

New programme of work.Macro-economic and social sector policies  
for a sustainable democracy in Chile.

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I. Introduction

The beginning of transition to democracy in late 1989 in Chile poses a number of important challenges which need to be overcome so this process is consolidated and becomes sustainable in the medium-term. The proposed research project would focus on the design and implementation of economic policies (particularly in the macro-economic and social area) that would contribute to the viability, consolidation and sustainability of democracy in Chile. A basic assumption of the project is that the instauration and eventual consolidation of political democracy constitutes a highly desirable goal; it is assumed that an important element in measuring a country's welfare is the extent to which its' citizens enjoy democratic rights. The priority attached to democracy as an important development objective goes back to the writing of authors like A. Hirschmann, Dudley Seers and R. Prebisch. Also, the encouraging of democracy and democratic institutions is among the key aims that development aid of certain donor governments (e.g. Sweden) explicitly pursues. Most importantly, in Chile - as well as in other Latin American countries - democracy is a major and very high priority objective for most political parties, social organizations and individual citizens; interestingly, most left wing parties share in the late eighties a deep-rooted commitment to parliamentary democracy, in contrast with the late sixties and early seventies, when democracy was often dismissed by parts of the left as "merely formal" or "bourgeois".(1)

Economic policies must meet at least two key requirements, if they are to contribute towards making democracy stable and viable. As Sheahan and others (2) have pointed out, these requirements pull in contrary directions. One requirement is that economic policies have the consistency necessary for a viable economy (in the short and also in the medium and long-term); such an economy would be able to function without major financial disequilibria (avoiding acceleration of inflation to high levels and frequent balance of payments crises), while achieving some economic growth. The other requirement is the ability to answer enough of the expectations of the politically aware

(1) The Partido Socialista de Chile defined in their programme in early 1988, "recovery of democracy" as the task with highest priority; see also I. Walker "Un nuevo socialismo democratico en Chile" CIEPLAN Estudios 24, June 1988.

(2) Sheahan, T. "Economic Policies and the Prospects for succesful Transition from Authoritarian Rule in Latin America" in (ed.) G. O'Donnell, P. Schmitter and L. Whitehead. Transitions from Authoritarian Rule, Prospects for Democracy. 1986. John Hopkins University Press.

groups in society to hold their acceptance; a related requirement is that levels of absolute and relative poverty need to begin to be reduced, after relative neglect during military governments.

The fact that important changes in the polity and/or the economy make consistent and viable economic policies both extremely difficult and crucial is well illustrated by Chilean history and the experience of numerous other countries. One of the main contributions of this project could be to draw out the lessons, both positive and negative, from previous experiences in the hope that at least past mistakes will not be repeated. Though obviously lessons cannot be mechanically extrapolated, valuable insights can hopefully be gained.

In the Chilean case, the attempt at transition to socialism in the early seventies partly failed due to inconsistent macro-economic policies, leading to rapid acceleration of inflation and severe balance of payments crises. As discussed elsewhere (3) this negative economic evolution not only had a deeply problematic effect on the achievement of the economic and political goals of the Allende government, but also contributed to the breakdown of democracy in Chile.

More recently, a number of countries in Latin America and elsewhere have undergone or are undergoing process of political transition to democracy. Particularly in the Latin American experiences of transition, most of their economies had a serious intensification of financial disequilibria leading for example to very rapid acceleration of inflation; this has had negative effects on the political process of democratization. Though the task of economic policy-makers has been particularly difficult due to the hostile international environment facing Latin America in the eighties, (and the specific problem of the debt overhang) an important explanatory element of the financial disequilibria are inconsistent macro-economic policies. Transitions to democracy in other areas of the world, as those of the Iberian Peninsula in the seventies, have on the whole been more successful both in consolidating democracy and in successful economic management.

Though the research project would include historical analysis on Chilean economic and political history and on other countries (including Portugal, Spain and Argentina) experience in transition to democracy, its main focus would be on the design and implementation of macro-economic and social ----- policies in Chile from 1990 onwards.

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(3) For one of the researchers' own detailed discussion, see S. Griffith-Jones. The Role of Finance in the Transition to Socialism. Frances Pinter. 1981. For excellent discussions of these and related issues, in the Allende period, see, for example, S. Bitar Transición, socialismo y democracia, la experiencia Chilena, Siglo XXI. Mexico. 1979, and Foxley A. and Munoz O. "Redistribución del ingreso, crecimiento y estructura social" in Foxley A (ed) Distribución del ingreso. F.C.E. Mexico. 1979.

Elaborating on Hirschmann's analysis (4) of disequilibrated development, it can be argued that recent governments in Latin America have focussed either on financial stability (both domestic and external) or on equity with rapid growth. Either financial stability or equity is sacrificed as a key policy objective. The strains produced from insufficient attention to one of the major objectives have in the past produced extreme pressures both on the economy and on the polity, leading in some cases to the breakdown of democracy.

This poses as a key challenge for the new democratic government in Chile to design and implement policies that simultaneously expand social expenditure, employment and economic growth, while encouraging directly productive investment, without leading to balance of payments crises and/or excessive levels of inflation. Clearly democracy would be consolidated in Chile if during the next two or three governments, moderate success was achieved on all these fronts simultaneously. The proposed project would attempt to contribute, however modestly, towards the achievement of these objectives, as well as attempting to evaluate and explain possible slippages.

The largest opposition party in Chile, the Christian Democratic one, as well as its close allies (5), have explicitly committed themselves to all of the objectives just described. The difficulty is to achieve not only the appropriate economic policy design, but also - and this is far more difficult - the necessary institutional arrangements and political agreements, to make implementation of such policies feasible.

## II. The content of the project.

### a. Specific features

The proposed research project would have several specific features:

1) It would be collaborative, with Chilean academic institutions (mainly but not only CIEPLAN) as well as with international institutions (e.g. CEPAL, UNICEF, I.L.O.); later, it could possibly have direct links to a new democratic Chilean government.

2) It would be interdisciplinary. Though the research project would start from economic issues, it would also concentrate on the relevant institutional, social and political issues. Past experiences (either in transitions to democracy or attempts at structural change in the economy) have shown the particular difficulty in implementing policy

(4) Hirschmann A. "Confessions of a dissident; revisiting economic development strategy" in G. Meir and D. Seers (eds) Pioneers in Development. O.U.P. 1985.

(5) See, for example Programa Basico de Gobierno para un periodo de transicion de cuatro anos, elaborado por los Partidos Democraata Cristiano, Padena, Humanista, Liberal Republicano, Radical, Usopo and U.S.P. Mimeo. June 1988, also, see programme of Partido socialista de Chile.

targets in societies undergoing major changes. This shows the need to carry out research that attempts to incorporate social, political and institutional variables into policy design and implementation.

3) The project's main focus would be national policy design and implementation particularly referred to Chile. However, it would be hoped that policy conclusions relevant for bilateral and multilateral aid donors would also be extracted. At a general level, a better understanding of economic and political interactions in the transition to democracy may be of interest to donors, particularly those (e.g. Sweden) which value democracy as a key objective. More specifically, certain industrial governments have begun to develop co-operation programmes, with "democracy conditionality" attached to them; thus, for example, major credits granted recently by Spain and Italy to Argentina have a special clause saying they are valid only under democratic governments. (6) Industrial governments and/or multilateral agencies interested in supporting democratic governments may well wish to support specific policies or policy-packages that can be shown to be likely to contribute towards the consolidation of democracy. Thus, this research project could be of particular interest and/or obtain some funding from donors or potential donors to the Chilean government.

b. The content of the research.

The research programme would operate at different levels;

1. Economic.

i) Identification, in a collaborative manner with Chilean researchers, of key high priority increases in expenditure in fields such as health, nutrition, education, low-income housing and social security spending. (e.g. family allowances, pensions).

As Raczynski (7) and others have shown, when the military government came to power, expansion of the welfare state came to an end. According to CIEPLAN figures (8) per capita public social expenditure in the mid-80's was below its' level in 1974; this deterioration has been particularly sharp in health and low-income housing. Furthermore, the coverage of social security, which historically had been high in Chile, was reduced; though the military government initially equalized family allowances for blue collar and white collar workers, it then allowed a large deterioration.

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(6) A. Marinakis "The Transition and Consolidation of Democracy in Argentina" I.D.S. Term paper. 1988.

(7) Raczynski D. "Social Policy, Poverty and Vulnerable Groups. Children in Chile" (ed. G. Cornia, R. Jolly and F. Stewart.) Adjustment with a Human Face. Vol II. O.U.P. 1988; another valuable study in this field is J. P. Arellano Políticas sociales y desarrollo; Chile 1924-84. CIEPLAN. 1985.

(8) For example, Marcel M. "Gasto social en Chile: 1979-83". CIEPLAN Notas técnicas 66. 1984 Santiago de Chile.

A paper would be written to identify alternative high priority increases in social expenditure that are likely to be undertaken by a new democratic government, with an evaluation of their total cost. An important part of this study would be done by Chilean researchers, partly drawing on their current and past work. Mario Marcel, researcher at CIEPLAN and involved in preparing the social programme for the new government, would co-ordinate this study; participation from other scholars, e.g. Dagmar Raczynski in CIEPLAN, Alvaro Garcia in I.L.O. is envisaged. Close collaboration with UNICEF, as well as possible funding assistance from them is hoped for.

ii) Funding of increased social expenditure programmes (in different scenarios).

The main sources of funding that would be explored are: increased taxation, re-structuring of public expenditure and a reduction of Chile's net negative resource transfer in foreign exchange related to the external debt overhang. The potential increase in taxation would partly relate to reversing some of the tax reforms (e.g. reduction in direct taxation) carried out by the present government) (9). Important issues would be not only the achievement of approval of changes in taxation in Congress, but also attempting to design policies so changes do not provide too much disincentive for private sector investment. Re-structuring in government expenditure would also include delicate political matters, such as a possible reduction in military expenditure. It has been estimated (10) that military expenditure has increased by around 2.5% of G.D.P. since 1973.

Last, but certainly not least, increased social expenditure could partly be funded by an increase of aid and credit flows to Chile and/or by some limitation of debt service payments. Obtainment of a favourable deal in this aspect should be eased by two factors: a) International sympathy and support for the process of democratization and b) Consistent macro-economic policies inherited from the military government, which imply low inflation, diversified exports, high foreign exchange reserves, etc. (The latter is also to an important extent the result of current very high copper prices). The ability to obtain/bargain for a good credit/aid/debt servicing package will also depend naturally on the quality of the macro-economic and development policies of the new democratic government.

Work on this part would be carried out by Stephany Griffith-Jones, in collaboration with Chilean researchers (particularly on the fiscal aspects). On the external resources front, some options on debt/development swaps, geared to social spending would be explored. (This would include not only debt to private creditors but also to official creditors, e.g. governments). More generally, the issues of new lending, as well as debt service policies would be analyzed for the Chilean context in the light of previous research. Consultation with Chilean scholars, like R. French-Davis is envisaged.

(9) See, for example, M. Marfan (1985) "Two essays on fiscal policy for the Chilean economy" Ph. D. dissertation, Yale University.

(10) Cortazar, R. "Conflictos macro-economicos y democratizacion" "Estudios CIEPLAN no.19, June 1986.

iii) Though the issue of increased social spending expenditure and its' funding is fairly specific, the margins of manouvre and the effects of policy change on the rest of the economy are closely linked to the overall macro-economic policy framework.

A first issue is that of relations and trade-offs between social expenditure (the social wage), monetary wages and level of employment.

Chile undergoes a transition to democracy, as trade union organizations are strenghtened and political procedures are re-established, there will be pressures to increase monetary wages, the social wage and employment simultaneously. (11) The pressure is particularly great given that real wages are still below their 1970 level, the unemployment rate (though far lower than in recent years) is above the average historical one and social spending per capita is below its pre-1973 levels.

Table 1.

Social indicators, 1970-87(a)

	<b>Real wage and salaries index</b>	<b>Unemployment rate</b>	<b>Per capite social expenditures</b>
1970	100.0	5.9	100.0
1971-73	98.8	4.7	n a
1982-85	88.7	25.7	50.9
1986-87	84.8	14.1	61.4

Source. Munoz. O. "Los empresarios y la industrializacion en Chile" CIEPLAN Nota tecnica 122. Nov. 1988.

(a) Government figures would give somewhat different results.

Key issues to be analized are the pace at which monetary and social wages, as well as employment can be increased, and the trade-offs between the increases, given different assumptions about economic constraints. The possibility of some type of social pact in which higher increases in employment and the social wage are accompanied by limitations on the rate of increase in nominal wages would be discussed in this section.

Issues of appropriate design of monetary, fiscal, exchange rate and incomes policy in this context would be analized, both at an economic and an institutional level.

Analysis in this section would draw on the specific discussions on macro-economic policy in Chile and on the emerging literature on economics of transition to democracy; it would however also relate to the more general discussion in the I.M.F., World Bank, UNICEF, etc

(11) For a recent useful explanation of some of these issues and of relevant economic models, see A. Solimano "Politica de remuneraciones en Chile: experiencia pasada, instrumentos y opciones a futuro". CIEPLAN Estudios 25 Dic. 1988.

(and indeed I.D.S. itself) on adjustment with equity. (or "adjustment with human face").

Work on this section would be started by R. Zahler, based at CEPAL, who would draw both on his theoretical work on macro-economic policy, and his advisory work to Latin American governments. A contribution on the trade-offs between investment and wages (both social and monetary) would be made by O. Munoz, a specialist on Chilean industrialization and Deputy Director at CIEPLAN. S. Griffith-Jones would co-ordinate this work, as well as linking to that in the previous sections.

## 2. Political and institutional.