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A Retrospective View 34 Years Later

Editor's Note: We consider it timely to publish this conference by Dr. Manuel F. Ayau, which he originally presented on November 11, 1961 at the II Inter-City Meeting of Rotary Clubs of Guatemala. While some of the circumstances of that year have changed, the reader may draw his own conclusions as to whether or not we have progressed on the path towards a free society without coercion or privilege.

A Retrospective View, 34 Years Later

*II Inter-City Meeting
1961-1962*

Rotary Clubs of Guatemala
Celebrated in Antigua, Guatemala
November 11 and 12, 1961

Conference presented by Rotary Member
Manuel F. Ayau
of the Guatemala City Club

Rotary colleagues:

I would like to thank you for having me with you on this occasion. I am honored.

I will address the documents entitled *Charter of Punta del Este* and the *Declaration to the Peoples of America*.

This is certainly a far-ranging topic, one that covers almost all aspects of economic development in Latin America. During a meeting such as this, time only allows for me to touch on a few points. I am going to refer only to those dealing with the economic and social philosophy on which the participants in this plan based their conclusions, inferred from their focus on the problems and the solutions they proposed.

Before addressing the matter, I would sincerely like to acknowledge the great humanitarian spirit of the people of the United States of America. With a generosity and sense of responsibility unknown before in history, they have demonstrated (and are demonstrating) by their deeds a desire to raise the standard of living of all nations that accept help. When he pays taxes to allow this type of tangible aid, each and every citizen of that great country is sacrificing something.

Remedying a situation is like curing a disease. What determines the cure's efficacy is not the value or amount of medicine, rather it depends first on the accuracy of the diagnosis and, second, on the effectiveness of the medicine applied. Many situations, just like diseases, often are cured simply by avoiding their causes.

I am not going to talk about issues for which I consider the diagnosis and medicine on target, since much has been said in favor by countless commentators and official representatives of different countries. Some examples include issues related to strengthening and perfecting democratic institutions; urban and rural housing programs; substantially increasing and sustaining per capita income; "maintaining a monetary and fiscal policy that, by avoiding the disasters of inflation or deflation, *defends* the purchasing power of the greatest number, guarantees greatest price stability, and fosters economies"; the elimination of illiteracy; health and hygiene programs; and, above all, educational programs that, rightly so, have received so much attention in these documents and plans.

I would like to mention another no less laudable objective pursued by Americans, in addition to the humanitarian one. It has to do purely with strategy in this Cold War. The goal is based on the theory that raising the standard of living of people is a way to avoid communism and socialism. I mention it because I consider such reasoning—which is very prevalent—a mistake. I believe there is no case in the history of humanity in which a movement towards the establishment of a collectivist economy (of which there have been many, including long before Marx) has emanated from the masses. Generally, it has come from small groups of well- or ill-intentioned people. They have preached the collectivist economic system (whether socialist or communist) as a means to achieve economic equality, by appealing to the lowest instincts in human beings (such as envy).

This reasoning is shared by many people, and many North American policies are based on it. To demonstrate the error in the reasoning that if you raise the standard of living of a nation, communism or socialism can no longer take hold, suffice it to cite cases such as Sweden and Nazism (National Socialism) in the time of Hitler. To illustrate this perceptual mirage, I would like to translate an excerpt from an article I recently read in the U.S. magazine *Fortune*:

To illustrate the point that material progress does not automatically lead to political stability, let's imagine a hypothetical situation: The United States decides to improve, as quickly and quantitatively as it can, the economic condition of a small country called *Cinderella*, recently emancipated from colonial rule. Let's suppose the United States immediately eradicates tropical diseases that are killing Cinderella's citizens; it contributes to building excellent railroads and a communications system that opens up opportunities for industrialization and a higher standard of living. The United States also makes special arrangements so Cinderella's export products will be guaranteed access to the U.S. market.

Cinderella's population quadruples and begins to prosper; industrialization and urbanization grow rapidly until the number of farm workers drops to half. Businessmen, doctors, engineers, lawyers, and other white-collar workers are educated in the United

States and their number as well as influence increases. The presence of a large and growing middle class in Cinderella can be seen in the number of automobiles per capita (approximately proportional to Italy's), by the number of phone calls per capita (approximately equal to Belgium's). The national income per capita in Cinderella reaches \$400 a year, almost equal to that of the country from which it gained its independence. Cinderella's rapid progress can be projected into an undefined future, in which domestic and foreign businessmen invest in the expansion of electrification.

Lucky Cinderella!

According to Mr. Rusk's diagnosis, Cinderella's prosperity should produce a stable democracy, a well-defined anticommunist stance, and a loyal ally to its benefactor, the United States. But then we discover that this case of Cinderella's progress is not hypothetical. Fact upon fact and statistic after statistic, it is the record of Cuba over the last 60 years and its economic association with the United States. Nevertheless, when the bell rang at midnight on the Sierra Maestra, Cinderella smashed the slipper on the Prince's head, rubbed the glass in his eyes, and pick-pocketed his wallet while accusing him of seducing her.

I don't want to be misinterpreted as uninterested in raising people's standard of living because I quote this example. It illustrates the theory that poverty does not necessarily produce communism: just because he is poor, a man does not become immoral and atheist. We see this here in Guatemala. A communist regime was imposed here. We are a poor and underdeveloped nation, and I am sure that at no time have the Guatemalan people been communist. The only thing that happened is that the communist *elite* took over.

But let's move on since, ultimately, raising the standard of living of our nations is the goal we share with the plan of the Alliance for Progress. Avoiding communism is nothing more than one of the measures we have chosen, because we understand that people's standard of living does not rise with communism, rather it *falls*. If we believed that the standard of living of nations would rise through socialism or communism, I am sure we would all be socialists or communists. It goes without saying that communists and socialists have *no* monopoly on "social awareness."

So, what method does raise a nation's standard of living?

What measures, what regime of government should be adopted; what institutions must be respected; what laws must exist and which should not exist; what taxes must exist and which should not exist? The *Punta del Este* documents explicitly propose certain guidelines that we need to evaluate. Two of these recommendations worry me the most. I oppose the proposals for tax reform (progressive taxes on income) and for agrarian reform. I believe that the *egalitarian* principles on which they are based and the ways proposed to carry them out do not lead to raising the standard of living, rather to the opposite, to lowering it. And in this process, those most affected are the poorest. I do not presume to defend existing tax systems. Many of them are terrible and have the same defects as those proposed as substitutes.

I find something very curious in the recommendations that currently emanate from the U.S. government. They come with the tacit warning that, if not adopted, the U.S. will not provide aid. The curious part is that when the United States became the great nation it is, it did not apply any of those systems. The United States was also an underdeveloped country. And it was at a greater disadvantage than underdeveloped countries currently enjoying the benefits of inventions, science, research, and new ways of doing things; underdeveloped countries can now copy from developed nations and, at the same time, even take advantage of their economic aid.

The United States did not adopt an egalitarian and redistributive economic policy (progressive income tax) until very recently. Never in its history did it have agrarian reform based on the expropriation of land and arbitrary redistribution decided according to the preferences of its planners. Its present systems of wealth redistribution using fiscal maneuvers are a recent phenomenon. While it is true that redistributive taxes were established at the beginning of the twentieth century, they were so low (2%) that practically no one cared. The only ones to protest were those who noticed that a precedent was being established. Just recently, some thirty years ago, the maximum rate was still 20%. For the first 150 years of its underdevelopment, *the U.S. did not have these taxes*. We should recall that they had to modify the Constitution to establish them, because the forefathers who laid the foundations that made this great nation what it is today expressly prohibited such actions. This is because they were fleeing from just such arbitrary power, typical of the countries from which they had emigrated.

The constitution they wrote left freedom clearly established, and it served as a model to many countries around the world, including Switzerland. This freedom was not so much freedom from the colonial yoke, which revolution had already taken care of, rather it was freedom of the *individual* from the arbitrary power of the state and of society itself, freedom from the abuse of the majority over the minority. It was freedom of the individual, and his right to property, principally his right to ownership of the fruit of his past, present, and future labor. Of course, they understood that liberty is based on respect for freedom of others and that, by definition, it must be limited and restrained by the freedom of others. There is a great difference between this limitation on freedom and granting rights to the fruit of the labor of another person. The founding fathers established a regime in which the government could have *no power* to alter economic inequality. They understood very well that economic inequality is necessary in order to raise everyone's standard of living. That without inequality, progress is not possible. That the great struggle for freedom has been the struggle for *equality before the law*. That by trying to establish economic equality through the coercive power of society—by treating minorities unequally—we destroy freedom. Such power constitutes one of the foundations of totalitarianism. Just because a minority is wealthy, it cannot be discriminated against. In the same way, one cannot legislate against minority groups due to race, color, or creed, without destroying the foundation of democracy: equality before the law.

The experience of all agrarian reforms tested in recent history has proven to be a failure. Mexico is one of the best examples, notwithstanding *official* versions of the Mexican revolution, which naturally mount a demagogic defense. What we all know, the Americans refuse to see.

It makes no sense to call for such changes in property rights while simultaneously vouching that private property constitutes the basis of economic and political stability. Is property and the fruit of one's labor to be respected only during those times when the law is not being changed?

I admit the possibility that, in some land-poor country, a group of people may have taken over all the productive land through abuse, disrespect for the rights of others, and devious acquisition of political power. However, this is not the rule, given that in almost all countries there is farmland in the hands of the state (less so in Guatemala). If such a case were to happen, what must be avoided is a repetition of the abuse.

We all know redistribution of land to be a socialist political argument. Its potency comes exclusively from its promise to redistribute land that has already been worked and is productive. Clearly, it is effective politically. To say that property already in production (or its value) is going to be freely distributed is very appealing. It's much more attractive than offering land that needs to be worked and that requires investment to make it produce; remote land, where you might have to wait years for modern communications, just as the current owners of productive land had to invest and wait for many decades. Agrarian reform only makes sense if land is to be given freely or for less than its market value; otherwise, anyone who wants it and can pay for it, can buy it in the market. Every day, land exchanges hands at a price related to its productive capacity. There are very many cases where the person who has worked, saved, and invested in land has come to be labeled a "feudal lord." The fact is that the size of farms in the United States is much greater than, for example, in Cuba or Mexico. It is also a fact that, as the standard of living in the United States has risen, rural population and the number of farmers has dropped and farm size has grown. Every day the number of owners is less. And this is the case not only in the United States, but in any country that has developed. Why, then, recommend the opposite for underdeveloped countries?

Evidently, we have failed to understand that economies referred to as "typically agricultural," with the low salaries they invariably pay, persist only because not enough capital investment has been made in higher productivity jobs, where the *fruit* of labor has *greater value*. These countries, for example, won't be able to plant coffee when people who currently harvest the beans have alternatives of employment that pay better. They simply don't exist now. Transformation cannot be instantaneous, and such evolution depends exclusively on the freedom and ability of individuals to accumulate capital that can be risked in the type of investment that can pay higher salaries. It also depends, of course, on foreign investment. By the way, we see constant proposals in favor of discriminating against foreign investment. These come from persons who do not appreciate how much foreign investment raises a people's standard of living. They don't realize the harm they are doing the nation by adopting positions of extreme nationalism, which are, in fact, highly unpatriotic.

In some of the pamphlets from the Center for Economic and Social Studies (familiar to many of you), we have repeated time and again, in articles written by the world's most prominent economists, that there are *two* basic requirements to raise salaries: education and capital investment.

There is no doubt in my mind which comes first. It is not a case of the chicken or the egg. Capital investment comes first and brings with it education as a result. Investment is what makes education possible. Human needs are satisfied in order of priorities. A person does not read if he has to spend all his time working in order to survive physically. Only when he reduces the time he needs to work for subsistence, will he be able to dedicate time to education. Without sufficient wealth, education cannot exist. You can't even buy books, much less pay teachers.

For a person to be able to raise his standard of living, obviously his work output in a single day must give him enough purchasing power to satisfy needs that, indeed, constitute a higher standard of living.

In modern society, based on the division of labor, in the final analysis every person exchanges the fruit of his labor for the fruit of the labor of others, using the indirect means of money and credit. Just because the means is indirect doesn't mean an exchange doesn't take place. What others are willing to give us voluntarily in exchange for what we produce in a day through the mechanism we call the market, depends, of course, on the quantity and quality of what we do in a day. What we call productivity is the degree of *quantity* and *quality* of work that we produce in a day. It is evident that to raise our standard of living (to satisfy a greater number of needs), we have to increase that productivity. But how do you raise productivity? Mainly by increasing the capital invested per capita.

The pamphlets I mentioned earlier have stated many times that the *difference* between the salary of a person working with a hand shovel and a person working with a mechanical shovel—or between a person driving an ox cart and a person driving a ten-ton truck—is due mainly to the value of the asset he uses for production. What is the source of this investment and how do we increase it? The source of investment is exclusively and *nothing more than* excess capital. It comes from those whose income is more than they need, and who can save it and invest it. This they do either directly themselves or by having others invest it through credits that banks are able to grant because they hold such funds in their keeping.

For this reason, the resolutions in the *Charter of Punta del Este* that recommend a tax regime based on the Marxist motto “from each according to ability, and to each according to need” harm mainly the most needy. Jobs and high salaries depend exclusively on *someone* having enough surplus money. Redistribution doesn't improve anyone's chances. It impoverishes everyone and consumes wealth that otherwise would be turned into capital.

Some months ago, I carried out a study among industries in Guatemala that pay what we consider here the *best* salaries. It turns out that investment per employee is approximately Q8,000 (in the United States, it is \$20,000 to \$60,000). Multiply Q8,000 by the number of people who enter the labor force annually and you have the amount of investment needed to provide decent employment to new workers. Add to that what we need to provide the same level of employment to those who currently don't reach that level (the majority of Guatemalan workers). Even then, it isn't enough to provide an adequate standard of living. So, now multiply the figure by five to get an approximate estimate of the capital we need to invest in order to raise the standard of living of all Guatemalans. What's the total? You work the figures. You will be astonished at the astronomical amount.

Instead, the idea is to impose taxes—justified as redistribution of wealth—on that very same income that can serve to create those jobs and elevate the standard of living. Indeed, low income is practically unaffected by progressive taxes, because people need all of it for consumption.

In my opinion, it is an *outrage* to recommend such a thing to underdeveloped countries. And foolish to adopt it!

The United States can afford the luxury of making such mistakes and of living with them for twenty or thirty years. Income tax was raised significantly after 1933 and the U.S. has carried on for close to thirty years with those taxes. But many people have already realized the harm this is doing to the United States. I am sure that in ten years the upper limit of income tax in the United States will be half of what it is today—and it will be below the off-the-record recommendations they make to us today. I base my opinion on research findings, on official recommendations of the U.S. Congress, and on studies by very prestigious economic authorities.

Unfortunately, it seems that U.S. politicians currently in power, and their advisors, haven't realized this. What is really regrettable is that the pressure on us to adopt measures that will lower Guatemalans' standard of living is so strong and difficult to resist when it is comes dressed up as I described before.

Consequently, we should be on the alert for these two aspects of the philosophy of *Punta del Este* and Alliance for Progress. We should understand their implications and try to correct them.

For those who are *truly* interested in understanding the political, economic, and social structure that enables progress, I respectfully recommend the following. Study the political and economic philosophy of the great men who made possible the development of those countries that have advanced in the world, countries whose inventions, labor saving devices, and science are copied by socialist nations. I know that some economists who see themselves as “advanced,” “modern,” and “open-minded” consider these philosophies old-fashioned, appropriate for other times. If we're truly interested, let's study the philosophy of John Locke, James Madison, the philosophy of the U.S. Constitution. Just because they reached their pinnacle over 150 years ago does not mean these theories—which have withstood the test of time with the greatest success in the history of man—should be invalidated. Should we invalidate the Ten Commandments from the time of Moses because they are antiquated? Let us adopt measures that are tried and true. Let us adopt what is good, not the bad. Let us work to achieve the healthy objectives of the *Charter of Punta del Este*: to raise the standard of living of the peoples of the world.

*I especially recommend the book recently translated into Spanish: *Socialism* by L. von Mises, which can be purchased at the Center for Economic and Social Studies.

Translated from the original Spanish

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