Lecture 3
Chile as a model

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By the mid 1980s, those countries in Latin America amidst stagflation processes or that saw their economies about to fall into hyperinflation, looked at Chile, the emerging model in the region.

The Chilean experience in the last quarter of the XX century has been intensely studied, and as a consequence there is a wealth of bibliography that analyzes, describes and explains Chile's economic process in that period. I cannot think of any other country in Latin America that has drawn the attention of the academia more than Chile, probably with the exception of the Argentine case from 1870 to 1930.

Chile in the last 25 years and Argentina by the turn of the XIX century attracted the attention due to the same reason. Argentina first, and Chile afterwards were the success stories in relation to economic and social development in Latin America.

Are there any common factors in those success stories?

In both, Argentina by the end of the XIX century and Chile by the end of the XX century, what stands out is the ability of the State to organize and govern the economy. This is what Javier Corrales calls "Stateness."

In my view, the main reason of Argentina's success by the turn of XIX century was not the adoption of an export-led growth strategy. Almost every country in Latin America adopted that model by that time. The success came as a result of the ability of the State to implement and sustain a particular set of policies, not only economic but also social policies. Those policies affected every aspect of economic life, from immigration policies that attracted people and capitals to the country, and the development of the transport and communications infrastructure to the creation of an education system, which was a milestone in Argentina's development process. It offered obligatory primary education to every child in the country and hence, was very successful in reducing illiteracy early on, and opened the door to social mobility.

Due to this set of policies, the country was able to take full advantage of the opportunities offered by the globalization process led by the United Kingdom back then.

I consider that Chile's success in the last few decades cannot be explained only because it opened its economy or implemented a free-market strategy that allowed for more private participation in markets, which in turn operated under competitive conditions.

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By and large, almost every country in Latin America followed the same path in the same period. Chile's success should be explained due to the ability of the State not only to establish new rules of the game, but also what is more important to sustain them. These new rules of the game have not been altered. Chileans only introduced changes that improved them, but never tried to go back to the old economic "disorder."

The article by Andres Velasco entitled "The State an Economic Policy: Chile 1952-1992" explores the reasons why the Chilean State was able to achieve an increasing degree of autonomy and increasing capacity to govern the economy, or, in other words, increasing "Stateness".

Chile during the period 1964-1990

Chapter 5 of the book by Javier Martinez and Alvaro Diaz, entitled "A Capitalist Revolution" summarizes the period 1964-1990 as a "revolution" that was not imposed by external forces nor was the outcome of an endogenous process. Rather it was a revolution imposed by the nation's leadership. From 1964 to 1990 the country, according to those authors, was led by three different political elites, each of which had developed its own program of radical reforms. The "Revolution in Liberty" led by Eduardo Frei, the "peaceful road to socialism" led by Salvador Allende and the "neo-liberal revolution" led by Augusto Pinochet were three programs aimed at radically changing the system.

The authors explain that those three elites ended up defeated in the political arena. The Christian Democrats by the Socialists, the Socialists by the Military and the Military by the forces of a new democratic consensus. However, the combined action of the three streams brought about a real capitalist revolution.

Most interestingly, the democratic administration that took over after the Military Dictatorship did not try to undo this revolution. On the contrary, it allowed the new rules of the game to stay in place and therefore, the economy could sustain high growth rates and society could achieve progress and enjoy higher standards of living.

Which was then a key factor in the stability of the new economic and social institutions in Chile?

I find Andres Velasco's explanation very convincing. Groups protected by the elites that alternatively had ruled the country: Conservatism, Christian Democrats and Socialism, exerted power in a discretionary fashion. This use of power affected so deeply property rights, freedom and security of the groups occasionally in the opposition that clientelism as a way to do politics fell into an insurmountable crisis by the time of the Military Coup of 1973.

Every sector that had benefited from the State's arbitrary use of power, had also suffered significant losses when they lost power. Therefore, when the technocrats that advised the Military proposed a complete overhaul of the economy and to set "rules" which in turn would significantly reduce the arbitrary use of power, every sector ended up endorsing the proposal.

By accepting the new strategy, these groups and elites would forgo the benefits of the arbitrary use of power in their own benefit, but by the same token they would be protected against the high risks that usually had accompanied abrupt changes in Government top positions.

What did Latin American leaders and economists learn from the Chilean Experience?

Economists across Latin America interested in public policy had followed the Chilean reform and had compared it with the situation in their own countries. Several of these economists were already involved in public policy discussions and public policy making. Others would enter that arena soon. To us, the Chilean experience became a crucial piece of learning. What did we learn from it? We understood the importance of the discussion about "rules versus discretion". In Europe and the US academia was discussing these topics in regards to monetary policy. The Chilean experience showed us, Latin Americans that an economic organization should be based upon clear rules of the game, and it should not leave room for discretion and arbitrariness. Such an organization is important not only in monetary policy, but also in fiscal policy, in trade policy, and more generally, it is important for the smooth functioning of every aspect of the economy and the society at large.

The ideological origin of Chilean reforms and its influence on other LA economies

From 1972 to 1977, Chile experienced stagflation and was at the brink of hyperinflation. In such dramatic moments, Chile started to shape the new rules of the game that the democratic process would consolidate in the 1990s.

In 1974 I came to Harvard to attend a PhD in Economics, and stayed until 1977. During those years, I had the opportunity to discuss with other colleges about what was going on in Chile and Argentina. Several of them would actively participate in politics and in Chile's Administration later on.

Among them, I remember Jose Piñera, who would be Minister of Mines and Labor during the military rule and would foster the labor and social security reform, his brother, Sebastian Piñera, who would be a Senator and the President of the Party for National Renovation, Eduardo Aninat, who would be Minister of Finance of Eduardo Frei Administration, and Jorge Dosermeaux, who is currently member of the Board of Chile's Central Bank. Alejandro Foxley and Vittorio Corbo used to visit Harvard and MIT. Alejandro Foxley would be Minister of Finance of Patricio Aylwin Administration and the President of the Christian Democratic Party. Vittorio Corbo is currently the President of Chilean Central Bank.

I remember our discussions back then, and hence, I am certain that neither the multilateral organisms nor the US Treasury had a say or influenced the process that was taking place in Chile. What I certainly do remember is that the Chilean economists were very aware of and concerned about the drama Chile was going through, as any other Latin American economist was.

In the summer of 1976 and the spring of 1977 I worked with Professor Richard Musgrave as a member of a Fiscal Reform Mission to Bolivia organized by Harvard

University. Professor Arnold Harberger from Chicago University and several Chilean economists were part of the mission as well. Professor Harberger was mentor of several Chilean ministers back then.

I remember our discussions in relation to Chile's situation over dinner in La Paz. That experience helped me understand the great influence Chile's experience would have on Victor Paz Estenssoro Administration in Bolivia during the 1980s, when hyperinflation imploded in a context that resembled Chile in 1976.

Without any doubt, Chile and Bolivia's experiences helped me to understand my country's problems in the 1980s, and to design the economic reform program we launched in 1991 in order to curb the hyperinflationary process that exploded in 1989 and 1990.

In those years, although I was well aware of what was happening in Latin America in the political, economic, and social arena, I had never heard of the Washington Consensus. Yet, by that time the US demonstrated its interest in providing support to Latin American countries that were pursuing democratization processes.

Standard wisdom says that the US decided to support Latin America economic growth as a means to foster the Washington Consensus in the region. I believe that the situation was somewhat different. I think that the Brady Plan and the negotiation of NAFTA were the positive responses to the demands made by the new Mexican Administration headed by Carlos Salinas de Gortari, who had taken over in December 1, 1988.

Hence, next class we will discuss the Mexican Way.