Montenegro, the leading civilian candidate for the presidency in 1966. His brother, Julio Cesar Mendez Montenegro, Dean of the Faculty of Law at the University of San Carlos, was nominated and elected.

Mendez was the first civilian president since 1951. He took office under a state of siege following the kidnapping of a Supreme Court justice and the head of the government information office. During his term in office the government tried to smash the rural guerrillas. In return two guerrilla forces, the Rebel Armed Forces (FAR), and the Revolutionary Movement of November 13 (MR-13), carried their campaigns to the cities. Between the guerrillas and the death squads, more than 2,800 prominent and politically active Guatemalans were killed in two years.¹⁵ Many more deaths followed.

Since the military takeover in 1983, Guatemala has been dominated by successive repressive regimes, mostly military. Government and semi-government repression has been strong and persistent. Since the mid-1970s, an often-heard justification for such assassinations of subversives has been that lawful trials of subversives put their judges and their judges’ families at risk of being killed or kidnapped.

Terrorist attacks from both ends of the political spectrum have become commonplace. Right-wing death squads have received the most U.S. press coverage, but there are terrorists of numerous political stripes, including the PGT (Guatemalan Labor Party). Thousands of important people — prominent lawyers, political organizers, trade unionists, etc. — have been systematically murdered for political reasons by government and other terrorist groups. The violence has not been confined to the urban areas. The rural areas have suffered greatly from indiscriminate attacks by both terrorists and government forces. Entire towns have been almost annihilated and at least 200,000 have fled to Mexico.¹⁶

¹⁴Eduardo Galeano, *Guatemala: Occupied Country* (New York: Monthly Review Press, 1969), pp. 62-68.

¹⁵Calver, *Guatemala*, p. 84.

¹⁶Handy estimates the number at 200,000; Calvert estimates the number at 500,000.

The people of Guatemala have seen few free elections and have had their rights taken away by laws enacted by governments ranging across the political spectrum. As Rosenthal says:

They have been persecuted by anti-anticommunists, anticommunists and communists alike. They have seen fathers, brothers, husbands and children languish in jail and face firing squads at the hands of both pro-democrats and pro-imperialists, and ever in the name of progress, humanity, democracy and freedom, the persecutions have been justified.¹⁷

THE FOUNDATION FOR A COUNTERREVOLUTION: A NEW UNIVERSITY

In the midst of so much violence and instability it may seem incongruous to turn attention to the role of colleges and universities. Yet higher educational institutions are part of the problem. They also have the potential to be part of the solution. Despite a long tradition of scholarly pursuit, most public Latin American universities, according to Peruvian writer Mario Vargas Llosa,

...have become instruments of violence and promoters of intolerance, fanaticism and, in many cases, even terrorism. Instead of promoting the idea of consensus, of pluralistic societies in which all ideas are welcomed, and in which dialogue and communication are respected, our public universities have become promoters of dogmatism and intolerance.

To do them justice, they have resisted the brutality of military dictatorship, often in a heroic way. For this, many teachers and students have been killed, imprisoned or exiled. But unfortunately they resisted the brutality of military dictatorship, not in the name of democracy, freedom and tolerance, but in the name of another form of brutality: in the name of extreme ideologists who have probably contributed

¹⁷Rosenthal, *Guatemala*, p. 267.

as much as the military dictatorships to the backwardness and violence still present in most of our countries.

The result has been tragic, not only for the universities, but for society in general. The result has been the academic collapse of many of these institutions. Teachers who wanted to teach in an independent and freethinking way were blackmailed, terrorized by the ideologists and forced to resign or comply with the extremists and become apathetic, resigned and conformist.¹⁸

In Guatemala, Manuel Ayau was one of a handful of people who appreciated the potential of the university for positive social change and who were committed to the values of freedom and free enterprise. Ayau and his business friends thought that in the free market they had found the solution to the economic and political problems of underdeveloped countries like their own. They had discovered the works of Ludwig von Mises and Friedrich Hayek and tried to get Guatemalan universities to offer courses examining these ideas. Rebuffed, they pooled \$40,000 from their pockets to start a new university, sought advice from Latin American, British, and U.S. educators they trusted, obtained a license from the Guatemalan government, and opened the doors to 125 students in January 1971.

Today, the University has more than 3,000 students enrolled in 15 graduate and undergraduate programs. It charges the highest tuition of any college in Guatemala and turns away on scholastic grounds about as many applicants as it accepts. No qualified applicant is rejected for inability to pay. To obtain degrees, all students, regardless of any other requirements, must complete the University's core courses in market economics and social philosophy based on the works of von Mises and Hayek. The University has home grown nearly 40 of its 200-plus faculty members, including its Dean of Economics. Recently, its Theology School opened satellite schools in Costa Rica, Honduras, El Salvador, and even Nicaragua.

Nobel Prize-winning economist Milton Friedman, who has gone to Guatemala three times to lecture at Francisco Marroquin University, calls the University "a dramatic and unusual example of

¹⁸Mario Vargas Llosa. "Latin America's Polluted Fountain of Knowledge." *Wall Street Journal*, April 10, 1987, p. 19.

how private initiative can promote a climate of opinion favorable to free markets.” Dr. Friedman adds that the university’s only initial resource “was the faith and dedication of a handful of Guatemalan businessmen.”

THE ROLE OF HIGHER EDUCATION IN GUATEMALA

Manuel F. Ayau

The current efforts in favor of free markets in Guatemala and its neighboring countries can be traced back to 1958. Concerned that no one was studying long-term problems, a group of seven friends, all businessmen, decided to found a center devoted to the study and dissemination of the ethical, economic, and juridical principles of a free society.

We were convinced that in the long run ideas determine destiny — and if our country were ever to enjoy peace, prosperity, and freedom from socialist oppression, we must assemble a group of influential people with courage and conviction. But before they could defend the free society, these people would need a clear understanding of its workings.

The socialist avalanche has had an immense impact on our world. Well-intentioned and influential people in politics, the clergy, academia, and the arts were victims of rationalizations presented as sound, modern and, above all, permanent and inevitable theories. Socialism threatened to crush all opportunity for peaceful progress, and to destroy individual freedom and individual rights.

What follows is a description of two contrasting efforts within Guatemala. One, independent private education, has been designed to solve the problem. The other, foreign aid, is destined to make matters worse.

THE ROLE OF FOREIGN AID

Latin Americans don’t stay poor because we want to. We do it because we are bribed into accepting interventionist economic

policies by international lenders. The lending institutions, especially the U.S. Agency for International Development (AID), set policies based on advice from so-called developmental economists, who view the free market as disorderly, inefficient, and unethical. This perception is the result of ignorance of how the market coordinates people's actions and how it allocates resources.

In truth, only a small fraction of the foreign aid given to Latin America in the past 30 years has actually been of help. Some has been wasted (to put it charitably). But most has actually aggravated the malaise it was intended to cure. There are three broad areas in which bad advice has been proffered as freely as greenbacks: tax policy, monetary mismanagement, and labor legislation. Most other bad policies are variants of these.

Tax Policy. Since its inception, foreign aid has been contingent on the adoption of tax policies that are prompted more by a desire to redistribute income than a desire to stimulate production. Redistribution of land and income disguised as "reform" and a more equitable distribution of wealth have been preconditions of aid.

In 1962, I drafted an income tax bill at the request of the president of Guatemala. Funds providing technical assistance for implementation of the tax came from the United States. When I attempted to correct the translation of a State Department draft that incorrectly used the Spanish word for "rent" instead of "income," the president became furious. Banging his fist on the table, he exclaimed that he didn't care what the bill said, but the tax must be called exactly what the gringos called it. Otherwise, he explained, no foreign aid money would be forthcoming.

Curiously, many U.S. advisers maintain that the per capita income tax in our countries is too low. This is the result of a lack of understanding of how Latin American economies work. Very few people in Latin countries come under the tax systems, given the large informal sectors and the subsistence level sector. Average taxes are calculated statistically, however, by dividing the taxes paid by the very few, by the total population, most of whom do not pay any taxes. The average tax burden, therefore, appears to be quite small — even though the burden may be quite high for those few who pay taxes. In Guatemala, of 3.2 million adults over age 25, only 32,000 are registered income taxpayers. Only 50,000 retailers collect the value-added tax on sales.

Within such a system, AID officials' suggestions of strictly enforced, progressive tax rates only hasten capital flight. From the point of view of eliminating poverty, the last thing underdeveloped countries need is a tax on capital accumulation. The difference between rich and poor countries is mainly in the capital investment per capita. But U.S. "economic experts" prefer equitable distribution of poverty to the creation of wealth.

Monetary mismanagement. All Latin American central banks have as their primary function the totally unnecessary task of expropriating all the foreign exchange earned by the citizens. They pay the producers who earn the foreign exchange less than it is worth in the market and then sell it at different higher prices depending on what it is going to be used for. Central banks become the arbiters of all activities, including how often and for what purposes their citizens should travel (as if they knew). By enforcing multiple exchange prices, many Latin speculators (or those with inside information) are able to obtain dollars at one rate and sell them at a higher rate. In effect, such policies force the producer of dollars to subsidize the spender of dollars and the flight of capital.

These policies are the tragic legacy of Keynesian economists and followers of the Argentine economist Raul Prebisch. These economists were the mentors of U.S. AID advisers, and their ideas still haunt the central banks and some of the international agencies that dispense money and advice. Their destructive recommendations prevail only because legal tender laws have allowed central banks to destroy their currencies through overvaluation (causing capital flight) or undervaluation (causing inflation). No Latin American would use his central bank's money if it were not a crime to use anything else.

Labor legislation. U.S. labor organizations, funded overtly and covertly by the U.S. government, have dispensed a lot of money in Latin America trying to reform Latin labor laws. Often the help does more harm than good — for the economy and for the workers.

A severance pay provision was initiated in Guatemala that gives workers the right to one month's wage for every year of employment, but only if they are fired. If they quit, they get nothing. Therefore the price of leaving voluntarily to take a better job is very high, equivalent to losing all their savings. As a result, workers are likely to pass up better job opportunities. Should the worker quit, the employer is relieved of a contingent liability. Thus, the employer has

a strong incentive not to raise wages to induce workers to stay. Under this system, workers become captive labor without bargaining power. Should they tell their employer that they will leave if their salary is not increased, the employer will not take the threat seriously. The end result is that most people earn less than they could — and they often are stuck in the wrong job as well. The productivity of the country is lower, diminishing the purchasing power of all earnings.

Of course, now that the free enterprise lexicon is chic (even among communists), AID officials must change their tune. But even in the name of capitalism, AID officials continue to foster critical misallocations of capital — currently by pouring money into *private* enterprise projects (as distinct from *free* enterprises). Private entrepreneurs can be just as opposed to the competitive forces of the free enterprise system as the most stubborn interventionists. Most by necessity are so entangled with and dependent on government intervention that they don't believe the world can operate without it. Since to free the economy means undoing the environment in which they have succeeded, they might not be enthusiastic about destroying their privileged positions.

Foreign aid cannot solve economic problems. It can contribute to economic development only when it is used to teach people about the function and ethics of a free society.

For more than three decades, a group of Guatemalans have been involved in such teaching. With meager resources, but with an enormous passion for freedom and a strong idea about how to defend it, they have waged a battle for better understanding of a free society. They have gone against the current and helped to turn the tide.

FIGHTING THE WAR OF IDEAS

In 1958 a handful of businessmen established the first institution in Guatemala since the Second World War to promote individual freedom. This institute, the Centro de Estudios Economicos Sociales (CEES) was based on the belief that a free society was the only ethical and productive system of organization. Their belief was that, contrary to common thought, capitalism has not caused Guatemala's problems. They believed that capitalism simply *had not been tried*.

The struggle to maintain CEES illustrates the pressures of the period. Most intellectuals viewed classical liberal ideas as being out-of-date. Such unpopular economic notions were better kept quiet if one wished to maintain one's position. It is not strange, then, that CEES was founded by businessmen rather than intellectuals. Even within this group, irreconcilable differences emerged when controversial subjects such as the minimum wage and progressive taxation came up. The free marketeers won the controversy but some members resigned in response. As CEES publications garnered attention, however, its numbers gradually increased. Slowly, sympathizers emerged to join the intellectual battle.

CEES sponsored a radio program, wrote a weekly newspaper editorial, engaged in pamphleteering, and held seminars featuring conservative and classical liberal speakers from the United States and Europe. All of this was accomplished with a budget of less than \$1,000 a month. CEES raised its money by giving occasional seminars and soliciting donations.

CEES was greatly influenced by the Foundation for Economic Education (FEE) of Irvington-on-Hudson, New York. Through acquaintances made at FEE seminars, a link was forged with other emerging institutions, including the Institute for Humane Studies and the Heritage Foundation. With the guidance and visits of such authors and mentors as Leonard Read, Henry Hazlitt, Friedrich A. Hayek, Milton Friedman, and Ludwig von Mises, the members of CEES became more knowledgeable and articulate. Because CEES seminars brought such prestigious speakers as Ludwig Erhard, Israel Kirzner, Max Thurn, Benjamin Rogge, Gottfried Haberler, Dean Russell and Hans Sennholz to Guatemala, respect for the organization grew. The business and intellectual community could no longer discount CEES after it hosted persons of such stature.

As CEES was growing, the political left was becoming more and more radical, resorting to violent guerrilla tactics and even kidnapping. This shift on the part of the left gave pause to moderates. Some turned to CEES as the only intellectual countervailing force.

In 1970 CEES took an unprecedented step toward building an intellectual base for the future: It founded a university, the Universidad Francisco Marroquin (UFM). In Latin America, liberal, leftist, collectivist ideas so dominate the universities that professors with other viewpoints often are simply not tolerated. The aim of CEES was to set up a private university to counteract this bias and

espouse free market principles. One of the first problems was to find professors familiar with liberty and a market economy. This task turned out to be far easier than we had anticipated. The academic program we proposed was more rigorous than that required elsewhere. As a consequence, we attracted dedicated academics who were politically uncomfortable in other universities.

Before the charter of the university was approved by an executive decree of the government, its academic philosophy was published. The university promised to focus on education, in contrast to universities which try to influence current events. And the education would be based on the theories of classical liberals such as John Locke, Adam Smith, F. A. Hayek, and Ludwig von Mises.

The founders were able to raise enough support to open the university. The groundwork laid by CEES gave credibility to the fundraising efforts. Some professors were imported from the United States and Argentina.

Thus Francisco Marroquin became the fourth private university in Guatemala. It is the only one dedicated to teaching a classical liberal philosophy, including the ethical nature, legal basis, and the role of the marketplace in a free society.

The university has about 3,550 students enrolled in law, economics, business administration, computer science, medicine, dentistry, psychology, theology, and teaching. In addition, UFM has 282 students enrolled in Honduras, Costa Rica, Nicaragua, and El Salvador in satellite schools. All students, whether on the UFM campus or at one of the satellite schools, must complete core courses in market economics and in the economic theories of Frederick Hayek and Ludwig von Mises. Not every graduate becomes a converted spokesperson, but free market ideas are becoming so widespread that our graduates can no longer be discounted or ridiculed.

We graduated our first students in 1977. More than 300 were graduated at our last commencement in 1986. It is exciting to see the ideological inroads that our students are making. In Latin America, many young people get involved in public affairs. Members of the Board of the Chamber of Commerce and other such institutions tend to be in their mid-thirties to early forties. Our legislators and other public officeholders also tend to be young. Thus many people who are sympathetic to UFM already hold influential public positions. They are not necessarily our graduates, but the existence of the

university has provided them with the opportunity to learn about the political and economic philosophies we teach. Many of our graduates are in teaching positions and/or serve on boards of directors or boards of trustees. Hardly a day passes without the appearance of at least one newspaper editorial or op-ed piece by a graduate of the university.

Over the past 10 years, we have awarded honorary degrees to numerous individuals who have significantly contributed to the advancement of freedom in the world. These include:

Jeanne Kirkpatrick, former U.S. Ambassador to the U.N.

Cardinal Miguel Obando y Bravo of Nicaragua

Milton Friedman

Friedrich A. Hayek

William H. Hutt

Peter T. Bauer

Leonard Read

Henry Hazlitt

Antony Fisher

Edwin J. Feulner, Jr.

The founders of Universidad Francisco Marroquin recently established the Foundation Francisco Marroquin in the United States as a way to channel U.S. tax-deductible funds to support its activities. This foundation has lent its support to other Latin American institutions which are involved in promoting free enterprise and classical liberalism.

One of the more popular programs of the Foundation Francisco Marroquin is the Latin American Forum (Foro Latinoamericano), established in 1986 and housed at UFM. Its members, skilled researchers, writers, and lecturers from throughout Latin America, are contributing to knowledge of the principles that liberate people from political repression and economic privation. The Foundation views the Forum as important in encouraging dialog and mutual

assistance and in improving the morale of market-oriented Latin American scholars. The Forum recently invited Latin American speakers and think tank organizers to a meeting in Miami to introduce them to one another.

Small think tanks are sprouting up all over Latin America, but their financial means are meager. The Latin American Forum encourages articulate and knowledgeable speakers to travel between countries by paying their airfares. In this way, the Forum enables institutes to host and organize activities that provide an audience for free market and classical liberal ideas. The Forum intends to heighten the visibility of these speakers and extend their influence, as well as acquaint them with their Latin American counterparts.

CONCLUSION

“It’s a daring speculation, but it is just possible that Latin America could become the next center of societal thought and leadership. God knows, someone has to pick up the baton.” So wrote a retired U.S. professor recently in a note accompanying a donation to a foundation supporting free market efforts in Latin America.

Repeated, his speculation brought a wry smile to the face of a Latin friend whose energies are focused on exactly that task. “We have a long way to go,” he said. That is undoubtedly so. But if ideas have consequences, don’t count Latin America out. As Guatemala demonstrates, the efforts to propagate ideas by providing a sound economic education are well underway.

8

LITERATURE

EDITOR'S INTRODUCTION

In general, artists, poets, writers, and other intellectuals are accorded more respect in Latin America than in the United States. Often, they enjoy celebrity status comparable to that of movie stars in our country. Often they are asked to give their opinions on subjects about which they have little, if any, expertise. Many Latin American writers are such prominent public figures they have followers who have not even read their books.

Literary figures also play a large role in Latin American politics. For example, Romulo Gallegos, who became President of Venezuela in 1948, was a noted writer,¹ as is Octavio Paz, who served as Mexico's ambassador to India until 1968 when he resigned to return home to protest the bloody suppression of the antigovernment student riots. Daniel Ortega Saavedra, the head of the leftist junta in Nicaragua, is a respected poet. Mario Vargas Llosa, one of Latin America's most famous novelist, is the leading (and pro-free enterprise) contender for the presidency in Peru.

This kind of relationship between politicians and intellectuals in Latin America has well-established roots in the history of Western civilization. It is a relationship that traces back at least as far as

¹Perhaps he is best known for *Doña Barbara*, whose theme is civilization versus barbarism.

ancient Greece, extends through the Roman Empire, and was evident in the royal courts in the Renaissance era. The leaders of the French, American, and Russian revolutions were intellectuals, as were the leaders of Latin America's wars of independence from Spain.

During the first three centuries after the Spanish conquest of Latin America, most intellectuals were Catholic clergy. Although at first the clergy assisted Spanish soldiers in conquering the native Indian populations (often using ruthless methods), subsequent clerics protested the enslavement of the Indians in colonial Mexico and were active in the Mexican movement for independence from Spain. Although the liberal reforms of the nineteenth century were almost dogmatically anticlerical, the Catholic Church continued to dominate social life for the next 100 years. Searching for answers to the social ills in their countries, many Catholic priests in the 1960s were drawn toward Marxism. Within the Church, the two faiths were fused into Marxist Christianity or liberation theology.² Within the intellectual community, these two faiths are frequently married in the social and/or political novel.³ A dominant theme is rebellion against the unjust exercise of authority and power.

Disillusioned with Russia's repressive and bureaucratic form of communism, many intellectuals focus instead on Cuba. The attraction of a Cuban revolution led by bands of idealistic rag-tag youth, coupled with the rancor between the United States and Fidel Castro, "gave birth to a new truly Latin American dogma — *La Revolucion* — that conveniently focused on Havana rather than Moscow and was dedicated largely to excoriating the 'evils' of United States 'imperialism'."⁴ The United States has long been viewed by Latin Americans as the colossal, imperialistic giant to the north. *La Revolucion* is a symbol of the struggle to win independence and self-determination.

The failure of socialism around the world has tested the loyalty to Marxist ideals, creating political crises for Latin American intellectuals. Long before perestroika and the collapse of communist

²See Alejandro Chafuen's chapter in this book on "The Church and Latin America's Struggle for Economic Freedoms."

³Often, political and social concerns outweigh literary and artistic concerns. See Kessel Schwartz, *A New History of Spanish American Fiction* (Coral Gables, Florida: University of Miami Press, 1971), p. viii.

⁴Alan Riding, "Revolution and the Intellectual in Latin America," *New York Times Magazine*, March 13, 1983, p. 33.

rule in Eastern Europe, the political thinking of many Latin American intellectuals had already evolved. Today, some of Latin America's most accomplished writers, artists, and poets are leaders in the struggle — not for socialism and dictatorship, but for freedom and free enterprise.

In the following chapter, Stephen Schwartz describes this amazing development.

LITERATURE AND FREEDOM IN LATIN AMERICA

Stephen Schwartz

The significance of the recent boom in Latin American literature was confirmed in June 1987 when the London *Economist*⁵ dedicated a four-page article, datelined Brazil, to the “second generation” of “the great Latin American novel.” The *Economist*'s typically exhaustive treatment of the subject, including the usual flippancies and occasional errors, outlined author by author a phenomenon that has gladdened the heart of many a bookstore owner around the world since the end of the 1960s.

Among the Latin American writers who, according to the London arbiter of world business trends, have “come to stay” are many novelists and a handful of poets including Peru's Mario Vargas Llosa, Columbia's Gabriel Garcia Marquez, Chile's Isabel Allende, Mexico's Octavio Paz, and the Nicaraguan poet Pablo Antonio Cuadra. But in its litany of names and titles and plots and clever comments, the *Economist* neglected to mention one very significant fact: the turn away from the political left by many of the leading Latin American writers.

An important intellectual change is occurring in Latin America today. Against a backdrop of apparent abdication of U.S. hemispheric responsibilities, of renascent democracy in such countries as Argentina, Brazil, and Chile, and of revolutionary aggressiveness in Nicaragua and elsewhere, respected intellectuals have begun affirming in Spanish and Portuguese a new faith in Western democracy and the free market. Although this point of view has yet to convince the

⁵“The Great Latin American Novel Enters its Second Generation,” *Economist*, June 13, 1987.

majority, and although leftist ideology still predominates among the Latin intelligentsia, a significant fissure has appeared. It is especially interesting that many of these newly-outspoken intellectuals are leaving behind a long experience with the revolutionary left in its most extreme forms.

Let us take, as a first example, the Mexican poet, political essayist, and aesthetician Octavio Paz. It would be hard to find an individual who better exemplifies the Latin American literary experience over the past half-century. Paz has introduced new styles into Spanish poetry, beginning with the surrealism he learned from the French poets of the 1930s and 1940s. He has written with wit and understanding about subjects as diverse as classical Hindu sculpture, the cultures of the Mayans and other indigenous Americans, and Marcel Duchamp. His studies of Mexican national psychology and traditions of governance, including his best known book, *The Labyrinth of Solitude*, place him in a distinguished tradition of civic criticism. And Paz was always of the left. His father, Octavio Paz, Sr., played an important role in the Mexican Revolution in the early part of the twentieth century, acting as ambassador to the U.S. for the peasant revolutionary Zapata. Paz himself, like many writers of his time, traveled to Spain during the Spanish Civil War to show solidarity with the cause of the left. He associated in Mexico and elsewhere with followers of the exiled dissident communist, Leon Trotsky.

However, in the past five years Octavio Paz has begun to publicly challenge many hallowed beliefs of the Latin American left. This was not a sudden change, for during the late 1970s Paz published his doubts about the increasing power of the "philanthropic ogre," the modern state. But the Nicaraguan crisis seems to have forced Paz into an aggressive new stance of skepticism and criticism about the promised benefits of Leninist revolutionary politics in this hemisphere.

The reader will find perhaps the most important of Paz's recent statements on this theme in an essay⁶ drawn from a speech he delivered in West Germany in 1984. In it he declares that, "The acts of the Sandinista regime are proof of its determination to set up in Nicaragua a bureaucratic-military dictatorship following the Havana model. The original meaning of the [anti-Somoza] movement has

⁶See Octavio Paz, "Dialogue, Democracy, and Peace," in Stephen Schwartz, ed., *The Transition: From Authoritarianism to Democracy in the Hispanic World*, (San Francisco: Institute for Contemporary Studies Press, 1987) pp. 9-10.

thus been perverted. The [anti-Sandinista] opposition is not homogeneous. It has a great many supporters in the interior [of Nicaragua].... None of these groups is fighting to restore dictatorship." It should also be noted that Paz's monthly cultural review, *Vuelta*, has been in the forefront of the campaign to defend the right of the Nicaraguan opposition daily, *La Prensa*, to continue publication.

By publicly stating such views, Paz has incurred the outrage of the Latin left. The publication of his West German speech, with its criticism of the Sandinistas and praise for the democratization of El Salvador under President Jose Napoleon Duarte, led to violent anti-Paz demonstrations in Mexico City in which the poet was burned in effigy. The Mexican daily press, largely controlled by a government that pursues a public pro-Sandinista international policy, heaps continuing abuse on Paz. It is common to hear Latin intellectuals, anxious to display their leftist credentials, denounce Paz for having "sold out to the CIA." Yet it is also undeniable that Paz's message has many sympathetic listeners in Latin America. Paz himself has gone on to praise the U.S. as the only modern society with a demonstrated capacity for self-reform and to declare a Sandinista-style regime in El Salvador unacceptable.

Another figure on the *Economist's* roster who has publicly challenged the Latin left is the editor of *La Prensa*, Nicaraguan poet Pablo Antonio Cuadra. Cuadra was never a leftist in the way Paz was, although he and his newspaper played a prominent role in the struggle against the Somoza regime. Even the Sandinistas proclaim Cuadra the greatest modern Nicaraguan writer. But Cuadra, who has remained in Nicaragua throughout the suppression and rebirth of his newspaper, has emerged as an eloquent spokesman for freedom of the mind and the spirit. According to Cuadra there has been a submission of the culture of Nicaragua — a nation fabled in the Hispanic world as "the land of the poets" — to a military-bureaucratic model borrowed whole from Cuba.⁷

The case of Peruvian novelist Mario Vargas Llosa is, in some ways, even more dramatic. Vargas Llosa, who is twenty years younger than Paz and Cuadra, has achieved worldwide success as a novelist. His most famous work is *The War of the End of the World*, a massive chronicle of political war in the hinterlands of Brazil during

⁷See Pablo Antonio Cuadra, "In Defiance of Censorship: Culture and Ideology in Nicaragua Today," in Schwartz, *The Transition*, pp. 149-163.

the last century. Like Paz, Vargas Llosa has a history of involvement with the revolutionary left. In keeping with the norms of the 1960s in which he rose to literary stardom, his affinity for Castro was much more pronounced than that of Paz, whose Trotskyism had left with him a distaste for open dictatorship.

But Vargas Llosa has gone even further than Paz in breaking publicly with the leftist Latin intellectuals. During the regime of Peruvian president Belaunde, Vargas Llosa served on a national commission of inquiry into a political massacre at Uchuruccay in the high Andes. The commission absolved the military of responsibility in the murders, and Vargas Llosa wrote movingly and frankly about the investigation in an article published in the *New York Times Magazine* and elsewhere. His defense of the democratic order in Peru, a country wracked by the depredations of the ultra-Maoist Sendero Luminoso (Shining Path) movement, has made him unpopular with leftist intellectuals in the U.S. and Western Europe. West German novelist Günter Grass has been especially vocal in attacking Vargas Llosa for his criticisms of the Sandinistas.

Still, Vargas Llosa has not wavered. In 1984 he assailed “the insulting, mendacious and slanderous reporting often heaped upon democratic Latin American governments by the Western media, [with] these regimes Often presented as if they were as bad as the vilest dictatorship [and as if] the only things worth reporting are the errors and horrors.” Since then Vargas Llosa has publicly expressed faith in something many people in the U.S. view as inappropriate for Latin America — the free market system.

To repeat: Intellectual change is occurring in Latin America. In addition to the new defense of democratic institutions there is a new faith in capitalism as a medium for increasing prosperity. Vargas Llosa has become part of this movement through association with the ideas of Peruvian economist Hernando De Soto,⁸ contributing a widely-discussed preface to De Soto’s book, *El Otro Sendero* (The Other Path). In the book, De Soto demonstrated that the entrepreneurial spirit of the Peruvian people is a much surer guide to lasting prosperity than the violence of the revolutionary left. He also illuminated the role of the centralist state in perpetuating urban poverty.

⁸Editor’s note: See Chapter 2.

De Soto, seconded by Vargas Llosa, has called on his fellow citizens to embrace the underground or informal economy and to support its transforming energies. Vargas Llosa has described how De Soto came to this radical conclusion. Traveling back and forth between his native country and Europe, De Soto observed how previously unoccupied and inhospitable land first sprouted individual, makeshift dwellings. On a later visit the shacks would be replaced by small but solid houses. Finally, television antennae would appear. A former slum had become a relatively prosperous residential district.⁹

To propose that Latin America is a fundamentally middle-class and entrepreneurial society whose own thinkers have more in common with Adam Smith and Edmund Burke than with Vladimir Lenin or Mao Zedong is to hold an opinion that many "liberal" North Americans will find distasteful. Pablo Antonio Cuadra, the editor of *La Prensa*, might observe that these "liberals" are somewhat behind Gorbachev in recognizing the virtues of free enterprise. In a tone not so different from that of Vargas Llosa and De Soto, Cuadra recently hailed renascent capitalism as the future and scored the Sandinistas as its irrational opponents.

Unlike Paz and Cuadra, Vargas Llosa has added another dimension to the debate on Latin America's future by dealing with it in a novel. We do not expect poets like Paz or Cuadra to pen verses on democracy and the free market. The willingness of Vargas Llosa to write a novel dealing with these themes and their impact on his life is remarkable.

Vargas Llosa explores the delusions of the revolutionary left in his short novel *The Real Life of Alejandro Mayta*.¹⁰ *Mayta* has stirred a debate in Latin America and Western Europe that is quite distinct from other controversies about this author. The novel recounts the life of a young and effete Trotskyist revolutionary in 1950s Peru as he is remembered in a future Peru collapsing under domestic terrorism and foreign interventionism. Using an anthropological perspective, Vargas Llosa dissects the dreams that have driven Latin politics in the past half-century. He presents a savagely accurate picture of loneliness and alienation of the revolutionary rebel: "A total orphan. That's what he became, by being a militant in smaller and smaller, ever more radical sects,

⁹Hernando De Soto, *The Other Path*, (New York: Harper & Row, 1989).

¹⁰New York: Farrar, Shaw & Giroux, 1985.

looking for an ideological purity he never found. He was the supreme orphan.”

The discovery of the inhuman loneliness of the Leninist revolutionary, and the recognition of the destructive effect of this fundamentally nihilist approach on civil and cultural institutions, is fundamental to the resurgent belief in democracy among Latin American writers. Of course practical political examples like Argentina, guided by the example of Spain after Franco, also play a role. But the spiritual testing, through which writers and thinkers have come to grips with the consequences of their ideological commitment, is a central factor in all the great cultural movements that have followed the First World War. The surrealists and other radical writers in France in the 1920s and 1930s were the first intellectuals to subject the Soviet experiment to a searching moral and political critique. A similar experience took place in New York in the 1940s and 1950s, with writers and critics schooled in Marxism (most of them in the Trotskyist tradition) laying the groundwork for the neoconservative intellectual movement in America. A similar perspective informs the work of today's outstanding Eastern European writers, such as Milan Kundera.

At its heart, the democratic faith of Octavio Paz, Pablo Antonio Cuadra, or Mario Vargas Llosa is impelled by a profound and almost irrational belief in the link between freedom and artistic/literary creativity. It is the faith that as poets and fiction writers these individuals have a relationship with their culture, language and professional activity that can only be individual and individualistic. The inspiration of a genuine writer of any political persuasion is an unclassifiable, unexplainable, unprogrammable phenomenon. To show us what happens when political cadres submit artists to a political uniform, we have the sterility of approved Soviet literature after two centuries of Russian cultural achievement, the hideous violence of the Chinese “cultural revolution,” and the harassment of writers in Cuba. Paz, Cuadra and Vargas Llosa have taken to heart the words of the early Soviet dissident, Yevgeny Zamyatin: “True literature can only exist where it is created, not by diligent and trustworthy officials, but by madmen, misfits, heretics, dreamers, rebels, and skeptics. When a writer must be sensible and rigidly orthodox ... there can be only a paper literature, a newspaper literature, which is read today and used for wrapping bars of soap tomorrow.”

How does the left react to the new political trend among Latin writers? In the U.S. the literary left has shied away from discussing the issue. In Western Europe such warhorses as Günter Grass have taken up polemical arms against Vargas Llosa. But even there the new Latin American literary trend is somewhat embarrassing, and the prevailing attitude is: better leave it alone. Interestingly, a recent and rather fashionable academic volume on Vargas Llosa's career by a Midwestern professor of literary criticism did not mention the novelist's political views at all. However, some on the political left have reacted with a curious dismay, remembering when Vargas Llosa was the darling of Havana. Recognizing his greatness as they recognize that of Paz and Cuadra, they are at the same time alarmed and intrigued.

A good example of this intrigue is provided by a recent issue of the *New Left Review*, a London publication that is as powerful a monitor of trends as the *Economist*. This British bimonthly, although rarely read in the House of Commons as it was in the 1950s, is regarded on many an Anglo-Saxon university campus as an authoritative publication in the field of "the new literary criticism." James Dunkerley, a Marxist historian, has written on Vargas's *Mayta*, comparing the pathetic life portrayed therein with that of the Latin Trotskyists he has known.¹¹ To one of them, recently deceased, he dedicates his text in rather old-fashioned style. Dunkerley goes on to heap derision on Vargas Llosa for his attendance at the PEN Club in New York, where he appeared in a nightmare trinity: Llosa, a critic of Marxism, alongside U.S. Secretary of State George Schultz and American novelist Norman Mailer. Dunkerley also criticized Llosa for his participation in a seminar sponsored by the owners of the *Washington Times*. But throughout his essay, Dunkerley professes an almost gushing admiration for Vargas as a writer. Can it be that in the mirror of *Mayta* the leftist finds himself?

For two hundred years, Western intellectuals have identified with the left. Only since Stalin has criticism of leftist excesses taken tenuous hold among the "information elite." Also since Stalin the left has embarked on political adventures, killing and brutalizing whole populations to the applause of a much larger section of the intellectual class. So long as the left does not morally examine itself, it will be

¹¹*New Left Review*, March-April 1987.

incapable of maintaining the loyalty of real writers and thinkers who, sooner or later, must favor civilization over barbarism.

It may be said that this presumption — that sectors of the Western intelligentsia will inevitably break with the left — is unsupported by evidence drawn from the United States, whose campuses, media, literature, and art are dominated by a “Hate America/Hate the West/Hate Democracy” outlook. Indeed, it may be argued that redirecting intellectual energies will be slower and more difficult here in the U.S. than in Poland or Peru or even Paris. But it seems certain that the new democratic trends in Latin America can contribute to a reexamination of North American leftist prejudices about the future of the hemisphere.

CONCLUSION

Since mid-1987, a crisis of centralist statism has ushered in a new and more acute phase in the political transformation of Latin America, one in which the individuals and options described above have come to the forefront.

The first chapter in this second phase came in Peru in 1987 when the government of President Alan Garcia moved to nationalize the country's entire banking system. Mass demonstrations and political organizing in opposition to this proposal were led by none other than Vargas Llosa, who is running for the country's presidency on a pro-free enterprise platform. Vargas's stand led to terrorist threats against his life by militants of Garcia's APRA party, a nationalist movement with a fascist tinge.

The next development came with the 1988 election in Mexico. For the first time in some 60 years, an unofficial coalition of opposition presidential candidates ranging from radical left populists led by Caudemec Cardenas to free enterprisers of the National Action Party (PAN) were able to expose the ballot-stuffing, violence, and other corrupt practices of the state party, the PRI. The moral setback to the PRI was so great that the election at the end of the current six-year term may be free and unencumbered. In the meantime, President Carlos Salinas de Gortari has acted decisively against police and union corruption.

The role in this process of such independent intellectuals as Octavio Paz, the main source for a critique of the PRI's public record, is unique. Poets, essayists, novelists, and other writers constitute the conscience of the country, as they did at the beginning of the Mexican revolutionary movement — in the days of Andres Molina Enriquez's pathbreaking analysis of the country's future, *Los Grandes Problemas Nacionales*, almost a century ago.

Perhaps the example most freighted with significance comes from Nicaragua. There, the reopening of Pablo Antonio Cuadra's newspaper *La Prensa* has been followed by a succession of policy decisions seemingly indicating that the Sandinistas will follow the "capitalist" road of their new mentor, Mikhail S. Gorbachev, rather than of the revolutionary intransigence of their past guru, Fidel Castro. These events have included the opening of other opposition media, criticism of Castro in official Nicaraguan publications and a new public commitment to private enterprise.

Developments in Nicaragua show that Paz, Vargas Llosa, and Cuadra may be joined by other former Marxists who have come to appreciate freedom. In the Soviet Union, Eastern Europe, and other regions now undergoing a "capitalist revolution," the vanguard has come from the literati. At the crossroads of the future, Octavio Paz, Milas Kundera, and others like them stand for hope.

9

RELIGION

EDITOR'S INTRODUCTION

The European conquest of land and souls in Latin America began when Queen Isabella of Castile and King Ferdinand of Aragon sent an ecclesiastical delegation, civil representatives, and a contingent of nobles on Christopher Columbus's second voyage in 1493. These 1,500 men planted an indelible stamp on Latin America by extending Spanish bureaucratic structure and the Catholic religion to the New World.

Augustinian, Dominican, and Franciscan priests accompanied the conquistadors as they explored and settled the continent. Later the Jesuits and other church orders joined them in the task of converting the Indians to Catholicism. The missionaries often employed brutal methods to encourage the Indians to convert to Christianity and to provide labor for mining and agricultural production.

Colonization and conversion were not always easy. Royal claims to the land were contested by the indigenous peoples, pirates, and colonists of other faiths. But after the Inquisition was introduced in 1517, the power of Church officials grew quickly and the Church's control of vast lands and other riches made it a formidable force.

For example, combining all properties, the various branches of the Church owned over half of the productive land in Mexico, and approximately one quarter of all the buildings in Mexico City and

Lima, Peru. The wealth of the Church and of high Church officials was immense, and the Church was very influential in politics. Throughout Latin America the Church sought to monopolize educational and moral leadership in every community.

It is not altogether clear to whom the Church fathers in the New World answered. As early as 1493, the Pope divided rights of jurisdiction in the New World between Portugal and Spain.¹ The Catholic monarchs acted as though this jurisdiction were territorial and political as well as ecclesiastical.² In the seventeenth and eighteenth centuries, however, Rome did not have the power over bishops and priests that it has today. Appointments of bishops often were made by European kings, rather than by Rome, and it is likely that the clerical hierarchy in many countries felt greater loyalty to the king who appointed them than to the Pope. In order to maintain power in the capitals of Europe and in Rome, Church leaders were selected carefully. The Church hierarchy in the New World was almost always comprised of immigrant rather than native-born clergy.

One of the reasons for the wars of independence from Spain was the role of the Church and the divisions that occurred within it. The Church collected tithes (taxes) of 10 percent of income on all agricultural and industrial products in the New World. The people often resented these taxes and the Church's extensive land holdings and other wealth. Many viewed the Church as an ally of Spanish colonial governments, and many young colonials, influenced by the Enlightenment, resented the persecution, torture, and "thought control" techniques of the Inquisition.

Divisions within the Church began to grow. Although the *gachupine* (Spanish-born) clergy lived in relative wealth, the *creole* (native-born) clergy in the frontier areas led frugal, hardworking lives. Moreover, precisely because the immigrant clergy were foreign born, they tended to know little about the New World policies they came to administer.

As the revolutionary flames erupted throughout Latin America, lower level *creole* clerics, especially in Mexico, mobilized

¹This division consisted of an imaginary line running north to south across Latin America.

²Sidney Rooy in Mircea Eliad, ed., *The Encyclopedia of Religion*, Vol. 3. (New York: Macmillan, 1987), p. 387

the *mestizos* (those of Spanish and Indian blood) and participated in the revolution. The roles the Mexican priests Hidalgo and Morelos played are well-known and widely celebrated. There were many others like them.

Anticlericism persisted in the emerging Latin American nations after the wars of independence. In some countries there were actual church versus state battles over control of the schools, regulation of marriage and divorce, and other issues. In each country, the Church lost these battles, leading to a legal separation of church and state throughout Latin America, although this division differed from country to country. Although the Church lost considerable political power in the nineteenth century, it remained an extraordinarily influential institution. This influence has begun to emerge in politics in the last several decades.³

An early example of the reemergence of religion in politics was the formation of the Christian Democratic parties, which came into being in Latin America after World War II. They were founded on a philosophy that combined the principles of political democracy with Catholic social doctrine. Christian Democracy today takes both progressive and conservative forms, and both types reject unregulated capitalism and the atheistic materialism of Marxist socialism. The progressives are more prominent in Latin America. They promote social welfare legislation, nationalization of large private companies, and labor unions. The conservative Christian Democratic parties, which are fewer in number, support a hierarchical social system, private property, the Catholic Church, and want a "humane version of capitalism."⁴

In the early 1960s, evidence of conflict within the Church began to appear. This conflict was undoubtedly aided by a general questioning of the role of the Church and Church doctrines of Vatican II (the Second Vatican Council) and the Second and Third General Conferences of Latin American Bishops, the first of which was held

³See Brian Smith, "Religion and Social Change: Classical Theories and New Formulations in the Context of Recent Developments in Latin America," *Latin American Research Review*, Vol. X, No. 2, 1975, pp. 3-34; and Daniel H. Levine, "Religion and Politics, Politics and Religion," *Journal of Interamerican Studies*, Vol. 21, No. 1, 1979, pp. 5-31.

⁴Ernest Rossi and Jack Plane, *The Latin American Political Dictionary* (Santa Barbara, CA: ABC-Clío, Inc., 1980), pp. 59-60.

in 1968 in Medellin, Colombia, and the second in 1978 in Puebla, Mexico. Vatican II was a major attempt to rethink the nature of the Church, the world, and the relationship between the two. The Bishops conferences reviewed and evaluated the Church during the previous decade, including its position on political issues.

One of the manifestations of the religious conflict within the Church is the shift away from concern over the roles, ranks, and hierarchy of people within the Church, and toward action to promote “social justice.” Most notable on the “left” has been the development of liberation theology. The politics of liberation theology is based on dependency theory, although this theory is not supported by empirical data. The major theme of dependency theory is that the economic life of Latin America is characterized by exploitation by powerful capitalistic nations such as the United States and Western European countries. On the “right,” groups like the Societies for the Defense of Tradition, Family, and Property have emerged. These groups appear to be very religious in a traditional sense and their political positions are sometimes closely tied to the nationalism being promoted by military regimes in their areas.⁵ In the “center” are a growing number of bishops and key Church institutions, trying to resist the pressures of the right and the left while, at the same time, responding to social and political problems.

Alejandro Chafuen is an international authority on the relationship between Catholics and politics. In the following chapter he examines the role of the clergy in the politics of Latin America over the last two decades.

THE CHURCH AND LATIN AMERICANS' STRUGGLE FOR ECONOMIC FREEDOM

ALEJANDRO A. CHAFUEN

The Roman Catholic Church is by far the largest Latin American church. Ninety per cent of the population is baptized in the Catholic faith. As a hierarchical religion, the Church is organized in a pyramid structure with the Pope at the top, followed by the bishops,

⁵Levine, “Religion and Politics, Politics and Religion,” p. 9.

the priests, and a huge base of laity. The Pope endorses encyclicals or makes statements on economic problems. The bishops write pastoral letters. The laity is involved in disseminating ideas, framing economic policies, and promoting ideologies. All of these actions greatly influence the chances for freedom in Latin America.

In every Latin American country except Cuba, the Church is a very influential institution — far more influential than in the United States or Europe. This clerical influence is not measured by the number of priests (in 1977 France had more priests than Latin America) but by the allegiance that the priests command. This influence is exerted mainly in the realm of faith. However, through the promotion of a religious message, the Church also exerts influence in the political and socioeconomic fields.

At times, the Church has recognized the autonomy of the sciences⁶ (including the science of economics) and has taken the position that it is not “for the pastors of the Church to intervene directly in the political construction and organization of social life.”⁷ This position reflects the view that it is not the essential function of the hierarchy or the priests to act as judges for economic science or the technical aspects of economic policy. This function is more appropriately performed by learned laymen.

Recently, Rome reaffirmed this doctrine through the statement that, “In the current state of the world, it is up to them (the laymen) to promote the indispensable alliance between science and wisdom, between technology and ethics, between history and faith.”⁸ Politics and economics, therefore, are areas specifically entrusted to the laymen.⁹ Despite these statements, popes, bishops, priests, and members of religious orders frequently pass economic judgments. In addition, many economists with close ties to the Church are trying to push economic reforms — some in favor of freedom and many more against it.

⁶“Pastoral Constitution on the Church in the Modern World,” *Gaudium et spes of the Second Vatican Council*, No. 36.

⁷*Instruction on Christian Freedom and Liberation* (Boston: St. Paul Editions, 1986), No. 80, p. 52.

⁸Ioannis Paulis pp. II, *Allocution ad Sodales Consilii Secretariae Generalis Synodi Episcoporum* die 19 Maii 1984, AAS LXXXVI (1984), p. 785.

⁹*Lineamenta*, p. 12.

This chapter is restricted to the last two decades of Latin American history and to the ideological (not spiritual) influence of the members of the Church. The investigation will center on the institutions that are represented in most Latin American countries. The reader has to bear in mind the immense social, cultural and political differences existing in the nations of the region. Church groups that have a strong influence in one area often are ignored in others.¹⁰

THE POLITICS OF THE CHURCH

The Roman Catholic Church, both hierarchy and laity, plays a significant role in the struggle for economic freedom in Latin America. At one extreme, "liberation theologians" are pushing for the socialization of the means of production. The term liberation theologians¹¹ describes theologians who in their teachings (a) emphasize the Christian message of liberation from temporal oppressions, de-emphasizing liberation from personal sin, and (b) use Marxist analysis to define and to find an escape from economic and political oppression.¹² Most of the bishops are sponsoring a

¹⁰See for example Ivan Vallier, "Church 'Development' in Latin America: A Five-Country Comparison," in Karl M. Schmitt, ed., *The Roman Catholic Church in Modern Latin America*, (New York: Alfred A. Knopf, 1972), pp. 167-193.

¹¹For one who shares my convictions that the world which liberation theologians aspire to construct is one of spiritual and material slavery, the term "liberation theology" is a misnomer. Among the institutions and theologians which were associated with liberation theology in the late sixties and early seventies we can mention: Movement for the Third World (Argentina); Christians for Socialism (Chile); ONIS, National Organization of Independent Priests (Peru); Golconda and SAL (Priests for Latin America, Colombia); Reflection Teams (Ecuador); and Priests for the People (Mexico). In the seventies and eighties the principal organizations are: Maryknoll, America's most active Catholic missionary order, USA; CEP (Peru); Seminario Biblico Latinoamericano, Centro Antonio Valdivieso, and Departamento Ecumenico de Investigaciones (Costa Rica); CONIP, National Council of the People's Church (El Salvador); Universidad Centroamericana (Nicaragua); and Centro Belarmino (Chile). The main figures in the movement are: Ernesto Cardenal, Gustavo Gutierrez, Alvaro Arguello, Juan Luis Segundo, Dom Helder Camara, Hugo Assman, Pablo Richard, Enrique Dussel, Jose Miguez Bonino, and Leonardo Boff.

¹²For the English reader, the best books yet written on liberation theology are Father James V. Schall, S.J., *Liberation Theology in Latin America* (San Francisco: Ignatius Press, 1982) and Michael Novak, ed., *Will It Liberate: Questions About Liberation Theology* (New York: Paulist Press, 1986).

hybrid middle-of-the-road interventionist approach. But even those members of the clergy who are “centrist” or even “conservative” tend to be hostile to freedom and free enterprise.

In 1968 a conference of Latin American bishops met at Medellin, Colombia. Some of the statements in the Medellin Documents have caused great harm to the cause of economic freedom. For example, the bishops concluded that:

The countries which produce raw materials — especially if they are dependent upon one major export — always remain poor, while the industrialized countries enrich themselves ... We wish to emphasize that the principal guilt for the economic dependence of our countries rests with powers inspired by uncontrolled desire for gain.¹³

Pope Paul VI, in his encyclical *Populorum Progressio* (1967), used similar language and analysis. He wrote that the economic system left to itself widens the gap between rich and poor nations: “Rich people enjoy rapid growth whereas the poor develop slowly. The imbalance is on the increase ...” He also condemned estateholders who use their property in a way detrimental to the common good and criticized those who protect their savings by sending their money abroad “purely for their own advantage, without care for the manifest wrong they inflict in their country by doing this.”¹⁴

¹³Basic Medellin Documents are in *The Gospel of Justice and Peace* (Maryknoll: Orbis, 1976), pp. 445-476. A balanced critique of the idea that “the reason that the poor are poor is mainly because of the attitudes and ideas of the rich” may be found in Father James V. Schall’s *Liberation Theology*, pp. 37-38. In another of his writings, Father Schall argues that the poor “are poor not because the rich are rich but because the poor have not yet learned, or in ideological regimes are not yet allowed to learn, how to be not poor.” See Schall, “The Bishops’ Pastoral on Economics and Social Justice” in *The Intercollegiate Review*, Fall 1985, p. 12.

¹⁴For an economist’s critique of *Populorum Progressio*, see Peter Bauer’s “An Economist Replies: Ecclesiastical Economics is Envy Exalted,” *This World*, No. 1, Winter/Spring 1982, pp. 58-69. Lord Bauer’s conclusion is that the encyclical is immoral because it is incompetent. Noted economists, however, have advanced the same conclusions as the Pope. Gunmar Myrdal, the Swedish Nobel Laureate, and Raul Prebisch (the late Argentine economist) are perhaps the best examples.

Among the Latin American hierarchy, Alfonso Lopez Trujillo of Colombia is regarded by many as being a leading conservative bishop.¹⁵ As early as 1975, he wrote a book condemning some aspects of liberation theology.¹⁶ He correctly stated that “at the core of liberation theology is the belief that underdevelopment is the result of dominance and the development of other, stronger countries to which others whirl around like satellites. Advances in international as well as in national affairs in some countries causes backwardness in others.”¹⁷

Unfortunately, Trujillo’s recipe for economic problems is the same one that has brought stagnation wherever it has been applied — more government control over the economy. He argued that one should encourage attempts,

to renew forms for state, collective, and social property which, technically and scientifically regulated, may bring remarkable advantages. In several instances, a certain process of nationalization, mainly of foreign corporations, may represent something healthy for the sovereignty and progress of our nations ... There are many areas of production that up to now have been in the hands of certain persons or certain groups that clearly should become social or state property.¹⁸

He scorned those who utter “museum-like sounds such as ‘total freedom of trade,’” and concluded by saying that “we are convinced that capitalism is a human failure. We maintain some reservations about socialism which have nothing to do with the survival of neo-capitalism that also crushes freedom, using another way to do it.”¹⁹ Perhaps Msgr. Trujillo is regarded as a conservative

¹⁵See for example Thomas C. Duncan, Chester E. Gabriel, and Mary Mooney, ed., *The Catholic Church and Religions in Latin America* (Montreal: McGill University Centre for Developing-Area Studies, 1984), p. 2. Msgr. Trujillo is president of the CELAM (Latin American Episcopal Conference).

¹⁶Bishop Alfonso Lopez Trujillo, *Liberation or Revolution, An Examination of the Priest’s Role in the Socioeconomic Class Struggle in Latin America* (Huntington, Indiana: Our Sunday Visitor, Inc., 1977). First Spanish edition, *Liberacion o Revolucion* (Bogota: Ediciones Paulinas, 1975).

¹⁷*Liberation or Revolution*, p. 39.

¹⁸*Liberation or Revolution*, pp. 97-98.

¹⁹*Ibid.* p. 101.

because he is also skeptical about centralized planning mechanisms. However, in 1976 Trujillo stated that “we cannot tolerate the widening gap in inequality and injustice. There has to be an advance in indispensable changes such as the bank and land reforms.”²⁰

In the first document of the Holy See on liberation theology,²¹ it is written that “the lack of equity in international transactions works to the advantage of the industrialized nations so that the gulf between the rich and the poor is ever widening.”²² The second document of the Holy See on liberation theology²³ repeats some of these arguments: “Whoever possesses technology has power over the earth and men. As a result of this, hitherto unknown forms of inequality have arisen between those who possess knowledge and those who are simple users of technology. The new technological power is linked to economic power and leads to a concentration of it.”²⁴

These statements are not accompanied by facts, but they show the popularity of the theory of the widening gap. This theory is based on the so-called law of the secular deterioration of the terms of trade as expounded by the late Raul Prebisch.²⁵ It is still being preached in most Latin American universities. The theory states that the world is divided into countries in the center and countries on the periphery. The former produce manufactured goods and the latter raw materials. According to the analysis, as the prices of manufactured goods increase faster than those of raw materials, the gap between the rich (the center) and the poor (the periphery) is bound to increase.²⁶

²⁰*El Tiempo*, Bogota, February 28, 1976.

²¹“Instruction on Certain Aspects of the ‘Theology of Liberation’” Sacred Congregation for the Doctrine of the Faith, Joseph Cardinal Ratzinger.

²²“Instruction on Certain Aspects of the ‘Theology of Liberation’”, (I-7).

²³“Instruction on Christian Freedom and Liberation.” Sacred Congregation for the Doctrine of the Faith, Joseph Cardinal Ratzinger (March 22, 1986, in *L'Osservatore Romano*, April 14, 1986, English Edition).

²⁴“Instruction on Christian Freedom and Liberation,” (I-12).

²⁵An Argentine economist who achieved international notoriety with his work at the CEPAL (United Nations Economic Office for Latin America). This last major published book was *Capitalismo Periferico* (Mexico: Fondo de Cultura Economica, 1981).

²⁶We will not deal here with the inconsistencies of this theory. For an analysis showing that the gap between Latin America and the United States has been gradually closing since 1940, see James W. Wilkie, *Primary Social Change in the Americas: The Myth of the “Widening Gap”: 1940-1970* (Los Angeles: UCLA Latin American Center, 1983). See also Melvyn Krauss, *Development Without Aid* (New York: McGraw-Hill, 1984), pp. 154-157, and Deepak Lal, *The Poverty of Development Economics* (London: Institute for Economic Affairs, 1983), pp. 20-25.

The second document of the Holy See on liberation theology also mentions certain parts of Latin America, where an oligarchy of owners bereft of social consciousness “seize the vast majority of the wealth” and refers to the “savage practices of some foreign capital interests.”²⁷ Rome is also calling the laymen to fight “every form of exploitation and all forms of slavery which violate personal dignity and regard people as ‘objects’,”²⁸ and to educate themselves “for active and responsible participation in political life, both national and international.”²⁹

These statements do not constitute an essential or even a relevant element in the teachings of Msgr. Trujillo or the Holy See. On the other hand, since liberation theologians conceive their mission to be a political and economic one, these statements are of primary importance and provide plenty of ammunition for their cause.

Clearly, the documents of the Holy See argue that (a) the international economic order is unjust and that the rich get richer and the poor get poorer, (b) greed and lack of social consciousness cause international and national inequalities, and (c) foreign capital interests sometimes engage in savage practices. Several liberation theologians argue that both (a) and (b) are the logical consequences of capitalism (the Vatican assumes that they are the result of “unbridled” capitalism) and that (c) is the outcome of a system that places profits above human beings.³⁰

The Vatican repeatedly has condemned the use of Marxist analysis and Marxist solutions to social problems; noting that the “class struggle as a road toward a class-less society is a myth which slows reform and aggravates poverty and injustice.”³¹ The Holy See

²⁷“Instruction on Certain Aspects of the Theology of Liberation,” (VII-12). Juan Luis Segundo, S.J., one of the leading liberation theologians, recently wrote that this paragraph is terribly correct and eloquent. See *Theology and the Church: A Response to Cardinal Ratzinger and a Warning to the Whole Church* (Minneapolis: Winston Press, 1985), p. 34.

²⁸*Lineamenta*, p. 30.

²⁹*Ibid.*

³⁰In 1962 the National Conference of Brazilian Bishops, under the leadership of Dom Helder Camara, made the statement that social imbalances were the result of “egotism and economic liberalism.” “Declaracao dos Cardeais, Arcebispos e Bispos do Brasil,” *Revista Ecclesiastica Brasileira*, 22 (June 1962), p. 488.

³¹“Instruction on Certain Aspects of the Theology of Liberation,” (XI-11).

adds that it is not enough to change structures, as the Marxists suppose; rather it is necessary to change the hearts of the people as well.

Some liberation theologians also agree. For them, it is necessary to act against oppressive structures as well as focusing on the hearts of the people. Education is the basic tool to achieve this change and to this end the “popular” church relies on the role of the Basic Christian Communities and the method of “conscientization.” This method relies heavily on Paulo Freire’s *Pedagogy of the Oppressed*.³² Practitioners water down their Marxism by adding a spiritual dimension to materialism and continue their “liberating” work as before. For example, consider Father Uriel Molina’s description of his Christian community:

We set up a schedule. Every morning before breakfast we got up for prayer. At night after university classes, we had a session analyzing Nicaragua using Marxism as a method. It ended up with chats that went far into the night with guitar serenades and protest music. We deepened our faith and our political commitment. Soon there were reactions, as was to be expected. Once owners raised milk prices, the young people could explain the problem, since they were linked to the parish council and parish religious organizations. After some reflection, a decision was made to organize a boycott and stop milk trucks by throwing tacks on the road.³³

Much of the negative influence of liberation theology is disseminated through the ‘comunidades de base’ or Basic Christian Communities. These base ecclesiastical communities have achieved their strongest development in Brazil, where they have been a leading voice denouncing the capitalist system as “one of the main causes of misery.”³⁴

³²Paulo Freire, *Pedagogy of the Oppressed* (New York: Herder & Herder, 1970).

³³Philip Berryman, *The Religious Roots of Rebellion: Christians in Central American Revolutions* (Maryknoll: Orbis, 1984), pp. 63-64.

³⁴P.I. Andre-Vincent, O.P. *L’Eglise dans les Revolutions de l’Amerique Latine* (Paris: SOS, 1983), p. 209. Father Leonardo Boff was adviser to these communities.

After recent Vatican condemnation of Marxism, liberation theologians quickly accommodated their language to show agreement with Rome.³⁵ For example, after Pope Paul VI condemned dialectical materialism in his encyclical "Octogesima adveniens," Dom Helder Camara, the Marxist bishop from Recife, Brazil, remarked that the relationship between socialism and dialectical materialism is not necessary or immutable.³⁶

To the accusations raised in the liberation theology documents, the response was that it is unfair to pin the label of Marxist to those who use some elements of Marxism and that "the Supreme Pontiff himself makes excellent use of Marxist analysis, such as the category of *alienation*, to describe the worker who gives up the fruits of his or her labor in exchange for a salary in capitalist (or socialist) systems."³⁷ V. I. Lenin was one of the first to analyze the "exploitation" of the periphery³⁸ and his arguments have been repeated so many times that some clerics believe one cannot understand international economics without using elements originating in Marxism. Juan Luis Segundo provides us with the clearest example:

It is true that in such matters, like those of the economic factors of national or international oppression, it is impossible (and the document shows this authentically) not to utilize elements that originate in Marxism, such as studying the mechanisms of

³⁵Liberation theologians have strong reasons to show communion with Rome. "It is our concern not to be taken as outsiders from the official Church so that our action will be efficient, since, in regard to the people, the Church we are evaluating has an enormous efficiency of conscientization. Therefore, it seems to us the commitment to man himself and to the revolutionary process forces us to continue in the priesthood." (Letter from J. Vernazza, representative of Permanent Secretariat from the Third World Priests, addressed to the leader of the movement for "Changes and Dialogue," published in *Enlace*, Buenos Aires, December 10, 1969).

³⁶Speech at the Catholic Institute, London, June 25, 1972. Quoted in P.I. Andre-Vincent, O.P. *L'Eglise dans les Revolutions de l'Amerique Latine*, p. 149.

³⁷Juan Luis Segundo, *Theology and the Church*, p. 96.

³⁸Lenin argued that to survive, capitalism has to expand and exploit the periphery, "La importancia de las zonas de la periferia mercado interior o mercado exterior?" in *El Desarrollo del Capitalismo en Rusia* by V.I. Lenin, reprinted in Karl Marx, *El Capital: Critica de la Economia Politica* (Mexico City: F.C.E., 1973), Vol. II, pp. 516-523.

international capitalism. Certainly, the social doctrine of the Church is not lacking in such elements.³⁹

The language of center-periphery is present in most liberation theology works. Juan Luis Segundo writes, "The choice we have to make is not between society as it exists in the U.S.A. or society as it exists in the Soviet Union. Our option is taken from the oppressed periphery of the great economic empires."⁴⁰ Brazilian Father Leonard Boff, O.F.M., also believes that "underdevelopment is the flip side of development, that underdevelopment is the price to pay in order to have the capitalistic development that we have in the Western world."⁴¹

TRAGIC BUT LOGICAL CONSEQUENCES OF THE MILITANT CHURCH

There are many stories of how pastoral agents helped Sandinistas. At one point a Capuchin priest took Henry "Modesto" Ruiz, today a commander of the revolution, to the cities of Bluefields and Managua disguised as a Costa Rican seminarian. The missionary Sisters of Christ in Siuna received medicines and ammunition by air and sent them to the Sandinistas.⁴²

Due to its popularity and its socialist goal, liberation theology has to be regarded as one of the main barriers to the resurgence of economic freedoms in Latin American countries. This religion has *The Communist Manifesto* as its gospel, the machine gun as its cross, and the United States as its devil. The consequences have been devastating.

³⁹Juan Luis Segundo, *Theology and the Church*, p. 167, fn.

⁴⁰*Ibid.*

⁴⁰Juan Luis Segundo, "Capitalism-Socialism; Theological Crux," in *Liberation North, Liberation South* (Washington, DC: American Enterprise Institute, 1981), p. 8.

⁴¹Commenting on Boff's theories, Father Colin Garvey, also a Franciscan with a Ph.D. from Louvain, remarked, "This sounds like economic lunacy to me...this I believe is deterministic nonsense." See "The Philosophy of Liberation," in *Catholicism in Crisis*, April 1985, pp. 36-37. This article originally appeared in *The CORD: A Franciscan Spiritual Review*, Vol. 34, N 11 (December 1984), pp. 333-343.

⁴²Philip Berryman, *The Religious Roots of Rebellion*, p. 88.

The Church is suffering from the effects of this “new” theology like a body that rots when separated from its head or soul. In 1965 there were 52,000 priests serving the Latin American population (where more than 40 percent of the world’s Catholic population lives). By 1969 that number had dwindled to 45,000, and by 1977 the population of priests had shrunk dramatically to 32,000.⁴³

Church members who were involved in the economic and political struggle often suffered the same treatment as others meddling in those fields. Liberation theologians complain because some of “their” priests have been regarded as subversive and thus have been repressed. The same thing, however, is happening to Christians who voice their opinion against Latin American socialist governments.

In socialist Nicaragua, Christians have been persecuted, priests deported, the Catholic press silenced and attacked, and ecclesiastical premises searched. Msgr. Bismark Carvallo, then press secretary for Nicaraguan Archbishop Obando y Bravo, was stripped and exposed naked in front of TV cameras by Sandinista intelligence services. He was later expelled from Nicaragua together with Bishop Pablo Antonio Vega. The division of the Church reached such levels that the Vatican reacted by suspending several priests. One of them, Miguel D’Escoto, Nicaragua’s Foreign Minister and a Maryknoll priest suspended a *divinis* by Rome, called Cardinal Obando y Bravo a “sacrilegious traitor.”⁴⁴

In Guatemala, the growing guerrilla-priest problem prompted a statement by the local bishops declaring that “if a priest or religious [person] chooses the option — denying our wisdom — to join whatever political faction or subversive group, he no longer belongs to the pastoral body of the Church and therefore the hierarchy cannot be held responsible for his later actions.” At the same time, they condemned terrorism and other actions “that lead to the implantation of communism in our country.”

⁴³France had more priests than all Latin America despite the latter’s much bigger population. Figures quoted from *Documentation Catholique*, February 1977, p. 144, cited by P.I. Andre-Vincent, in *L’Eglise dans les Revolutions de l’Amerique Latine*, p. 44.

⁴⁴See “El Asedio Sandinista,” by Paolo Defani, in *Temas de Actualidad* No. 604, April 15, 1986, reprinted from *Hoy*, March-April, 1986.

The Guatemalan case shows that when the Church enters the arena of controversial social policy and attempts to control or design policies on foreign affairs, economics, or politics, it is usually dealt with as an organization of political power. Revolutionary Christians who joined guerrilla forces⁴⁵ suffered the same treatment as other terrorists.

An example of a revolutionary call to action is a commencement address given by Guatemalan Jesuit Cesar Jerez in Buffalo, New York, in 1978. Jerez challenged the students with these words:

Do you plan to follow in the footsteps of Dean Acheson and John Foster Dulles, of Richard Nixon and the CIA ... who kept silent in face of the plot by sinister forces to destroy a new beginning, a new creation, an attempt never before made in that part of the world known as Chile to achieve socialism with liberty and without violence?

Do you plan to earn your degrees by your own efforts and not in an honorary capacity and then to use them for your own profit ...? Will you end up with General Motors or Morgan Trust, with Chase Manhattan or Abbot Laboratories, with Goodyear or Boeing?⁴⁶

In Chile the hierarchy had different problems that also were rooted in political involvement. In the 1960s, the Church endorsed the Christian Democratic Party and its policies of a "peaceful revolution." It was not long before both socialists and conservatives saw weaknesses in this middle-of-the-road solution. The left complained that state intervention was failing because property was not socialized; the right complained because they saw that the Christian-Democratic road was leading the country to a Marxist regime.

⁴⁵Foreign priests, such as Father Donald McKenna from Northern Ireland, also opted for armed struggle and suffered the same treatment as other terrorists.

⁴⁶Quoted in James V. Schall, *Liberation Theology*, pp. 5-6.

In the early 1970s the Chilean bishops refused to publicly criticize the socialist policies of Salvador Allende and encouraged “social reform.” The socialist faction, however, was disappointed because the hierarchy “refused to give in to the pressures of the Allende regime to urge Catholics to collaborate actively in the process of turning Chile into a socialist state.”⁴⁷ The Chilean Conference of Bishops stated that the Church takes no political position — it belongs to all the people of Chile. To this Juan Luis Segundo remarked; “Among intellectuals, the reactions toward this type of pastoral practice and against its theological implications can even be of scorn.”⁴⁸

THE ROLE OF THE JESUIT ORDER

Juan Luis Segundo is perhaps the best known Latin American Jesuit theologian. Michael Novak referred to him as the “chief systematizer of liberation theology”⁴⁹ and quotes Segundo as telling a group of American Jesuits:

There is no perfect solution. The only way is for us to choose between two oppressions. And the history of Marxism, even oppressive, offers right now more hope than the history of existing capitalism Marx did not create the class struggle, international capitalism did.⁵⁰

For more than two decades the Jesuits have been active participants in Latin America’s intellectual life. In Colombia they have been directors of the National Coordination of Catholic Action and of the Center for Social Action and Social Research (CIAS,

⁴⁷Ernest S. Sweeney, S.J., “The Church and the Allende Regime: A Study of Change, Continuity, and Conflict in a Revolutionary Society,” in J.A. Cole, ed., *The Church and Society in Latin America* (New Orleans: Tulane University, Center for Latin American Studies, 1984), p. 323.

⁴⁸*Capitalism-Socialism*, Concilium, No. 96, p. 405.

⁴⁹Michael Novak, “Liberation Theology and The Pope,” *Commentary*, June 1979, reprinted in James A. Schall, S.J., *Liberation Theology*, p. 283. By 1979 Father Segundo’s five-volume treatise, *Theology for Artisans of a New Humanity*, had sold 64,000 copies.

⁵⁰*Ibid.*

Centro de Investigacion y Accion Social). Father Vicente Andrade Valderrama, S.J., founded the Colombian Workers Union (UI) and was a director of Catholic Action.

In the 1960s Roger Vekemans of Belgium was the most influential Jesuit in Chile. He was the head of the Institute of Chilean Development (CEDEP) and chief adviser to Eduardo Frei. Father Vekemans brought to Chile an American-educated Nicaraguan priest, Father Miguel D'Escoto, who was given the task of organizing and providing technical assistance to 30 key neighborhood associations. According to D'Escoto, these associations represented nearly 300,000 slum dwellers.⁵¹ As mentioned earlier, Miguel D'Escoto today is Foreign Relations Minister of the Sandinista forces occupying Nicaragua and a former director of communications at Maryknoll.

D'Escoto was joined by another active Jesuit, Father Gonzalo Arroyo, who was a fervent supporter of socialistic reforms,⁵² and by Alberto Hurtado, S.J., who is credited with having shifted the Chilean Christian Democratic Party to the left.

To be fair to the Society of Jesus, we should acknowledge those priests who have remained faithful to Rome and who do not share the view that to be socialist is a prerequisite for salvation. Father Mario Zañartu, S.J., with degrees in philosophy and theology and a Ph.D. in economics from Columbia University, agrees with the opinion of a prominent free market Jesuit, Enrique Menendez Ureña of Spain. He says, "It seems that the capitalist mode of production, a market economy, does not necessarily generate an increased exploitation of the salaried classes or an irrational growth of

⁵¹David E. Mutchler, S.J., "Adaptations of the Roman Catholic Church to Latin American Development: The Meaning of Internal Church Conflict," in Karl M. Smith, ed., *The Roman Catholic Church in Modern Latin America* (New York: Alfred A. Knopf, 1972), p. 207.

⁵²*Ibid.*, p. 205.

production,” and that the famous “third road” has been, at least up to now, far from ideal.⁵³

Father Zañartu believes that societies with free markets have been the true liberators from political oppression. On the other hand, the lack of freedom and the political oppression existing in socialist countries is “structurally dependent on its economic system.”⁵⁴ From the point of view of the liberation of productive forces, Father Zañartu also demonstrates the higher liberative power of free markets.

It is the hope of many Latin American Catholics that the works of American Jesuits such as James Sadowsky, James Schall, and Donald O’Keefe, all strong critics of liberation theology, will exert a positive influence in the numerous academic centers run by the Jesuits in Latin America.

UNIAPAC

UNIAPAC is an acronym for Union Internationale Chretienne des Dirigeants d’Enterprise (International Christian Union of Business Executives) with headquarters in Brussels. Its goals are to unite business people who wish to promote human “values” in their businesses and society. In various Latin American countries, the names of their affiliates may vary.⁵⁵

⁵³Enrique Menendez Ureña, S.J., *El Mito del Cristianismo Socialista*, (Madrid: Union Editorial, 1981) p. 190, quoted in Mario Zañartu, S.J., *Sistemas Economicos y Doctrina Social de la Iglesia* (Santiago, Chile: CEP, August 1985), Doc. de Trabajo N 51, p. 37. Father Menendez Ureña’s book is a best-seller in Spain. He had a contract signed with Orbis Books (Maryknoll) for the translation and publication of his book *The Myth of Socialist Christianity*. As one would expect, Orbis broke the contract and Father Ureña settled for a token sum of money as a compensation. The book was published by another U.S. religious publishing house as: Enrique Menendez Ureña, S.J., *Capitalism or Socialism: An Economic Critique for Christians* (Chicago: Franciscan Herald Press, 1988).

⁵⁴Zañartu, *Ibid.* p. 36.

⁵⁵In Mexico it is called USEM (Union Social de Empresarios Mexicanos, or Social Union of Mexican Entrepreneurs); in Argentina ACDE (Asociacion Cristiana de Dirigentes de Empresa, or Christian Association of Business Managers).

They share the idea that private enterprise is the most important foundation of socio-economic life. They believe that economic policy should take into account the interests of all members of society according to the principles of solidarity and subsidiarity.⁵⁶ They also promote a positive belief in entrepreneurs and their roles in building economic prosperity.

It would appear to those with some knowledge of the history of economic thought that these organizations promote the goals and use the analysis of so-called social-market economics. The writings of Catholic German moralists, well-trained in social-market economics, circulate widely among UNIAPAC members. The most respected authors in this tradition are Johannes Messner, Arthur Fridolin Utz, and Cardinal Joseph Hoffner. Hoffner, for example, studied economics at Freiburg University under Walter Eucken and was an authority on Late-Scholastic economic thought. He was highly respected by the Vatican and most orthodox theologians.

Although some libertarians regard social-market economics as a variety of interventionism,⁵⁷ these entrepreneurs and Christian laymen usually are strong defenders of the market order. They seldom confront free enterprise advocates.

The USEC (Union Social de Empresarios Cristianos) created an institute in Chile in the 1960s. It was intended to be a think tank to prevent the growth of socialist ideas. This Institute of Economic and Social Research (Instituto de Investigaciones Economicas y Sociales), which was regarded by some as “the most important entrepreneurial effort to fight communism,” was a failure.⁵⁸ The work of free market institutes, as other chapters of this book suggest, only recently gained momentum and achieved a professional approach.

⁵⁶“By virtue of [solidarity] man with his brothers is obliged to contribute to the common good of society at all its levels. Hence the Church’s doctrine is opposed to all the forms of social or political individualism. By virtue of [subsidiarity] neither the state nor any society must ever substitute itself for the initiative and responsibility of individuals and of intermediate communities at the level on which they can function, nor must they take away the room necessary for their freedom. Hence the Church’s social doctrine is opposed to all forms of collectivism.” “Instruction on Christian Freedom and Liberation,” No. 73.

⁵⁷Ludwig von Mises, *Human Action*, 3rd revised ed. (Chicago: Regnery, 1966), p. 723.

⁵⁸See Marcos Chamudes, *Chile: Una Advertencia Americana* (Santiago, Chile: SOPECH, 1973), p. 269.

In late 1986 the Christian Association of Business Managers of Argentina, ACDE, published an analysis of the Argentine economy.⁵⁹ The report calls for deregulation, spending cuts and a reduction in inflation. It also stresses the need for a strong private sector.

The Mexican USEM has its own institute of economic research, which is headed by Manuel Loza Macias, a Jesuit who has a Ph.D. in philosophy as well as a degree in economics. He is very favorable to free markets. "The freedom of enterprise," he says, "is a guarantee of the other freedoms."⁶⁰ USEM magazine's editor Lorenze Servitje wrote a brilliant piece entitled "We Have to Halt the Growth of the State." In it Servitje explained the process of the growth of the state by the combined effect of economic planning, redistributionism, left-wing ideologies, and the pressures of the bureaucratic status quo. He called the state a philanthropic ogre, a heartless and megalomaniacal monster. The growth of the state "invariably leads to political oppression," he wrote.⁶¹

THE "MYSTERIOUS" OPUS DEI

The Opus Dei (Latin for "Work of God") was founded by Josemaria Escriva de Balaguer in Madrid on October 2, 1928. Since then, Opus Dei has extended its work to most of the non-communist world and moved its headquarters to Rome. By the late 1940s and early 1950s, the Opus Dei had been established in most Latin American countries.

The Holy See approved the Opus Dei in 1948 and erected it as the Catholic Church's first personal Prelature on November 28, 1982. A personal Prelature is a jurisdictional structure of a hierarchical nature, created by the Supreme Authority of the Church for the service of the universal Church and the particular Churches. Personal Prelatures are composed of priests, deacons of *secular* clergy, and laymen. In the case of the Opus Dei, the laity is incorporated by a covenant or contract by which they dedicate their efforts to the apostolic works of the Prelature.⁶²

⁵⁹La Prensa, Buenos Aires, November 30, 1986.

⁶⁰Manuel Loza Macias, Revista USEM, October 1985, No. 104, p. 12.

⁶¹Revista USEM, March 1985, No. 97, p. 1.

⁶²See P. Rodrigues and A. de Fuenmayor, The Nature of Personal Prelatures: Their Insertion Within the Structure of the Church, IUS CANONICUM, Vol. XXIV, no. 47 (1984), pp. 9-47.

According to the Vatican, not only has this institution strived to illuminate the mission of the laity in the Church and in society, but it has also endeavored “to put into practice the teaching of the universal call to sanctity, and to promote at all levels of society the sanctification of ordinary work, and by means of ordinary work.”⁶³

Almost from the moment of its creation, this Roman Catholic institution was the object of accusations and misunderstandings. Fascists in Spain, freethinkers in London, and socialists from various countries have voiced their attacks. According to Msgr. Escriva, “No sooner had it been born, than it met with the opposition of all the enemies of personal freedom . . . people characterized by partisanship, when not by narrowmindedness or a totalitarian mentality, who do not understand pluralism and who use their reputation as Catholics for political purposes.”⁶⁴

There is nothing secret about this institution. Certain myths and misunderstandings persist perhaps because their 80,000 members carry out their vocation by living ordinary lives and are seldom noticed. They do not wear habits (except the priests, who represent less than 2 percent of the membership), they do not carry banners, and they do not send official delegations to theological conferences.

As some members have reached high political positions,⁶⁵ a number of observers have concluded that Opus Dei has a political-economic agenda. This, however, is not the case. Opus Dei members often are political adversaries and have been criticized by both the right and the left.⁶⁶

⁶³From the Apostolic Constitution *Ut Sit*, St. Peter's, Rome, November 28, 1982.

⁶⁴*Conversations with Monsignor Josemaria Escriva*, Manila, Sinag-Tala, first English ed. 1968, 2nd Philippine Ed. 1981, (No. 33), pp. 54-55.

⁶⁵In 1957, Alberto Ullastres, an Opus Dei member, was appointed minister by Francisco Franco.

⁶⁶Due to the uncompromising and universalist stance of the Opus Dei, the name of his founder and “his” doctrine were sent with a condemnatory judgment to the secret archives of the Falange. Spanish official documents attacked the institution. See *El Fundador del Opus Dei*, by Andres Vazquez de Prada (Madrid: Rialp, 1982), pp. 223-224. Opus Dei was also denounced to the “Tribunal for the Repression of Freemasonry” as being a “Jewish sect in league with the Masons.” A profile of Msgr. Escriva, *Founder of Opus Dei*, Sinag-Tala, Manila, New York, n.d. p. 310. Original ed. *Mons. Josemaria Escriva de Balaguer Apuntes sobre la vida del Fundador del Opus Dei* (Madrid: Rialp, 1976).

Libertarian intellectuals such as Friedrich A. Hayek, Ludwig von Mises, Milton Friedman, and even Murray Rothbard have their fans within Opus Dei ranks. Others may be disciples of such Keynesian advocates as Kenneth Arrow, James Tobin, or Paul Samuelson. On the whole, however, in Argentina, Mexico, and wherever Opus Dei has been extended, leading economists affiliated with Opus Dei are members of noncommunist political parties that promote the respect for personal freedom and private property. Opus Dei regards nationalism (not patriotism) as a sin.

The main goal of Opus Dei is the sanctifying of Christians through daily work. The Christian ethic of work for Opus Dei is comparable to the Protestant ethic of thrift, initiative, self-discipline and the desire to contribute to society. Those who consider the lack of a work ethic to be the main cultural barrier hindering Latin American economic development may see the Opus Dei spirit as conducive to material growth, and perhaps a contributing factor to a better environment for economic freedom. Prosperity, however, does not necessarily generate more respect for economic freedom as poverty, per se, does not generate a desire for socialism.

To some, Opus Dei may seem a bastion for conservative causes because its members understand that the Church teaches that "Marxism is incompatible with the Christian faith."⁶⁷ Apart from this, Opus Dei "is absolutely foreign to any political, economic, ideological or cultural tendency or group."⁶⁸ If the struggle for economic freedom is a choice between an interventionist and a free market economic system, the conclusion should be that the outcome is independent from Opus Dei influence. If, on the other hand, the struggle includes the possibility of a communist economic system, undoubtedly Opus Dei members should be regarded as furthering the cause of economic liberties.

THE T.F.P.

Unlike Opus Dei, the members of the Society for the Defense of Tradition, Family, and Property (TFP), carry banners, publish books, and are easily recognized. TFP is a civic organization drawing

⁶⁷Josemaria Escriva de Balaguer, *Friends of God* (New York: Scepter, 1979), No. 171.

⁶⁸Josemaria Escriva de Balaguer, *Conversations* (No. 28), pp. 44.

inspiration from the traditional doctrine of the Catholic Church. “It specializes in carrying out a peaceful, ideological action of an anticommunist character mainly in Catholic circles.”⁶⁹

TFP is an association of Catholics but not an official Catholic institution. Its more than 30 published books and its position papers and newspaper advertisements usually reflect strong criticism of left-wing bishops. The Society is especially active in Brazil.

TFP considers the Brazilian Bishop Conference (CNBB) as the fifth branch of government (the fourth being the media). Communism is growing in Brazil by “its diffusion in religious guise by followers of certain currents of the so-called liberation theology.”⁷⁰ TFP’s confrontational stance may be seen in the following statement of its leader: “In Brazil, this controversy (between communism and anticommunism) has two poles. On one side are those who adhere to a certain ‘liberation theology’ — these are openly esteemed by the CNBB (acting through the Basic Christian Communities [BCCs]). And on the other side is the TFP.”⁷¹ Some TFP tactics seem so shocking and extravagant they have produced an image of fanaticism. They often gather on busy street corners, carrying ten-foot-tall medieval banners whose red and gold colors and careful crafting recall an almost forgotten age of chivalry. Using non-electric megaphones, they loudly condemn communist policies. Their impeccable clothes and masculine haircuts enhance their Ivanhoe images.

TFP is now active in the United States, which may explain why their first publication in English is more scholarly than most of their previously published books. Their analysis of agrarian reform in Brazil⁷² denotes a clear understanding of the free market order and the danger of government intervention in the economy. Despite their essential agreement with the goals of this organization, most conservative Christians will not endorse their activities due to TFP’s barricade tactics.

⁶⁹The latest book published by TFP is Carlos Patricio del Campo, *Is Brazil Sliding Toward the Extreme Left? Notes on the Land Reform Program in South America’s Largest and Most Populous Country* (New York: TFP, 1986), with a foreword by Plinio Correa de Oliveira. The quote is from the foreword, p. 28. Plinio Correa de Oliveira is former president of Catholic Action.

⁷⁰*Ibid.* p. 26.

⁷¹*Ibid.* p. 27.

⁷²*Is Brazil Sliding Toward the Extreme Left?*

THE ROLE OF CATHOLIC UNIVERSITIES

Since early colonial times, Latin America has had many Catholic universities. Although the Church is theoretically responsible for the economics taught at these academic centers, the teaching varies greatly from university to university.

I studied at the Argentine Catholic University from 1972 to 1978, then taught there for four years. During my student years almost all of the economics professors were Keynesian (only one assistant professor was from the monetarist branch of Keynesianism). Our textbooks were similar to the books then used at American Keynesian universities (Paul Samuelson, James Tobin, Richard Musgrave, Warren Smith, et al.). We had 12 semester-long courses in mathematics and econometrics and only one semester on the history of economic thought. In the faculty of business administration, the books of John Kenneth Galbraith were regarded as the ultimate words of economic wisdom. It is appropriate to conclude that in Argentina most Catholic universities are orthodox in theology and interventionist in economics.⁷³

Crossing the Andes, 1,500 miles west from Buenos Aires, the Chilean Catholic University has been following a different path. For almost four decades, the Catholic University there had strong academic ties with the University of Chicago. It is from this relationship, not from Milton Friedman's visit to Chile, that close ties developed between Chilean economists and the Chicago School. Graduates from Chicago form the core of the economic faculty at Chile's Catholic University and hold prominent positions in its administration. The faculty in the political science department also is receptive to free market scholars, and the journal produced by their institute has published articles by Michael Novak and several other pro-free market Catholics.

In contrast, the Universidad Centro Americana Jose Simeon Cañas (UCA) should be noted. The famous left-wing leaders of the Salvadoran terrorists, Guillermo Ungo and Ruben Zamora, were

⁷³There are at least ten Catholic universities in Argentina. For their economic beliefs, see *Conclusiones y Recomendaciones del Tercer Congreso Argentino de Economía Política de Universidades Católicas*, La Plata, Federación Argentina de Universidades Católicas, 1980.

professors at the UCA. Liberation theology, however, is not totally unchallenged in Central America. In beautiful Guatemala City, the Universidad Francisco Marroquin and the Salesian Order have a joint university program in theological and philosophical studies. Like every student at the university, each theology student and seminarist is required to take two courses on free market economics and two on social philosophy (where books by F.A. Hayek are mandatory reading). A former Jesuit, Armando de La Torre, is the dean of the faculty of political science. He is a brilliant critic and analyst of liberation theology.

Except in the case of Chile, almost all Latin American Catholic universities are disseminating interventionist and socialist dogmas. Some have flirted with Marxism, others with fascism. Since most school officials are appointed with the consent of local bishops, the Church cannot claim to be without blame. However, in order to accurately assess the responsibility of the Catholic universities' role in the decline of economic liberties, one must also take into account other leading universities. Undoubtedly, state universities in Latin America have leaned even further toward socialism than have Catholic ones.

CHRISTIAN DEMOCRATIC PARTIES

Christian Democratic Parties (CDP) were created in the late 1920s. By the 1950s they had shifted to the left. This change prompted divisions among many Christians, who saw contradictions between their beliefs and the socialist platforms of Christian Democratic parties. In Guatemala, Chile,⁷⁴ Venezuela, and Argentina, most of its members are leftist, in the style of French-Belgian Christian Democrats. In Panama, however, the party resembles the kind of Christian Democracy found in West Germany. Both its president, Dr. Ricardo Arias Calderon, and its vice-president, Dr. Guillermo Cochez, are strong defenders of political and economic freedoms.

The conservative Christian Democrats receive strong support from the Konrad Adenauer Stiftung (KAS) and the Institute for Internationale Solidaritat. This foundation, with offices in several

⁷⁴On the flirtation of the Chilean Christian Democratic Party with communism, see Marcos Chamudes, *Chile: Una Advertencia Americana* (Santiago, Chile: n.p., n.d.), pp. 202-242.

Latin American countries, promotes social-market economic principles through publications, seminars, and conferences. The ideology of Christian Democrat Latin American parties varies widely; hence, the Adenauer Foundation sometimes supports Christian socialists rather than sound economics.⁷⁵ This tends to occur whenever and wherever there is not an organized conservative Christian Democratic Party, as in Guatemala and Chile.⁷⁶

CATHOLIC ACTION

The Catholic Action organizations, founded in the 1920s, were considered to be the right hand of the hierarchy of the Church. Their members, mostly laymen, had an ecclesiastical spirit with absolute fidelity to the Roman Pontiff. For decades, their objective was to spiritually transform the society.

While some Catholic Action groups retained these qualities,⁷⁷ others, such as the Brazilian Catholic Action, changed. Perhaps the most radical group is the Catholic Youth Workers Movement (JOC). In the late 1950s this group was primarily concerned with its members' sacramental life, but by 1970 it was committed to a socialist project.⁷⁸

It seems fair to say that Catholic Action groups' role in relation to economic freedom will tend to be similar to the role of the hierarchical Church.

⁷⁵On the role played by Christian Democratic parties in furthering the cause of socialism with strong support from American and German liberals, see Educocio Ravines, *El rescate de Chile* (Santiago, Chile: Edimpres, 1974).

⁷⁶It would be logical for the KAS to review its definition of "Christian Democratic Party." Many parties and research centers not allowed to use that name may embody the principles of the Christian Democratic Union and Ludwig Erhard much better than the official Latin American Christian Democratic parties.

⁷⁷As the Argentine Catholic Action.

⁷⁸Scott Mainwaring, *The Catholic Youth Workers Movement (JOC) and the Emergence of the Popular Church in Brazil* (Notre Dame, Indiana: Helen Kellog Institute for International Studies, University of Notre Dame, 1983), p. 2.

OTHER CHRISTIAN CHURCHES

About 30 percent of all Protestant missionaries are in Latin America. The Church of Jesus Christ of Latter-day Saints (Mormon Church) alone claims more than 900,000 members in the region. With 7,200 missionaries in the area, the Mormons regard Latin America as its most productive territory. Because they are devoted to the principles of a free society, the Mormons should be regarded as a positive influence in the battle for economic freedom in Latin America.

CONCLUSIONS

There is no doubt that a confrontation is taking place in the Catholic Church and that Latin America is one of the principal battlegrounds. While factions in this battle are growing more diverse, the destiny of economic freedom in the area depends in part on the outcome of this confrontation.

It would seem that the so-called Popular Church has the advantage. Supposedly, the main objective of orthodox Christians is to grow inwardly. However, the goal of the politicized Church is to grow outwardly. In the former, the struggle occurs within each soul; in the latter it occurs with others, the revolutionary class, against the dominant class, the rich. If the orthodox Church is indeed passive regarding political activity, then the temporal struggle will be won by the militant Church.

The message of the hierarchy to the laity does not encourage passivity and lack of commitment.⁷⁹ On the contrary, it calls for involvement. The activities of the members of lay organizations serve to balance the activism of the left. The same may be said of the work of multitudes of Catholics who, while faithful to Rome, do not belong to organizations and strive for a Latin America with "freedom and justice."⁸⁰ While the current stance of the Vatican is not supportive, it is at least not aimed at undermining the efforts of those who think

⁷⁹Rome has been criticizing what it describes as a "negative flight from the world" on the part of lay people. *Lineamenta*, p. 10.

⁸⁰I am using these words in the sense of Michael Novak's *Freedom With Justice* (San Francisco: Harper & Row, 1984).

that economic freedoms are an essential element for the order of any Christian society.

International funding organizations⁸¹ will continue supporting liberation theologians and their allies. The voice of the hierarchy may increase the exposure of some Church organizations that are in the socialist vanguard, such as Maryknoll, and therefore decrease the amount of support they receive from innocent parishioners. But this will not be enough to halt the flow of aid that the Popular Church receives from the Western world.

By way of summary, it is reasonably safe to make the following predictions:

1. The Church, apart from a very small minority, will keep assuming positions and issuing statements on economic matters.
2. These statements will tend to reflect mainstream economic thought.
3. The ideas of conservative free market theologians such as Michael Novak, and of free market Jesuits including James Schall, James Sadowsky, and Enrique Menendez Ureña, will attract more followers.
4. At least for the two next decades, the Church will maintain a middle-of-the-road approach that will be criticized by both communists and libertarians.
5. Radical liberation theologians will see their ranks dwindle.

⁸¹Not only left-wing foundations support liberation theology. Very recently I told a senior program officer of a major U.S. conservative foundation that I assumed they were not supporting liberation theology causes. His sincere answer was, "If you give general support to the Church, some of the money, unfortunately, goes to support liberation theology, and that is what we do."

Pope John Paul II reminded the faithful that “the Church endeavors to remain free in relation to opposing systems.”⁸² If the hierarchy ceases issuing political pastorals, the battle will still go on, but it will be between lay Catholics. The prestige of the Church will not suffer, as it will not be obliged to take sides. But as politics and economics are intrinsically connected with the dignity of the human person, it is doubtful the Church ever will remain silent on such topics.

From a free market perspective, the Church’s most positive contribution to economic freedom is that, due to its teaching, there is a reluctance on the part of the faithful to accept socialism without limits. For this reason the left regards the hierarchical Church as a supporter of the “capitalist” status quo. Every stance that does not call for the complete socialization of the means of production is considered by them as “reformist” and bound to fail.⁸³

To what degree should the Church be blamed for its espousal of bad economic policies? Suppose we ask about the influence of economists in the struggle for economic freedom. Our answer will be very much the same as with the Church. Several Nobel Laureates in economics frequently preach against free markets. The Ivy League universities, with their scholarship programs for Latin American bureaucracies, have helped to indoctrinate several generations with statist dogmas. Is it fair then to demand that Church members know economics better than the economists? Are we not asking the impossible? If politicians, sociologists, lawyers, philosophers, and others do not know economics, why should the Church be different? In our age the Church is not an originator of economic ideas. It is a disseminator, a powerful disseminator granting moral approval to the economic policies it endorses.

The best way to understand the fate of economic freedoms in Latin America is to look at the centers of economic learning. If the

⁸²Pope John Paul II, “Truth, Unity and Human Dignity,” address at the opening of the third General Conference of the Latin American Episcopate (January 28, 1979), reprinted in James V. Schall, *Liberation Theology*, p. 347.

⁸³Liberation theologians criticized the Alliance for Progress for being reformist. See Lopez Trujillo, *Liberation or Revolution*, p. 40. The Alliance for Progress was a plan devised by U.S. bureaucrats for gradually socializing Latin American economies. Ernesto “Che” Guevara, at the time Commerce Minister of Cuba, praised the economic aspects of the plan.

Vatican shifts into neutral, then the battle will be decided by the economists. The fate of freedom then will rest primarily on the work of all those intellectuals at free market research centers that are sprouting up throughout Latin America and the world. Or it will depend on those few scholars in fewer universities who have the courage to resist the socialist deluge. As the Church changed its views on matters of interest rates, the Church can easily change its views on matters of production and distribution, inflation, and international trade.

The division and confusion in the Church today does not allow for an easy forecast. Economic freedoms have very few champions. Latin America is not an exception, nor is the Catholic Church. The growth of free market institutions, the failure of socialistic and interventionist economies, and the new respectability of free market economists⁸⁴ should be influencing the opinion of all serious intellectuals. If the Church fails to understand the benefits of a free economic system, it will lose the chance to further the development of many poor regions in the world.

The dominance of Keynesian and Marxist analysis in leading academic centers has influenced the training of economists, philosophers, sociologists, and politicians. Theologians were not an exception. The emergence of new centers of economic learning and research and the increasing prestige of free market academicians will moderate Church doctrine. However, at least for the next decade, the Church will continue to support interventionist policies. The torch for economic freedoms will be carried by laymen; the hierarchy, at most, will be less active in promoting economic systems that produce stagnation.

⁸⁴As evidenced by the Nobel prizes in economics awarded to Milton Friedman, F. A. Hayek, George Stigler, and James Buchanan.

APPENDIX

THE ECONOMIC MESSAGE OF POPE JOHN PAUL II TO LATIN AMERICANS

During his recent trips to Latin America, the current leader of the Catholic Church spoke frequently about economic issues. In some instances, as in his speech before the economists of the CEPAL,¹ economic judgements have been central to his message. John Paul II has defended private initiative, condemned class struggle, analyzed regional and international economic programs, extolled the labor unions, and praised the entrepreneurs. He repeatedly warned his audience that he is not speaking as an economist or politician. The power of the Church and his role is such that few take these warnings into consideration. His message will be politicized by all those who think they can profit from it.

What follows is a collection of quotes about economic matters from the speeches made by John Paul II during his 1987 and 1988 trips to Latin America. In an effort to contribute to the readability and value of this appendix, I will provide only minor comments on his remarks.

THE IMPORTANCE OF PRIVATE ENTERPRISE

Speaking to economists in Chile, the Pope defended a mixed economy, the boundaries of which are not clearly defined, and greatly lauded the creative power of private enterprise:

¹The United Nations' Economic Commission for Latin American and the Caribbean (ECLAC), with headquarters in Santiago, Chile.

The State must not supplant the initiative and responsibility which the individuals and the smaller social groups are capable of assuming in their respective fields; on the contrary, the State should foster actively these environments of freedom; at the same time it ought to order their activity and watch over their adequate insertion into the common good.

Very different forms of relationship between public authority and private initiative can fit in this framework.

The challenge of poverty is so great that in order to overcome it, we must make the greatest possible use of private enterprise, with its potential effectiveness, its capacity to use resources efficiently, and the abundance of its energies for renewal. The public authority, for its part, cannot abdicate the direction of the economic process, using its ability to mobilize the nation's strengths to cure the characteristic deficiencies of developing economies, in short, from its ultimate responsibility for the common good of the entire society.²

INTERNATIONAL TRADE

The Argentine economy has suffered not only from local mismanagement, but also from the agricultural protectionist policies of the developed world. On April 11, 1987, speaking to entrepreneurs in Buenos Aires, the Pope addressed these issues:

I am also aware that, together with this abundance of resources, in recent years you have suffered economic and financial difficulties, which were sometimes critical. I am referring particularly to the serious problems concerning the foreign market for the products of your agricultural and livestock industries, as well as the repercussions of that situation on your economy. You have seen to what extent the progress

²To the economists at the CEPAL, in Chile, April 3, 1987, *L'Osservatore Romano*, English weekly edition (hereinafter *OSR*), No. 18, May 4, 1987, pp. 6-7. Emphasis Added.

of nations depends greatly on the international order, which demand the search for solutions expressive of true solidarity and cooperation among different peoples, and based on the consciousness of universal brotherhood.³

THE ROLE OF THE ENTREPRENEURS

The Pope spoke very highly of the role which entrepreneurs play in society:

[T]he degree of well-being that society enjoys today would have been impossible without *the dynamic figure of the entrepreneur*, whose function consists in organizing human labor and the means of production in order to produce goods and services. Without any doubt, your task is the first order for society.⁴

He added that “resources should be administered not only with technical competence and the capacity of initiative, but above all, with a well-formed Christian conscience.” In this way “the work of the entrepreneur can very well be compared to that of the steward.” The Pope concluded that entrepreneurs “are to contribute to ... the opening of opportunities that will allow more people to own property.”

John Paul’s defense of private initiative and the importance he assigns to the dissemination of private property are further enhanced by his argument that

[B]usinesses are legitimate expressions of freedom. They belong to the vocation of man, to his creative initiative, to the needs of the community and to the possibilities which the riches of creation entrusted to the human being offer.⁵

In this way, business is not only increasing material wealth and the great promoter of socioeconomic

³April 11, 1987, speaking to Argentine entrepreneurs, *OSR*, No. 20, May 18, 1987, p. 12.

⁴Speech to the entrepreneurs in Milan, May 22, 1983. Emphasis added.

⁵*Ibid.* Emphasis added.

development, but also the cause of personal progress, which allows the creation of more humane living conditions. Its activity is inserted within the *framework of the common good*

[T]he *fundamental law of all economic activities is the service of man*, of all men and of the whole man, in his complete totality — material, intellectual, moral, spiritual, and religious. Consequently, profit should not only be used to increase capital, but it should also be destined, with a social sense, to the raising of the wages, providing social services and opportunities for technical training, research and cultural promotion along the path of distributive justice.⁶

After such an analysis it is understandable for the Pope to conclude that “there is a certain biblical similarity between the businessman and the Shepherd. It is an analogy.”⁷

ON LABOR

The Pope’s attitude and stance regarding the labor market is exemplified by the following quote: “Let salaries be set in accordance with human dignity and the personal and family needs of the worker rather than what are sometimes the cold and inhuman *laws of the market*.”⁸

On May 8, speaking to the workers in Melo, Uruguay, he argued that the employer “should see to it that the farm workers have living conditions that will keep them from migrating to the cities, which causes serious human and social problems.”⁹ And addressing the Argentine laborers he censured: “*Enough* to certain situations in which the rights of labour are harshly subordinate to economic

⁶Emphasis added.

⁷April 11, 1987, speaking to Argentine entrepreneurs, *OSR*, No. 20, May 18, 1987, p. 13.

⁸Speech to the Workers in Bahia Blanca, Argentina, April 7, 1987. *OSR*, No. 19, May 11, 1987, p. 8.

⁹*OSR*, No. 21, May 23, 1988, p. 5.

systems, which seek exclusively the greatest profit, without considering the moral quality of the means that are used to obtain it.”¹⁰

CLASS STRUGGLE

The Pope asked the Bolivian representatives of culture and businesses to make a “wide area open to economic initiative ... This initiative is also an inalienable right which is often denied because of the irresponsibility and selfishness of the dominant classes.”¹¹

On the other hand, he clearly contradicts Marxist ideologues with the following statements: “Be careful not to let yourselves be seduced by teachings that try to justify violence or hatred, which reduce the members of the human family to simple factors of historical evolution ... who oppose one another in a class struggle.”¹²

Labor union activities “cannot be identified with the struggle of social classes; such an idea is ideologically and historically unsatisfactory, and its worst consequences lead to the disadvantage of men and women workers.”¹³

Unlike the communists, the Pope frequently reminds Latin Americans that owners, managers, employees, and workers, “are not enemies, but brothers and sisters.”¹⁴

After stressing that labor unions should not become a “mouthpiece” for class struggle, he asserted that “efforts to secure the rights of workers who are united by the same profession should always take into account the limitations imposed by the general economic situation of the country.”¹⁵

¹⁰April 10, 1987, speaking to the workers, *OSR*, May 18, 1987, p. 8.

¹¹To the representatives of culture and businesses, May 12, 1988, *OSR*, June 13, 1988, p. 17.

¹²May 11, to the youth in Cochabamba, Bolivia, *OSR*, No. 24, 13 June, 1988, p. 12.

¹³April 10, 1987 to the Workers in Buenos Aires, *OSR*, No. 20, May 18, 1987, p. 8.

¹⁴April 11, 1987, speaking to the Argentine entrepreneurs, *OSR*, No. 20, May 18, 1987, p. 12.

¹⁵*OSR*, No. 21, May 23, 1988, p. 5.

In Argentina, the Pope added that even “when the purpose of a specific action is to safeguard the rights of a person or a working class, that objective *must not be in opposition to the common good of the whole society*. Neither should you forget solidarity with those persons who, for various reasons, are not members of your organizational force.”¹⁶

INEQUALITIES OF WEALTH, THIRD WORLD DEBT, AND LAND REFORM

On May 11, 1988, speaking to the youth at Cochabamba, Bolivia, the Pope sounded like a harsh social critic:

It is not easy to understand the reasons for so many situations of injustice and oppression, of disregard for fundamental human rights. Inequality with no possible justification from the Christian or even human point of view exists when, side by side with people with abundant riches who are driven by unbridled consumerism, there are other people suffering from hunger and every type of material and spiritual need.¹⁷

On May 10, 1988, John Paul II condemned the practice of donors conditioning economic aid with practices inconsistent with Catholic doctrines. Do not, he said, “tolerate the injustice in their making the limitation of births a condition for their giving economic aid for the promotion of your communities. (*c/f Sollicitudo Rei Socialis*, 25).”¹⁸

We should never cease working for justice. In doing so, however, we should avoid the extremes of certain liberation theologies.

This commitment to justice and to eliminate every abuse and form of oppression, has led to a current of thought and action which, especially in Latin

¹⁶*Ibid.*

¹⁷*OSR*, No. 24, June 13, 1988, page 11.

¹⁸*OSR*, No. 23, June 6, 1988, p. 7.

America, has taken the form of a yearning for *liberation* from every yoke and slavery.

Without doubt, it is a noble and valid longing; one cannot deny that there are positive values in a liberation theology which is sound and genuinely evangelical. However, it must not be forgotten that “the deviations and risks of deviation, which are connected with this form of theological reflection and method, have been appropriately pointed out by the Church’s Magisterium” (c/f *Sollicitudo Rei Socialis*, 46).¹⁹

According to the Pope, in order to achieve justice we need to promote development — both spiritual and material. Speaking to diplomatic corps he said:

Indeed, peace, which is essentially a work of justice, finds its way and its strength in the promotion of development. However, this development is not all limited to quantitative economic growth, but hastens, first of all, total social development, under the forms of a better distribution of wealth and improvement of living conditions — both spiritual and material — of each individual and of all the people.

The extreme poverty that still burdens many countries is an insult to the whole of humanity. The abysmal gaps between rich and poor countries are incompatible with the divine plan for everyone’s just and equitable sharing in the goods of creation. Furthermore, underdevelopment, as you well know, is one of the causes of the serious social and political instability of many countries afflicted by it. It is a fact that these factors of instability affect not only the less-developed countries, but they are also the cause of other, larger conflicts which can threaten international peace.

Among these factors of instability that afflict today’s world, particularly the developing countries, is the heavy burden of the *foreign debt*. The imbalance

¹⁹*OSR*, No. 23, June 6, 1988, p. 5.

between the amount of the debt and the ability to repay it, the difference between the sum given to the borrowers and the profits [sic]²⁰ demanded by the creditors, cause very serious harm to many poor countries. The enormous burden of that debt puts these countries in danger of frustrating their legitimate aspirations to the development which is their due.²¹

Most of the Pope's statements are normative; when he speaks about economics and history, however, he frequently makes positive statements which can be verified or refuted by empirical analysis. An example of a positive statement is his judgement, at a meeting with the workers of Oruro, Bolivia, that the instances of poverty "are more evident every day."²² The Pope also remarked "I know that there is a great imbalance between the salaries you receive and the ever-rising cost of living."²³ On the controversial subject of land reform, the Pope argued that he knew "that Bolivia was one of the first countries in Latin America to implement land reform, which in the beginning enabled many of you to acquire a title to at least a small piece of land. Nevertheless, the inconveniences of owning a small piece of land in a vast thinly-populated area and the existence of very large estates have not ceased to create serious problems for the farmer." He then called for a more "*equitable distribution of arable land*" and for the authorities "to improve the farmers' conditions with regard to land ownership, culture and sanitation, and *provide them with property deeds*, which many of them still lack."²⁴

ON FREE MARKETS

The Pope expressed both praise and criticism for free market economies:

Certainly, we cannot deny that good results have been achieved by the joint effort of public and

²⁰I apologize for including this *sic* but the billions of dollars in *losses* incurred by the shareholders of the banks which lent money to Latin America undermine the Pope's statement.

²¹*OSR*, No. 23, June 6, 1988, p. 5.

²²*OSR*, No. 24, June 13, 1988, p. 6.

²³*Ibid.*

²⁴May 11, 1988, at a meeting with the workers at Oruro, Bolivia, *OSR*, June 13, 1988, p. 6.

private initiative in those countries where a free regime is in force. Such gains, nevertheless, should not serve as a pretext for overlooking the defects of an economic system whose main motivating factor is profit, where the person is subordinated to capital, thus becoming a mere cog in the immense machinery of production, reducing work to a mere commodity subject to the fluctuations of the law of supply and demand.²⁵

He then called for economic models which are not based on profits or consumption “but on *sharing and solidarity*.”²⁶

THE NONPOLITICAL MISSION OF THE CHURCH

Although he passes judgment on such important issues, the Pope clearly states that his mission and that of the Church is not to give technical solutions to political and economic problems. At a Mass in Florida, Uruguay, he told the bishops that,

Truly convinced that it is the laity’s task to sanctify temporal structures, you are to inculcate in the consciences of the priests the obligation, which their own identity imposes on them, not to water down the authentic ministry in activities that are not proper to their condition. Let them show their unity with the whole Church by teaching the truths of the faith without reductionism of dubious interpretations. Here too the words of St. Paul are relevant when he says to Timothy, “I asked you . . . to insist that certain people *stop teaching strange doctrines* . . . which are only likely to raise irrelevant doubts instead of furthering the designs of God which are revealed in faith” (*1 Timothy 1:3-4*). Unity is threatened particularly by that erroneous theological position which “emphasizes, unilaterally, the liberation from servitude of an earthly and temporal kind” (*Libertatis Nuntius*, Introduction), forgetting that “liberation is

²⁵May 11, 1988, at a meeting with the workers at Oruro, Bolivia, *OSR*, June 13, 1988, p. 6.

²⁶*Ibid.*

first and foremost liberation from the radical slavery of sin” (*Ibid.*).²⁷

On another occasion, he declared that “The Pastor who is speaking to you has no technical solutions to offer you; this is your task as experts.”²⁸ And on April 11, speaking to entrepreneurs in Buenos Aires, he added: “You know very well that the mission of the Church and of the Pope is not to give technical solutions to socioeconomic problems.”²⁹

This nonpolitical mission of the Church is an essential point of Catholic Social Doctrine:

The Church recognizes, respects, and encourages the legitimate autonomy of temporal realities, and specifically of politics. Her mission places her on a different level; she “is a sign and a safeguard of the transcendent character of the human person” (*Gaudium et Spes*, 76) ... “the vast area of political questions belongs to the proper role of the Catholic laity; they must seek solutions which are compatible with Gospel values from among the different ones ...” (*Gaudium et Spes*, 76).³⁰

²⁷*OSR*, No. 22, May 30, 1988, p. 4.

²⁸*OSR*, No. 18, May 4, 1987, p. 7.

²⁹*OSR*, No. 20, May 18, 1987, p. 12.

³⁰*OSR*, No. 19, May 11, 1987, p. 6.

10

POLITICS AND ECONOMICS

EDITOR'S INTRODUCTION

Ever since Adam Smith produced his classic work, *An Inquiry Into the Nature and Cause of the Wealth of Nations* in 1776, advocates of liberty have held that freedom and economic progress go hand in hand. Free societies allow individuals to engage in mutually beneficial exchange and to take full advantage of opportunities for specialization and trade — activities which Adam Smith believed were essential to efficiency in production and economic growth. Such economic growth increases the standard of living of individuals and families.

Until recently these beliefs were articles of faith, buttressed only by casual empiricism rather than rigorous scholarship. Modern research techniques, however, allow scholars to make quantitative estimates of the scope of freedom within particular countries and of the efficiency of entire economies. With these tools in hand, researchers are not merely affirming traditional beliefs about the importance of liberty to economic prosperity, they are quantifying this relationship. Gerald Scully, the author of the following chapter, has been an intellectual pioneer in developing these research techniques.

The degree to which countries permit economic, political and civil liberties varies widely in Central and South America. So does economic prosperity. For example, Costa Rica not only has the freest economy south of our border, it ranks seventh among all the nations on a comprehensive scale of economic liberty. Costa Rica also has sustained an annual 2.5 percent rate of increase in Gross Domestic Product (GDP) from 1950 to 1985.

By contrast, Haiti and Guyana have two of the least free economies in the world. On the scale of economic freedom, Haiti ranks 96th out of 144 countries; Guyana, 106th. Not coincidentally, these countries have two of the lowest growth rates in the world. From 1950 to 1985, Haiti's annual growth rate was only .24 percent and Guyana's was negative.

Scully shows that political liberty (e.g., free elections) and civil liberty (due process, freedom of speech, etc.) are also important to economic well-being. In general, countries which protect civil and political liberties have economic growth rates twice as high as countries that do not. Countries which ensure all three types of freedom — economic, political, and civil — have economic growth rates three times higher than countries which suppress all three.

Similar findings apply to the efficiency with which countries use labor, capital and other resources to produce goods and services. Scully finds that, on the average, countries which protect economic, political, and civil liberties are twice as efficient. Unfree countries could in principle double their national output, other things being equal, simply by adopting institutions of freedom.

Yet another way to approach this question is to focus on the size of government, measured as the percent of GDP represented by government spending. Scully finds that an increase from 10 percent to 30 percent in the share of GDP spent by government will cut a country's economic efficiency in half. Conversely, cutting government's share of GDP from 30 percent to 10 percent will double the country's output, given the same resources.

These findings are not restricted to the less-developed countries of Latin America. They have worldwide implications.

STATISM VERSUS INDIVIDUALISM AND ECONOMIC PROGRESS IN LATIN AMERICA

GERALD W. SCULLY

How much has the material progress of countries been affected by their choice of political and economic institutions? The Western industrialized countries and many of their former colonies chose an institutional framework which permitted a wide latitude for

individual initiative, choice, and responsibility. In general, these countries are capitalist, democratic, and committed to the rule of law. However, rising nationalism and the independence movement after World War II gave many new nations the opportunity to choose an institutional framework which emphasized state control and economic planning and which deemphasized individual initiative. Many nations selected this route and sufficient time has passed to judge the results. In what follows, we examine the effect of the choice of an economic system, levels of political and civil liberty, and the size of the state on the growth and the efficiency of Latin American economies. The conclusion: Nations that suppress economic, political, and civil liberties have gravely affected the standard of living of their citizens.

TWO PARADIGMS ON ECONOMIC PROGRESS

There are two contrasting paradigms of the path by which countries progress economically: individualism and statism. Both paradigms are old and are still debated. The idea that government planning leads to material progress is the older vision. The wisdom of the state in creating the conditions for material progress through intervention and regulation was first articulated systematically by the mercantilists. In modern times state intervention is justified by the “vicious cycle of poverty” thesis. This thesis has been advanced by many writers, but has been elaborated substantially by Gunnar Myrdal.¹ The contrasting vision is that material progress is greatest if individuals have the right to pursue their own affairs unmolested by the state. The concept of society as a nexus of private arrangements that are mutually beneficial is contained in the contractarian political theory of David Hume;² the concept of law as sanctioned private arrangements was advanced by Sir Edward Coke;³ and the economic theory and policy of *laissez-faire* was developed by Adam Smith in 1776.⁴ Modern thinkers who adopt Smith’s premises on economic

¹Gunnar Myrdal, *An International Economy: Problems and Prospects* (London: Harper, 1956); *Development and Underdevelopment: A Note of the Mechanism of National and International Inequality* (Cairo, 1957); *Economic Theory and Underdeveloped Regions* (London: Duckworth, 1957); and *Asian Drama: An Inquiry into the Poverty of Nations* (London, Penguin, 1968).

²David Hume, *Treatise on Human Nature*, edited by L. A. Selby-Bigge (Oxford: Clarendon, 1960).

³Edward Coke, *First Institute: A Commentary on Littleton* (London, 1628).

⁴Adam Smith, *The Wealth of Nations* (New York: Modern Library, 1937).

development are Sir W. Arthur Lewis⁵ and Peter T. Bauer and Basil S. Yamey.⁶

The current views of economic development through state control of the economy and economic planning are rooted in the mercantilist conception of the conditions of economic progress. S. R. Sen credits Sir James Steuart's *An Inquiry into the Principles of Political Economy: Being an Essay on the Science of Domestic Policy in Free Nations*, which was published in 1767, as the pioneer theoretical work on economic planning.⁷ Among the principal concerns of Elizabethan times were an adequate supply of food, an adequate supply of labor in agriculture and in the crafts, and price stability, particularly for grains and for labor. Elaborate policies and regulations were introduced to pursue these goals. The mercantilists believed "... that the government ought actively to undertake to guide the activities of its citizens into those lines which were conducive to national well-being ... And so for almost the whole realm of economic life, that the government should have a detailed economic policy which required active intervention in the affairs of the community in a thousand and one ways, all with the great purpose of achieving exactly the aim Adam Smith wanted to achieve: the most rapid possible increase in the country's wealth."⁸

Beyond reconstructing war-ravaged economies and restoring the international economic order, the great concern of the twentieth century has been improving the standard of living of the underdeveloped nations. The fashionable view was that the gap between rich and poor nations was caused by a vicious circle of poverty, which could only be broken by extreme measures. The diagnosis was as follows: Incomes were low because productivity was low; productivity was low because of a lack of capital formation; capital formation was low because of a "small capacity to save"; saving was low because income was low. Alternatively, the inducement to invest was low, because income (buying power) was

⁵W. Arthur Lewis, *The Theory of Economic Growth* (London: G. Allen and Unwin, 1955).

⁶Peter T. Bauer and Basil S. Yamey, *The Economics of Underdeveloped Countries* (Chicago: University of Chicago, 1957); and Bauer, *Dissent on Development* (Cambridge: Harvard University, 1972).

⁷S. R. Sen, *The Economics of Sir James Steuart* (Cambridge: Harvard University, 1957).

⁸Wesley C. Mitchell, *Lecture Notes on Types of Economic Theory* (New York: August M. Kelly, 1949), pp. 16-17.

low; income was low because productivity was low; productivity was low because of a low ratio of capital to labor; the low employment of capital may be due to a small inducement to invest.⁹ Thus, symmetrical circularity of argument is achieved on both the supply side and the demand side.

The remedy for breaking the vicious circle of poverty, in this view, is state control and economic planning. According to Myrdal, domestically the state must purposefully apply controls, interfere with market forces, preempt many of the functions normally left to private enterprise, and guide the allocation of resources in the economy, according to its vision of development.¹⁰ Rather than rely on an “irrational” price system, the state should plan the industrial mix, raise agricultural productivity through irrigation, and so on. In international commercial relations, import restrictions, export subsidization and foreign exchange controls are the appropriate policies. According to this view, the theories of comparative advantage and free trade are fallacious. There are “sound reasons why [a country] may chose to produce at home things which it could import more cheaply or to export things at a loss to be covered by subsidy.”¹¹

In *Rich Lands and Poor*, Myrdal wants to change the traditional social institutions that cause economic stagnation by “creating a psychological, ideological, social, and political situation propitious to economic development.”¹² A decade later, in *Asian Drama*, Myrdal abandons what could be interpreted as an educative approach to social change and opts for compulsion.¹³ He now advocates a complete transformation of the peoples’ values and attitudes and the institutions that foster those values and attitudes. Myrdal is not a tyrant; neither was Stuart. Yet the means they chose to achieve their visions were not dissimilar. Stuart would allow private initiative so long as private pursuits were in the public interest as perceived by those who govern. All that Sir James Stuart required was an “exact

⁹Ragnar Nurkse, *Problems of Capital Formation in Underdeveloped Countries* (New York: Oxford University, 1953), p. 5.

¹⁰Myrdal, *Economic Theory and Underdeveloped Regions*, pp. 81-94.

¹¹Myrdal, *Economic Theory and Underdeveloped Regions*, p. 98.

¹²Myrdal, *Economic Theory and Underdeveloped Regions*, pp. 83-4.

¹³Myrdal, *Asian Drama: An Inquiry into the Poverty of Nations*, pp. 67, 115-6, *et passim*.

obedience to the laws,” which were to be fashioned by public-spirited statesmen in the public interest. Transgressors would be punished.¹⁴

Of course, Adam Smith would have none of this. Self-interest, he believed, promoted the general welfare. “It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our necessities, but of their advantages.”¹⁵ For the mercantilists, national wealth was the stock of precious metals at hand. Policies were to be adopted to increase the store of these metals. For Adam Smith, national wealth was the aggregation of individual wealth.¹⁶ Smith’s conception of national wealth was radically different from the mercantilist conception, and hence the appropriate institutional structure and policies are quite different. To the mercantilist, the legal, political, and economic institutions of mercantilism were justified insofar as they increased the national wealth (the stock of precious metals). Restrictions on labor mobility, contract labor, wage and price regulation, the Poor Laws, the Corn Laws, industrial policy, monopoly grants from the Crown, and protectionism all were justified as serving the public interest. Adam Smith condemned the mercantilist institutional framework as anathema to private interests. Given Smith’s theorem of the “invisible hand,” mercantilist policies conflicted with the public interest as well.

Much of *The Wealth of Nations* is an examination of the institutional framework and the property rights structure and their effects on material progress. Rosenberg argues that Adam Smith recognized that self-interest can get out of hand unless institutional restraints are present.¹⁷ “Smith is, in effect, searching for the appropriate definition of an institutional order which will eliminate zero-sum (or even negative-sum) games. It is the function of the institutional arrangements to cut off all avenues (and there are many) along which wealth may be pursued without contributing to the

¹⁴James Steuart, *An Inquiry into the Principles of Political Economy: Being an Essay on the Science of Domestic Policy in Free Nations* (London, 1767), pp. 162-5.

¹⁵Adam Smith, *The Wealth of Nations* (New York: Modern Library, 1937), p. 14.

¹⁶Adam Smith, *The Wealth of Nations* (New York: Modern Library, 1937), p. 423.

¹⁷Nathan Rosenberg, “Some Institutional Aspects of the Wealth of Nations,” *Journal of Political Economy*, 68, December 1960, p. 560.

welfare of society. Such a goal in practice requires a careful balancing of incentive, the provision of opportunity to enlarge one's income against the need to minimize the opportunities for abuse"

ECONOMIC GROWTH AND THE RIGHTS STRUCTURE

Firms transform inputs into marketable output. Successful firms do so with a minimum amount of inputs. Economies can be thought of as large firms. Just as the efficiency of firms is affected by the structure of property rights, so is the efficiency of entire economies. Firms choose a particular organizational form, but the political, social, legal, and economic systems within which those choices are made are exogenous to the firm. On the other hand, nations determine the rights structure or "rules of the game" in which individuals make choices. The institutional framework of an economy has important consequences for the allocation of its resources and for its degree of efficiency.

An economy can be characterized by a production function, which describes the relationship between per capita gross domestic product (output per person) and capital stock per capita (the machine/man ratio). Converted to a growth relationship, the production function describes the relationship between the growth rate of real gross domestic product and the growth rate of the capital stock per capita.

The effect of an increase in the growth rate of capital on the growth rate of real gross domestic product depends upon how efficiently resources are employed in the economy. For equal rates of capital formation, economies that transform inputs into output relatively efficiently will have higher growth rates than less efficient economies.¹⁸ The economies of other countries can be compared to the most efficient economies, and a measure of efficiency obtained. Such an efficiency measure will be a fraction between 0 and 1, with 1 representing maximum efficiency and 0 representing total inefficiency.

¹⁸For a technical explanation of this technique, see Gerald W. Scully, "The Institutional Framework and Economic Development," *Journal of Political Economy*, Vol. 93, No. 3, June 1988, pp. 652-62.

The economic and institutional data employed here come mainly from two sources. Robert Summers and Alan Heston have constructed internationally comparable economic series for a large number of countries over time.¹⁹ The economic data used here is for the period 1950 to 1985. Data on some of the institutional characteristics of countries comes from Raymond D. Gastil, who since 1973 has published annual country rankings of political liberty, civil liberty, and other measures of freedom.²⁰

Data on real gross domestic product per capita, population, and the percentage of real gross domestic product devoted to gross domestic investment were available annually for most of the world's market economies for the period. From these data the growth and efficiency variables were calculated.

Institutional Variables. Gastil has created two measures of liberty: political liberty and civil liberty. Political rights are ranked by Gastil from 1 (the highest degree of liberty) to 7 (the lowest). The rankings are based on the degree to which individuals in a country have control over those who govern. A rank of 1 describes a political system in which the vast majority of the polity is enfranchised with the right and the opportunity to elect those who govern. Political parties may be freely formed for the purpose of competing for public office. A rank of 2 is accorded to states with an open political system that works imperfectly, because of inherent poverty, backwardness, ignorance, violence, or other structural limitations. Yet in such countries those who govern can be voted out of office. Countries with a rank of 3 have political systems in which elections occur but in which coups d'état, ballot stuffing, vote buying and other

¹⁹Robert Summers and Alan Heston, "Improved International Comparisons of Real Product and its Composition: 1950-1980," *Review of Income and Wealth*, June 1984. The Summers and Heston data are made comparable across countries through the employment of a common set of world average prices. Intercountry per capita income figures suffer from the intractable index numbers problem, differences in national accounting systems and in the coverage and statistical reliability of the accounts data, and in exchange rate conversion problems in translating income data in different national currencies to the US dollar, the conventional, common numeraire. The Summers-Heston-Kravis technique tackles some of these problems and provides the only available comparable set of international product and product composition data. The World Bank now uses this approach.

²⁰Raymond D. Gastil, *Freedom in the World* (Westport, CN.: Greenwood, 1982).

nondemocratic irregularities occur with distressing frequency. A rank of 4 describes political regimes in which free elections are constitutionally curtailed or in which the outcome of the electoral process is meaningless in determining the configuration of power. A rank of 5 describes a political process which is tightly controlled by those in power and the electoral results are without significance. Political regimes without the formality of elections or those states which offer a single list of candidates and in which voting is largely a ritualistic celebration of the leadership are ranked with a value of 6. A rank of 7 is reserved for tyrannical regimes that are without legitimacy.

In the broadest sense, Gastil's ranking of civil rights purports to measure the rights of the individual relative to the state. In a narrower sense, the ranking of civil liberty measures the independence of the judiciary and the freedom of the press. Countries with political systems which adhere scrupulously to the rule of law and constitutionally protect and enforce freedom of expression are ranked as 1. A rank of 2 describes political systems with similar aspirations but which fail to achieve these standards because of internal strife and violence, ignorance, or limited channels of expression, or because order is maintained by laws more restrictive than necessary. A rank of 3 is accorded to political systems which give the appearance of civil liberty but experience unresolvable political deadlocks and resort to martial law, jailing for sedition, and suppression of the media. Such governments, however, can be successfully opposed in the courts. In political systems with a rank of 4, broad areas of freedom coexist with areas in which rights are proscribed or circumscribed. In regimes with a rank of 5, civil rights are denied arbitrarily and the media is controlled and censored by the state. In countries with a rank of 6, the rights of the state take precedence over the rights of the individual, although the occasional complaint — if politic — is permitted. A rank of 7 is bestowed on regimes in which citizens have no rights relative to the state.

Gastil measures economic liberty in two ways. He categorizes economic systems as capitalist, mixed-capitalist, capitalist-statist, mixed-socialist, or socialist. Capitalist economies generally have a high degree of economic freedom and relatively little market intervention by the state. In mixed-capitalist economies, the state is activist in income redistribution and in market intervention and regulation, although it is not particularly active in the direct allocation of resources. Capitalist-statist regimes are characterized by a much

greater intervention by the state in markets and a much greater state command of resources, but in general remain committed to private property. Mixed-socialist economies are command economies that allow some economic freedom, private property, and individual initiative. Socialist economies are command economies with very low degrees of economic freedom and with restricted private property rights. The socialist countries in the sample used here are more or less independent socialist regimes. Communist bloc, nonmarket economies have been excluded from this analysis.

Gastil also describes the level of economic liberty in nations. Economic freedom is designated by Gastil as high, medium-high, medium, low-medium, and low. These rankings were converted to the ordinal scale employed by Gastil for the political and civil liberty rankings.

Economic Liberty in the Americas. While Gastil's measures of civil and political liberty have gained widespread acceptance, economists have expressed skepticism about his measures of economic liberty. The Gastil measure is an average of four sub-indices of economic freedom: (1) the right to private property; (2) the right to freedom of association (mainly, the rights to form trade unions and to form business associations or cartels); (3) the right to freedom of internal and external travel; and (4) the right to information (which includes price controls, subsidies, a minimum wage, and the right to private ownership of the media). Freedom of association, as Gastil measures it, is the freedom to collude to redistribute income. This is hardly the notion that a classical liberal has of an individual right. Although freedom of the press is an important attribute of economic liberty, freedom of information ought to be the right of economic actors to confront free market prices. Contrary to the assumptions made by Gastil, artificial government control of prices and wages interferes with freedom of information.

The Fraser Institute with the participation of the Liberty Fund is engaged in a multiyear project to come to grips with the concept of economic freedom. As part of that effort, I present in Table 1 an estimate of the rank of a measure of economic liberty for the countries of the Americas based on fifteen attributes of economic freedom. These fifteen measures are defined in a note at the end of the table and range from the type of foreign exchange regime (a proxy which measures the right to face world prices under freedom of trade) to the freedom from the arbitrary seizure of property.

TABLE 1

VALUES OF ECONOMIC LIBERTY IN THE AMERICAS															
Central/North America	L1	L2	L3	L4	L5	L6	L7	L8	L9	L10	L11	L12	L13	L14	L15
Barbados	1	3	1	1	1	2	1	1	2	1	1	1	1	1	1
Canada	1	1	1	1	1	1	1	1	1	1	1	1	1	2	1
Costa Rica	2	1	2	1	1	1	1	1	1	1	1	1	1	1	1
Dominican Rep.	2	1	3	1	2	3	1	1	2	1	1	2	1	1	1
El Salvador	3	4	3	4	3	4	1	2	2	2	2	3	1	4	1
Guatemala	1	1	3	3	4	4	2	2	2	2	1	1	1	2	2
Haiti	2	1	3	3	5	6	2	3	3	2	2	4	1	4	2
Honduras	2	2	2	1	1	3	2	1	1	3	1	2	1	3	1
Jamaica	3	1	2	1	2	3	3	1	3	1	1	1	1	3	1
Mexico	1	1	3	2	3	4	3	2	2	1	1	2	1	3	1
Panama	1	1	3	1	3	3	3	1	2	1	1	2	1	2	1
Trin./Tobago	3	1	3	1	1	2	3	1	1	1	1	2	1	1	1
United States	1	1	1	1	1	1	1	1	1	1	1	1	1	1	1
South America															
Argentina	2	3	2	2	2	3	3	2	3	1	2	1	1	2	1
Bolivia	1	2	3	2	3	3	4	2	3	1	1	2	2	1	1
Brazil	2	2	3	2	3	2	3	1	2	1	1	1	1	2	1
Chile	2	3	2	3	3	5	1	2	2	2	2	4	1	4	4
Colombia	2	2	3	2	2	3	1	1	1	3	1	2	1	3	1
Ecuador	2	3	3	2	2	3	2	1	1	1	2	2	1	2	1
Guyana	3	1	4	4	5	5	6	2	2	3	2	3	1	4	2
Paraguay	2	3	3	4	4	5	4	2	2	1	2	3	1	3	1
Peru	3	3	3	2	2	3	4	1	1	2	1	3	1	2	1
Suriname	3	4	3	3	4	6	1	3	3	3	3	4	1	4	3
Venezuela	2	2	2	1	2	2	3	1	1	1	1	1	1	1	1
L1: Foreign Exchange Regime	L9: Freedom of Broadcast Media														
L2: Military Draft Freedom	L10: Right to Travel at Home														
L3: Freedom of Property	L11: Right to Travel Abroad														
L4: Freedom of Movement	L12: Right to Peaceful Assembly														
L5: Freedom of Information	L13: Permit not Required to Work														
L6: Civil Rights	L14: Freedom from Search														
L7: Type of Economic System	L15: Freedom from Property Taking														
L8: Freedom of Print Media															

Scale for Variables: 1 is Free; 7 is Least Free

TABLE 1A

VALUES OF ECONOMIC LIBERTY IN THE AMERICAS	
Central/North America	Overall Rank¹
Barbados	19
Canada	6
Costa Rica	7.5
Dominican Rep.	31
El Salvador	77
Guatemala	60
Haiti	96
Honduras	45
Jamaica	40
Mexico	48
Panama	39
Trinidad/Tobago	33
United States	2.5
South America	
Argentina	59
Bolivia	64
Brazil	46
Chile	81.5
Colombia	54
Ecuador	52
Guyana	106
Paraguay	72
Peru	62
Suriname	115
Venezuela	34

¹Country ranking out of 144 countries

The work in progress on measuring economic liberty is a study of economic freedom in some 144 countries. Table 1 reveals an extraordinary range of economic liberty in the Americas. The United States, Canada, and Costa Rica have the greatest amount of economic freedom as measured by these fifteen attributes. Barbados is in a distant fourth place. In Central America, Haiti, El Salvador, and Guatemala have the least amount of economic freedom. The level of economic liberty in these countries is comparable to that of countries such as Egypt, Indonesia, and India. Other than Barbados, the Dominican Republic, Trinidad and Tobago, and Panama have the greatest degree of economic liberty in Central America. These countries are comparable to Greece, Italy, and Norway in the amount of economic freedom. The simple average of the ranks of the Central and North American countries in the table is 38.8 on a scale of 1 to 144.

South America manifests less economic liberty than Central and North America (the simple average of the ranks is 67.8). Venezuela has the greatest amount of economic freedom in South America, while Guyana and Suriname are the least free. The countries in South America with the lowest levels of economic liberty are comparable to countries such as Congo, Libya, Rwanda, and Saudi Arabia. The remainder of South American countries have economic liberty rankings in the range of 81.5, making them comparable to countries such as Senegal, Thailand, Taiwan, and Pakistan. On the whole, economic liberty and individualism are not widely admired by governments in South America.

Evidence of the Effect of Liberty on Economic Growth.

Empirical evidence of the effect of liberty on economic growth over the period for the market economies classified by type and degree of liberty appears in Table 2. On average, politically open societies grew at a compound real per capita rate of 2.53 percent per annum compared to a 1.41 percent growth rate for politically closed societies. On average, societies that subscribe to the rule of law grew at a 2.75 percent rate compared to a 1.23 percent rate in societies where government rights take precedence over individual rights. On average, societies which subscribe to private property rights and a market allocation of resources grew at a 2.76 percent rate compared to a 1.10 percent rate in nations where private property rights are circumscribed and the state significantly intervenes in resource allocation. The institutional framework not only furnishes a statistically significant explanation of intercountry variation in the growth rate of real per capita gross domestic product, but it also has an effect of considerable

magnitude. Economic growth rates in societies which restrict political, civil, and economic liberties are only about half of those in societies in which individual rights are protected.

Combining all three measures of liberty, the calculated compound growth rate of real domestic product per capita for the average nation that has an institutional framework with a high degree of political liberty, civil liberty, and economic liberty is 2.73 percent per annum. The calculated growth rate for the average nation with an institutional framework where political rights are proscribed, government rights take precedence over individual rights, private property is circumscribed, and the state intervenes in resource allocation is 0.91 percent per annum. Hence the average growth rate in societies where these freedoms are restricted is one-third of that of free societies. These combined restrictions on liberty constitute a 67 percent tax on the wealth of the citizens of such states.

TABLE 2

AVERAGE GROWTH RATES AND INSTITUTIONAL ATTRIBUTES¹

Institutional Attribute	Per Capita Growth Rate	Institutional Attribute	Per Capita Growth Rate	Difference in Growth Rates
Politically Open	2.53 %	Politically Closed	1.41 %	1.12 %
Individual Rights	2.75 %	Government Rights	1.23 %	1.52 %
Free Market	2.76 %	Command	1.10 %	1.66 %
Politically Open		Politically Closed		
Individual Rights } Free Market }	2.73 %	Government Rights } Command }	0.91 %	1.82 %

¹Growth of per capita real Gross Domestic Product

Evidence of the Effect of Liberty on Economic Efficiency.

Efficiency measures for each economy were calculated, and the results averaged and classified by type and degree of liberty are shown in Table 3. The average economy that is politically open, in which individual rights take precedence over state rights, or in which private property and market allocation of resources prevail, has an efficiency level of .74 to .77, depending upon the freedom measure.²¹ On the other hand, the average economy that is politically closed, in which the rights of the state prevail, or in which private property and the market allocation of resources is circumscribed, has an efficiency rating of .34 to .36. Thus, societies where freedom is restricted are less than half as efficient in converting resources into domestic production as that of free societies. Alternatively, more than twice as much output could be produced with the same resource endowment in these societies, if liberty prevailed.

TABLE 3

AVERAGE EFFICIENCY OF ECONOMIES AND INSTITUTIONAL ATTRIBUTES

Institutional Attribute	Efficiency Measure	Institutional Attribute	Efficiency Measure	Percentage Difference
Politically Open	.75	Politically Closed	.36	108 %
Individual Rights	.77	Government Rights	.35	120 %
Free Market	.74	Command	.34	118 %
Politically Open Individual Rights } Free Market	.79	Politically Closed Government Rights } Command	.31	155 %

²¹The highest possible efficiency measurement is 1.0.

Like water that seeks its own level, resources are predisposed to flow to their highest valued uses. But a necessary condition for achieving this efficiency is that all resources are owned exclusively by private individuals, and that these resources are transferable. The political, social, legal, and economic framework of society defines what resources can be owned, who can own them, and how they can be employed. The institutional framework sets the parameters of rights in a society. The menu of choices open to humankind is rich. What is sanctioned in law ranges from judge-made rulings, as in common law, to decisions based on the “Word of God,” as in Muslim law. In politics, the range is from town hall meetings, in which everything is settled by the citizens, to totalitarian states, where even the most private interpersonal matters are decided by the state. In economics, the range is from purely private economies, in which even the legitimacy of a government-provided lighthouse is disputed, to completely communal societies, exemplified by religious orders, in which everything is owned in common.

ARE INCREASES IN THE SIZE OF GOVERNMENT BENEFICIAL OR HARMFUL?

The size of the state, measured conventionally as government expenditures as a fraction of national output, has grown enormously in modern times. Among developed nations, government spending has risen from less than a tenth to more than a third of GNP during this century. The rise of government control over national resources is ubiquitous. Is this substitution of public choice for private choice beneficial or harmful to society based on some objective criterion? The evidence offered here suggests that it is harmful.

Several caricatures of the state are found in the literature. In the English public finance tradition, the democratic state is characterized as benevolent. In this view, politicians and bureaucrats benignly serve the polity by performing certain fiscal functions.²² From a public choice perspective, the bureaucratic state in majoritarian, representative democracies is fiscally expansionist, redistributive, and self-serving, with public resources being allocated in a political

²²Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw Hill, 1959), Chapter 1.

market.²³ In the Italian and American public choice-public finance tradition, the state is characterized as malevolent.²⁴ Unshackled by constitutional rules, the revenue-maximizing Leviathan drives the polity to penury.²⁵

While malevolence for its own sake cannot be ruled out, the pursuit of self-interest in politics usually is linked with rent seeking.²⁶ In representative democracies, logrolling politicians redistribute public income by concentrating net benefits (benefits minus taxes) among the majority coalitions electing them. This tends to lead to a growth of the public sector²⁷ and a redistribution of public resources toward the middle class.²⁸ With nonrepresentative governments, the public sector is a source of rents to the ruling class and a source of much mischief. Tullock's important theoretical insight on rent seeking identifies tariff-induced rents as a prize up for grabs.²⁹ In a laissez-faire, free trade, market economy, competition erodes rents. State command of resources through its fiscal function and government

²³Anthony Downs, *An Economic Theory of Democracy* (New York: Harper & Row, 1957); James M. Buchanan and Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962); Gordon Tullock, *The Politics of Bureaucracy* (Washington: Public Affairs Press, 1965); Mancur Olsen, *The Logic of Collective Action* (Cambridge: Harvard University Press, 1965); and William A. Niskanen, Jr., *Bureaucracy and Representative Government* (Chicago: Aldens and Atherton, 1971).

²⁴James M. Buchanan, "La Scienza Della Finanze: The Italian Tradition in Fiscal Theory," in Buchanan (ed.): *Fiscal Theory and Political Economy* (Chapel Hill: University of North Carolina Press, 1960); Buchanan, *The Limits of Liberty* (Chicago: University of Chicago Press, 1975); and Geoffrey Brennan and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press, 1980).

²⁵Brennan and Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution*, p. 40.

²⁶Robert D. Tollison, "Rent Seeking: A Survey," *Kyklos*, 35, 1982.

²⁷Buchanan and Tullock, *The Calculus of Consent*.

²⁸George J. Stigler, "Director's Law of Public Income Redistribution," *Journal of Law and Economics*, 13 (April 1970); Gordon Tullock, *Economics of Income Redistribution* (Boston: Kluwer Nijhoff, 1983); Tullock, *The Economics of Wealth and Poverty* (New York: New York University Press, 1986).

²⁹Gordon Tullock, "The Welfare Costs of Tariffs, Monopolies and Theft," *Western Economic Journal*, 5, June 1967. Also see Anne O. Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review*, 64, June 1974.

rules, regulations, licensing, etc. give rise to political markets for rents. Resources flow into the pursuit of those rents. Buchanan argues that the level of rent seeking and the resources devoted to this socially unproductive pursuit are directly related to the relative size of the public sector in the economy.³⁰ Therefore, the increased size of government is harmful. Resources are reallocated from productive activities into unproductive, rent seeking pursuits. A consequence of these distortions in resource allocation is a decline in economic growth and in efficiency.

Traditional arguments also plausibly link the size of the government sector with a reduction in national economic performance. Value added in the government sector is lower than in the private sector. Resources are allocated not to their highest valued uses but on the basis of political concerns. High taxes, tax progressivity, and the substitution in consumption of politically-priced public goods for market-priced private goods reduces the incentives of private producers.

The secular rise in the size of the state and the near-universal appeal of the relatively large government sector suggests that large segments of these societies find this result desirable. Arguments that the increased size of the public sector is beneficial and may promote growth and efficiency include the following: (1) The larger the government sector, the greater is the macroeconomic stability, since government expenditures exhibit less variance than private sector expenditures. *Ceteris paribus*, economies with more economic stability grow at a higher rate than those with less stability. (2) The larger the size of the government, the greater is the scope for income redistribution. Too much income inequality may create incentives for those with low incomes to seek another social order. Redistribution of income may reduce work incentives, but may also be an inexpensive means of preserving the social order. Satisfying the demand for income redistribution promotes political and social stability, which are preconditions for growth and efficiency. Thus, the income distribution partly may reflect the opportunity cost of rebellion. (3)

³⁰James M. Buchanan, "Rent Seeking and Profit Seeking," in James M. Buchanan, Gordon Tullock, and Robert D. Tollison, eds., *Toward A Theory of the Rent-Seeking Society* (College Station: Texas A&M University Press, 1980), p. 9.

The state is necessary in order to produce public goods which the private sector will not produce, or to regulate and control costs and benefits which are external to the market. These state actions include government provision of an infrastructure. (4) In a less developed country, the private sector is incapable of modern transformation of the economy.

Empirical testing of these hypotheses is difficult. The relatively little empirical evidence that exists is conflicting. Ideally, the vector of government policies (tariffs, quantitative restrictions, licenses, export marketing boards, foreign exchange controls, etc.) that give rise to rent seeking and that yield negative net social benefits would be identified and their effects estimated. Yet data limitations preclude wide testing of this proposition.

The effect of the size of the state sector on economic growth and efficiency can be tested in an alternative but less adequate way. Utilizing International Monetary Fund, World Bank, and United Nations sources, Landau found that the size of government was negatively correlated with the compound growth rate of per capita gross domestic product for a sample of 65 less-developed countries over the period 1960 to 1980.³¹ A weakness of the Landau study is that a multiplicity of regressors (frequently more than 20) appear in the equations without concern for a theoretical specification of relationships and interrelationships among the variables. Using an earlier version of the data set employed here, Landau examined 104 developed and less-developed countries over the period from 1961 to 1976. He found a negative relationship between size of government and the growth rate of per capita GDP.³² Marlow found a negative relationship between the size of the state sector and the compound growth rate of real gross domestic product for the industrialized countries over the decade from 1960 to 1970.³³

³¹Daniel Landau, "Government and Economic Growth in the Less-Developed Countries," mimeographed.

³²Daniel Landau, "Government Expenditure and Economic Growth: A Cross-Country Study," *Southern Economic Journal*, 49, January 1983.

³³Michael L. Marlow, "Private Sector Shrinkage and the Growth of Industrialized Economies," *Public Choice*, 49, 1986, pp. 143-54.

TABLE 4

INCOME AND ECONOMIC GROWTH IN THE AMERICAS

Country	Per Capita Income, 1985 ¹	Rank ²	Growth Rate, 1950-85	Rank ²
Central/North America				
Barbados	\$5,212	36	4.59 %	16
Canada	12,196	5	2.43	62
Costa Rica	2,650	61	2.45	60
Dominican Rep.	1,753	75	2.64	55
El Salvador	1,198	85	0.92	99
Guatemala	1,608	77	0.96	97
Haiti	631	99	0.24	109
Honduras	911	94	0.74	102
Jamaica	1,725	76	2.03	77
Mexico	3,985	43	2.60	56
Nicaragua	1,989	71	2.03	78
Panama	2,912	57	3.00	44
Trin./Tobago	6,884	29	2.99	45
United States	12,532	3	1.97	80
South America				
Argentina	\$3,486	50	0.93 %	98
Bolivia	1,089	90	0.36	108
Brazil	3,282	54	4.92	13
Chile	3,486	51	1.21	94
Colombia	2,599	62	2.30	65
Ecuador	2,387	65	2.88	48
Guyana	1,259	82	-0.23	116
Paraguay	1,996	70	1.90	82
Peru	2,114	67	1.63	87
Suriname	3,522	49	3.49	36
Uruguay	3,462	52	0.66	104
Venezuela	3,548	48	-0.08	114

¹Real per capita Gross Domestic Product.

²Out of 121 countries.

Economic Progress and the Size of the State: The Experience in the Americas. Table 4 presents data on the level of per capita real gross domestic product in 1985 and the growth rate in per capita real GDP from 1950 to 1985 for the Central and North American and for the South American countries. The growth experience in the Americas has been highly mixed, but in general has been poor. Brazil and Barbados have had a period of solid economic growth. At the other end of the spectrum, Guyana, Venezuela, Haiti, Bolivia, Uruguay, Honduras, El Salvador, Argentina, and Guatemala have had among the lowest growth rates in the world. Chile, Peru, and Paraguay have had average growth rates below 2 percent per annum.

Table 5 shows the size of government expenditure and the rate of growth in the size of government expenditure. On the whole, the size of government in the Americas is somewhat above the world average (the average rank of all of the countries in the table is 75). The trend in the size of government in the Americas also is above the world average. At the extremes of the size of the state (measured as government expenditures as a share of GDP) are Trinidad and Tobago, Mexico, Guatemala, Argentina, and Venezuela with a range of 6.74 to 9.45 percent and Costa Rica, Guyana, Panama, and Suriname with a range of 20.35 to 27.91 percent. The most rapidly expanding governments in terms of marginal resources absorbed by the public sector are Guyana, Jamaica, Nicaragua, and Bolivia, all of which added annually an average of at least one half of a percentage point in government expenditures as a fraction of GDP over the period. The countries with a significant shrinkage in the relative size of the state over the period were Suriname, Brazil, the Dominican Republic, and the United States.

TABLE 5

GOVERNMENT SPENDING IN THE AMERICAS

Country	Government Spending ¹	Rank ²	Growth of Government Spending ³	Rank ²
Central/North America				
Barbados	14.08	86	.175	49
Canada	13.61	90	-.032	93
Costa Rica	20.35	35	.169	51
Dominican Rep.	12.35	97	-.244	110
El Salvador	18.59	44	.219	43
Guatemala	7.60	114	.011*	86
Haiti	15.14	75	.053*	80
Honduras	13.64	89	.242	41
Jamaica	15.14	76	.732	9
Mexico	7.32	118	.145	58
Nicaragua	15.62	69	.531	19
Panama	24.96	21	.071*	76
Trin./Tobago	6.74	119	.340	33
United States	17.20	55	-.172	106
South America				
Argentina	9.19	109	.036*	82
Bolivia	15.24	72	.471	24
Brazil	15.44	70	-.487	118
Chile	18.80	42	.118	64
Colombia	11.17	104	-.032	93
Ecuador	15.23	73	.061	78
Guyana	24.28	22	.912	6
Paraguay	13.02	94	-.115	101
Peru	14.86	79	.113	66
Suriname	27.91	10	-.649	121
Uruguay	15.14	77	.152	53
Venezuela	9.48	106	.328	35

Note: a * next to the growth coefficient indicates a lack of statistical significance at the conventional level.

¹As a percent of Gross Domestic Product.

²Out of 121 countries.

³Annual rate of growth.

TABLE 5A
INVESTMENT IN THE AMERICAS

Country	Investment ¹	Rank ²	Growth of Investment Spending ³	Rank ²
Central/North America				
Barbados	19.60%	49	.103%	63
Canada	23.91	32	-.094	98
Costa Rica	14.15	75	.095	67
Dominican Rep.	16.29	63	.331	31
El Salvador	7.48	108	.068	71
Guatemala	8.75	105	.029*	77
Haiti	7.10	111	.431	24
Honduras	13.56	80	.052*	74
Jamaica	22.48	36	-.559	116
Mexico	18.61	53	.175	50
Nicaragua	13.54	81	.024*	78
Panama	24.04	30	.272	37
Trin./Tobago	20.33	47	.310	35
United States	21.08	42	.024*	79
South America				
Argentina	25.15%	24	-.091*%	97
Bolivia	12.75	85	.001*	84
Brazil	24.43	28	-.309	111
Chile	29.71	11	-.351	112
Colombia	18.90	52	-.141	102
Ecuador	23.88	33	.115	60
Guyana	31.81	6	-.162*	106
Paraguay	9.92	100	.408	26
Peru	13.16	82	-.211	109
Suriname	19.45	51	-.431	114
Uruguay	12.22	91	.063*	62
Venezuela	11.71	92	.159	54

Note: a * next to the growth coefficient indicates a lack of statistical significance at the conventional level.

¹As a percent of Gross Domestic Product.

²Out of 121 countries.

³Annual rate of growth.

Table 5A shows the size of domestic investment and the rate of growth of domestic investment. For the Americas as a whole, the share of GDP going to gross domestic capital formation during 1950-85 was at about the world average (mean rank of 60), with North and Central America having somewhat higher national investment ratios than South America. Haiti, El Salvador, Guatemala, and Paraguay invested less than 10 percent of GDP for future economic progress. Trinidad and Tobago, the United States, Jamaica, Ecuador, Canada, Panama, Brazil, Argentina, Chile, and Guyana all invested over 20 percent of GDP for future growth. The trend in investment as a share of GDP over the period is about the world average for Central and North America (mean rank of 64.3), but well below the world average for South America (mean rank of 87.5). The nations in the Americas with the largest increases in the national investment share were Haiti and Paraguay (both of which have low average values of investment as a share of GDP), the Dominican Republic, Trinidad and Tobago, and Panama. The countries with the largest decreases in the national investment share were Jamaica, Suriname, Chile, Brazil, and Peru.

Size of Government and Economic Growth. The variable chosen to capture the effect of the presence of the state on economic growth and economic efficiency is government expenditure as a share of gross domestic product. Peltzman points out that the role of government is far more pervasive in economic life than is implied by this variable (e.g., statutes, administrative rules, and regulations reallocate resources as much as do fiscal activities), but data limitations dictate the choice.³⁴ Notwithstanding this caveat, the size of the government sector so measured represents a substitution of public choice for private choice in the allocation of resources.

The relationship between economic growth, as measured by the compound growth rate of real gross domestic product over the period and the share of government in the national economy, and the inter-period change in the share of government, were estimated. The regression results are not presented here, but the interested reader can consult them in my article in *Public Choice*.³⁵ It was found that each percentage point increase in government expenditures as a fraction of GDP in the initial year, or in the inter-period change in the government

³⁴Sam Peltzman, "The Growth of Government," *Journal of Law and Economics*, Vol. 23, No. 2, October 1980, p. 209.

³⁵Gerald W. Scully, "The Size of the State, Economic Growth and the Efficient Utilization of National Resources," *Public Choice*, 1989.

fraction of GDP, reduces the growth rate of the economy by roughly one-tenth of a percentage point. The average value of the initial size of government is 16.2 percent (standard deviation = 6.6), the average value of the inter-period change in the size of government is 3.1 percent (standard deviation = 7.6), and the average real per capita growth rate is 2.5 (standard deviation = 2.1).

The negative effect of government expenditure on economic growth can be seen more clearly in Table 6, where average predicted growth rates based on the estimated relationships for a range of values of the initial size of the state and the change in the size of the state across these market economies are presented. The least interventionist states at one standard deviation *below* the mean, have initial values of government share of GDP of 9.6 percent and change in government share of -4.5 percent. Such hypothetical economies would have real per capita growth rates of 3.8 percent per annum. The most interventionist states (at one standard deviation *above* the mean) have initial values of size of the state of 22.8 percent and an inter-period change in the size of the state of 10.6 percent. Such hypothetical economies would have real per capita growth rates of 1.3 percent per annum. Obviously, the negative impact of the size of government on growth is of an important order of magnitude.

TABLE 6

**PREDICTED AVERAGE GROWTH RATES FOR VARIOUS
LEVELS OF GOVERNMENT SPENDING**

Increase in Government Spending ²	Government Spending ¹				
	0%	10%	20%	30%	40%
0%	4.2	3.3	2.4	1.5	0.6
5	3.8	2.9	2.0	1.1	0.2
10	3.3	2.5	1.6	0.7	-0.2
15	2.9	2.0	1.1	0.2	-0.6
20	2.5	1.6	0.7	-0.2	-1.1

¹As a percent of Gross Domestic Product.

²Inter-period change.

The Size of the State and Economic Efficiency. The negative effect of government expenditure on economic efficiency can be seen clearly in Table 7, where average economic efficiency values for a range of values of the size of the state are presented. The values are based on a regression equation which appears in my *Public Choice* article.³⁶ Setting the value of the size of the state equal to zero, the technical efficiency of the average economy among the world's market countries is 84 percent — meaning that such a hypothetical economy produces 84 percent of its potential or GDP per worker with its observed capital-labor ratio. For each percentage point increase in the size of the state sector there is a loss of technical efficiency of about 1.8 percentage points. At one standard deviation above and below the mean, the difference between the size of the most and least interventionist states is 12.5 percentage points. This difference yields a 23 percentage point difference in technical efficiency (60.4 percent versus 37.1 percent). Alternatively, the least interventionist state hypothetically produces 62 percent more output per worker with the same input ratio as the most interventionist state.

It is clear from these results that increments in the relative amount of resources allocated by the government sector reduce the efficiency of the economy. The greater the share of private sector allocation in the economy, the greater the efficiency by which inputs are transformed into output. The efficiency measure also was regressed against the share of gross investment out of GDP. The results appear in Table 7A. Clearly, higher levels of private capital formation are associated with higher levels of economic efficiency in the economy. The size of the effect is on the same order of magnitude as the effect of the size of government, but of the opposite sign. As such, each unit of resource converted from the private sector to the public sector is associated with a proportional loss of efficiency for the economy.

³⁶*Ibid.*

TABLE 7

**PREDICATED AVERAGE LEVELS OF EFFICIENCY FOR
VARIOUS VALUES OF GOVERNMENT SPENDING**

Government Spending¹	Efficiency Measure²
0%	0.84
10	0.66
20	0.47
30	0.28
40	0.10

¹As a percent of Gross Domestic Product.

²On a scale of 0 to 1, with 1 representing the highest degree of efficiency.

TABLE 7A

**PREDICTED AVERAGE LEVELS OF EFFICIENCY FOR
VARIOUS VALUES
OF INVESTMENT**

Investment Spending¹	Efficiency Measure²
0 %	0.14
10	0.32
20	0.49
30	0.66
40	0.84

¹As a percent of Gross Domestic Product.

²On a scale of 0 to 1, with 1 representing the highest degree of efficiency.

CONCLUSION

The motives of the state in projecting a more than minimal presence in the economy may be seen as benevolent or malevolent. Yet, however these motives are characterized, increases in the government share of the economy adversely affect economic growth and resource allocation. Nations with relatively large government shares on the whole have grown more slowly than nations with relatively small government sectors; increases in the size of government were associated with lower growth rates over the period studied. In general, the size of the government has had a substantial depressing effect on economic growth.

Government allocation of resources is less efficient than private allocation. The size of the government share in these economies was negatively correlated with economic efficiency and with the change in economic efficiency over the period. Nations with relatively large state sectors produced less output per person with the same input ratio than nations with relatively small government sectors.

11

TAXES AND DEBT

EDITOR'S INTRODUCTION

The worst possible income tax structure is one in which *marginal* tax rates are very high and *average* tax rates are very low. High marginal tax rates cause severe economic dislocation and give people strong incentives to avoid realizing taxable income. Low average tax rates mean that governments gain very little revenue in return for the economic harm they cause.¹

Yet as Alan Reynolds shows in the following chapter, this is precisely the tax structure that has been adopted in most Latin American countries. When all taxes on labor income are combined (income tax plus payroll tax plus excise taxes), the marginal tax rate on labor is 95 percent in Argentina, 90 percent in Peru and 60 percent or higher in Brazil, Mexico, and Ecuador. As a percent of gross domestic product, however, the average taxes on labor actually collected are quite modest — only 12.7 percent in Argentina, 8.8 percent in Peru and 9.3 percent in Mexico.

¹The average tax rate is total tax divided by total income. However, if average tax rates are low, then the total government revenue will be a small fraction of the country's total income. A marginal tax rate is the tax imposed on the last dollar of income. It is the marginal tax, not the average tax which determines the individual's incentive to earn an extra dollar of income.

If one ignores sales taxes and focuses on the direct taxes on labor income, the differences are even more striking. Before the recent 1989 tax reform, Argentina's personal income tax rate reached 45 percent and its social security tax rate is still 46 percent. Yet the amount of revenue Argentina collects from both these taxes was only 4.4 percent of GDP. Peru's personal income tax rate reaches 45 percent and its payroll tax rate is 36 percent. Yet the amount of revenue Peru collects from both these taxes is only 1.1 percent of GDP.

In Latin America, high marginal tax rates are not reserved for the very rich. They fall on low- and average-income workers at very modest levels of earnings. For example, in many Latin American countries marginal tax rates are 50 percent or higher on annual incomes as low as \$5,000. Moreover, the practice of imposing high marginal tax rates on modest incomes is a fairly recent phenomenon. Prior to 1961, for example, Mexico did not even have a progressive income tax.

The 1980s has been the decade of supply-side economics. Following the lead of the Reagan administration in the United States, virtually every developed country has sharply reduced marginal tax rates on personal income. Yet prior to 1989, with few exceptions (e.g., Bolivia and Colombia) Latin America moved in the opposite direction as high rates of inflation pushed moderate-income workers into extraordinarily high tax brackets.

Why did Latin America move in the opposite direction of the developed countries? One reason was that policy "experts" from those latter countries, operating through the International Monetary Fund and the World Bank, advised Third World countries to follow policies that were diametrically opposed to the policies followed by their own governments.

The anti-supply-side advice from the international lending institutions was based on the belief that Latin American countries can never repay their outstanding debts unless they collect more revenues from their citizens. Yet as Reynolds shows, the only possible solution to the debt problem is economic growth and an expanding tax base, and this can only occur if the debtor countries lower their marginal tax rates and stimulate and reward economic activity.

As Reynolds explains, privatization will not work without a healthy private sector. Debt-equity swaps will not work unless equity

in private companies is secure and profitable. The only thing that *will* work is low tax rates and policies that promote investment and economic growth.

THE CASE FOR RADICAL TAX REFORM IN LATIN AMERICA*

ALAN REYNOLDS

The Third World debt crisis has haunted the U.S. economic expansion since August 1982. Yet far more attention has been paid to trivial changes in high-quality U.S. government debt (the U.S. budget deficit) than to a half-trillion-dollar drop in the market value of Third World debt. Between August 20 and October 14, 1987, just before *world* stock markets — including that of Mexico — collapsed, the value of Latin American loans on the secondary market fell from 64 to 49 cents on the dollar in Venezuela, from 44 to 33 in Argentina, from 41 to 35 in Brazil, from 34 to 31 in Ecuador, and from five cents to two cents in Peru.² Only a year earlier, the salvage value of these loans had been twice as high. Such shrinking foreign assets added much more to the actual U.S. “net debt” than the trade gap. Confidence in the dollar and in the U.S. financial system was surely undermined by such a sharp drop in the value of U.S. foreign assets.

There had been glimmers of hope when the “Baker Plan” first suggested a shift toward growth-oriented strategies for Latin America, and again when John Reed, chairman of Citicorp, talked about exerting leverage in a similar direction. With “Citicorp’s action,”

*An earlier version of this chapter was produced for Polyconomics Inc., Morristown, NJ.

²*Grant’s Interest Rate Observer*, January 11, 1987. Market values of debt improved from October to January in Mexico, Venezuela, and Chile, but that mainly reflects higher expected inflation in U.S. commodity prices due to the drop in the dollar. See also Jeffrey Sachs and Harry Huizinga, “U.S. Commercial Banks and the Developing Country Debt Crisis” *Brookings Papers on Economic Activity* (Washington, DC: Brookings Institution, 1987), p. 563: “It is not difficult to understand the growing discount on LDC paper in the secondary market. The economies in most cases are not getting better.” Sachs and Huizinga don’t propose to make the economies better, only to convert banks loans into bonds of lesser value.

wrote the *Economist*, “the old caricatures — glowering debtors, recalcitrant bankers, the arm-twisting International Monetary Fund — could begin to change, with lenders taking advantage of new ways of getting money into Latin American economies that used to grow at 8 percent a year, and could do so again.”³ But that euphoria soon vanished, and the caricatures returned. The Reagan Administration retreated into vague and cautious slogans. Even Federal Reserve Vice-Chairman Manuel Johnson was soon tiptoeing around the dreaded “T Word” (tax rates), talking about “a variety of domestic economic reforms ... often through private sector initiatives.”⁴ New York bankers reverted to promoting marginal schemes for repackaging “Old Bonds in New Bottles,” as Wendell Gunn described the disguised Mexican debt-relief plan in the *Wall Street Journal*.⁵ In Congress, the Sarbanes-LaFalce amendment to the omnibus trade bill would buy up less-developed countries (LDC) debt with International Monetary Fund gold and World Bank bonds in order to force Latin America “to more strictly follow the economic prescriptions of the international agency experts.”⁶ But the experts don’t know how to make economies grow, and only the prospect of future income can service past debts.

There is no solution to the LDC debt problem without sustained economic expansion in the entire world — particularly Europe and Latin America. Privatization in Latin America cannot work until those countries permit a vigorous private sector to take up the slack. Debt-equity swaps cannot work until equity in Latin American enterprises is secure and profitable. Converting loans into peso bonds cannot work until Latin American currencies are stabilized and prospective growth of the real tax base is restored.

WHY LATIN AMERICA STOPPED GROWING

From 1965 to 1980, Latin America’s real per capita output rose by 3.4 percent per year, but it *fell* by 3.4 percent per year from 1981 to 1983, and recovered by only 1.4 percent per year in 1985-86.

³*Economist*, July 11, 1987.

⁴Manuel H. Johnson, “Reflections on the Current International Debt Situation,” Federal Reserve Bank of Kansas City, *Economic Review*, June 1987, p. 4.

⁵*Wall Street Journal*, January 14, 1988.

⁶James Srodes, “Memo to Morgan: Mañana,” *Financial World*, February 9, 1988, p. 11.

Fixed capital investment collapsed, dropping from 24 percent of GNP to 15.3 percent from 1980 to 1986. Inflation has lately been in triple digits in the largest economies, including Mexico, Brazil, and Argentina.

With few exceptions, Latin American nations suffer from the following related, self-inflicted wounds:

1. **No bond market.** Even when inflation is down, investor confidence in most Latin American currencies is too low to allow governments, households, or businesses to borrow over long periods at bearable, fixed interest rates. Steep interest rates on short-term or indexed debt, due to inflation, are themselves a major cause of government borrowing.
2. **Small stock markets.** The capitalization of Brazil's stock market is only 16 percent of Brazil's GNP. If it rose to 50 percent — the level of Malaysia — through repatriation of flight capital and fewer barriers to foreign investment, this would amount to \$90 billion. Larger, more liquid stock markets would make big debt-equity swaps much more feasible, and Latin American mutual funds could replace the perceived need for foreign finance.⁷
3. **Perpetual devaluation.** Latin American currencies are almost constantly being devalued, with the enthusiastic support of the International Monetary Fund. Inflation soars, even in anticipation of devaluation, wiping out the intended "real" devaluation. Despite massive devaluations from 1983 to 1986, *real* exchange rates in Latin America never changed by more than about 3 percent in any year.⁸

⁷"Growth With Equity," *Economist*, July 11, 1987, p. 16; Peter Truell, "Some Banks Are at Odds With Mexico, While Relations With Brazil Also Erode," *Wall Street Journal*, January 13, 1988, p. 2.

⁸Inter-American Development Bank, *Economic and Social Progress in Latin America: 1987 Report*, p. 14. The small "real devaluation" that did occur reflects the Federal Reserve Board's 1982 and 1984 deflation of commodity prices — in U.S. dollars — and therefore the related damage to the terms of trade of commodity producers. But Latin American currency devaluations could not affect the dollar price of internationally traded commodities.

4. **Periodic price controls.** In a futile effort to conceal or redistribute the burden of devaluation (inflation), price controls are often adopted, abandoned, then adopted again. This distorts price signals and incentives, makes business plans impossible, and creates bottlenecks and shortages. An International Monetary Fund study reports, without intentional humor, that “Argentina adopted a series of stabilization programs (1953-57, 1959, 1966-69, 1976-81, 1982, 1984, 1985-86) In most cases, these programs relied on exchange rate devaluations supported by wage and price controls.”⁹
5. **Monetization of government debt.** Lacking a credible currency, and therefore a market for fixed-income bonds, governments have no choice but to cover revenue shortfalls by creating new money. Monetarist solutions (controlling the money supply, irrespective of the government deficit) are unworkable — the distinction between fiscal and monetary policy disappears when there is no market for fixed-income securities.
6. **Punitive taxation.** Extremely high tax rates on personal income, payrolls, and consumption yield extremely low real tax revenues over time, due to anemic growth of real taxable income (apart from that of the “underground” economy).
7. **A huge underground economy.** To avoid the impacts of taxes, inflation, and price controls, hidden commerce is largely financed with U. S. currency or barter. Underground enterprises are extremely *inefficient* — very small scale with no advertising, limited competition beyond a small local market, and uneconomic constraints on the use of capital, since it is easier for an underground auto mechanic to hide wrenches than to hide a whole factory. Nearly all increases in Latin American employment have been in this informal sector since 1980, and account for 40 to 60 percent of all jobs in major cities.¹⁰

⁹International Monetary Fund, *Staff Studies for the World Economic Outlook*, August 1987, p. 131.

¹⁰Inter-American Development Bank, *Economic and Social Progress in Latin America: 1987 Report*, p. 126.

8. **Large budget deficits.** Outlays are bloated by high interest expense due to weak currencies, subsidies to offset shortages due to price controls, subsidies to maintain employment in state industries that lose money, and welfare spending to alleviate the symptoms of falling per capita output and income. Real revenues are depressed by weak growth, the underground economy, and capital flight. Keynesian budgetary stringency is politically unworkable, because it does not get to the root of any of these problems.
9. **Capital flight.** A chronic tendency is for wealth to be removed from, rather than reinvested in, ailing economies. Capital flight is due largely to tax evasion, insecure property rights, and the tax on money associated with perpetual devaluations. The flight of human capital, or brain drain, occurs for similar reasons. Were it not for capital flight, foreign debt would now be some \$49 billion smaller in Argentina and \$85 billion smaller in Mexico. Conversely, simply reversing *past* capital flight — even without new domestic savings — could provide resources to retire that much foreign debt.¹¹
10. **Protectionism.** High tariffs are imposed to offset small revenues from income taxes, as well as to generate an export surplus to offset capital flight and pay interest on foreign debt. The resulting high cost of imported technology makes domestic industry uncompetitive and provokes retaliation. The high cost of imported consumer goods reduces incentives.

This is not a description of ten separate economic diseases, but of a syndrome. Efforts to treat each symptom separately, as the International Monetary Fund does, must invariably fail. The way to break out of this downward spiral is to begin with the easiest, most politically popular reform.

¹¹Joe Foweraker, "What's Good for Citicorp...", *Challenge*, January-February, 1987, pp. 47-50. See also Steven Plaut, "Capital Flight and LDC Debt," Federal Reserve Bank of San Francisco, *Weekly Letter*, January 8, 1988.

THE CASE FOR MUCH HIGHER TAXES AND MUCH LOWER TAX RATES

To secure the future value of Latin American *government* debt to U. S. lenders, there must be a large, sustained increase in *real* tax revenue over decades — measured in U.S. dollars. It is arithmetically impossible to squeeze rising real revenues out of a stagnant or shrinking tax base for more than a few years, and trying to do so makes growth impossible by confiscating any potential increase in output and income. Increasing real revenues from continual increases in taxes on trade is likewise impossible, because the resulting higher costs and reduced competition weaken the economy (particularly potential exports) and thus shrink revenues from other taxes. To make debts manageable, there must be sustained growth of the “above-ground” economy — including employment, profits, and *domestic* sales — and therefore of the tax base. The prospect of strong tax receipts would make it possible to sell bonds to domestic and foreign investors, rather than monetizing public debt, thus stabilizing exchange rates and prices by repatriating flight capital.

A major obstacle to such constructive reform is the unquestioned assumption that debtor countries must run a big trade surplus to service their debts through tariffs, costly export subsidies, and currency devaluation. The hard currency revenue from exports — *minus the capital outflow* — is the net amount left to pay for imports and to service foreign debts. But there is no reason to assume that inability to attract foreign investment, or to avoid domestic capital flight, is unrelated to policies. Slashing the formidable import barriers in any Latin American country would attract capital by making the labor, capital, and materials now wasted in protected industries available to competitive entrepreneurs. Indeed, the fact that Chile cut average tariffs from 110 percent to 15 percent ad valorem explains much of its recent economic success.

Sound, stable currencies also attract capital. The only reason less-developed countries have to export to acquire hard currencies is that their own currencies are soft. This is a direct result of policy, not a matter of fate. For many decades, Guatemala’s currency, the quetzal, was exactly equal to one dollar. If that were still true, Guatemala’s ability to sell bonds to Americans or to its own citizens would be limited only by its ability to raise enough tax revenues in

terms of quetzals (and dollars) to service that debt. The balance of trade would then be irrelevant, just as it is for U.S. government debt. Since the quetzal has instead dropped to about 2.5 per dollar, the Guatemalan government would have to raise 2.5 times as much tax revenue to service the same amount of dollar debt. Devaluing the currency makes it *harder* to raise *real* revenues, because taxes are paid in shrinking money *after* inflation raises government expenses.¹² Real revenues usually fall with serious inflation. An expected devaluation also encourages underground activity, barter, and capital flight, all of which shrink the real tax base, thus weakening the prospective capacity to service government debt. In short, the International Monetary Fund *solution* to the debt problem — devaluation — is a direct *cause* of the debt problem. (It is in this sense that Jack Kemp says, “The IMF is a greater threat to Central America than the Sandinistas.”)

Tax havens also attract capital. Raising the creditworthiness of Latin American governments depends on substantially increasing *real* tax revenues over time in ways that *improve* opportunities for profitable production and trade. Otherwise the tax base cannot grow, and Latin America’s *private* debts will sour. This prescription may sound impossible, but in fact it is easy.

Tables 1 and 2 show a wide discrepancy between tax rates and revenues for the major debtors. Comparing the first column of each table shows how easy it would be to increase personal income tax revenues in Latin America. Few Latin American countries collect even as much as 1 percent of gross domestic product (GDP) from personal income taxes, compared with 12 percent in the OECD countries, although *marginal* tax rates are typically much higher than in the industrial countries, at comparable incomes. *It is arithmetically simple to show how a massive cut in marginal tax rates on personal income will result in a dramatic increase in tax revenues.*

Suppose personal income is only 80 percent of GDP, which is an understatement even if hidden income is ignored. In addition, suppose we exempt the poorest half of the population from paying any income tax. That leaves 40 percent of GDP as the tax base for the personal income tax. A flat rate tax of 10 percent on that 40 percent

¹²Vito Tanzi, “Inflation, Real Tax Revenue, and the Case for Inflationary Finance: Theory with an Application to Argentina,” *International Monetary Fund Staff Papers*, September 1978, pp. 417-51.

would obviously yield 4 percent of GDP — *double* what Mexico’s tax rates of 20 to 55 percent now yield!¹³ In the cases of Argentina, Brazil, Venezuela, and Peru, the immediate, *static* revenue increase from a 10 percent flat tax with a generous exemption also would amount to 4 percent of GDP. Collection of a 10 percent tax would be simple, requiring only an appeal to peoples’ sense of fairness and patriotism. Paying such a tax is cheaper than avoiding it.

Yet 4 percent of GDP is obviously a gross *underestimate* of what a 10 percent tax on the top half of the income distribution would really yield. It ignores any incentive to move from the underground economy to the visible, taxable economy, as well as any dynamic supply-side effects on personal effort, entrepreneurship, repatriation of flight capital, etc. In reality, the immediate yield of a 10 percent tax would surely be closer to 6 to 7 percent of GDP. Much more important, *real revenues would grow over time with the added growth of the above-ground, taxable economy*. Mexico would have to put up border guards to keep expatriate Mexicans — and Americans — from rushing back into the country with skills and satchels of money. One study on Peru found that if productivity in the entire economy could be brought up to the level of its above-ground economy, “this would yield an extra 4.4 percent [of *annual* real GDP growth] over a ten-year period.”¹⁴ *Radical reduction of personal income tax rates in Latin America is absolutely guaranteed to increase tax revenues, in static terms, even if tax rates had no effect at all on tax evasion, capital flight or incentives!* It’s really that simple — a free lunch.

¹³In 1985, Mexico’s individual income tax yielded only 2 percent of GDP, less than the earlier figure in Table 1. There have been public tax protests, but IMF demands for higher tax revenues amounting to 1.3 percent of GDP were wrongly considered inconsistent with lower tax rates. William A. Orme, “Mexico Hears Call for Tax Reform In Order To Check Massive Evasion,” *Journal of Commerce*, August 26, 1986. As this book goes to press, the highest income tax rates are being reduced in 1989 to 40 percent in Mexico, 35 percent in Argentina and 25 percent in Brazil.

¹⁴Robert Litan, *et al.*, “Internal Structural Reforms in Peru: A Promising Road Out of the Debt Crisis,” *Journal of Economic Growth*, National Chamber Foundation, 1986 II, p. 33.

Table I

MAJOR TAXES AS A PERCENT OF GDP

	Personal Income	Social Security	Sales	Corporate Profits	Trade
Argentina	0.1%	3.4%	8.8%	.01%	1.9%
Bolivia	0.7	NA	2.7	0.4	2.2
Brazil	0.1	7.6	11.3	1.1	0.8
Chile	3.1	3.3	13.3	2.3	1.4
Colombia	1.3	1.9	4.0	1.6	2.3
Ecuador	NA	NA	2.2	2.3	4.0
Mexico	2.6	2.4	5.3	3.1	2.7
Peru	0.4	0.7	7.7	3.6	5.1
Venezuela	0.8	1.1	1.4	14.1	2.0

Source: Vito Tanzi in David Newberry and Nicholas Stern, *The Theory of Taxation for Developing Countries* (Oxford: World Bank, Oxford University, 1987), p. 210.

Note: The data in Table I and Table II are from the early 1980s—before income tax rates were cut from 48 percent to 10 percent in Bolivia, and from 56 percent to 30 percent in Colombia, and before the 1989 tax cuts which reduced the highest income tax rates to 40 percent in Mexico, 35 percent in Argentina, and 25 percent in Brazil.

Table II

MAXIMUM TAX RATES IN LATIN AMERICA

	Personal Income	Social Security	Sales	Marginal* Tax on Labor	Corporate Profits
Argentina	45%	46%	18%	95%	33%
Bolivia	10	13	10	18	NA
Brazil	50	10	17-30	61	6-35
Chile	50	21	20	60	37
Colombia	30	1	10-25	36	31
Ecuador	55	19	10	79	22-30
Mexico	55	8	15-20	63	39
Peru	45	36	6-90	90	35
Venezuela	45	8	1	46	50

Source: Price Waterhouse

* Estimate. Adjusted for income caps and deductibility of social security. Assumes only half of estimated average sales tax is the marginal burden, because of exemptions. Employer contributions to social security are assumed to be borne by employees.

The fourth column of Table 2 estimates the top marginal tax rate from only three major taxes — personal income, social security and sales — with adjustments to avoid double counting (e.g., when higher incomes are exempt from social security, or the individual's contribution is deductible). In all but three of these countries, *marginal tax rates are at least 50 percent at very modest incomes, around \$5,000 a year, and rise as high as 79 to 95 percent on managerial, professional, and investor incomes.* In some countries (e.g., Chile and Mexico), the income tax schedule simply applies high income tax rates to low incomes. In other countries (e.g., Argentina, Ecuador, and Peru), marginal rates on low incomes are high mainly because of huge social security taxes that do not have a cap on the amount of income subject to the tax. In still others (e.g., Brazil) any after-tax income is heavily taxed once again when spent, through VAT and excise taxes.

Every country, including the United States, was once a less-developed country. But no country in the history of the world has managed to move from less-developed to developed with the punishing

marginal tax rates on modest incomes that are typical in Latin America. Since the Middle Ages, extreme taxation of very poor people is rare. Mexico had no “progressive” income tax until 1961; then the “tax reform” of 1979 piled a new 10 percent VAT on top of a higher (55 percent) income tax rate, which was soon followed by an income tax surtax and a 15 percent VAT. In the 1970s, despite imperfect indexing in some Latin American countries, inflation also pushed ordinary workers into tax brackets once reserved for Swedish entertainers.¹⁵ Yet even in 1979, after years of inflation, the highest tax rate still applied at an income of over \$108,000 in Ecuador, \$76,000 in Brazil, \$30,000 in Chile. By the end of 1986, however, the top tax rate applied at less than \$51,000 in Ecuador, \$41,000 in Brazil, and a bit over \$4,000 in Chile. In Nicaragua, the 50 percent tax rate, which used to be encountered at \$200,000, is now reached with an income of about \$60 a year.

INCOME TAX REVENUES CAN REPLACE TARIFFS AND EXCISE TAXES

One of the most important benefits from a radical reduction of these revenue-losing income tax rates is that the added revenue makes it fiscally responsible to slash the worst taxes of all: tariffs. As Table 1 shows, Latin America’s taxes on trade — mostly on imports — are usually *much* larger than the take from individual income taxes. Actually, government revenues would *increase* with less protectionism, because many tariffs and import quotas stop legal imports of the protected goods — in which case customs revenues are zero. Replacing even the nonprohibitive tariffs with income tax receipts can cut the cost of imported technology, improve incentives, and hold prices down. It is no coincidence that the real growth of Latin American countries averaged 5.6 percent a year from 1973 to 1980, when real imports rose by 6.7 percent a year, or that real growth then slowed to 0.7 percent a year from 1981 to 1985, when real imports *fell* by 6.8 percent a year.¹⁶ Growth requires imports, and imports require growth.

¹⁵The sharp drop in income thresholds subject to higher tax rates, from 1979 to 1984, is shown in Alan Reynolds, “Some International Comparisons of Supply-Side Tax Policy,” *Cato Journal*, Fall 1985.

¹⁶International Monetary Fund, *Staff Studies for the World Economic Outlook*, August 1987, p. 83.

Latin American tax reform might keep the highest personal tax rate as high as 20 percent without defeating the purpose of reviving tax compliance. But that would be prudent only if combined with sharp reductions of the punitive excise taxes in Brazil and the incredibly high payroll taxes in Argentina and Peru. One reason Argentina's income tax yields so little revenue is that there is a huge incentive for both employers and employees to evade the payroll tax (and split the savings). In Argentina, "only 130,000 out of three million people who were supposed to pay the three main taxes actually did."¹⁷ Luxury taxes of up to 300 percent in Brazil likewise ensure that the revenues collected are very low. "In Mexico, in the early 1970s," writes Francisco Gil Diaz, "a 30 percent excise tax on mink coats caused tax collections to fall to below one-third of former levels, when the tax had been 10 percent... The same consequences followed when the luxury tax on jewels was raised from 10 percent to 30 percent."¹⁸ Cuts in prohibitive payroll taxes, sales taxes and tariffs will *increase* the growth of real tax revenue, but the absolute *certainty* of higher income tax receipts can allow skeptics to be bold about reducing other tax rates too. When receipts turn out too high, they can retire more debt.

The sort of taxes that get the most attention from "capital formation" lobbyists have, as usual, been kept fairly low in Latin America. Corporate tax rates are usually well below 40 percent; most countries exempt dividends at either the corporate or personal level; capital gains on equities are exempt in Mexico, Brazil, and Peru, and taxed at 15 percent in Argentina; Chile, only taxes "real" interest income, and Mexico has a generous IRA-like exemption for savings.

The actual Latin American tax problem, as in the weakest European counties, is an extremely high combined tax rate on the rewards from *added labor effort* — personal income taxes, payroll taxes, and consumption taxes. That raises labor costs and lowers the pre-tax return on capital, offsetting any tax breaks for capital. The

¹⁷Maria E. Estenssoro, "When An Economy Goes Underground," *New York Times*, July 26, 1987.

¹⁸Francisco Gil Diaz, "Some Lessons from Mexico's Tax Reform" in Newberry and Stern, *The Theory of Taxation for Developing Countries*, p. 334. Diaz also notes that "authorship rights are exempt from the income tax ... a group which incidentally contains some from the most vociferous advocates of confiscatory taxation and soak-the-rich measures." Such tax favoritism is rampant in Latin America.

typically generous corporate tax breaks for buying a new machine, compared with tax penalties for hiring a new worker, can encourage substitution of scarce capital for underemployed labor.

Lower marginal tax rates on personal income will also raise the after-tax return for adding to *domestic* personal saving rather than with Swiss bank accounts, gold, or hoarded U.S. currency. Since the after-tax yield is higher, at the margin, the added demand for *domestic* deposits and securities lowers interest rates in a noninflationary way. That is, real savings out of future income will increase, and past savings now hidden overseas or hoarded in nonfinancial form will flow into domestic financial markets. This strengthens the nominal exchange rate by raising the demand for local money, and it also helps reduce inflation.

Table III

MARGINAL TAX RATES AND ECONOMIC GROWTH

	Marginal Tax on Labor	Change in Per Capita GDP 1980-86 (in 1986 U.S. \$)
Argentina	95%	- 14.2%
Peru	90	- 9.1
Ecuador	79	- 6.4
Mexico	63	- 11.9
Brazil	61	1.6
Chile	60	- 6.4
Colombia	36	4.1

Source: Inter-American Development Bank, *Economic and Social Progress in Latin America*: 1987 Report, p. 2.

Table 3 compares our estimate of marginal labor taxes (from Table 2) to the total change in per capita GDP, from 1980 to 1986, measured in 1986 dollars. The point of Table 3 is not simply that higher marginal tax rates have been associated with six years of outright declines in real living standards. These figures on GDP, stated in U.S. dollars, make a more subtle point — namely, that the most overtaxed Latin American countries have *shrinking tax bases*.

Their ability to raise enough dollars to repay dollar debts is diminishing. Self-destructive tax rates are a luxury that debtors can't afford.

ADDITIONAL EVIDENCE

During the past year alone, Jude Wanniski's decade-old argument for massive reduction of marginal tax rates in developing countries has been strongly supported by major studies from the Institute for International Economics, the Rand Corporation, the Hoover Institution, and the World Bank.¹⁹ Yet the actual policy advice attached to International Monetary Fund or World Bank loans, or to foreign aid or debt relief, continues to ignore this growing body of research. As Chad Leechor of the World Bank points out, "The importance of tax policy is well recognized in the more advanced market economies. In the context of developing countries, however, tax policy has received relatively little attention. ... Policy advice has often consisted of recommendations to increase taxes ... without adequately evaluating the impact on the supply side of the economy ... Even if revenue increases temporarily, the change may take place at the expense of potential growth, in which case future revenue will be diminished."²⁰

A recent study for the National Bureau of Economic Research by Jonathan Skinner looked at taxation in 31 African countries between 1965 and 1973, and between 1974 and 1982. He concluded that "personal and corporate taxation reduce output growth, while import, export, and corporate taxes discourage investment."²¹ Yet

¹⁹"Capital flight ... is also promoted by high taxes In the absence of inflation adjustments in the tax system, inflation discourages savings as well as work effort and risk taking Proper prices may not suffice, however, for sustained growth until the tax system also promotes growth Direct taxation provides limited revenue, despite high nominal tax rates." Bela Balassa, *et al.*, *Toward Renewed Economic Growth in Latin America*, Institute for International Economics, 1986, pp. 111, 117, and 135. See also: Newberry and Stern, *The Theory of Taxation for Developing Countries*, pp. 39-40; Charles Wolf, Jr., *Markets or Governments*, (Santa Monica, CA: Rand Corporation, 1988), Ch. 7; Alvin Rabushka, "Taxation, Economic Growth and Liberty" *Cato Journal*, Spring/Summer 1987, pp. 121-148.

²⁰Chad Leechor, "Tax Policy and Reform in Semi-Industrial Countries," *The World Bank, Industry and Finance Series*, Vol. 13, January 1986, pp. 2 & 6.

²¹Jonathan Skinner, "Taxation and Output Growth: Evidence from African Countries," *National Bureau of Economic Research Working Paper*, No. 2335, August 1987, pp. 30-31.

Skinner's study understates the impact of African taxes (i.e., depressing growth by only 6 percent per decade) because it deals with *average tax revenue*, which is typically very low in both Africa and Latin America precisely because marginal tax rates are ridiculously high.

Richard Koester and Roger Kormendi of the University of Michigan undertook an econometric investigation of both average and marginal tax rates for 63 countries. They found a strong effect of *marginal* tax rates on the *level* of per capita GDP, assuming average rates are unchanged. "These calculations," report Koester and Kormendi, "showed that a 10 percent revenue neutral reduction in marginal tax rates would yield a 12.8 percent increase in per capita income for LDCs [less-developed countries] and a 6.1 percent increase ... for non-LDCs."²² If a 10 percent reduction in marginal tax rates can lift LDC per capita income by 12.8 percent, then raising per capita income by 40 to 50 percent is a modest ambition in countries where marginal rates typically exceed 60 percent with very little revenue. And, of course, an extra 4 to 5 percent of growth each year for a decade would not be "revenue neutral" at all, because the higher level of income necessarily raises sales and income tax revenue.

CASE STUDIES IN FAILURE AND SUCCESS

Monetary reform is just as important as tax reform, since inflation erodes the government's real revenue as well as undermining incentives. But lower marginal tax rates make monetary stability much more feasible. The major industrial countries are acutely aware of the inflationary implications of sinking currencies in their own countries, yet they nonetheless insist that Latin American countries repeatedly devalue. The World Bank's 1987 report states, "When domestic inflation is higher than world inflation, a country must devalue ... Frequent adjustments in the nominal exchange rate ... promote stability in the real exchange rate."²³ That is a risky scheme for capitulating to whatever inflation exists, probably provoking an upward inflationary spiral. The assumed imbalance between inflation and the exchange rate could just as well be repaired by lower inflation.

²²Richard B. Koester and Roger C. Kormendi, "Taxation, Aggregate Activity and Economic Growth: Cross-Country Evidence on Some Supply-Side Hypotheses," University of Michigan, October 1987, p. 20.

²³The World Bank, *World Development Report 1987*, p. 101.

Besides, an exhaustive survey of the evidence by Richard Blackhurst of GATT has demonstrated that “there is no solid evidence that exchange rates influence the current account balance in a predictable way.”²⁴

The standard World Bank and International Monetary Fund recipe is high tax rates and frequent devaluations, with at least a tolerant attitude toward steep tariffs. The International Monetary Fund imposed this sort of advice on Peru and Jamaica for several years after 1978, and real per capita GDP fell by 13 to 14 percent in those countries while inflation soared. The next “adjustment programs” were in Nicaragua and Bolivia after 1980, and real output in those countries fell by 13 percent and 28 percent respectively, accompanied by the two worst hyperinflations since the 1920s. The International Monetary Fund record was only slightly better in the Philippines before the Aquino tax cuts and throughout Africa except in Botswana and Ciskei, where the International Monetary Fund was not invited.²⁵ Yet the U.S. banks, and their myopic regulators, continue to view an International Monetary Fund adjustment program as something that will somehow squeeze more funds out of an economic and political collapse.

“The only notable case of success is Turkey,” wrote Jeffrey Sachs of Harvard.²⁶ Why was Turkey so different? Private investment, which had fallen every year from 1977 to 1981, began to rise in 1982, when the corporate tax was cut from 50 percent to 40 percent. But the real success that Sachs describes is not attributable to the International Monetary Fund whose involvement in Turkey largely ended in 1982. It is instead a supply-side success story. In 1985-86, Turkey slashed personal income tax rates from 40 to 75 percent to 25 to 50 percent.

²⁴Richard Blackhurst, “The Relation Between the Current Account and the Exchange Rate: A Survey of the Recent Literature,” in P. De Grauwe and T. Peters, *Exchange Rates in Multicountry Econometric Models* (New York: MacMillan, 1983), p. 89.

²⁵Ciskei adopted a 15 percent flat tax, inspired by C. Northkote Parkinson of “Parkinson’s Law” fame, who had once persuaded the Channel Islands to adopt a 20 percent flat tax. See Anthony Robinson, “The Supply-Siders of Ciskei,” *Financial Times*, November 19, 1986. For other examples, see Ron Scherer, “Developing Countries Cut Income Tax to Fight Evaders, Promote Growth,” *Christian Science Monitor*, July 7, 1987.

²⁶Jeffrey Sachs, “Managing the LDC Debt Crisis,” *Brookings Papers on Economic Activity* (Washington, DC: Brookings Institution, 1986), pp. 402-403.

Real economic growth then jumped to 5 to 7 percent a year. A recent International Monetary Fund study belatedly acknowledged that, *before* Turkey's dramatic supply-side tax reform, "most taxpayers were placed into income brackets subject to very high marginal rates. This development contributed to a steady erosion of work and savings incentives."²⁷ Turkey still devalues, however, and has a 50 percent inflation and matching interest rates which drain the budget.

In 1986 Jamaica refused an International Monetary Fund order to devalue once again. Instead it cut tariffs and reduced the top tax rate from 57 percent on \$700 a year to a still-brutal 33 percent at about \$1,500. Inflation abated, unemployment dropped from 27 percent to 22 percent, and real output began rising at a 5.5 percent pace.²⁸

In May 1986 Bolivia switched to a 10 percent flat tax on personal income, plus a 10 percent VAT that is deductible against the income tax. Tariffs, which had been as high as 80 percent, were cut to 20 percent. Revenues soared, and the budget deficit fell from 28 percent to 4 percent of GDP. In 1987 a new currency was pegged at two bolivianos to the dollar. Inflation fell from 60,000 percent, from May to August 1985, to 10 percent by mid-1987. Real output, which fell by over 7 percent in 1985-86 alone, began rising at a 3 to 4 percent pace.²⁹

Colombia is perhaps the only South American debtor country that has *not* recently been involved with the International Monetary Fund. Colombia repeatedly cut personal income tax rates — from 56 percent in 1979 to 30 percent today — and the lower rate only applies at a higher income, over \$35,000. Real growth averaged 3.3 percent from 1979 to 1986 (illegal drugs are *not* included, and coffee is less than half of exports); inflation averaged 20 percent (compared with 106 percent in Brazil, 257 percent in Argentina). Colombia's unique method of shrinking foreign debt as a percent of GDP is to increase real GDP.

²⁷George Kopits, "Structural Reform, Stabilization and Growth in Turkey," International Monetary Fund, *Occasional Paper*, No. 52, May 1987, p. 15.

²⁸Canute James, "Jamaica Buoyancy A Cause of Worry," *Financial Times*, October 28, 1987.

²⁹William N. Raiford, "Bolivia's Monetary Reform Leads to Supply-Side Revolution," *Wall Street Journal*, July 24, 1987. [The title is backwards — the flat tax came first — and Raiford wrongly describes the exchange rate of two bolivianos per dollar as "floating."] See also "Bolivia: For Our Next Miracle ...," *Economist*, August 22, 1987, p. 59.

In the early 1980s, the African island of Mauritius cut tax rates to 35 percent from 60 percent. It also created free trade zones with no taxes, duties, or constraints on foreign investors. Growth of real GDP averaged 6.5 percent from 1984 to 1987, and hit 8.1 percent in 1988. Real tax receipts grew even faster than the real economy, by 10 percent a year, so the budget deficit dropped from more than 12 percent of GDP in 1981-82 to 3.7 percent in 1986-87.

Israel is a relatively advanced country, but its program since July 1985 is instructive. Israel slashed inflation from over 1,000 percent in September 1984 to 15-20 percent since the end of 1985. Like Bolivia, but unlike Argentina or Brazil, Israel used a *combination* of fixed exchange rates *and* supply-side tax reform. A temporary surtax was soon dropped, and the top marginal tax rate on personal income was reduced from 66 percent to 48 percent; employer's payroll taxes were also reduced. Real output briefly dipped while the surtax was in effect, but then increased by over 5 percent last year. "Virtually all of the deficit reduction was achieved through a recovery of revenue," notes the International Monetary Fund, which was not involved. "The rising revenues stemmed mainly from the positive effect of declining inflation and buoyant wages, consumption and imports."³⁰ Monetary policy, as Stanley Fischer of MIT points out, was simply that, "The Bank of Israel would conduct monetary policy with the exchange rate as its main nominal target."³¹ The shekel was pegged at 1.5 to the dollar in mid-1985, plus or minus 2 percent, and it was still worth 1.58 to the dollar in early 1988. Contrary to the International Monetary Fund ideology about floating money, *no country in the history of the world has ever stopped a serious inflation without fixing exchange rates* — either to a commodity such as gold or silver or to a more credible foreign currency.

The plans of Bolivia and Israel to follow the supply-side "Hong Kong Model" — slash marginal tax rates and peg currency to the dollar — are very similar to what happened to the big debtors Austria, Germany, and Hungary during their runaway inflations of 1923-24. At that time, in the first year after monetary reform, *real* tax revenues came in 37 percent higher than the experts predicted in

³⁰"Israel Curbs Inflation, Improves Budget Balance," *IMF Survey*, September 14, 1987.

³¹Stanley Fischer, "The Israeli Stabilization Program, 1985-86," *American Economic Review*, May 1987, p. 277.

Austria, 40 percent higher in Germany, and 54 percent higher in Hungary. This was not due to higher tax rates, but to improved economic conditions (Austria's real GNP rose 10 percent in 1924), and reduced incentives to cheat (more light was let into the underground economy with the restoration of a usable currency). France also stopped a 100 percent inflation in 1926, pegging the franc to the gold dollar, and cutting marginal income tax rates from 60 percent to 30 percent in order to repatriate flight capital.³²

CONCLUSION

The issue of Latin American debt is really very simple. Economies cannot grow, and both democracy and property rights are at risk, where taxes are confiscatory and the value of a country's currency is sinking. Economies that cannot grow cannot sell shares of future output and income, as equity or debt, to either domestic or foreign lenders. Countries that have slashed their marginal tax rates and stabilized their currencies have vastly improved their ability to service old debts and attract and retain new investment. Countries in which the creation of wealth is punished through punitive taxes, suffocating tariffs, and sinking currencies will remain bad credit risks. And so will the countries that lend to them.

³²Alan Reynolds, "Draining Israel's Red Sea," *National Review*, August 1, 1986, and "A Baedeker to Better Living," *Wall Street Journal*, February 23, 1989.

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FIGHTING
THE **WAR OF IDEAS** IN
LATIN AMERICA

JOHN C. GOODMAN
RAMONA MAROTZ-BADEN



A war of ideas is raging in Latin America. It is a classic battle between freedom and free enterprise, and statism and dictatorship. It is every bit as important as the battle in Eastern Europe, and the results to date are just as astonishing. In almost every country, the policies of statism (socialism and neo-mercantilism) are in retreat.

Those leading the struggle for freedom have received little help or encouragement from multinational corporations and international lending institutions — both of which tend to support the status quo. Instead, they are drawing on Latin America's heritage of classical liberalism and on a network of private think tanks located in the United States and in other countries around the world.

This publication of the National Center for Policy Analysis is the third in the series on *How Ideas Cause Change*.

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