

CHAPTER 11

Conclusions and Challenges

Classifications and categories tend to be arbitrary, but if they are coherent they provide a guiding framework for analysis and policy actions. Following are four groups of economic lessons or conclusions drawn from the recent decades of Chilean economic history. They are followed by a ten-point grouping of future challenges.

Four Conclusions

First of all, the challenge of making growth consistent with distributive equity is ever more important, especially in light of the sharp drop in the standard of living of a wide segment of the population in the 1970s and 1980s and the fact that two democratic governments have only partially met the expectations they aroused in the 1990s. It is clear that substantial political consensus among the main social and political groups will be required to meet the challenge. Only in this way can the country implement action over time that will distribute the costs and benefits of economic growth in a more equitable fashion, with progressive improvement in the distribution of opportunities, productivity, and income. Democracy requires that growth and equity progress together.

Second, there is overwhelming evidence that macroeconomic balances are crucial to the success of any development strategy. One component that tends to be omitted from the catalog of macroeconomic factors, and should always be in the foreground, is the relationship between new productive capacity creation and actual increases in production (or utilization of capacity). As has been pointed out, there were deep imbalances in the relationship between the two variables during the Pinochet regime (fig. 11.1).

Underutilization was notably high, both in 1975–79 and in 1982–87. In both periods capital formation plunged, reducing sharply the creation of new capacity, productive employment, and equity. In fact, the consequences of that macroeconomic disequilibrium were long lasting. The same sort of disequilibrium emerged in 1998–2001, even though much milder. Consequently, the effects are also negative—

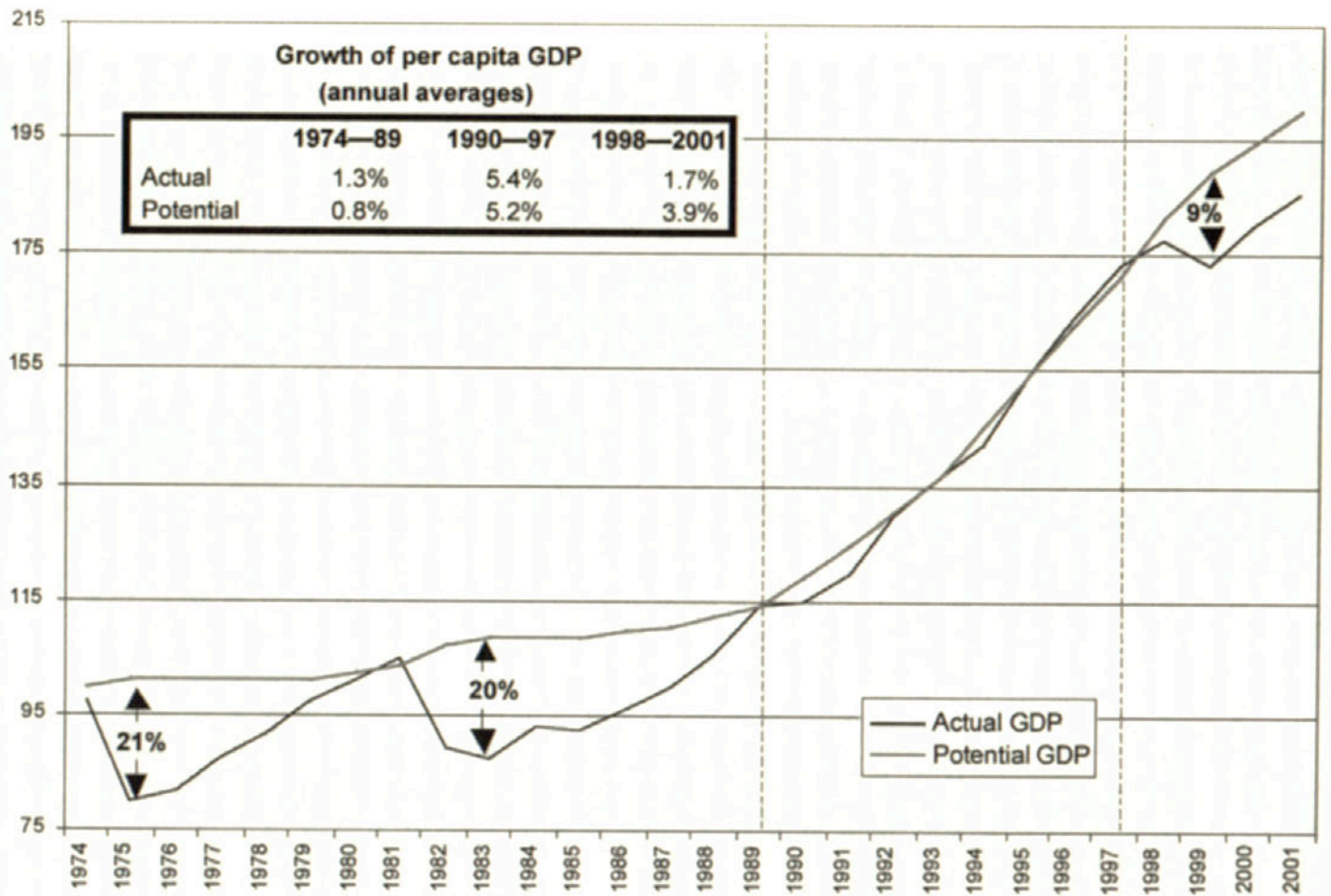


Fig. 11.1. Actual and potential per capita GDP, 1974–2001 (potential per capita GDP of 1974 = 100). (Data from chap. 1 and fig. 1.1.)

lower capital formation, higher unemployment, less equity — but notably milder than in the two older conjunctures. It must be stressed that the most significant macroeconomic balance is the sustainable use of economically productive capacity. An economy working on the production frontier, with right macroprices, achieves higher productivity, encourages larger capital formation, and fosters the demand for labor.

The cost of such macroeconomic imbalance is high, indeed. Besides the fact that such a situation leads to a reversal of the initial success that may have been achieved in growth and redistribution, experience shows that it entails costly political losses for governments that succumb to populist temptations, whether from the Left (as with unfunded social spending) or the Right (e.g., with tax cuts that make it impossible to finance the investment in the human capital that is essential for growth with equity or with the excessive financial deregulation that paves the way for macroeconomic imbalances).

The ways of achieving macroeconomic balances can be very diverse. They may have progressive or regressive effects and may be procyclical or anticyclical depending, among other things, on the relative weight given to variables such as inflation and economic activity, the composition of public spending and revenue, the nature and condition of financial institutions, and public actions that contribute to building the capacity and organization of low-income segments of population. Sustainable comprehensive macroeconomic balances are essential, and they must be consistent with macrosocial balances.

Third, in the 1970s and 1980s there were several reforms directed at modernizing the country's economic organization. Undoubtedly, many constitute permanent and valuable bases for democratic development strategies. The changes included significant growth and diversification of exports, the achievement of a more efficient fiscal budgeting process, and the development of a new generation of entrepreneurs more dynamic and modern than the traditional business class. This progress achieved in the 1980s contributed considerably to the outstanding performance of the 1990s.

Finally, structural reforms suffered from various failures that had severe repercussions for potential economic growth and the population's welfare. The 1990s saw significant *reforms to the reforms* of previous decades, with the specific objective of introducing more pragmatism. These *reforms to the reforms* did reflect a great concern to reduce the vulnerability of the Chilean economy to the international environment, with its increased volatility, while stressing policies that contribute to greater equity in distributing opportunities, productivity, and income. The results of this change of focus, despite a number of contradictions, were notable. During almost the entire decade, Chile saw an expansion

of its productive capacity unprecedented in its previous history, along with very important achievements in the fight against poverty. The recessive gap of 1999–2001, nevertheless, pointed out failures and insufficiencies and the lack of greater *reforms of the reforms* (see Ffrench-Davis 2000). From an optimistic perspective, this recession can help us to recognize these problems and find ways to solve them. With this book, I hope to contribute to the thinking and dialogue needed if we are to achieve growth with equity.

Ten Challenges

How can vigorous growth be achieved while advancing toward equity? First, there must be an understanding of how this can be achieved and what the country's real record is so far. Development occurs when growth is sustainable over long periods of time. If we measure progress in Chile by the decade, counting both good and bad years, only in the 1990s do we observe a figure of 6 to 7 percent. In the 1960s, GDP grew by 4.3 percent and in the 1970s and 1980s at less than 3 percent. It is not easy to live up to standards of exceptional performance. Some outstanding priorities that need to be kept in mind if the country is to replicate the exceptional record of the 1990s and grow with more equity are grouped here under the ten points that follow:

1. Chile must regain a macroeconomic environment of sustainable development with three features. The first is to achieve, as between 1991 and 1997, a level of effective demand close to the productive capacity of the Chilean economy—always a key objective for efficient macroeconomic balances and vigorous productive investment. This implies avoiding unsustainable booms and applying vigorous and consistent actions during recessions. Otherwise, if we are in the middle of a recession and there are expectations of other crises, how can one expect businesspeople to invest? Second, it will be necessary to maintain a competitive and stable real exchange rate, which is not feasible with corner solutions (a fully free rate or dollarization). Third, interest rates must be kept within a moderate range. These three objectives require a more flexible fiscal policy, with effective anticyclical measures (in the fiscal budget, monetary policy, and banking supervision) and an increased ability to discourage excesses in speculative capital inflows. The great danger is a “populist” attitude that fails to weigh the broad negative effects on the economy of excessive capital flows that are speculative, short term, merely financial, or aimed at purchasing what already exists without creating new productive capacity. In fact, the main cause of the recession of 1999 was the huge capital inflow in 1996–97, as shown in chapter 10.

2. Export dynamism is a determining factor for the ability to grow. Several main traditional natural resource exports will lose speed in this decade. We cannot afford to continue simply doing more of what we have always done. Markets become saturated and resources are exhausted or become less profitable. We must develop new types of exports, without losing what we have gained. This means (i) moving forward strongly to add value and technology to the traditional natural resources and develop the production of intermediate goods and services as well as capital goods linked to the productive process in those traditional areas, (ii) developing nontraditional natural resources, and (iii) finding niches for the ability and experience of national entrepreneurs and technicians in order to acquire competitive advantages. This will require an intense national effort to *complete* markets for technology, labor training, and long-term capital.

3. As far as exports are concerned, negotiating access to Latin American markets, taking advantage of geographical proximity, will be crucial. (Geography still counts for a lot, as the North Americans, who sell half their exports to their two nearest neighbors, can testify, or as the Europeans, for whom the corresponding figure is 60 percent can confirm.) MERCOSUR and its eventual future connection with the Andean Community should be key ingredients in export diversification because they would provide more accessible markets for nontraditional exports. New problems will probably emerge — among them, the macroeconomic instability of country members — but they must be confronted constructively, and mature thinking must be brought to the task. A well-designed regional integration is one way to *make*, rather than *take*, globalization.

4. Development always leaves some productive sectors behind. It is better to anticipate malaise than ignore it and have to deal with a moribund patient later. Comprehensive macroeconomic stability can make a great contribution to development and can help minimize the number of associated losers, but pragmatic, forward-looking sectoral and regional policy is also indispensable. Significant sectors of agriculture and mining are urgently in need of further thought and timely action for reconversion.

5. Growth is not possible without physical investment. The years 1999 and 2000 were recessive because of faulty macroeconomic management and the Asian crisis. The Chilean economy needs more, not less, productive investment. First, a dangerous rent-seeking bias, intensified in recent years, must be avoided: there are too many efforts and capabilities devoted to mergers and transfers of existing assets. It is necessary to strengthen creative skills; upgrading the quality of macroeconomic policies and enhancing actions to *complete* markets of factors and exports

are essential. Second, domestic capital formation is an overwhelming proportion of investment everywhere in the world. Only one of every ten dollars invested in the world comes from abroad. Domestic saving and investment are determinant. We must design the way to assure that Chile's long-term savings—such as those of the pension funds—go to domestic firms, especially SMEs. Funding for productive innovation also must be improved.

The prevailing tendency in Chile to transfer the funds of the private pension system abroad presents an unfortunate contradiction to the objective of raising the domestic savings rate so as to increase capital formation in Chile. The purpose of increasing the savings rate should be to provide financing for higher productive investment in Chile. Priority should be given to improving the transmission channels between those long-term funds and productive investment—naturally, always with guarantees and prudential principles to protect the savings of workers. This is consistent with the fact that average profitability is higher in Chile than in most developed countries.

6. Investment in human capital is a key input for stability and growth with equity. The educational reform of the mid-1990s has been a great step forward, but it is only the beginning. We must give it the priority it deserves, always keeping in mind that education is dependent on teachers. Social trust and recognition of their importance must be rebuilt. Education, however, operates over the long term. Most of the labor force of the first decade of this new century will consist of Chileans who have already finished their formal education. Chile faces the great challenge of enhancing the flexibility of the supply of labor with a farsighted and well-focused national labor-training program (looking to the year 2010, when Chile will be completing its second century of independence).

7. The environment has become a leading issue in modernization. Chile must make up for its lag in addressing environmental issues and in integrating them into the design of public policies. A highly pragmatic and participatory approach is needed to reconcile the development of today's productive capacity with preventive action, sustainability over time, and the present welfare of citizens.

8. Income distribution is highly inequitable. Chile must intensify its efforts to improve the quality and coverage of social spending, make an effective impact on hard core poverty, and eliminate the possibility that a young, intelligent person will not receive a good education because of a poor social origin. Strengthening the fight against tax evasion and the regressive loopholes that still exist in the system would provide financing and contribute to social equity. Once again, global consistency of policies and their interrelations are crucial. The quality of macroeconomic

policies strongly affects poverty and income distribution. In 2001, the regressive bias of 1999–2000 was still present with the impact of the recessive adjustment on productive investment and employment.

9. The state must be reformed. The main issues here are professionalizing public administration, raising productivity, improving the quality of public service, making space for participation of people in identifying priorities and failures (in education, health, public works, labor training, etc.) and heightening transparency in government. Simultaneously, salaries must be gradually raised to levels consistent with those prevailing in the private sector.

10. Paradoxically, since the return to democracy the quality and intensity of thinking about Chile have eroded. They have become too focused on the short term and concentrated on what “the market finances.” Too much confidence has been placed in what other countries think and do (some specialists even believe that other countries should drive our macroeconomic policy, e.g., through the dollarization), and too little attention has been paid to the importance of each country’s or region’s specific characteristics and targets. The figure of globalization has taken the shape of mythic immutability. However, globalization is a highly heterogeneous process, incomplete, and rather unbalanced with respect to social and economic factors. It is urgent that Chile rethink the role of globalization in its economic life in order to understand how to move more effectively toward sustained growth with equity and to position itself to act cogently as it moves into this new decade.