PROPERTY RIGHTS, LAND REFORM, AND ECONOMIC WELL-BEING

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Introduction

The basic premise of this paper is the belief that ownership enhances economic performance. Aside from token reference to political stability, little or no reference is usually made to the role of property rights in economic development.[1] Nevertheless some economists have recognized that the assignment of property rights is an important step in promoting a higher standard of living for any country's citizenry.

By pursuing different economic policies, governments can alter the allocation of property rights and, in so doing, can also alter the economic and political environment of a given country. At one extreme, governments can choose to promote an environment conducive to the use and exchange of private property. At the other extreme, they can promote the egalitarian distribution of property rights, including the enforcement of communal ownership.

Two basic political options are available to these governments. One option can be characterized as a political laissez-faire, that is, a process in which individuals express their choices through democratic elections. The other option is one in which the government curtails liberties and makes many or all the choices for the people.

A widely held view in Latin America postulates a trade-off between political freedom and economic prosperity. A cursory examination of many Latin American countries seems to support this view. In general, most of the Latin American countries where civil liberties are

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[1]"Property rights" is defined here as rights associated with uses of economic goods. These include rights to make decisions as to the use and transferability of the goods in question.

most rigorously observed are countries with a redistributive economic system. Examples include Jamaica during the Michael Manley administration, and Chile during the Eduardo Frei and Salvador Allende administrations. Although not technically part of Latin America, Puerto Rico is another example. Similarly, many of the high-growth countries in the early and middle 1970s did not have true democracy—for example, Chile under the military junta and Panama under Omar Torrijos—or, if they did, it was an autocratic government as the Dominican Republic had during Joaquin Balaguer's presidency.

The assertion that Latin American countries must make a choice between political freedom and economic freedom is not only unnecessary but misleading. If anything, political freedom is an important condition for economic prosperity, and vice versa. In the absence of economic freedom, political freedom ultimately is undermined. Symmetrically, without political freedom, economic freedom ultimately is lost to the pervasive power of the government. Both conditions foment change—either toward more freedom or toward curtailment of civil and economic liberties. In some cases the change occurs within a democratic system. Countries may move to the left, as was the case of Chile under Allende, or to the right, as in Jamaica under Edward Seaga. At other times the change may occur abruptly with bloodshed, as happened in Chile under Augusto Pinochet and in Nicaragua under the Sandinistas.

Political freedom and economic freedom complement one another. The role of personal incentives provides a strong argument against government intervention and an equally strong argument for individual freedom. Economic growth will occur in the property rights structure if a country makes socially productive activity worthwhile.

The possibility of changing ownership in private firms leads to specialization in the ownership where owners find their highest return. The possibility of changing ownership leads to a stronger association between efforts and rewards.

The Role of Government

Two important aspects of the relationship between government policies and property rights are (1) the effects of government policy in the allocation of property rights, and (2) the effects of property rights on political stability.

Historically, governments in the Western world have provided protection for and enforcement of property rights. In such a world, rational economic agents respond to incentives, and resources are allocated to their highest-valued uses. Similar arguments apply to

the allocation of factors of production across countries. That is, in the absence of any friction, such as transportation cost and/or taxes, differences in prices, wages, and rates of return on capital across domestic and national boundaries are eliminated either through trade in goods or by factor movements (that is, migration and/or foreign investment).[2]

Through tax and expenditure policies, governments can alter the assignment of property rights. Such changes, however, affect incentives to invest in productive activities within their political jurisdiction, as well as the choice of investments.

It has long been recognized that the economic unit on which taxes are levied is not necessarily the unit that ultimately will incur the full cost of the tax. The final incidence or burden of a tax is dictated by price sensitivity, or elasticities of supply and demand for a good or factor on which the tax has been levied.[3] In either case, the more elastic (price sensitive) the supply, the lower the ability of the government to tax that factor of production. Similarly the lower the elasticity, the higher the government's ability to tax the factor of production.[4]

Supply elasticity may be large for one of two reasons. First, the factor of production is highly mobile across national boundaries; any attempt to lower its after-tax return below the return earned in the rest of the world will cause the factor to leave the country. Second, the factor of production has the ability to switch easily to other nontaxed activities (the underground economy, leisure, etc.); any attempt to lower its after-tax return will cause the factor to cease performing the taxed activity.

A strong argument can be made that in Latin America the least mobile factors are unimproved land and unskilled labor. The most mobile factors are capital and skilled labor. The above analysis suggests that broadly speaking, any attempt to tax mobile factors will result in those factors switching to nontaxed activities or migrating from the country.

The inability to tax a mobile factor directly is generally recognized by governments throughout the developing world. Evidence of this exists in the various forms of tax-holiday programs, free zones, or other methods of exempting mobile capital from domestic taxes.

[2]The conditions under which trade in goods is sufficient to equalize factor prices are well documented in the economic literature. See, for example, Samuelson (1948). For the effect of factor mobility on the equalization of factor prices, see Mundell (1957).

[3]On this issue, see the classic paper by Harberger (1962).

[4]For a discussion of the optimal tax structure along the lines discussed in the text, see Canto and Joines (1983).

Nontraditional exports also are granted partial or total tax exemptions. By contrast the consumption of luxury goods (air conditioning, automobiles, etc.), as well as traditional exports (usually agricultural products), is heavily taxed.

Governments, however, typically fail to recognize that any attempt to tax indirectly those factors of production that are mobile ultimately will be borne by the immobile factors. A tax on traditional exports, for example, will induce a reduction in the amount of capital utilized in the agricultural sector. Furthermore, since capital is mobile, the after-tax return earned in agriculture must be the same as in all other activities either inside or outside the country. The burden is borne by those fixed factors. Farm wages and the return to land will decline.[5]

This analysis suggests that depressed rural wages and the apparently inefficient production techniques used by landowners are attributable neither to exploitation nor lack of entrepreneurial ability. Rather, they are the direct result of the government's overall domestic policies. Over time this effect becomes even more pronounced. The tax burden reduces the landowners' incentives to improve or to keep up the quality of the land (less fertilizer is used, etc.). As this occurs, productivity and the salaries of farm workers decline.

The cost of political instability also is borne disproportionately by the least mobile factors—the land and unskilled labor. From an economic perspective, political instability raises the risk of reassignment of property rights. The result is not only reduced incentives to engage in productive activity but also the creation of incentives to devote resources to uses intended to minimize the potential economic losses arising from the loss of property rights.

The notion of political risk in the economics literature generally has been confined to risk analysis of countries. Such analysis usually deals with the possibility of an investment in a politically unstable country being expropriated with no compensation. Traditionally the way foreign investors have dealt with such risk has been by increasing the required rate of return on their investment. The end result has been lower foreign investment and, as a consequence, lower employment levels and wages within the country in question.

Outright expropriation with no compensation is rare. More common is inadequate compensation or incomplete expropriation. Examples of incomplete expropriation abound, in such forms as exchange controls and taxes. An example of inadequate compensation would

[5]A formal analysis of these propositions is developed by Canto (1983).

be land reform where landowners were not paid a fair market price for their land.[6]

In the case of unskilled labor and land, there are striking similarities between inadequate compensation and incomplete expropriation. Because the incidence of direct and indirect taxes ultimately is borne by the fixed factors of production, the after-tax return to unskilled labor and land will decline as taxes rise anywhere in the economy.

A similar phenomenon may be true of land reform. In the case of partial expropriation through inadequate compensation, landowners clearly will suffer a loss of wealth. The effect of land reform on the wealth of rural workers, however, is not at all clear. Initially, giving the expropriated land to the workers increases their wealth. But to the extent that the political risk of the country increases, the required return on capital will increase. Hence the sum of workers' wages and the return to land will decline. In addition, to the extent that rural workers and land remain the inelastic factors of supply, they will ultimately suffer the burden of any increase in taxes to fund land reform and associated credit policies.[7]

Land reform is merely another attempt to redistribute wealth by taking from the rich and giving to the poor. However, economic forces that are beyond the control of any small country typically frustrate such attempts. The experience of land reform in Mexico—the *Ejido*—provides a clear-cut illustration of the fallacy of attempting to improve the economic well-being of the poor through land reform.

Mexican Land Reform: *Ejido* versus Private Sector Farms

Mexican land reform was introduced by legislation during the years 1915 to 1917. The unit of land that is distributed to rural workers is called an *ejido*. Each *ejido* consists of two kinds of land: noncultivatable land, which is essentially an open range used collectively; and cultivatable land, which may be farmed either individually or collectively by members of the *ejidos*.

The *ejidatarios* receive a use title that may be passed on to their heirs. Otherwise, land tenure is a nonnegotiable item. The security of the land is determined only by the *ejido* holder's presence in the community to defend his title. *Ejidatarios* have no right to sell, rent,

[6]The analysis presented assumes that current landowners are the rightful owners of the land. If they have acquired the land by illicit means, however, our analysis suggests that as a guarantor of property rights, government should develop the proper mechanism for the rightful owners to reacquire their land.

[7]See Canto (1983).

lease, or mortgage their allotment of land. This restriction is intended to be a safeguard against the upper classes reacquiring large land holdings through foreclosure.

In general, arguments for land reform have been associated with political objectives. Increasingly, however, a focus on economic analysis is being used to justify land reform. The bulk of these economic analyses compare the productivity of the land-reform sector with that of the nonreformed, private sector. Several recent studies, including those by Dovring (1970), Muller (1970), and Nguyen and Martinez (1979), have provided evidence that contradicts the view that the land-reform sector is inefficient.[8]

The Nguyen and Martinez study's statistical analysis yields some interesting results:

- Both *ejidal* and private-sector farms exhibit positive rates of returns.
- The mean marginal yield for *ejidal* farmers is higher than for private-sector farmers.
- *Ejidal* farmers have a lower elasticity of returns to total expenditures than do private-sector farmers. The authors attribute this, in part, to the higher average marginal yields of *ejidal* farmers.

The empirical results reported by Nguyen and Martinez provide convincing evidence that the productivity of *ejidal* farms is as good if not better than that of private sector farms. These results, however, are somewhat misleading.

The higher marginal return of *ejidal* farmers is easily explained in terms of credit availability. *Ejidatarios* do not hold title to their land and cannot pledge their land as collateral. The only collateral they can use is their future crops. This limitation increases the risk of lending to *ejidatarios*. Consequently, either *ejidatarios* will be charged a higher interest rate or only the most productive—or lower-risk—*ejidatarios* will obtain loans. Either alternative explains the higher marginal yield of the *ejidos*.

In addition, the Nguyen and Martinez analysis of the productivity of *ejidal* farms overestimates their profitability. Nguyen and Martinez do not incorporate into their cost calculation the value of the time spent by *ejidatarios* and their relatives working on the *ejidos*. One common argument made to minimize this omission is that unemployment in the developing nations is so great that for all practical purposes, labor can be considered a free resource.[9] This argument,

[8]An interesting discussion on the *ejido* system is found in the cited publications.

[9]This assumption is commonly used in the evaluation of public projects in developing countries. For a discussion of the fallacy implicit in such an assumption, see "Social Opportunity Cost of Labor" in Harberger (1974).

however, does not change the fact that private sector farmers must pay wages to their workers. Thus, given that in some sense *ejidatarios* or their relatives have the option of working on private sector farms, their work time should be valued at the going wage rate. Moreover, the *ejidal* sector has a considerably higher labor/land ratio without having a higher yield per unit of land. It necessarily follows that once the value of the *ejidatarios* is factored into the total cost, the *ejidos* are substantially less profitable than private-sector farms. Furthermore, the higher labor/land ratio and equal yield of *ejido* farms suggest that people in the *ejidal* sector have a lower standard of living than those in the private sector.

Although in principle *ejido* land can neither be rented nor sold, and is transferable only to the user's heirs, in practice much of it has been rented for many years to outsiders or has been sold in violation of the Mexican constitution. The agrarian authorities may have been unable or unwilling to stop this practice.[10] One of the many ways the *ejido* land transferability limitation is circumvented is through sharecropping arrangements. The sharecroppers are basically small businessmen who maintain a labor force of their own and, in many cases, provide financing for the crops. As part of the basic arrangement, they lend the *ejidatarios* a sum of money to sharecrop the land. The "loan" does not bear interest and is not repayable until such time as the landowner decides to discontinue the sharecropping arrangement. As a rule of thumb, the sharecroppers keep 50 percent of the profits, which gives them an equity position in the land. In short, the sharecropping arrangement is one way to circumvent the sale, lease, and rental restrictions on *ejido* property.

The sharecropping arrangements also defeat the basic objectives of the *ejido* system: to break up monopolistic control of the land and to create a symmetrical social and economic relationship between peasant and landholder. Ironically, now that the *ejidatarios* (who were formerly landless peasants) own the land, they have become dependent on landless sharecroppers. To the extent that sharecroppers, who are a mobile factor, hold control over the *ejidatarios*, they will capture a larger share of the profits than the *ejidatarios*, thereby defeating the basic objectives of agrarian reform.

In short, after 60 years, land reform in Mexico has had little or no impact on the distribution of income or wealth among its citizens. Moreover, while Mexican land reform has done well in terms of productivity (output per acre of land) and employment objectives, it

[10]On this issue, see Stavenhagen (1973).

has done little to improve the standard of living of the country's formerly landless peasants.

Land Reform in El Salvador

El Salvador's land reform is viewed by many as a direct result of U.S. foreign policy during the Carter administration, and as continued through the Reagan administration.[11] The political motives for the land reform are fairly well established. In the words of Secretary of State George Shultz, "Promotion of land reform stands at the very heart of El Salvador's effort to encourage social equity, political stability and economic development."[12] The land reform consisted of three phases: phase I was to nationalize all farms in excess of 1,250 acres, and phase II was to expropriate farms of between 250 and 1,250 acres. For political reasons, phase II has not been implemented.[13] Under phase III, El Salvador's bank must give priority to the newly financed cooperatives under the land reform. The big farms held by the oligarchy—194 in all, accounting for 11 percent of the land—were nationalized and converted into 317 cooperatives with some 31,000 members.

In 1982 proponents of the land-reform program cited a study that found first-year production of the land taken under phase I to have declined by perhaps 10 percent. The study also noted that second-year production had rebounded and was expected to increase by 10 to 20 percent. Alternatively stated, proponents of land reform said that the reform had no adverse effect on the productivity of the expropriated farms. This information was then used as evidence that reform had not caused severe economic damage and had solved many of the grievances of the previously landless Salvadoran peasants.[14]

If the Mexican experience is any guide, a strong case can be made that productivity figures quoted in the El Salvador study do not provide evidence of an improvement in the distribution of income. One only needs to be reminded of the fact that the "benefactors" of land reform use a considerably higher labor/land ratio without having a higher yield than private sector farmers. The evidence available three years after the March 1980 land reform indicates that except

[11]A brief account of U.S. policy toward El Salvador is presented in "Democracy When It Suits" (1982) and "Salvador's Fibrillating 'Heart' " (1984), as well as in Alfamiano (1982).

[12]See "Salvador's Fibrillating 'Heart' " (1984). For a very persuasive counterargument to Shultz's views, see Ayau (1984).

[13]For a discussion of the measures adopted to curb land reform, see Sieb (1982).

[14]See, for example, Prosterman (1982).

for corn and bean production, the production on nationalized farms has fallen: Coffee production declined by 50 percent, sugarcane by 43 percent, and cotton by 55 percent.[15] These results were contrary to the initial expectations of proponents of the reform.

The decline in agricultural output on nationalized farms is attributable in part to El Salvador's war effort. The U.S. embassy in El Salvador estimates that of the 325 farms turned into cooperatives under the land reform, 40 are in the war zone, 95 are holding their own, 95 have serious problems that may be resolved, and 95 are beyond hope. This indicates that even after accounting for misfortune and the fall in international prices, production undeniably has declined. It necessarily follows that the standard of living of peasants in the land-reform sector will be below that of private sector farmers. Whether their well-being increases compared to their previous status will depend upon whether titles to the land are transferable through sale, rent, or lease.

The combination of land reform, depressed international prices, and civil war has caused many of the employees-turned-land holders to look for employment elsewhere. At many nationalized farms the wage rate has been slashed by more than the decline in international prices.

If land titles could be sold, then those individuals who acquired land from the 1980 reform but who lacked entrepreneurial capacity and sufficient credit-worthiness would sell their titles, and land would flow to more productive uses. In addition to their wages as employees, these individuals would receive a one-time wealth transfer from the sale of their land. On the other hand, those peasants with entrepreneurial capacity and sufficient credit would have an incentive to retain titles to their land. And, to the extent that these individuals make up only a small fraction of the population, land tenure would quickly revert to the pre-reform ways. The option to sell one's property title, however, appears to have been already ruled out by Decree 207, which makes it illegal for new owners to sell or rent their land.

If this decree remains in place, it is likely that Salvadoran ingenuity, like that of the Mexican *ejidatarios*, will find a way to circumvent the restrictions on the sale of land. Sharecropping arrangements can be expected to flourish as peasants lacking entrepreneurial capacity and/or credit enter into sharecropping agreements. Again, the new landowners will be better off to the extent that they receive one-time, interest-free loans to enter into sharecropping agreements.

[15]Corn and bean production were maintained because of the larger acreage devoted to these staples. See "Salvador's Fibrillating 'Heart' " (1984).

Such an arrangement, however, will ultimately reduce the efficiency of the land-reform sector. Because the land is nontransferable, the land-reform sector will be a higher credit risk. Productivity of the land and the well-being of the farmers may be reduced further if the land-reform program does not take into consideration the fact that some plots of land in El Salvador are often left fallow for one to four years. This consideration alone suggests that the plots will have to be two to five times larger than at present to support the farmers.

Several other economic considerations further reduce the attractiveness of the Salvadoran land-reform program. The reform will impose an enormous and costly administrative burden on the government. Also, to the extent that the farmers truly pose a high risk to lenders and that the sources of funds dry up, the government will have to develop special credit programs, thereby further distorting the economy. In addition, to the extent that funds are fungible, there is no guarantee that the funds lent will be put to the use for which they were ostensibly borrowed.

Evidence of poor production in land-reform farms is well documented.[16] Consider, for example, the poor performance of the cooperatives. A recent U.S. Agency for International Development (AID) report says that cooperatives have a larger-than-needed labor force. This evidence clearly indicates that phase III has not improved management.[17]

Another consequence of the land reform is that it reassigns property rights, which in turn creates an environment of economic uncertainty. This not only results in reduced incentives to engage in productive activities but also creates incentives to devote resources to uses intended to minimize potential economic losses from arbitrary property rights reassignment. Such activity would include attempts by the upper classes to relocate a portion of their wealth outside the jurisdiction of the Salvadoran government. These symptoms are already evident in El Salvador. As the business community attempts to take capital out of the country, these outflows create substantial balance-of-payment pressures. Rather than pledging to guarantee the property rights of business owners, the Salvadoran government has responded to the outflow by nationalizing banks and export companies, thereby further increasing the country's political risk.

Additional side effects of the land reform include capital losses suffered by previous landowners paid in government bonds for their

[16]On these issues, see Schuster (1982a, 1982b). More recent information points to the continuing decline in production; see, for example, "Salvador's Fibrillating 'Heart' " (1984).

[17]See "Salvador's Fibrillating 'Heart' " (1984).

confiscated farms. These bonds are trading at 50 percent of their face value. Many farmers, as a result of the uncertainty surrounding phase II of the land reform, did not bother to plant any crops on their farms because of the risk of expropriation.[18]

The net effect of this increase in uncertainty from the land reform and its accompanying policies has been to increase the return required by potential foreign investors. In other words the availability of private capital, an already scarce resource in El Salvador, will more than likely decrease in a significant manner. With less capital to work with, the overall efficiency of the economy is likely to decrease, *thereby reducing the overall well-being of* the Salvadoran people.

Other available information on El Salvador suggests that many of Mexico's experiences with the *ejido* system will be repeated in El Salvador if land reform as advocated by the United States is fully implemented.

Failure of the Redistributive Model

In light of the experience of other Latin American countries, the available data for El Salvador suggest that Salvadoran land reform may radically alter property rights and increase political risks in that country.[19]

The net effect of these policies will reduce direct foreign investment and result in significant capital outflows. Judging from recent experience, the expected reaction of the government will be to infringe even further on current property rights, which in turn will only reduce the efficiency and overall level of economic activity in El Salvador.

The productivity of the land-reform sector (output per acre of land) may be as high as that of the private sector. It is highly unlikely, however, that land reform will lead either to a more equitable distribution of wealth and income or to a generalized improvement in the standard of living of the country's poor. Land and unskilled peasants are the least mobile factors of production. As such, the burden of financing government expenditures ultimately will fall on them, thereby reducing their after-tax income.

The problems of insufficient income among the rural peasants in El Salvador, as well as in other developing nations, are fundamentally economic problems. As such, they require an economic, not a political, solution. Using the Latin American experience as a guide,

[18]See Schuster (1982a, 1982b).

[19]See Ayau (1983) for a persuasive argument that much of Guatemala's political unrest can be traced to its 1952 land reform legislation.

numerous examples can be found in which politically motivated redistributive policies have failed. Examples include those involving Chile during the administrations of Eduardo Frei (1964–70) and Salvador Allende (1970–73).

The objectives of the Frei administration included the nationalization of major industrial companies and utilities. In its first year, the administration instituted a wealth tax to finance these programs. This led to substantial increase in government expenditures. The Frei administration relied mainly on internal deficit financing and introduced a "crawling peg" exchange rate system. Continued currency devaluation averaged 30 percent per year.

The Allende government may be viewed as having carried to their logical extremes many of the reforms initiated by the Frei administration and now advocated by the U.S. government for implementation in El Salvador. Under the Allende administration, property rights were abrogated throughout the economy. Major industries and utilities were nationalized, a comprehensive welfare system was enacted, and price controls on food products were instituted. Unemployment was fought by increasing employment in government-owned mines. The goal was full employment, income redistribution, and price stabilization. Real wages and social security pensions were increased by 32 percent. The tax system also was made more progressive, wealth taxes were eliminated for the lower third of the population, and the income tax exemption was raised to two times the *Sueldo Vital* (the minimum guaranteed salary), thereby essentially excluding 20 percent of the population from paying the tax.

All this led to a dramatic increase in government expenditures as a share of gross domestic product. By 1973 this ratio had reached an all-time high of 43 percent. The Allende government lost most of its international credit, owing in part to political pressure from the United States. Money creation became the only viable route to finance public expenditures. Money supply growth accelerated from 35 percent in 1965 to 345 percent in 1973. In the same period, inflation spiraled upward from 29.3 percent to 316 percent.

As a result of rigid price controls, black market activities flourished. The government's nationalization policy contributed to substantial capital outflows. These factors, combined with galloping inflation and work stoppages, led to the collapse of Chile's government. The economic and political crises produced by the failure of these policies paved the way for the 1973 coup d'etat, when Allende was overthrown by the military.

The case of Jamaica, like that of Chile, is an example of the failure of the redistributive model. The Jamaican experience, however,

illustrates that the changes from one system to another can occur within a democratic process. The election of Edward Seaga as prime minister in 1980 was a repudiation of previous interventionist economic policies in Jamaica. As indicated in Table 1, the Jamaican inflation rate was in double digits in all but one of the years of the Manley administration, and the growth rate of real output was negative in every year except 1973. All this occurred while government intervention increased substantially. Government expenditures (consumption) as a share of gross national product increased from 13.9 percent in 1972 to 23.2 percent in 1980. During this same period, direct foreign investment declined, becoming negative in 1975 through 1979.

Conclusion: Finding a Solution for Latin America

The experiences of Jamaica and Chile suggest that as economic policies failed, they precipitated a change to a different economic model. In the case of Jamaica, these changes occurred within a democratic process when Michael Manley's administration was voted out of power. In the case of Chile, the redistributionist policies, in addition to precipitating economic changes, resulted also in changing the political process: The democratically elected Allende administration was overthrown by the military.

At the other end of the spectrum lie those governments that repress civil liberties while pursuing economic liberties. Although the economic costs of such a system may be small, the costs in human life and civil liberties, which are difficult to quantify, are substantial. As a result, authoritarian governments also are inherently unstable. Chile, under Augusto Pinochet, appears to be an example of economic liberalism and political suppression. Recent events seem to signal an end to the Chilean economic miracle. It remains to be seen whether the economic failures of the junta will precipitate a political change as well. In short, the Latin American experience suggests that the combination either of economic liberalism and political suppression or of political liberalism and economic repression results in an unstable system.[20]

[20]Our analysis does not explicitly consider the case in which both economic and civil liberties are curtailed. In fact, in Latin America, one can find examples of both totalitarian and authoritarian governments that appear to have endured the test of time (for example, Castro in Cuba and Stroessner in Paraguay). However, it is also fair to point out that previous experiences there have been authoritarian governments that have lasted longer (for example, Trujillo in the Dominican Republic and the Somozas in Nicaragua). In both cases the regimes ended abruptly, but the two countries adopted vastly different systems: The Dominican Republic adopted a democratic process while Nicaragua opted for a totalitarian government.

TABLE 1

SELECTED ECONOMIC STATISTICS ON THE JAMAICAN ECONOMY DURING THE MANLEY ADMINISTRATION

Year	Inflation Rate	Real Output Growth Rate	Government Expenditures as % of GNP	Direct Foreign Investment[a]	Merchandise Trade Balance[a]
1972	18.0	−2.6	13.9	97.8	−151.90
1973	21.8	1.3	16.4	75.1	−178.30
1974	16.0	−2.3	17.3	23.3	−59.10
1975	9.2	−6.9	18.5	−1.8	−161.00
1976	10.8	−2.6	21.4	−0.6	−135.10
1977	29.9	−0.3	21.5	−7.0	70.10
1978	25.5	−1.5	21.5	−26.7	80.20
1979	24.0	−5.5	21.2	−26.4	−64.30
1980	12.7	−15.5	23.2	27.6	−74.50

[a]Millions of U.S. dollars.

SOURCE: International Monetary Fund, *International Financial Statistics* (Washington, 1982).

Required Policies

The solution to the Salvadoran problems (as well as to those of other Latin American countries) requires a reorientation of economic policies. Elevating the standard of living of the poor requires a complete restructuring of El Salvador's economic policies:

- A first and necessary step is to reinstitute the government in its role as protector and enforcer of property rights by ending land reform, nationalization, and other associated policies. To succeed, new policies must be able to attract new capital, which in turn will increase the demand for the domestic factors of production.
- Second, these policies must also reduce the burden of the tax system on the traditional sectors of the economy.
- Third, the government must develop programs to increase the skill levels and hence the mobility of poor people.

The Role of the United States

The United States can contribute a great deal to the achievement of a desirable political and economic balance in Latin America. Politically, it should encourage continued progress in human freedom without directly interfering in internal political affairs. Economically, it can provide aid—although not direct assistance, which serves only to create economic dependency. The best aid the United States can provide is to allow the Caribbean and Central American countries access to U.S. markets.[21] This action, including a reduction in the current trade restrictions on a number of agricultural and labor-intensive manufactured products, would (1) provide higher revenues to the national governments which would enable them to implement their own development plans; and (2) increase the total price received by local producers, which would increase the profitability of the traditional export industries, and thus provide an incentive for capital to flow into these areas.

In the process, the level of employment and well-being of the poor of Central America would be improved. The United States, therefore, would contribute in a significant way to the strengthening of economic development and to the democratic process in El Salvador.

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[21]Krauss (1984) reaches a similar conclusion.

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