

**A CONFERENCE ORGANIZED BY  
THE CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE  
(CIPE) AND  
THE RONALD COASE INSTITUTE**

**PROMOTING INSTITUTIONAL REFORMS IN  
LATIN AMERICA**

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**UNIVERSITY OF SAO PAULO  
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DAY TWO**

[TRANSCRIPT PREPARED FROM TAPE RECORDINGS.]

So I will introduce the panel after we get started, but first, I would like to invite Steven Johnson, who is with The Heritage Foundation in Washington, D.C., to join us. We have invited him to give us an overview on some of the key points, strategic issues that we see happening in Latin America across the board.

The Heritage Foundation, for those of you who don't know, is one of the premier think tanks in Washington and I think probably the very best of all of them in terms of making the linkage between policy on Capitol Hill and in the White House in Washington and the ideas and concepts that come out of the think tank. So he will provide us with an overview, and then I will come back and introduce some of our panelists for the first panel.

Steve?

**Mr. JOHNSON:** Thank you, John.

Buon gia, muito, obregado [phonetic], y muchas gracias.

They say the best speech is the one with a good beginning and a good ending and not much in between, so I am going to try to stick to that high standard this morning and keep it short so that we can get on to talk with our distinguish panelists, many of who would be the generals and the foot soldiers in the trenches of reform in our countries, and the people who do very, very valuable work.

Even though I am going to go on to thank the University of Sao Paulo, the Ronald Coase Institute, and the Center for International Private Enterprise for their kind invitation to let me be sort of a fly on the wall--and I am kind of interested to know how the translators will interpret that expression--but a fly on the wall observing this very important conference. You have a beautiful university here, you have a talented faculty, and you have a student body that has many fine minds among it, and I met some of you yesterday; obviously, a talented pool of leadership for this great nation.

The purpose of this workshop and conference is to learn how to apply that leadership to identify problems and how to solve them, particularly those at the confluence of economic theory and political reality. Yesterday, Professor North set the stage by advocating an organic approach to economic theory by taking into account the different dimensions in which society exists.

The Benhams from the Ronald Coase Institute showed how the cost of exchange analysis could help identify roadblocks on the highway to prosperity and overcome them by acting on them. It can't be done. We are too path-dependent, and we cannot abandon our patron-client relationships and treat everyone the same, you might say.

Well, today, you are going to meet some of the people who are in the trenches who are doing just that--changing attitudes and patterns of behavior to improve governance and try to expand prosperity in their

countries. Their experiences are lessons that all of us can apply to problems that we all have or may have at different times in our histories.

In the United States, we have lingering trade barriers that keep us from being better partners in international commerce. We also have a growing list of entitlements that threaten to bankrupt the national Treasury in a few years.

These are problems that we face. Colombia is acting to end a 40-year civil conflict. Mexico is trying to free itself from an aging political mafia, while Bolivia looks for what might be something that would unite a diverse people who are now experiencing deep fractures in their society.

We all have problems, my friends, and as Lee Benham alluded to yesterday, as long as we are in trouble, we are interesting. So, although it would be nice to solve these problems, at least while we have them, we will be interesting to the rest of the world. I say that kind of facetiously--I laughed at it a little bit yesterday--but there will always be problems that we will have to solve, and of course, always things to keep us interested in the work that we are doing.

What are these problems? What are the major problems that we see in the United States? And of course, you would ask, why does the United States care what is happening elsewhere in the Hemisphere? And I guess it is probably a sense of communitarianism that we have in our own country that we project abroad to other societies, because I think there is kind of a recognition in our own countries, and our country grew up primarily from the community level first--we never had a state imposed on top of us; it grew from the initial immigrants in their own communities, and they had community government--and they knew that their well-being depended on the well-being of their neighbors. So you could not grow rich unless your own neighbor was prosperous, because there was no one else to trade with.

So that is kind of the projection of our policy of our feeling toward our neighbors in the Hemisphere as well, that we know that we cannot continue to be prosperous unless our neighbors are prosperous as well, because our neighbors represent markets for our products and services, as we represent a market for their products and services. So as long as we are open to that, and as long as people can participate in that, we are going to be well-off, and that prosperity is going to be shared. But if we have poor neighbors, then we are going to have problems, because we won't have markets.

That's kind of the long and the short of why we should care. But what are these problems?

Every year, polls by Latino Barometro [phonetic] show declining confidence by Latin Americans in democracy and free markets. Last year, confidence in democracy slipped down to about 32 percent. The year before, it had been 37 percent. Some 12 out of 23 economies in the region were

ranked as mostly not free by my organization, The Heritage Foundation in our annual Index of Economic Freedom. That might seem exaggerated to some of you, but the same criteria is applied to every country, and that is essentially how the region falls out. Half of the region is economically not free, or mostly not free.

At issue is the fact that initial steps toward creating democracy and free markets cannot be the only steps. As Professor North pointed out, path dependence forces stakeholders to defend the status quo and to develop compensating behaviors to preserve traditions despite changes in formal laws. The results include what you might call "bottleneck bureaucracies," or "bureaucracies de [inaudible]."

Now, I didn't make up that term. I heard it from President Lucio Gutierrez of Ecuador when he spoke of the need for reform in his own country. Elections don't make a democracy--they are only one element--and can't defeat the inertia of powerful centralized ministries, powerful interest groups dominated by strong presidents.

Far from sources of local information, they seek to do everything from maintaining foreign relations for a country to fixing the streets in remote rural villages.

Since few individuals actually make the nations' decisions, the process slows down, and corruption enters in to become the grease that makes the machine of government begin to move.

In many countries, party leaders, not voters, chose candidates who run for elected office on lists. Placed on these lists for their respective parties, they owe their loyalties mainly to the party leaders, not to the voters. My friends, that is not democracy--that is subterfuge.

Then, there is this thing that we call "crony capitalism," or "capitalismo de complise" [phonetic]. And I understand that all rights are reserved on that phrase, because I picked it up from my friend Rafael Merchan from Colombia this morning.

While free trade may open up markets, few people can actually participate in them, because there are laws that block competition that you talked about yesterday and the day before in your workshop; officials in state monopolies like TENEX [phonetic] in Mexico still misdirect public funds for their own benefit; weak property rights and complicated regulations keep many poor entrepreneurs on the informal side; and in most countries in the region, informality runs an incredible 40 percent; business cannot grow, and taxes to run the state cannot be collected.

That is a real problem, especially when you are trying to enact social programs to try to improve the lot of some of the poorer citizens. It also is a problem when you are trying to just, plain run the government and provide basic services.

While centralization creates decision making bottlenecks, it also leads to scarce presence of state authority in rural areas. Colombia, Ecuador, and Peru find it hard to control their national territory. That is because the national policy and the army are the entities that have to do the job that local police and constabulary would do in most industrial countries.

The basis for correcting some of these ills is changing the concept of governance from one of rule and one of control to one of providing services for constituents. First, government should be limited and dedicated to protecting liberties and not imposing a false order.

Second, government needs a new foundation in local communities so that decision making begins at home, where information is freshest and where it is closer to those who make the decisions and where it involves more of the citizenry in making those decisions.

Interestingly enough, the "partido travador" [phonetic] in Brazil has been advancing this concept with its idea of participatory budgets, and if that isn't democracy in action, I don't know what is, because deciding how you are going to spend money that is collected from your own taxes I think is in part at the heart of democratic decision making.

Now, bloodlines might be important in passing on the family fortune, but they really have no place in politics in this modern era, and they have no place in the marketplace.

Fourth, citizenship matters. Democracy thrives on an informed and educated citizenry. Public education must prepare people to participate in and manage their own government. And it is not something that can be overlooked in the rural areas, it is not something that can be overlooked in the troubled parts of the inner cities. It is something that has to extend to every citizen

Reforming these basic concepts is a price that many countries in Latin America will have to pay to become prosperous and self-sustaining. It is a price that we in the United States and Canada and other industrialized nations pay every day. Much of this price will have to be on the shoulders or paid by the elite who have to give up their political and economic monopolies.

But the incentive for them--and this is important, as Professor North talked about incentives yesterday--the incentive for them is a much more prosperous society and a better place to sell one's own products and services. And after all, I think that's why we should all care, because when your neighbors aren't prosperous, your prosperity is limited. But when they have the freedom to create and to be productive, they become a healthier market, and you prosper, too. Andrew Carnegie knew that, Henry Ford knew that. Many of the industrial giants in the United States in the past century have known that and have struggled to improve their own neighborhoods.

Bottleneck bureaucracies and "capitalismo de complice," skeletal or absent local government--these are all problems that my colleagues here on this panel and later today will be addressing and are addressing in their everyday lives and in their work. They understand what the Spanish writer Jose Ortega Gaset [phonetic] said, that "Life is a series of collisions with the future. We are not the sum of what we have been, but rather what we want to be."

So my question to you today is what do you want to be?

Mucho obligado.

[Applause.]

**MR. ZEMKO:** Thank you, Steve.