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**The Future of
U.S.-Chilean
Relations**

By Alejandro Foxley



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The Heritage Foundation
214 Massachusetts Avenue, N.E.
Washington, D.C. 20002
U.S.A.
202/546-4400

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By Alejandro Foxley

I welcome this opportunity to come to The Heritage Foundation, and to be able to share with you some of my thoughts about the moment we are living in. It is a very interesting and, I think, a key moment with respect to issues as important as free trade and the Enterprise for the Americas Initiative.

Surveying the main trends today in the international, political and economic situation, one observes a very powerful trend toward democracy. Look at Eastern Europe and look at what has happened in Latin America in the last few years. There is also a very clear trend toward the transformation of economies so that they can fully integrate themselves into the world market, both commercially and financially. This is true for many Latin American countries, but it is also true for Poland, Czechoslovakia and Hungary and some countries in Africa; in other words, this seems to be a global trend.

As a Chilean I have to ask myself: What role can a small distant country in South America such as Chile play? Chile has a well functioning democratic system, a solid open market economy and does well in its export performance. What role can this small country play in the emerging new world order?

As you know, Chile today is completing its transition away from an authoritarian regime and toward a multiparty democracy. Several challenges were initially faced by the Patricio Aylwin Administration. First, we had to prove that we were able to achieve stability: political stability and economic stability. Second, we had also to prove that it is possible for a democratic government in Latin America in the early 1990s to be efficient in managing the economy, to do things well in economic affairs – in fact, to do things better than others.

Building a Consensus. Because stability is such a key factor for us, we have placed a lot of emphasis on rebuilding a sort of national consensus on politics and also on economic policies. Chile was a polarized and confrontational society for two or three decades, and it is time now to bring people together to agree on a longer term common purpose.

We have worked very hard in building this consensus. For each single piece of legislation we have sent to Congress on economic policy, we have always looked for the support of the opposition conservative parties, the National Renovation Party and Independent Democratic Union (UDI) Party. We sent to it, for instance, a tax reform bill which was supported by the main opposition party and of course by the parties supporting the government. Today that bill is the law of the land. Similar consensus was obtained in our efforts to reform the labor code.

We have managed throughout the first year in office to keep a sense of national economic policy. This is very important, because the message that we were trying to send – and I think it is being understood – is that the policies we are following today should be worth preserving beyond the period of time that we are in office. We are also saying that what we are doing

Alejandro Foxley is Minister of Finance for the Republic of Chile.

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today builds on several policies of the previous government in terms of economic policy. We have no prejudices about that. We have always said that it is a sign of maturity for a country to be able to accumulate experience and project it forward in time. Fortunately, I think we have already achieved a broad consensus on the type of policies that are being pursued.

Tough Fiscal Policies. The second priority for us is to achieve microeconomic stability. Today, a year after having inherited an overheated economy with an inflation rate of around 31 percent, we have managed to reduce it: in 1991 the rate of inflation will be around 18 percent. This has been achieved after applying some very tough monetary and fiscal policies last year. Perhaps you are not aware of the fact that, in spite of a lot of people's expectations, we have not done what many other governments in Latin America have done when democracy returns — start increasing expenditures to please their constituencies and win votes in the next election — in the typical “populist cycle” of Latin America. We have said from the beginning that we will break this populist cycle.

We ran a budget surplus of about 1.5 percent of the GDP last year, something which was not an easy thing to do. It took a lot of toughness. But I think that we have succeeded in sending a clear message: we will keep the economy orderly, and we will not run a deficit. In real terms, government expenditures were reduced and not increased last year.

When we talk about the pursuit of stability in our country, we also have to talk about resolving social problems. Chile is still a country whose per capita income is not more than \$2,000. Some people have compared the democratic transition of Chile to that of Spain, and I think that there are similarities. But one difference is that Spain has a per capital income which is much higher than ours. Figures show that in Chile almost 40 percent of the population live below the poverty line. We have the problem of a great disparity in the distribution of income. Anybody who has been to Chile knows that this is true. This is a problem we have to face. If we want to have political legitimacy for the kind of economic ideas we are pursuing, we have to do better in terms of opening up opportunities for those that have been on the periphery of the system. We have to make a constant effort to integrate them more into the benefits of economic growth.

Increased Public Acceptance. We have proposed, as I said, a tax reform which essentially increased taxes. We received widespread support for it, and we targeted the additional revenues for social expenditures, for investment in human capital. In fact, 100 percent of the increased tax revenues went to education, health services, youth training and to housing for the poor. That effort, I think, made a difference. The degree of public acceptance of the market-oriented economic policies we are pursuing has greatly increased. A recent public opinion poll in Chile was very favorable to this kind of policy, in spite of the fact that we had to cool down the economy, bringing the growth rate down from 10 to 2 percent. That is not something people generally appreciate. The effort, in social policy, I think, was very important in providing wider acceptance and legitimacy for our prudent macroeconomic policies.

Let me say a few words about investment. It is quite clear that in the final analysis if you want to be successful in the world economy, you have to increase your rate of investment. Last year, the first year of the democratic government, we did have a record level of investment: 20 percent of GNP. We also received record direct foreign investment, accounting for about 5 percent of GNP, without taking into account the debt equity swaps which also bring us investment. But we are quite clear that we have to increase investment even further if we

want to grow permanently at the rate, say, of 6 percent a year. This year, coming out of the anti-inflation effort, we are planning to grow between 4 percent and 5 percent.

Long-Term Financing. Now, here is a connection with the first remark I want to make on President Bush's Enterprise for the Americas Initiative. What we want to do is to find ways to increase investment opportunities for the private sector. As you may know, most public companies have been privatized this year already. The energy sector, for example, is basically 100 percent private. A recent law has also created an opportunity for the private sector to invest in infrastructure. One interesting question that arises is how to get long-term financing for huge investment projects in infrastructure or energy? Furthermore, how to increase the likelihood of additional investment in mining, in forestry, in fisheries, or in the food processing industry? How to bring small firms into the modernization effort? Financing is an important part of the answer. Chile has quite a sophisticated domestic capital market, but it is not a long-term capital market. It is not a capital market that will provide funds over an 8-, 10-, or 15-year period, which is what many firms need for their big investment projects.

So, this is where I think President Bush's Enterprise for the Americas Initiative could play a very useful role. First, we hope that some funds will be available to help us with the institutional reforms necessary to broaden our capital market. Second, we plan to continue our efforts to open up new areas to private sector investment. Last, we want to help change the role of the multilateral lending agencies so that they can in fact help us in developing this long-term capital market. I think it is almost unavoidable that they will have to get involved in private sector lending directly or through private bank intermediation, in contrast to their historical emphasis on public sector loans. Furthermore, we do not think that government should be in the business of guaranteeing such loans to the private sector. Hence, new and flexible mechanisms must be found to channel the lending to the private sector that the World Bank or the Inter-American Development Bank (IDB) might make.

These are, I think, some of the basic notions behind the investment part of President Bush's initiative. We have been working very closely with the IDB for the first loan to be issued as part of the initiative. We hope this loan will be approved as early as the end of June 1991, for the first anniversary of President Bush's Enterprise for the Americas Initiative.

Injecting Private Capital. What are we going to do with these funds? What are the specific plans for this loan? First, to allow the private sector to invest on a B.O.T. (build, operate and transfer) basis in the infrastructure sector, building ports, roads and tunnels. Companies can bring in private capital, build, and then manage the port or road under a concession. This is a new area for private investment to participate. Since we want to maintain a fiscal balance, bringing private resources into this is very important because then the demand on public resources for infrastructure investment will decrease.

We are doing something similar in the copper sector, where we have a large state company, CODELCO. CODELCO holds many mineral deposits which are not being exploited. We have sent legislation to Congress to allow for the private sector to mine these deposits, something the law we inherited from the former government did not allow CODELCO to do. So this is another area where private investment will be increased.

The third one is the small business. Small firms are, of course, very important. The export effort so far has been concentrated in large companies, in the natural resources sector. But a successful exporting country has to move on to the stage where it exports light manufacturing products based on these natural resources. This implies bringing in the small firms, which will

make an important contribution to employment and growth. Chile already exports about a third of its gross domestic product (GDP). This puts Chile in the category of countries such as Korea, Sweden, Denmark and Finland. In other words we have a very open economy. We want to open it up even more. We want to get involved in the world economy even more. And for that we need to bring the small firms into the picture.

Including Small Firms. It used to be that governments in Latin America would attempt to provide direct financing for small firms. It is very easy to lend to a small firm; it is not so easy to get the money back. Because governments do not usually have enough administrative capabilities, they cannot run efficient financial systems for the small firms. What we want is that this funding be provided and administered by the private sector, and we would like to use President Bush's Enterprise for the Americas Initiative financing to allow private consulting firms to provide assistance. We would subsidize project development in such firms in order to render them capable of going to banks and asking for loans. Banks do not like small firms, because administrative costs are too high relative to loan amounts. So banks have to be induced to do the job. The quality of the financial information contained in the projects small firms present has to improve. This is something which I think is a key, not only for the export effort, to increase the productivity of a small firm, but also from the equity point of view. Once we incorporate small firms in the development process, its positive impact will be much more widely felt.

Let me finally talk about trade. Chile was exporting 15 percent of GNP in 1975 and in 1990, almost 33 percent. In 1994 we think we will be exporting more than 35 percent of GDP, which is a noteworthy achievement. Here I want to refer back to the beginning of my talk. We in Chile are quite concerned by what we see as a potential problem now brewing for the international economic system. I just came back from Europe. I went there accompanying President Aylwin, and we had a chance to get a very close appraisal of European Community (EC) protectionism. Some of it is hard-core protectionism, which is very much alive and which will not be at all easy to change. Real trade liberalization would mean serious negotiation on those items in their trade which could potentially hurt them: agricultural products, textiles, shoes, clothing and steel products. There is a whole structure of non-tariff restrictions, a very intricate system, very difficult to penetrate. It is there that I do not really see any real will to dismantle protectionism.

Trade Dangers. What we might be seeing in the near future is very worrisome. I don't think the main players in the international economy today can afford to let the GATT negotiations fail totally. After all, GATT has performed a useful role for several decades by helping to liberalize trade. The danger is that there will be a cosmetic success of the Uruguay Round. Countries will realize that they cannot afford to admit that GATT has failed. They will have to agree on something, but something marginal to this hard-core problem. The "agreement" will allow everybody to save face, and continue with free trade rhetoric.

That is really dangerous, because it will mean that we will be deceiving people. And we particularly will be hurting the chances of the well-performing economies in middle-income countries such as Mexico, Venezuela, Chile and others which have gone through the long, painful process of structural adjustment, opening up their economies, countries such as Chile which have been willing to pay the costs associated with unilateral trade liberalization.

Returning to GATT negotiations, we have additional worries. First of all, they do not take into consideration the fact that countries such as Chile already went a long way ahead of the

pack in liberalizing trade. For instance, we do not have a single non-tariff restriction to trade. We do not have any subsidies; we do not have any licensing system; we do not have any import prohibitions; and we have a uniform tariff rate. But nobody will accept any of that as a credit as compared to what others could order.

I am also much concerned that the whole international economic system – by the system I mean the institutions and the governments of the industrialized world – has been, in fact, asking these countries for the last two decades to open up their economies, lower tariffs, privatize state companies, be serious about the export effort, have the right exchange rate policy and pay the costs associated with such reforms. Countries such as Poland, Hungary and Czechoslovakia are just beginning to see the costs of that process. At some point they will begin to see the light at the end of the tunnel. At that point they will expect to reap the benefits of adjustment, one of which is having export potential and access to foreign markets. At that point, somebody will tell them, “Sorry, there has been a terrible misunderstanding here, but this is not what we had in mind.”

I think this is a very worrisome possibility. It is something that could have a very negative political impact throughout the developing world. In the final analysis, this could provide a strong impetus to the political forces that try to backslide and go back to the traditional protectionist stance in many of these developing countries. So this is, I think, a very important issue today.

It has been interesting for me to come to Washington at the time when a significant event is taking place, which is the discussion of the fast track authorization in Congress. Obviously this is closely related to what I have been saying about Europe. The same problem, the same issue is being discussed and, in fact decided, in this country. And the debate is precisely between protectionists and free trade.

But I don't think people in this country realize the tremendous international political implications of Congress's decision at the end of this month. First of all, because of what I have been saying about GATT. We have been very supportive of the U.S. position in the trade negotiations in GATT. We would like to see as a logical consequence of that that the U.S. Congress will go along with the Administration by supporting the extension of the authorization.

Key Component. At the same time, it is quite clear that the free trade component of President Bush's Enterprise for the Americas Initiative is the key component of the Initiative. It would be very difficult for us to understand why the U.S. Congress would consider a trade deal with Mexico devastating for the United States economy – the largest, most powerful economy in the world. We then have to ask very many questions about rhetoric and practice. What is the nature and the seriousness of the commitments of the U.S. government to supporting trade liberalization for the entire world and for the Americas in particular? I think the fast track authorization, both for the GATT negotiations and for Mexico, would provide a glimmer of hope in this rather bleak scenario I have been describing.

Let me finish by saying that in spite of this, we are very optimistic in Chile. We made tremendous progress in the last year, somewhat unexpected by all of us, to be candid. We thought we would face many difficulties that just did not materialize. As a result of the return to democracy, some people were predicting a lot of disorderly people in the streets, strikes, etc. They were also predicting that the government would be handing out money to everybody, and that we would have rampant inflation. Well, if you come to Santiago

nowadays you will be surprised. We have not had any major strike. Inflation has not gone up — in fact, it is going down quite significantly. The economy is growing — around 5 percent this year — and we do not want it to grow more at the present time. We have a commitment to fiscal balance that we are going to maintain for the whole four years of this administration and hopefully later. We have a very impressive export performance. Exports, excluding copper, grew 12 percent last year. We have a record level of foreign exchange reserves, equal to ten months of imports, and a very strong balance of payment. We therefore are confident that Chile is an attractive country. I would like to use this opportunity you have given me today to invite people and companies to join in. In spite of all the problems on the international economic scene, we are really making a very serious attempt fully to integrate our economy into world markets. For that, we need friends and partners.

