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Feature Article

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The Institute for Economic Freedom is an independent non-political non-profit Bahamian institute that promotes economic growth, employment and entrepreneurial activity. It believes that this can best be achieved with a free market economy and a decent society...one that embraces the rule of law, the right of private property, the free exchange of property and services and the individual virtues of self-control, commitment and good will.

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Vol. 1/No. 1. The Caribbean Tiger: A Development Strategy for the Bahamas

Vol. 1/No. 2. Remarks by Nicholas F. Brady and Comments on the 1995 Bahamian Budget Debate

Vol. 2/No. 1. Fifty Years of Socialism

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Janet and the Trip to the Summit

In December of this year the Hon. Janet Bostwick, the Minister of Foreign Affairs, will travel to Bolivia to participate in the Summit of the Americas of the Organization of American States (the "OAS"). **The central theme for this conference is sustainable development and the environment;** and the Ministry Staff is now preparing for it. In this connection the following is intended as a briefing memo.

The OAS has held two major conferences this year already. The Miami conference addressed a number of issues, the most notable being free trade. The second held in Uruguay dealt largely with the internal problems of countries and the methods whereby the interests of significant minorities could be incorporated into the political mainstream.

This memo will deal only with the economic issues related to sustainable development. It will focus on the growth in Gross Domestic Product Per Capita and recent work on economic freedom as it applies to the OAS member states. The recent ground breaking work on the relationship of economic freedom and economic growth published by the Fraser Institute was introduced in the last issue of **The Review**.

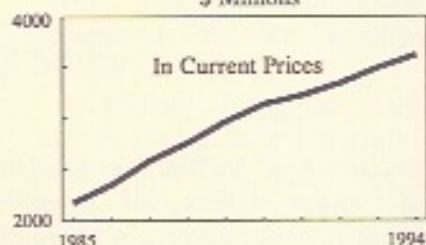
The Bahamas. Sustained economic growth is a major problem in the Bahamas as it is for all members of the OAS. Turning first to the Bahamas one can examine the Gross Domestic Product, the "GDP", for the period 1985 to 1994 and the effect of population growth and then inflation on this data. Such analysis focuses on the most accurate measure of the welfare of the average Bahamian.

The graph to the right shows Total Gross Domestic Product for the country as a whole. This data was presented by the Minister of Finance in his Budget Address. The data for calendar years 1985 and 1994 were estimated by the author based on the Minister's data. In current market prices GDP rose from \$2,176 million to \$3,620 million, an average annual increase of 6% per annum. (See Exhibit I.)

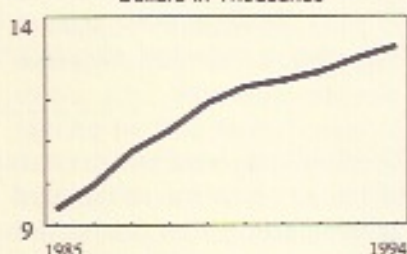
This data was restated to a per capita basis. During the period the population grew at an average annual rate of 2% per annum, GDP Per Capita grew from \$9,380 in 1985 to \$13,262 in 1994, an increase of 4% per annum.

During the period retail prices rose at an annual average of 5%. The GDP Per Capita in Current Prices is restated to constant 1987 prices, producing "real" GDP by eliminating the effect of inflation.¹ Real GDP per person started at \$10,193 in 1985, peaked at \$10,755 in 1987, declined to a low of \$9,092 in 1993 and recovered to \$9,153 in 1994. **On a per capita basis and when adjusted for inflation GDP declined at an average annual rate of 1% per annum for the period 1985-1994.**

Total Gross Domestic Product
\$ Millions



GDP Per Capita In Current Prices
Dollars in Thousands



GDP Per Capita In Constant 1987 Prices
In Dollars



¹ See note at end of article.

The data of the Minister of Finance included in the Budget Address indicates a modest recovery since 1994. This no doubt in part is the result of the actions taken by the FNM to date. But...

Are the actions taken sufficient?

Will the FNM program likely be associated with a level of sustained growth in excess of population growth?

Such a level of growth is the only solution to the country's major economic problem...jobs, the product of sustained growth.

The OAS. Fortunately, the December meeting of the OAS in Bolivia can provide valuable insights into the process of sustainable economic growth.

The table on the next page is taken from the previously mentioned study on the **Economic Freedom of the World**.² The objective of this study was to construct an Index of Economic Freedom and then relate it to economic growth. A listing of the factors used in the Index is contained in Exhibit II. The Study discovered a positive relationship between economic freedom and growth.

In the table selected countries are organized in three groups; the economic achievers, "High Freedom and Growth", the prime under-achievers, "Low Freedom and Growth" and "OAS". For the period 1985-94 Hong Kong and Singapore, two other island countries, are the best with astounding growth in Real GDP of 5.7 and 5.9% per annum. At the other extreme Zaire declined at -5.3% per annum. Among the OAS countries Chile was clearly the star performer.

² James Gwartney, Robert Lawson & Walter Block, **Economic Freedom of the World 1975-1995**, co-published by twelve economic institutes in twelve countries and printed by The Fraser Institute, Vancouver, Canada, 1996.

Freedom and Growth in Selected Countries

Country	Index of Economic Freedom Average		Change in Real GDP Per Capita in % per annum	
	1975	1993-95	1980-90	1985-94
High Freedom and Growth:				
Hong Kong	9.2	9.2	5.4	5.7
Singapore	6.8	8.2	5.2	5.9
OAS:				
Chile	2.8	5.8	1.9	4.8
Argentina	3.1	6.3	(2.3)	2.2
Costa Rica	5.2	6.7	(0.4)	2.1
Mexico	5.0	5.8	(0.3)	1.2
Brazil	3.2	3.3	(0.6)	0.8
Guatemala	6.5	6.5	(2.0)	0.6
Venezuela	6.9	4.5	(1.7)	0.2
Bolivia	5.5	6.4	(2.4)	0.1
Honduras	7.4	5.5	(0.9)	(0.1)
Peru	3.7	5.9	(2.8)	(0.7)
Bahamas				(1.1)
Nicaragua	6.4	3.3	(3.8)	(3.8)
Low Freedom and Growth:				
Syria	3.7	2.6	(1.2)	0.6
Zaire	3.6	1.9	(2.0)	(5.3)

Note: Factors included in the Index are rated on a 10 point scale.

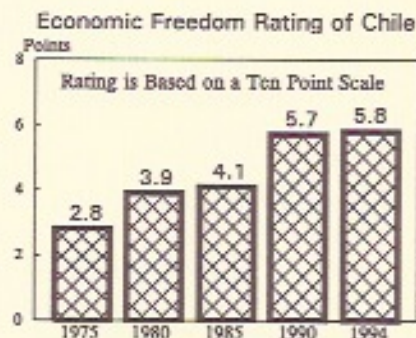
All countries were clearly affected in the 1980-90 period by the world wide recession and debt crisis of 1982. A noticeable feature of the table is that there is not the clear and precise relationship between the Index and Growth for all countries. Nevertheless, the economic growth of Chile is a direct result of reforms initiated by General Augusto Pinochet and the decline of the Nicaraguan economy reflects the political conflict there. In all OAS countries economic freedom and growth do not come close to the economic achievers of Asia.

The Bahamas was not included in the Study; but the growth data for 1985-94 is shown for reference purposes.

It clearly indicates that the Bahamas is one of the poorer performers in this OAS group.

Chile. The economic growth of Chile highlights the importance of economic freedom. This is shown in the graph at the right and the preceding table. "In 1975, only 7 countries had a lower economic freedom rating...than Chile. The economy was characterized

by monetary instability, hyperinflation, large government expenditures, high taxes, and restrictions on international transactions. Things began to change for the better during the latter half of the 1970s.³ The story behind these developments was controversial then, remains so and merits further comment.



Modern Chilean history can be broken into three periods:

1929 to 1973. After the Great Depression Chile earned the

³ Ibid, p. 130-131.

description, "the fatherland of the state."⁴ The government filled an ever increasing role in the economy and society. It became the promoter of business activity, an industrialist in its own right, controller of capital, credit, foreign exchange rates and interest rates, advocate of strong powerful unions, redistributor of income. In foreign trade for example, there were multiple exchange rates, import quotas and bans, tariffs that averaged 94 percent plus prior deposits on imports. The country moved inexorably down the road of socialism, a trend in part nourished and supported by the United Nations Economic Commission for Latin America.

This march to the left reached its apex in September 1970 with the election of the Communist government of Salvador Allende. President Allende rapidly nationalized the banking system and expropriated land on a large scale. It sought to dismantle the "bourgeois state" and "monopoly capitalism" and curtail private property rights. The man of the 70s seemed to be a Chilean Ché Guevara.

After a very brief period political and economic chaos developed. "Political life gradually became an alternative defined by opponents as a choice between communism or fascism".⁵ Wages grew rapidly, subsidies to state enterprises mushroomed, the fiscal deficit soared and inflation reached 605.1 percent in 1973.

1973-1990. In September 1973 the military, which historically had been non-political by Latin American standards, staged a coup under General Augusto Pinochet and assassinated President Allende. The economic plan, known as "El ladrillo [the brick]"⁶ because of its physical size, was rigorously

⁴ Juan Gabriel Valdés, **Pinochet's Economists: The Chicago School in Chile**, Cambridge University Press, Cambridge, England, 1995, p. 100.

⁵ Ibid, p. 243.

⁶ Ibid, 252.

implemented. Its goals were to reduce the public sector, minimize government regulation, privatize government owned business, and privatize the social security system. It freed interest rates and prices, unified the exchange rate, reduced tariffs to 10% and eliminated all trade barriers. It introduced a Value Added Tax, created a fiscal surplus in fiscal 1979-81 and fragmented union power.

The plan called for a complete change in the public policy framework, the value system and the institutional structure that developed over a 44-year period. **A determined military dictatorship forcefully moved the country from national socialism to an "economically free", more internationally orientated society.**

1990 to Date. Democracy returned to Chile in 1990 with the election of Christian Democrat Patricio Aylwin and a constitution that retained General Pinochet as army commander-in-chief until 1997. President Aylwin ended his term peacefully amid an aura of successful economic management.

The Chicago Boys. As the above brief narrative suggests Chile was the site of a struggle of epic proportions and one very notable participant was a group of Chilean economists known as "The Chicago Boys". This cohesive group developed from a university-to-university program created by the joint effort of three entities.

The U. S. government, specifically the International Cooperation Administration, saw the need to promote economic development and strengthen non-communist forces in developing countries. It saw the need for trained economists and university-to-university programs as the solution. It had the funds to finance such endeavors.

The University of Chicago's Department of Economics over a long period developed a "school", a body of neo-classical

theory that it actively applied to the problems of the world. These problems included the investment in human beings, price controls, inflation, protective tariffs, public education, etc. Chicago had a group of professors who saw an opportunity to apply their science to the problems of Latin America.

The Catholic University of Santiago in the early 1950s was without an economics program. It witnessed the impact of the socialist and Marxist economists trained at the University of Chile, a phenomenon occurring in virtually all Latin American countries. It sought partners to rectify its deficiency in economics.

On March 29 and 30, 1956 three-year contracts were signed by the participants. Immediately leading professors from Chicago established an undergraduate economics department and a research center at the Catholic University. Between 1957 and 1973 100 Chileans did graduate studies in economics at the University of Chicago. They returned to Chile as professional economists to teach, do research and work in business and government. They formed a rigorous and cohesive Chilean school of economics and became known as "The Chicago Boys".

For years their work went unheralded within Chile. As the struggle progressed and politics became more highly polarized the Chicago Boys moved into the political mainstream, produced "el ladrillo" and provided the economic leadership of the Pinochet government. The struggle was not without significant reversals and involved two distinct generations of economists. In the end the Chicago Boys left an indelible stamp on Chilean society and its position in world. **Chile did not follow in the economic footsteps of either the world's military dictatorships that typically favor increasing state economic controls or Cuba. Chile's decisions are an important, lasting contribution to the Western Hemisphere.**

The Bahamas. In making the trip to the Summit it will be easy, as at all international conferences, for the participants to become consumed in rhetoric and photo opportunities that play well back home. This is a political need that cannot be dismissed.

But there are lessons to be learned at the Summit, particularly those related to sustained economic development. This is the country's major economic problem; and it is hoped that the Bahamas helps focus the conference on these issues.

Note on Inflation Adjustment:

The inflation adjustment is the biggest one made in going from the Total Gross Domestic Product for the Country to "Real" GDP for each Bahamian. This adjustment was made using the Retail Price Index for New Providence as produced by the Department of Statistics. For this purpose this is the next best technique to the use of a Price Deflator for National Income Accounts. The development of such a deflator is a goal of the Department of Statistics.

Gross Domestic Product Per Capita of the Bahamas

1985-1994

Sources:	GDP in Current Prices in \$ Millions	Population	Per Capita GDP in Current Dollars	RPI N.P. 1987= 100 **	Per Capita GDP in Constant Dollars
Year	1	2		3	
1985	2,176.2 *	232,000	9,380	92.4 *	10,193
1986	2,350.3	236,000	9,959	97.5 *	10,231
1987	2,581.2	240,000	10,755	100.0 *	10,755
1988	2,756.7	245,000	11,252	107.9	10,402
1989	2,963.7	249,000	11,902	112.8	10,526
1990	3,134.0	255,000	12,290	120.4	10,096
1991	3,222.3	259,000	12,441	128.2	9,408
1992	3,341.0	264,000	12,655	132.7	9,138
1993	3,493.0	269,000	12,985	136.2	9,092
1994	3,620.5 *	273,000	13,262	138.2	9,153

Average Annual Growth in Per Cent Per Annum:

5.84 1.82 3.95 4.59 (1.13)

* Estimated by author.

** Retail Price Index for New Providence; see note on page 9.

Sources:

1. Ministry of Finance, Budget 1996-97
2. Demographic Yearbook 1980 and The Bahamas in Figures 1995
3. The Bahamas in Figures 1995, Dept. of Statistics

Elements Measured in the Index of Economic Freedom

1. Expansion of Money Supply
2. Variation of Change in Rate of Inflation
3. Freedom of Resident to Own Foreign Currencies Domestically
4. Freedom of Citizens to Maintain Bank Balances Abroad
5. Freedom to Engage in Capital Investments/Transfers with Foreigners
6. Government Consumption Expenditures as Percent of GDP
7. Government Enterprises as a Share of the Economy
8. Extent of Price Controls on Goods and Services
9. Freedom of Enterprises and Cooperatives to Compete in the Market place
10. Equality of Citizens under the Law and Access to a Nondiscriminatory Judiciary
11. Government Regulations and Policies that Cause Negative Interest Rates
12. Transfers and Subsidies as a Percent of GDP
13. Top Marginal Tax Rate and Income Threshold
14. Non-Voluntary Military Conscription
15. Average Tax Rate on International Trade
16. Black Market Exchange Rate Premium
17. Size of the International Trade Sector

Views of Economic Freedom Institute on Day Care Centres

LETTERS TO THE EDITOR

EDITOR, The Tribune,

Your editorial of July 16th indicates that the Prime Minister intends to pay the salaries of personnel at the day care centre at Workers House and presumably wherever such centres are operated. You were quite right in pointing out the adverse implications of what appears to be a benevolent "political" act that benefits a chosen few at the expense of all.

The twin acts of licensing day care centres and subsidizing their operations with the tax payers' money is the perfect example of socialism at work in a democratic society.

The apparent logic is as follows. Licensing is done on the grounds that parents are unable to judge the competency of a day care worker or centre. They do not look at alternatives and will not exer-

cise their parental responsibility to choose a proper home away from home for their loved ones. In contrast the state believes that it is anointed with a special wisdom to deal with this; and it takes on the responsibility to protect the health and welfare of the child. It assumes some measure of the parent's responsibility.

Then the government without publicly establishing a national need for action expresses its appreciation to one entrepreneur, the Workers Union, by "pitching in and paying". The FNM which has been critical of past government employment excesses now finds a reason to expand government under a new guise. Without a clear national need to act it takes money earned by all its citizens and gives it to some in the form of government licensed and subsidized day care.

Such government actions have been the modus operandi of compassionate democratic governments everywhere. The govern-

ment's discretionary spending of tax revenues deprives the individual of his discretionary spending. The social and economic cost of such programs...their results versus their intentions...have only recently been thoroughly documented. The fourth issue of the Review of the Institute for Economic Freedom that is now in distribution makes several points that are relevant.

"When a government plays favorites - when it takes from one group in order to make transfers to others...the government becomes an agent of plunder. Such actions conflict with economic freedom.

"Countries that had improved Economic Freedom ratings experienced economic growth; those with ratings that declined experienced economic decline."

It is hoped that your editorial of July 16, 1996 and the most recent Review of the Institute for Economic Freedom do not go unnoticed.

August 2, 1996

Views of Economic Freedom Institute on minimum wage

LETTERS TO THE EDITOR

EDITORS, The Tribune & Guardian,

On Thursday, September 19, Prime Minister Hubert Ingraham announced an increase in the minimum wage for all government employees and stated that it is "a darn good wage by any standard anywhere, any time." Immediately the Opposition demanded that this action be extended to the private sector.

The forthcoming election makes this the season for measures with political appeal...measures intended to produce greater economic justice. In the case of the minimum wage this is done despite the almost unanimous opinion of economists that in the private sector an increase in the minimum wage produces unforeseen results that are the opposite to that intended.

In the case of the government action, added

funds...taxes...will be taken from present and future taxpayers (through the vehicle of added public debt) to provide added income for some government workers, a forced transfer of funds from one group of citizens to another. It is done on the basis of a judgement on economic equity and is packaged with other actions that may increase worker productivity.

In the case of the Opposition proposal the government would mandate the payment of higher salaries by private enterprise to the lowest skilled workers on the employment ladder. The effect of such a proposal would be to reduce the jobs available to such workers...to increase unemployment.

To see this more clearly one should look to the United States and the effect of minimum wage legislation on black teenagers.

"The American minimum wage law, the Fair Labor Standards Act of 1938, remained essentially unchanged until 1950. By that time, the

inflation that began during World War II had in effect repealed the law by raising wage rates for even unskilled workers above the level specified in the Act. As of that time, teenage unemployment was not appreciably higher than that of older workers, and black and white teenagers also had very similar unemployment rates. Beginning in 1950, however, Congress passed a series of minimum wage increases over the years, while also spreading the coverage of the law to new low-wage sectors that had been exempt previously. Over the next three decades, teenage unemployment rose relative to the unemployment of older workers and black teenage unemployment rose far above white teenage unemployment. By the 1970s, black teenage unemployment had risen to several times what it had been in 1950. At no time during the three decades after 1950, not even in the most prosperous years, was black teenage unemployment as low as it had been in 1949--a recession year."

(Source: Thomas Sowell, **Race and Culture: A World View**, Basic Books, 1994, p.

94 and Walter E. Williams, **Youth and Minority Unemployment**, Hoover Institute Press, 1977, p. 14.)

A private employer must earn a margin over his out-of-pocket costs for every resource that he utilizes. He will hire low-skilled beginner workers if he can absorb the costs of on-the-job training, disruption caused by lack of discipline, high employee turnover, etc.. For any worker, getting on the lowest rung of the job ladder is an important milestone in life; generally in the private sector one remains on this rung for a relatively short period of time. The acquisition of basic job skills facilitates the move to more productive and better paying positions.

In the season of political promises, the public should be aware of the unintended consequences of an obligatory increase in the minimum wage in the private sector...namely, higher unemployment for the unskilled. Is this a good deal? Not at all.

September 27, 1996.