Chile in the 1990s

Embracing Development Opportunities

A review of Chile's recent economic performance shows that, overall, the 1990s were a period of vigorous and unprecedented expansion, with average annual GDP growth of 6.5 percent. While 1999 was a time of economic adjustment after the fallout of the Asian crisis, Chile is now ready to resume healthy growth in 2000 and beyond.

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AT THE END of the nineteenth century, Chile—mired in political and economic stagnation—wasted a historic opportunity to embrace a development-oriented economic strategy. At the close of the twentieth century, it did not repeat this mistake. Taking advantage of an increasingly effective economic and institutional infrastructure, Chile seized the opportunity and left the twentieth century with poverty levels significantly reduced, the distribution of personal spending notably improved, and education, judicial, and tariff systems substantially reformed. A decade of change left Chile poised to strengthen its development performance and stride purposefully into the new millennium.

Growth and stability

Over the past decade, Chile at last broke free of two long-standing economic handicaps: a highly volatile pattern of economic growth and a long history of inflation. In the 1990s, Chile recorded its highest average growth rates and the least volatility in a hundred years (see table). Between 1994 and 1998 (when major crises occurred in Mexico, several Asian countries, Russia, and Brazil), the Chilean economy grew an average of 6.9 percent a year, well above the average annual growth rate of 3.0 percent for the twentieth century. For most of the past century, Chile's growth rates fluctuated sharply, with the variability in those growth rates—as represented by the standard deviation of the rate of growth—several times larger than the average growth rate. During 1970–79, for example, annual growth averaged 2 percent, but the standard deviation was 7.3 percent. Between 1990 and 1998, this relationship was reversed. Average annual growth was 7.3 percent, but the standard deviation was just 2.9 percent.

From 1986 through the end of the 1990s—including the 1999 recession—Chile enjoyed the longest, strongest, and most stable period of growth in its history. During this period of vigorous, sustained growth, the country was also able to overcome its second economic handicap: perennially high and unstable inflation. Chile now has brought its inflation rate down to international levels, and its central bank has announced the introduction of a new inflation targeting system. The central bank's inflation target is around 3.5 percent for 2000 and within an annual range of 2–4 percent indefinitely thereafter. To use a horse-racing metaphor, Chile in the 1990s entered the "home stretch" toward its goal of mature development.

Main macroeconomic variables, 1880–1998
(percent)

	GDP (annual change in real terms)		Inflation (December–December change)		Current account balance (percent of GDP)		Fiscal surplus (percent of GDP)	
	Period average	Standard deviation	Period average	Standard deviation	Period average	Standard deviation	Period average	Standard deviation
1880–89	3.2	5.0	1.1	7.2	1.2	3.8	–2.8	1.3
1890–99	3.4	5.1	4.8	15.4	0.8	3.6	–2.6	2.3
1900–09	3.0	5.1	5.2	10.5	3.4	2.3	–2.2	1.0
1910–19	0.2	11.1	6.1	8.5	4.8	7.3	–1.7	1.7
1920–29	4.4	11.1	3.5	5.4	6.6	2.9	1.5	3.2
1930–39	1.2	15.0	5.5	8.2	n.a.	n.a.	1.4	1.8
1940–49	3.0	7.2	17.6	7.9	n.a.	n.a	1.2	1.0
1950–59	3.6	4.8	36.6	24.4	–1.2	1.9	–1.6	1.3
1960–69	4.8	3.0	24.3	12.1	–2.3	1.6	–5.6	1.9
1970–79	2.0	7.3	131.9	174.4	–3.2	3.2	–3.7	5.9
1980–89	3.3	7.0	20.5	6.3	–7.1	4.2	0.0	3.2
1990–98	7.3	2.9	11.5	7.3	–3.6	2.2	1.7	0.7

Source: Chilean Ministry of Finance.
Note: n.a. denotes that data are not available.

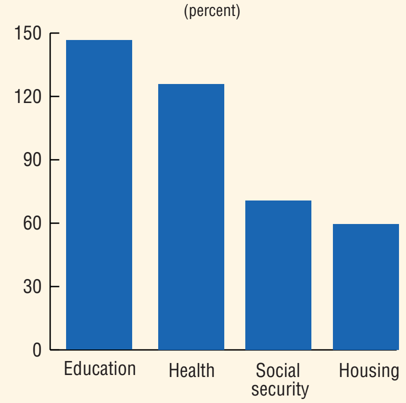
Decade of reforms

A decade of reforms lies behind Chile's impressive macroeconomic performance. The two governments of the "Concertación" coalition led by Presidents Patricio Aylwin (1990–93) and Eduardo Frei (1994–99) broadened and deepened a wide range of "first-generation" reforms that had begun in the 1970s. The governments also turned the country's attention to key "second- and third-generation" reforms, notably a strengthening of the country's education and judicial systems and a deepening of the social security reform undertaken in the early 1980s. In line with their commitment to integrating Chile into the global economy, the democratic governments pursued trade liberalization policies that included two unilateral tariff reductions (in 1991 from 15 percent to 11 percent and, in 1998, from 11 percent to 6 percent over five years), as well as the adoption of free trade agreements with a number of Latin American countries and Canada.

During the 1990s, privatization efforts were deepened, but under a fresh approach that emphasized greater transparency, open competitive bidding, and fair pricing to ensure appropriate safeguards for government property. Priority was given to the design and prior implementation of appropriate and up-to-date regulations. As a result of these initiatives, government proceeds (in terms of constant purchasing power) from privatizing public enterprises increased over the past decade to $2.5 billion—more than double the dollar amount of privatization earnings collected by the military government in the previous round of privatization in the second half of the 1980s.

The democratic governments also placed early emphasis on human capital development and institutional modernization that lay at the heart of the second- and third-generation reforms. Recognizing that human capital is critical to achieving long-term growth and reducing income inequality, the authorities focused on improving the quality of public education. They boosted the budgetary funds allocated for the education system, introduced a comprehensive education reform plan to upgrade teacher training, increased the number of hours that children spend in school, and modernized curriculums (Chart 1).

Chart 1
Real social expenditure increases, 1990–99
(percent)



Source: Chilean Ministry of Finance.

To improve the quality and efficiency of its judicial system, Chile embarked upon wide-ranging reforms that have introduced new criminal trial courts. These reforms are intended to enhance the timeliness, transparency, and fairness of the trial process and, more broadly, to improve dramatically the access that average citizens have to their court system.

Chile's robust economic performance underwrote the country's ability to address poverty reduction and human development. Real per capita GDP grew at an average rate of 5.6 percent a year between 1990 and 1998, and real wages rose at an annual rate of approximately 4 percent over the past decade. Targeted social investment and strong economic growth provided powerful tools in the war on poverty. The percentage of the population officially defined as living in poverty declined to 21.7 percent in 1998 from 38.6 percent in 1990. Over the same period, the percentage of the population defined as living in extreme poverty fell to 5.6 percent from 12.9 percent (Chart 2).

The quality of life of the population also recorded remarkable improvements. Life expectancy rose from 73 years in 1990 to more than 75 years

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in 1997. Chile strengthened its position in the 1999 United Nations Development Program’s *Human Development Report*, ranking first in Latin America and ahead of the Czech Republic and only slightly behind Portugal overall.

Coping with the crisis

At the end of the 1990s, Chile, like most of Latin America, faced a one-year downturn. Its domestic economy underwent a minor recession and its growth faltered briefly. In early 1999, Chile’s private sector experienced a crisis of expectations triggered by the negative impact of the Asian crisis on its terms of trade and export volumes, sharp fluctuations in domestic interest rates, exchange rate pressures, and a serious drought (attributable to the weather phenomenon La Niña). To give fresh momentum and confidence to the market, the authorities embarked upon a proactive strategy to improve the expectations of market participants and adopted direct fiscal measures to achieve a sustainable economic revitalization.

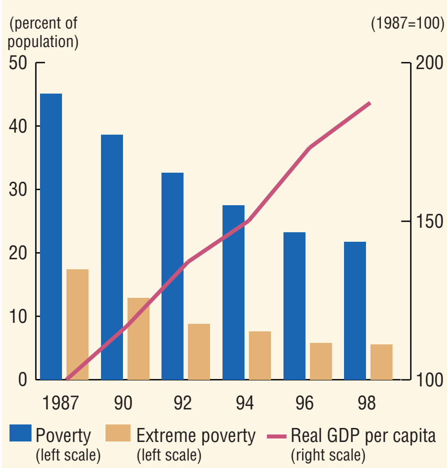
In 1998 and 1999, Chile pursued a countercyclical fiscal policy. In 1998, when aggregate demand was growing excessively, the government carried out three successive fiscal budget decreases, which together amounted to 1 percent of GDP. In 1999, after a sharp drop in private expenditure, the authorities implemented prudent pro-employment policies. Carefully designed measures and a credible fiscal track record since 1990 made it possible for the authorities to draw from accumulated savings and stimulate the economy with a temporarily expansionary fiscal policy. Chile ended 1999 with a central government budget deficit of roughly 1 percent of GDP, chiefly because the severe drop in private expenditure reduced the net tax yield in the first half of 1999.

Data for the third quarter of 1999 point to a turnaround in fiscal revenue performance, reflecting a recovery in economic activity over the same period. This favorable development will help to ensure that the fiscal deficit will be reversed in 2000. Also, the fiscal policy measures adopted during the Asian crisis have already been fully financed or have been designed to take due account of the cyclical situation, as in the case of the special employment programs initiated during 1999 and implemented through municipalities.

The unemployment rate peaked at 11.5 percent in 1999—well above the average levels recorded during the 1990s but significantly below the high levels encountered during the 1980s.

Chart 2

Trends in poverty, 1987–98



Source: MIDEPLAN, Central Bank of Chile, INE.

Three fiscal policy packages implemented by the authorities in 1999 helped revitalize employment levels in vulnerable subsectors and in the regions most severely affected by the adjustment process. The fiscal measures included a labor-intensive special public investment program, government investment in targeted regions, partial rescheduling of the debts of small-scale and medium-scale enterprises, and the introduction of credit insurance for nontraditional exports.

Although Chile had to contend with an external crisis that was larger than expected, the government did not borrow from external sources and avoided making cuts in social spending (something that did happen during the external debt crisis of the 1980s). Instead, Chile successfully brought inflation down to 2.3 percent in 1999 for the first time in its history and continued to implement its reforms in contrast with other economies in the developing world, where these reforms were brought to an abrupt and regrettable halt.

The macro adjustment policies of 1998–99 generated the expected results, and positive growth resumed in September after only 11 months of recession. Real GDP is expected to have expanded by about 4 percent in the last quarter of 1999, and the unemployment rate declined to 8.9 percent in December.

In 2000, growth is expected to rise even more strongly toward the country’s potential (around 6 percent a year), in an environment of low inflation and sustainable external accounts.

Outlook for the new century

With the advent of the year 2000, Chile faces further challenges. The chief priority at present is to strengthen the economic recovery and ensure its sustainability over the medium term.

Chile’s external imbalances have been fully corrected and its economic fundamentals remain sound. This record should enable Chile to return to high rates of growth and seize the opportunity to achieve a high level of development while providing decent living standards for all its citizens. The very positive performance of the 1990s can be repeated again. But Chile must also persevere along its chosen path; these goals will not be achieved overnight, and consistency must continue to characterize the policy mix. F&D