IDEAS ON LIBERTY

Essays in Honor of
Paul L. Poirot

The Pen Is Mightier than the Plan

BY GREGORY F. REHMKE

FOR OVER three decades *The Freeman* has been a source of income for economists. *The Freeman* has purchased and published hundreds of short essays on topics ranging from the political economy of a campus hot dog stand to the causes of poverty in the underdeveloped world. For *The Freeman*, the proper role of economists is simply to teach economics. And the proper place for an economist is in front of a classroom of curious students, or seated quietly, pen in hand, before a blank sheet of paper (or, nowadays, keyboard in lap, before a blank computer monitor).

Freeman articles, however, have not been particularly popular with the majority of economists, perhaps because they have advocated a private property order that would not need economists advising government. A quiet satisfaction from explaining a concept, and a modest payment for thoughtful wordcraft are the rewards a free society would offer its economists.

What is this discipline that can be taught but not practiced? Economics is an apparatus of the mind, and economic concepts are tools of thought; they help us understand the daily flow of goods and services in a society. But economics is not a language of power or control; its concepts do not, in themselves, bestow power. Its concepts do not even provide management or investment expertise, and many a good economist has proved a poor investor or manager.

Yet, if *The Freeman*'s view of "economist as teacher" is reasonable, why are economists today among the most powerful men on earth; why do their reports and advice directly affect the lives of billions of people? One answer might be that some economists have succumbed to the allure of power and have, like wizards and astrologers before them, fashioned their advice to please those in power. Economists have come to advise kings, presidents, and prime ministers, have become the trusted counsel of congressmen and bureaucrats, judges and juries. Their brand of economic science claims to know what the most efficient role of government in society is. In the twentieth century economists have wedded "science" to political power.

No wonder *Freeman* articles have been so widely disregarded by the economic advisers on government payrolls. It is a sour message for a self-regarded scientist to hear that his science has, in practice, only power to destroy an economy, and that his proper role is to teach students how smoothly societies function without citizens understanding just how (and without needing to). The most important job for free market economists is, sadly, to try to undo the work of other economists.

While in North America economists have considerable influence in finance, industry, and government, in South America their influence has been even greater. From Mexico to Argentina, from Brazil to Peru, state by state, each capital has its priesthood of economists. Economists' sophisticated theories and well-researched studies have served to justify turning over ever larger control of Latin American resources to politicians and bureaucrats. The disaster of protectionism in Latin America finds its justification in works on "dependency theory" by top Latin American economists like Celso Furtado. His *Economic Development in Latin America* explains why protectionism is needed to escape from what he calls "traditional forms of external dependence." His reasons for keeping out foreign manufactured goods are the same as those Frederic Bastiat refuted in nineteenth-century France, when France tried to keep out English manufactured goods. As long as there are domestic manufacturers facing foreign competition there will be economists marketing "new" defenses of protectionism.

For decades economists served up their theory that modern economies were far too complex to be left unplanned, far too advanced to be left unsupervised. With foreign goods securely excluded, economists presented studies designed to "rationalize" economies. With such theories and studies as justification, hundreds of Latin American companies have been nationalized and most industries heavily regulated. Nationalization, economists argued, would help free their economies from foreign control and would keep future profits from leaving the country (though firms once nationalized generally stopped making profits altogether). Regulation, they said, would protect the consumer and prevent cutthroat competition and wasteful duplication.

With foreign competition locked out by protectionism, domestic competition was that much easier to suppress. Protectionism and regulation made the cartelization of domestic industry inevitable. The consequences of these policies have been disastrous. The lesson? Efficiency should never be a goal. The "creative destruction" of market capitalism never looks particularly efficient, often hiding productivity and progress in mountains of apparent waste from failed entrepreneurs and energetic competition. The market economy is a process and requires only a few rules to protect property, enforce contracts, and adjudicate torts.

But, economists said the government should do more, and claimed skills in fine tuning Latin American economies, skills in rearranging them and preparing them for bursts of growth. Enormous construction projects were advocated to speed development. The economist/planners must have known that much would be lost to waste and corruption as politicians made their modifications, and bureaucrats administered the details of the projects. They should have known that the politically connected builders would artfully revise and expand their cost-plus contracts. Yet there was, insisted the economists, no alternative: the economy must have development plans and development projects.

In Brazil, 360 major companies are owned and managed by the government, including four of the ten largest. Economists with university training in "public administration," "public finance," and "urban planning" advise these firms, while others run the bureaus that regulate companies in Brazil's private sector. In the political world, however, power shifts quickly to those most adept in its use. Though it was economists who provided the rationale for government ownership of private industry, and politicians who designed the laws to implement those theories, a third force has now risen to the top.

Influence and control have gravitated to a class of mixed-economy entrepreneurs, a breed of businessmen who flourish in mercantilism's mixture of commerce and privilege. As happened in the United States, regulatory agencies were quickly captured by the industries they were supposed to regulate. And, businessmen not adept in manipulating their regulatory agencies were soon outmaneuvered by their more adept (and often less principled) competitors.

Over time government-owned and -regulated firms become umbrellas providing for and protecting "families" of private sector suppliers and subcontractors—umbrellas wide enough to shield ever larger troops of unionized laborers, working ever shorter hours for ever more pay. The lucky few who made it into the government workers' unions learned, like their counterparts in management, to set their course by the stars of the developed world—and left their countrymen behind.

Hundreds of state-owned enterprises across Latin America pile up steady losses while steady profits flow to their politically connected "family" of dependent firms. When new technology or cheaper goods from foreign lands pose a threat, connected politicians and regulators are quick to come to the rescue, and quick to protect the status quo of the ancient regime. The YPF, Argentina's nationalized oil company, for example, loses $350 million a year, and even managed to lose money even during the oil boom of the 1970s. (David Asman, "Liberation Argentine Style," *Wall Street Journal*, May 4, 1987) But its private sector family of suppliers made fat profits selling overpriced parts, like perforation pipes, at twice world prices (after securing legislation that forced the YPF to buy domestic pipe, for which they are the only supplier). The state airline, Aerolineas Argentinas, loses $130 million a year, though its suppliers surely do well.

In his seven-month tenure as "Secretary of Growth Promotion" in Argentina, Manuel J. Tanoira found similar arrangements all across the Argentine economy. When Russian, German, and Argentine firms offered to take on a $300 million enlargement of Port Ingeniero White, the bureaucrats in charge avoided even formally receiving the proposals, much less considering them. The bureaucrats were waiting for IMF money to be promised so they could administer the project themselves, and divide the fat contracts among the local engineering and construction firms (and they know they will eventually turn to these same firms for future employment). (Manuel J. Tanoira, "Confessions of an Argentine Privatizer," *Wall Street Journal*, May 29, 1987, p. 27)

It was the same story for the toll roads private firms offered to build and pay for. Transportation bureaucrats at the *Vialidad Nacional* oppose all toll roads (and have even "liberated" some existing toll roads). Though they are able to block private construction of roads they seem unable to build any themselves. Their objection to toll roads is again a smokescreen for keeping the construction project and its lucrative contracts under their control.

Where Did the Idea Come From?

If we step back for a moment from the Third World horror stories, we wonder how it all could have happened. From where did the idea come that government should or could do anything beyond providing defense, a court system and police (and perhaps quietly mismanaging a postal service and a few lighthouses)? The vast intrusion of government into private sector development received theoretical support from a few key theories of "market failure."

Economists insisted that markets failed from time to time and that collective action, coercively funded, was a society's only hope. A modern economy ought to have a modern plan, and not be at the mercy of the "chaos of the market." Collectivization swept North America and Western Europe, but their wealthy economies and stable institutions had the wherewithal to survive until their governments eventually (and only partially) retreated from central planning. In Latin America the vogue of central planning, assisted by new international aid money, refueled the ancient mercantilist institutions that always cohabited their economies. Ironically, Spain of the sixteenth to nineteenth centuries avoided reforming its mercantilist institutions by ingesting a steady diet of gold and silver taken from Latin America. Now, in the second half of the twentieth century, Latin

America's own mercantilist institutions have survived only with the assistance of a similar infusion of wealth from Western banks and governments.

The private sector, market-failure theories explained, acts only in its narrow interests, so governments must design and carry out development plans (with the help of economic advisers, of course). Great hydroelectric dams were needed ("too large for private enterprise," claimed the economists) jungles needed taming ("roads and dams to provide the infrastructure to spur private sector development"); airports were needed, as were railroads, ports, and gleaming new capital cities perched on desolate plateaus. So it was theorized, so it was done; all these massive projects now stand in Latin America, along with thousands of smaller government-engineered cousins: neighborhood and village projects, office buildings, shopping malls, factories, and steel mills.

The economists, politicians, bureaucrats, and contractors have created much. From the rubble of the earth they have created a world where theories generate investigations that generate reports, followed eventually by projects that create jobs and provide services. All according to plan, but the plans have problems. Petrobras, for example, is Brazil's national oil company, and—not to be outdone by Argentina's YPF—engineered what *The Economist* cites as Brazil's biggest mistake in recent times. In the 1970s, just as the oil boom hit, Petrobras pulled back from oil exploration and poured its resources into alcohol and gasahol production. Alcohol is competitive at prices over $40 a barrel, but not below; so as Brazil's oil production stagnated (since its monopoly producer had put all its eggs in the alcohol basket), the bill from imported oil went from $280 million in 1970 to $10 billion in 1979. There was plenty of oil to be found in Brazil, but only now, after international prices have dropped dramatically, has the lumbering Petrobras been looking, finding, and producing. (*The Economist*, "Survey Brazil," April 25, 1987, p. 18)

Brazil's national road building program provides an example of how the best laid plans of economists get tweaked on their trek from theory to reality. Economists often complain that Third World countries lack sufficient infrastructure. They insist that though thousands of farms, ranches, and small industries would benefit from a connecting network of roads, the costs of organizing and financing such a system is beyond the means of the private sector. In Brazil the politicians agreed with their economic advisers that government roads were needed, and promptly financed a highway system connecting all but one of Brazil's state capitals. Most of these roads have little traffic, while new roads needed between commercial centers like Sao Paulo and Rio de Janeiro go unbuilt. He who pays the piper calls the tune.

The Polonoroeste plan, a project in the north of Brazil funded by the IMF, foreign lenders, and the government, was to develop some 100,000 square miles of tropical forest for small farmers. Some 17% of the land has been deforested so far. The farmers placed on small farms by the planners after the forests were slash burned are quickly going bankrupt on the thin jungle soil. Their exhausted land gets bought up and consolidated by cattle ranchers (who appeared nowhere on the original plans) (*Insight*, August 17, 1987, p. 16). Would the private sector have found it profitable to destroy thousands of square miles of jungle in order to provide cattle ranchers with inexpensive rangeland?

Brazilian planners and their economic advisers, like their counterparts across Latin America, have made mistakes. Many of the great projects built in Latin America over the past decades should not have been built, or at least should not have been built quite the way they were built. And it turns out that most of them have not been paid for. Creditors from overseas now want their money back—money spent by the billions in pursuit of a combined vision of economists and politicians that saw Latin America suddenly transformed into an industrialized and modernized civilization. Instead, Latin America has become a Frankenstein monster stitched together of ill-fitting pieces from the industrialized world, and, worst of all, sporting a head transplanted from mercantilist Europe of the sixteenth century.

Lately economists have been shifting gears. Now some proposals call for governments to sell off nationalized companies and deregulate their economies. Now, after billions of dollars, and millions of hours of labor have been lost in pursuit of these plans, after aching arms have welded miles of steel bars, poured sweat with uncounted tons of concrete into public projects across a hemisphere—they are blithely told their labor was lost, their capital squandered, their paychecks mere borrowings from foreign investors who will now and forever demand interest on the unpayable principal of those lost loans.

Instead of just accepting what economists say, perhaps economists should be taken out of the public-policy decision-making loop and returned to the profession of teaching. Latin America has had too much of economists. Too many failed economic plans, like Argentina's Austral plan and Brazil's Cruzado plan, darken the memories of once hopeful people. Too many failed projects litter Latin American landscapes—concrete and steel monuments to wasted resources and labor, symbols of a reach toward a modern world mysteriously never grasped, and ever-present reminders of self-esteem lost in the effort. Monuments, too, that are powerful magnets drawing wealth from Latin societies, pulling dollars through taxes, tariffs, and interest and exchange controls, to service debts incurred in their creation. A bad investment is no investment at all.

What New Vision for Latin America?

If *Freeman* authors were asked to advise Latin American governments, what advice would they offer? For starters they would suggest government officials get honest jobs in the private sector. Latin American governments need only get out of the way of their naturally entrepreneurial people. Entrepreneurship flourishes in Latin America's diverse underground economies, and these hard working people require only that their property rights be defined and defended and made freely transferable. They must be assured that their contracts are enforceable. They would like taxes drastically reduced and inflation stopped. And they would be most happy occasionally to read the thoughtful essays of their otherwise unoccupied economists in a journal much like *The Freeman*.

If such a revolution ever takes place in Latin America the role of economists in preserving it through education would perhaps redeem the profession for the evils wrought by its fallen associates.

Economist Alfredo Irigoin, in a recent letter to *The Wall Street Journal*, offered his thoughts on current plans for reform in Latin America proposed by American economists: "It is interesting to see how many intellectuals love to advocate policies for Latin America that they would not dare even to mention for the U.S. . . . Latin America does not need plans that call for more governmental interference, even when its ultimate goal is to establish a free-market order. Latin America needs a clearer definition of property rights to prevent governments from tinkering with the market, and a stable institutional framework to ignite entrepreneurial vision and alertness. Let the market choose—not the advisers." (*Wall Street Journal*, May 11, 1987)

One more time for emphasis: "Let the market choose—not the advisers"!

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