

COMMUNIQUÉ

on

the Rule of Law in Latin America

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Introduction

A failure to implement market-based reforms and embrace the rule of law has resulted in a lost decade for most Latin American nations, the Economic Freedom of the World Network said in a statement issued prior to global meetings in San Jose, Costa Rica.

To truly improve living standards and the plight of the poorest citizens, Latin American nations must undertake a true reform effort focused on establishing the rule of law, not the failed approach to reform that has characterized the region in the past.

The Economic Freedom of the World network consists of independent social and economic policy research organizations from 72 nations coordinated by Canada's Fraser Institute. It publishes the *Economic Freedom of the World Annual Report* which is recognized globally as a marker of good institutions.

Latin America's Lost Decade

The network's research conclusively dispels the myth that Latin America moved to market reform and that market reform failed to produce results for the region. Instead, the research shows the region never had a sustained reform effort and most dangerously, has failed to establish the rule of law. Limited reforms were attempted in the first half of the 1990s but these were too restricted and too short lived to have much effect.

Since 1995, Latin America has a negative record in every key area of market reform:

- government size;
- rule of law and property rights;
- sound money;
- freedom to trade; and
- regulation

The sole exception is in the area of sound money.

Successes and Failures by Country

Chile is the only nation in the region to establish a high coherence with the rule of law and adopt wide-ranging market reforms. Consequently, it continues to outpace all other Latin American nations by a wide margin with real per capita growth of just under 25 percent between 1995 and 2004, compared to a Latin American average of just over 10 percent.

Venezuela lies at the other extreme, ranking as one of the least free nations in the world since 1995. Today, Venezuela has the lowest level of economic freedom in Latin America and the fifth lowest in the world. Despite great oil wealth, the lack of market economics has deprived the people of Venezuela of the prosperity they should enjoy. Per capita GDP in Venezuela was lower in 2004 than in 1995 and the current government seems set on a course that will deprive the people of Venezuela of their birthright and keep them mired in poverty.

Brazil, the largest country in the region, has a mediocre economic freedom performance by Latin American standards and a very poor one by world standards. It does slightly better than the Latin American average in rule of law, 4.2 out of 10 compared to the Latin American average of 4.0. Brazil's score in rule of law has declined by 1.6 points since 1995, worse than the average Latin American average decline of 1.0 points.

On its overall economic freedom score, Brazil at 5.9—ranking 88th out of the 130 nations in the full index—does rather worse than the Latin American average of 6.4, but this is still a substantial improvement over its score of 4.4 in 1995. Brazil's weak performance in economic freedom is reflected in its per capita GDP growth. The total increase between 1995 and 2004 is just 8.5%, worse than the regional average.

Numerous economic studies have shown that economic freedom is a powerful impetus to growth. However, over the short-term, small resource dependent economies like many in Latin America will be heavily affected by resource prices. As well, many Latin American nations have undergone wild swings in economic policy, such as Peru, which varied between 40th and 101st in the rankings between 1990 and 2001.

Despite this, nations that have built the strongest market economies have done considerably better than those where reform has failed to take hold. The nations with the four highest economic freedom scores in Latin America—Chile, Panama, El Salvador, and Costa Rica—have average per capita GDP that is 19.2 per cent higher than in 1995. This is more than five times the average growth of 3.7 per cent of the four worst performers, Venezuela, Colombia, Ecuador, and Guyana.

Latin America as a Region

The average score of all Latin American nations ranks the region 65th out of 130 nations in the index in economic freedom, tied with Namibia, Tanzania, and Uganda in 2004, the year in which the most recent data are available. Even worse, Latin America as a region ranks 85th in rule of law behind Russia, Senegal, and Uganda.

In 1995, despite half a decade of hesitant reform, Latin America's average score ranked it 48th out of 123 nations then in the economic freedom index, behind Botswana and Indonesia and tied with Hungary and Namibia among others. Latin America has always been particularly weak in rule of law. Despite some improvements in the first half of the 1990s, Latin America's average score in 1995 ranked it 83rd in the rule of law, tied with Bangladesh.

Economic Freedom and the Rule of Law

Douglass North, winner of a Nobel Prize in economics and a senior fellow at the Hoover Institution, describes the Economic Freedom Index as the best analytical description now available of efficient markets. The index uses 38 variables to rank economic freedom in five key areas: Rule of Law, Size of Government, Sound Money, Freedom to Trade, and Regulation. Economic freedom essentially describes the policies and institutions that contribute to creating freer and more prosperous societies.

Throughout history, only market-based economies have continuously improved the lives of their citizens. Prior to the establishment of modern market economies, the vast majority of the population lived short, unhealthy lives in abject poverty. That remains true in the modern world for those nations which have failed to establish well-functioning market systems. Unfortunately, many of those nations are in Latin America. Despite the obvious benefits of market-based economies, special and ideological interests continue to frustrate and reverse reform in Latin American.

The rule of law provides the infrastructure of a market economy and too many nations in Latin America do not have the legal infrastructure they need for success.

- Individuals cannot borrow to invest and create new prosperity and jobs without legal property rights.
- Successful businesses are targeted by the politically powerful when there is no rule of law.
- Contracts cannot be enforced by those without political connections, forcing businesses to depend on immediate sales and payment and hampering the economy.

Only Belize, Costa Rica, and Colombia advanced in the rule of law between 1995 and 2004, though Colombia started the period at a very low score and continues to under-perform the Latin American average. Belize and Costa Rica are in the top three in rule of law in Latin America along with Chile.

On average, Latin American nations retreated in the rule of law since 1995. Paraguay, Bolivia, Venezuela, Ecuador and Honduras have especially bad records, more than double the average decline in the rule of law index for Latin American. The five are also at the bottom in their rule of law score except for Bolivia, which comes in sixth. The other member of the bottom five is Nicaragua.

There are several key areas to reform under rule of law:

- *Judicial Independence*: In this variable, Latin America scored 2.8 out of 10, where 10 indicates the highest level of economic freedom, which would place it at 80th out of the 109 nations in the index for which these data are available. This represents a decline in this score of 1.4 points since 1995.
- *Impartial Courts*: In this variable, Latin America scored 3.2 out of 10, which would place it at 95th out of the 130 nations in the index. This represents a decline in this score of 1.6 points since 1995.
- *Protection of Intellectual Property*: In this variable, Latin America scored 3.1 out of 10, which would place it at 80th out of the 109 nations in the index for which these data are available. This represents a decline in this score of 1.5 points since 1995.
- *Military Interference*: In this variable, Latin America scored 5.8 out of 10, which would place it at 81st out of the 129 nations in the index for which these data are available. This is the only variable for which Latin America has not backslid since 1995.
- *Integrity of the Legal System*: In this variable, Latin America scored 4.5 out of 10, which would place it at 87th out of the 122 nations in the index for which these data are available. This represents a decline in this score of 1.1 points since 1995.

Although there are no immediate, simple solutions for building the rule of law, Latin American governments and the people of the region must focus on it as the number one priority to building a prosperous society and defeating poverty.

Economic Freedom of the World Annual Reports are available for free download at www.freetheworld.com.