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TOWARD A FREE MARKET ECONOMY:  
CHILE, 1974-1979

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"Chile is a case study in sound economic management."  
Time, January 14, 1980, quote attributed to an officer  
of the U.S. Department of State.

"The most important reforms undertaken in the underdeveloped  
world in recent history. . . ."  
Wall Street Journal, October 5, 1979, declaration by  
A. Harberger.

"When Washington ends its political sermons to Pinochet's  
government, perhaps as a retribution for the restoration  
of friendly relations Chile should lend us its economic  
team. Economists who can simultaneously reduce inflation,  
tariffs, and unemployment are welcome in Washington."  
Wall Street Journal, January 18, 1980, editorial.

"Would-be imitators in other countries should have a field-  
day watching how this pilot experiment in radical right-  
wing social and economic policies works."  
The Economist, February 2, 1980.

"We are so monetarist, we have reached a position where  
the Central Bank is hardly in control of the money supply  
anymore. It controls itself."  
The Economist, February 2, 1980, declaration by the  
vice president of the Central Bank of Chile.

"This kind of economic liberalism is incompatible with  
any type of political liberalism. They could not impose  
an economy at this kind of social cost without resort to  
dictatorship."  
New York Times, May 5, 1979, statement by E. Frei.

"The Chicago Boys are very satisfied. Their critics affirm  
that the situation evolves from bad to worse. No doubt both  
are right. Because the contrast could hardly be greater  
between the positive trend of the indicators and the lack  
of 'spill over' on the population in this happy juncture."  
Le Monde, April 7, 1979.

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Introduction

The economic policy of the Chilean military regime is attracting interest and stirring up controversy beyond Chile's boundaries. The international press dedicates long articles to the analysis of what is being called "the Chicago experiment." Why this interest, which is disproportionate if one considers Chile's limited influence in the world economy?

There are several reasons. Some see in this "Chilean experiment" a test of the consistent and sustained application of the monetarist approach to the problems of economic instability and chronic inflation which have affected most of the western economies during the last decade. For others, it represents the "most important reforms in the underdeveloped world during recent history," a view which implicitly attributes validity to the "Chilean model" as an alternative to the economic policies applied by many developing countries during the postwar period. A third factor is that, given the context of political authoritarianism in which these policies are applied, and their high social cost, the "Chilean experiment" raises the issue of the interrelationship between economic orthodoxy and political freedom in developing economies. A thesis favorable to the authoritarian formula suggests that the promotion of economic freedom is a prerequisite to the attainment of effective political freedom.<sup>2</sup> An opposing thesis focuses on the basic contradiction generated in a developing economy between ultra-orthodox liberalism and the real democratization of society.<sup>3</sup>

The importance of monetarism, the search for new development models, and the significance of authoritarianism in the economic stabilization process are subjects constituting an important part of the agenda of discussion in contemporary economic policy, and the policies of the Chilean military government provide an especially suitable case study to enlighten the discussion of some of these topics. The most obvious questions arising with regard to the Chilean case are the following: Has this economic experiment been a success or a failure? What is the nature of the policies applied: are they merely policies of short-term economic stabilization or policies intended to alter the long-term development pattern? What is the impact of these policies on the productive structure, on distributive patterns,



and on the ownership of assets? We shall approach some of these subjects in this paper.

In the first section, the principal macroeconomic results are analyzed in relation to various possible objectives of the policies. The second section discusses the nature of the policies undertaken and the interrelationship between the short-term objectives and those of long-term structural transformation. The third section describes the principal changes in the functioning of the Chilean economy during this period, including: (a) changes affecting various economic agents (State, private-enterprise sector, workers) and the processes of transference of resources to the new agents which the economic policies have made possible; and (b) changes in the external sector as the Chilean economy moves from closed to open. A fourth section deals with modifications in the productive structure and in distributive patterns. A final section offers some conclusions.

#### I. Success and Failure of an Economic Policy

As occurred a decade earlier with regard to the Brazilian case, the economic policy of Chile in the period 1974-1979 has been a subject of deep controversy. The economic results of the period are interpreted by some as a total success, and by others as being strongly negative. As we shall see, two completely different stories can be told, depending upon which indicators are chosen in making the evaluation.

Table 1 provides the information which usually serves as a basis for arguing in favor of the success of the policy. The macroeconomic indicators chosen show the following: (1) a decrease in the inflation rate from 600 percent in 1973 to 39 percent in 1979; (2) the achievement of relatively high rates of growth in GDP starting in 1977 and for two consecutive years, after the 1975 recession; (3) a significant reduction in the fiscal deficit, to the point that it nearly disappears toward 1978; (4) a dynamic growth in non-traditional exports, which in 1978 were more than twice their 1974 level; (5) an increasing surplus in the balance of payments since 1978, as a result of the accumulation of reserves; and (6) an increase in reserves, due to a rapid inflow of foreign capital, amounting to more than one thousand three hundred million dollars per year in 1978 and 1979. Results such as these are considered the ingredients of a typical "success story" if one follows the criteria of performance usually endorsed by international organizations such as the IMF. And they conform to what the international private banks consider to be indicators of the economy's improvement.<sup>4</sup>

TABLE 1

## MACROECONOMIC INDICATORS

Year	G D P	Consumer Prices	Fiscal deficit	Non-tra- ditional exports	Net capital inflows	Balance of Payments	Gross Reserves
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1970	3,5	36,1	2,9	225,9	531,3	226,1	1.006
1974	4,2	369,2	8,9	273,2	275,0	-54,4	645
1975	-16,6	343,3	2,9	401,9	323,6	-297,5	463
1976	5,0	197,9	2,0	510,3	252,4	490,8	880
1977	8,6	84,2	1,5	588,5	444,0	-7,0	871
1978	6,0	37,2	0,8	644,9	1.384,1	539,8	1.397
1979					1.475.2	819,3	

(1) ODEPLAN, Cuentas Nacionales de Chile. Annual rates of variation. The figures for 1977 and 1978 correspond to provisional estimates for GDP.

(2) INE, Indice de Precios al Consumidor. Annual rates of variation.

(3) Treasury Department, Exposición sobre el Estado de la Hacienda Pública (January 1979), and ODEPLAN, Cuentas Nacionales de Chile. Percentages of GDO.

(4), (5), (6), (7) Central Bank of Chile, in R. Ffrench-Davis, "Políticas de Comercio Exterior en Chile," mimeo (Santiago: CIEPLAN, 1979). Figures in millions of dollars of 1977.

A different story can be told based on other indicators, such as those appearing in Table 2. These have been used by some to argue that the policy has been far from successful. A simple version of the critical view could be summarized as follows: (1) the Chilean economy has grown in the period 1974-1979 at an average rate significantly below the recent historic rate (as shown in Table 2, GDP growth in per capita terms has not reached one percent per annum); (2) this increase has been even lower for the goods-producing sector--thus the modest growth observed at the aggregate level is based mainly on the expansion of services; (3) the potential for future growth finds itself limited by the low investment rates, which have scarcely exceeded 11 percent of GDP; and (4) the employment level has stagnated during the period, while the unemployment rate has doubled, and at times tripled, historical rates.

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TABLE 2

## OTHER MACRO RESULTS

	1960-1970	1970-1979	1974-1979
(1) GDP	4,5	2,6	2,5
(2) Production of goods	4,5	1,6	1,9
(3) Production of services	4,4	3,1	3,7
(4) GDP per capita	2,3	0,7	0,8
(5) Rate of investment	15,3	11,7	11,2
(6) Total employment	2,1	0,7	0,4
(7) Rate of unemployment	6,5	9,8	13,4

(1) ODEPLAN, op. cit. and estimates. Gemines Report N. 21 for 1979. Annual variation rates.

(2) Ibid. The production of goods includes agriculture, fishing, mining, industry, and construction.

(3) Ibid. The production of services includes electricity, gas and water, transportation, trade, and other services.

(4) Ibid.

(5) Ibid and Taller de Coyuntura. Department of Economics, University of Chile, Comentarios sobre la situación económica, First semester 1979. Investment in fixed capital over PGB.

(6) P. Meller, R. Cortázar, and J. Marshall, "La Evolución del Empleo en Chile 1974-1978," Colección Estudios CIEPLAN No. 2 (1979); Treasury Department, op. cit., annual variation rates.

(7) Ibid.

The preceding figures represent averages for the period. A more accurate picture is given by yearly data, as in Table 3, which shows that it was only in 1978 that GDP recuperated to 1970 levels.<sup>5</sup> The investment rate has reversed very slowly as from 1977, as can be observed in the fourth column of Table 3, but is still far below historical levels. On the other hand, the surplus in the balance of payments, observed in Table 1, has been accompanied by a marked deficitary tendency in the current account (as well as in the trade balance), which has been covered with external financial resources. The debt-service ratio has risen to 46 percent of exports in 1978.

One of the most salient aspects of the Chilean economic experience in the last six years has been the simultaneous deterioration in employment, salaries, per capita consumption, the distribution of consumption by income brackets, and other social indicators which measure the population's access to housing, education, and health care. The corresponding figures are shown in Table 3. The recuperation trends in these indicators are not very significant. The national unemployment rate has remained above 13 percent. Wages and salaries in real terms in 1979 were still 18 percent below 1970 levels.<sup>6</sup>

TABLE 3

## ECONOMIC AND SOCIAL INDICATORS

	GDP per capita	Balance in current account	Debt service ratio over	Investment rate	Total employment	Employed in pop. of 12 years and over	Unemployment rate	Real salaries + wages	Salaries and Wages as a share of National Income
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1970	100,0	-159,9	33,5	15,0	100,0	42,9	6,1	100,0	44,3
1974	102,4	-254,3	18,6	13,0	104,6	40,4	9,2	65,1	34,6
1975	89,3	-532,3	40,0	10,7	99,0	37,4	13,4	62,9	34,7
1976	91,4	143,5	44,2	9,8	94,9	35,0	16,3	64,8	34,7
1977	97,6	-531,0	49,2	10,6	99,3	35,8	14,0	71,5	-
1978	101,7	-817,1	46,1	11,3	102,7	36,2	13,9	76,0	-
1979	-	686,2	-	-	-	-	-	82,3	-

	Per capita consumption	Consumption of the		Average pension	Housing construction, avg. per person	Enrollment in pop. of 10-20 years of age	Enrollment in 1st grade in corresponding population	Hospital beds per person	Health serv. per person
	(10)	Poorer 20%	Richer 20%	(12)	(13)	(14)	(15)	(16)	(17)
1970	100,0	7,6	44,5	100,0	100,0	100,0	100,0	100,0	100,0
1974	102,7			59,3	85,3	113,1	106,3	94,4	89,3
1975	91,2			54,4	49,8	-	99,4	91,7	84,5
1976	87,3			56,2	38,4	-	94,3	88,9	90,3
1977	-			60,7	42,0	116,3	96,2	86,1	91,3
1978	-	5,2	51,0	66,4	44,2	115,2	-	83,3	94,2
1979	-			-	-	-	-	-	-

(1) ODEPLAN, *op. cit.*, See note (1) in Table 1. (2) Central Bank of Chile, in French-Davis, *op. cit.* Figures in millions of dollars of 1977. (3) Central Bank of Chile. (4) ODEPLAN, *op. cit.*, and Taller de Coyuntura, *op. cit.* (5) Meller, Cortázar, and Marshall, *op. cit.* (6) *Ibid.* (7) *Ibid.* (8) Taller de Coyuntura, *op. cit.* (9) ODEPLAN, *op. cit.* (10) *Ibid.* (11) INE, *Encuesta de Presupuestos Familiares*, 1969 y 1978. (12) Superintendency of Social Security. (13) ODEPLAN, *op. cit.* and estimates for 1977 and 1978 based on Taller de Coyuntura, *op. cit.* (14) INE, *Compendio Estadístico*. (15) Schiefelbein and Grossi, *Análisis de la Matrícula Escolar en Chile*, CIDE, 1978. (16) INE, *Compendio Estadístico*. (17) *Ibid.*

In brief, the economic results of the 1974-1979 period give mixed signs: the rate of inflation decreases, after a deep recession GDP reaches pre-recession levels, the fiscal deficit is eliminated, there is an accumulation of reserves, and non-traditional exports expand rapidly. At the same time, a low investment rate, a significant deficit in the commercial balance, increasing external indebtedness, high unemployment, real wage reduction, and a deterioration in the distribution of consumption and basic social services are among the negative factors.

Can this be considered a successful result? Obviously the information given up to now is relatively aggregated. On the other hand, as is obvious, the evaluation of any economic policy depends on the objectives chosen. Some of the objectives in Chile during 1974-1979 were related to economic stabilization. Others had to do with an attempt to transform the economy's functional basis, radically altering the ownership of property, the structure of production, and the development strategy. We must thus go beyond macro-economic indicators in order to evaluate the degree of success in these other objectives.

## II. The Nature of Economic Policies in Chile, 1974-1979

The economic policies evaluated in this paper have been an attempt to radically apply the monetarist stabilization approach which, under very different political conditions and with little success, was put into practice in several Latin American countries in the late 1950s and early 1960s.<sup>7</sup> As in those earlier experiences, the first aim of the policies has been to balance the external accounts and reduce inflation. The principal tools are monetary control and elimination of the fiscal deficit. Together with these key policy measures, the orthodox policy has gradually eliminated subsidies and exchange controls, freed prices, including the interest rate, gradually readjusted the exchange rate, sought to eliminate restrictions to the flow of foreign capital, introduced severe norms of self-financing to public enterprises, and strongly reduced real wages. This policy package has been oriented toward eliminating market disequilibria resulting from the inflationary process. The adjustment process would be basically neutral in its impact on the various social groups, according to the monetarist view.

But the policies applied in Chile after 1973 have not been merely short-term adjustment policies. As we have argued elsewhere,<sup>8</sup> these policies have a strong component of structural change. The diagnosis of inflation, although stressing its monetary origins, broadens to engulf a supposedly generalized malfunctioning of the economy. Key factors would be the excessive size of the State (including public enterprises), the inefficient allocation of investment due to the lack of a private capital market, and the misallocation of resources resulting from high tariff barriers. This is the rationale behind orthodox structural changes such as those in Chile after 1973.



The implementation of structural reforms along these lines has been given as high a priority as the economic stabilization program itself. When there has been a trade-off between the two, it is the long-term objectives that have often prevailed.<sup>9</sup> Therefore, it seems justifiable to define the character of the Chilean economic policy, as opposed to the monetarism of the 1950s, as a new form of structuralism. Obviously the objectives and the instruments used differ radically from those proposed by the so-called Latin American structuralist school, as do the implications of the policies in terms of income distribution and changes in the power structure. But in its reach, and even its "revolutionary" fervor, it has been no less ambitious than the most radical attempts at structural change from the left, such as those during the Allende period.

This new "face" of monetarism is not only a Chilean phenomenon. Similar policies are being applied in Argentina and Uruguay.<sup>10</sup> Nor is it necessarily a coincidence that in all three countries these "orthodox-structuralist" policies are being applied by repressive authoritarian governments.

Long-term structural changes are undertaken on at least two levels: (1) in the role assigned to economic agents, especially the State and the private sector; and (2) in the way the domestic economy relates to the world economy. The policies seek a reduced role for the State, a privatization of public assets and resources, and an opening up of the economy to world trade. We shall examine these changes in the next section.

### III. Changes in the Functioning of the Economy

For clarity's sake we shall separate the subject into three different, although related, aspects: (1) changes in the role of economic agents; (2) mechanisms of transference of resources to the "new" economic agents; and (3) opening up of the economy to world trade.

Changes in the economic agents: the State and the privatization of the economy. One of the basic elements of the new economic policy has been a drastic change in the roles assigned to the various economic agents in Chile. The State gradually decreased in importance. This was attained by means of a reduction in public expenditures, and by the more limited presence of the State both as a regulator of private economic activities and as a producer.

The reduction in public expenditures was justified at the beginning by the need to eliminate the fiscal deficit as a source of inflation. Nevertheless, the policy of fiscal restriction was applied beyond the point at which the excess of demand was the principal factor of inflation. By the beginning of 1974, signs of recession and excess capacity were already evident; nevertheless, the reduction in public expenditures continued to be enforced until 1979. As can be seen in Table 4, fiscal expenditures as a proportion of GDP dropped from 26 percent in 1974 to 18.6 percent in 1977.<sup>11</sup>

TABLE 4

## FISCAL EXPENDITURES AND FISCAL DEFICIT (Percentages of GDP)

<u>Year</u>	<u>Total expenditures excl. public debt</u>	<u>Fiscal deficit</u>
1970	22,7	2,9
1971	27,1	9,3
1972	29,1	12,2
1973	40,8	27,7
1974	25,8	8,9
1975	19,4	2,9
1976	17,6	2,0
1977	18,6	1,5
1978	19,7	0,8

SOURCES: Treasury Department, op. cit., and ODEPLAN, op. cit.  
 The 1978 figures include our estimation of nominal GDP.

On the other hand, the deregulatory policy meant the elimination of price controls, with very few exceptions. Among the latter, wages and the exchange rate continued to be controlled. With regard to the State's role as producer, the government implemented a policy of privatization of public enterprises, which meant that out of 507 public enterprises in 1973, only 21 remained in government hands by 1979, as can be seen in Table 5.

The State has also diminished its development role, which had been a key characteristic of state activity since the creation of the "Corporación de Fomento." This development role had increased considerably during the governments of Frei and Allende, as can be seen from the figures on public employment by activity in Table 6. This affected the State's assistance to small producers in the agricultural, mining, and industrial sectors, as well as the process of agrarian reform, which not only has come to a halt but has in fact been reversed, by returning a significant share of expropriated land to old owners, as will be seen later on.

Another field from which the state has withdrawn, giving way to the private sector, has been that of financial intermediation. Table 7 shows that financial resources deposited in public institutions decreased from 50 percent of the total in 1970 to 28.7 percent in 1978, while the share of the private sector increased from 11 percent in 1970 to 63.5 percent in 1978.

Finally, the State has withdrawn as regulator of external flows. The tax treatment for foreign investment has been liberalized, restrictions on the remittances of profits abroad have been eliminated, and the ceiling on external borrowing by the private sector has gradually been lifted.<sup>12</sup>



TABLE 5

## PUBLIC ENTERPRISES (Number of enterprises)

	<u>1970</u>	<u>1973</u>	<u>1977</u>	<u>Target 1980</u>
With participation in ownership				
-Enterprises	46	229	45	15
-Banks	-	19	4	-
Intervened enterprises	-	259	4	-
Enterprises in liquidation	-	-	17	-
Total	46	507	70	15

SOURCES: CORFO, Gerencia de Normalización, and El Mercurio, February 27, 1980. The figures correspond to firms owned by CORFO.

TABLE 6

## EMPLOYMENT IN THE PUBLIC SECTOR (Thousands of persons and annual variation rates)

	<u>Administrative Services</u>	<u>Development Institutions</u>	<u>Social Services</u>	<u>Public Enterprises</u>	<u>Total</u>
1964	32,3	28,5	94,5	49,6	209,9
1970	46,1	44,3	133,8	55,8	280,0
1974	52,8	69,5	178,3	59,5	360,2
1978	46,2	34,4	176,9	35,9	293,3
Variation					
1964-70	6,1	7,6	6,0	2,0	4,9
Variation					
1970-74	3,5	11,9	7,4	1,6	6,5
Variation					
1974-1978	-3,3	-16,1	-0,2	-11,9	-5,0

SOURCE: Treasury Department.

TABLE 7

## FINANCIAL SAVINGS IN PUBLIC AND PRIVATE INSTITUTIONS (Percentage of total)

	<u>1969</u>	<u>1970</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
<u>Public Sector</u>	<u>46,7</u>	<u>49,3</u>	<u>30,0</u>	<u>29,7</u>	<u>33,6</u>	<u>31,4</u>	<u>28,7</u>
Central Bank Certificates	6,2	7,7	5,3	5,1	11,9	8,0	6,9
Public Housing Corp.	3,3	3,2	0,8	0,9	0,6	0,6	0,5
Treasury Bills	-	-	6,0	10,0	8,2	9,1	10,1
Reconstruction Bonds	-	-	1,3	0,7	0,6	0,4	0,2
Savings State Bank	37,2	38,4	16,6	13,0	12,3	13,3	11,0
<u>Mixed Sector (Savings and Loans)</u>	<u>40,5</u>	<u>39,5</u>	<u>62,5</u>	<u>56,2</u>	<u>36,1</u>	<u>17,8</u>	<u>7,8</u>
<u>Private Sector</u>	<u>12,8</u>	<u>11,1</u>	<u>7,5</u>	<u>14,1</u>	<u>40,3</u>	<u>50,9</u>	<u>63,5</u>
Savings Commercial Banks	11,5	9,8	1,6	9,0	26,2	40,2	50,7
Savings Development Banks	1,3	1,3	0,1	2,3	0,7	1,8	4,0
Saving Financing Institutions	-	-	5,8	2,8	3,4	8,9	8,8
<u>Total</u>	<u>100,0</u>	<u>100,0</u>	<u>100,0</u>	<u>100,0</u>	<u>100,0</u>	<u>100,0</u>	<u>100,0</u>

SOURCE: Banco Central, Boletín Mensual (several issues).

This withdrawal of the State from economic activity has been accompanied by a substantial decrease in public employment, as can be seen in Table 6. Public-sector employment fell nearly 20 percent between 1974 and 1978. Thus, previous expansionary trends were drastically reversed.<sup>13</sup> The employment reductions have been more important in development institutions (19 percent reduction per year) and in public enterprises (10.5 percent reduction per year). These figures clearly reflect the priorities in the new economic policy.

The fields of action left vacant by the State were naturally taken over by the private sector, either domestic or foreign. Particularly important is the growth of private financial institutions, as can be gathered from Table 7.

Organized labor is entirely left out of this picture. Not only have wages been controlled and in fact drastically curtailed in real terms, but no collective bargaining has been allowed, strikes are forbidden, and no mechanism exists for the participation of labor in economic decisions. Only in 1979 was a "Labor Plan" implemented, which regulates the functioning of labor unions, under conditions of subordination of workers to their employers, and which allows for a very restricted form of collective bargaining.

Mechanisms of transference of resources to the new economic agents. The change in the role of economic agents which we have just described (less State participation, privatization of economic activities, modifications in labor legislation) was initially posed only as an efficiency requirement of the model. It was a supposedly neutral policy with regard to its distributive effects. In practice, however, it was not so, as we shall now see. In fact, the economy's process of adjustment to the desired conditions implied a massive transfer of resources toward the private sector, particularly toward financial firms and large industrial enterprises. This transfer of resources was made possible because of the particular form taken by the processes of privatization, market liberalization, and inflationary control.

Thus, for example, the privatization process of the State enterprises occurred under conditions extremely advantageous for the new owners. In Table 8 we have estimated the implicit subsidy for those who bought these public assets. It turns out to be equivalent to 30 percent of the firms' net worth and up to 40 percent and 50 percent of the purchase value.<sup>14</sup> The low sale price was influenced by the State's urgency to sell, and doing so in a moment of deep recession and high interest rates: the short-term profitability of the enterprises decreased. Expecting lower sales, accumulation of stocks, and limited access to domestic credit, only those firms which had liquid resources or access to clear foreign credit were in a position to buy the auctioned enterprises.

Something similar occurred in the agricultural sector, where the policy was to return a portion of the lands expropriated during the agrarian reform to their former owners. Another portion was subdivided into individual plots and handed over to peasants, as indicated in Table 9. By April 1979, 30 percent of the expropriated land

had been returned to the former owners and 35 percent had been assigned in individual plots to peasants and small farmers. Moreover, by June 1978, nearly 40 percent of these lands had been sold or leased by the peasants to third parties, as a consequence of the high cost of credit and the scarce backing of the State to peasants and small farmers in the form of technical assistance.<sup>15</sup>

TABLE 8

SUBSIDY IN THE SALE OF STATE ENTERPRISES  
(Millions of Dollars of 1978)

Discount rate		Sale value	Value of assets in 1978	Subsidy	Subsidy as percentage of asset value
1974-78	1979-83				
10	10	496,1	731,8	235,7	32,2
25	15	533,0	731,8	198,8	27,2

Note: The figures correspond to a sample of 41 enterprises and banks which represent around 60 percent of the firms auctioned. The value of the sale updated to 1978 assumes a 4-year payment period for the industrial firms and 8 quarters for banks, with interest rates of 10 percent and 8 percent respectively.

SOURCE: Dahse, *op. cit.*, and CORFO, *Gerencia de Normalización*.

TABLE 9

BALANCE OF THE AGRARIAN REFORM IN APRIL 1979

<u>Situation</u>	<u>Hectares</u>	<u>Percentage</u>
1) Restitution to former owners	2.965.640	29,8
2) Area assigned <sup>1</sup>	3.521.141	35,3
3) Transfers to CORA <sup>2</sup>	1.639.772	16,5
4) In the hands of ODENA	1.839.315	18,4
5) Total expropriated	9.965.868	100,0

<sup>1</sup>From the total of the area assigned to the beneficiaries of the agrarian reform, to June 1978, almost 40 percent had been sold or leased for its exploitation to third parties.

<sup>2</sup>Includes auction of lands and transfers to other public institutions (such as CONAF) or to private ones.

SOURCE: Presentation of the Government of Chile to the Conference on Agrarian Reform and Rural Development, 1979, in *Taller de Coyuntura, Comentarios sobre la Situación Económica*, first semester, 1979.

As can be seen, the privatization of the industrial and agricultural sectors implied a transfer of assets, generally undervalued either to the former owners, in the agricultural case, or to business groups in the industrial and financial sectors. The foregoing tendency was reinforced by the form taken by the process of market liberalization. Thus, for example, liberalization of the foreign credit market was only partial. A ceiling was imposed on foreign borrowing, as a percentage of the value of assets. As a result, only the large enterprises and the better established banks and financial institutions had access to it. Zahler has estimated the profit for enterprises which had access to external credit in the period 1976-1979 to be in the order of \$800 million as illustrated in Table 10, in which we have reproduced Zahler's study.<sup>16</sup> These profits arose by the high differential in interest rates, taking into account expected devaluation, between the foreign rates (from 6 percent to 11 percent) and domestic interest rates in dollars (between 118 percent and 42 percent).

On the other hand, the process of market liberalization did not follow uniform rules with regard to salaries or the prices of goods. Upon the drastic freeing of prices followed by wage repression, a strong readjustment in relative prices arose which lasted until the final year for which information is available, as can be seen in Table 11. In it, we have calculated the relation of wages and salaries to wholesale prices and to an export price index (exchange rate adjusted by an external price index). We have also calculated the relation between wages and salaries and industrial prices. The drastic fall in the relative price of labor with respect to any of those indices is obvious when inspecting Table 11. The relative reduction in wages reached 50-60 percent in 1976, and was still 30-40 percent during 1978.

This price relativity has been extremely favorable for productive enterprises, particularly for those in export activities. Undoubtedly it allowed them to absorb a good part of the greater costs associated with the acute recession in 1975-1976 and, to this date, it provides them with a margin of adjustment to face external competition resulting from lower tariffs.

The effect of changes in relative prices is reinforced when considering the reduction in the employer's contribution to social security. The accumulated effect of both factors on the cost of labor can be observed in column 2 of Table 12. Since at the same time labor productivity increased, as shown in Table 12, the incidence of labor costs for the industrial producer dropped from 15.8 percent of the gross value of production in 1970 to 9.4 percent in 1978, as indicated in the last column of Table 12.

The other important process through which the transfer of resources has been achieved has to do with the nature of the economic stabilization policy applied. As previously stated, it was characterized by a strictly monetarist approach to the closed economy. It sought to stabilize by controlling the money supply, real wages, and the fiscal deficit.

TABLE 10

FINANCIAL PROFITS OF PRIVATE ENTERPRISES WITH ACCESS  
TO FOREIGN CREDIT (In millions of Dollars)

	Annual interest rate			Financial profit		
	LIBOR	Domestic	Difference*	Art. 14	Autonomous capitals	Stock foreign debt
1976	6,12	118,53	106,3	121	170	681
1977	6,42	58,38	45,5	169	207	351
1978	9,35	51,10	32,4	251	326	318
1979						
(1st sem.)	11,21	42,10	19,7	113	133	155
Total				654	836	1.505

\*Difference between the interest rate in Chile and twice the LIBOR rate.

SOURCE: Zahler, op. cit.

TABLE 11

PRICES AND WAGES (1970 Indexes = 100)

	(1) Remunerations ÷ <u>Wholesale prices</u>	(2) Remunerations ÷ <u>Export prices</u>	(3) Industrial remunerations ÷ <u>Industrial prices</u>
1970	100,0	100,0	100,0
1974	49,7	50,3	57,5
1975	40,0	36,3	46,7
1976	40,5	45,3	53,5
1977	52,2	60,7	67,2
1978	57,9	57,9	73,1

SOURCES: (1) INE, Indice de Sueldos y Salarios (ISS) and IPM, national products; (2) INE, ISS, Exchange rate, and French-Davis, "Indice de Precios Externos y Valor Real del Comercio Internacional de Chile," Notas Técnicas N. 15 (Santiago: CIEPLAN, 1979); (3) INE, ISS, Industrial Sector and Industrial IPM.

TABLE 12

## PRODUCTIVITY AND LABOUR COSTS IN THE INDUSTRIAL SECTOR

Year	Wages (1)	Cost of labor (2)	Physical productivity (3)	Cost of labor over GVB (4)
1970	100,0	100,0	100,0	15,8
1974	57,5	59,9	95,5	9,9
1975	46,7	47,6	80,7	9,3
1976	53,5	54,5	97,8	8,8
1977	67,2	67,6	107,8	9,9
1978	73,1	70,5	118,4	9,4

SOURCES: (1) INE, ISS, Industrial sector and industrial IPM; (2) Column (1) plus the employer's contribution to social security. The actual rate of contribution effective for 1974 was considered, as calculated by ODEPLAN, Cuentas Nacionales de Chile and it was varied for the following years according to the rates of the Service of Social Security. (3) Sociedad de Fomento Fabril, Indice de Producción y Ocupación Industrial; (4) For 1970 ODEPLAN, op. cit., for the following years it is calculated using columns (2) and (3).

The approach was effective both in producing a sharp fall in effective demand and in reducing real wages. By ignoring the role of expectations and cost-push factors in a situation which drastically passed from repressed inflation to open inflation, the policy proved ineffective in curbing the rate at which prices increased.<sup>17</sup> In fact, high inflation continued far beyond what was expected. During this whole period, the economy was characterized by generalized market disequilibria. These imbalances surfaced in the form of sharp and discontinuous movements in relative prices.

Those firms which had access to liquid resources profitted from the situation, particularly if they were able to correctly anticipate the movement in relative prices, and thus make huge speculative gains.

Summarizing, the functioning of the Chilean economy has been deeply altered since 1973, not only because the role assigned to economic actors has changed substantially, but also because the dynamic processes of economic adjustment have seemed to favor the transfer of resources toward large firms in the financial and industrial sectors. By these means, these firms have acquired a dominating position in the economy, as will be shown later on.



From a closed economy to an open economy. At the end of 1973, the average nominal tariff in the Chilean economy was 94 percent. In June 1979, that tariff had been reduced to 10 percent and covered all imported items except cars. This process of tariff reduction, completed in little more than five years, was accompanied by a general liberalization of the external sector: elimination of non-duty restrictions on imports, and liberal treatment of foreign investment, external borrowing, and the purchase and sale of foreign currency. On the other hand, the exchange-rate policy sought to maintain an exchange rate favorable to exports. The latter were also exempted from the value-added tax.

Progress in these areas of economic policy was noticeable in the period 1974-1978. In a brief six-year period, the Chilean economy had advanced substantially toward transforming itself into an economy open to international trade, with practically no barriers to trade. In what follows, we shall briefly review the principal changes which took place as a consequence of trade liberalization.<sup>18</sup>

One of the objectives of trade liberalization was to stimulate the development of the exporting sector. Lower customs duties would reduce the cost of imported inputs and increase the volume of imports. The latter would force a higher exchange rate for the dollar and thus benefit export growth. The policy of export promotion was also helped by the prevailing low salaries during the period (as shown in Table 3), and by idle capacity in industry resulting from the stabilization policy-induced recession.

The growth of exports in the period was undoubtedly significant. Normalizing for the price of copper, total exports rose from 15 percent of GDP in 1970 to 18 percent in 1977.<sup>19</sup> Nevertheless, the greater success was obtained in the growth of non-traditional exports, as shown in Table 13. During the period 1974-1978, non-traditional exports more than doubled. This was accompanied by export diversification. Industrial exports also displayed dynamic behavior. If copper is excluded from total exports to avoid the effect of the excessive price fluctuations, industrial exports rose from 59 percent of total exports in 1974 (excluding copper), to 65 percent in 1978.<sup>20</sup>

Regarding imports, the principal effect of trade liberalization was that it brought about a marked change in the composition of imports, rather than in their rate of growth, as seen in Table 13. The expansion was significant in imports of non-food consumption goods, which grew by 74 percent between 1974 and 1978. This expansion was concentrated in the period 1976-1978, which was characterized by simultaneous reduction in duties and in the real exchange rate. Thus the cost of imports decreased sharply between these two years. During this sub-period, imports of non-food consumption goods grew by 260 percent. On the other hand, imports of capital goods fell during the recession, and it was not until 1978 that they again reached 1970 levels. Something similar occurred with intermediate imports.<sup>21</sup>



TABLE 13

IMPORTS AND EXPORTS (In millions of dollars of 1977)

	1970	1974	1978
<u>Imports</u>			
Food consumption goods	107,4	85,5	115,7
Non-food consumption goods	191,6	236,8	410,7
Capital goods	550,2	336,3	566,6
Intermediate goods	1.055,2	1.769,7	1.533,8
Intermediate goods including oil, wheat, maize	907,4	1.099,6	940,9
Total	<u>1.904,4</u>	<u>2.428,3</u>	<u>2.626,8</u>
<u>Exports</u>			
Traditional	1.897,0	2.257,1	1.233,6
Semi-traditional	93,2	174,5	226,7
Non-traditional	225,9	273,2	644,9
Total	<u>2.216,1</u>	<u>2.704,8</u>	<u>2.105,2</u>

SOURCE: French-Davis, "Políticas de Comercio Exterior en Chile."

What impact did the opening of the economy have on the productive structure, particularly in the industrial sector? From 1974 onwards, the industrial sector suffered the simultaneous impact of recession and customs-duties reductions, which affected its production levels, as can be observed in Table 14.<sup>22</sup>

It is not easy to separate the recession from the tariff reduction effect. In Table 14, we have grouped data from a paper by P. Vergara in order to distinguish among sectors depending on how they have been affected by trade liberalization and the recession, respectively. In Group A, we classify those sectors that were simultaneously affected by decreases in internal demand and by tariff reduction. In these sectors, production decreases and imports increase, giving way to a marked "de-substitution" of imports. This is therefore a case of sectors which have been affected simultaneously by drops in demand and by the liberalization of imports. This group includes textiles, shoes, and clothing, as well as some intermediate inputs for industry.

Group B includes those activities in which, despite an increase in domestic demand, production has fallen. At the same time, imports have increased significantly--i.e., there is import de-substitution. These are sectors typically affected by the opening to trade. The increase in demand has been supplied by imported goods. Furthermore, these have even substituted for internal production at the levels of initial demand. There is no other way to explain the fact that internal production has fallen in absolute terms in spite of the increase in demand. This group includes the electronic industry and transport, among others.

TABLE 14

OPENING UP TO WORLD MARKETS: EFFECTS ON THE INDUSTRIAL SECTOR  
(Annual variation rates 1969/70-1976)

	Production (1)	Imports (2)	Exports (3)	Domestic Demand (4)	Import Substitution (5)
(A) <u>Affected by opening and fall of internal demand</u>	<u>-2,5</u>	<u>4,7</u>	<u>22,6</u>	<u>-1,8</u>	<u>-11,2</u>
-Textiles, clothing, footwear (321, 322, 323 and 324)	-1,6	6,1	46,0	-1,2	-3,4
-Industrial inputs (351, 354, 361 and 382)	-5,9	4,8	24,2	-3,3	-22,2
-Others (342 and 385)	-2,2	2,8	-7,4	-0,6	-9,1
(B) <u>Affected by opening to trade</u>	<u>-1,1</u>	<u>8,7</u>	<u>23,3</u>	<u>2,0</u>	<u>-17,7</u>
-Electronic equip- ment (3832)	-1,1	14,0	-15,4	6,7	-27,2
-Transportation material (384)	-1,2	6,9	46,5	2,2	-14,4
(C) <u>Affected by the fall in internal demand</u>	<u>-1,6</u>	<u>-7,0</u>	<u>5,8</u>	<u>-3,0</u>	<u>8,0</u>
-Intermediate for construction (369, 371 and 381)	-1,5	-6,0	12,9	-2,9	6,7
-Unvulcanized rub- ber and plastics (355 and 356)	-1,9	-16,4	-8,7	-3,6	13,2
(D) <u>Oriented to exports</u>	<u>2,9</u>	<u>-9,2</u>	<u>11,4</u>	<u>-0,7</u>	<u>6,4</u>
-Timber (331)	4,4	-29,9	15,4	2,9	11,4
-Paper (341)	0,6	2,4	10,0	-8,5	-2,0
(E) <u>Others (311, 312, 313, 314, 352, 362, 3833 and 390)</u>	<u>2,1</u>	<u>4,8</u>	<u>17,1</u>	<u>1,7</u>	<u>-1,4</u>
<u>Total</u>	<u>0,2</u>	<u>1,6</u>	<u>15,3</u>	<u>-0,6</u>	<u>-1,4</u>

SOURCE: Vergara, *op. cit.* Domestic demand is measured as a proxy by the difference between production plus imports-minus exports. Column 5 indicates the variation in the import coefficient over total supply.

Group C includes activities which depend very much on domestic demand. These are principally non-tradable goods such as intermediate inputs for construction; also rubber and plastics. These sectors are affected more by recession than by tariff reduction. This may be verified by observing that in the face of drops in demand, both imports and production decreased, but the former fell even more sharply.

Group D represents sectors such as wood and paper. These are export-oriented activities that successfully adjusted to lower tariffs. In group E, whose principal component is "food, beverages, and tobacco," we include sectors for which both domestic and external demand have grown. The same is true of production and imports.

Table 15 shows the behavior of employment by branches of industry. The available figures permit us to circumscribe the analysis to the period in which the greater changes were produced with regard to the degree of opening of the economy--i.e., between 1976 and 1978. The sectors most affected were textiles, clothing, footwear, metallic products, machinery, and equipment. These are activities in which the negative impact of recession and trade liberalization were probably reinforced, as we saw before. Other sectors similarly affected were non-metallic minerals and basic metals, which typically depend on domestic intermediate demand, particularly of investment goods, which remained at low levels throughout the period.

TABLE 15

INDUSTRIAL PRODUCTION AND EMPLOYMENT (1970 indexes = 100)

	<u>1970</u>	<u>1974</u>	<u>1976</u>	<u>1978</u>
<u>Employment</u>	100	110,4	92,6	92,0
Food, drink, tobacco	100	107,0	103,4	99,1
Textiles, clothing, leather	100	109,9	87,1	87,6
Timber	100	99,5	72,2	99,3
Paper	100	109,3	98,0	94,5
Chemicals	100	114,1	102,3	98,5
Non-metallic minerals	100	117,4	91,6	86,0
Basic metals	100	112,6	101,3	88,9
Metallic products, machinery, equipment	100	117,8	92,0	84,3
<u>Production</u>				
INE	100	108,6	81,9	96,3
SOFOFA	100	107,3	92,2	110,9

SOURCES: SOFOFA, Indice de Producción y Ocupación Industrial, e INE Indice de Producción Industrial.

It is interesting to note that for all industrial sectors except wood and paper, an additional deterioration in employment has been produced after the recessive cycle--that is, after 1976. This has been a period in which the reduction of customs duties has had its strongest impact, which would indicate that the decline in industrial employment cannot be explained merely as a transitory result of recession. The ongoing change in the industrial structure seems to be generating a lower level in the demand for labor. Whether this is only a transitory phenomenon typical of the process of adjustment to the new tariff structure or a more permanent phenomenon is something which cannot be answered with available evidence.

In brief, available data seem to indicate the following:

(a) successful export expansion; (b) a change in the composition of imports, in which the most rapid growth is observed in the imports of non-food consumption goods; (c) a differentiated impact of tariff reduction on the industrial sector; and (d) stagnant industrial employment and recuperation of production after 1976. In fact, industrial output grew at rates of 6.8 percent in 1976, 12.2 percent in 1977, and 10.7 percent in 1978, which at an aggregate level seems to indicate more capacity to adapt to the new conditions than what was to be expected in light of the drastic changes in customs duties.

Undoubtedly this adjustment process was helped by the remarkable fall in wages with respect to the exchange rate and to industrial prices, as seen in Table 11. By this means, the industrial sector was able to absorb part of the impact of increased external competition. This capacity to adjust was also enhanced by the long lag in the adjustment of domestic prices to international prices. There is, at the same time, evidence that many firms hedged against foreign competition by becoming importers of competitive products.<sup>23</sup> On the other hand, there is also evidence of greater specialization in production in some industries, as a way of increasing production efficiency in order to meet the import challenge.<sup>24</sup>

Another factor which facilitated the adjustment was access to foreign indebtedness. In fact, the free-trade policy was accompanied by a gradual process of opening to external capital flows. The flow of foreign credits increased, as seen in Tables 1 and 16. The composition of the external debt also changed. The larger part of the new loans originated in private sources and was directed to the domestic private sector.<sup>25</sup> On the other hand, even though the abundant availability of external financing facilitated the adjustment in the real sphere, it also caused serious distortions to monetary and exchange-rate policy. The former proved more expansive than was compatible with the stabilization program, due to the accumulation of reserves, and the exchange rate lagged behind, generating significant deficits in the trade balance.

Obviously the time which has passed since these tariff changes took place is too short. The full impact has not yet been felt on the structure of the economy. Some changes can already be observed, as is clear from this section, but a more definite evaluation must wait until more time has elapsed and more data become available.

TABLE 16

## FOREIGN DEBT

	Public Sector		Private Sector		Short-Term Monetary system		Total	
	dollars, in	%	dollars, in	%	dollars, in	%	dollars, in	%
	millions		millions		millions		millions	
1970	2.574	82,4	501	16,0	48	1,5	3.123	100
1974	4.022	84,2	413	8,6	339	7,1	4.774	100
1978	4.840	66,2	1.569	22,7	502	7,2	6,911	100

SOURCE: Central Bank, *Foreign Debt of Chile 1970*, Table 2, adapted from R. Ffrench-Davis and J. P. Arellano, "Apertura Financiera Externa, la Experiencia Chilena," mimeo (Santiago: CIEPLAN, 1980).

IV. Changes in the Structure of the Economy

We have, to this point, analyzed the principal changes in the functioning of the economy since the onset of the reforms in 1973. These changes have affected the production structure and distributive patterns. The alterations, however, have been slow in taking shape, and considering the short time-period involved we shall only comment on the apparent significance of some tendencies.

Changes in the productive structure. In Table 17 we show the composition of production and employment for the principal productive sectors. The primary sectors increased their relative importance in production from 20 percent in 1970 to 22 percent in 1978. Despite their greater importance in production, the primary sectors' participation in employment fell from 28 percent in 1970 to 24,6 percent in 1978. On the other hand, the manufacturing sector's relative importance in GDP decreased, as would be expected, since it was the most heavily protected sector prior to the tariff reforms and was at the same time affected by strong decreases in domestic demand. The industrial sector's participation in GDP fell 4 percentage points between 1970 and 1978. In employment, the decline exceeded 5 percentage points. The reduction of industrial employment has continued as a tendency even after 1976, when the industrial product began to recuperate.

The most dynamic sectors in the period are commerce and services. Jointly considered, their participation in production rose from 42 percent in 1970 to 45 percent in 1978. One out of every two jobs in the economy was generated in these sectors by 1978.<sup>26</sup> The importance assumed by the service sectors is such that their participation in production and employment is higher than that of all productive sectors jointly considered (agriculture, mining, and industry). On the other hand, the sectors of infrastructure and construction decreased their importance. The latter reduced its participation in production and employment by half.

TABLE 17

## PRODUCTION COMPOSITION AND EMPLOYMENT (Percentages)

	1970		1974		1978	
	Produc- tion	Employ- ment	Produc- tion	Employ- ment <sup>1</sup>	Produc- tion	Employ- ment <sup>2</sup>
Agriculture	9,7	24,6	9,1	21,7	10,2	20,2
Mining	10,7	3,3	11,6	3,1	12,0	4,4
Industry	26,0	18,8	25,7	16,9	22,7	13,3
Construction	5,0	5,9	4,8	4,5	2,8	3,6
Energy and transportation	6,4	6,3	6,8	7,3	7,1	7,7
Commerce (trade)	22,3	15,1	21,9	14,7	23,6	16,1
Services <sup>3</sup>	19,9	26,0	20,1	31,7	21,6	34,7
Total	100,0	100,0	100,0	100,0	100,0	100,0

<sup>1</sup>Corresponds to the survey of 1975. There is no information for 1974.

<sup>2</sup>Corresponds to the survey of 1977, last information available.

<sup>3</sup>Excludes housing property.

SOURCES: The production columns come from ODEPLAN, Cuentas Nacionales; those for employment from ODEPLAN, Antecedentes sobre el Desarrollo Económico Chileno 1960-1970 and INE, Encuesta Nacional de Empleo.

Summarizing, the changes in the structures of production and employment are meaningful in spite of the short time-frame involved. Some of these changes do not reflect alterations in productive capacity, but only in the degree of utilization of that capacity.<sup>27</sup>

The direction of the changes is clear: the production of primary goods and of commerce and services has grown at a significant rate; industry and the sectors of infrastructure at a very slow pace.<sup>28</sup> Eventually these imbalances in sectoral growth, if persistent, will permanently modify not only the productive structure but also income distribution patterns.

Distributive Changes. Important factors in income distribution in the long run are the changes in property ownership, in the relative power of the different economic agents, and in the sectoral composition of production.



What has happened to the first two factors in the period under study? With regard to economic agents, we earlier described the diminished role of the State and the rapid privatization of economic activities, observing that through this and the general orientation of government policy, the full participation of business (at the expense of labor) was favored, especially that of the large firms and the financial sector. These were the sectors benefitting from the massive transfer of resources which characterized the period of transition toward price stabilization and free trade.

In fact, a recent study on the subject identifies the groups favored by the process and describes the degree of asset concentration that results. Some indicators at the end of 1978 were the following: (a) five economic conglomerates controlled 53 percent of total assets in a sample of the 250 largest private enterprises; (b) nine conglomerates, including the previous five, controlled 82 percent of assets in the banking system; (c) the same groups controlled 60 percent of banking credit and 64 percent of loans by non-banking financial institutions; and (d) in a sample of 100 enterprises, the assets of firms controlled by the five more important groups grew by 97 percent between 1969 and 1978, while for the rest of the enterprises the real value of assets grew by only 14 percent.<sup>29</sup> This figure is indicative of the rapid expansion of conglomerates, a significant feature of the process of asset concentration, together with the privatizations, the reversal of agrarian reform, and the liberalization of prices accompanied by wage repression.

In the short term--that is, until 1978--the distributive changes observed were strongly influenced by high unemployment and the fall in real wages observed as of 1974. In Table 18, employment and unemployment figures are given.<sup>30</sup> Employment at a national level, which had grown 2 percent per year during the 1960s, showed a growth of only 0.3 percent per year between 1970 and 1978, and stagnation between 1974 and 1978.

The slow growth of employment, together with an expansion in the working-age population of nearly 10 percent between 1974 and 1978, explains the high unemployment rates, which are more than twice the historic rates. In 1979, unemployment reached 13.8 percent. Adding to this the so-called "minimum employment program," the figure would rise to 18.4 percent. The unemployment rate for blue-collar workers reaches 28.4 percent if one includes the minimum employment program.<sup>31</sup> High unemployment has been accompanied by a drop in real wages that reached 40 percent in late 1974-early 1975.<sup>32</sup>

The simultaneous reductions in employment and wages have generated a regressive distribution of income, a proxy for which we consider household consumption expenditures by income brackets. The figures are given in Table 20 and point to a concentration of consumption in high-income families.<sup>33</sup> On the other hand, empirical evidence shows a marked stratification in consumption. The consumption of non-essential consumption goods imports, which grew by about 300 percent between 1970 and 1978, has been densely concentrated

in the highest 20 percent of the families. These families consume nearly 60 percent of the total, as can be seen in Table 19. The trickle-down in consumption to other income groups has been scant, being almost negligible for the lower 20 percent of the families.

TABLE 18

## EMPLOYMENT AND UNEMPLOYMENT (thousands of persons)

	Labor force (1)	Employed (2)	Unemployed (3)	Unemploy- ment rate (4)	PEM* (5)	Unemployment plus PEM on labor force (6)
1970	2.950,1	2.770,1	180,0	6,1	-	6,1
1974	3.189,6	2.896,2	293,4	9,2	-	9,2
1975	3.169,8	2.743,5	426,3	13,4	60,6	15,4
1976	3.139,8	2.628,0	511,8	16,3	157,8	21,3
1977	3.197,3	2.750,7	446,6	14,0	187,7	19,8
1978	3.307,2	2.845,8	461,4	13,9	145,8	18,4

\*PEM: Minimum Employment Program.

SOURCES: Columns (1) to (4) Meller, Cortázar, and Marshall, *op. cit.*; column (5) *INEC* E, *Informativo Estadístico*; column (6) is obtained from columns (1), (3) and (5).

In contrast to the expansion of sumptuary consumption which has been concentrated in the high-income groups, essential food consumption per family for the poorer groups experienced a reduction of 20 percent in real terms between 1969 and 1978, as can be observed in Table 20. Instead, consumption per family of the same basic food products for the high-income groups has grown slightly. This marked dualism in consumption seems to be an essential characteristic of the model. It is in agreement with the patrimonial changes and income-distribution patterns previously discussed.

### V. Conclusions

The Chilean economy in the period 1974-1979 has simultaneously been subject to a process of economic stabilization and a transition toward a free market economy.

In the first aspect, a substantial decrease in the rate of inflation was attained, the balance of payments was adjusted accumulating international reserves, and, after passing through a deep recession, the economy shows signs of recuperating to 1970 levels of production. Other indicators, however, show negative results:



TABLE 19

IMPORTED NON-ESSENTIAL CONSUMPTION (millions of dollars of 1977 and % of the total consumption)

	Imports			Consumption by quintiles				
	1970	1978	Rate of growth	High in-comes V	IV	III	II	Low in-comes I
1. Leather manufactures and furriers	1,3	3,4	161,5	69,2	16,9	8,6	4,0	1,3
2. Imported alcoholic drinks	0,6	11,9	1,883,0	54,8	5,0	0,0	0,2	0,0
3. Imported tobacco, cigarettes, and cigars	7,7	9,4	22,1	91,7	4,5	3,6	0,2	0,0
4. Clothing, textiles for the house, and carpets	24,1	91,0	277,6	55,0	21,1	12,9	8,0	3,0
5. Photographic and cinematography products	7,8	10,3	32,1	62,6	14,8	22,0	0,6	0,0
6. Footwear, hats, umbrellas, and sunshades	2,0	7,3	265,0	41,6	24,2	17,3	11,2	5,7
7. Musical and optical instruments	4,3	9,6	123,3	59,6	20,3	13,5	5,5	1,1
8. Toys, games, and recreational articles	3,4	22,6	564,7	61,0	22,3	8,9	5,7	2,1
9. Cosmetics, Eau de cologne, and perfumes	0,1	6,6	6.500,0	39,7 (44,5)	24,9 (25,4)	16,8 (14,9)	12,0 (10,1)	6,6 (5,1)
10. Black and white, and color TV sets (only color)	0,7	56,3	7.942,9	30,3 (100,0)	18,3 (0,0)	23,5 (0,0)	19,3 (0,0)	8,6 (0,0)
11. Radios (excluding portable radios)	4,6	28,7	523,9	48,7 (54,9)	21,5 (22,9)	14,6 (11,1)	12,5 (11,0)	2,7 (0,1)
12. Cars and motorcycles	19,0	40,6	113,7	97,4	2,6	0,0	0,0	0,0
Total	75,6	297,7	293,8	56,4	19,1	12,6	8,4	3,5

SOURCES: French-Davis, "Políticas de Comercio Exterior en Chile: 1973-78"; Instituto Nacional de Estadísticas, III Encuesta de Presupuestos Familiares, Vol. III (May 1979).

TABLE 20

CONSUMPTION OF BASIC FOOD PRODUCTS BY HOUSEHOLDS (Pesos of June 1978)

	Lower 20% Consumption			Higher 20% Consumption		
	1969	1978	variation %	1969	1978	variation %
1. Flour and starch	387,6	406,8	5,0	778,6	719,6	-7,6
2. Meats	357,9	219,1	-38,8	1.534,5	1.627,2	6,0
3. Oils	105,4	71,2	-32,4	269,4	201,0	-25,4
4. Milk products and eggs	138,9	106,1	-23,6	618,3	641,5	3,8
5. Vegetables	144,0	97,5	-32,3	257,9	197,4	-23,5
6. Sugar	97,0	73,4	-24,3	191,8	154,2	-19,6
7. Energy and fuel	227,3	181,8	-20,0	501,6	641,1	27,8
8. Urban transport	129,8	102,9	-20,7	277,8	284,5	2,4
9. Total	1.587,9	1.258,8	-20,7	4.430,0	4.466,5	0,8
10. % of total consumption		49,9			18,0	

SOURCE: INE, Encuesta de Presupuestos Familiares, 1969 and 1978.

high unemployment which persists in the seventh year of the application of the policy, a regressive distribution of income and household expenditures, low investment levels, a deficit in the current account of the balance of payments, and increased external debt. These indicators cast a shadow on the growth potential of the model applied in Chile and on its capacity to absorb labor in productive activities.

But macroeconomic indicators are only the more visible, and perhaps less important, part of the revolutionary process of change in the Chilean economy during the period. The process of transition to a free market economy implied that, simultaneously with the anti-inflationary policy, deep structural reforms were carried out: a drastic privatization of the economy, a quick opening of the economy to world markets, and a massive transfer of resources to the modern sector of industry and finance. As a consequence of the latter, powerful conglomerates with broad economic and political influence have emerged. This is one of the outstanding traits of the industrial organization scheme which has arisen from the experiment.

The conglomerates, or "economic groups," are in fact the new actors in the development process. They increasingly control industrial assets, as well as those of banks and financial institutions. In addition, they are the dynamic agents in the process of industrial revitalization to face foreign competition. These conglomerates are also the entities that have established close relations with the private

international banks which control the larger proportion of the flow of external loans.

The other basic modification in the functioning of the Chilean economy refers to the radical opening up to world markets. This process has not resulted in as profound a dislocation of the industrial sector as could have occurred. Although several industrial branches have suffered significant losses in markets and industrial employment has dropped, other activities seem to have adapted successfully.

The financial opening which has accompanied the commercial opening has helped to overcome the problems derived from the recession and the transition to the open economy. Nevertheless, it has had distorting effects in other aspects. It has prolonged the price stabilization period, as it has become the most important source of monetary expansion. At the same time, it has reinforced the tendency toward asset concentration, as it has given differentiated access to cheap external credit (in comparison to internal credit) mainly to large enterprises in the modern sector. And it has made it possible to keep an undervalued exchange rate that coexists with large deficits in trade flows.

Production adjustment, as a result of the opening up of the economy, is just beginning to show. As expected, new production patterns are oriented toward expanding primary production activities (mainly copper mining and agricultural and forestry products) and exports. However, the most dynamic sectors are commerce, financial activities, and personal services. The first two correspond to expanded foreign trade and development of the capital market. Demand for personal services has grown as a consequence of the rapid expansion in income for high-income groups.

At the same time that the productive structure has changed, a higher degree of asset and income concentration can be observed.

What type of economy emerges from the deep structural changes undertaken in Chile after 1973? Certainly what we have is an open economy, with more specialization and with potentially higher incentives for efficiency in domestic production. It is also an economy more vulnerable to changes, shocks, and fluctuations in the international economy. It is, on the other hand, highly dependent on the availability of private external credit to balance the current account deficit.

A salient feature of the model is the wide dispersion between income and consumption patterns between the rich and the rest of the population. With respect to consumption, a marked stratification has been produced. The "deprivation horizon" is a fact for low-income groups, as is the "opulent consumer society" for the higher-income sectors.

This is only one of the unsolved problems of the model. The other results from the inherent contradiction between economic

freedom--a basic objective of the model and of "Friedmanian" conceptualizations--and the political authoritarianism which has accompanied it. Facing the dilemma, the Chilean model has clearly chosen capitalism but forgotten about freedom.

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- <sup>2</sup>J. Cauas and A. Saieh, "Política Económica 1973-1979," Boletín del Banco Central, No. 621 (November 1979).
- <sup>3</sup>R. Prebisch, "Estructura Socioeconómica y Crisis del Sistema," Revista de la CEPAL (2nd sem. 1978). "Even if orthodox neo-classical principles are followed with intelligent virtuosity, the great objectives of economic efficacy, social efficiency, and respect for human rights cannot be reached simultaneously."
- <sup>4</sup>I. Friedman, "The Role of Private Banks in Stabilization Programs," mimeo (Washington, D.C.: Brookings Institution, 1979). His study deals with this topic from the point of view of private international banks.
- <sup>5</sup>It should be noted that the National Accounts have been published until 1976 only. There are estimates for some global indicators prepared by ODEPLAN which cover the years 1977 and 1978, and which have been repeatedly modified by ODEPLAN. These must be considered provisional figures. The estimate of the 1979 growth rate was made by GEMINES, a private firm. It is not an official estimate.
- <sup>6</sup>The Wages and Salaries Index in nominal terms has been deflated by the Consumer Price Index as corrected by R. Cortázar and J. Marshall. The corrected CPI shows that actual price increases in 1978 were 52.8 percent over the official CPI published by the National Statistical Institute (INE) and 27.5 percent over the CPI corrected by the University of Chile, the latter having been the most commonly used until the Cortazar-Marshall study.
- <sup>7</sup>A. Foxley, "Políticas de Estabilización y su Impacto sobre el Empleo y la Distribución del Ingreso," Colección Estudios CIEPLAN No. 2 (1979).
- <sup>8</sup>A. Foxley, *ibid.*
- <sup>9</sup>Some examples are given in A. Foxley, "Inflación con Recesión: Las Experiencias de Brasil y Chile," Colección Estudios CIEPLAN No. 1 (1979).
- <sup>10</sup>C. Díaz-Alejandro, "Southern Cone Stabilization Plans," mimeo (Washington, D.C.: Brookings Institution, 1979).
- <sup>11</sup>There are no National Accounts available after 1977.
- <sup>12</sup>J. E. Herrera and J. Morales, "La inversión financiera externa: el caso de Chile 1974-1978," Colección Estudios CIEPLAN No. 1 (1979).
- <sup>13</sup>With regard to 1973, the fall in public employment was 25 percent and represented a decrease of 100,000 persons.

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<sup>14</sup>The calculation was made based on the figures of F. Dahse, Mapa de la Extrema Riqueza (Santiago: Editorial Aconcagua, 1979), for a sample of 41 enterprises, as explained in the note of Table 8.

<sup>15</sup>Although no information is available, it is probable that the sale price of the lands has been significantly below market value due to the sellers' inability to operate at a profit under drastically changed conditions: very expensive credit, no technical assistance, etc.

<sup>16</sup>R. Zahler, "Repercusiones Monetarias y Reales de la Apertura de la Economía Chilena, 1975-1978," mimeo (Santiago: CEPAL, 1979).

<sup>17</sup>J. Ramos.

<sup>18</sup>Ffrench-Davis, "Políticas de Comercio Exterior en Chile"; P. Vergara, "Apertura Externa y Desarrollo Industrial en Chile: 1974-1978," mimeo (Santiago: CIEPLAN, 1980).

<sup>19</sup>Most of what follows is based on Ffrench-Davis, "Políticas de Comercio Exterior en Chile."

<sup>20</sup>Only exports of goods are considered in these figures.

<sup>21</sup>Excluding oil, wheat, and maize.

<sup>22</sup>The customs-duties reduction started to be an important factor only in 1976. See Ffrench-Davis, "Políticas de Comercio Exterior en Chile"; Vergara, op. cit.

<sup>23</sup>Ffrench-Davis, "Políticas de Comercio Exterior en Chile."

<sup>24</sup>Vergara, op. cit.

<sup>25</sup>The private debt increased from 8.6 percent of the total in 1974 to 22.7 percent in 1978 (Ffrench-Davis and Arellano, op. cit.). The origin of the foreign debt also changed significantly. While in 1975 only 14 percent originated in banks and private financing institutions, in 1978 this percentage had grown to 43 percent. This fact alters the credit conditions, since the terms are generally shorter and the interest rates higher. See Herrera and Morales, op. cit.

<sup>26</sup>This happens in spite of the fact that employment in education and health was reduced. Employment in "other services" increased by 21 percent between 1975 and 1977.

<sup>27</sup>Of course to the extent that idle capacity is maintained as such for an extended period in some sectors, it becomes an incentive for further expansions to be oriented toward other activities, those where the "new" demand is concentrated.

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<sup>28</sup>According to ODEPLAN, the production indexes for 1978 (basis 1970 = 100) are the following: primary goods, 126; trade and services, 124; industry, 102; infrastructure, 101.

<sup>29</sup>Dahse, op. cit.

<sup>30</sup>Employment figures rectify previous official estimates that showed a rapid expansion in employment. New figures are from the study by Meller, Cortázar, and Marshall, op. cit.

<sup>31</sup>This figure is for 1977, the last year for which this information is available. See Instituto Nacional de Estadísticas, "Encuesta Nacional del Empleo," 1977.

<sup>32</sup>It should be noticed that the index of wages and salaries utilized underestimates the actual wage reduction in the economy as a whole. The index only represents adequately the average wages and salaries in industrial firms with more than 20 employees, and in mining and public services. It does not include the agricultural, trading, and services sectors, in which wages and salaries are lower. See University of Chile, Department of Economics, "Comentarios sobre la situación económica," 2nd. semester 1978.

<sup>33</sup>This information, which is in accord with the employment and salary indicators, contradicts recent affirmation that income distribution in 1978 would not be significantly different from that of 1970. According to I. Heskia's figures, the distribution would even have improved in the worst recession years. For a criticism of the results of I. Heskia, see R. Cortázar, "Remuneraciones, Empleo y Distribución del Ingreso en Chile 1970-1978," mimeo (Santiago: CIEPLAN, 1979).