

Chile: maybe next time

There has been an obvious loss of momentum in our economic growth, relative to our own past two decades and the rest of the emerging world. In figures, whereas in the 90's and 2000's Chile had an average annual growth rate of 6,37% and 4,34% respectively, the emerging and developing economies had equivalent growth rates of 3,24% and 6,34% for the same periods (IMF World Economic Outlook Database 2008 *). In other words, inverse GDP growth rates paths.

Opening to foreign trade, freeing the price mechanism and making the Central Bank independent in the 70's and 80's, among other policies, had a deep impact in Chile's long term GDP growth perspectives. Furthermore, the necessary democratic change in the 90's consolidated this path. However, something else has been happening with the passing of time that needs a strong and direct intervention. It is a sort of a three way equilibrium that is affecting the whole growth process but when viewed from each partial perspective makes sense for each one involved in it. It is a classical case of unsolved externalities where pressure groups only consider their own net benefits but not the social cost of their deeds that is being internalized under the new lower GDP growth rate path.

For one part, we have an unequal income distribution that gets corrected by the government through its social expenditure in health, education and direct monetary subsidies, but which has resulted in that, on average, 37% of the total income of the poorest 40% income group is explained by the government safety net (CASEN 2006). Paradoxically, restrictive and inflexible government sponsored labor laws weaken by far the same poor groups that do have less human capital. In some sense, while the poor get damaged through erroneous but silent policies "sold" for their benefit, they get stridently "rescued" through social expenditure. This way, they get dependent on the government purse, specially the one in charge.

For another part, we have an active government that expends approximately 20% of our GDP and has a direct ownership over firms such as banks, mining, exploration and refinery companies and even mail post ones that usually operate under political criteria instead of economic ones in their own businesses, along with a regulatory system that is increasingly being captured by interest groups. As a result and for instance, we have no oil and no gas and Codelco, with the biggest Chilean copper reserves, is clearly lagging the industry under most objective measures.

And finally, we have an entrepreneurial system that is getting increasingly too comfortable protecting small business niches, particularly capital markets, that enable a significant but quite small friends club to control major businesses in Chile. According to official banking figures (SBIF 2008), 83% of all commercial credit goes to 1.6% of debtors. Moreover, pension funds – biggest domestic funds source – invest 34% of their funds in domestic bank deposits and 27% in shares and bonds that are exclusively related to AAA Chilean firms (SAFP 2008). In other words, we have created a self perpetuating cycle with asymmetric access to capital markets that inhibit major challenges from outside.

Net result? The country gives less than what it can – there is no reason to not having Chinese GDP growth rates, to whose economy we are much closer in per capita terms (US\$ 14.673 v US\$ 5.869 at PPP *) than to the US (US\$ 46.541) – and becomes more unstable. A private sector that avoids competition in its own backyard, a government that acts as an active entrepreneurial entity with unjustified direct ownership in businesses and a too ambitious regulatory control, along with the humiliating dependency of the poor ones from its purse, constitute an unhealthy system where each party acts as if the others were not responding to their own behavior. But they are wrong: their decisions are not independent of the others' ones. If one is protected, the other one will try the same; if the private sector is favored, the government will seek power to compensate for that. At the end of the day, we are getting a less competitive entrepreneurial system at the price of a bigger redistributive and economically active government, losing all in the process.

Next year we have presidential elections. Maybe this time we elect someone who confronts the whole problem and dares to put competitive pressure on every economic sector, getting rid of all kinds of protections embedded in the system, especially in capital markets, definitely frees labor markets and directly helps the poorest with money given to them to be used in competitive education and health markets. The country needs people working by themselves on their own future, not eternally thanking the government for doing so. Nor do we need a private sector looking for its next favor.

Down with pressure groups everywhere is the only course of action that will cause a big change in our long term economic perspectives. Other way, Chile is doomed to rest on its past reforms and slowly fall into the now forgotten average emerging country tradition.

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