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Economic Freedom in the "Bolivarian Andes" Is Melting Away

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Abstract: *In the past, "Bolivarian" referred to those Andean countries that had been liberated by Simón Bolívar. Today, for the three countries in the Andes that are following Hugo Chávez's "Bolivarian Alternative" path—Bolivia, Ecuador, and Venezuela—it has come to signify declining economic freedom. A closer look at those countries' scores on the 10 indicators in The Heritage Foundation's 2010* Index of Economic Freedom *will shed light on exactly how and why their economies are failing to deliver the prosperity that their populist leaders have repeatedly promised and failed to deliver. The performance of market-friendly and democratic countries such as Peru, Colombia, and long-time Latin American economic freedom leader Chile is proving that Andean governments can deliver true economic and political freedom to their citizens if leaders govern with the correct mix of policies favoring private property, rule of law, and market-based democratic institutions.*

There is dramatic news in the 2010 edition of The Heritage Foundation's annual *Index of Economic Freedom*: For the first time, the United States has dropped from "free" to only "mostly free" and the United Kingdom has dropped out of the top ten. What is less shocking, however, is that the *Index* scores for the three countries in the Andes that are following Hugo Chávez's "Bolivarian Alternative" path—Bolivia, Ecuador, and Venezuela—continue to plunge. In the past, "Bolivarian" referred to those Andean countries that had been liberated by Simón Bolívar. Today, it has come to signify declining economic freedom.

Talking Points

- *Index of Economic Freedom* scores for the three countries in the Andes that are following Hugo Chávez's "Bolivarian Alternative" path—Bolivia, Ecuador, and Venezuela—continue to show declining economic freedom. In fact, they are among the worst performing countries in the 2010 *Index* in all of Latin America.
- A common pattern among the three Bolivarian countries is that they all suffer from institutional weakness and do not have clearly established rules of the game. All three countries have recently adopted new constitutions that concentrate power in the executive and favor government intervention in the economy.
- The best performer in the Andes is Chile, with the highest 2010 *Index* score in Latin America. In vivid contrast with the other countries in the "Bolivarian Andes," one of Chile's biggest strengths is its regard for the rule of law and the protection of property rights. These are the two institutional essentials upon which the economic development and prosperity of any country depend.

This paper, in its entirety, can be found at: *http://report.heritage.org/hl1157*

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While it is not surprising, it is sad that the leaders of those countries—Presidents Evo Morales, Rafael Correa, and Hugo Chávez, respectively—as well as the people who support them do not seem to realize that their statist "Bolivarian" policies are doomed to failure. A closer look at those countries' scores on the 10 indicators in the *Index* when compared to the only successful economies in the Andes—Peru, Colombia, and especially Chile—will shed light on exactly how and why their economies are failing to deliver the prosperity that their populist leaders have repeatedly promised and failed to deliver.

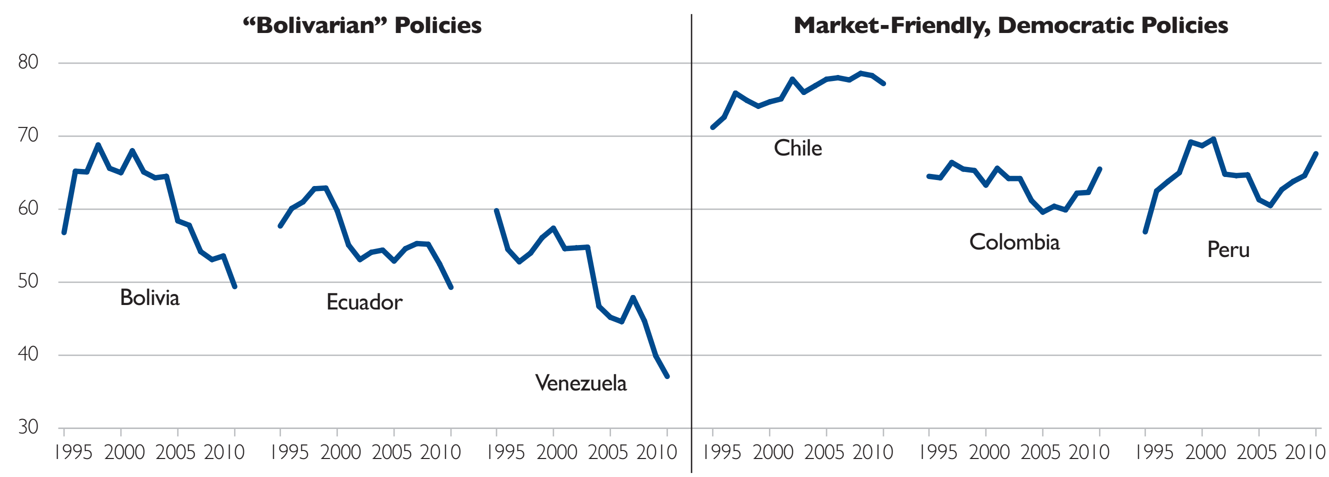
Bolivia, Ecuador, and Venezuela are among the worst performing countries in the 2010 *Index* in all of Latin America. Several of the other poor performers in the region—such as Cuba and Nicaragua—are also governed by statist regimes. Meanwhile, the performance of market-friendly and democratic countries such as Peru, Colombia (the most improved country regionally in the 2010 *Index*), and long-time Latin American economic freedom leader Chile are proving that Andean governments can deliver true economic and political freedom to their citizens if leaders govern with the correct mix of policies favoring private property, rule of law, and market-based democratic institutions.

Chart 1 shows these diverging performances graphically. Chile has scored highest throughout the period, while Colombia's score has improved steadily in reflection of the tough economic reform measures implemented by President Álvaro Uribe over the past half-decade. Meanwhile, all three Bolivarian countries in the Andes have registered a progressively downward trend in their scores and now sit at the bottom of the rankings—both in their own region and among worldwide *Index* scores.

A common pattern among the three Bolivarian countries is that they all suffer from institutional weakness and do not have clearly established rules of the game. All three countries have recently adopted new constitutions that concentrate power in the executive and favor government intervention in the economy. This does not incentivize any entrepreneur to prosper and generate prosperity for others. A deeper look at each of the Bolivarian countries' scores reveals the failures they have in common and how they differ from economic freedom leader Chile. The statist policy errors they share have

"Bolivarian" Means Less Economic Freedom

Three Andean nations following Hugo Chavez's "Bolivarian Alternative"—Bolivia, Ecuador, and Venezuela—have scored progressively worse in the *Index of Economic Freedom*, while three market-driven nations in the same region have seen their scores improve.



Source: Terry Miller and Kim R. Holmes, *2010 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2010), Appendix: Index of Economic Scores 1995–2010.

Chart 1 • HL 1157 heritage.org

resulted in exceptionally low scores on the indicators shown in Table 1.

Indicator Scores by Country (Out of 100)

	Chile	Bolivia	Ecuador	Venezuela
Investment Freedom	80	15	25	5
Property Rights	69	10	20	0
Freedom from Corruption	85	30	20	19

Source: The Heritage Foundation, *Index of Economic Freedom*, Economic Freedom Component Scores, All Countries (2010), at *http://www.heritage.org/index/Explore.aspx*.

Table 1 • HL 1157 heritage.org

Bolivia (146th out of 179 Ranked Countries)

Bolivia is one of the countries that fell the most in its economic freedom score from 2009 to 2010. It registered declines in nine of the 10 freedoms. All of these indicator scores combine to show Bolivia's institutional weakness. Recently held democratic elections were marred by numerous credible allegations that supporters of the Morales government committed human rights violations and intimidated and prosecuted the few remaining politicians from opposition parties in the Senate and among the state governors. Morales' ruling MAS party has used its greater concentration of power in the past few years to exert nearly totalitarian power over almost every dimension of economic freedom, opening the door wider to corruption. The new constitution engineered by President Morales is hindering long-run growth and industrial diversification.[1] The lack of an institutional framework within which businesses have incentives to operate has crowded out both domestic and foreign private direct investment.

Although Bolivia's economy has grown at an average nominal rate of 4.9 percent in recent years, this growth is due mainly to higher commodity prices for hydrocarbons and minerals, which are Bolivia's main exports. Real economic growth is actually negative; inflation rates have averaged 11.8 percent between 2006 and 2008 as a result of extensive price controls.

Ecuador (147th out of 179 Ranked Countries)

As with Bolivia, Ecuador's score dropped again in 2009, with declines in eight of the 10 freedoms reflecting steadily weakening government institutions. High inflation in recent years has turned Ecuador's small amount of nominal economic growth into either very low or negative real GDP growth. The inefficient judicial system lacks transparency and is plagued by corruption. Laws and regulations to combat official corruption are inadequate, enabling politicians to pressure businesses and investors for bribes and payoffs.

Government control of Ecuador's strategic resources has scared off foreign investors, and the new constitution pushed through by President Rafael Correa has concentrated the state's power even more and increased the government's intrusive role in the economy. The entrepreneurial environment is made even worse by burdensome regulations. Starting a business takes longer than the world average; closing one is a lengthy process. Labor regulations making dismissal of employees difficult disincentivize new hiring and hinder productivity growth.

Although government spending has remained relatively low, it has risen rapidly since 2007. Monetary freedom has been severely undercut by domestic price controls on staples from bread and chicken to coffee. The fact that only public or mixed enterprises are allowed to provide public services is another cause of price distortions.

Venezuela (174th out of 179 Ranked Countries)

Venezuela is the worst among the three Bolivarian countries. It ranks 174th out of 179 countries, and its *Index* score has dropped steadily since President Hugo Chávez took power in 1999, with

1. For more on constitutional changes in Bolivia, see James M. Roberts and Gonzalo Schwarz, "New Constitution Pushes Bolivian Economy into Socialism," Heritage Foundation *WebMemo* No. 2355, March 23, 2009, at *http://www.heritage.org/Research/LatinAmerica/wm2355.cfm*

scores on eight out of 10 economic freedom indicators deteriorating further in 2010. Venezuela is one of the worst performers in the region and worldwide. Among Western Hemisphere countries, only Cuba has a lower economic freedom ranking. Although nominal economic growth is present due to high world oil prices, real growth is negative because of the country's very high inflation (around 30 percent).

Hugo Chávez's rule has brought chaos to Venezuela, undermining the rule of law and the right to free speech, imposing foreign exchange controls as well as price controls on almost all goods and services, and nationalizing various industries and companies. The government's influence and political pressure are felt in every sphere of the economy. Venezuela's high rates of crime and unemployment reflect the true impact and cost of *Chavista* populism.

Venezuela's score of zero on property rights in 2010 is not surprising: The judiciary is completely controlled by the executive. Foreign and domestic private investors have frequently experienced discrimination and have seen their assets and companies expropriated. Coupled with a low score in investment freedom, this has created a very negative environment for international investment and disincentives for any local entrepreneurs who are out of favor with the ruling regime. Corruption among government officials and managers of state-owned enterprises is perceived as very high.

Beyond the necessary political pull, opening a business takes a burdensome and costly 141 days, well above the world average. Financial freedom has been severely damaged by the increasing levels of government intervention and nationalization. Central bank independence has been compromised, and the president now directs its actions through political pressure. Constant anti-market and anti-private property rhetoric from President Chávez and anti-market sentiment push the current government toward more intervention in the economy and constant political pressure against whoever seeks to oppose the ruling party. Expropriations have become the rule rather than the exception, and no business can operate with complete safety.

Chile: A Stark Contrast in the Andes

In contrast to the Bolivarian countries, the best performer in the Andes is Chile, whose rank in the *Index* is a remarkable 10th out of 179 ranked countries—the highest score in Latin America. The country's exceptional openness to international trade and investment is reflected in its high score in the trade freedom category; prudent governance has also translated into a high score on government spending. In vivid contrast with the other countries in the "Bolivarian Andes," one of Chile's biggest strengths is its regard for the rule of law and the protection of property rights. These are the two institutional essentials upon which the economic development and prosperity of any country depend.

How did Chile prosper? Economist Peter Boettke argues that the prerequisites for progress and development are:

> legal certainty which encourages investment, a motivation for responsible decision making on behalf of owners, the background for social experimentation which spurs progress and the basis for economic calculation by expanding the context within which price signals can reasonably guide resource use.[2]

These are all factored into decision-making by entrepreneurs who, notwithstanding the many obstacles erected by the Bolivarian governments, are still hanging on in all three countries. However, Boettke argues that all of these attributes must rest on a solid foundation of protection of private property rights and a well-established rule of law. "Economic progress is a function of the rules of the game" established on that basis.[3] This is why the countries that do not follow these norms and prerequisites are the ones that fare worst in the ranking. Nations that are able to establish these vital institu-

2. Peter J. Boettke, "The Political Infrastructure of Economic Development" (1994), as reprinted in Boettke, *Calculation and Coordination: Essays on Socialism and Transitional Political Economy* (London, Routledge and the Taylor & Francis Group, 2001), p. 241.

3. *Ibid.*, p. 244.

tions enjoy more economic freedom and, more important, greater prosperity for their citizens in the global economy.

Another distinguished economist and champion of entrepreneurial freedom, New York University Professor William Baumol, draws the distinction between the productive and unproductive roles of the entrepreneur. He argues that an entrepreneur's actions and decisions depend upon the rules of the game—what he calls the "reward structure in the economy."[4]

Entrepreneurs are always among us, but the role they choose to have in the economy depends on the rules of the game.

In his analysis, Baumol presents an important proposition: "the rules of the game that determine the relative payoffs to different entrepreneurial activities change dramatically both over time and from one country to another depending on the variations in the rules."[5] Some of the unproductive sectors and distortions that are present in many developing and underperforming countries occur because of faulty tax structures, corruption, and rent seeking, among other reasons, as the examples in his analysis show.

Bolivia, Ecuador, and Venezuela all possess rich natural and human resources. They all have the potential to encourage productive entrepreneurship and to become, as development expert Professor William Easterly puts it, "searchers" rather than "planners" of prosperity.[6] The example of Bolivia's vast workforce operating in the shadow economy proves that there are many people who understand the value of markets and want to progress by their own means. However, the "Bolivarian" history, since its imposition by Morales, Correa, and Chávez, has been more famous for unproductive entrepreneurs and corrupt government officials because of institutional weakness inherent in all these economies.

Conclusion

The rapid descent of these three resource-rich nations toward the status of failed states and the threat that this poses to the security of the Western Hemisphere are of great concern to policymakers. The statist "Bolivarian" policies being pursued are doomed to failure since they aggravate institutional weaknesses that the three Bolivarian states have in common, which are underlined in the 2010 *Index* (e.g., no clearly established rules of the game and very low scores on property rights and corruption).

Meanwhile, the performance of more market-friendly and democratic countries such as Peru, Colombia (the region's most improved country in the 2010 *Index*), and long-time Latin American economic freedom leader Chile proves that Andean governments can deliver true economic and political freedom to their citizens if their politicians govern with the correct mix of policies favoring private property, rule of law, and market-based democratic institutions.

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4. William J. Baumol, "Entrepreneurship: Productive, Unproductive, and Destructive," *The Journal of Political Economy*, Vol. 98 No. 5, Part 1, (October 1990), p. 894, at *http://faculty.washington.edu/latsch/SISAF444_Baumol_Entrepreneurship.pdf*
5. *Ibid.*, p. 899.
6. William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, (London, U.K.: the Penguin Group, Inc., 2006) pp. 3–6.