

# OUT OF COMMUNISM: AN ETHICAL ROAD MAP—THE DIGNITY OF THE HUMAN PERSON AS THE FOUNDATION OF THE TRANSITION FROM COMMUNISM

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Transitions from communism created many new and important ethical concerns. Some countries have yet to start this transition or are on its very early stages. Cuba is one example. The major concern is that the transition will maintain the worse at the top. Such a result might bring internal discontent, create new negative moral incentives and build the conditions for instability.

The paper addresses the issue of the ethics of the transition from a Judeo-Christian perspective. It will emphasize economic ethics and recommend policies that are more consistent with the dignity of the human person. After cautioning about the danger of current fashionable new ethical foundations I offer recommendations for action from inside and outside Cuba that might enhance the chances for minimizing moral hazards during the transition.

The paper makes no effort to thoroughly explain or justify the superiority of Judeo-Christian moral philosophy. It will only describe in more detail the notion of *distributive justice* as it is essential for the topic of the paper and very poorly understood by moralists, economists, and legal experts.

In conducting research for this paper and interviewing people who have lived during transitions from Communism, it soon became apparent that the task at hand deserves a book more than a paper. But even a book would have to reach very few conclusions as “the jury is still out,” and will be out for a long time, on the impact that different transition policies have

on some of the most important ethical questions. The many different methods of privatization, the difference that exists between the size, history, and productivity of the company to be privatized, all pose different moral dilemmas. Much research needs to be done to have empirical proof of some of the tentative conclusions that I will offer in this paper.

## THE ETHICAL FOUNDATION

For those who believe in a single Creator, its essence, or nature, is the ultimate source of morality. The proximate norm is man’s nature, created in the image of God. This is not the place for a complete explanation of the foundations of ethics from a Judeo-Christian perspective. It will suffice to say that my approach to the question of this paper will be based on traditional ethics or, at least, in a view of the human person that is largely consistent with the above.

Social ethics distinguishes the reciprocal ties between persons in relation to the end that has to be achieved in common (the common good). The social moralist questions if a particular institution is fulfilling its natural function in civil society. It also asks how should we, in order to seek the common good, distribute rights and duties among the members of that institution. (Utz 1964, pp. 361-362).

Ethics is the science of the morality of human acts. Although ethics and morality (or moral philosophy) have the same object, their means for discovering truth are different: “Moral theology relies on revealed religion for its conclusions, whereas ethics depends

on human reason alone” (Noonan 1947, p. 3). “Ethics is essentially practical. Its object is to direct human action toward morally good ends,” and “morality is the goodness or the badness, the rightness or the wrongness, of human acts” (Noonan 1947, p. 1). “The act of the will, then, is right (and also good) when the object of the act is the morally good; contrariwise, it is wrong (and also bad) when its object is morally evil.” “Moral good is a quality of the human act by which it tends to its proper purposes or end.” It is always necessary to distinguish between real and apparent good.

In ethics, we are only concerned with free or voluntary acts. These are acts where the will is in control. One can choose not to do them. These acts can be directly voluntary or indirectly voluntary, as when “the will chooses another object from which it can be foreseen that the second result will follow” (Noonan 1947, p. 7). When one channels funds to the accounts of an evil dictator or his cronies, for example, one is *directly* supporting an evil. When one invests or provides resources for an activity that will end up providing jobs and services to human beings in a dictatorial state, one might be *indirectly* providing support for a dictator.

Human beings are accountable for their moral acts. Such accountability requires “knowledge of what we are doing and freedom of choice.” One is more or less accountable for human acts in relationship to the degree of knowledge and freedom about the act. Concupiscence, fear and violence, also influence the imputability of the act.

The dignity of the human person will be the guiding principle of this paper. The Catechism of the Roman Catholic Church provides a good summary: “Respect for the human person entails respect for the rights that flow from his dignity as a creature. These rights are prior to society and must be recognized by it. They are the basis of the moral legitimacy of every authority: by flouting them, or refusing to recognize them in its positive legislation, a society undermines its own moral legitimacy. If it does not respect them, authority can rely only on force or violence to obtain obedience from its subjects” (Catechism, point 1930).

In addition, “respect for the human person proceeds by way of respect for the principle that ‘everyone should look upon his neighbor (without any exception) as another self, above all bearing in mind his life and the means necessary for living it with dignity.’” “No legislation could by itself do away with the fears, prejudices, and attitudes of pride and selfishness which obstruct the establishment of truly fraternal societies” (Catechism, point 1931). While human persons have equal dignity, their “talents” are not distributed equally: “These differences encourage and often oblige persons to practice generosity, kindness, and sharing of goods; they foster the mutual enrichment of cultures” (Catechism, point 1937).

Apart from natural inequalities there are unjust *inequalities* that affect millions of men and women. “Their equal dignity as persons demands that we strive for fairer and more humane conditions. Excessive economic and social disparity between individuals and peoples of the one human race is a source of scandal and militates against social justice, equity, human dignity, as well as social and international peace” (Catechism, point 1938).

Some of the problems that arise in a free society can only be overcome with Solidarity: “Solidarity is manifested in the first place by the distribution of goods and remuneration for work. It also presupposes the effort for a more just social order where tensions are better able to be reduced and conflicts more readily settled by negotiation. Socio-economic problems can be resolved only with the help of all the forms of solidarity: solidarity of the poor among themselves, between rich and poor, of workers among themselves, between employers and employees in a business, solidarity among nations and peoples. International solidarity is a requirement of the moral order; world peace depends in part upon this” (Catechism points 1940-1941).

One should not confuse true solidarity with the attitude of being a willing or passive actor in government led efforts to “help” the poor. Even Pope John Paul II was aware of this when he wrote *The Acting Person*. Quoting Karol Wojtyła: “opposition is not inconsistent with solidarity. The one who voices his opposition to the general or particular regulations of

the community does not thereby reject his membership; he does not withdraw his readiness to act and to work for the common good.” And he adds: “It would be too easy to quote endless examples of people who contest—and thus adopt the attitude of opposition—because of their deep concern for the common good (e.g., parents may disagree with the educational system or its methods because their views concerning the education of their children differ from those of the educational authorities)” (Wojtyła [1969] 1979, p. 286).

Although I am not going to focus on the issue, as human capital is essential in today’s economy, intellectual property rights (IPR) might play a very important role in the Cuban economy. IPRs are important both to attract foreign direct investment, and also to enable the most creative Cubans, to put their talents to good use and letting the person, rather than the state, receive the rewards. This fact was recognized more than half a century ago, “Modern wealth is due in no small part to the talent and genius of gifted men. To deny them a just return for these talents is to undermine all justice in the social order, and therefore society itself” (Noonan 1947, p. 190).

In addition to the dignity of the human person, the concept of “just law” is also key for recommending policies conducive for more ethical transitions from communism. As it will become apparent in the pages that follow, the many conflicting claims, and material possibilities, will make the transition far from perfect from an ethical perspective. But a law, and a legal framework, need not be perfect or required to produce perfect results in order to be just. This principle is not only recognized in Thomistic ethics but also by individualist philosophers such as Herbert Spencer: “it is impossible during stages of transition which necessitate ever-changing compromises, to fulfill the dictates of absolute equity; and nothing beyond empirical judgments can be formed of the extent to which they may be, at any given time, fulfilled. While war continues, and injustice is done between societies, there cannot be anything like complete justice within each society” (Spencer, pp. 331-332). Yet, it is only by knowing or having an approximate knowledge of the requirements of absolute equity

that one can begin to act and promote policies that take us to a better ethical outcome.

There might be an attempt to apply another ethical principle, *catastrophic emergency*, to the transition. For centuries, a similar principle, that of *extreme need*, was common doctrine among Western moral philosophers. One should be extremely careful before using it as a justification to violate justice. “In a catastrophic emergency, survival may ‘trump’ justice” (Silver 1989, p. 174). In old moral philosophy, a typical example given was that of a lady who in order to escape from a bunch of potential rapists, takes the horse of the neighbor (Chafuen 2003, pp. 42-45). In recent times, we can recall that after an anthrax scare following the terrorist attacks of 2001 in the United States, the Secretary of Health and Human Services stated that the emergency was justification enough to tell a pharmaceutical company that if they did not lower the price of their drug, the government would violate the patent.

In traditional moral philosophy, moralists distinguished between *grave need*, which did not justify violations, and *extreme need*, which did. Silver argues that “an individual who steals in ‘bad-but-not-so-disastrous’ circumstances will be blamed—that is, his action will trigger moral indignation and a desire for punishment” (Silver 1989, p. 165).

I chose to ground my definitions on Roman Catholic ethics due to their wider acceptance (at least in theory) in Latin America. Classical Liberal and libertarian authors might reach similar conclusions. Two valuable attempts to build an ethical foundation of an economic system based on private property and without having recourse to God are *The Right to Private Property* by Tibor Machan (2002) and *The Foundations of Economic Justice* by Morris Silver (1989).

Machan bases his views on “the basic notion held that the kind of being we are, namely, human (and this possessed of personal authority or sovereignty), has the right to private property as a basic principle of our social existence” (Machan 2002, pp. 3-4).

In his work, Silver presents Durkheim’s view that “Property is property only if it is respected.” That is to say, the feelings of other members of society must

also be taken into account” (Silver 1989, p. 14). While I do not endorse Silver’s view that feelings are the foundations of private property, I do agree that they are essential for their exercise.

Silver is correct to add that “The gaps in our *evolved* property feelings exposed by the occurrence of the truly novel must be filled by legal rule or social convention” (Silver 1989, p. 169). He concluded that “The implications of the psychology of property for public policy are monumental” (Silver 1989, p. 170).

I do believe that to be successful in helping create the right ethical incentives one needs to have the right values. It was F.A. Hayek, the noted free-market Nobel Laureate who wrote “It should also be obvious that the results of freedom must depend on the values which free individuals pursue. It would be impossible to assert that a free society will always and necessarily develop values of which we would approve, or even, as we shall see, that it will maintain values which are compatible with the preservation of freedom. All that we can say is that the values we hold are the product of freedom, that in particular the Christian values had to assert themselves through men who successfully resisted coercion by government, and that it is to the desire to be able to follow one’s own moral convictions that we owe the modern safeguards of individual freedom. Perhaps we can add to this that only societies which hold moral values essentially similar to our own have survived as free societies, while in others freedom has perished. (Hayek 1962, p. 45-46).

### **Policies that Encourage Virtue**

To speak about ethics, and professional ethics, without dealing with moral virtues is similar to speaking about physics without mentioning the law of gravity (Termes 1992, p. 186). When one speaks of solidarity without focusing on it as a virtue, one is speaking more about the *spirit* of solidarity. The confusion between virtue and feelings is a type of moral suicide, as much as in the individual as in the social sphere.

While the feeling of solidarity leads to the welfare state, with all its weaknesses, the virtue of solidarity moves people to help others with concrete acts, with personal sacrifice. It is almost impossible to find *vir-*

*tue* discussed in today’s world: “Without moral virtues one can’t have rational behavior, as rationality, which is not rationalism, consists in the right use of reason. It does not exclude sentiment, or feelings, but it excludes sentimentalism, as a guide for personal action; and it is the virtues that determine the capacity of a subject to use reason in the right way” (Termes 1992, p. 210).

What is more important for the economic process, is that as virtues are a good habit, they are acquired by learning. It is in that learning that a process of change takes place in the person, giving ethical value to his acts. Although it has not been immune to abuse, the advantage of privatization through vouchers, or any other scheme of distribution of shares, has a bigger chance to produce a learning process by dissemination of property and the opening of a space for market in vouchers.

The reforms, in an ideal transition, need to engage the person, the individual, more than the “collective” (which usually means the bureaucrat or those anointed by the dictator). This is especially important, from the learning process perspective, during a transition from communism. From the short-term perspective of pure economic expediency, it might be easier, for example, to “privatize” a company and give it to the former communist bosses. Such privatization would have almost no positive effect on the learning process needed to acquire the virtues that are needed for the free society. On the contrary, it might teach people that the bad always win.

The more people participate in markets, in small trade, in stock exchanges, the more used they will get to the virtues of the market place. As James Bryce wrote “the more the citizens acquire capital and themselves enter on commercial undertakings, and form business habits, and get to look at things with a practical eye, the stronger and more general will grow the public sentiment that insists on replacing the reign of force by the reign of law” (Bryce 1912, p. 573).

When the government of Cuba began the experiment to allow “personal” small businesses, thousands took advantage of the opportunity. Despite new taxes

and restrictions to their operations, these truly micro-enterprises continue to create wealth. When liberated, they could serve as the fountainhead of Cuban reform. This, coupled with the many small and large investments of expatriates and returning Cubans would have a much more salutary ethical impact than a top down, IMF, IADB, or World Bank led reform that would mostly benefit the bureaucrats (both in Washington and Havana).

### True Versus False Prudence

Another fundamental virtue that needs to play a role in the transition process is prudence. If solidarity is interpreted more as a feeling than as a virtue, prudence today is presented as the ability to escape responsibility or avoiding tough choices. Its true meaning, however, requires that the will and the action conform to truth, to objective reality (Termes 1992, p. 212).

The fact that I mention the importance of virtues does not mean that only virtuous people can be given freedoms. F. A. Hayek warned us that: “it is most important that a free society be based on strong moral convictions and why if we want to preserve freedom and morals, we should do all in our power to spread the appropriate moral convictions. But what I am mainly concerned with is the error that men must first be good before they can be granted freedom” (Hayek 1962, p. 46).

Human works have two aspects, the doing (*facere* in Latin) and the action (*agere*). The art, the technique, the knowledge of the market process, are important for the doing. The virtue of prudence, is important for the action. It is in acting that a person discovers value. And doing so he discovers the most important value: the self, the person.

When prudent and rational people decide to sacrifice their personal interest when they see that those interests can go against the true interests of others and the development of virtue, they can maximize the development of moral virtues. Perhaps some of my libertarian allies think that I have turned into a moralizer, and advocate something that seems that goes against economic theory: self-sacrifice. Yet it was Ludwig von Mises who wrote: “Mankind would never have

reached the present state of civilization without heroism and self-sacrifice on the part of the elite. Every step forward on the way toward an improvement of moral conditions has been an achievement of men who were ready to sacrifice their own well-being, their health, and their lives for the sake of a cause that they considered just and beneficial. They did what they considered their duty without bothering whether they themselves would not be victimized. These people did not work for the sake of reward, they served their cause unto death” (Mises 1974, p. 78).

### Communism and the Transition from Communism

I will work with the definition of communism as the economic system based on state ownership of the means of production. During the last century, communist leaders have interpreted this as including the laborer thus infringing on his rights to emigrate and even to move internally from job to job or from region to region. This is a clear affront to the dignity of the human person.

It is proper to speak of a *transition* from Communism when a continuous process of weakening of the state apparatus of coercion begins, both in the economic and political arena. This process can start in either field, but it only becomes certain and almost irreversible when it encompasses both.

Transitions can take several forms. There are three typical scenarios. That of a “liberal” revolution (LR), such as the one that took place in several Central and Eastern European countries; that of a controlled transition (CT) such as the one taking place in China and Vietnam; and a mixture of both, where liberal and “conservative” forces alternate in power without achieving ultimate victory. A more thorough analysis should take into consideration that each of these scenarios might create a different set of ethical issues.

### Applying the Principles of Distributive Justice

All different species of justice are relevant for the issues brought up by transitions from communism. Restitution of property to its rightful owners should be determined by the principles of *commutative justice*. The right to be taxed or have access to the goods,

services and jobs provided by authority should be ruled by *distributive justice*. *Legal justice*, is responsible for the principles of the concrete order, limited by time and space. These transitions also bring up issues relevant for *international justice*, such as the principle of abiding by all past treaties between states.

The traditional notion of Distributive Justice is an essential guide for the distribution of taxes, government jobs, subsidies, and all other issue involving the distribution, allocation and maintenance, of goods held by the state. The traditional definition follows the teachings of Aristotle and St. Thomas Aquinas. As did Aristotle, St. Thomas postulated two forms of justice:

In the first place there is the order of one part to another, to which corresponds the order of one private individual to another. This order is directed by commutative justice, which is concerned about the mutual dealings between two persons. In the second place there is the order of the whole toward the parts, to which corresponds the order of that which belongs to the community in relation to each single person. This order is directed by distributive justice, which distributes common goods proportionately. Hence there are two species of justice, distributive and commutative (Aquinas, II-II, qu. 61. art. 1).

Noting that this definition of distributive justice is consistent with the principle of justice in general, i.e., “to render to each one his right,” he continued:

Even as part and whole are somewhat the same, so too that what pertains to the whole, pertains somewhat to the part also: so that when the goods of the community are distributed among a number of individuals each one receives that which, in a way, is his own (Aquinas, II-II, qu. 61. art. 2-3).

It is important to note that in the Thomist tradition, distributive justice refers only to common goods. Furthermore, St. Thomas distinguished between public common goods and common goods belonging to a family or to other groups of people. Since “the act of distributing the goods of the community belongs to none but those who exercise authority over those goods” (Aquinas, II-II, qu. 61. art. 2-3), he indicated that the charge of distributing public

common goods falls to governmental authorities, bureaucrats or anyone charged with their care or provision. The “subjects” are also responsible for distributive justice “in so far as they are contented by a just distribution” (Aquinas, II-II, qu. 61. art. 2-3).

Aristotelian, Thomist and Scholastic thought provided that just distribution of common goods involves proportionate allocation. St. Thomas noted that

In distributive justice something is given to a private individual, in so far as what belongs to the whole is due to the part, and in a quantity that is proportionate to the importance of the position of that part in respect of the whole. Consequently, in distributive justice a person receives all the more of the common goods, according as he holds a more prominent position in the community. This prominence in an aristocratic community is gauged according to virtue, in an oligarchy according to wealth, in a *democracy according to liberty*, and in various ways according to various forms of government (Aquinas, II-II, qu. 61. art. 3, Italics mine.).

The Jesuit Luis de Molina (1535-1600) reasoned similarly:

Distributive justice refers precisely to what is owed to someone because he belongs to a community, in which case common goods must be divided among the members (something that seldom occurs). And since a republic is a collection of members, it is evident that its goods belong to its members, who own them in common. If they come to be overabundant, they should be distributed and divided among the members of the republic, and each should receive a share (Molina 1614, bk. 1. col, 24).

Some lines later, he defined this kind of justice as that which “gives each member of the republic what belongs to him when the common goods are divided according to geometric proportion.” It appears that, for Molina, it was rare for common goods or the surplus of a common good to be divided among the citizens (“something that seldom occurs”). In his experience the opposite is the norm: the citizens are obliged to maintain common goods.

While distributive justice takes place in the context of the relationship between the state and the people, “*commutative* justice directs *commutations* that can

take place between two persons” (Aquinas, II-II, qu. 61. art. 3).

Late Scholastic theory analyzed profits, wages and rent as matters of commutative justice and applied rules similar to those used to analyze the prices of goods. The Schoolmen determined that wages, profits and rents are not for the government to decide. Since they are beyond the sphere of distributive justice, they should be determined through common estimation in the market.<sup>1</sup>

For the sake of this paper the principles of distributive justice need to be applied to each of the matters that were handled by authority as being part of the “common good.” The principles of *commutative justice* need to be applied with all the property and contracts that were not respected by the communists and are in need of restitution. As part of the costs of restitution fall on a large segment of society, there is a difficult area of overlap where elements of distributive and commutative justice need to be taken into account.

### **Transferring and Returning Productive Assets from the State to the Private Sector**

Privatization has been accompanied by unethical behavior and accusations of corruption in most transitions from communism. As one analyst wrote: “In Russia, following privatization of the oil industry, the controlling shareholder of Yukos Oil ‘skimmed over 30 cents per dollar of revenue, while stiffing his workers on wages, defaulting on the payments by claiming that Yukos couldn’t afford them, destroying the value of minority shares in both Yukos and the production companies that Yukos controlled but only partly owned, and *not* reinvesting in Russia’s run-down oil fields, which badly needed new investment” (Black, Kraakman and Tarassova (1999:1737). In the Czech Republic, firms were “tunneled out,” that is, stripped of their assets and left with debt, disenchanting workers and investors, and little hope of raising capital to fund future investment projects. As one foreign investor warned in

a full-page ad in the *New York Times*, “Think twice before you invest in the Czech Republic. Otherwise, you could be left to ‘twist in the wind’” (*New York Times*, November 8, 1999) (Dick 2001, pp. 59-84).

Alexander Dyck recommends strengthening the governance chains in order to achieve more just solutions. One needs to “find a way to protect public and private investors by providing information and accountability.” A good method, which is applicable only to the largest companies to be privatized,<sup>2</sup> is to list the company in the New York Stock Exchange (NYSE), or one of the few other Stock Exchanges that has very strict requirements for listing. As the Enron, and other scandals proved, including the governing of the NYSE, this is not a foolproof method, but it goes a long way to reduce unethical practices.

During revolutions, as it happened in Romania, the losers have less time to protect their power or their lives. But after a period of time, it is likely that some of them will find their way to positions of power. Under controlled transitions, leaders will carve for themselves an important slice of all major sources of wealth. Although friends and foes alike deny that there is a transition in Cuba, partial “privatizations” have been taking place. In order to increase its power base, some of the pie is given to “new” entrepreneurs.

### **Land Restitution**

Restitution to the victims of communism should be one of the most important guiding principles during a transition from communism. The late Murray Rothbard correctly stated that “The idea of primacy for restitution to the victim...has been allowed to wither away as the State has aggrandized and monopolized the institutions of justice...in the Middle Ages generally, restitution to the victim was the dominant concept of punishment” (Rothbard 1983, p. 87). As the State grew more powerful “emphasis shifted from restitution to the victim, from compensation by the criminal to his victim, to punishment for alleged crimes committed ‘against the State’” (Rothbard 1983, p. 87).

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1. For a more detailed analysis see Chafuen (1985).

2. At least on this regard, the privatization of the Argentine oil company YPF is a good example to follow.

There are many ethical questions surrounding the restitution of land that continue to create barriers for faster economic development in former communist countries. One of the typical concerns, such as the fear that foreigners will crowd out the locals and therefore create a social backlash, end up putting in place a vicious circle. Valentin Braikov, referred to as one of the most prominent lawyers in Bulgaria, explained “New owners cannot afford the necessary farming equipment to make land efficient, prices of farming land are ridiculously low due to almost no demand . . . [The] government is afraid to allow foreign purchasing power to buy the cheap land because it will cause a social earthquake. ... As a result of low land prices farmers cannot use a part of their land as collateral for bank loans, which is a vicious circle.” (Rhett Miller 2003, p. 81).

The problems with land restitution in Bulgaria can serve as warning for when the time comes to reconstitute land in Cuba. A partial list of problems affecting other transitions include: short application periods to apply for restitution (which can create a flood of requests that no bureaucracy can handle); property boundaries that “had been obliterated with the formation of state farms”(Rhett Miller 2003, p. 81); land records that have been destroyed; “privatised plots [that] are illicitly handed-out to associates” (which makes restitution very difficult since “in most cases the participants are now *former* party cadres who have become businessmen with a proficiency in stockpiling former state assets.”); requirements that the old owners compensate the state for “improvements” done since expropriation; conflicting rights between current tenants and old owners; and a weak history of judicial independence.

According to Rhett Miller, one of the most unethical aspects of land restitution in Bulgaria is that land that was seized by the state by force (without an order of expropriation) was determined by legislators to fall “under the so-called ‘10 years possession rule’ ... Thus even though seizure represented an illegal act, the state nevertheless legally acquired owner-

ship of the seized properties through adverse possession once 10 years had gone by. Landowners were afforded no legal remedy” (Rhett Miller 2003, p. 79). It is these properties that are in a legal limbo which have largely failed to be maintained or returned to full productivity.

Despite these problems, Bulgarian reforms and restitutions are seen and presented as being highly successful. Going back to one of our guiding ethical principles, what we seek are legal institutions that will maximize respect for the human person, and provide the right, although not perfect incentives. The experience in Bulgaria provides useful lessons for further transitions.

### Monetary System

Money is the most commonly used medium of exchange. Reducing its value arbitrarily reduces the wealth of any person holding money. One of the major lessons that I remember from my years at the Argentine Catholic University is the analysis by our professor of economic ethics, that “monetary emission is lying knowing that you are lying and stealing knowing that you are stealing.”<sup>3</sup>

The late William Hutt, one of the leading market oriented economists of the twentieth century, is one of the few English speaking economists who, although sparingly, used the concept of distributive justice in a correct manner, especially in the area of inflation:

Nor can we be blind to the **distributive injustices associated with inflation**; its merciless treatment of the politically weak; its tendency to reward those responsible for the discoordination which it so crudely rectifies; its penalization of those whose actions have in no sense been responsible (those classes which loathe the idea of striking or threatening to strike—the salaried middle classes, the thrifty rentiers, the learned and charitable institutions which have relied upon interest on endowments, the pensioners, and so forth); its encouragement of a sordid scramble on the part of each organized group to get more for itself out of the common pool; its destruction of the motive to give of

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3. Prof. Cayetano Licciardo in 1976-7, former minister of economics .

one's best in the common social task, particularly at the entrepreneurial level; its weakening of the rewards for ingenuity, enterprise and effort; its sapping of the incentive to thrift and growth; its discouragement of individual responsibility toward one's own future and that of one's dependents; its creation of resignation toward a taxation system which robs the community of capital for the financing of innovations; its encouragement of acquiescence in the squandering of the community's capital; its need, in practice, for a multitude of officials and controllers with delegated judicial and legislative powers, able to make or destroy fortunes and subject therefore to the temptations of corruption; and the tendency it serves toward the degeneration of representative government into a system of vote buying (Hutt 1979, bold mine, p. 179).

Our guiding principle is that inflation is akin to theft and if the country chooses to have a local monetary system it should be handled by and independent but strongly accountable monetary authority. This has been the case in New Zealand, where if the central bank cannot meet its inflation goal, the president has to resign.

In addition to the litany of evil results mentioned by Hutt, another example of unethical acts in monetary policy is the dissemination of information regarding Central Bank actions to privileged parties.

As a means to reduced unethical practices, currency boards are even better than rule-constrained Central Banks: "A currency board is a monetary institution that issues notes and coins (and in some cases, deposits) fully backed by a foreign 'reserve' currency and fully convertible into the reserve currency at a fixed rate on demand. The reserve currency is a convertible foreign currency or a commodity chosen for its expected stability. The country that issues the reserve currency is called the reserve country. (If the reserve currency is a commodity, the country that has the currency board is considered a reserve country)" (Hanke, Jonung, Schuler, p. 5).

Dollarization, especially if is accompanied by a law authorizing the freedom to use any currency, is another easy way for a country to minimize the temptation to conduct unethical monetary policies. Although dollarization seems the easiest road for Cuba,

in order to increase the political feasibility of the reform one could explore establishing a currency board requiring half of the reserves be constituted in dollars and half in Euros. A similar reform failed in Argentina but, as the great champions of currency boards, Hanke and Schuler, had been warning since the early 1990s, Argentina did not have a currency board. It had a Central Bank pretending to act as a currency board. As in other pretentious experiments, it was only time until the public realized that the emperor had no clothes.

A currency board backed by dollars and euros might, by its symbolism, encourage a climate of cooperation between Europe and America.

### Price Dislocations

The artificial prices that exist for most products and services during the period of communist control create another set of special ethical issues.

During the reform period that preceded the collapse of the Soviet Empire, several communist leaders implemented mild reforms that created very different categories of prices. In Hungary, for example, prices were "divided into four categories: centrally fixed, maximum, limited (both as to a maximum and minimum), and free" (Ureña 1988, p. 172).

Whenever these mild reforms were tried, while centralized power continued, when they failed to produce rapid results, bureaucrats used the opportunity to increase controls rather than to further liberalize. When partial reforms are tried within a totalitarian framework several results create problems in a society brainwashed by socialist propaganda including: "a broadening of the wage scale, contrary to the socialist distributive ideal (arousing numerous protests); a weakening of the job security that prevailed in the centralized models (except for ideological reasons), arousing discontent in broad sectors" (Ureña 1988, p. 174).

According to Ureña, the resistance of old time party leaders "is not, then, merely the fruit of a selfish fear of loss of privilege, but has an objective basis as well: the fear of an economic, and consequently a political, decentralization and liberation that would go beyond limits tolerated by socialism" (Ureña 1988, p. 175).

As I believe that no one should play God and try to know what the market prices should be, I believe that the most ethical path is to liberate all prices. Very much like Ludwig Earhard did in Germany breaking with the recommendations of U.S. bureaucrats and experts. Whenever the price of commodities which are deemed essential for daily life are very different from the prices in comparable economies, one could explore policies to mitigate the suffering by providing vouchers and subsidies rather than by maintaining artificial prices. If a price jumps too high, one should allow these “extraordinary profits” to encourage entry in the trade or business. When prices were artificially high and are reduced drastically by open markets, one could consider a temporary subsidy to the seller or producer.

Personally, I would not favor such subsidies. They would require a large bureaucracy to implement and they would have the incentives to continue, rather than eliminate, the controls, and therefore their government jobs.

#### CAN THE WEST HELP?

If we judge by past experience, the role of the so-called West in providing the right incentives for an ethical transition from communism, is dubious at best. Analysts, such as Brian Mitchell, have argued that in Central and Eastern Europe, U.S. administrations have favored returning the power to the former communists and collaborators because they have been more willing to engage in economic and financial dealings, from sale of assets to purchase of weapons, than the center-right and “anti-communists.”

There could be a right motive in this. The dissemination of ownership, even when it goes to a few large foreign owners with ties to local elites, might create new incentives, which can alter the political landscape forever. Foreign governments and investors, understand that the goal of some of the former communist or current totalitarian regimes is to sell assets and contracts to obtain resources to maintain and consolidate power and wealth. But they might also

be thinking that they will outlive the current regime and that it is better for them to make a fast deal now than to lay their hope on weak center-right coalitions.

This has not only happened in Central and Eastern Europe but might be happening also with Venezuela. The argument goes as follows: “Let us make deals with Chávez and get some contracts, we will make some money, one day he will not be there and the opposition is so ineffectual that there is little cost to us for working with the regime.” Stories in *The Wall Street Journal* and other important newspapers have described the role played by “free-market” advocates, such as former Vice Presidential Candidate Jack Kemp, acting if not as agents, at least as friendly ambassadors for the Chávez regime.<sup>4</sup>

Several of the ethical questions relevant for a transition from communism, have also been difficult for transitions from economies with a high degree of government ownership and intervention in the economy. Accusations of corruption have accompanied not only the privatization processes in Russia, Poland and the Czech Lands, but also in non-communist, highly interventionist economies such as Argentina, Peru, and Mexico.

Differential exchange rates, and official exchange rates that diverge from the free-market rates have been a formidable incentive for corruption. They are easily fooled, they can make bureaucrats and accomplices rich and, from the point of view of natural law, differential exchange rates are seen as so artificial that parties feel justified in their attempt to elude them. A trader who undervalues the cost of his export load, might be violating a regulation and lying, but the foreigner who buys it, sees nothing wrong when asked to pay full value to a foreign account or subsidiary of the trader.

Locals and foreigners know that most Latin American governments have acted as predators rather than protectors of economic human rights. During the

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4. It is always possible that Jack Kemp is collaborating with Chavez to infiltrate the regime. That would be a redeeming factor, but I do not have any information to confirm or deny that possibility.

last decades, governments from Argentina, Brazil, Ecuador, to name a few, have prevented nationals from having access to their own deposits.

I will stop here because I think that there is a growing consensus about the need for having a uniform exchange rate that does not differ much from market rates. This is important from the economic aspect but much more important from the ethical point of view.

### A Special Clash of Cultures

Perhaps, as in no other case, when the signs of transition are certain, we can expect a massive flow of foreign direct investment by expatriates. We might also expect “half-year” migrations, from Cuban-Americans.<sup>5</sup> Some of the ethical questions that such an influx might create have more to do with *personal morality* (such as the feeling of envy that it might incite), and *social ethics* (large groups of local residents, and also returning expatriates reacting to this clash of wealth and culture), than with economic ethics.

The attraction of the “pearl of the Caribbean” will be hard to resist, not only for Cuban-Americans, but for citizens of most western countries.

### Three Special Challenges

During the transition process actors need to be aware of three challenges faced by most developing countries: inequality, environmental degradation and corruption. I choose these three problems as current fashionable approaches to deal with them might make them worse.

**Inequality:** Unequal distribution of economic freedom is exacerbating natural inequalities. Those who are involved in the transition will need to become champions in the battle against the unequal distribution of economic freedom. Studies show that inequality in Latin America is not the result of wealth inequality but of income inequality. In an open economy, income is determined by workers productivity, which is, in turn, highly correlated with levels of education and capital accumulation in the economy. In lower levels of the scale, the poor have little

access to useful education. Studies conducted in Chile, even after more than two decades of reform, show that public schools contribute very little to increase the ability to earn an adequate income. Other Latin American countries also show very poor scores. Only the wealthier, and a few lucky ones, can escape the bad schools.

In closed economies, wealth depends more on accepting an education useful to promote the system. Cuba has the best scores of educational achievement in several areas but has never been compared on the issues relevant to prosperous civil societies. One might need strong verbal comprehension skills to understand the interminable speeches uttered by dictators, and strong imaginative mathematical skills to justify their numbers, but unless one is educated on the value of respect for human dignity, there is little profit to be had from such high educational scores. Fidel Castro might take pride that in his Cuba, “even the prostitutes” have university degrees. But educated people would be more proud if they could use their talents with the freedom required by their personal dignity.

What we say here about education can be generalized to other areas of the economy. In many countries, only those in better position in society can afford adequate pensions, legal access, security, and other services where the government plays a key role. Only the well off can exercise economic freedom because local authorities have closed the doors to private solutions to many public problems that could benefit the poor. To the natural inequality based on productivity that would exist in a free economy is added an unequal access to economic freedoms.

**Pension reform:** Public and semi-public pension systems, if not structured properly, might also generate more inequalities. A pension reform needs to take into account the interest of current and future generations. Need and history are important but should not override all other considerations especially the possibilities of the economy. One of the first steps is to establish the starting point and use it as a bench-

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5. Given what has taken place in other transitions, I doubt that most Cuban-Americans will “jump ship” and move full time to Cuba.

mark. Given the dislocations in the economy, the benchmark should be set in purchasing power more than in monetary units.

In addition to the typical problems faced by any society willing to reform a pension system, in most communist countries, civil society will have to face the additional problem of a very fragile family structure. Communist regimes had an active policy of attacking and dividing the family, helping sever family bonds and therefore making it less likely that younger generations will take care of the old.

In a recent unpublished paper, "Paying for the Transition to Private Market Provision of Elderly Entitlements," Thomas Saving shows how "future generations are unambiguously better off when a generation transfer system of providing retirement benefits is replaced with a prepaid system" (Saving 2003). He concludes that in order that the old generation is not made worse off during the transition, the young and the new entrants to the labor force will have to pay more in taxes.

One could try to establish a scheme where the companies that have been dealing and profiting with a communist regime, when the tide changes would be allowed to continue doing business only if they would pay an extra contribution to the pension system. As several countries in Central and Eastern Europe have implemented or are implementing pension reforms, those involved in the Cuban transition should study those cases in great detail. In Poland, for example, payments do not go directly from the contributor to the private companies but go first to the government that then distributes them to the pension fund. What the government retains is open to political and economic mischief. An old saying in Spanish is that "el que parte y reparte se queda con la mejor parte" (he who cuts and distributes the parts, keeps the best parts).

There is no room to analyze in detail the process of reform of the pension, health and educational system

in order to maximize the proper ethical incentives. I will refer the reader to the records of the Vatican on a meeting held in Vatican City from March 6 to March 9, 1996, on "The Family and the Economy in the Future of Society."<sup>6</sup> The guiding principle of the reforms proposed in that meeting focused on empowering the person and the family rather than bureaucratic institutions. Educational vouchers, transferable medical savings accounts, and individual retirement accounts were the recommended process.

**Development and environmental degradation:**

Compare the scenery around Niagara Falls and Iguazú Falls, on the Northern limit of Argentina and Brazil. One borders the two most powerful countries of North America, the other one, those of South America. Judging by surrounding flora and fauna, Iguazú wins hand-down. If we judge by income and health of the surrounding population, Niagara is far ahead. Does development and wealth always have to be at the expense of nature?

Increased economic freedom, when it is real and not fiction, is bringing increased development to small and large countries alike. Once the storms of the war against terrorism settle, we will again see most nations return to a path to prosperity. People agree that most wars are devastating for the environment but what about prosperity? In its earlier stages economic development might produce an increase in environmental degradation. Yet as incomes rise, economic development becomes the best ally of the environment and poverty its main enemy. Analysts from the right and left of the ideological spectrum recognize this. Even the main Cuban environmental official center has blamed Latin American environmental degradation on poverty.

The human person needs to be at the center of any environmental policy. Increasing life expectancy by improving access to clean water, adequate medicines, nutritious food, and adequate housing is essential for human ecology. During this last decade, child mortality rates have decreased significantly in most Latin

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6. The proceedings were published in the *Osservatore Romano* and were also published in *La Società: Studi, Ricerche, Documentazione, Sulla Dottrina Sociale Della Chiesa*, Anno VII, N. 1/97, Verona.

American countries. For the process to continue, the region and Cuba, need more respect of private property not less. That is the only path to prosperity. Just titles to property are “the only safeguard of freedom. If ownership of all these resources is turned over to the state there perish the dignity and liberty of men” (Noonan 1947, p. 190).

There is no need to repeat mistaken policies which we know carry environmental costs much higher than the economic benefits. But it makes less sense to ignore the dynamic relationship between wealth and the environment and put barriers on any policy potentially harmful to the environment. By some definitions of sustainable development, mining for fossil fuels is unsustainable. A push by NGOs and rich nations to absolutize the environment will condemn resource-rich nations into poverty. Bolivian environmental challenges also provide good examples. The population is still subject to malaria and other infectious diseases, which could be eradicated by the responsible use of DDT. Worldwide bans on the manufacturing and trade of some of these useful chemicals can prove devastating for humans. Bolivia is the poorest country in South America, and a landlocked country, it could also reap great benefits with a planned hydro-way connecting its southern region with the Paraná River. Yet many environmental lobbies have been blocking the project.

Think tanks in Chile, Argentina, Bolivia, Venezuela, Guatemala, Spain and France, to name a few, have been addressing the issue of environmental degradation with much less funds than the environmental lobbies. Their analysis shows that secure property titles and prosperity are the best allies of the environment and that following paths of extreme environmentalism will condemn poor countries to permanent stagnation.

One of the most important issues that might be affected by environmental disputes, for its potential impact not only in Cuba but in neighboring islands and Florida, is off-shore drilling. Again I would recommend an economic policy that prioritizes human needs. If one can have off-shore drilling off the coasts of the British Isles, or of California, the possibility of

such methods used in the Cuban waters should be an alternative.

### Corruption

In other academic settings I have shown the high correlation that exists between the lack of free-markets, free trade and corruption (Chafuen and Guzmán, 1999). As economic freedom rises, corruption tends to fall. This is not an automatic process and people in countries undergoing radical changes take time to adapt. In addition, the same complex regulatory frameworks that have evolved in several developed nations, might not show a large increase in the perception of corruption in those countries (e.g., Scandinavia, Western Europe, and even the U.S. and Canada). This is possible because countries in that region have a long tradition of public service and equality before the law. Governments have earned a better reputation than in less developed countries. Unless one can import those institutions, as when countries join a trading block that has lower corruption levels, corruption will likely increase in less developed countries that try to copy complex Western regulatory schemes.

Apart from hyper-regulation, high taxation is another incentive for corruption. Of all the international financial organizations, the International Monetary Fund is on a class of its own when recommending high levels of taxation. In country after country of Latin America, the IMF has been pushing for governments to tax as much as they can. Value added taxes of over 20% might not be uncommon in European countries where institutions have evolved over centuries. Attempts to impose such level of taxation in Latin America, and the same would happen in Cuba, always led to huge evasion, justified a large informal economy, and undermined overall respect for the rule of law. Amongst post-communist economies, Russia and Slovakia have already implemented tax reforms based on a flat-tax imposed at levels much lower than western countries. These reforms have been led by local economists, not by Washington based technocrats, and often, against the advice of the IMF.

### CHECKLISTS FOR REFORM

As a summary for what will continue to be a “working paper” I offer checklists for government policy during a reform process away from Communism. As a starting point let us use the list of government activities deemed legitimate by the late Lord Peter Bauer, another renowned figure in the world of liberal economists. He lists:

- public security (protection of life and property, including the definition of property rights)
- maintenance of the value of money
- management of external relations in the interests of the population
- provision or oversight of basic education, public health, and transport
- assistance to those in need who cannot help themselves and are not helped by others (Bauer 1998, pp. 243-244).

I addressed the first two, but similar principles to those listed below should be applied to the others. Such analysis calls for a much larger paper and multidisciplinary collaboration.

Apart from being careful that the transition policies are conducive to economic development, to establish the foundation for long term growth policy makers need to be concerned about the effects of the policies on:

- The dignity of the human person;
- The short and long term efforts to build a rule of law;
- The incentives to acts of solidarity;
- The respect of past contracts and just titles to property;
- The victims who suffered more from communism;
- Those who profited from dealing with the regime or who committed the worse type of human rights abuses; and

- The learning process of market virtues

I could add more items to the list, but the above seven elements need to be complemented with an overall preferential option for the poor. After so many years of communism, many poor will find themselves ill-equipped to deal in an open and free society and policies need to take that into account.

Our major challenge to help in the transition from communism is to try to create incentives that will increase the chances of:

1. seeking and building the right moral foundations for the free society;
2. creating structures, institutions that will make it easier to reward good and punish evil; and
3. preventing the initial reforms from becoming a “shooting star” or to have a boomerang effect.

All the efforts to produce the above are relevant for those who are preparing the ground for the transition from inside and outside Cuba.

As final words, let me conclude quoting again F. A. Hayek:

It is also an old insight that a free society will work well only where free action is guided by strong moral beliefs, and, therefore, that we shall enjoy all the benefits of freedom only where freedom is already well established. To this I want to add that freedom, if it is to work well, requires not only strong moral standards but moral standards of a particular kind, and that it is possible in a free society for moral standards to grow up which, if they become general, will destroy freedom and with it the basis of all moral values (Hayek 1962, p. 45).

It is up for each of us to promote, with our actions and words, moral standards that will help us move away from the tragedy of communism.

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