Committee IV
Developmental Experiences In
East Asia and Latin America
1068

Draft - For Conference
Distribution Only

Discussion paper

by

Armando de la Torre
Dean, Division of Social Sciences
Francisco Marroquin University
Guatemala City, Guatemala

on

Paul E. Sigmund's

**DEVELOPMENT STRATEGIES IN CHILE, 1964-1983:
THE LESSONS OF FAILURE**

The Twelfth International Conference on the Unity of the Sciences
Chicago, Illinois November 24-27, 1983

DEVELOPMENT STRATEGIES IN CHILE (1964-1983):

THE LESSONS OF FAILURE

SPEAKER: PAUL E. SIGMUND

DISCUSSANT: ARMANDO DE LA TORRE

The paper of Professor Sigmund, "Development Strategies in Chile, (1964-1983): The Lessons of Failure", is an excellent introduction into the lessons for the West, and particularly for Latin America, of several successive Chilean political experiments.

Professor Sigmund correctly envisions the Chilean experience of the last twenty years as a "series of case stories and the direct application of contrasting theories of development".

He assigns evenly responsibilities, successes, and failures to Frei's "Revolution in Liberty", Allende's "Transition to Socialism" and Pinochet's "Chicago boys" exploits, and in his presentation he consistently pursues a balanced weighing of these opposing policies.

It is difficult to object to such a well summarized and comprehensive appraisal; I will, however, allow myself a couple of remarks from a slightly different perspective.

I think that the successive shifts in policies under those three so different political administrations do not constitute the discreet "jumps" in policies that the author appears to suggest, but rather that they represent changes forth and back (in the case from Allende to Pinochet, a violent one) within a continuum of pervasive state-dirigism, effective all over Latin America.

Allende's road to Socialism seems to be part of the generalized leftward drift that took roots in Latin America since the end of the Second World War, and gained increased momentum, first through the Revolution in Bolivia (1952), and later via the Castro Revolution in Cuba (1959).

Within this general trend,—that includes Arbenz attempt in Guatemala in 1954, and the socialist policies of the Peruvian military from 1968 to 1980—, Chile appears to be a very special case for several reasons:

1) It enjoyed a long functioning democratic tradition, that allowed even for the free election of a Marxist President.

2) It has a large, well educated middle class.

3) It came close to its "take-off" economic stage.

4) It has a highly vocal and politicized population, not easy to fool.

5) It tried harder than most to learn from past mistakes.

But Allende's "road to Socialism" was also the outcome of two other trends peculiar to the Chilean scene: a secular, sometimes anticlerical frame of mind among some of its leading intellectuals and politicians, and a vigorously militant trade unions movement, with some vaguely adopted Marxist methods of analysis, including the concepts of class struggle and the desirability of public ownership of the most important means of production.

When Allende took over in 1970 with the electoral support of less than three out of eight Chileans,"... the state controlled (totally or partially) more than ninety enterprises that encompassed all sectors of the economy; in 1981, 66 remained in the hands of the state, which includes three very large firms that did not belong to the state in 1970: Codelco (copper), CTC (telephones), and Chilectra (electricity). In 1970, public-sector enterprises employed 4.8 per cent of the labor force; in 1981, 3.4 per cent; in 1970 state enterprises satisfied 22.5 per cent of total demand in the economy; in 1981, that had fallen to 20 per cent. In 1980, the capital of the 12 most important companies of Corfo (a state-owned capital company) amounted to 60 per cent of the capital of all enterprises registered in the stock exchange. While the efficiency of state enterprises has improved, three companies—CAP (steel), IANSA (sugar), and LAN Chile (the state airline)—managed to lose $156 million in 1981 (nearly 1 per cent of CNP). The state, as an entrepreneur, has not been eliminated in Chile". (Daniel Wisecarver, Estudios Públicos (published by the Centro de Estudios Públicos), Winter, 1983).

Therefore the Pinochet experiment with a free market economy could be construed as a radical departure from previous state-capitalism practices only within the context of a long established state-dirigism, Chile been no exception to that. Even today, at the end of 1983, the public sector in Chile still is proportionally larger than in the United States or Switzerland, and almost the equal to what it was back in 1970 under Frei. (See Larry A. Sjaastad, "What Went Wrong in Chile", National Review, September 16, 1983).

Another dimension of the same phenomenon of continuous state-interventionism is constituted by the labor laws. Aside from permitting the usual right to close down any enterprise by means of a strike, and the fixing of minimum wages above realistic market levels, the Pinochet's goverment compounded its problems, by indexing the salaries not covered through collective bargaining. Therefore, when in 1981-82 economic conditions dictated real wage reductions, the labor law, written when the Chilean economy peaked at the late 1970's, made impossible any fast adjustment to the changed market conditions. When at last a modification was written into this law, providing that the real wages pacted in new labor contracts could fall below their previous level,—but not below a floor equal to their level, at the moment the labor law had taken effect—, it was too late, and unemployment soared back to 23.9 per cent in the third quarter of 1982. Again, state intervention in the labor market made things worse, as has been the case throughout Latin America for the last forty years.

But probably a most damaging factor among the lessons of failure that Professor Sigmund derives from the three successive Chilean experiments, is the monetary and fiscal policies of the Chilean goverments. I must hasten to add that in this respect the Pinochet goverment, at least during the period of 1975 to 1981, did far better than its predecessors. Frei's "Revolution in Liberty" ran increasing budget deficits to finance its agrarian reform schemes and its "Chileanization" of the copper mines; this, as usual, triggered an accelerated inflation, that was to peak disastrously under Allende's mushrooming budgetary chaos, and which turned more destructive of the national economy as agrarian production dropped to a third of its previous level, and public confidence in the Allende Administration, in and out of Chile, completely collapsed. Under Allende, the already existing price controls where extended in such a way that most private enterprises went bankrupt, or were close to bankruptcy, at the time he was overthrown by the military in 1973.

When Pinochet reduced price controls and even import duties, in the first two years of his tenure, and returned to their original owners most firms illegaly confiscated by Allende, industrial and agrarian private enterprises, not to speak of state enterprises, found themselves very much strapped for funds. That was the source later of many bad loans by the banking system, that were to become a very heavy burden on the Chilean economy when the financial crisis struck in 1981. This was the main factor, too, in the huge increases of interest rates from 1975 to 1981.

If the record of the fiscal policies of the Frei's and Allende's governments were miserable, the Pinochet government made a valiant effort first to diminish the budget deficits, and later to eliminate them altogether. Subsidies were slashed, and approximately 100,000 government jobs(roughly 3 per cent of the labor force) eliminated. Inflation was correctly identified as enemy number one. The results were impressive: from 1975 to 1981 the rate of inflation went down dramatically from a peak hovering around 600 per cent a year in 1975 to slightly less than 10 per cent six years later. In this sense, the Pinochet government meant a real departure from previous Chilean administrations, even in regard to the standard practices of most South American countries.

But if the fiscal policies of the Pinochet government (including a tax reform and substantial changes in the social security system)—coupled with the liberalization of trade—, reflected itself in this astonishing decline of the inflationary rate, the monetary policy of the Pinochet government has shown itself less coherent and firm. The government appears to be incapable, over the long run, to resist the inherited traditions of a pretectionist state, with all the vested interests that sprout under its umbrella among industrialists, trade unions, bureaucrats, and politicians in general.

According to Arnold Harberger, in a discussion paper presented last August at the Mont Pélerin Society annual meeting in Vancouver, Canada, the international reserves grew dramatically under Chile's fixed exchange rate. That rate was fixed in July 1979, at the ratio of 39 pesos to the dollar. But when the peso was inevitably devalued in June 1982, those reserves had dropped already by 700 million dollars, and when the peso was again devalued in August of the same year, Chile's reserves shrunk by an additional 400 million dollars. Harberger points out correctly, in my view, that if Chile has pursued a floating rate policy starting sometime in 1978 or 1979, with other things remaining more or less the same, her exchange rate would probably have appreciated in nominal as well as real terms. But Harberger adds another reason for the economic boom going on in Chile until 1981, that I don't think could have justified the fixing of the rate of exchange by the Central Bank of Chile from 1979 to 1982. According to him, "the key reason why things were so good in Chile in 1981 was an inflow of capital, equal (over the whole year) to about 15% of Gross Domestic Product". This extra amount of demand kept the economy going at a relative low level of unemployment, <u>despite</u> a highly appreciated exchange rate. But what must also be taken into consideration is that the fixing of the exchange rate, as the dollar at its turn appreciated against the peso, had the negative effect of encouraging the outflow of dollars and discouraging the inflow of foreing capital, particularly venture-capital. This monetary policy, coupled with the other one of increasingly bailing out major private corporations (since May, 1981),—like the major private-sector Sugar Company, CRAV—, or by outright intervining the eight largest finantial institutions (by November of the same year), exploded into the grave financial crisis which is afflicting Chile and from which no easy exit can be forseen, at the very least for the next two years.

In retrospect, the following can be concluded:

1) Chilean policies under Pinochet were free enterprise oriented only with respect to what they replaced: a combination of inefficient state capitalism and pervasive government intervention.

2) The fixing of the rate of exchange, the indexing of wages, and the progressive bailouts of Chile's banks meant a return to "bussines-as-usual" along the lines of the well established

Latin American state paternalism.

And yet, Chile has better prospects of coming out of the recession than most South American countries. Most Chileans seem by now to be convinced of the superiority of the free market. They have also turned probably into the most sophisticated electorate in Latin America, and in the view of many outsiders, like myself, have even broke ground into the 21^{st} century, ahead of the rest of us in Latin America, with those courageous, if sometimes mistaken, political experiments.