A Tale of Two Countries

Lessons from the Latin Quest for the Balance of Equity, Progress, and Freedom

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Poverty effaces dreams. Oppression defeats hope. These conditions ruin the human spirit, which no one should tolerate. Liberals and conservatives agree on this. Consensus does exist to increase the standard of living, afford greater opportunities, and extend more freedom. The cause of progress is the cause of mankind. All of us have a stake in it.

Debate, however, will forever wage on the question of “how?” Following this supreme interjection, all consensus dissolves. A question of policy, of direction: how does society get to a better place? Where does the path lie to happiness, freedom, and the common good?

Every person, every country, has to grapple with these questions individually. Opinion and ideology aside, however, common sense dictates that everyone consider the past. It contains a record of trial and error, experiments conducted and results observed, decisions and consequences – ample statistics and information from which to base our conclusions. History must be our guide.

After living and traveling in Chile for three months earlier this year, I frame these questions in the context of Latin America. To best effect the general welfare, what roles should public institutions perform? To what degree should government extend economic freedom? What policy achieves the most equitable use of natural resources? In sum, which arrangement of government and society achieves optimum results?

For me, the search for answers is crucial and urgent. I am inspired by what I experienced in Chile, and I have

endeavored to explore for solutions. I have studied Venezuela in contrast to Chile, two countries in some ways similar, but whose paths diverged in the last fifty years to produce very different results.

In 1917 foreign oil companies came to Venezuela to start drilling in the shallow waters of Lake Maracaibo.¹ By 1928 Venezuela had emerged as the world’s top oil exporter, and this touched off a wider economic boom.² Visionaries saw an opportunity to turn a profit outside the oil sector by laying the foundations of a modern economy. Standard Oil heir Nelson Rockefeller, for example, founded the International Basic Economy Corporation (IBEC) to channel venture capital into Venezuelan fishing, agriculture, and supermarkets.³ Local businessmen were invited to become shareholders to “teach them how to turn a profit,” while promoting the idea of “doing well by doing good.”⁴ The government sensibly spent its revenues on infrastructure, and welcomed foreign investment. An agricultural society urbanized quickly. Europeans were encouraged to settle, and immigrants as well as native entrepreneurs started new businesses according to their predilections and capacity: grocers, cab drivers, restaurants, retailers, mechanics, and manufacturers. Over several decades, many earned large fortunes in consumer goods, retailing, building materials, construction, and media. In Keynesian fashion, spending on public works provided a legion of private contractors and industrial suppliers with prosperous demand.

And yet, in 1936, a dire warning was published on the front page of a Caracas

newspaper by the intellectual Arturo Usler Pietri. He coined a phrase that became legendary: “sembrar el petróleo,” literally “plant the oil.” With this phrase, he made a case for sustainable growth outside the oil sector.

“The wealth of the soil among us not only does not increase, but tends to disappear... Paying the entire budget solely from mining royalties will make Venezuela lazy and unproductive, an immense parasite of oil, swimming in abundance both transitory and corrupting, pitching forth towards an imminent and inevitable catastrophe.”⁵

In 1945, the Venezuelan government raised the oil tax to 50% of profits. A coup in 1948 installed a profligate dictator, but by 1958 democracy was restored with the inauguration of the first modern Venezuelan President, Rómulo Betancourt. While scrupulously paying down inherited debts, his administration conceived of, and soon succeeded in creating, the OPEC oil cartel with four other exporting countries. With a higher oil tax and the birth of OPEC, Venezuela by 1960 had laid the groundwork for a tremendous future surge in government oil revenues.⁶ In 1973 as a result of the Arab oil embargo, the price of oil quadrupled in less than a year, eventually moving from under \$4 a barrel to a peak of \$38 by 1981.⁷ State coffers saw a flood of wealth beyond the dreams of avarice. Revenues seemed inexhaustible. The 1973 inaugural address of President Carlos Andrés Pérez famously called for “administering abundance by the standard of scarcity.”⁸ Government revenues had tripled. Spending surged on public works, housing, health, education, and every imaginable project. At the outset, a “lockbox” was created with the prudent intention of saving half of current oil royalties for future investments. It’s almost impossible to imagine, but these massive savings were tapped out within a few years, as the government borrowed

heavily to finance nationalization of both the oil and steel industries. These were enormous acquisitions, even at below market rates. Fearlessly, the government banked on the future, and borrowed billions of dollars. The size of bureaucracies expanded, as the state crossed the Rubicon and became not only a buyer from the private sector, but an enormous producer in its own right. It is hard to overstate how prosperous and hopeful this period was. A *Time* magazine article from March 1975 opens with a glowing description of “its Caribbean beaches, its expanses of jungle, its kinetic, polyglot capital” and concludes that “Venezuela is fast becoming one of the most formidable nations in the Western Hemisphere.”⁹

Seven years later, Usler Pietri’s prophesied “imminent and inevitable catastrophe” finally occurred, as in 1982 the price of oil began a long slide back down to \$12 a barrel.¹⁰ Devaluation ensued and its dollar-denominated debt became toxic. Financially wrecked, the private sector looked towards the government. Corruption became an issue, because the public finally felt the absence of misappropriated funds. Trying to service foreign debt and meet popular expectations enlarged by the boom years seemed impossible. Twenty five years after his first five-year presidency, Carlos Andrés Pérez was elected again in 1989, this time boldly calling for a great turnaround -

"el Gran Viraje"- to radically reform economic policy on free market lines.¹¹ But abrupt increases in subsidized bus fares triggered riots and massive violence, leading to a crisis of legitimacy. Dissatisfaction with the two principal parties, exacerbated by ten years of a worsening economy and corruption scandal after scandal, led Hugo Chavez to foment rebellion and attempt a coup in 1992. He was jailed and released just two years later. Pandering to people's frustration, and promising sweeping reforms, Chavez won his first Presidential election of 1998.¹²

Moving quickly, Hugo Chavez rewrote the constitution and consolidated his power. Now in his third term, his party controls 100% of the seats in the Venezuelan National Assembly.¹³ Opposition parties have withdrawn all their candidates in protest over alleged vote fraud. (The government is alleged by the opposition to control Smartmatic, the vendor of electronic voting machines used for the past two presidential elections). Mr. Chavez today effectively wields the entirety of political power in Venezuela. His explicit goal is to achieve "Socialism of the 21st Century." His administration has abrogated contracts with foreign oil companies, re-nationalized electric utilities and phone companies, confiscated large farms, declared "war" on the food industry, instituted price controls, raised subsidies, severely regulated businesses, increased taxes and tariffs, and ended the era of open investment.¹⁴ Taking the hint, entrepreneurs, investors, and business owners took their losses and fled. Of 11,198 private companies existing in 1999, only 6,623 remained by 2003. The once vibrant Venezuelan private sector is a shadow of its former self.

Yet those Chavez came to save, the poor, have suffered the worst. Inflation is the highest in Latin America today, near 20%.¹⁵ The average Venezuelan family must spend 46% of its budget on food and beverages, a higher proportion than before Chavez

came to power.¹⁶ In 1998 the price of oil was \$11 a barrel, and today it has reached over \$90. Chavez failed to translate this into wealth for his people. Yet, Venezuela still has *not* recovered the ground lost since the 70s: real per capita income in 1978 was *double* that of 2005, and 2005 purchasing power parity GDP remained at the 1998 level.¹⁷ Uslar Pietri had urged six decades before Chavez: "Plant the oil!" before easy wealth could ensnare the country, make it dependent, and ruin it. Other oil-dependent countries seem to exhibit similar symptoms: politics focused entirely on divvying up vast state owned resources, and governments which pocket, squander, or waste billions of dollars, often on vain delusions of grandeur.

Whereas Venezuela's case since 1973 shows the tragic consequences of the wrong answers, one doesn't have to look far in South America to find a country that found enduring and sustainable solutions, starting by coincidence in the same historic year.

The use that Chileans make of their natural resources makes a fantastic model for the world. Apart from tourism and copper, Chile's industries would not seem obvious. It has no oil. The key agricultural exports aren't even native species. Yet Chile is one of the world's great exporting economies. How? Part of the explanation lies with institutions like Fundación Chile, which played a brilliant role in propelling

Chile's 'smart growth,' acting in a manner strikingly similar to Rockefeller's IBEC, as a public-spirited venture capitalist. A non-profit, *private* company created in 1976 by the Chilean Government and the United States' ITT Corporation, Fundación has excelled in creating new technology driven industries suited to local conditions.¹⁸ Its first success came early on, in 1980, when the foundation's research indicated that conditions along Chile's 4000 mile coastline could give it competitive advantages in the commercial salmon farming industry. BusinessWeek reports that "By 1982, Fundación Chile had its first salmon farm up and running. Seven years later it sold it to a Japanese company for \$22 million."¹⁹ Today, Chilean salmon account for 35% of the world supply, employ 45,000, and sell \$1.4 billion. One glowing success after another, Fundación moved on to create a \$2 billion berry industry using advanced biotechnology, provide farmers with technical assistance that caused the widespread cultivation of asparagus, start a successful meat packaging industry, and plant pine forests that turn profits. An institution like Fundación evidently serves an incredible role. As a non-profit, yet private company, created in partnership with the government, its projects guide the economy towards sustainable growth, while generating billions, increasing employment, conserving the environment, promoting foreign investment, and harmonizing both private and public sectors for the benefit of all.

An institution like Fundación is a surprise, because it included a role for government in its cooperative, largely private initiative to pioneer an economy. Agencies like CORFO (economic development) work entirely on helping the private sector, aiming at increasing competitiveness and efficiency in management, specialization and meeting standards in global markets, harmonizing links between large companies and smaller

suppliers, funding organizations similar to Fundación Chile, developing financial intermediaries providing microcredit, and facilitating foreign and national investments among other things.²⁰ Another government initiative, called CONICYT, funds research institutions which beneficiaries in the private sector co-finance. These government institutions oriented to the private sector have been tremendously successful in Chile.²¹

But by far the biggest contributor to the Chilean economy has been private enterprise, enabled by economic freedom. The Heritage Foundation/Wall Street Journal Index of Economic Freedom ranks Chile the 11th most free country in the world, on a list that includes tiny Hong Kong, Singapore, and New Zealand above it.²² In contrast to Venezuela, where the capital intensive oil industry only employs 0.4 percent of the labor force, in Chile capital and labor are more proportional: the largest and most labor intensive industries are manufacturing and trade.

All this prosperity and opportunity has come only as a result of the last twenty five years of governmental policy and economic freedom. Chile's recent history provides a fascinating counterpoint to Venezuela's. Following a long and stable democratic tradition, in 1971 an avowed communist became President with a mere 36% plurality.²³ Salvador Allende used the power of the state to nationalize industries without compensation, to impose price controls, to regulate companies, to expropriate land, and to print and freely distribute money, engendering 500% inflation. The resulting economic and political crisis set the stage for a military coup in 1973. The authoritarian General Augusto Pinochet directed the wholesale reformation of the government. Though it was indeed a dark time for political freedom, he reversed Allende's policies, restored the economy, and extended maximum economic freedom. With the advice of American-

trained Chilean economists, Pinochet's administration crafted a new constitution, and wrote new laws.²⁴ His cabinet minister, José Piñera, crafted a pension system that is today regarded as a model around the world.²⁵ Eventually, Pinochet ceded a transition back to democracy, and Patricio Aylwin was inaugurated as a democratically elected president in 1990, calling for "growth with equity."²⁶ Since then, the country has held numerous elections, and the new left of center governing coalition, today led by President Michele Bachelet, has remained committed to free market principles. The economy remains open to foreign trade and investment, and the state deliberately fosters venture capital and new business formation. In the words of Chilean Senator Alejandro Foxley, the Chilean government has been characterized by "a commitment to a permanent budget surplus, and to retiring government debt as an insurance against future financial shocks."²⁷

Chile and Venezuela represent diametric positions in the range of world governments. Chile has believed that engaging its people in trade with the world develops the poor, and advances society. Venezuela has rejected economic freedom as a solution, and opted instead for dependence on natural resources and government hand-outs. Clearly, the story shows a divide in their policies. So I return to the original question: how do economic freedom, public policy, and institutions correlate with improving the standard of living, prosperity, and progress for all?

The results can be shown by a direct statistical comparison.

Poverty declined in Chile, from 40% in 1990 to 20% in 2000. In the same period, debt as a percent of GDP dropped from 43% to 13%. Inflation sharply decreased from almost 25% in 1990 to 2.3% near 2000.²⁸ Economic growth averaged 6.1%, the highest and most consistent in Latin America. Income rose an average of 51%, though among the poorest the increase

is greater.²⁹ And falling from an average of 15% in the 80s, unemployment reached 7.4% in 1998.³⁰

In Venezuela, President Chavez has enjoyed significantly more oil revenues than the previous three administrations combined.³¹ It is shocking then, that official statistics report no change in extreme or total poverty and many studies claim that total poverty has actually increased by ten percent.³²

In health, the Food and Agriculture Organization of the United Nations (FAO) reports malnourishment in 17% of the Venezuelan population, even though nearly thirty years ago, between 1979 and 1981, only 4% lacked sufficient nutrition. Yet even that statistic disguises the reality in rural areas, such as the states of Amazonas and Apure, where over 2/3 of children are malnourished. Some of Chile's cities are far more remote, such as Puerto Williams and Punta Arenas near Antarctica, yet Chile consistently meets World Food Summit benchmarks and has reduced malnutrition from 8% in 1990 to less than 4% in 2007. This alone should elucidate the human suffering behind misgovernment.³³

An overview of global reports and studies demonstrates a multilateral agreement on their performance. The World Bank's *Doing Business* report ranks Venezuela 164th in its analysis of business climates in 175 nations, whereas Chile leads Latin America in 28th place. The World Economic Forum's 2007 *Global Competitiveness* report rates Chile the 27th most competitive economy of 125 measured, whereas Venezuela languishes in 88th place. Even less forgiving, the World Competitiveness Center's 2007 competitiveness 'scoreboard' places Venezuela in dead last, 55th of 55 nations studied. Concurring with these studies, the Fraser Institute evaluates Chile as the 20th and Venezuela the 126th of 130 nations in its 2006 study of the *Economic Freedom of the World*. The countries stand on opposite ends of the spectrum.

Corruption indicates the health of society. Finding widespread corruption in businesses, government, and the courts is a sign of a broken social and political system. Transparency International's 2006 publication of the global *Corruption Perceptions Index* regards Chile on par with the United States in 20th place, but at 138, Venezuela enters Haiti's company. When the statistics speak so loudly, covering your ears simply does not work. Corruption to that degree paralyzes society, and those *always* damaged the most by this injustice are the poor.

Chile participated in 8 regional and global educational testing programs from 1995 through 2006; Venezuela only participated once, just prior to Chavez first inauguration, and has not participated since then.³⁴

Homicides in Venezuela tripled in 7 years of Chavez to 13 per 100,000, whereas a recent survey measured homicides in Santiago Chile at 1.4 per 100,000. UNESCO in as 2004 study qualified Venezuela as the most violent country in Latin America.³⁵

What do these statistics mean? How should this history be interpreted? Where is the moral of the story?

To me, the essential lesson is not the repudiation of a particular ideology. Leaders come from both the Right and the Left, from both government and the private sector. In Venezuela, Nelson Rockefeller's visionary IBEC reached out to the poor

to show them how to better themselves by participating in the market. President BetancourtaffirmedVenezuela'ssovereignty and national interests by increasing the government's share of revenues and by founding OPEC, but he encouraged a private sector which thrived under his policies. The prophetic warning of Arturo Uslar Pietri was nonconformist. He simply feared that dependence on a single natural resource administered by a single organization was an inadequate foundation and a recipe for disaster. And in Chile, I admire visionaries like Jose Piñera and organizations like Fundación Chile. But I also admire, and very much respect, the leadership of many legislators and Presidents of the Chilean Left, in departing from orthodox socialist attitudes toward the free market and the private sector. Instead, they have sought to partner with the private sector to alleviate suffering, raise the standard of living, and bring prosperity and opportunity. Common sense and honesty triumphed.

Given fair government, sound policies, and a vision: the poorest man on earth can become the richest; the least, the greatest; the most destitute, the most filled with joy. Such is the power of liberty enthroned in laws, and justice upheld. For the nations of the world, this should be the goal. The potential of the majority of their people lies dormant, until leaders embrace the self-evident truth confirmed by history: *Liberty is the cause of Progress.*

Endnotes

- 1 (Library of Congress, Federal Research Division 1998)
- 2 (Encyclopaedia Britannica Online 2007)
- 3, 4 The Rockefeller Archive Center, <http://archive.rockefeller.edu/collections/rockorgs/narorgs.php>
- 5 (Pietri 1936)
- 6 (Library of Congress, Federal Research Division 1998)
- 7 (Energy Information Administration 2007)
- 8 (Fundación Empresas Polar 2007)
- 9 (Time Magazine 1975)
- 10 (Energy Information Administration 2007)
- 11 (Fundación Empresas Polar 2007) <http://www.fpolar.org.ve/Encarte/fasciculo25/fasc2508.html>
- 12 (Bureau of Western Hemisphere Affairs 2007)
- 13, 15 (Encyclopaedia Britannica Online 2007)
- 14, 16 (Orozco 2007) (CNN 2007)
- 17 (Súmate 2006) Cites Daniel Ortega of Instituto de Estudios Superiores de Administración (IESA), Caracas
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- 19 (Business Week 2005)
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- 21 http://www.conicyt.cl/index.php?option=com_content&task=view&id=346&Itemid=115
- 22 (Heritage Foundation/Wall Street Journal 2007)
- 23, 25 (Encyclopaedia Britannica Online 2007)
- 24, 26 (Piñera 2004)
- 25, 27-30 (Foxley 2004)
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- 31 (Ministerio de Finanzas de Venezuela 2006)
- 32 (Súmate 2006) Study cites Universidad de Andres Bello, and others.
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- 34 (Súmate 2006) Cited by Sumate, "2006 Cantidad sin Calidad." Programa de Promoción de la Reforma Educativa en América Latina y el Caribe"
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