

THE CHILEAN CRISIS: A NOTE ON THE CONSEQUENCES OF LIBERAL POLICIES TOWARDS THE PRIVATE SECTOR

CARMEN LUZ LATORRE

CHILE has been in economic, social, and political crisis since the second half of 1981. The economic indicators show that production fell 14.3 per cent in 1982 and foreign currency reserves fell to U.S.\$1,485.6 million in April 1983, the lowest level in four years. The balance of payments deficit was U.S.\$1,007 million in July 1983. Unemployment for the entire nation was 17.8 per cent and for the metropolitan region 18.6 per cent for May–July 1983. Participants in the Minimum Employment Program (PEM)¹ and the Household Heads Program (POJH)² should be added into these figures because they actually constitute a form of disguised unemployment, 10.6 per cent and 4.2 per cent, respectively, of the labor force in July 1983. Unpaid debt to banks in March was 1.36 times the capital and reserves of the entire nation's financial institutions. In 1983, the economic crisis extended to the political and social sphere as well.

The crisis was a surprise to many people, both nationally and internationally, because it was a rejection of the widespread image of success that Chile retained until the middle of 1981. That image was widely perpetrated, not just by Chilean authorities, but by respected foreign personalities and institutions in the academic and financial world.

What are the causes of the present crisis? Why was there such a difference between what was expected and what really happened? Answers to these questions must be clarified and perspectives given for the future. Even though the crisis is economic, social, and political, I will deal here mainly with the economic aspects.

The Chilean case is quite interesting, because it represents an extreme application of the market economy model. The monetarist focus has been used for short-run control of the economy. And a profound structural change has taken place in the organization of society based on neo-liberal conceptions. The “ex-

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¹ PEM is the Programa del Empleo Minimo. It is a special program created by the government to provide some income to the unemployed.

² POJH is the Programa Ocupacional para Jefes de Hogar. Its purpose is the same as with PEM, but the target is heads of households. The program was created in 1983.

periment" was made possible by the military government's tight political control over the population.

Although the government usually blames the international situation for the crisis, the main factors determining the outcome lay in the particular features that the government has given to the development process; transferring most of the responsibility for resource allocation to the private sector. The private sector organized itself and operated in such a way as to make the economy work for the benefit of a few. That is the situation that existed until crisis forced the government to intervene. It must be said that the private sector showed a complete lack of understanding of what benefitted the country, always setting their own interests above those of the nation.

The experiment has resulted in low rates of investment, high foreign debt levels, especially by the private sector, and regressive changes in income distribution.

I. THE ECONOMIC FRAMEWORK SET BY THE GOVERNMENT

A. *Stabilization Policy*

When the military government took power in September 1973, Chile's rate of inflation was so high that it would have been impossible to implement any economic program. According to the official price index, the rate of inflation was 34.9 per cent for fiscal 1970 (Jan.-Dec. 1970), 221.6 per cent for 1971-72 and 508.1 per cent for 1973. Later studies show that the situation was even worse: 1970, 36.1 per cent; 1971-72, 355.4 per cent; and 1973, 605.9 per cent [8, p. 161].

At the same time, there were serious problems in the balance of payments. The government required external support in order to renegotiate the debt and obtain new credits. But to do that, the government first had to get inflation under control. And, to get a handle on inflation, the government put the main focus of its economic policy on stabilization. The program to reduce inflation consisted of (1) making prices play a greater role in guiding resource allocation; (2) adjusting the rate of exchange on the peso so that it would reach its true value and so that foreign prices would operate as a brake on internal prices; and (3) controlling the public deficit.

To accomplish that: (1) Prices were liberalized in a hope that the pricing situation would change once and for all and that there would be a more efficient allocation of resources. (2) The rate of exchange on the peso increased in real terms from 1974 to early 1976, but the trend subsequently changed because the rate of exchange began to be used to control inflationary expectations. Consequently, the exchange rate has been very unstable. (3) The public deficit has been reduced to less than historical levels by reducing expenditure and increasing indirect taxes.

The annual rate of inflation finally slowed to about 25 per cent, clearly one of the government's achievements.

However, the simplistic application to an underdeveloped economy of an economic theory that assumes automatic adjustment of market had disastrous consequences, causing among other things great losses in production and employment.

First, when prices were liberalized in the early months of the new government, salaries were fixed. The government anticipated that such a measure would produce equilibrium after the first jump in prices. However, it should not have been taken as given, because since prices had been controlled for such a long time, an abrupt liberalization had to make them jump upward in a chain reaction. Uncertainty makes every businessman estimate what the levels of inflation will be and forces him to set prices accordingly. As a consequence, inflation stayed at high rates, production and employment began to deteriorate (after some improvement at the end of 1973) and the balance of payments went into serious disequilibrium.

Second, as a consequence of the above described situation in 1975 the government instituted its "shock policy": strict monetary control, reduced public expenditures and the privatization of a large number of public corporations. Such measures meant that the government was operating as if the economy was closed. The international recession caused by the first oil price hike was already affecting the Chilean economy and the measures taken in the "shock period" contributed substantially to worsening the recession. Public expenditure was reduced mainly by decreasing investment and personnel expenses, thus increasing unemployment. The result was a combination of inflation and recession.

Third, in June 1979, the peso was pegged at a fixed rate of thirty-nine pesos to one U.S. dollar until the middle of 1982. The assumption behind this move was that since the economy was already open with tariffs at a level of 10 per cent (except for cars), if the rate of exchange was fixed, domestic inflation would move towards an equal level with international inflation. The rate of inflation did decrease, but it stayed well above the international level. This damaged exports and encouraged imports. The situation was worsened by the fact that the currency to which the peso was pegged, the dollar, was constantly revaluating (about 15 per cent between June 1979 and June 1982) with respect to the currencies of the other industrialized countries, rendering Chilean exports more expensive in two ways. The government's approach exacerbated the existing trade deficit. Moreover, domestic businesses producing goods competitive with foreign imports faced a very unfavorable situation because prices of their goods were rising. The increased need for loans kept domestic interest rates high and raised national indebtedness and resulted in obvious damage to domestic production and employment. The loss of reserves at the end of the period was extraordinary. A policy of gradual revaluations would have been much more appropriate.

B. *Financial Policy*

One of the government's basic objectives has been to develop an active private capital market because this was thought to be the best complement to an agile

private business sector, guaranteeing high domestic savings and the best allocation of resources.

To accomplish this goal, most of the existing restrictions on the operation of the capital market were eliminated and the market was opened to foreign capital. Through this approach, the government intended to equalize internal and external interest rates.

However, the resultant situation has been quite different. Real domestic interest rates have been very positive: 51.2 per cent in 1976; 39.4 per cent in 1977; 35.1 per cent in 1978; 16.9 per cent in 1979; and 12.2 per cent in 1980 [10, p. 31]. In 1981, the rate again jumped to 35.5 per cent. On the other hand, real interest rates on foreign credit have been negative for some years.

The operations of a free capital market have not encouraged internal savings. Instead, they have increased, relatively, the incentive to consume. The average annual rate of consumption has increased by 1.9 per cent, while domestic savings have declined. The rate of domestic savings was 15.1 per cent between 1960 and 1970, but it declined to an average of 11.5 per cent for the period of 1974–82, and as low as 7.3 per cent for 1981 and 2.6 per cent for 1982 [16, p. 45]. This has meant greater dependency on external savings.

The financial policy's contribution to the crisis can be seen not just in terms of high interest rates and declining domestic savings, but also in the way the policy was implemented making it become an important vehicle for the concentration of wealth in the large corporations, which has been very damaging to the national economy. For example, most of the banks were privatized during the severe recession of 1975. The only people who could buy the banks were those who had large amounts of their own capital available or who had access to foreign credit. This financial power allowed them to buy other enterprises at relatively low prices because the owners were having serious financial problems. In addition, the government ignored the segmentation of the capital market; the restrictions set on foreign indebtedness were such that they guaranteed greater access by the larger corporations and banks, a fundamental source for the accumulation of wealth. On the other hand, medium and small business could hardly have access to foreign credit, since the state had ceased its intermediary role between small business and the foreign capital market.

The private sector as the major channel for foreign credits rather than the state or CORFO³ has had a series of deleterious consequences. First, it prevented the state from directing industry towards activities in the greater national interest. Second, the autonomous power of the private sector in creating money through the flow of foreign currency has, on a number of occasions, forced the government to enact measures such as altering the rate of exchange and increasing the restrictions on capital flow. The government has done this to control the effect that massive capital flow would have had on monetary expansion and consequently, on inflation. Third, the access to cheaper foreign credit has not significantly decreased domestic interest rates.

³ CORFO is the *Corporación de Fomento de la Producción*. It is a public institution which promotes industrial development.

The way in which the financial sector has developed has not been controlled by the government. Only until well after the manifestation of crisis did the government start to design measures for intervening in the operations of the private financial institutions.

C. *External Policy*

Another basic government target was the opening of the economy to free international trade. Under free trade, the assumption was that Chile would develop activities in which it has comparative advantage and that inefficient industries would disappear. Although production would become more specialized, the aggregate economy would operate more efficiently. These factors, together with the relatively free flow of capital, would ultimately make market forces determine the rate of exchange. During the transition period, the rate of exchange was to be adjusted so that its real value would increase. The adjustments would also compensate for the effects of opening the market to international trade so that business would have time to adapt to the new conditions. In the new context, exports would be the most dynamic area of the economy. They would be stimulated by increases in the real rate of exchange, lower prices of imported inputs, and complementary measures that include return of the value-added tax on components and export products, tariff exemptions on imported components and export goods, and creation of the Office for Export Promotion (PRO-CHILE).

Even though non-traditional exports expanded, the high speed at which the market was opened, the indiscriminate low level of tariffs for all imported goods, the acceptance of any type of imports and the use of the exchange rate to attain other objectives (i.e., controlling inflationary expectations) resulted in such a rapid increase of imports, principally consumption goods other than food (where most luxurious goods are included), that a substantial trade deficit was produced from 1978 until the crisis.

The large flow of foreign credit, principally from private sources with shorter payment terms and higher interest rates, increased the absolute amount of annual interest and amortization. This, together with the people's free purchase of foreign currency, has produced large deficits in the current account. Deficits sustained over long periods were possible due to the increased quantity of foreign credit arriving in the country. But, as a result, the country became extremely vulnerable to external conditions and heavily dependent on foreign savings. Thus, the international recession, which affected all countries during 1981 and 1982, produced such a profound crisis in Chile that the country will continue to be affected far beyond 1984.

The importance of the external sector in the country has greatly increased during the period. The rate of the combined value of exports and imports of goods and services as a part of GDP shifted from 39 per cent in 1970 to 80 per cent in 1980, while the rate for all of Latin America went from 26 per cent to 50 per cent [13, p. 24]. Nevertheless, the greater importance of the external sector has not given the country a solid basis for development.

D. *The Changing Role of the Public Sector*

The changes undergone by the public sector during this period shows it as a sphere where the long-range objectives of the government's political, social, and economic programs can be more clearly seen. One of the government's major goals was to reduce the public sector's role; the grounds for this move being that its operations were inefficient and regressive. Consequently, the government decided, in 1974-75, to sell most of the public banks and corporations to the private sector at low prices. As part of its strategy for reducing inflation, public expenditures were reduced, particularly those on investment. The sectors most affected were housing and transport-communications [14, p. 71]. Reduction of investment in those sectors had serious social consequences: it generated great numbers of jobless workers and biased the housing programs to detriment of low-rent housing for the poor, because the private sector, unlike the government, does not usually construct low-rent housing. To cope with that problem, the government devised subsidies for low income families, but the subsidies have not worked well. Medium and upper-income families, rather than the poor, have received government support [1, p. 58].

The state's role as employer, especially in development services, has also declined. Between 1974 and 1978, administration reduced its number of employees by 3.3 per cent, social services reduced theirs by 0.2 per cent, the development services by 16.1 per cent, and the public corporations by 11.9 per cent [12, p. 55].

The state has also lost importance in the financial sector. The public sector's 49.3 per cent share of all financial institutions savings in 1970 had dropped to 25.3 per cent in 1980. The private sector share went from 11.1 per cent to 73 per cent in the same period [18, p. 136].

The state's role of obtaining foreign capital and guiding it into projects with high social return has also declined. In fact, the state share of medium- and long-term foreign debt went down from 80.1 per cent in 1970 and 87.8 per cent in 1973 to 35.1 per cent in 1981 and 37.2 per cent in 1982 [3, p. 229].

There have been three main uses for public foreign debt. Amortization of existing foreign debt, covering deficits in the current account, and accumulation of reserves.

Reduction in the state's economic role has not been offset by active development of profitable and strategic public enterprises (e.g., CODELCO).⁴ Public corporate development has been seriously restrained by government restrictions on access to foreign credits and abrupt pressures on the public corporations to find their own sources of financing. Many public corporations have had to raise funds from the more expensive domestic capital market and this has placed even greater upward pressure on interest rates.

⁴ CORDELCO is the Corporación del Cobre. It is a public service in charge of the management of the most important copper mines.

II. THE PRIVATE SECTOR UNDER THE NEW ECONOMIC FRAMEWORK

Up to 1973, the industrial sector was the main promoter of Chilean economic development. This sector was well insulated from foreign competition and the peso was overvalued, a factor that made imported industrial components cheaper. The result was a weak Chilean industry. The industrialists were always urging the state to provide them with even better conditions. The existence of idle capacity was more the rule than an exception. Thus, the rapid and wide-ranging reduction of tariffs and the decline in domestic demand had a severe impact on the industrial sector. Besides, the government's basic target of transforming the export sector into the leader of the economy has not been achieved. The most dynamic sectors have been commerce and services. These changes in productive structure are clearly shown in the way the private sector has reorganized itself and in the pattern of new leadership of development and accumulation in the country.

A. *Emergence of New Economic Groups*

There were three large and seventeen medium-size economic groups in the 1960s. The rest were individual entrepreneurs. During the period under study, the number of economic groups and their wealth has increased and there has been an overall reduction in the number of individual businessmen.

The economic groups in the textile industry were a powerful influence during the 1960s, but their importance has greatly declined. The new groups that have appeared base their power mainly in the activities of the financial sector.

Elements contributing to the formation of these economic groups are listed here.

(1) The privatization of public corporations and banks at highly subsidized prices.

(2) The relative autonomy given to the operation of the financial market and extraordinarily high rates of interest prevailing for the period which generated important margins from financial intermediation.

(3) The tariff reduction rapidity and high interest rates meant difficulties for many corporations and even drove some into bankruptcy. These conditions made the corporations available at especially low prices.

(4) The opening of the economy to foreign credit, though gradual, has been done under such conditions that only the largest banks and corporations have access to that credit. Substantial differences in international and domestic rates of interest have been a great advantage to those with access to foreign credit.

(5) Social security reform has channeled important resources toward groups dominating the economy.

(6) Contraction in labor costs (through reductions in real and, sometimes, in nominal salaries) and increased labor productivity (due principally to fear of unemployment) has increased corporate income.

A study done by F. Dahse 1979⁵ showed that big economic groups controlled nearly all the private banks, the most important financial institutions, most of the insurance companies, most of the exporters, the largest importers, and the majority of the wholesale and distribution companies [9]. In addition, these groups control the mass media, and as a consequence, they have extended their power to the social and political arenas.

An analysis of the five most important economic groups clearly shows the rapid concentration of wealth into the hands of these groups from 1974 to 1978 and the wide range of activities they are involved in.

Group I: Cruzat-Larrain

In 1974, Cruzat-Larrain controlled ten corporations. In 1978, this economic group already had a say in the control of the patrimonial property of 109 companies: 26 real estate and investment; 6 banking, finance and insurance; 12 agricultural and forestry; 4 mining; 7 construction; 34 manufacturing; 10 commercial, and 10 in the miscellaneous category. The patrimony of corporations controlled by this group on December 31, 1978 was about U.S.\$1,000 million, far greater than the total of \$818.7 million in foreign currency obtained from non-traditional exports in 1978.

Group II: Banco Hipotecario de Chile (B.H.C.)

In 1974, B.H.C. controlled 18 companies and by 1978 was participating in the property of 65, 61 of which it controlled. The total patrimony for December 1978 was about U.S.\$520 million. The companies controlled by B.H.C. at that time were 18 real estate and investment companies; 9 banking, financial and insurance; 6 agricultural and forestry; 3 mining; 2 construction; 15 manufacturing; 3 commercial, and 10 miscellaneous companies.

Group III: Matte

Matte participated in the property of at least 45 companies, directly controlling 35, for which the patrimony in December 1978 totalled about U.S.\$360 million. The types of companies participated in were: 17 real estate and investment; 8 banking, financial and insurance; 8 agricultural, forestry and mining; 7 manufacturing, and 6 miscellaneous.

Group IV: Angelini

Angelini controlled only 4 corporations in 1970, but by December 1978 it participated in the patrimonial property of 26 corporations, and controlled 16, the patrimony of which was U.S.\$140 million. Angelini mainly concentrates on forestry and fishing companies.

Group V: Edwards

Edwards was the most important economic group at the end of the 1960s, but it has now been surpassed by the previous four. In 1970, Edwards participated in 30 companies and in 1978, the number had increased to 35. There were 13 real estate and investment companies; 10 banking and financial institutions, 6 manufacturing companies, and 6 miscellaneous organizations. In December

⁵ The data for December 1978 is taken from the work of F. Dahse [9]. The work was completed during a period of heavy political control and it has enormous importance.

1978, Edwards controlled 26 entities with a patrimony of approximately U.S.\$74 million.

In Dahse's examination of the control of the 250 biggest enterprises in Chile with a total December, 1978 patrimony of over U.S.\$3,000 million, he found that only 5 economic groups controlled 36 per cent of the corporations and 53 per cent of their patrimony. Group I controlled 37 and 25 per cent; Group II controlled 25 and 13 per cent; Group III controlled 12 and about 9 per cent; Group IV 8 and about 4 per cent [9, pp. 146-47].

The big economic groups' control over the capital market was obvious by 1978. They controlled eleven banks with a patrimony in December 1978 of U.S.\$347 million, 45 per cent of all banking patrimony [9, p. 155].

The speed of accumulation has been impressive. For example, group controlled banks increased their patrimony by 38 per cent from 1977 to 1978, while the state's banks patrimony increased by only 22 per cent. In addition, financial institutions, mainly owned by the economic groups, increased their patrimony by 84 per cent from 1977 to 1978 [9, pp. 157-58]. Fifty persons at most controlled private banking. The dispersion of bank stockholders had disappeared.

There are two other channels through which most economic groups have increased their power, mutual funds, and insurance companies.

Mutual funds have rapidly increased their patrimony. From 1977 to 1978, the largest, Cooperativa Vitalicia increased its financial capital from U.S.\$24 million to U.S.\$ 79.37 million, Mutual Fund B.H.C. increased its capital from U.S.\$19.85 million to U.S.\$29.28 million and Capitales Unidos increased its holdings from U.S.\$3.25 million to U.S.\$6.69 million.

Insurance companies are another important channel for group resources. The insurance companies have to keep a certain percentage of the premiums paid by their policy holders in reserve, but this can be invested in stocks. The reserves are consequently concentrated in stocks of companies belonging to the economic groups or companies that they want to control. It must be taken into consideration that if stock ownership is dispersed the percentage needed for control is less than 50 per cent. In 1978, the insurance companies of thirteen groups and sub-groups controlled 53.3 per cent of direct premiums in life and general insurance. One company had 14.2 per cent of the sale of direct premiums.

The problem with such interconnections between financial institutions and business corporations is that if one group's corporations are in trouble, it affects banks in the same group or in different groups if they are lenders to those enterprises. Such problems also simultaneously affect the insurance companies and mutual funds related to the group, and this in turn, affects thousands of depositors.

In May 1981, reform of the social security system opened the way for the organization of the New Pension Funds (AFP)⁶ the final step in the accumulation process. The AFP organizations are enormously important because they guarantee a permanent flow of funds to the owners.

⁶ AFP is the Asociaciones de Fondos de Pensiones.

TABLE I
CONCENTRATION OF CREDITS

	(U.S. \$ million)				
	Cruzat-Larrain	B.H.C.	Matte	Angelini	Edwards
Direct national debt*	452.31	205.61	18.12	} 6.50	40.28
Direct credit from public	26.60	38.80	—		7.58
Debt with CORFO	71.00	45.00	—	10.00	—
Mmutual funds debt	79.00	29.28	—	—	—
Direct foreign debt (1976-78)	110.28	117.99	9.70	1.50	22.22
Total debt	740.00	436.70	27.82	18.00	70.00

Source: Based on the data from [9].

* Does not include financial institutions belonging to the group.

The main organizers of AFPs were the economic groups. In December 1982, AFPs had 44,826.6 million pesos in funds obtained, or 22.6 per cent of the deposits in all financial institutions [4, p. 1,094]. As a security measure, AFPs are required to keep 5 per cent as a reserve in the central bank. The rest of the funds were invested in all kinds of financial instruments.

In December 1982, the AFPs had 1,741,000 participants, or 61.6 per cent of all employed persons and 49.7 per cent of the labor force. The biggest AFP covered 31.5 per cent of all participants and the second largest, 19.2 per cent. In this year, the AFPs of the two most powerful groups had control of three-fourths of the funds [7, p. 12]. The levels of concentration are obvious.

B. Credit Concentration

The accumulation of funds by the economic and financial institutions resulted in a concentration of credits. In December 1978, the economic groups already controlled 60.4 per cent of all foreign and domestic credits, and the state controlled only 27.1 per cent. The state thus lost an important instrument for redistributing and reorienting the economy's productive processes.

In December 1978, only six economic groups had 25.3 per cent of the direct credit given by central, state, and commercial banks to the private non-banking sector. The biggest two already had 20 per cent of the total. A little more than 100 persons or less than 1 per cent of private debtors were absorbing 52 per cent of the total direct credit. Concentration has not only affected direct credits, but other important channels of indebtedness such as debts with CORFO, private deposits from the general populace, money obtained through the mutual funds, and corporate foreign debt (under Article 14 of the Law of International Exchange).

Table I shows the magnitude of credits obtained by the most important economic groups.

The main activities for which the groups funds have been used are:

(1) Purchase of and/or investment in corporations and services they want to control.

(2) Increase of patrimony in member corporations. Corporations controlled by the economic groups have increased patrimony much more than the inde-

pendent corporations have. Of the 100 most important corporations in 1969, 41, which are member to an economic group, increased their patrimony by 96.9 per cent in the period from 1969 to 1978 while the remaining 59 increased theirs by only 13.8 per cent [9, p. 200].

(3) Financial market operations. One of the most profitable activities of the economic groups has been obtaining cheap foreign credit and deposits from the general public and lending them at high rates in the domestic market. In December 1978, state banks had a foreign debt of U.S.\$219 million or 23.4 per cent of the total and the economic groups banks had a debt of U.S.\$620 million (66.4 per cent).

(4) Trading and construction. Among enterprises under the control of the big economic groups, trading and construction companies were of special importance in the non-financial sector. The major trading companies are mainly importers of non-food consumption goods in response to the new demand structure (the demand for imported dispensable consumption goods increased by about 300 per cent between 1970 and 1978) [12, p. 71]. In addition, since only a few importers handle the bulk of import activities, they can keep the prices of import goods at much higher level than what they are on the international market [17, p. 116]. This assures substantial profit margins for the importers.

In the case of construction sector, the impact of recession was severer than on any other sector. The major construction enterprises, all affiliated to a big economic group, have adapted to the new structure of demand and devoted themselves into the construction of commercial centers in all major urban areas where most imported goods are sold. In addition, the construction industry has been used in the rapid development of luxury houses and apartments. The type of construction undertaken by the industry is one accessible only to a few and demand was quickly saturated. The industry continued to buy urban land and use credits until the first half of 1981. In 1981, the international recession that triggered the domestic crisis made interest rates jump again. GDP fell by 14.3 per cent in 1982 and the construction companies could not sell their finished products. In April 1983, eleven construction companies held 30 per cent of the effective housing supply in the Greater Santiago area. But, about 17,000 homes on the market could not find buyers.

The economic groups acquired huge profits from construction during 1978-81, but they suffered drastic losses with the 1982-83 contraction in demand.

III. EVIDENCE OF THE CRISIS AND GOVERNMENT INTERVENTION

A. *The Crisis*

Events from 1981 to 1983 show that the basis of the new development model was very unstable and very dependent on international conditions. Increasing rates of interest and tightening credit conditions on international capital market pressured the domestic capital market producing substantial real-term increases in domestic interest rates. In addition, it was harder to get a long-term loan.

Most of the loan demand came from businessmen paying for previous loans, they were not destined for any productive investment use. It became very difficult for banks and financial institutions to recoup these loans and the possibilities of recouping them were dependent on the length of the recession.

The CRAV bankruptcy⁷ in May 1981, was the first sign of crisis for banks lending to big and/or related corporations that did not have sufficient collateral. Nothing was done at the time, but on November 1981, the government was forced to intervene in the operation of four banks and four financial institutions to prevent them from going bankrupt. They were the Banco Español, Banco de Talca, Banco de Fomento de Valparaíso, Banco de Linares, Financiera de Capitales, Financiera Cash, Compañía General Financiera, and the Sociedad Financiera del Sur. In February 1982, the Banco Español was sold to the Banco de Santander of Spain. In April 1982, the Banco de Talca was sold to the Banco Central de España. The other six institutions were dissolved because their loss were greater than their capital and reserves.

The Superintendencia de Bancos e Instituciones Financieras (SBIF)⁸ began examining the situation in other financial institutions and found that by April 1982, the amount of non-recoupable credit was U.S.\$950 million and that there was strong evidence of the concentration of those credits in the groups' member corporations. In July 1982, the government requested the central bank to offer to buy all "carteras vencidas"⁹ from the financial institutions in return for a promise that they would be repurchased within ten years. The measure was taken so that the banks could give longer periods of loan repayment to their clients. The SBIF also required that the financial institutions devise a program that would deconcentrate credits.

In the prevailing uncertainty, the public began to buy dollars as a safer investment, and this resulted in a rapid drain on central bank reserves. The peso's 18 per cent devaluation in June 1982, did nothing to put a halt to the outflow of reserves. The public saw a devaluation at this time as another indication of uncertainty which just led to a further rush to buy more dollars. The August 1982 liberalization of the exchange rate provided a strong jump in the price of the dollar.

Reserves were at their highest level in December 1980 at U.S.\$4,073.7 million. By the end of 1981, reserves had dropped to U.S.\$3,775.3 million and in 1982 to U.S.\$2,577.5 million [3, p. 239]. In 1981, the banking system's over-the-counter sales of foreign exchange was U.S.\$957.2 million, a figure which jumped to U.S.\$1,229.5 million in 1982 [5, Table 28].

The reserve loss and current account deficit put the balance of payments into serious deficit. The deficit in balance of payments during 1983 was: January–March, U.S.\$1,015.3 million; April, U.S.\$1,147.0 million; July, U.S.\$1,007 mil-

⁷ CRAV stands for Compañía Refinadora de Azúcar de Viña del Mar. It was a very large and important enterprise in the Chilean economy.

⁸ SBIF is the public institution in charge of controlling the operation of banks and financial institutions.

⁹ Carteras vencidas are unpaid debts ninety days after they are due.

lion, even though the trade balance moved towards a slight positive trend in 1982 and 1983 due principally to the serious contraction in imports.

The rise in the price of the dollar, starting in 1982, affected enterprises which had dollar loans. They were caught between a rock and hard place, faced with reduced sales due to diminishing demand on one side and higher loan payments on the other. In August 1982, special credit lines were made available to those having debts in dollars, with a maximum credit of U.S.\$30,000. In addition, preferential rates of exchange were established for these debt holders. But U.S.\$30,000 was of little use to the corporations since their debt was almost always far higher than that sum. Besides, the increase in interest rates on the international capital market not only made new loans more expensive, it also made existing debt more expensive due to the variable rates. The large corporations were also affected because new foreign credit was becoming very scarce. A situation critical for the corporations was extending to the banks as well.

Although the banking system (banks and financial institutions) sustained profits from 1977 to 1981, their losses in 1982 were heavy.

The banking system also had a high level of unpaid debt in relation to capital and reserves in 1982. In fact, the "cartera vencida" plus "cartera vendida"¹⁰ level was 61 per cent of the financial institutions capital and reserves in July 1982, 73 per cent in August, 89 per cent in November, 78 per cent in December, and 82 per cent in January 1983.

B. *Government Measures to Cope with the Crisis*

Since it was becoming evident that an important part of the financial system was going bankrupt, the state intervened in the operations of five banks in 1983. They were the Banco de Chile, Banco de Santiago, Banco de Concepción, Colocadora Nacional de Valores, and Banco Internacional. All of these banks belonged to a major economic group, and we see here the first stroke in the conflict between the government and Chile's economically powerful.

The intervention forced a greater clarification of the amount of the bank debt. The authorities stopped the automatic renewal of bank credits to group enterprises. As a result, the level of "cartera vencida" plus "cartera vendida" increased in February to 1.2 times the financial system capital and reserves and to 1.36 times in March.

At the end of 1982, economic problems led to social and political unrest. Dissatisfaction with the government extended to the upper class. The people began to express themselves through the media and through street demonstrations.

The situation forced the government to take a series of emergency economic measures.

(1) At the end of 1982, it decreed a protectionist policy to prevent unfair competition. In March 1983, the government raised tariffs from 10 per cent to 20 per cent and promised that in October 1984, they would begin a gradual return to 10 per cent.

¹⁰ Carteras vendidas refer to carteras vencidas sold by the commercial banks to the central banks with an obligation to purchase them back within ten years.

(2) The government sought new foreign credits to aid the balance of payments problem and to compensate for the losses in reserves. In January 1983, the International Monetary Fund approved a U.S.\$900 million standby credit and compensatory facility for Chile, subject to strict economic performance by the country. Requirements were 1.7 per cent of GDP as maximum public deficit and a maximum loss in reserves of U.S.\$485 million. Chile was unable to meet these restrictions and it called for a new series of meetings with the IMF. The conditions eventually agreed on were reserve losses of up to U.S.\$606 million, internal credit expansion of 50,000 million pesos and a public budget deficit of 2.3 per cent of GDP. The IMF supported Chile in its attempts to renegotiate payments to private foreign banks (U.S.\$2,100 million in debt amortization and U.S.\$1,300 million in short-term commercial credit) in 1983 and 1984. The banks agreed to the renegotiated payment and an additional loan of U.S.\$1,300 million was approved for 1983. The state had to guarantee the renegotiation and the new loans.

The new conditions provided the government with temporary relief. It also made it possible to apply reactivating domestic programs. Nevertheless, temporary relief meant a heavier burden in the short run for a country already deeply in debt with a net real external debt to GDP of 58.6 per cent in 1982.

(3) Some measures had to be devised to stimulate productive enterprises and to increase the financial system's level of recouping from debt. In March 1983, the total debt to the financial system was 900,000 million pesos, 550,000 million of which was productive sector debt.¹¹

The central bank created a special line of credit of 165,000 million pesos for banks so that the banks could in turn offer their clients a 30 per cent debt renegotiation. By July 1983, out of a potential 120,000, only 40,000 debtors had renegotiated. Thus, in July, the central bank opened a new 4,800 million pesos line of refinance so that the banks could give credits and discounts to their clients in commerce and the productive sectors. In August 1983, another new loan was offered to private enterprises to finance 10 per cent of existing personnel salaries and 40 per cent of the salaries of new employees. This program is along the same lines as the above with an aim of increasing corporate working capital and stimulating new employment.

Since the construction industry was nearly paralyzed, had stopped repayments to the banks and laid off people, and contributed to increased unemployment, the government created lines of credit in April 1983 for new housing loans at 8 per cent interest payable in twenty years in adjustable monetary units called U.F.¹² There was no limit on home prices, but no house could be bought that was greater than 168 square meters in area. Another restriction was that the buyer had to have 25 per cent of the purchase price for down payment. But

¹¹ The average exchange rate (banking system) during 1983 was January, 74.04; February, 76.38; March, 74.48; April, 73.69; and May, 75.10.

¹² U.F. is the Unidad de Fomento. These special monetary units were adopted considering the high rates of inflation in the Chilean economy and they are now equivalent to about 2,000 pesos. They are adjusted to the rate of inflation and are quite commonly used in loans.

the effects of this program were limited because: (a) Most houses and apartments available were high-priced luxury homes and so, impossible purchases for the majority of people. Not only that but after this measure was adopted the price on all housing went up. (b) The 25 per cent down payment restriction was crucial. Even though banks offered loans to cover the down payment, those loans were at standard interest rates and so, too high for most potential buyers. (c) In the climate of uncertainty from 1981 onwards, only a few people would risk a major investment like the purchase of a house. (d) After the government had adopted a series of contradictory measures, people were hesitant to purchase any large assets, fearing that the conditions would again change.

(4) A credit was signed with the Inter-American Development Bank (IADB) to improve urban infrastructure. Total expenditures for the program were U.S.\$290 million, 80 per cent (U.S.\$236 million) of which would be provided by the IADB. The program includes thirty-five projects for urban public roads, water supplies for fifteen to twenty medium-sized cities and sewage facilities for three to six medium-sized cities and a minimum of 20,000 *lotes*¹³ for poorer locations.

(5) To increase domestic demand and facilitate the payment of personal debt, monthly housing dividends in U.F. were temporarily reduced from July 1983 to July 1987 postponing the difference to be paid at the end of the debt with an 8 per cent real interest rate. Public salaries were also increased by 5 per cent in July.

(6) To reduce the cost of capital, the central bank in December 1982, "suggested" a 2.3 per cent interest rate on deposits which was later reduced to 2.1 per cent.

(7) To reduce unemployment, the government started an extraordinary program to build 6,000 low-income housing units which was to generate 20,000 jobs. In 1983, the total housing program was to provide 31,500 housing units, including 6,000 units from the above mentioned program. The Ministry of Housing hoped to generate 80,000 jobs in all.

These measures show that the government had finally taken on the more active public sector role urged on it by different groups for many years. Nevertheless, even though quite necessary, the measures were delayed emergency solutions. The programs have been placed together piecemeal and do not constitute the kind of coherent reactivation program that would provide a real basis for national development. Another problem is the almost impossible-to-recover loss of confidence in the present government by the great majority of social and economic agents.

IV. ECONOMIC AND SOCIAL PERFORMANCE IN 1973-83

A. *Evaluation*

It would be fair to start the evaluation of the period from 1973 to 1983 by

¹³ Small lots of land assigned to dwellers in which only the sanitary facilities have been installed. The owner has to finish the rest of the house construction.

looking at what was achieved. The statistical information shows that the rate of inflation was greatly reduced and that there was a decline in the public deficit. We have, of course, already looked at what the cost of those achievements was. Another element usually mentioned is that Chile had high growth rates for 1976–81. But those levels were obtained on top of the incredible decline that occurred in 1975.

The government usually lays the blame for Chile's problems on the international situation. Chile is one of the Latin American countries for which trade terms have deteriorated most in the 1970–80 decade. The price of copper, the main export, has undergone enormous fluctuations and the average price has been lower than the long-term price. However, the freedom given to private sector operations has increased (from 1976 to 1981) imports despite the decline in export returns.

With respect to the impact of the last international recession, it is estimated that the trade deficit attributable to worsened trade terms was about U.S.\$780 million greater in 1981 than in 1980. Interest payments increased by U.S.\$500 million, of which only U.S.\$260 million was due to higher interest rates. In sum, of a total of U.S.\$4,800 million in 1981 current account deficits, about one-fourth was determined by international factors [2, p. 48]. The rest was caused by the loss in competitiveness for Chilean exports, high import levels, and increased private foreign indebtedness. The high availability of funds in the international capital market alleviated some problems but it also postponed needed adjustments in financial and external policy. This made the present crisis worse due to the cumulative worsening effect from a large number of negative factors over a long period of time. Those factors are:

(1) Investment. The rate of investment on fixed capital declined seriously from the 15.3 per cent of GDP in 1960–70 to 11.1 per cent in 1974–80. The reasons were mainly: (a) Contraction in public investment which also indirectly affected corporations producing intermediate goods. (b) Imports were concentrated in non-food consumption goods. Imports of machines and equipment fell substantially and did not recover to 1970 levels until 1979. (c) Productive investment decreased due principally to high interest rates. Only a small part of the productive investment could cover those costs. In addition, the short-term repayment of a loan is a hindrance to productive investment. Sumptuous and speculative investment were the main forms which could cope with the conditions.

(2) Foreign Debt. Chile's foreign debt, mainly with private financial institutions, increased rapidly from the late 1970s through the early 1980s. Medium- and long-term debt was U.S.\$3,261 million in 1973, U.S.\$5,923 million in 1978, and U.S.\$13,892 million in 1982 [3, p. 227]. It is noteworthy that short-term debt became a greater part of total debt, 19.3 per cent by 1982. This debt is mainly in the private sector. In 1969, private medium- and long-term debt was 30.2 per cent of the total, in 1973, it had dropped to 12.2 per cent but went back up to 62.8 per cent in 1982 [3, p. 229]. Debt to private foreign banks and financial institutions has increased substantially in importance for most Latin

American countries, 80.5 per cent of all medium- and long-term debt in 1982.

The reasons why rising foreign debt was possible are: (a) Sustained economic growth from 1976 to 1981 with increased amounts and diversification in exports, above all non-traditional exports. This gave the country an image of credit worthiness. (b) Private lenders consider the amount of foreign currency reserves that a country has on hand to be a key indicator of that country's credit endorsement. Since Chile was receiving more funds than it was able to productively use, the government began to accumulate reserves. (c) Wide availability of funds, particularly in the Eurodollar market of the 1970s.

(3) Income Distribution. Many factors contributed to an income distribution situation worse than what it was in 1973: (a) The concentration of the sources of wealth (productive and financial) in the hands of a few private groups. The main interest of those groups is to increase their own wealth, they have little concern for the country as a whole. (b) The shrinking of the role and the expenditures of the state, clearly in a regressive direction. (c) The tax system was revised to activate private business and this decreased the importance of direct taxes and increased the relative weight of indirect taxes. The indirect taxes are regressive. Direct taxes have more distributive potential. (d) Salaries have been subject to greater government control since 1973 in order to decrease excess demand and to promote private business activity by reducing the costs for business.

With the average salary for employed persons indexed at 100 for 1970, the trend in salaries has evolved as follows: 1974, 65; 1976, 64.9; 1978, 76.0; 1980, 89.3; and 1981, 97.4 [7, p. 22].

Unemployment has hit unskilled and low-paid workers the hardest. In 1982, unemployment for workers was at 28.9 per cent; for employees, 15.6; for workers on their own, 9.1 per cent; and others (including executives), 2.6 per cent [3, pp. 204-5]. This data means that the situation is even worse than what the data on average salary indicate. In fact, if the lower paid workers are dismissed in large numbers, the average salary of the employed will increase.

Unemployment is intrinsic to the new productive structure. Even in the 1979-81 period when the Chilean economy had attained high growth rates, the rate of unemployment averaged 16.7 per cent, a marked contrast to the 3.5 per cent average for 1970 and 4.98 per cent for the 1966-78 period. In 1982 the rate of unemployment hit 28.4 per cent. High unemployment is one of the most serious consequences of the government's experiment.

The causes of unemployment are manifold. (a) Contraction of the state's role in the economy meant a reduction in government employees in many sectors. (b) Reductions in public expenditures affected not only those directly working for the government, but also those working in the industries from which the state bought intermediate goods. (c) The large number of corporate bankruptcies, particularly in small- and medium-sized companies which tend to be labor intensive. (d) The changes in the productive structure have been towards contraction of labor use. One of the sectors of greater expansion has been financial services which has less employment potential for unskilled labor. These changes have

all tended to accentuate unemployment, especially for those of lower educational levels.

Other indicators demonstrate a deterioration in income distribution. For example, average consumption changed very little between 1969 and 1978, but the distribution of that consumption moved in detriment to the poorer groups and to the betterment of the richest [6, p. 10]. In addition, labor payments to total internal income, according to national accounts, went from 61.7 per cent in 1971 to 51.7 per cent in 1981 [3, p. 32].

B. *Perspectives*

What ways are there for getting out of the present crisis? What conditions do the various alternatives present?

A small country like Chile is obviously quite dependent on international conditions. Even though most of the industrialized countries have recovered from the international recession, their future rates of growth are certain to be lower than what they were in the 1970s. The lack of higher growth will have a decided effect on the Latin American countries, for they are dependent on the income obtained from exports to the industrialized nations. Not only that, but there is little likelihood of an expansion in private capital markets in the 1980s as occurred in the 1970s. Funds are becoming more scarce and more expensive. The impact on a country like Chile is to force it to increase domestic savings and decrease dependency on foreign capital. Meanwhile, external debt continues to increase due to higher interest rates which affect not only new loans but also existing ones (due to the importance that variable credit has acquired as a part of total debt).

Given the circumstances, profound changes should be made along the following lines.

(1) Increase the level of domestic savings sharply to compensate for the relative scarcity in foreign funds, and, above all, to decrease the country's dependency on international conditions.

(2) The state must abandon its passivity. Special programs must be designed that stimulate employment. The characteristics of the productive structure must be altered because unemployment rates of 30 per cent are proof of the inefficient allocation of resources. No country can neglect the contribution of such a large segment of its population.

(3) A much more thorough study must be made of what degree the domestic market can be opened to international trade. That study would include the degree of opening of the market according to product type.

(4) The state has to use its own financial institutions to intervene in the financial market so that interest rates are at levels that make productive investment possible.

(5) The state must reestablish its intermediary role of obtaining resources from foreign capital markets and channeling them into productive investment that is in the social interest. One example is in the development of the more

labor intensive small and medium businesses, where active state support is required in order to obtain foreign credits and technical assistance.

(6) A consistent development plan must be adopted that has the support of the majority of the Chilean people. This would mean profound changes in other areas too. The inconsistencies between economic liberty and political control must be abandoned. If not, the country will remain in crisis for a long while because the people cannot be forced to collaborate.

(7) There must be an end to discrimination against public corporations and services. Many efficient public enterprises should be stimulated so that they can take a greater role in the Chilean economy.

(8) The state must intervene more in the social sectors (education, health, housing, etc.) in order to prevent greater inequities.

What will happen in the near future is not easy to predict. The present government does not seem to have made a decision on the profound changes in policy that most of the country is demanding. Without such changes, the government will have a difficult time obtaining the cooperation of all sectors in extricating the country from its present state of economic inactivity and stagnation.

What is clear is that even if a new government comes to power and even if that government has the support of the majority of the Chilean people, the development process will still be in difficult straits for the near future. Many years will be required before Chile can recover from the damage of the last decade, before it regains normal levels of unemployment and higher rates of investment.

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