

GIVE FREEDOM ITS TURN IN LATIN AMERICA

by Manuel F. Ayau

Editor's Preview: Latin America's political instability and meager living standards are not the result of deficiencies in national character, says Guatemalan leader Manuel Ayau. They are the fault of a system that ordains failure by stifling economic freedom.

While the heads of government in this country's southern neighbors change with disturbing frequency, Ayau notes, their huge bureaucracies continue imposing the policies that cause it all: tariffs, progressive taxation, price controls, government monopolies, foreign exchange controls, destructive labor laws.

The true sources of the region's agony are masked by myths that blame overpopulation (nonexistent), restlessness of the "oppressed masses" (provoked by a few troublemakers), or concentration of land ownership (a natural by-product of economic progress).

Worse, Washington and the international lending agencies are part of the problem. Socialism would have disappeared from the earth long ago if it was not kept alive by the United States, the author charges.

He urges action to bridge the cultural gap whereby most people in most countries are ignorant of the principles of the free society. The U.S. must waken to realize that it is the ultimate target of Soviet terrorism in the Americas. **The bailing-out agencies must stop postponing economic self-correction. Then Latin America may have a chance.**

Latin America is well known for its endemic political instability, coups d'etat, widespread underdevelopment, monetary instability, disproportionate foreign debts, corruption, violence, and recently, the implausible scenario of oil-rich countries going broke.

Today, most Latin American countries are regressing to standards of living of earlier decades. To varying degrees their economies are being deliberately sabotaged by terrorists, obviously well supported by the Marxist international movement and aimed ultimately at the United States.



Yet the image that these countries project does not correspond to the character of their people. By far the overwhelming majority are decent, hard-suffering people, trying to make good in a constantly decreasing sphere of free or less hampered activities.

What is the future of our people? Is there hope that our countries will enjoy peaceful prosperity in the future?

Why Governments Fall

When looking at political systems, we should not be misled by the outcry of politicians who greatly exaggerate, for their own benefit, the political concerns of the supposedly "suppressed" people. My experience is that, except for those who are looking for a political job, the vast majority of our people don't want to give much time to political affairs. Even at election time, many vote not because it is a political right, but because it is a legal obligation.

The government bureaucracies in Latin America are quite stable. Not so the high officials who are changed

from time to time, in some places more often than in others, sometimes through elections but also through revolutions. Whatever the method, the "ins" are ousted because they have failed in their efforts to bring peace and prosperity.

As a result, they are considered inept or corrupt, or both. Contrary to popular opinion, the military coups are brought about more by this failing than by the personal ambition of military officers. In general, military officers would rather not have their institution participate in the management of political affairs because it hurts their image.

The military usually take over a government as a measure of last resort, when generalized discontent begins to prevail and they anticipate the breakdown of law and order. This is the reason why most of the coups d'état are well received by the people.

Whether by coup d'état or elections, the system keeps failing, but it is invariably the people in charge who are blamed.

Now it just isn't probable that every group or person that has reached power in so many countries has been incompetent, dishonest, or unpatriotic. Therefore, it is hard to evade the only explanation for the persistent failure of

About Manuel Ayau

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Besides heading his own industrial firm since 1957, Dr. Ayau has served his country as a member of the Legislative Assembly, a director of the Central Bank, and vice president of the Chamber of Industry.

He is a past president of the Mont Pelerin Society, and founder of Guatemala's Centro de Estudios Economico Sociales. He holds a bachelor of science degree from Louisiana State University (1950) and an honorary doctorate in humane letters from Hillsdale College (1973).

Dr. Ayau returned to the Hillsdale campus to deliver this paper as part of a recent seminar in the Center for Constructive Alternatives examining U.S. policy in Central America.

You are invited to write us for copies of other papers already published from that seminar: Harry Summers on strategic and military concerns, Humberto Belli on totalitarianism in Nicaragua, and Agustin Navarro on the crisis in Mexico.

a tremendously rich continent with good, patient, and suffering people who have ready access to the marvels of modern civilization and technology.

The fault lies in the system, or if one wishes, in the absence of a system. Mind you, this is not a unique malaise: most of the world suffers to some degree from it, and the so-called developed or industrialized countries are not immune to it, either.

Stranglehold of Bureaucracy

Only thirty years ago, Argentina was one of the richest and most prosperous countries of the world—fourth or fifth place in income per capita.

One can date Argentina's turning point in prosperity to the modifications of its constitution. It substituted the rule of men for the rule of law. It made government responsible for prosperity. Now the underground economy, governed by its unwritten laws, and by its very nature without recourse to judicial settlement of disputes, is the basis for keeping activity alive. (In this the Argentines aspire to surpass Italy.)

The Argentines amended their constitution in 1957 and now, for instance, they have two different articles numbered fourteen: the original, a one-paragraph Article 14, that affirms people's rights as individuals to their freedom, and the three-paragraph Article 14 (bis.) which transfers those same rights to the unions and the government.

According to Article 14 (bis.), "the Law" will assure labor... "of minimum adjustable wage... paid vacations... profit sharing... control of production and management... protection against dismissal... access to a home and family income...."

Can "the law" provide all that?

A recent editorial in *The Wall Street Journal* by James Neilson, editor of the *Buenos Aires Herald*, ends by stating: "The gap between expectations and possibilities in Argentina is unbridgeably wide, and any government—Radical or Peronist—attempting to make the country live within its slender means will soon face mass unrest."

This is an ominous prediction. Unfortunately, it seems likely to come true, and it appears equally applicable to most of Latin America, perhaps with a few exceptions.

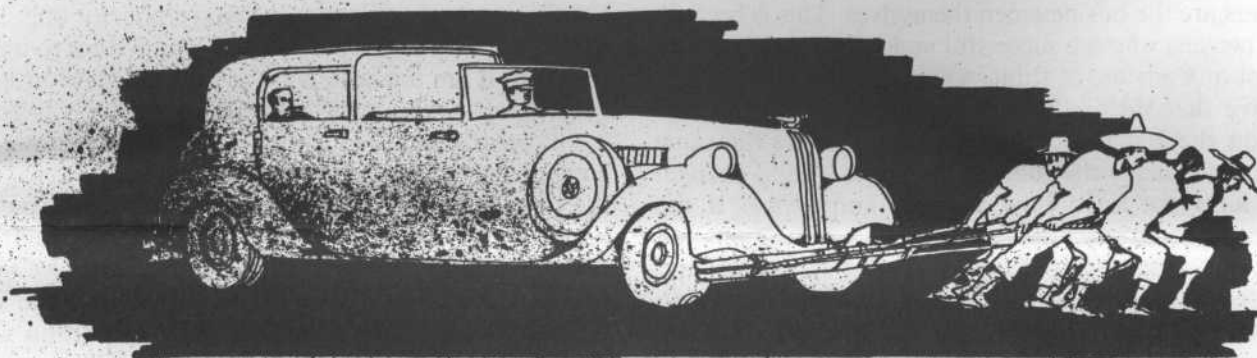
The one thing no one has tried in Latin America in the past quarter-century is freedom. Every other recipe has had its opportunity. In the meantime, it just isn't feasible to succeed in the chaos caused by discretionary bureaucratic decision-makers who attempt to manage everybody and everything.

The economies are stifled in perennial agony. Everybody spends a good deal of time solving inane problems: In Guatemala, a manufacturer of raw material urgently needs a spare part worth fifty dollars in the U.S. To save time, he calls on the phone, explains his predicament,

ment to his supplier, who accommodates him in spite of the fact that due to exchange controls, he is delinquent in his account. Due to the urgency, the part is shipped by the most modern and fastest means available by modern science, the jet. The part arrives in Guatemala the next day and there it sits in customs while papers are shuffled. Is his import quota exhausted? Is there an import license? Is the importer solvent regarding prior imports or exports? Two weeks later, the part arrives at the plant, after he has satisfied the various authorities that he is innocent

market value. In other words, have the earners subsidize the spenders to solve the exchange crisis.

One of the most generalized and damaging features of the prevailing tax systems in Latin America is very high import duties. It would appear that not one in one million policy makers and advisers is aware that import duties reduce the yield of export activities. Import duties reduce the demand and thus, the price of foreign exchange. Exporters' income is reduced because they sell their foreign exchange at this lower price. As a result, the foreign ex-



of economic crimes. Just in management and bureaucratic effort, this fifty-dollar part can end up costing more than one thousand dollars. The loss of production can be tremendous.

Tax and Monetary Follies

All Latin America is overburdened with destructive tax systems. All of the countries have high marginal rates of income and corporate taxes. This is much more absurd and harmful in a poor country, because economically speaking it is a tax on capital formation; recall Ludwig von Mises' insistence that the difference between a wealthy and a poor country is due to the capital investment per capita. Another way of saying the same thing in a more mundane way is that a country with many factories is richer than one without them. Apparently this is not so obvious. Progressive income taxation means that incomes are taxed at higher rates according to their susceptibility to form capital. Can one devise a more effective retardant to progress?

Foreign exchange controls prevail in all countries of Latin America. I know of no exception other than Panama, where the U.S. dollar is legal tender. Invariably central banks get into the currency-changing business along with price fixing. And invariably they do it in the most harmful manner: by overvaluing their own currency in relation to others.

In other interventionist countries with less ignorant bureaucrats, they *undervalue* their currencies for the purpose of solving their insufficiency of foreign exchange. In Latin America, the attitude seems to be: expropriate the foreign exchange earners at below market value and sell to the foreign exchange spenders also at less than

change earnings of the country go down, aggravating the balance of payments problem which import duties are supposed to safeguard.

Outlawing Cheap Power

On the expenditure side, what is the meager government revenue spent for? Granted, some of it improperly ends up in private pockets, and some of it is used properly; but a great deal is just outright wasted. The waste takes many forms, but it is so typical that one can generalize for all Latin America. Just the losses of the government enterprises, such as railroads, airlines, etc., probably exceed the U.S. foreign aid budget for Latin America.

Take the electric power generating industry, a monopoly, which is a generalized example. Let me tell you about Guatemala. After twenty years, since it became a government monopoly, the whole generating apparatus has become uneconomical. Because a large foreign debt was incurred in order to build it, the creditors logically insist that rates must be sufficiently high to guarantee sufficient profit to cover amortization and interest. The result is that the lowest rates charged to industry are above 12 cents per kilowatt-hour, compared with current costs of generating with your own small inefficient diesel engine of around 8 cents. How can one expect industrial jobs to be created with such non-competitive energy costs? Typically, in Guatemala it is against the law to produce cheap power for sale. Here is a case where if the international lending institutions had not existed, it is very unlikely that our governments would have obtained the large-scale credits required for power generation. Consumers would have to depend on "odious" profit-seekers to purchase competitively priced energy. To boot, pro-

bably from some imperialistic multinational. But at one-third the price!

If these enterprises were private, they could be offering better and cheaper services, while at the same time contributing with taxes. In other words, they could be creating wealth instead of consuming it.

It is impossible that even the best-intentioned and most competent government facing those burdens can succeed. Howelse, for instance, can one explain a country with large oil reserves going broke, like Mexico, Venezuela and Ecuador, and supporting those losses of their oil operations with tax revenue?

More priority is given by governments to such schemes as organizations for tourist promotion, the national powdered milk company, or the national arts foundation, than to the protection of people's lives, property, and contracts, the very foundations on which social progress is based. Instead of governments being agents of stability and security, they are the principal forces of destabilization.

How Aid Postpones Reform

Yet people continue to blame those in power, not the system itself. And, of course, when the cause of the disease is not identified, the remedies will be of no avail. By no stretch of the imagination can one believe that a person or group of persons can succeed in managing such a system, much less keeping it honest, when that system depends on the discretionary authority of a myriad of bureaucrats who go home at the end of each day oblivious to the magnitude of the effects of their intromission in people's peaceful productive endeavors.

Therefore, all our governments will continue to fail until it is recognized that it is not a problem of people. It is the system that is at fault, a system that has been kept alive principally by lack of understanding of the economic principles and ethics of a free society, a system which survives in no small part due to bailouts from international and U.S. financial assistance programs.

It does not require much insight to see that England would have not changed its expanding socialistic policies had the effect not been obvious to a sufficient number of people because they were suffering the consequences. There is enough evidence now that suggests that the socialistic trend in France will end with the present government, because the effects of its policies are being felt by a sufficient number of people.

But if aid had continued to bail out England and should bail out France today, no imperative to change would emerge. When the consequences of bad policies are not allowed to be felt, it is not likely that correction will be forthcoming. Politicians are interested in the short-run. And whereas financial assistance seems small, and therefore not that important compared to a country's GNP, it is more significant when compared to balance of payment deficits, and to the disposable monies in the

hands of politicians. Thus, economic foreign aid in many cases makes the difference that postpones correction of the system.

I, for one, believe that socialism would have disappeared from the face of the earth long ago if it was not kept alive by the United States.

Although aid cannot, in justice, be blamed for Latin America's failure, it deserves a good part of the blame for the persistence of this failure, especially when combined with the left-wing bias of the advice on policy which accompanies the aid.

The main reason for the lack of success in Latin America is the failure to realize that it is not corruption or incompetence that prevents people from solving their problems, but rather it is the system that makes success impossible. The system itself brings about the corruption as a consequence of the discretionary authority of the bureaucrats which affects everybody in every endeavor. By preventing freedom we assure failure.

Failure to Understand Freedom

Why is it not understood that freedom is a prerequisite for sound allocation of resources, for widespread incentives to exist, and even for morality to prevail?

This lack of understanding is the underlying cause of the failure. This is the real problem, and it is not unique to Latin America.

I have learned that it is a universal problem, and that even the few countries that are not underdeveloped owe their success, I believe, more to historical accidents than to a *widespread* understanding of the factors involved in social organization. The U.S. enjoys the effects of the system established by a small group of men who coincided at the right time in the right place: your Founding Fathers. They instituted a government of law and not of men, *i.e.*, a free society.

If it depended on the opinions prevailing *today* in the U.S., I don't think the present system would ever have emerged. I believe, for instance, that if it were not forbidden by the Constitution, by this time the U.S. would have export duties as well as import duties between the individual states. (It's a pity import duties into the U.S. were not forbidden also. It would cost you less to sweeten your coffee.)

The world—and Latin America to a greater degree—suffers from a cultural gap. I know because I am a victim of it. You are fortunate to be in Hillsdale College, because you won't be a victim of it as most college students in the world will be.

I went to high school in three different countries. To college in three different countries. Never was I exposed to the explanations of the mechanisms that coordinate people's behavior in a free society. Sure, I was taught that Columbus discovered Australia, that the Amazon River is in Michigan, some of the laws of chemistry and physics, math, etc. But no one ever mentioned to me the

Law of Association. No one ever mentioned how, in a free society, people are constrained to work for the benefit of other people whom they don't even know.

Incredibly, too many economists, as I've discovered in my youthful middle-age, don't understand comparative costs, which to me is the single most important principle of economic science. These insights should not belong only to the domain of a lucky minority. Understanding how people work together in a free society in their quest for happiness and well-being deserves as much priority as the three R's.

Economic illiteracy is the biggest obstacle to freedom, not only in Latin America, but throughout the world. I am speaking of basic concepts, not of elaborated and sophisticated fine points. The consequences of this illiteracy are tragic. And among the illiterates, I am referring to successful bankers, university professors, newspapermen, religious leaders, and so forth—not simply the masses.

Unmasking the Myths that Impoverish

Let me mention some examples of the destructive and impoverishing policies that could not exist if the Law of Association were taught in schools as part of elementary education: import substitution attempts, land reform, import duties, progressive taxation, price controls, government commercial monopolies, foreign exchange control, and destructive labor legislation.

The reason I believe that they would be rejected is that most people would realize that these policies work against the alleged beneficial objectives pursued by their proponents. The myth would be denied.

For instance, the myth that tariffs protect jobs (actually they destroy jobs), that the rich get rich at the expense of the poor (in a free economy the rich get rich because they decrease poverty), that land tenure patterns would be such that everybody has a little bitty plot (as countries become better off, land concentration typically increases). All those notions could hardly exist but for the widespread economic illiteracy.

In the usual assessment of Latin America's problems, a lot is said about agrarian reform, violence inflicted on the oppressed masses, overpopulation, etc., more myths and misconceptions; let me take up each one in turn.

First, the supposed problem of overpopulation. The most densely populated country in Central America (El Salvador) has a lower population density per square kilometer (165) than: Italy (187), Jamaica (190), Germany (247), Japan (306), Korea, (370). Argentina, once very rich and now very poor, has 9 inhabitants per square kilometer, Bolivia (5), Brazil (13), USA (23), Ecuador (27). Obviously this is far from being an aggravating factor to our troubles. What Latin America needs is more, not fewer people to fully exploit and enjoy its potential.

Second it is commonly heard that the masses are oppressed. This may be so, but mainly in two ways: first,

by their disillusionment with the growing gap between achievement and unrealistic expectations created by politicians, and the performance of the politicians themselves. Second, by the failure of the system. However disappointed the people are, they bear their poverty with patience and in peace. The troublemakers are others. Not the so-called masses, but the political activists who may at times provoke misfortune deliberately to further their political ends.

Third, land reform: this is just another form of socialism, under a "human face." The object is to destroy production, not to promote justice. The proof is that proponents of land redistribution invariably oppose the granting of free and clear titles to the new owners. Obviously, they are aware that uncoerced human behavior would revert the process to the natural model of ownership, which is not to their liking.

Land reform has never worked and it cannot work because it allocates land *not* according to the law of comparative advantage. In the market economy, the respect for legitimately acquired land, and for voluntary transfers of title, tends to allocate land so as to allow all of society to enjoy more and higher-quality products. That is the object of land utilization. It isn't to enjoy producing but to enjoy production, its fruits. But land reform turns governments into agents promoting the insecurity of rights, instead of the protector of rights. It dispossesses some and gives rights to the *same* land to others. Violence is bound to occur.

Land concentration is a natural phenomenon, as people leave the farm for better opportunities in the urban centers. As a country progresses, farmers find that they have to get bigger to become competitive in the capital market, to stay in business. Productivity increases as farms become more capital intensive and thus can yield sufficient income to attract enough farmers to be farmers and feed the rest. For example, in the U.S. the natural outcome has been that 50% of the privately owned land is owned by 1% of the population.

Thus the process of land concentration is not a conspiracy of the oligarchs. It is the natural course of events. On the contrary: to prevent it people must be coercively suppressed. Common-sense people understand this. It is the confused, sophisticated, Ph.D.s, the local and foreign social engineers who are the conspirators.

Bankers, Business, and Educators Share Blame

Please note that many of these impoverishing policies have been propagated by the aid-lobby fellows in high official positions in the U.S. State Department, the United Nations, the International Labor Organization, the World Bank, and the rest of those "renowned" institutions that hover over us simple folks who provide their tax-free salaries and pay for their travels and happy reunions. (You are aware, I trust, that most incomes earned in those lofty international jobs are not subject to *any* taxes.)

Socialization of Latin American economies could hardly have been possible if they had not had recourse to intergovernmental financial institutions like the World Bank, the Inter American Bank, etc. It is unlikely that governments could have obtained such gigantic quantities of credits from private capital markets. Our countries would have been completely different.

It is hard to imagine a more damaging combination than leftist politicians with "have-money-must-lend" institutions.

Another very significant pressure group preventing progress are the businessmen themselves. This is because those persons who are successful under the current system are not anxious to see things change. They instinctively perceive that their talents or connections, which have brought them riches or power, might not be the same ones to succeed if the rules of the game should change. They have the know-how and the know-who. If the economies were suddenly freed, their world might fall apart; any upstart could try to do better than they, and might even displace them. They have a vested interest in the system in which they have shown expertise. They *are* the experts.

In Latin America, even the military will ask the business community for help whenever there is a military takeover, because they are the people who are supposed to know. Businessmen derive their authority from their management success in the status quo.

Another very large influence-preventing progress is the educational establishment. The educational budget in most of Latin America's countries is quite large. In Guatemala, in spite of the costly guerrilla warfare, the budget for education is larger than that for defense. The sad part is that it is an investment in mal-education. Unfortunately, the notion prevails that government education is the best way to educate the people. Even its victims believe this because they have never heard the contrary case for free markets.

Typically, an education lobby becomes powerful and operates for the security and benefit of the educators, not the students. The current narrowmindedness goes to the extreme that in our private university, we can't employ foreign professors; they would displace Guatemalan nationals! The talents required in Guatemala to succeed professionally in the present educational establishment are definitely not the same as those required to succeed if promotion depended on the customers of education, the children's parents. The politics involved guarantees the failure of the strict educators. The cultural level of

our societies thus degenerates from our elementary schools through our universities.

The Future

Is there any hope? If there were not, I wouldn't be here. Many of us—albeit a tiny minority—are aware that the only solution is freedom: to allow people to peacefully solve their own individual problems.

But freedom is not going to be sought unless it is understood by a sufficient number of the thinking elite: the opinion formers, the politicians, and the educators. Some degree of consensus, even a minority one, is required even by a political dictator who wishes to impose freedom. (I am one who believes that, since the principal function of government is to protect people's freedom, it follows that it is proper to use the coercive powers of government to maintain freedom. This seems to me to be the same thing as saying freedom paradoxically must be imposed.) Therefore, in order to achieve sufficient consensus to enjoy freedom, there is no alternative but to educate a sufficient number of the influential elite. What this number is, I don't know, but in proportion to the total population it is not large.

Latin America thus faces a difficult task. In the light of the cultural gap that I mentioned before, where will we find the teachers? Considering vested interests, is there a chance that influential lobbies in the foreseeable future will promote policies consistent with freedom?

Most people make policy decisions based on ethical judgments. If they had to choose, most people would prefer a just solution to an efficient solution. But unless one understands the cause/effect relationships of social behavior, one cannot make correct ethical judgments. Unless principles like the Law of Association and its many implications are understood, it will not be clear that freedom is just *and* efficient.

Meanwhile, of course, terrorism can destroy everything. While the Soviet-financed terrorist movement—aimed ultimately at the U.S.—is disposed to ruin Central America, not much progress can be expected. Central America is ill-equipped to fight Cuba, especially if its system is producing poverty and discontent.

The tasks appear to be insurmountable. Yet, if (1) the bailing-out agencies refrain from preventing corrective measures, and (2) we expand the efforts to disseminate the economic and ethical principles of the free society, perhaps the Latin American countries will be ready to try freedom before they reach a total collapse.

