



For more information, contact:

John D. Sullivan, Executive Director, CIPE

John A. Zemko, Senior Program Officer, Latin America and the Caribbean

Center for International Private Enterprise

1155 15th Street, NW • Suite 700

Washington, DC 20005

Telephone: (202) 721-9200 • Fax: (202) 721-9250

The Center for International Private Enterprise is a non-profit affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy. CIPE has supported more than 1000 local initiatives in over 100 developing countries, involving the private sector in policy advocacy and institutional reform, improving governance, and building understanding of market-based democratic systems. CIPE provides management assistance, practical experience, and financial support to local organizations to strengthen their capacity to implement democratic and economic reforms. CIPE programs are also supported through the United States Agency for International Development.

Center for International Private Enterprise © 2006

# Table of Contents

1. The Prospects for Reform in Latin America <i>John D. Sullivan, Ph.D.</i>	1
2. Local Knowledge and Insitutional Reform <i>Douglass North, Ph.D.</i>	7
3. Building Free Markets in Latin America <i>Álvaro Vargas Llosa</i>	10
3. Legitimizing the Reform Process <i>Hugo Maúil Rivas</i>	21
4. Developing a Congressional Caucus to Promote Fiscal Reforms in Argentina <i>Miguel Braun</i> <i>Luciana Díaz Frers</i> <i>Jinu Maria Koola</i>	29
5. Promoting Institutional Reforms in Ecuador <i>Dora de Ampuero</i>	39
6. The Colombian Confederation of Chambers of Commerce—Confecámaras <i>Harvey Rodriguez</i>	48

# The Prospects for Reform in Latin America

John D. Sullivan, Ph.D.

*Executive Director, Center for International Private Enterprise*

Today, some twenty years after many countries in Latin America began to carry out reforms advocated by the Washington Consensus, the development of pro-market, democratic systems throughout the region remains a work in progress. As the results of the 2006 presidential and parliamentary elections in Latin America show, the perennial question remains: “What are the prospects for economic and democratic reform in the region?”

Clearly, in many countries, there is a backlash against the reforms that took place during the 1980s and 1990s. However, to be able to predict the impact this backlash will have on the future policy decisions of the newly elected leaders, we must understand its underpinnings.

There is one particularly interesting trend evident in the region. Public polling data continues to suggest that despite a highly publicized negative reaction to policies of the past, many, if not most, of the region’s citizens perceive market-based democracy as a more viable and sustainable path toward economic growth than state-driven growth strategies.

Take, for example, Latinobarómetro, a Chile-based polling organization that conducts an annual survey of regional attitudes toward democracy. The results from the most recent survey in 2005<sup>1</sup> indicate that most respondents continue to regard democracy favorably:

- More than half (53%) of the respondents feel that democracy can solve national problems, while 37% feel that it cannot. In the 1995 poll, 50% of respondents felt that democracy could solve problems and 40% felt it could not.
- 62% of respondents are opposed to military rule under any circumstances, compared to 63% in 2004.
- 70% strongly agree or agree that, although it has problems, democracy is the best system of government; 66% agree that democracy is the only system that will enable their country to become developed.
- 53% feel that democracy is preferable to any other form of government.

What we have here is a dichotomy. A majority of respondents support democracy in general, yet at the same time they are not satisfied with how their democracies are performing. Only 31% of respondents feel very or somewhat satisfied with how democracy functions in their country, while 61% are not very or not at all satisfied. The lack of satisfaction with democracy implies a failure of the political systems in many of the countries to deliver benefits – such as a reduction in poverty and improved standards of living.

In other words, it seems that the movement toward more open trade regimes, democratic political systems, and a reduced role of the state in economic management – symbolized in many cases by privatization – failed to improve the well-being of large segments of the region's populations. These perceptions often do not align with the reality – there has been significant improvement in Latin America's economic

---

<sup>1</sup> Latinobarómetro Corporation, responsible for carrying out the Latinobarómetro surveys, is a private, non-profit institution based in Santiago, Chile. The Corporation also maintains overall responsibility for the Latinobarómetro project and data distribution. The most current set of data available at the time of the publication is for 2005. More information is available at <http://www.latinobarometro.org/>.

performance in the 1990s, especially when compared to the “lost decade” of the 1980s.

For example:

- Real GDP from 1980-1989 in Latin America grew at an annual average of 1.8%; over 1990-2003, annual GDP growth improved to 2.8%.
- In per capita terms, real GDP growth over the same two periods improved from -0.2% to 1.1%.
- Inflation went from an annual average of 191% over 1985-1994 to 12% over 1995-2004.
- The exports/GDP ratio, a measure of economic openness, has increased from an average of 12.4% over 1980-1989 to 14.8% over 1990-2003 and to 18.7% over 2000-2003.

The region has benefited from higher economic growth and more stable macroeconomic conditions, particularly with regard to inflation. The hyperinflationary outbreaks that undermined economic stability in various countries during the 1980s, including Argentina, Bolivia, and Ecuador, have largely been brought under control. Greater economic integration has helped as well, since greater competition from imports serves as a check against unrestrained price increases by protected domestic producers. In light of these economic successes, why, then, there is such a backlash against free market reforms?

One way of looking at the problem is contrasting achieved macroeconomic stability with microeconomic problems that still persist. For example, in many cases the benefits of the improved economic performance did not flow through to large segments of the region’s population. We are talking about people largely excluded from the political process, without a voice in economic policymaking. To make their voices heard, they are forced to take to the streets and vote into office leaders who promise such representation.

Economist Paul Holden argues that the perceived failure of market reforms is due to fact that markets have not really developed. Although

there are ample cash-based or spot markets in every country, many countries in the region have yet to develop the types of markets that serve as the foundation for sustainable growth and development. In Holden's words, "As economies develop, markets should increasingly become longer term and a different type of contracting should evolve so that there is a transition from spot cash markets to markets that promote investment and productivity."<sup>2</sup> It is difficult to enter into and enforce long-term contracts in Latin America, a problem that stems from corruption, lack of property rights, and weak rule of law. As a result, commercial relations are based largely on personal relations, and short-term markets remain the norm.

This is one of the reasons that despite the evident macroeconomic stability and growth throughout the region, foreign direct investment (FDI) has not shown much improvement. Over 1980-89, Latin America captured an annual average of 9.5% of total FDI. From 1990 to 2003, its share of total FDI averaged 10%, remaining essentially flat despite progress in controlling inflation and creating more open economies.

Many countries in the region also lack a long-term vision, according to Rafael Merchán, former editor of *Perspectiva* magazine and recent candidate for the Colombian Congress. This lack of vision, in Merchán's view, stems from the weakness of the region's political parties, which prevents them from carrying out the important functions undertaken by their counterparts in more mature democracies. These functions include helping forge a minimum consensus on how to address current problems and offering a bulwark against the personalistic political movements that have dominated the region's political development since the mid-20th century. In Merchán's view, it is no coincidence that neo-populist movements, headed by such figures as Hugo Chávez in Venezuela and Evo Morales in Bolivia, have emerged in countries with weak political parties.

The 2005 Latinobarómetro poll highlights the low regard in which political parties are held in the region. Asked to indicate their confidence

<sup>2</sup> Paul Holden, "Did the Market Economy Fail in Latin America? The Second Generation of Institutional Reform" (presentation, CIPE, Washington, DC, October 28, 2002). Available at <http://www.cipe.org>.

in 18 local institutions, the respondents rated political parties the lowest, with only 19% having a lot or some confidence in them (vs. 79% for the highest-rated institution, firefighters).

Beatriz Merino, former Prime Minister of Peru, argues that political parties must devote themselves to institutional reform for the region's societies to advance. In her view, the region continues to operate in a paradigm of underdevelopment, in which institutions protect the interests of the privileged elite while ignoring the majority. Political parties devoted to institutional change will be more effective in generating a new paradigm of progress, based on more open markets, stronger rule of law, and more stable democracies.

This report describes various facets of strengthening institutions, using examples from programs conducted throughout the region. The article by Douglass North captures well the kinds of institutional problems reformers face. Other articles give very good examples of concrete institutional reforms that can be undertaken to improve the functioning of economies so that people gain representation in a manner consistent with the principles and values of free markets and democracy.

In Ecuador, for example, Dora de Ampuero of the IEEP describes how political parties have systematically failed to represent the popular will and how her organization is working to promote a reform-oriented consensus in the country's political leadership. Hugo Maúl describes how CIEN in Guatemala built a consensus on how to improve competitiveness using a bottom-up approach that incorporates the views of export-oriented medium-sized businesses. Miguel Braun, Luciana Díaz Frers, and Jinu Maria Koola showcase CIPPEC's program in Argentina, which aims to improve public administration through the creation of a congressional caucus to overhaul the constitutionally mandated system, transferring federal tax receipts to the provinces. Finally, in Colombia, Andrés Bernal of Confecámaras discusses how the adoption of corporate governance tools by small- and medium-sized businesses as well as large firms will help expand their access to financial markets and economic growth in general.

Through these and other programs, slow but steady progress is helping meet the challenge of institutional reform in the region. This effort is crucial to ensuring that Latin America continues to build on the progress achieved thus far and that a market-based consensus so essential to the region's future wins the ongoing debate.

*John D. Sullivan is Executive Director of the Center for International Private Enterprise (CIPE), an affiliate of the U.S. Chamber of Commerce. As Associate Director of the Democracy Program, John helped to establish both CIPE and the National Endowment for Democracy in 1983. After serving as Program Director, John became Executive Director in 1991. Under his leadership CIPE developed a number of innovative approaches that link democratic development to market reforms including: combating corruption, promoting corporate governance, building business associations, supporting the informal sector, and programs to assist women and youth entrepreneurs. Today CIPE has 75 full time staff with offices in Afghanistan, Egypt, Iraq, Jordan, Pakistan, Romania, and Russia. In addition, CIPE participates in over 60 programs throughout the developing world in partnership with think tanks, business associations, civil society groups, and educational institutions. More information, including a list of current projects and publications, can be found at [www.cipe.org](http://www.cipe.org).*

*John's academic specialties buttress his international interests. He received a Ph.D. in political science from the University of Pittsburgh. John is the author of several publications on the transition to democracy, corporate governance, and market-oriented democratic development. He is also an adjunct faculty member at Johns Hopkins University School of Advanced International Studies (SAIS) as well as at George Mason University Graduate School of Public Affairs. He is a member of the Council on Foreign Relations, the Russian Institute of Directors' Advisory Board, the Bretton Woods Association, and the American Political Science Association.*

# Local Knowledge and Institutional Reform

Douglass North, Ph.D

One of the deficiencies of economic theory is that it is static. The theory we've inherited in economics is concerned with the performance of an economy at a moment in time and, therefore, the policy implications you derive are once and for all changes that will produce the results you want. But we live in a dynamic world of continuous change and this dynamic world is one in which we need to have comprehension of time, of the way humans learn, and of history because it's the historical past that constrains the present and the future.

Today, we know a lot about the economic performance of countries, and we also know what it takes to bring about economic growth. Economic development is a function of the productivity of an economy – nothing more and nothing less. Simply put, if an economy is productive, it's going to be rich, and if it's not productive, then it's going to be poor. Yet, our knowledge of economics allows us not only to realize that productivity makes for economic growth, but we also know the kind of institutions that are required for economic growth to occur.

The most important of those institutions are well-defined and specified property rights that provide incentives for people to be productive. Equally as important is a need to have both a political system that will put in place a legal system and a judiciary that will

enforce contracts and agreements. Although becoming productive is a key to economic development, it is even more imperative to establish an institutional framework to take advantage of that productivity. That requires enforcement of contracts and agreements, as well as maintaining a level playing field, keeping markets open to everyone and not just to a select few.

Naturally, the question arises: “If we know that, how come we’re not all rich?” My answer would be that it’s one thing to know the sources of economic growth and it’s another thing to know the kind of institutions you have to put in place to realize economic growth and more importantly, how those institutions must be built and put in place.

Economic theory was never designed to tell people how to achieve economic growth. Neoclassical economic theory was designed to talk about how well-developed markets work and how to improve their performance. But in many countries we have a much more fundamental problem: their markets are not well-developed. The challenge is to create efficient markets – not simply economic markets, but political ones. The reason for that is that it is political markets that first put in place the economic rules of the game and enforcement. If you don’t have a policy that in turn is going to encourage putting in place efficient property rights and a judicial system, you’re not going to get anywhere.

Institutions are incentive systems and that’s all they are. It’s important to understand that, because as incentive systems they provide a guide to human behavior. Therefore, you want institutions that present rewards for being productive and creative and punish unproductive, uncreative activity. Yet, there is one important dilemma about institutional analysis — institutions are the best game in town, but they’re very imperfect with respect to the way in which they produce the outcomes we want. The fact of the matter is, the same institutions can be applied to different problems and produce different outcomes. In some systems the norms of behavior may not be strong enough to get people to live up to standards of honesty and integrity and in some they may be successful in achieving just that. Therefore, the key is to understand how the formal rules and informal norms as well as enforcement characteristics work in particular markets and what makes them work differently from their intention.

In institutional analysis we have to recognize that we inherit laws, rules, norms, and beliefs from the past that we have to live with and cannot simply discard. Thus, they have to be built into necessary reforms, which cannot be borrowed from others. Here emerges one of the reasons that decades of the Washington Consensus did not produce any results. The theory that was used to develop policies with respect to the rest of the world or the IMF or the World Bank assumed that a neoclassical model of the world, in which people had perfect information and institutions functioned, already existed. The assumption was that all you had to do was incrementally change things at the margins, and all would be well.

Yet, to design effective reform policies, we must understand the cultural heritage and historical background. It is impossible to make sense out of any economy by just starting and looking at it fresh. It is the mixture of formal rules, informal norms, and enforcement characteristics that defines institutions and shapes economic performance. And although the rules may be changed overnight, the informal norms usually change only gradually. To be successful you have to understand the existing structure of your economy and the transaction costs. If we go to the developing countries and try to propose reforms without understanding their beliefs and therefore the incentives built into their beliefs, then the kind of institutional change we will be attempting to make is not going to work. To bring about economic growth we must know where we've come from and employ the local knowledge in developing institutions

This article was first published in CIPE's *1983-2003: 20 Year Report* published in 2004.

*Douglass North, Ph.D. received the Nobel Memorial Prize in Economic Sciences in 1993. He was elected a fellow of the British Academy in July 1996 and was installed as the Spencer T. Olin Professor in Arts and Sciences at Washington University in Saint Louis in October 1996. He has lectured at most major American and European universities and many Asian universities. His areas of expertise include research on property rights, transaction costs, economic organization in history, a theory of the state, the free rider problem, ideology, growth of government, economic and social change, and a theory of institutional change.*

# Building Free Markets in Latin America: Engaging the Disenfranchised and Creating Wealth

Álvaro Vargas Llosa

*Senior Fellow and Director*

*The Center on Global Prosperity at the Independent Institute*

Latin America is a diverse region, but many of its countries are experiencing a very alarming trend. Although the macroeconomic situation throughout Latin America has been continuously improving, the citizens of many countries are turning toward radical leftist leaders. It is apparent that while statistics show growth and increasing prosperity, the average citizen has not reaped any of the benefits. Voters are expressing their frustration with their current socioeconomic status, their lack of options, and their exclusion from the economic system by choosing presidents like Hugo Chávez and Evo Morales.

It is evident that current policies are not working and that fundamental institutional changes are necessary to ensure that Latin America moves towards free-market reform and democracy and away from populism. The current levels of centralization, bureaucracy, corruption, and poverty have created a large population that does not trust politicians or the government. It is only through enfranchisement, transparency, and increased economic opportunities for all citizens that Latin America will reverse the current political trend.

Let's start with the positive side of things. Latin America today is doing very well by historical standards. Macroeconomic statistics are very positive. For instance, GDP growth in Latin America was about 4.3

percent last year. Direct foreign investment has increased dramatically, to approximately \$50 billion in the last year. That is about five billion more than the previous year, which demonstrates a trend of positive growth.

A closer look at specific countries paints an even brighter picture. The economy of Venezuela grew by nine percent and Argentina's grew by eight percent. Peru, Chile, Panama, and Uruguay all experienced a six percent growth rate the last year. Although those rates may not be as high as China's or India's, they are still good.

In addition, inflation is very low, and fiscal deficits are both low and manageable. Debt has decreased from about 50 percent of GDP to about 30 percent of GDP – and a 30 percent debt is quite manageable. This is a significantly better situation than the one in Europe, for example, which is burdened by a high debt to GDP ratio.

Adding to that, the positive trends above are not new. In fact, in the last four years, Latin America has experienced substantial economic growth. Between 2003 and 2006, the average GDP growth rate was four percent across the region, and poverty has decreased from about 45 percent to about 40 percent. That type of growth is exactly what the region needs.

The estimates for this year look positive as well. GDP growth, on average, is going to be about four percent. Although it will be slightly lower than last year in Argentina and Brazil, dropping from eight and nine percent respectively to six percent, six percent is still a commendable figure. In Peru and Colombia, the growth rate is going to be approximately four or 4.5 percent, which is encouraging by the standards of the region's complicated past.

In other words, the macroeconomic situation in Latin America is encouraging. So why is Latin America voting in so many left-wing radicals like Venezuelan President Hugo Chávez, Bolivian President Evo Morales, and possibly Ollanta Humala in Peru?<sup>1</sup> Why is there a huge backlash against sensible reform, good management, rational government, and good governance?

There is a huge disconnect between the macroeconomic statistics and what is happening at the grassroots level. The direction of grassroots movements and voting patterns seems to be moving in the opposite direction of economic trends. This is a development that will have a major impact on the future of Latin America, and it has happened many times before – in the 1950s, the 1970s, and parts of the 19th century. There is a tendency for the region to experience periodic backlash against free-market reform and good governance and support for populism.

‘Populism’ in Latin America has a completely different meaning than populism in the United States. The populism in Latin America is not related to local governance; it is not Jeffersonian populism. It is a heavy left-wing form of populism native to Latin America and exemplified by the regimes of Juan Perón in Argentina, Getúlio Vargas in Brazil, and Alan García in Peru.<sup>2</sup>

Although this situation has occurred many times before, this iteration is particularly important, as it will have a large impact on the future of Latin America. If it is not addressed, it is going to continue to reoccur. In today’s world, that means that while Central and Eastern Europe, the Asia-Pacific region, and East Asia are moving towards development, Latin America is going to continue electing leaders like Chávez and Morales.

The statistics provide some insight as to why this is happening and what exactly is going wrong. Investment levels are very low – between 15 and 20 percent of GDP. Compared to East Asia, where investment rates are between 25 and 30 percent, Latin America is lagging far behind.

The actual reason for the positive macroeconomic statistics presented above also helps to explain the problem. There is a heavy reliance on profits from natural resources, as there has been throughout history. Recently, demand has risen by approximately 30 percent as a result of increased trade with China and India. However, the profits from those commodities do not reach the people; there is no trickle-down effect. Only the elites benefit. Thus, the macroeconomic picture does not reflect the situation at the local level.

In the 1990s, a number of free-market reforms were implemented across Latin America and a number of significant accomplishments were made. Inflation was controlled, which was a major feat. For example, in the 1980s, before the reforms, Peru experienced one million percent accumulated inflation over five years. Hyperinflation devalued the currency to such a degree that 100 intis in 1985 were worth two intis in 1990.<sup>3</sup>

Inflation was controlled in the 1990s due to a series of monetary and fiscal reforms, and some of the fiscal deficits were reduced. In addition, investment increased in some countries. However, although Latin America experienced economic growth, some necessary reforms were not implemented, and some were not true free-market reforms.

Privatization caused a number of problems because some state-owned companies became monopolies, which translated into high tariffs and high prices, especially for social services. In Argentina, most tariffs decreased dramatically in the early 1990s, but because of regional trading blocs like Mercosur, tariffs on 71 out of 97 goods increased. Of course, the fallout was a backlash against privatization.

These reforms created a lot of frustration. They created a lot of losers – disenfranchised citizens – who then turned against free-market reform. Thus, the current situation in Latin America, which is characterized by a vibrant anti-market movement, is not entirely surprising. However, the situation is not entirely negative because there are many different ‘anti-market’ constituencies and not all of them are really anti-market. At least half of the ‘anti-market’ constituencies can be addressed in an effective way from a free-market point of view.

There are many different types of anti-market movements. The first type is relatively anarchist, radical, left-wing, such as “Que se vayan todos” – “Get rid of all” – in Argentina. The next type is protectionist, comprising business leaders, labor leaders who lost ground in the 1990s, and politicians who fell from favor in the 1990s. The third group of anti-market proponents is composed of nationalists – people who resent partnerships with the United States, with the International Monetary

Fund, and other international organizations. Those three groups are the most hard core anti-market constituencies, and there is no effective way to accommodate them. No amount of reason will convince them that free markets will ensure a better future; they do not want progress for Latin America.

However, those groups do not constitute a majority. There are other groups that consider themselves anti-market but may be amenable to market reforms. For instance, there are many people who shun market reforms as a reaction against corruption. This group wants more transparency and more accountability, which was sorely lacking during the reforms undertaken during the 1990s. Yet, what occurred then simply was not full, free-market reform. Although it is a difficult argument to make, the people opposing market reforms as a result of the corruption in the 1990s are not truly anti-market – they are against the type of bureaucracy that makes corruption a way of life.

Another group of people misguidedly reacting against free markets is composed of the disenfranchised. Their reaction stems from their own socioeconomic situation. They are excluded from the market and have not benefited from it, although they have seen others prosper. The feeling of exclusion fuels the anti-market sentiment, but their true issue is not with the market itself. They simply would like the opportunity and know-how to play a more integral role in society.

They would like the post-privatization prices of social services to decrease to levels indicative of a competitive market, not a monopoly. They would like lower interest rates. They would like the tax burden to be reduced. Most importantly, they want to participate. Unfortunately, they currently see insurmountable obstacles in the way of participation. Yet, this is actually a good sign. Although they are angry and resentful, they want to become contributing members of society and their communities.

There is a third group that can likely be convinced of the merits of a free-market system. This group is made up of people who want to spend on healthcare, education, and infrastructure. They are not advocates of

redistribution, they do not want to expropriate companies, and they are not in favor of big government. Instead, their priorities are focused on providing for society as a whole; they want to improve and expand the educational systems, and they want to build infrastructure, which is direly needed in most countries in the region.

For instance, experts calculate that Peru needs a \$20 billion investment in infrastructure, and in January, the main highway from Maiquetia, Venezuela's airport, to Caracas collapsed, which is likely the result of imprudent economic policies. There are real infrastructure problems such as this, and it is logical that people want more investment in infrastructure, healthcare, and education. However, by no means are they populist or vehemently opposed to the concept of a market economy.

There is also an ethnic dimension to this problem that could easily be addressed. There is a large indigenous and mestizo population in Latin America, and politicians have gained their support through anti-market rhetoric. The speeches of politicians like Humala, Morales, and Chávez are resonating with people, who are beginning to believe that there is a policy of ethnic apartheid in Latin America.

To some extent, there is. Many of the disenfranchised – those people who have been left out of the market economy – are of a particular ethnic background and come from specific regions. These regions are often poor and the inhabitants live far from the capital, where almost all of the opportunities for upward mobility lie. This problem is a factor of the high degree of centralization in many Latin American countries. For instance, Lima, the capital city of Peru, produces almost 60 percent of the wealth in the country. The second largest city in Peru produces no more than six percent. That demonstrates the huge divide between Lima and the provinces. If the second largest city produces only six percent, other poorer regions produce only nominal amounts of wealth. The centralization penalizes those who do not live in the capital city, who are disproportionately indigenous persons. In the case of Peru, most of the Humala's voters come from the Andean south, where there is a heavy concentration of indigenous persons. In Bolivia, indigenous people from La Paz and Oruro came out in support of Evo Morales.

However, those voters are not necessary anti-market. In fact, the indigenous population believes in the market because it values production, trade, and creating value. Unfortunately, while the values of the indigenous community are not different from any other sector in society, it has not been able to translate this politically into a pro-market movement. For this reason, indigenous people have become dazzled by populist politicians.

Thus, within the group of anti-market proponents, there is the potential for change, but currently there are many different groups of people in Latin America reacting against the market and electing anti-market governments. However, because these groups are so different, with diverse and contradictory priorities and values, the populist governments do not know to whom to cater.

Three excellent examples of this are Argentina, Brazil, and Uruguay. Argentinean President Nestor Kirchner will act like a left-wing populist one day and a responsible advocate of free markets the next. In Brazil, President Luiz Inácio Lula da Silva has a very strong anti-market base of support, but behaves in a very responsible way, at least from a macroeconomic point of view. Even though he is not engaging in radical free-market reform, he campaigned on a Marxist platform, he is doing exactly the opposite of what the people who voted for him were expecting from him, and he still has enough support. Perhaps he will be reelected later this year in Brazil.

In the case of Uruguay, current President Tabaré Vázquez comes from an even more radical background than Lula. Most of the people supporting him had some connection to the Tupamaros movement.<sup>4</sup> These were revolutionaries, violent people who took up arms in the 1960s, and yet Vázquez has turned out to be a very responsible leader. He is currently advocating a free trade agreement with the United States.

Therefore, there are not one, but many different left-wing currents in Latin America. There is the Chávez line, the Lula line, and even the

Chilean line. Under a socialist government, Chile was able to reduce poverty to about 18 percent of the population. Chile is truly on the right path and is slowly becoming a developed nation. If the trend continues, within approximately the next generation, Chile will join the ranks of developed countries, which is a wonderful success story for Latin America. The interesting part of this situation is that Chile has had two consecutive socialist governments – socialist governments that have implemented reasonable policies promoting free-market reform.

There is a battle going on in Latin America for the soul of the left, and the goals of the two opposing sides can be summarized as follows. One wants to turn Latin America's left into a European Social Democratic kind of left and the other simply wants to continue along the path of Fidel Castro and Hugo Chávez.

It is heartening to note that Chávez, despite his petro-diplomacy and the approximately \$25 billion he has spent over the past seven years in an attempt to woo the rest of the region, is not winning – at least not yet. He has an ally in Evo Morales, yet even Morales has not behaved quite like Chávez would prefer. In general, most leftist leaders are a great deal more moderate than he is, which is a positive indicator.

From a long-term perspective, these issues will continue to play an influential role in the development of Latin America, and they are something that must be addressed now. The 1990s were full of light, but also full of shadows – and in order for the proponents of free markets to succeed, those shadows must be addressed head on. Free marketeers need to understand that unless they break down the barriers that separate a large part of the population from the realm of opportunity, people are going to oppose market reforms and continue to support the types of reactionary leaders that have been voted into power recently. The solution is to generate and foster wider participation in the market.

The first step is that the moderate left needs to win this battle against the radical left. However, that is not enough. When the pendulum swings in the other direction, and it will eventually, as it has always happened in Latin America, the center-right and the liberals (in the Latin

American sense of the word) need to come to power and support free-market reform. Of course, it is not just a matter of support – they need to learn from the mistakes of the 1990s. They need to engage in much more meaningful reform that will enfranchise the large segments of the population that feel excluded, are naturally reacting to their feelings of exclusion with passion, and are lending ears to the first demagogue that comes along, simply out of desperation.

The situation is not entirely negative, and Latin America is not condemned to a future full of leaders like Chávez and Morales. Throughout the rest of the world, countries are winning their battles against poverty, and it is possible for Latin America to do the same. The region has natural resources and a very creative population. It is readily apparent from the success of Latin American immigrants to the United States that the potential for Latin American prosperity is alive within the people. They open businesses, they create wealth, and they want bright futures for their children.

It is the institutional environment that has been holding Latin America back. Without institutional reforms that facilitate wealth creation, entrepreneurship, and enfranchisement, people will remain angry, and their anger will be perfectly justified. If Latin American leaders have the courage to address these issues in a fundamental way, there will not be a future for demagogues and populists.

This message is both optimistic and realistic. Latin America has a lot of hard work ahead of it, and its leaders must be realistic about current trends and sentiments. Previous governments in the region made a lot of mistakes when they had the chance to engage in free-market reform and now there is a natural backlash against that. However, that will run its course, they will get another chance, and when they do, they need to get it right!

## Notes

<sup>1</sup>This speech was given before the June 2006 elections in Peru, in which Alan García was elected president.

<sup>2</sup>This refers to García's first presidency.

<sup>3</sup>The inti was Peru's currency between 1985 and 1991. It was replaced by the nuevo sol.

<sup>4</sup>Tupamaros, also known as the MLN (Movimiento de Liberación Nacional or National Liberation Army), was an urban guerrilla socialist organization in Uruguay in the 1960s and 1970s. Its primary base of support was peasants and members of trade unions in poverty-stricken rural districts. The movement began by staging the robberies of banks, gun clubs, and other businesses in the early 1960s, then distributing stolen food and money among the poor in Montevideo. By the late 1960s, it engaged in political kidnappings, "armed propaganda," and assassinations. As the result of a military campaign against the movement, by 1972 the MLN had been severely weakened. After democracy was restored to Uruguay in 1985, the Tupamaros returned to public life as a legal political party, the Movimiento de Participación Popular.

This article was adapted from a presentation given by Mr. Vargas Llosa at the Center for International Private Enterprise on April 11, 2006.

*Álvaro Vargas Llosa is a Senior Fellow and Director of The Center on Global Prosperity at the Independent Institute and a nationally and internationally syndicated columnist for the Washington Post Writers Group. He is a native of Peru and received his BSc in international history from the London School of Economics. He has been a member of Board of the Miami Herald Publishing Company and op-ed page editor and columnist at the Miami Herald and a contributor to the Wall Street Journal, Los Angeles Times, BBC World Service, and Time Magazine. In addition, Mr. Vargas Llosa has been a commentator at Univision TV, news director at RCN radio (both English and Spanish), London Correspondent for Spain's ABC daily newspaper, commentator at Radio Nacional de España in Madrid, international affairs editor at Expreso (Peru), arts editor at Oiga, commentator at Panamericana Television, host of the weekly TV program Planeta 3 (aired in twelve Latin American countries), and columnist at La Nación (Argentina), El Nacional (Venezuela), Reforma (Mexico), El Tiempo (Colombia), El País (Uruguay), El Listín Diario (Dominican Republic).*

*His articles have also appeared in Granta Magazine, International Herald Tribune, El País, and El Mundo, as well as distributed through Agencia Interamericana de Prensa Económica (AIPE). He is the author of the*

books *The Madness of Things Peruvian*, *Guide to the Perfect Latin American Idiot* (with Carlos Alberto Montaner and Plinio Apuleyo Mendoza), *The Manufacturing of Poverty* (with Carlos Alberto Montaner and Plinio Apuleyo Mendoza), *El Exilio Indomable*, *Cuando Hablaba Dormido*, *El Diablo en Campaña*, *En el Reino del Espanto*, *Tiempos de Resistencia*, *La Mestiza de Pizarro*, *La Contenta Barbarie*, and *Liberty for Latin America*.

Mr. Vargas Llosa was Press Spokesman for the Democratic Front presidential campaign (1990) in Peru and Advisor on International Relations for the presidential campaign of Peru Posible (2001). He is the recipient of the A.I.R. Award for Best Current Affairs Radio Show in Florida in 1998, the Puerto Rican Parliament Award for the Defense of Freedom (1997), the Award for the Defense of Freedom from the Peruvian Asociación de Pescadores Artesanales de Chimbote (2000), The Freedom of Expression Award given by the Association of Ibero-American Journalists (2003), and his book *Liberty for Latin America* received the Sir Antony Fisher International Memorial Award (2006).

He has lectured widely on world economic and political issues including at the Mont Pelerin Society, Friedrich Naumann Foundation (Germany), FAES Foundation (Spain), Brazilian Institute of Business Studies, Fundación Libertad (Argentina), CEDICE Foundation (Venezuela), Florida International University, and the Ecuadorian Chamber of Commerce.

# Legitimizing the Reform Process: Consensus through the National Business Agenda

Hugo Maúl Rivas  
*Director of Economic Programs,  
National Economic Research Center (CIEN)*

## **Introduction**

Democracy and free enterprise ideas are under attack in Latin America, and the rise of populism and left-wing-oriented governments does not come as a surprise. Despite countless efforts toward reforming economic and political institutions to promote economic freedom, many of these reforms have been perceived as “recipes” imposed by international financial organizations and foreign governments - a costly misperception exacerbated by the top-down approach used to develop public policies that are designed and debated exclusively by technocrats. In countries that urgently need broad-based institutional reforms, from political parties to economic institutions to social practices, the problems are so ubiquitous, so deeply related with everyday life, that technocrats do not know how to handle them.

Polarized and fragmented societies lack democratic mechanisms to promote dialogue and understanding. Not only do bureaucracies have a tendency to not pay attention to the needs of their client beneficiaries, but in most cases the beneficiaries of a particular policy do not have effective mechanisms to organize themselves to express their opinions in an effective manner. Furthermore, since policymakers rarely pay attention to the “voice” of the beneficiaries of a proposed policy, ordinary

citizens do not perceive reform policies as the outcome of a legitimate process.

The exponential growth of the informal economy is a clear example of an absence of communication between policymakers and the business community. While policymakers are always devising new ways to “capture” informal entrepreneurs, the entrepreneurs are always discovering new ways to “escape” from government regulations. Without open and direct communication between the two sides, it is almost certain that the informal economy, in the long run, will win the battle.

However, beyond the task of organizing the beneficiaries of a particular policy, the challenge for reformers is to develop consensus among all beneficiaries as to the role of incentives, government intervention, scope of the market, etc. To achieve such a consensus, reformers have to learn from the private sector, from entrepreneurs, about their needs and realities. In turn, it is important to have actors inside the private sector capable of articulating and promoting the needed changes because those changes cannot be made from the outside. Thus, as participative mechanisms to organize the voices of the beneficiaries are developed, a consensus in terms of pro-market and free enterprise-friendly reforms can begin to emerge.

In the future, successful economic reforms will be the outcome of an effective communication process between the public and private sectors. The Guatemalan National Economic Research Center (CIEN) has been working to frame public policy development in this manner for many years, based on the firm belief that reform success lies not in the technocracy or bureaucracy, but in free enterprise.

### **Developing a Reform Agenda**

The first step in developing a reform agenda is to identify prominent economic sectors, such as the export business sector in Central America. Exporters are the businesspeople who most frequently confront international competition and the rigors of international trade, and, it

can be said that they often have the best ideas and are more amenable to enacting sweeping reforms. Various exporters also represent very well the overall structure of the economy.

One of CIEN's initial efforts at consensus-building focused on competitiveness as the top priority for a reform agenda. The results of a survey CIEN conducted illustrate the difficulties of building a consensus. CIEN asked exporters, business associations, and public servants to identify the most important factors in improving Guatemala's competitiveness - the issue that everybody regarded as the most important tool for participating in global markets. Whereas exporters rated access to markets as the most important factor, it was only the sixth-highest priority for the business association representatives and civil servants.

After countless meetings, public presentations, and interviews with business leaders, union leaders, politicians, and policymakers, CIEN and other reform-minded groups helped develop a National Competitiveness Agenda<sup>1</sup> for 2005-2015, which was adopted by the Guatemalan government. This Agenda is designed to improve the competitiveness of the nation through free market reforms and participatory mechanisms. A strategic alliance between CIEN and AGEXPRONT (the Guatemalan Non-Traditional Products Exporters Association) organized exporters and gave them a voice in identifying specific areas of reform, prioritizing them, and proposing entrepreneur-based solutions.

The second reform priority is the need to base a reform agenda on democratic principles. CIEN uses competitiveness to define the importance of using free-market reforms to advance democratic principles and to increase the leadership role of the private sector. The impetus for reform flows from the grassroots to the government – not in the opposite direction. As people identify and discover their strengths and needs, they mobilize the government to cooperate with them to overcome obstacles.

To do so, however, they must eliminate practices that have become well-established in developing countries, such as pervasive crony capitalism. They must develop an equally powerful force on their

side – organizing regular businesspeople and identifying business leaders who are not crony capitalists and are willing to participate in the system openly and implement reforms. To mobilize this broad support, reform leaders can use the national business agenda, which in its essence is a democratic mechanism for consulting with the business community to identify obstacles hindering business capacity and develop priorities about reforming public policy. The methodology of the national business agenda is based largely on focus group interviews and surveys. Through the national business agenda, it is possible to get in touch with the real experts – entrepreneurs – who go every day to get a permit to operate a truck or to pay taxes, or to register a business. In Guatemala, Nicaragua, and Honduras, CIEN has worked with more than ten business associations that count more than 500 entrepreneurs and business leaders as members to identify the problems they face and devise some solutions to those problems. Through this national business agenda advocacy process, CIEN has been able to legitimize business needs.

### **What Are the Obstacles?**

What obstacles to doing business did CIEN find in Guatemala through the national business agenda process? Surveys and interviews revealed the following six major reform priorities in addition to the problem of the top-down reform approach described above:

- Access to credit is hampered by the judicial system. It is impossible to make borrowers repay their loans, so banks will not lend money to anybody. CIEN participated in formulating a new law regulating the use of collateral in the banking system that is currently under discussion by the government. If enacted, the new law will speed up the process of adjudicating disputed debts in the courts.
- In housing, construction is costly because regulations are not uniform – every municipality has its own labor and building codes. To address poor incentives for owning a home, CIEN has been designated by the government to evaluate

the possibility of adopting a more beneficial tax system to encourage home ownership, including the possibility of abolishing an existing 12% tax on every sale of a house and allowing a tax deduction on mortgage interest payments. Homogenizing the disparate labor and building costs remains on CIEN's reform agenda.

- Stolen property sold on the black market results in unfair competition for honest firms. Thieves go to the same markets as legitimate firms, who find their own products for sale at half of their cost. CIEN joined an alliance with the Chamber of Commerce and a citizen-based NGO (Acción Ciudadana) that is working to denounce and combat fraud and corruption as well as modernize customs. The alliance has helped achieve notable improvements in customs operations over the last two years and is also working to promote transparency in the management of public funds.
- Labor regulations, such as the minimum wage and other mandated worker benefits, impose too many costs for firms and reduce productivity. CIEN has been working with leaders in the labor unions and informal economy to show them the dangers of a politically influenced minimum wage policy. CIEN and the National Federation of Agricultural, Commercial, Industrial and Financial Organizations (CACIF) have joined forces to push for reform in the minimum wage law, featuring the introduction of productivity indicators into the mechanism for setting the wage rate. The minimum wage rate rose by less than 10% last year, the lowest increase of the last five years. CIEN is also working with the Economic Commission and Labor Commission in the Congress to introduce greater flexibility as part of a reform of the Labor Code.
- The taxes paid by small- and medium-sized enterprises are levied at a fair rate, but the costs of compliance are very burdensome. SMEs do not have in-house lawyers or

accountants and seek an easier way to comply with their tax obligations. In 2004, CIEN publicly proposed the abolition of the income tax on firms and the adoption of a flat-tax for individuals. The Congress approved a new income tax regime based on a pseudo-flat tax of 5% on gross income. Tax revenues from this system are above initial estimates.

- The lack of good infrastructure, exemplified by poor roads and airports and seaports with inadequate facilities, raises transport costs and delivery times. Joint public and private sector partnerships have led to international certification for Guatemala's two major ports, the reconstruction of its international airports, and the expansion of the Atlantic Highway - the most important road in the country - to four lanes.

By defining these top reform priorities in Guatemala, CIEN and other private sector representatives can approach policymakers to ask for specific solutions to a specific problem; many of these problems do not require additional public spending, just political willingness to implement the changes. CIEN plans to review the record of policymakers and issue a report card that will provide an account of their commitment to implementing reforms.

## **Lessons Learned**

CIEN has learned many lessons in developing and implementing these reform initiatives. In particular, the following findings deserve special mention.

- To achieve consensus about the need for reform, the private sector needs to speak the same language. To accomplish this, CIEN used "competitiveness," to define how to operate in a modern, free-market economy. One also has to identify the most developed sectors, such as exporters in the case of Guatemala, to lead the change within the private sector, and business leaders must be willing to deal with the costs

associated with leading the initiative. Government officials must be willing to listen and work with the private sector. Think tanks have a special role and can be helpful to business leaders and government officials by trying to mediate between them to help the reforms advance.

- Another lesson is that organizing the voice of businesspeople is a unifying process. In Guatemala, CIEN started with exporters, but soon, manufacturers, farmers, builders, and others joined the competitiveness framework and the business agenda. If there is a legitimate way of presenting the problems and needs of businesspeople, the others that are not as advanced as the exporters will have a way to participate.
- Spreading the word will pay off. CIEN and some of the chambers participating in the process held hundreds of press conferences, participated in TV and radio shows and wrote in the print media. These efforts are worth it because when a group starts to make noise, politicians, political parties, and civil society will listen. If that group has a democratic-based reform agenda, they don't have any way to oppose that.
- Democratic principles legitimize private sector proposals. Even in Guatemala, a highly polarized society where the private sector is largely ignored by those on the left, political opponents were won over by CIEN's methods. When they learned how CIEN built the business agenda, based on democratic principles and the suggestions of regular businesspeople, they were won over because they could not use the argument that CIEN was just promoting crony capitalism.

This approach to reform is not a traditional private sector proposal, but a new way of presenting the problems and needs of regular businesspeople. It challenges the traditional perspective that all progress is made using a top-down approach, and shows how reformers can start doing things on a grassroots level, like entrepreneurs and businesspeople

do every day. In this way, reformers can set free the spirit of free enterprise and provide people with means to take advantage of economic opportunities.

---

<sup>1</sup>The National Competitiveness Agenda is based on the national business agenda process.

This article was first published as a CIPE Economic Reform Feature Service article on April 17, 2006.

---

*Hugo Maúl Rivas is director of economic programs at the National Economic Research Center (CIEN) in Guatemala. He is a professor of economics at the University Francisco Marroquín, focusing on fiscal, macroeconomic, and competitiveness issues. Mr. Maúl is currently the project manager of the CIPE-funded informal sector project “Building Consensus to Reduce the Informal Sector in Guatemala.”*

*The National Economic Research Center (CIEN) was founded in 1983 with private sector support as a non-partisan research institute dedicated to the study of Guatemala’s socio-economic problems and their solutions within a democratic market economic framework. CIEN is professional, dynamic, and highly regarded by the private and public sectors in Guatemala and by the U.S. Embassy. Its researchers are often looked to for analysis and recommendations by both the Guatemalan executive and legislative branches of government.*

# Developing a Congressional Caucus to Promote Fiscal Reforms in Argentina

Miguel Braun

*Policy Director, CIPPEC*

Luciana Díaz Frers,

*Project Director, Fiscal Policy Area, CIPPEC*

Jinu Maria Koola

*Volunteer, CIPPEC*

## **Introduction**

Argentina has a long history of fiscal mismanagement. Over the past 20 years, the country has undergone two debt crises and two periods of hyperinflation. Public expenditures have been systematically higher than tax revenues. As a consequence, successive governments have resorted either to printing money or issuing debt to finance the gap. The abuse of these instruments in Argentina has led to recurring crises. An inability to achieve prudent fiscal management became a systematic feature of the Argentine political system.

Although the latest figures seem to indicate a more responsible fiscal management, few structural changes to the system have been implemented. The reality today is that fiscal institutions need to be strengthened (or created in some instances) in order to ensure prudent fiscal policies in the long run.

The poorest Argentines have been hurt the most from these policy failures. Inflation and devaluation have affected the purchasing power of peso incomes, but left wealthy citizens with dollar-denominated assets better off. Furthermore, when a recession hit and credit dried out, the government was forced to reduce spending on social services,

which are mainly targeted to the poor. This practice is contrary to countercyclical fiscal management policies typically implemented in developed countries.

The result of these and other misguided policies was that between 1975 and 1990, real GDP per capita in Argentina fell by over 30% (with a bubble in the late 1970s due to the unsustainable overvaluation of the peso promoted by the military dictatorship). Growth in the 1990s resumed following market reforms, deregulation, and financial stability measures, but given the existing imbalances, it did not prove to be sustainable. Furthermore, income distribution became substantially more unequal. The richest 20% of the population earned 26 times more than the poorest 20% in 2001, whereas this ratio was considerably lower at 14 in 1991. All these indicators worsened severely after the last crisis, which drove more than half of the population under the poverty line and a quarter under indigence levels in 2002.

### **Consequences of Weak Fiscal Institutions**

The weakness of fiscal institutions and the subsequent recurrent crises have had a significant negative impact on general economic performance, on the business environment, and on the incentives of the private sector for long-term investment.

Moreover, fiscal instability has had negative consequences in the provision of public goods, thus limiting the outcomes of Argentine democracy and its public legitimacy. Argentina's Congress, as others in Latin America, lacks adequate technical staff and institutions to analyze, debate, and control fiscal matters in an appropriate manner. There is no institution comparable to the U.S. Congressional Budget Office, for example, and few legislative aides have professional proficiency in tax and federal issues. In that sense, the quality of the debate on fiscal issues in the legislative branch of government through in-depth analyses, advice on implementation, and targeted advocacy strategies is lacking.

The negative consequences of this state of affairs in Argentina are both economic and, more importantly, political. There is popular

support for democracy in Argentina, yet very low levels of satisfaction with its performance. The 2003 Latinobarómetro poll, for example, showed that in Argentina a democratic government is preferred over an authoritarian one by 69% of the population, compared to the average of 53% for the rest of Latin America. But only 29% of those polled in Argentina showed satisfaction with the day-to-day functioning of its democracy, compared to 34% in other Latin American countries. The disparity is evident.

Failures of the fiscal system and the subsequent socioeconomic failures are one of the reasons for this frustration with democracy in Argentina. Further, the functioning of the fiscal system, which lacks true civil society participation in the process, is a testament to the lack of participatory democratic institutions in the country. Such institutions are integral to the success of any democracy. This emphasis on participation in policymaking is key, because democracy is about much more than simply electing officials to the public office.

### **The Real Problem**

Clearly, the federal fiscal system in Argentina is in a state of disrepair. Rather than providing equality, transparency, and stability for Argentina's federal and provincial governments, the system exacerbates the country's pervasive inequalities, corrupt practices, and instability. But what are the underlying reasons for this problem? Although the factors behind this mismanagement are many, three in particular must be emphasized.

The first major problem is the existence of discretionary, non-transparent fiscal expenditures. In Argentina, expenditures have been consistently higher than taxes. Lacking transparency and subject to political pressures, successive governments have resorted either to printing money or issuing debt to finance this gap.

The second major problem is the complex, unstable, and inefficient tax system. Although Argentina's tax rates are similar to those of other countries with comparable levels of economic development, its tax receipts are relatively small - a clear indication of low tax administration

efficiency and high levels of tax evasion. Furthermore, this makes the tax load excessive for those who cannot or will not evade, creating multiple distortions and feelings of injustice and general discontent. The 2001 fiscal crisis exacerbated the situation through new, highly distorting taxes such as the levies on financial transactions and exports.

Finally, Argentina also has a very complex and arbitrary federal co-participation system. Established in the 1930s, the Argentine Federal Co-participation System (FCS) transfers a portion of the revenues collected from certain federal taxes, including personal and corporate income taxes and the value added tax, to the 24 provincial governments. In 1997, for example, the federal government collected 79% of total tax receipts, while the provinces and municipalities collected 16.5% and 4.5%, respectively.<sup>1</sup> In addition to the tax revenue sharing, there are several other mechanisms by which the federal government transfers revenues to the provinces, despite the constitutionally granted power of local governments to institute their own direct taxes. The FCS has been severely criticized for 1) a high degree of vertical disequilibria; 2) extreme complexity and lack of transparency; 3) arbitrary distributions; 4) absence of debt limits; 5) federal bail-outs through ad-hoc agreements; 6) repeated breaking of commitments by the federal government and the provinces; and 7) the absence of a federal fiscal or judicial institution to solve these conflicts. Overall, the FCS has produced funding difficulties among the different levels of government as well as abundant opportunities for corruption via the discretion used to distribute resources among the provinces.

### **Addressing the Problem: FCS Reform**

The weak, inefficient federal fiscal system has had a significant negative impact on economic performance, the business environment, and private-sector incentives for long-term investment. There is no doubt in anyone's mind that the system must change.

One of the benefits of implementing FCS reform is that if done right, it would lead to more predictable fiscal outcomes, thus facilitating better public policy planning and better quality and/or quantity of public

goods provision in the federal, provincial, and municipal governments. Such improved planning and public goods provision, in turn, can lead to increased equality of opportunity for Argentine citizens. For example, the provinces of La Rioja and Cajamarca have similar characteristics in terms of population density and per capita income, but La Rioja receives \$900/month more per capita from the federal government, the apparent result of political bargaining. Improved planning and public goods provision will also help stimulate long-term investment.

Another benefit is a major improvement in the Argentine government's transparency via the improved transparency of fiscal institutions and reduced tax evasion. Higher transparency standards and less evasion and corruption are especially important for a democracy like Argentina's, in which corruption ranks as the most important issue second only to unemployment (Latinobarómetro 2003 poll), and would create a more level playing field for private activity.

FCS reform would also lead to more transparent and efficient tax and revenue allocation systems, which may help diminish existing citizenship contradictions in Argentina, in which citizens' rights and obligations have been excessively dissociated.

A reform of Argentina's fiscal federal system can only come about with the commitment and support of the executive and legislative branches of government at the national and provincial levels. These two branches, however, have severely undermined efforts for reform. The legislature usually exercises its power to stop reforms or introduces unnecessary complexities to legislation, leading the executive to approve reforms by decree, without input from the public or civil society groups. While the legislature is more suited for this type of discussion, it is constrained by a shortage of technical staff that can evaluate all the implications of fiscal policies. As noted earlier, few legislative aides have professional proficiency in tax and federal issues, and there is no regular mechanism for training members of Congress on tax issues. Consequently, there is a serious lack of understanding, which hampers the objectivity of debates and the ability of Congress, the media, and citizens for meaningful participation in these issues.

## **A Novel Approach to Reform: The Caucus**

To strengthen the legislature's ability to examine and debate FCS reforms, the Argentine Center for the Implementation of Public Policies Promoting Equity and Growth (CIPPEC) helped to create a congressional co-participation caucus consisting of reform-oriented legislators from across party lines, civil society leaders, and academics. The caucus was launched on December 16th, 2004 by Senator Celso Jaque, President of the Senate Co-participation Commission, and Vice-President Daniel Scioli, who also serves as President of the Senate.

The caucus represents a ground-breaking approach to addressing fiscal imbalances some seventy years in the making by providing a transparent forum for analyzing and debating reform-related issues as well as reform proposals. It has raised awareness among members, the legislature, and the public of the need for and benefits of a responsible, stable fiscal policy. It has also provided sound information and analyses to foster a better understanding and strengthen debate of tax and co-participation policies. A website (<http://forofederalismo.senado.gov.ar>) was developed to register the events of the caucus and link its participants.

A key element of CIPPEC's approach to developing the caucus centered on identifying legislators with an interest in and influence on fiscal-policy decision-making, inviting them to meetings, introducing policy briefs to them, and soliciting their cooperation as disseminators of these briefs within committees and Congress. By building a closer relationship with legislative offices, CIPPEC was able to enhance the effectiveness of our efforts and thereby strengthen the links between research and policymaking.

Initially, CIPPEC developed three policy briefs on co-participation. An analysis of the negative consequences of co-participation on the education system struck a cord with and was well-received by the politicians and academics, since the impacts of the FCS on everyday life are generally either not addressed at all or are treated in a very abstract

manner. A detailed analysis of the evolution of provincial finances, featuring a comparison before and after the 2001 crisis, with emphasis on the role of co-participation, generated significant interest among the media.

CIPPEC sent copies of policy briefs to the offices of all representatives (257) and senators (72) and followed up by telephone. Thirty one-on-one meetings with legislators and advisors were held to discuss the best way to advance discussion on co-participation in Congress, including personal and partisan incentives to support change and challenges of implementation. Additionally, CIPPEC organized and participated in eight presentations and seminars attended by 45 legislators and advisors to discuss fiscal issues. A very successful seminar in May 2004 was attended by well-known politicians, legislators, and aides, including the governor of the province of Buenos Aires, Felipe Solá and it received extensive coverage through 13 newspaper articles.

CIPPEC worked closely with the Senate Co-participation Commission, which is charged with overseeing legislative proposals concerning the FCS. The Commission also examines the provision of transfers and other services to the provinces by the federal government. As such, it takes the lead in all caucus events, but many other institutions participate in the forum. Together with other organizations, CIPPEC has organized several workshops to encourage policymakers, business, and other civil society leaders to discuss how to shape specific policy reforms. Specialized journalists were also invited to help disseminate the ideas discussed during these events. Interaction among these sectors plays a pivotal role in building consensus, increasing advocacy opportunities for different groups, and strengthening civil society's participation in the policymaking process.

CIPPEC has focused on supporting the caucus by providing technical advice on tax bills in the form of policy briefs and complementary communication strategies. CIPPEC has published 10 policy briefs on tax bills, covering topics ranging from the Fiscal Responsibility Law to the taxes implicitly approved in the national budget to very specific tax bills.

## Impact

CIPPEC's biggest achievement has been the formation of the caucus and the commitment from the Senate Commission on Co-participation to lead its events. Given that caucuses are not a common strategy to advance reform in Argentine politics, the fact that CIPPEC achieved institutional support from Congress to set up a caucus to address reforms in such a sensitive legislative area is a clear signal of success.

The activities carried out within the caucus have had several impacts. Clearly, there is an increasing awareness in Congress and civil society regarding the importance of sound fiscal policy, thanks to the influence in Congress and the media of CIPPEC's policy briefs and presentations. The research, website, and workshops are providing Congress, civil society, and the public with sound information and analysis on tax and co-participation issues.

From CIPPEC's own small survey of legislators conducted in March 2005, 25 out of 26 respondents (96%) said that they had read at least some of the organization's policy briefs. Of these, 21 (84%) said the topics discussed were very relevant, 19 (76%) stated that the documents were interesting, and 17 (68%) found the policy briefs useful for their decision-making process. Furthermore, CIPPEC estimates that around 30 legislators are active participants in the caucus, while 75 legislators and 60 advisors have participated in nearly 100 meetings.

Another way to assess the impact is to analyze the results on the bills CIPPEC evaluated. Although it must be recognized that other factors have contributed to their implementation, recommendations from several of CIPPEC's policy briefs that dealt specifically with tax bills were included in the approved legislation. For example, recommendations from Policy Brief #3, which focused on the analysis of the 2005 budget, on stronger anti-evasion measures, a reduction in the financial transactions tax, and a stronger analytical capability on budget issues, were included in legislation.

Through its program, CIPPEC received media coverage in 81 newspaper articles, 64 radio/TV interviews, and 45 online website articles. Some policy briefs, like the one on education and co-participation or the one on the social security system, have received significant popular and media attention, with numerous requests for further information from other NGOs and academics, as well as legislators and their aides. Media plays a crucial role in allowing civil society to introduce new topics into the public agenda as well as enhance the quality and depth of discussion around significant public issues such as tax reform and co-participation. CIPPEC has become a reference source for journalists and opinion leaders, who, in turn, influence policymakers through news coverage. Several legislators indicated in the survey that they use newspapers and CIPPEC's policy briefs as their sole sources of information, aside from some research carried out by their aides.

Much work, however, remains to be done. CIPPEC's experience thus far indicates that tax bills are generally not significantly modified in Congress and are either approved or discarded in their original version. Nonetheless, there has been a significant improvement in how the system functions, in that an outside party like CIPPEC has been given the opportunity to contribute to the policymaking process. The inroads that the organization has made into the legislative process provide ample opportunity for future achievements.

CIPPEC's next steps include implementing programs to strengthen the analytical capability of the Argentine legislature on fiscal policy. CIPPEC has observed that one of the main reasons behind the pass/fail approach to passing laws seems to be the lack of technical capabilities to thoroughly evaluate the effects of pending legislation. Through its capacity-building efforts, the caucus can help advance the cause of fiscal reform in Argentina and stimulate progress toward the other important benefits described above. In addition, the caucus will continue to serve as the only vehicle in Argentina for organizing a reform-minded coalition of legislators, civil society leaders, and academics to discuss issues, find solutions, and implement change, thereby strengthening Argentine democracy.

---

<sup>1</sup>In the same year, however, provinces and municipalities accounted for 47.3% of total spending, versus 52.7% for the federal government.

---

## References

1. Braun, Miguel. "Legislative Advisory on Tax Issues" 2004-2005.
2. Braun, Miguel. "Legislative Advisory on Tax Issues and Coparticipation" 2005-2006
3. Uña, Gerardo. "El Congreso y el Presupuesto Nacional: Desempeño y Condicionantes de su Rol en el Proceso Presupuestario." June 2005, mimeo.
4. Abuelafia, Emmanuel; Miguel Braun; Luciana Díaz Frers. "Co-participación Federal: una mirada más allá del debate de corto plazo" Documentos de Políticas Públicas, CIPPEC, Buenos Aires, December 2004.

This article was first published as a CIPE Feature Service Article on March 30, 2006.

---

*Miguel Braun received his Ph.D. and MA in economics from Harvard University and a BA in Economics, summa cum laude, from Universidad de San Andrés in Buenos Aires, Argentina. In 2000, he cofounded CIPPEC, a think tank dedicated to policy research and implementation in Argentina, and became director of the Fiscal Policy Area. He teaches at Universidad de San Andrés, where he also served on the Advisory Council, and has worked as a consultant for the Inter-American Development Bank, the Economic Commission for Latin America and the Caribbean, and the World Bank.*

*Luciana Díaz Frers graduated as an economist at the University of Buenos Aires, Argentina. She continued her studies abroad, obtaining a Certificate of Postgraduate Studies in International Economics from the Institute of World Economics, Kiel, Germany and finished a Master of Science in Economic History of Developing Countries at the London School of Economics, United Kingdom. Since September 2002, she has been working as a project coordinator at CIPPEC, specializing in the area of Fiscal Policy.*

*Jinu Koola expects to earn an A.B. in Social Studies from Harvard University in June 2007. In 2005, she interned at CIPPEC and researched issues related to federalism. Jinu Koola expects to earn an A.B. in Social Studies from Harvard University in June 2007.*

# Promoting Institutional Reforms in Ecuador

Dora de Ampuero

## **The political and institutional setting**

Ecuador's recent history has been characterized by chronically weak institutions that constantly violate the Constitution in their attempts to grab for power at the expense of other institutions. As a result, the country's economic and political development has been hampered by numerous political crises that, in turn, led to military coups or civilian insurgencies.

Political developments over the last several years present a clear demonstration of this phenomenon. In December 2004, the Executive Branch joined some members of the Congress to oust all the members of the Supreme Court of Justice, the Constitutional Court, and the Electoral Tribunal by a simple majority vote. No new members of these institutions were elected. As a result of these arbitrary actions by the President and the Congress, the judicial processes were suspended for a long period of time.

With both the Executive Branch and Congress freely able to intervene in other functions of the state, and the Judicial system and the Constitutional Court not able to restrain or reverse such actions, the democratic system of checks and balances has not worked well in

Ecuador. Because the judicial system is weak and does not have the power to enforce the law, the rule of law in Ecuador is weak. As a result, corruption in Ecuador is very high and property rights are not well-protected by the state.

In addition, the Constitution opens the door for violations of property rights because it states that government protects property if it has a social function and that the state has the obligation to redistribute wealth to all the segments of society. The Executive Branch has the power to guarantee the welfare of the majority of the population as well as oppress individual rights in the name of public welfare and the common good. The Ecuadorian Constitution confers rights such as quality of life; good health, food, drinking water, and nutrition; education; a clean environment; employment; housing; clothing; and recreation, among other social services. Populist politicians during campaigns promise to give all these rights to the people if they are elected. To comply with these promises, they offer to transfer wealth from the rich to the poor, causing a decline in the welfare of all Ecuadorians. This power leads to excessive intervention in the economy, which in turn dampens investment and growth.

The extensive government intervention in the economy limits economic freedom. Ecuador ranks 107th out of 157 countries in the 2006 Economic Freedom Index of the Heritage Foundation and the Fraser Institute. Protectionist policies limit competitiveness and free trade. Worker stability is guaranteed by law, making it very costly for an employer to reduce personnel. Saving and investment are limited due to weak property rights and excessive government regulations. While the adoption of the U.S. dollar as legal tender has helped in creating monetary stability, stopping inflation, and reducing interest rates, Ecuador has not made other political reforms to promote the creation of wealth and strengthen its weak democracy.

### **Political parties and popular representation**

The way the parties operate precludes them from representing the people. Political parties are managed by entrenched political elites who

control major decisions made in their organizations. They choose which persons, members, or newcomers will run for the different political positions. In many cases, citizens do not know the candidates. When these people are elected, they obey instructions from the party leaders rather than the citizens who elected them. This situation explains why congressmen and other elected officials do not have strong ties to the people. The political class pursues its own personal interest and does not necessarily address people's need for freedom to pursue their own goals.

Another problem stems from the great fragmentation of political parties, which are dominated by interest groups, and their struggle for power, which is the primary cause of Ecuador's political turmoil. Left-wing organizations, including indigenous organizations, human rights institutions, and environmental organizations, have opposed market reforms and supported government intervention in the economic, social, and cultural realms. Leaders from the right, such as the Social Christian Party, Roldosist Party, Popular Democracy Party, and the Independent Renovation Party, have no clear idea of how markets really work and of the consequences of government intervention in the economy.

The political class and civil society leaders, have not reached a consensus about the political and economic reforms Ecuador needs to promote economic growth. New political parties and political groups are formed prior to a national election, with no real differences in ideology among them. Usually their political platforms have a populist base that appeals to the emotions of the electorate. The majority of them are inclined to support state intervention rather than private initiatives to address societal problems. In other words, they focus on redistributing wealth rather than instituting reforms necessary to facilitate the creation of wealth by the private sector. To fulfill populist programs, the government has grown in size, absorbing more and more financial resources. In addition, the Ecuadorian fiscal budget has grown more than 40% in the last seven years, financed via oil revenues, taxes, and debt.

Political turmoil has also caused the early exit of the last three presidents elected by a popular vote. In all three cases, the Congress found a legal excuse to terminate the President's mandate, with the Vice President or an interim President serving out the remaining term. Without political or popular support, the new presidents were not able to implement a sound economic program and thereby address some of the main problems Ecuador was confronting. In addition, rules are changed frequently with new governments in power, creating uncertainty among local and foreign investors.

### **An agenda for promoting institutional reforms**

The Ecuadorian Institute of Political Economy (IEEP), an independent, non-profit organization established 15 years ago, has actively promoted classical liberal ideas in Ecuador, particularly the importance of strengthening basic institutions such as the rule of law, open markets, and a limited government. Ideally, an effort to strengthen institutions must address some of the problems described above, such as clearly enumerated powers, checks and balances on the various branches of government, and a more stable political environment that will allow the private sector to flourish.

To contribute to better understanding for Ecuadorians on the basic principles of economics and the importance of democracy towards improving the political stability of the country, IEEP organized two international workshops, inviting about two hundred political leaders, entrepreneurs, and civic organization leaders to discuss economic and political issues and the reforms Ecuador needs to promote economic growth and strengthen democracy.

During the workshop sessions most of the participants agreed on the importance of an independent judiciary system that would enforce the rule of law and protect property rights. Consensus also was reached upon the harmful implications of excessive government spending and the increase of government indebtedness. Some participants advocated for the imposition of constitutional limits to government spending. The issue of excessive government regulations on business generated much

discussion. Participants recommended that government should reduce bureaucracy to a minimum, while concentrating its efforts to protect individual freedoms and the rule of law. Participants also agreed on the importance of a system of checks and balance among the functions of the State for solidifying democracy in Ecuador and recommended a constitutional amendment to incorporate this principle.

No consensus was reached on the issue of protectionism in trade and the intervention of Government in the economy. Several people believe national industries should be protected against competition from more developed countries. Other people still believe in market failures and the need for government action to correct them.

New opportunities to influence public policies also arise after IEEP seminars. A proposal was submitted to the Congress by the Social Christian Party that gives more power to the government and the Central Bank to intervene in the banking system. This anti-market law determines how financial resources are altered for investment and also fixes the interest rates. IEEP joined a campaign against this law through TV and radio programs and articles in the newspapers. It seems the law will not be approved because people now recognize the negative effects that would result from this policy.

The Congress and the Executive Branch, are working to hold a referendum in order to introduce changes to the Constitution. IEEP prepared a proposal containing six key reforms needed to promote economic growth in Ecuador. These reforms have been discussed at IEEP seminars with the participation of representatives of political parties. The document has been distributed to all the congressmen, business leaders, and journalists. IEEP has distributed this proposal to all the presidential candidates and politicians running for Congress in the 2006 political campaign.

## PROMOTING INSTITUTIONAL REFORMS IN ECUADOR

Ecuador is one of the few countries in Latin America where economic and political reforms have not been implemented due to a lack of decision-making by political parties as well as by pressure from interest groups that are beneficiaries of maintaining the status quo. Some attempts in the past to modernize the state have failed because of strong opposition from leftist interest groups as well as others from the right. More than two decades ago politicians campaigned to change poor people's economic situations and reform political institutions. However, they failed to implement such reforms. Nowadays people are tired of listening to false promises and are demanding economic and political reforms. However, few efforts are underway to promote reforms in the area of economic growth and democratic leadership.

IEEP, founded fifteen years ago, is the only free-market think tank in Ecuador that promotes free-market ideas and the importance of democratic institutions. IEEP carries out its mission through important forums on economic and political issues in order to build consensus necessary for reforms. Through television and weekly radio programs, IEEP has reached broad audiences all over the country, and discussed and proposed solutions to current economic and political issues. IEEP's studies and publications are distributed to decision-makers and leaders in Ecuador.

One important accomplishment by IEEP is its contribution to monetary stability in Ecuador with the replacement of the Ecuadorian sucre with the U.S. dollar in January 2000. IEEP conducted the basic studies of feasibility and organized conferences with outstanding monetary specialists brought in from abroad. Six years after the implementation of the dollar system, inflation been controlled and interest rates have declined. Monetary stability has cushioned the economy against recent political turmoil. Periodic surveys taken in Guayaquil and Quito showed that about 14% of the people interviewed have seen and listened to IEEP's programs. They appreciate the discussion of current economic and political issues and the new proposals made to solve them.

IEEP has proposed several key reforms to accelerate economic growth in Ecuador:

1. To promote the integration of the Ecuadorian banking system with the international financial system in order to attract foreign investment and improve the efficiency of the local banking system. This is necessary to complement the dollarization of the economy.
2. To strengthen the judiciary system to protect private property rights.
3. To reform fiscal policy in the following areas: a) reform the tributary system in order to simplify and reduce the high number of taxes, b) reform the custom duties to facilitate free trade, c) constitutional reforms to limit government expenses and the internal and external debt.
4. To privatize government enterprises in basic services such as telecommunications, energy, ports, water for human consumption, and sanitation.
5. To reform the social security system, substituting the “pay as you go” system for a capitalization system.
6. To promote decentralization of some central government services to municipalities to improve basic services.
7. Reforms in education in elementary, high school, and university levels through more participation by the private sector.
8. Reform the health system by giving priority to prevention of diseases and attention to mothers and children through more participation of the private sector and the government. More attention would be focused on the most vulnerable segment of the population.
9. To reform the old labor legislation in order to facilitate a new relationship between enterprises and workers.

IIEP organizes seminars and workshops to discuss economic policy issues and reforms necessary to promote economic growth. Young political leaders from the left and right are invited to discuss economic reforms in conjunction with young leaders from the business community. One important objective of the IIEP program is to reach consensus on economic reforms and the importance of strengthening democracy in Ecuador. Usually leftist organizations (young socialist activists from universities, political parties, the Federation of Indian Nationalities, and Pachacutik) oppose market-oriented economic reforms. The leftist groups consistently are against free trade agreements, multinational corporations, and Ecuadorian cooperation with Colombia in its war against terrorism and drugs.

IIEP maintains close contact with some of the young leftist leaders that have been invited to its programs, and regularly invites them to participate in IIEP activities. IIEP also sends out its publications to all the participants in its seminars and workshops. Some young people from the left have registered as members and pay regular dues. These funds assist IIEP in carrying out its work.

One example of this is the case of Mr. Moisés Yáñez, a member of the Indian organization CONAIE, who was invited to one of IIEP's events and has maintained close contact with this institute ever since. Mr. Yáñez requested IIEP assistance to implement a program on land titling in the Indian communities of the highlands. Many small farmers do not have legal property rights for their land and are abused by squatters. IIEP's Director mentioned a successful program in Peru where 1,250,000 property titles have been given to people of the so-called "Pueblos Jovenes" and recommended Yáñez contact the leaders of this program. Another example of IIEP's reaching out to young people is the case of the newly formed "Movimiento Libertario." A group of participants in these free-market seminars have organized this political organization to participate in this year's election.

IEEP believes that important progress has been made to create new policy directions by putting people from the left and right together to discuss and reach consensus on important economic and political issues. This effort should continue until the reforms the country needs are implemented.

# The Colombian Confederation of Chambers of Commerce – Confecámaras

Harvey Rodríguez  
*Manager of the Probidad Program,  
Colombian Confederation of Chambers of Commerce*

The Colombian Confederation of Chambers of Commerce (Confecámaras) was founded in 1969 at the initiative of local chambers of commerce. Today, Confecámaras represents business interests on the national level, providing research and consulting assistance to the business community, and coordinating training and institutional support for the organizations under its umbrella. Since 1999, CIPE has worked with Confecámaras on a variety of issues, notably corporate governance reform and anti-corruption initiatives.

Most recently, Confecámaras engaged in an active campaign to increase the adoption of corporate governance practices. In Colombia, the majority of companies are closely held (the average concentration of share ownership is around 80%), family businesses predominate, and capital markets are insufficiently developed. As most companies in Colombia are family-owned businesses and closely held companies, there is a need to strengthen corporate governance in order to create wealth and employment as well as increase the confidence in markets. “The implementation of corporate governance measures allows firms to extend the sources of financing, and to strengthen the process of formalization and professionalization, which necessary elements for increasing the confidence of the investor community and translating the

opportunities of globalization into economic and social benefits,” says Andres Bernal, Corporate Governance Program Manager, Confecámaras.

Confecámaras has significantly improved the understanding and practice of corporate governance in Columbia. Highlights include the passage of a new Capital Markets Law that includes a chapter on corporate governance, development of the Framework Code of Good Corporate Governance for Small- and SMEs, launching of an e-survey software tool for use by local companies to evaluate corporate governance, and the establishment of the National Center for Corporate Governance with training facilities. Such reforms and resources have catapulted Colombia up 23 country positions in the World Economic Forum’s 2004-2005 Global Report on Competitiveness.

### **Capital Markets Law**

Confecámaras achieved a major accomplishment with the passage of a new Capital Markets Law (Ley 964 de 2005), which includes a chapter on corporate governance entitled “Investor Protection.” Under this law, independent directors, audit committees, and practices strengthening shareholders’ rights are now obligatory for Colombian issuers.

The new Capital Markets Law requires a minimum of 25% percent of the board to be filled by independent directors and mandates creation of an audit committee made up of independent board members. Key provisions emphasize the protection of minority shareholders. Voting mechanisms are prescribed that permit minority shareholders to influence decisions. Furthermore, the boards are obligated to respond in writing to any shareholder proposals put forth by a group representing 5% of the shares.

### **Framework Code of Good Corporate Governance for Small- and Medium-Sized Enterprises**

In Colombia, there are 183,437 companies registered in the chambers of commerce, but only 124 are issuers of stock. This fact demonstrates the low liquidity of the Colombian capital market and

the importance of working with closely held companies to strengthen corporate governance practices as a pre-requisite for entering public markets. To respond to this demand, Confecámaras has developed a voluntary Framework Code of Good Corporate Governance for Small and Medium-Sized Enterprises (SMEs). The general principles of this Code are transparency, accountability, the fair treatment of partners/shareholders, and the responsibility of small and medium-size enterprises vis-à-vis their respective interest groups.

Confecámaras worked together with CIPE to institute the OECD's framework of four core concepts that underpin effective corporate governance: (1) protecting and facilitating the exercise of shareholders' rights; (2) equitable treatment of all shareholders, including minority and foreign shareholders; (3) recognizing the rights of stakeholders established by law or through mutual agreements; and (4) timely and accurate disclosure on all material matters affecting the corporation. The Code also incorporated the OECD principles regarding the role of the board of directors in corporate governance.

The objective of the Code was to provide the closely held SMEs in Colombia with a tool that would ensure sustainability and competitiveness of these businesses in today's global economy. It was also intended to serve as a frame of reference for companies that want to develop internal codes of corporate governance. The Code primarily specifies the rights, protections, and obligations of partners/shareholders and the board of directors, and proposes best practices for family-owned businesses.

The Code outlines the scope of rights and protections to ensure fair treatment of partners/shareholders, some of which include: the right to participate and vote at meetings of the company's governing body, an active role in the appointment of administrators, communication with the board of directors, and a share in company dividends and profits. The Code also states the obligations of partners/shareholders: approving amendments to company bylaws or partnership agreements; approving year-end financial statements and balance sheets; ensuring clear policies for the protection of minority or noncontrolling partners/shareholders; appointing the members of the board of directors and establishing a fair

compensation system; and appointing a statutory auditor when required by law.

The Code identifies the members of the board of directors and the chief executive officer as company administrators with duties of loyalty and due diligence. The board is also responsible for ensuring that the company's performance is in line with market conditions and that information is properly disclosed, ensuring implementation of good corporate governance, meeting at least once a month, working with executives in the framing of business strategy in line with the company's mission and vision, financial and risk management plans, and policies for handling conflicts of interest.

In the case of family businesses, the Code states that in order to ensure the firm's continuity, the board of directors should advocate the adoption of a succession plan and encourage family members in the business to undergo professional training and help prevent family disputes by forming family councils. The Code also provides guidelines to prevent conflicts of interest by requiring family businesses to establish a separate fund independent from the business for handling of family emergencies and loans to family members.

The Fehrmann Ltda., a local distributor for manufacturers such as Johnson & Johnson and Gillette for more than 50 years, provides a good example of a family-owned company that adopted corporate governance techniques acquired through the program in 2004. Upon the death of its founder, his widow and one of their sons were left in charge. The only shareholders were three children and the new managers. While it may be too soon to detect a significant impact on the firm's bottom line, the Fehrmann managers pointed out the benefits of a clearer separation of family issues from business decisions, leading to decision-making that is more aligned with the best interests of the firm; stronger technical analysis in decision making; and implementation of long-delayed restructuring. These reported improvements of one firm are an encouraging sign of the potential for a more competitive economy as the adoption of such practices becomes more widespread.

The creation of the Code has made Colombia a regional leader with respect to corporate governance and has shaped the management of both listed and non-listed companies to foster greater transparency and performance for those who want to invest in the country. The Code was presented at the “kick off” meeting on corporate governance for unlisted companies that was held in Istanbul in April 2005 and has received international recognition from institutions such as the OECD. Organizations that promote corporate governance in other Latin American countries, such as the Center for Financial Stability (CEF) in Argentina and the Association of Venezuelan Executives (AVE), have decided to create instruments similar to Colombia’s new SME Code created by the project.

### **The National Center for Corporate Governance**

Confecámaras employed many avenues to promote a better understanding of the importance of corporate governance as well as to galvanize support for the new legislation. The National Center for Corporate Governance was created to be the preeminent institution for corporate governance training in Colombia by adapting national corporate governance standards and activities for training on the regional level. The project focused on medium-sized companies as they are a special segment of the economy - forming only 11% of the business sector, but representing 76% of sales for the private sector and a large segment of the country’s employment. Ten short seminars were organized in different cities as part of the strategy to mobilize and attract the attention of the chambers and the business community. These seminars were attended by the representatives of family businesses, finance directors, SMEs, corporate lawyers, and post-graduate students.

In addition to the five training seminars, Confecámaras organized international seminars, attended by 1,500 participants. In all, more than 3,550 businessmen attended national and international events, learning about practices and strategies of corporate governance for closely held companies. To increase the media coverage and promote greater public awareness of corporate governance issues, Confecámaras created an eBulletin, launched a webpage and electronic forums, and published

academic articles. To address the lack of corporate governance literature in Spanish, Confecámaras produced articles and two books in Spanish on corporate governance in Latin America.

### **E-survey software tool**

Confecámaras also developed an e-survey software tool, which allows institutional investors, the stock exchange, and chambers of commerce to evaluate existing levels of compliance with international corporate governance standards. The tool is geared for use by SMEs and is designed to help in risk management for institutional investors, consultants, and regulators.

The instrument has given companies an easy, cheap, and confidential way to evaluate the quality of their corporate governance based on five dimensions: shareholders' rights and equitable treatment; boards of directors, disclosure and transparency; corporate social responsibility; and CEO function. To date, 69 companies have used this diagnostic tool to evaluate the quality of their corporate governance. The feedback from SME owners and managers indicates that over half of the entrepreneurs who received the model framework or accessed the diagnostic tools have incorporated at least some of the concepts into their operations.

The e-survey was mentioned in Global Proxy Watch, an international bulletin on corporate governance. Institutions in Venezuela, Peru, Argentina, Mexico, and Ecuador have shown interest in adopting this tool.

*Harvey Rodríguez graduated from the Universidad Javeriana in 1999, and obtained his Masters in Economics from the same university in 2003.*

*Harvey Rodríguez has been with Confecámaras since 2000 where he serves as the Director of Social Programs of the business confederation. He specializes in the areas of Corporate Social Responsibility, Anti-corruption, and Transparency.*







Center for International Private Enterprise  
1155 15th Street, NW • Suite 700  
Washington, DC 20005  
Telephone: (202) 721-9200  
Fax: (202) 721-9250  
Website: [www.cipe.org](http://www.cipe.org)