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CHILE'S SUCCESS STORY

HERNAN BÜCHI

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تقديم

تذهب النظرية الاقتصادية إلى أن الإقتصادات الفقيرة قادرة على أن تنمو بمعدلات أعلى من معدلات نمو الإقتصادات المتقدمة. ويأتى ذلك نتيجة أن الدول الفقيرة يمكن أن تستفيد من التقدم التكنولوجى فى الدول المتقدمة، كما يمكنها أيضاً أن تجتذب المستثمرين عن طريق منح عوائد أفضل على الإستثمار فى ظل الندرة النسبية لعنصر رأس المال فيها. إلا أن العقود السابقة أثبتت إستناد هذا التنبؤ إلى كثير من الأماني، حيث أن عدداً محدوداً من الدول الفقيرة إستطاع أن يبدأ مرحلة اللحاق بركب التقدم.

فى هذا الإصدار يعرض "هرنان بيخى" تجربة شيلى، كإحدى الدول التي إستطاعت أن تحقق معدلات مرتفعة للنمو. وتبدأ القصة فى عام ١٩٧٣ عندما واجهت شيلى كارثة ذات أبعاد سياسية و إقتصادية و مؤسسية كانت فى حد ذاتها دافعاً قوياً للإصلاح، حينئذ تولت السلطة حكومة جديدة إجتهدت لتحويل إقتصاد شيلى من إقتصاد مغلق موجه، إلى إقتصاد مفتوح تتحكم فيه قوى السوق و يقوم فيه القطاع الخاص بالدور الرئيسى. وقد ظهرت ثمار هذه الإصلاحات التى إمتدت لنحو سبعة عشر عاماً فى شكل معدلات أعلى للنمو و التشغيل، وكان من نتاج هذا النجاح أن إستمرت الحكومة المدنية الجديدة، التى انتخبت عام ١٩٨٩ ، على نفس النهج فيما يتعلق بإجراءات الإصلاح الإقتصادى.

إن عرض مثل هذه التجربة من شأنه أن يثير إعجاب البعض من منطلق إعجابهم بأخضر كأحد صانعى هذه التجربة، بينما قد يعجب بها البعض الآخر لأنها توضح كيف يمكن للدول النامية أن تتحرك فى المسار الصحيح نحو تحقيق أهدافها، و هناك آخرون مما قد تعجبهم النهاية الموقفة التى انتهى إليها الإقتصاد الشيلى.

هذا بالطبع لا ينفى أن بعض القراء قد يكون هم رد فعل مخالف لما سبق. فالبعض - عن حق - قد يثير التساؤل حول التكلفة السياسية للنظام العسكرى فى شيلى، والبعض قد يجد أن تفاصيل النموذج الشيلى غير مناسبة لدول أخرى، وآخرون قد يشككون فى كون التجربة الشيلية معجزة حقيقية. و قد إنعكس هذا الخلاف فى الرأى فى المناقشات التى أعقبت المحاضرة التى ألقاها بيخى.

أياً كانت النتيجة التى يصل إليها القارئ، فالحقيقة التى تبقى هى أن شيلى تقدم مثلاً مهماً للدول النامية التى تعتمز السير فى طريق الإصلاح. هذا على الرغم من أن الحدود الحقيقى لنجاح أى دولة نامية هو مدى قدرتها على تصميم إستراتيجية للإصلاح تراعى خصوصيتها، و تستفيد فى إعدادها و تنفيذها من عناصر النجاح و الفشل فى تجارب دول سبقتها فى مسيرة الإصلاح الإقتصادى.

أحمد جلال

المدير التنفيذى بالإناابة، المركز المصرى للدراسات الإقتصادية

القاهرة، مايو ١٩٩٦

FOREWORD

Economic theory maintains that poorer economies should grow faster than richer ones. They can profit from the technological innovations of developed countries, and can better attract investors by offering higher returns, given the scarcity of capital relative to other factors of production in these economies. Unfortunately, the past few decades have proved this prediction to be wishful thinking; only a few countries around the world have begun the process of catching up.

In this publication, Hernan Büchi tells us the story of Chile, one of the countries now catching up. His main story line is that Chile confronted a political, institutional and economic crisis in 1973, which provided the impetus for reform. A new government took over and diligently transformed the economy from one of the most closed, government-led economies in Latin America to one of the most open, market-led and private sector-dominated economies. The reforms, which spanned some 17 years, have been paying off in higher growth and lower poverty. As a result, the democratically elected government which took over in 1990 left these reforms in place and augmented them.

When such a story is told, some of us appreciate it because it evokes admiration for the story's heroes. Others like the story because it shows us how we might journey successfully in search of our own destiny. Many people enjoy the story because it has a happy ending. And Büchi tells it in a spontaneous style, rather than from a written presentation, supplying his insights gained from firsthand experience.

Not all readers will react similarly to the story, however. Some will rightly question the political costs of the military regime in Chile. Others will find some details of the Chilean model inappropriate for other countries. Yet others will doubt that the "Chilean Miracle" actually is one. These views are expressed eloquently in the discussion following Büchi's presentation and featured in the second part of this publication.

Whatever the reader concludes, the fact remains that Chile offers an important example for developing countries contemplating reform. The trick for each country is to find its own strategy, avoiding the mishaps and capitalizing on the triumphs of those who have preceded them.

Ahmed Galal
Acting Executive Director
The Egyptian Center for Economic Studies
Cairo, May 1996

ABOUT THE SPEAKER

HERNAN BÜCHI*Founder of the Institute for Liberty and Development, Chile*

Hernan Büchi is one of the architects of Chile's much-admired economic transformation. While still in his twenties, Büchi became advisor to Chile's Minister of Economy. When he was barely 30 years old, he became Chile's Undersecretary of Economy and later the Undersecretary of Health. He ascended to the position of Minister of Planning in 1983 at the age of 34. Two years later he became Chile's Minister of Finance, and served from 1985 to 1989 as the guiding force behind Chile's massive structural reform, from which Chile continues to benefit today.

As one of the leading policy makers of Chile's socioeconomic reform, Büchi was instrumental in the transformation of the economy under one of the most successful experiments in Latin America. His leadership accomplished the implementation of tariff and taxation reform, trade and price liberalization, market deregulation, capital market reform, public enterprise reform and privatization, new investment and labor legislation, overhaul of the educational, health, and pension systems, and reform of the system of financing public housing.

Büchi was twice a candidate for the Chilean presidency, and his deep commitment to public service continues through his work with the Institute for Liberty and Development. He is a professor of engineering at the University of Chile and professor of economics at the Catholic University of Chile. In addition, Büchi is a director of several private companies, and serves as a policy advisor to governments in Latin America, Eastern Europe, and Asia.

PART I

CHILE'S SUCCESS STORY

1. Introduction

I appreciate the opportunity to share with you my views about what happened in Chile during its period of economic transformation. Of course, every country is unique in some way, and each should make its own decisions. But on the other hand, countries around the world have many things in common. I visited the Philippines when President Aquino was in power, and they were trying to advance certain reforms at that time. There, as well as in Chile and elsewhere, I heard the same argument when it came to introducing economic reform: they could not open the economy quickly and introduce other reforms because of political problems. So there are a lot of similarities between countries with respect to the problems that have to be faced and the decisions that should be made. I hope you can find Chile's experience relevant for Egypt.

Chile is still a poor country, and many people wonder why we talk about success if we continue to be poor. But even in a developed economy like the US, there is poverty. Our success is that we turned our situation around, after becoming probably the worst performer of all in Latin America. Although we had lived in a democracy, by the time we initiated reform in late 1973 we were lagging behind so much that we were experiencing great instability and institutional crises, and nearly faced civil war. Yet today we are on the road to development. The figures on Chile recorded in books written three or four years ago were probably not convincing enough. The success is much clearer now, after a period of almost half a generation of growth. With 13-14 years of growth close to 7 percent per annum, and a population rate of growth of only 1.3 percent, Chile is advancing. People said that Chile would never have a market economy because there were no entrepreneurs, and only copper to export. But Chile now has plenty of entrepreneurs and has diversified its exports. We still have problems, but our evolution shows that the ingredients for success exist in any society. Surely they exist in Egypt today, where the situation is less complicated than that of Chile at the start of its reform, at least concerning stability and inflation.

In the rest of my presentation, I would like first to discuss general reform issues, then to take a broad look at several Latin American countries, and finally to focus on Chile and its reform program.

2. Ingredients of Successful Reform for Growth

To get out of underdevelopment, you need sustained growth of 7 percent or more, depending on the population growth rate. If the population is growing at 1 percent, economic growth of 6 or 7 percent is probably acceptable. If the population rate of growth is 3.5 percent, like Bolivia's, then growth should be between 8 and 9 percent.

Table 1 shows a number of selected indicators of high- and low-growth developing countries over the periods 1971-83 and 1984-93. The countries that grew fast between 1984 and 1993 generally had stable currencies. Their inflation, although not zero, was moderate and stable. The low-growth countries had neither stable currencies nor moderate inflation. Latin America was having, not two-digit inflation, but four-digit inflation. For 60 years Guatemala pegged its currency to the dollar and was relatively stable, but it was not able to get out of underdevelopment. Pegging the currency is useful, but it is not enough. Successful economies are open to the world. They are generally flexible, competitive, market oriented—and they are successful exporters. Behind these facts is what is called structural reform. Countries with good growth rates also tend to invest and save more, at a rate of 30 percent or higher, whereas low-growth countries save at rates below 20 percent. Three broad ingredients are therefore required for success: stability, structural reform, and a process of mobilizing savings. Without those three ingredients, an economy cannot gain enough momentum for growth.

Table 1: Selected Indicators of Economic Performance of Developing Countries

Indicators	1971-83		1984-93	
	High-growth countries	Low-growth countries	High-growth countries	Low-growth countries
GDP growth (%)	5.8	4.0	7.4	1.4
Consumer prices (%)	12.0	26.4	11.5	53.5
Fiscal Deficit (% of GDP)	-2.8	-4.1	-3.2	-5.3
Investment (% of GDP)	25.8	26.3	30.1	20.9
Savings (% of GDP)	24.5	24.1	29.3	18.8
Export volume	8.6	-0.5	10.4	3.4
Factor productivity	1.9	0.2	3.4	-1.1

Note: Data covers 90 developing countries.

Source: *Sources of Growth*, the International Monetary Fund.

Poverty is strictly related to the capacity for growth. In the 1950s, Singapore was a poor nation and the Philippines was the best performer in Asia. Today this is hardly the case. Up to five years ago, the Philippines was backward looking. It was in a good neighborhood but didn't use the opportunity for 30 years. The Philippines didn't have the excuse that Chile had: all of Latin America was not performing well, so the neighborhood was not good.

One key element of successful reform is the coherence of the reform program and attention to details. When you do a jigsaw puzzle without knowing the picture beforehand, it is much harder, and until you have enough pieces in place you won't have an idea of what is going on. In the economy, you may have stability in one place, but if you don't have enough pieces in place, it will not generate growth. Maybe one country needs certain pieces in place more than others, but it has to have enough pieces correctly in place.

For stability, you need the correct monetary policy, fiscal policy, and exchange rate policy. But it's not that simple. If a government stabilizes by abusing exchange rate policy, this will adversely affect other areas. You can stabilize with fiscal policy but in such a way that crowds out the private sector and saving, so there will be stability but no growth or saving. You can have a strict monetary policy in an environment where the financial markets cannot cope with it, and then have a financial crisis. So how you combine these pieces is important. It is not just a matter of balancing the budget. Abusing monetary policy causes financial sector problems—or even collapse.

In structural reforms, the most important factor is integration with the rest of the world, opening up the economy in goods, services and capital. Some people argue that opening the economy would damage local industry, but that only happens if structural reform is coupled with the wrong exchange rate policy—if you overvalue your currency when you open the economy. If you have the right policy, you won't have the problems. Normally, people will have to shift from one sector to another, but they should be able to find something to do successfully. Deregulation should be designed to accommodate to the markets. Before reform, Latin American economies had been regulated to accommodate to government intervention; prices were fixed, and money was becoming worthless.

In addition to the three main ingredients, a society needs to perceive that the changes are necessary, and it must have the will to reform. The government must be convinced that change is necessary, and there must be a critical mass of technical people to do the job in all its details.

Latin America has this stock of human capital, and Egypt surely has it, too. But Egypt must find a way to use the capacity of its people and put all the ingredients together. The first step is public opinion. In Chile, everybody knew there was a crisis. And isn't having a lot of poverty in Egypt a crisis in itself?

3. Reforms in Latin America

Latin America wasted at least half a century discussing how to proceed, whether to give priority to distribution of income or to growth. In the end, growth is what improved the situation of the poor. Now Latin America seems to be changing and trying to pull together, because they went through crises. The average inflation in the continent for the period 1990-94 was over 1000 percent. Chile's crisis practically destroyed its institutions, and almost brought complete economic and political breakdown. Finally Chile simply had to reform. But it should not be necessary to go through crises in order to change. Some say that what happened in Chile was because of the military regime and not relevant to other countries. But Argentina is reforming today, and it is not a military regime.

Latin American countries today are aiming for those critical ingredients: stability, structural reform, and savings. Some countries are more advanced in the reform process than others. These variations are reflected in the different GDP growth and inflation rates shown in table 2. I will give a brief description of where some Latin American countries are in their reform processes.

Table 2: GDP and Inflation in Selected Latin American Countries

Country	Relative Weight of GDP in Sample 1994(%)	GDP Evolution Average annual rate (%)			Inflation Average annual rate (%)		
		1985-89	1990-94	1995E	1985-89	1990-94	1995E
Argentina	19.3	-0.8	6.2	-4.4	468.6	103.4	1.6
Brazil	38.7	4.4	1.0	4.0	453.5	1163.8	22.0
Chile	3.6	6.3	6.4	8.5	19.8	15.8	8.2
Colombia	4.6	4.7	4.2	5.3	24.3	25.8	19.5
Ecuador	1.2	2.3	3.5	3.0	43.1	42.4	22.8
Mexico	25.4	1.0	3.0	-6.9	73.8	14.8	52.0
Peru	3.4	0.4	2.9	6.9	445.9	242.0	10.2
Venezuela	3.8	1.6	3.6	1.5	32.5	42.5	56.6
Total/Average	100.0	2.2	2.8	0.6	365.6	513.2	25.0

E = estimated.

Note: Latin American inflation excludes Brazil. Latin American GDP is based on 1994.

Source: Institute of Liberty and Development, Santiago, Chile; based on central bank reports of each country.

We will consider Mexico and Argentina first. Mexico has advanced a lot regarding stability. Although their inflation is around 52 percent, they are close to stability because they now have control over the elements of the government budget. Inflation figures should soon become much more reasonable.¹ Mexico introduced structural reforms, but not enough, which is why they haven't had more growth. Figure 1 shows that Mexico has also made significant progress in increasing its exports. This year they will probably have \$95 billion of exports, of which oil accounts for only \$8 billion. Some say being close to the US helped exports, but Mexico has always been close to the US and wasn't exporting that much before. (Egypt is also quite close to major markets, especially Europe.) Mexico used to rely on money from outside and had low savings. You can do that for a few years, but suddenly you have to adjust to your own means and increase savings to generate growth. Mexico should use the opportunity of the devaluation to create savings.

Argentina is similar to Mexico. After a lot of reforms to stabilize and restructure the economy, today they look much more stable. In the last 12 months they have had four months of deflation (see figure 2). But they have not generated enough savings—the same problem Mexico has. To generate savings without devaluing requires lowering prices internally, which is difficult. Devaluation is very tough because it can create economic turmoil. But if you overcome that, and reduce the budget and real wages, it is easier to go forward. If you don't devalue, you avoid the turmoil—but it takes a long time to adjust the economy. In the years to come we will continue to compare Mexico and Argentina. After the turmoil of devaluation, the Mexican government is worth little in the minds of its population. But I wonder what will happen to the Argentinean government in the next two or three years, when they have low growth and high spending. In 1994, Argentina had only a 3.5 percent GDP deficit in the current account, but that was \$10 billion, and they were exporting only \$15.8 billion.

Now consider Peru and Bolivia. Peru, in my view, is stabilized, after suffering from hyperinflation—not chronic inflation, as so many Latin American countries had for so long (see, r

¹ Compare Mexico to Turkey. In February 1994, Turkey had a major devaluation, and then a major recession. They recovered from that, but they still don't have the budget under control. They will continue to have high inflation as long as they don't handle the problems of the budget.

Basic Economic Indicators for selected Latin American countries 1985-1996

Figure 1. Mexico

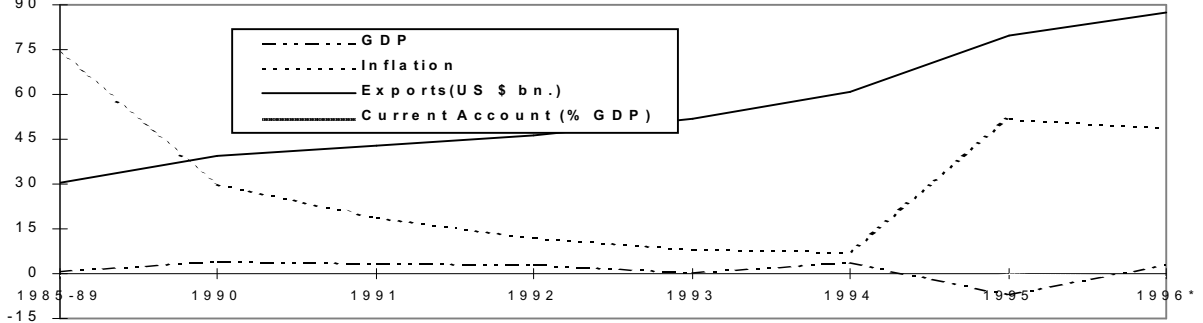


Figure 2. Argentina

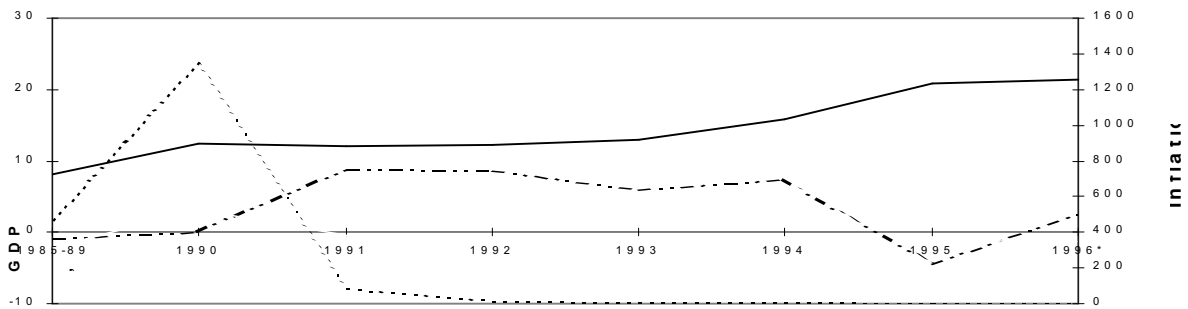
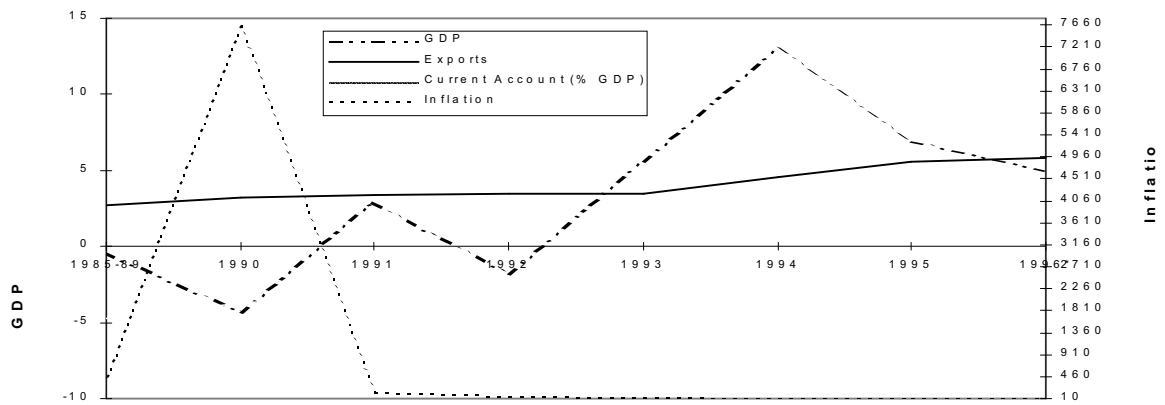


Figure 3. Peru



saving enough. They drastically reduced inflation, not by fixing the exchange rate but by putting the right instruments in the budget.

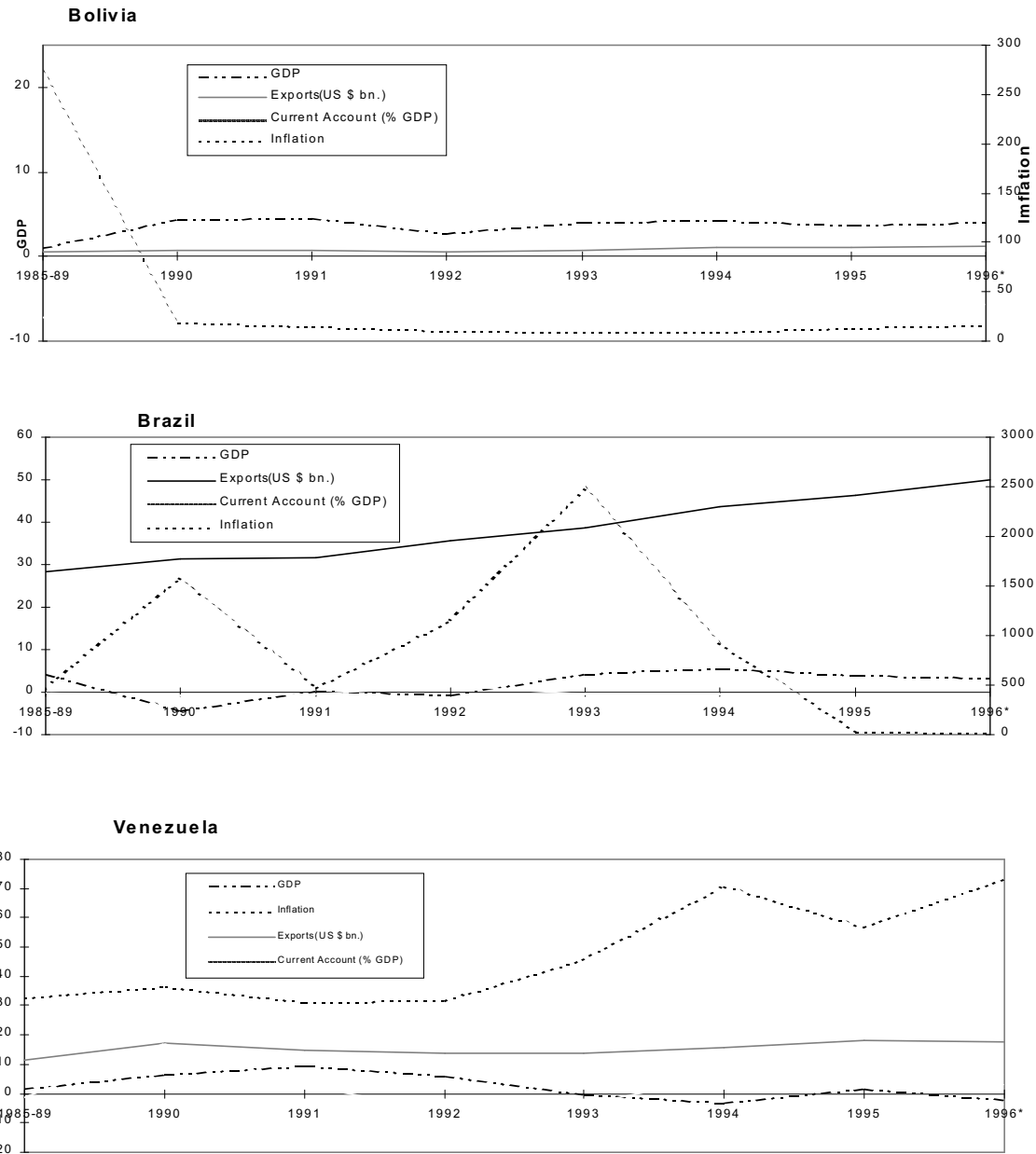
In 1984, Bolivia's inflation was 20,000 percent. Now they've stabilized and they are growing (see figure 4), but with a population growing at 3 percent or more, they don't have the rate of growth they need. Their structural reforms were not sufficient. If a government starts to reform structurally but then loses its nerve and goes backwards, the economy will become unstable again. Bolivia's president is aware of this challenge, and I think he is advancing, but the jury is still out.

Now look at Brazil and Venezuela. Brazil is not yet stable and has a lot of budgetary problems. Brazil's economy was very powerful and dynamic 20 years ago. But recent growth has been erratic. If they stabilize and put together enough structural reforms, they could recover. After their reforms in 1994, they got a major current account deficit in 1995 (see figure 5). Brazil must complete its stabilization, and reform its budget as well as the way the states and central government behave.

Venezuela tried to reform, but failed. In some countries, leaders have been able to implement reform that was against the foundation of their parties. Argentina's populist leader Menem was elected saying the opposite of what he did in office, and the same holds true for Peru's Fujimori. These leaders were able to maintain party cohesion. But this was not the case in Venezuela. There, the president was not able to handle his party or to put enough reform pieces in place, and everything simply collapsed. People took their money out of the country, and unemployment and inflation rose. This country had its exchange rate pegged to the dollar for 20 years, so they were used to stability. Now they've had 10 years of double-digit inflation (see figure 6). The president says he doesn't believe in what they call "IMF-oriented reforms". But Chile did not start reforming because the IMF told us to; we reformed because we believed in change, before anybody advised us to, even before such programs were created. In fact, if you are forced to reform, you may act like you are, without actually doing it.²

² Columbia is unique among Latin American countries. It has been a reasonably stable performer, with growth of 45 percent. When inflation reaches 30 percent, they take measures, but when it is reduced to 20 percent they relax, and it goes up again. Columbia has been like that for 30 years and has been paying a price: it has been unable to solve its problems, which has led to more problems.

Basic Economic Indicators For Selected Latin American Countries 1985-1996



(*) 1996 Inflation rate in calculated as twelve month percentage as of march for Bolivia and Venezuela and as of February for Brazil.

Sources: Institute of Liberty and Development, Chile, Based on Country Central Bank reports and references from Getulio Vargas Foundation.

4. Reforms in Chile

Chile is the only country in the last 20 years that consciously tried to reform, and can now show that reforms pay off. Other reforming countries are not yet in that position. Macroeconomic policy in Chile was aiming for growth, stability, and savings. Since 1984, Chile has had average growth of 6.7 percent per year with population growth of 1.3 percent. This means per capita growth of 5.4 percent. Chile has achieved a per capita of \$5000, or \$8000 in terms of purchasing power (see table 3).

In 1985, Chile's exports were \$3.5 billion. Now Chile—a country of 14 million people—exports \$16.5 billion in goods, in spite of being far from most of its markets (see figure 7). Argentina may look more stable with 0.2 percent inflation compared to Chile's 7.9 percent. But because of indexation in Chile, the government decided to reduce inflation more slowly and not by abusing the exchange rate. Chile undertook structural reforms, achieved stability and increased savings. In structural reforms, Chile was quite aggressive in opening its economy. Its maximum tariff rate is now 11 percent (this was agreed upon unanimously in Congress).

The government freed all prices, including bread. To make this politically feasible, direct subsidies, not price subsidies, were given to the poor. We overcame the problem of fixed housing

Table 3: The Chilean Economy in 1973 and 1996

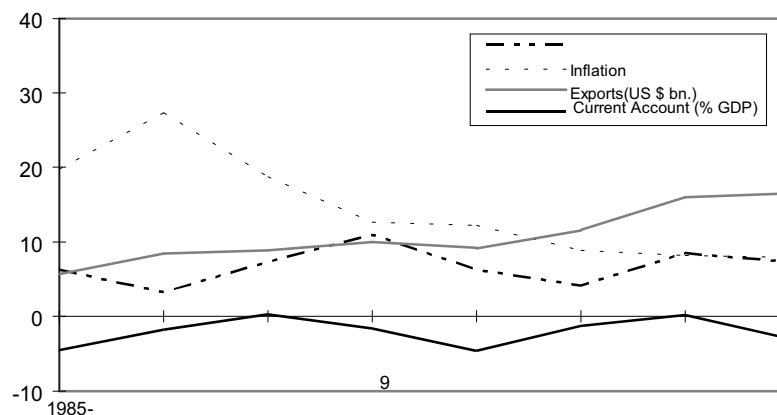
Indicators	1973	1996*
GDP (US\$ M 1994)	17,180	71,500
Population (thousands)	10,020	14,300
GDP per capita (US\$ 1994)	1715	5000
Inflation (%)	500	7.9**
External debt/exports (ratio)	2.5	1.4
Exports (% of GDP)	8	23
Exports + imports (% of GDP)	16	43
Copper exports (% total exports)	82	37

* Estimated

** 12 months March 1996

Sources: Central Bank of Chile and Institute of Liberty and Development.

Figure 7. Basic Economic Indicators, Chile, 1985-1996



Note: 1996 Inflation rate is calculated as 12-month percentage change as of March
Sources: Central Bank of Chile and Institute of Liberty and Development.

rent, which was an obstacle to investment. In agriculture, we regularized property and water rights, and allowed people to buy and sell land. People were permitted to get rid of tenants by paying indemnity; it's better to pay than to stay in the old situation with no hope. Since the military government was so affected by the prior agrarian reform and the socialist mentality about land ownership, the exercise took several years. We also opened the mining sector successfully, with new legislation for private investment.

Transforming the transportation sector was one of the key moves that allowed Chile to export grapes and other fruits to all parts of the world. The government changed the regulations and allowed the private sector to operate ports. Unions received compensation when the labor laws were changed; there was no other way to alter the structure of the ports. The telecommunications sector was opened, so even remote farmers could communicate immediately with markets.

Chile reformed its financial sector to allow exporters easy access to credit, and taxation was changed so that no one pays tax to export. There is an organization that helps people reach markets, because one exporter cannot do it alone. The government helps achieve "critical mass" and then withdraws. We also formed cooperation between the government and the private sector in funding and acquiring new technologies. In agriculture we are flexible in allowing new species in quickly enough to help us compete in markets, while still protecting our environment.

We promoted industry, not as a special sector, but in the same way as the other sectors—agriculture, transportation, energy, etc. Since labor laws in Latin America tend to create either high unemployment or informality, we changed labor laws to allow flexibility and reduce taxation. Previously, the employer/employee wage tax was 60-70 percent of wages—obviously a major taxation. This was reduced to 20 percent. In changing the tax structure, corporate tax was reduced. So corporations could save, and the money was not taxed if it was invested rather than spent.

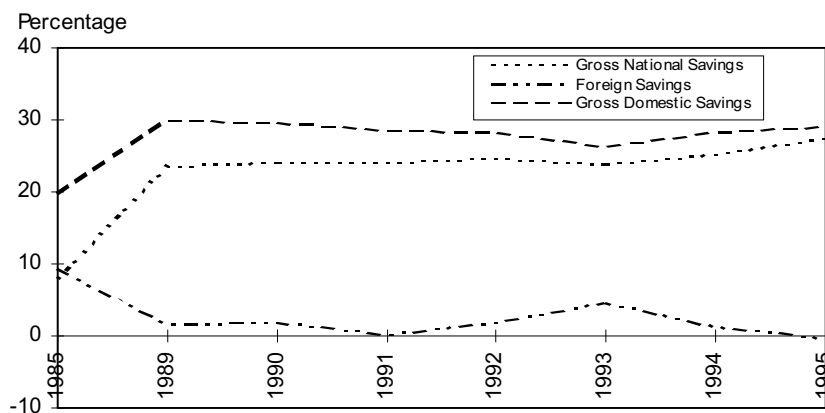
Chile's privatization process was not simply having the old private sector buying companies. The process actually created a new private sector. When the electric company was to be sold, there were no foreign investors and no one able to buy it outright. So the government opened the company to the public and allowed people to buy shares. Pension funds were also allowed to invest in the companies. Many of today's major private companies in Chile used to be government companies, and they are now broadly owned, like big corporations in the US. The government did not have the funds to offer severance pay, so public employees were allowed and encouraged to buy shares. Privatization is an opportunity to gain the public's faith in reform, and it encourages further reform.

In 1960 Chile had practically no capital market, but today Chile's capital market is well established and broadly-based. The process was complicated because the banks were privatized simultaneously with real sector firms, and privatization requires savings and good institutions. Now, a company in Chile can borrow money for 20 years. Good companies can issue bonds in the market. We have pension funds and institutional investors, and the market is quite sophisticated. Pension funds represent about 45 percent of Chile's capital market. But pension funds in the private sector are not enough to mobilize savings. Economic savings means that people are consuming less. Today close to 4 percent of GDP is being saved in private institutions. In 1994 Chile had accumulated 43 percent of GDP in funds.

After the debt crisis of the early 1980s, Chile transformed its budget deficit into a surplus, without crowding out the private sector (see table 4). By 1989 our savings were reasonably high (see fig. 8). Indeed, Chile was the first country in Latin America to successfully mobilize reasonable savings. Increasing saving is difficult, but in the end it generates more production. In order for Chile to maintain its rate of growth in the future, it should continue with reforms and

increase its saving rate to that of a typical Asian economy, 34 percent or more. We are not yet doing that, but we are discussing it openly in Chile.

Figure 8. Savings, as percentage of GDP at current prices, Chile 1985-1995



Note: Savings as percentage of GDP at current prices, Chile 1985 -1996.
Source: Central Bank of Chile

Growth is an opportunity to diminish poverty. But many people perceive poverty-related social programs as programs that spend money on the wrong people. For example, if you want to offer cheap housing loans, people who buy bigger housing can receive bigger subsidies. If you want to offer low-interest loans to promote small business, some people find ways to get these cheap loans and put the money in the bank. The dilemma is how to target resources to the poor and design social programs that are compatible with economic development.

Table 4. Chile: Government Budget (as percentage of GDP)

	1984	1989	1990	1991	1992	1993	1994	1995
Current revenues	27.9	24.9	22.8	23.0	22.7	22.4	22.1	22.5
Tax revenues	19.3	14.8	14.5	16.7	16.9	17.6	17.1	16.5
Current expenditures	29.8	17.7	18.1	18.6	17.5	17.7	17.2	16.2
Interest payments	2.3	1.7	1.9	2.2	1.4	1.2	1.0	0.7
Current surplus	-1.9	7.2	4.7	4.4	5.2	4.6	4.9	6.3
Overall surplus	-3.5	5.5	3.0	2.2	2.5	1.7	1.8	3.5
Memorandum								
Current expenditures excl. interest payments	27.5	16.0	16.2	16.4	16.1	16.5	16.2	15.5

Source: Ministry of Finance, Chile

Table 5. Chile: Main Social Indicators

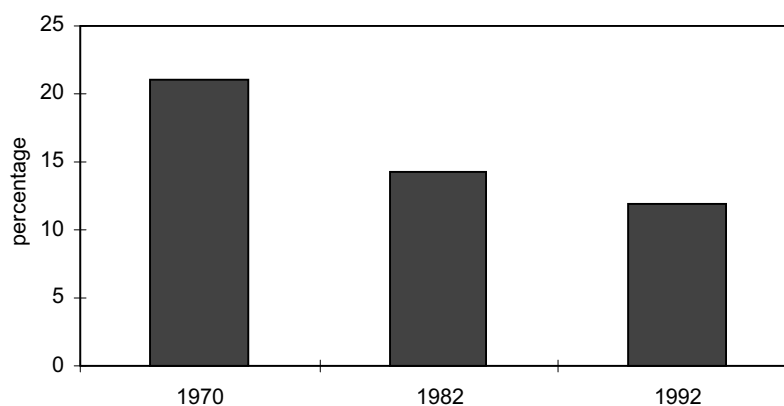
Indicators	1973	1991
Infant mortality rate (per 1000 live births)	66	15
Access to safe water (urban)	67%	98%
Life expectancy at birth (in years)	64	72
Average school courses (in years)	4.5	8.7

Sources: Ministries of Health and Education, Chile

There is a major discussion in Chile about whether we have been helping the poor enough. I think we have been taking care of the poor as much as possible. Infant mortality for 1996 is 12 per 1000, very low for a developing country. The figures on access to safe drinking water and on life expectancy show that Chile has advanced (see table 5). Chile used to be worse than Argentina and the USSR in infant mortality, and now we are far better. Our infant mortality improved faster than that of the oil-rich countries after they became wealthy between 1973 and 1990.

In 1970, 21 percent of Chile's population lived at the extreme poverty level. By 1992, the level was 11.9%. In other words, in roughly 20 years Chile reduced extreme poverty by almost half (see fig. 9). This was achieved through the combination of growth and targeting programs to improve the well-being of the very poor.

Figure 9. Evolution of Extreme Poverty, Chile, 1970-1992



Source: Institute of Liberty and Development.

PART II

A RECIPE FOR REFORM

Following his presentation on Chile and Latin America, Büchi drew some implications of his analysis for Egypt. He then responded to questions and remarks from the audience. The participants were Mohamed Ozalp from banking, Heba Handoussa and Galal Amin from the academic and research community, and Raouf Saad from the government sector. (See Appendix for a complete list of attendees.) The following is a summary of the discussion.

1. Implications for Egypt

I would argue that the principles we used in Chile are applicable anywhere. I believe that a country like Egypt can become a developed economy in a generation. If you do things right, you will notice a difference in 10 years, as it has been noticed in Chile. The reforms will generate not only better economic performance but also political stability, and allow successful political transition if desired or needed. You will have more options, and I am certain it will improve the situation of the poor. What is required is conviction and the perception that the changes are necessary. Then you need enough well-prepared people to do the job. Egypt is not economically unstable as the Latin American countries were. This is an advantage because it is easier to start from a stable situation, and also a disadvantage because you may feel you have plenty of time and you don't need to change quickly. But I believe there is never enough time in the race to develop.

2. Discussion

Participant: Chile's reforms were kicked off during the Pinochet government, an autocratic government. Some of the examples you gave, such as Singapore, also reformed under autocratic governments. Do you believe that you can have a serious structural reform without having a government where the decision making is autocratic and ignores consensus, rather than depending on a conglomeration of ideas or on the population at large?

Speaker: Even in a military government, like the one that I was involved in, there isn't complete agreement on what to do, and the government cannot do whatever it wants. I think that, in general, military governments in Latin America are cautious because they don't feel backed by votes, so they try to more or less be agreeable with the population to gain legitimacy. All reforms are politically costly. Within the government in Chile, there were always arguments about the political costs, and whether or not to risk them. Generally we had to create the perception of a crisis in order to go ahead with the reform. The government knew that if it didn't advance, it would collapse. Labor reform was done when unemployment was skyrocketing. Pension fund reform was done when the government was unable to pay for pensions. Certainly some people in Chile were thinking differently and opposing reform. But once the reform took momentum, some of those same people had the opportunity to be in command, and they upheld and improved the reform; they didn't go backward. I think that shows the political reality somewhat. Peru and Argentina started a process of reform when the military regimes failed. Peru tried to socialize everything to solve its poverty problem, and when the military regime failed, Alan Garcia, a populist, came into power, and the country went even deeper into populist policies. Finally everything collapsed, and they elected President Fujimori, a professor of mathematics who was not from the military or political elite. He was elected fairly with more than 60 percent of the votes, and he was able to go ahead with reform.

Argentina has a populist leader elected from the same party that created its problems. Once a rich country, Argentina went from development to underdevelopment, because of the populist policies of that party. Now Menem is carrying out reforms, perhaps more bravely than Chile, and although they still have a lot of problems, they have advanced much faster than us. A government that is really convinced, and has able people to put together the right ingredients for growth, and creates the perception that change is needed, should be able to go ahead without being autocratic.

Participant: You say that Chile's successful reform program did not use much advice from the IMF or the World Bank, but a local set of decisions on how to proceed. Did you have advice or models from other parts of the world, in terms of the export drive and savings? Egypt is having great problems in these two critical areas: how to get sustained growth in exports and how to increase savings, especially the major transition from public savings which has accounted for 2/3 of savings in Egypt. What are the major requirements for success in a period of four years or so?

Also, how do you measure the speed of reform implementation? I think Egypt has proceeded quickly once it decided to do it, between 1991-94.

Speaker: Chile received backing from the IMF and the World Bank at times, especially when we were dealing with foreign creditors. The backing and advice of those institutions were important. I believe that we were growing together in a sense, learning by doing things at the same time. However, nobody told us how to reform pension funds, how to privatize an electrical sector. Nobody gave us a model. There was no other experience to draw from. But we did look at other parts of the world; you never invent things from nothing. In the mid-70s there was a lot of discussion of how exports were successful in Asian countries because the governments were guiding and focusing efforts on specific industries. So we took that into account. When I visited Korea in 1978, I was told they were promoting shipyards and shipbuilding by their heavy metals industry. But soon after that, when the Iranian crisis happened, oil prices skyrocketed to 40 dollars a barrel on the open market, and all the industry related to shipbuilding collapsed. So in that case their government's guidance was not providing the key to success.

We decided to clear the field for export, to design a system where exporters would not pay taxes; value-added taxes would be the main tax. Other taxes were set in such a way that they would not impede exports. We reduced tariffs until they were the lowest rate compatible with the political reality. So we had to finance the government through other revenues. We were not in a position to lend money directly with low interest rates to specific programs, so we needed a general capital market. We worked area by area. Corporate taxes were reduced across the board. If somebody in the agriculture sector was saying they were having problems because they were not allowed to import a variety, we would look at the problem and clean the field. We were very attentive in responding to the private sector, not in granting favors but in trying to solve problems. Sometimes it was necessary to change the people in charge of institutions in order to do this. In the case of exports, obviously the exchange rate was very important.

I believe that four or five years is enough to reduce tariffs. At the beginning of 1973-74 we had 1000 percent tariffs, and prohibitions. The average tariff was close to 100 percent. It became 10 percent in 1979. The combination of correct exchange rate and tariff policy will bring results much faster. In Egypt the maximum tariff is 70 percent, and the average is about 30, and that is quite high. Exporters are affected by that. Agricultural exporters have to pay tariffs for fertilizer and equipment. Five years is a long time. Colombia was a very closed economy at the beginning

of the 90s, but today they have much lower tariffs than you. Brazil was a very closed economy. India was probably one of the most closed economies at the end of the 80s and beginning of the 90s, and the numbers show that they have advanced a lot more than Egypt. What happens depends on many things, obviously; but your exchange rate appears to be overvalued. You need to balance things if you are going to advance. In our 1982-84 crisis, because of the debt crisis and political reasons, Chile increased its tariffs from 10 to 35 percent. So we went backwards then. Later we reduced tariffs, and it was perfectly possible to do so because there was also a change in exchange rate policy. Tariffs were reduced from 35 to below 15 percent in 12 months, and no one really perceived a major effect because it was compensated for by the exchange rate. Obviously there was a major effect in the economy, but in the end there were ways of coping with it. We reduced the size of the budget in five years (1991-96) from 30 to 17 percent. Egypt's budgets in 1991 and in 1996 in terms of GDP are not very different, going from 42 to 38 percent. That is completely different from reducing the size of the budget from 30 to 17 percent in four years. You may say that such a reduction will generate social turmoil. The fact of the matter is that we were very successful.

Savings is a very tricky issue. There is no easy answer. We did two things. We simply said we have to allow savings to grow naturally, and as long as income grows and GDP grows, savings will grow. Second, we promoted our capital markets, reduced the budget, transferred savings to the private sector, and reformed taxation in such a way to promote savings.

Participant: I think it is important for Egypt at this point, after implementing the first phase of reform and getting to a more painful one, to know more about the package with which you succeeded. You rightly mentioned three major ingredients: perception, good government and a critical mass of technicians. To have perception, though, you need a concept. I don't think a crisis situation is enough. A group of economists can formulate a concept and then implement a program, but linked to this are other important ingredients: one is the political system. As it was mentioned, some Southeast Asian countries today, and Chile previously, could not claim to have full-fledged democratic systems, but still they are successful. You used the words *convinced* and *believed* many times. In the case of Egypt I think people were able to bear the costs and consequences of the first phase because it was consumers who paid. I cannot confirm that they did that upon belief rather than just being presented with a program by the government. But will they be able to bear the second phase without being fully convinced? In Chile, how were you able to

first convince yourselves and then to convey the message to the people? After all, the people are either implementing the program or paying the price, or both. I think Egypt is badly in need of getting into such a mental state of affairs.

Speaker: I was using the words *convinced* and *believed* from the perspective of the policy maker, not the consumer. In Peru in the beginning of the 90s, people were not convinced that they needed a free market; they probably were not even considering it. But it was clear to them that there was chaos, and somebody was now providing leadership in order to go ahead. Their leader was convinced of the need for reform. When you are in a plane, you have to trust the pilot and not go into the cockpit and start touching the instruments. You need somebody there who knows what to do, without having people doubting and interfering. How to achieve that depends on each society's reality. Brazil could have 20 percent inflation in a month and people say: okay, there is inflation but we can cope, it could be worse. And then, at 40 percent a month they say: okay, it could be worse. So even when there is a problem, people often need somebody to point it out.

In Chile, we had an agreement at the end of the 50s, beginning of the 60s, between certain universities and Chilean universities for training a diverse group of people. One of them, from the Christian Democrat party, is minister of health today in Chile. Another was the first important minister in the military government, and he was very prominent in our initial reform process. Argentina happened to have another reality. Cavallo, formerly governor of the central bank, was out of the government for years. During that time he created a foundation that trained people, in a province far away from the capital. When he was called to government he was able to bring many people who had been working with him, and put them in various posts. So one can say how it was done in Chile, in Peru, in Argentina, and somewhat in Mexico, and how it was not done in Venezuela. But I cannot say how it can be done in Egypt; I don't know enough about Egypt. When I say convinced, I mean that the people in charge need to be convinced. When I say creating an environment, I mean the perception in the population that you have a leadership, and that you need the change. I think it is very difficult to convince the population of how to fly the airplane, and that will take much longer. I think it's just happening now in Chile. Our institutions have been creating the entrepreneurs, so they have sufficient backing. We have a very good technical dialogue now, but it has taken many years.

Participant: You said that the fact that Chile has grown for about half a generation at about 6 or 7 percent is assurance enough of success, but consider the first 10 years of Chile's experience. In

1983 many things were worse than in 1973. Per capita income was lower, unemployment was higher, so actually the success is really more or less concentrated in the last 10 years. But even there one can see signs which make one unsure. People talked about the Brazilian miracle, but Brazil has been growing at an annual average of 2 percent for more than 10 years. Actually Chile's success could be reversed. The weaknesses in the last 10 years throw some doubt. The rate of growth could be tied quite a lot to the performance of exports, and you may have been lucky. Perhaps you can attribute the success to good export markets or high export prices. The rate of growth has been quite volatile; the average is 6-7 percent, but some years had 3-4 percent in the last decade. The success in diversifying exports is also doubtful. You greatly reduced the importance of copper, but you are still dependent on primary commodities. As far as I can see from the figures, manufactured exports have not really improved much as a proportion of the total. The share of manufacturing in total output doesn't seem particularly impressive. External debt seems to be rising slightly, rather than falling. Also, distribution could reflect on future growth. If you have 50 percent of income going to 10 percent of the population, seemingly the highest in the world with the exception of Brazil, how much can you rely on the domestic market to protect you from fluctuations of the export market?

Speaker: I believe that you have to be cautious and maintain the stamina, and not become overconfident. I'm the first to say that we shouldn't be sure of success in the next 15 years. That is the main reason I created a foundation in Chile, and still participate in public life and try to influence public opinion. That does not mean that I don't believe the last 15 years were a success. Brazil grew 9 percent a year from 1964 to 1979, with population growth of 3-4 percent, similar to what is going on in Chile today. Brazil has problems, but imagine what their problems would be today if they hadn't gone through a process of 15 years of growth. The next 15 years of growth are not already in our pocket in Chile, but what we have achieved is worth a lot. Remember that in the 1970s and the beginning of the 1980s we went through a crisis. There's always a reason for a crisis and you have to pay the cost. Latin American countries are paying for what they did, with 10-15 years of no growth. Many African countries have not been growing in per capita terms for the last 20 years. I'm not aware of the figures on Egypt, but I'm sure that they don't show a success story in relative terms—certainly Egypt was once much more important to the world than it is today.

It was tough to get out of the crisis but we were able to recover. Others are still suffering and are not yet in a position to start recovering. When you go into a process of turmoil like major relative price changes, oil prices going up, or copper prices falling, statistics are a problem. You compared 1983 with 1973; but 1973 was a year of very low oil prices. We were consuming a lot of oil, and driving big cars. By 1983 we had small cars. Using 1973 data for comparison does not really reflect what happened. What we already have done is enough to show that reform really deserves the effort.

You mentioned certain weaknesses. Actually our export markets have not been so favorable. Copper was an important export, and its 1973 absolute real value today should be about \$2.50 a pound. The corner price today would be about \$1.10, less than half. At times we have had copper prices of 0.60 a pound, and we were able to cope. We have had volatile growth in a certain sense, but we have been consistently growing. We had a 3 percent growth rate one year and 12 percent another year, but that's because of mathematics, and we have cycles. If you look at December to December, or June to June, the results could be nine and four, or nine and five. Chile's economy goes through cycles like other economies. We should do better in managing those cycles, but clearly we are not going into a process of a boom that is not sustainable.

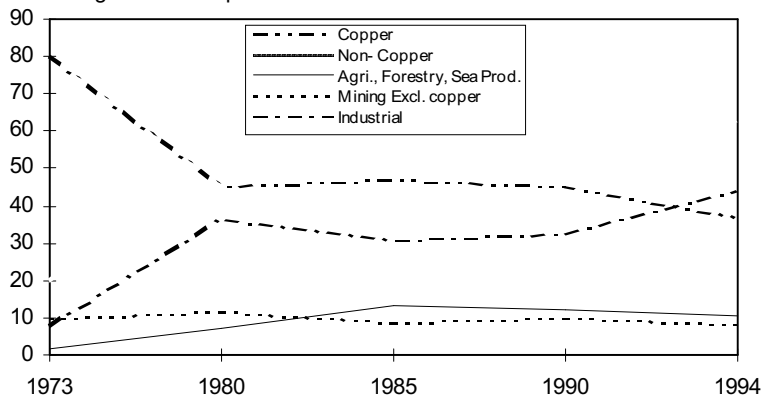
As for whether we have diversified our exports, copper was once 80 percent of our exports, but today it comprises 36 percent, although we are exporting about three times the volume of copper (see figure 10). We nearly erased everyone else from the map of copper production; Africa and Peru are no longer major producers. We almost erased the US from the copper market. With less than half the price, we export more than double what they export. We have diverse exports, not as much as the US, but we are only 14 million people. It's much better for us to have the best technology in the world for producing copper than to export cars. We are very good technologically in copper.

Only part of our success can be attributed to our luck in having natural resources. We are developing technology for our resources, applying genetic engineering in forestry and in cultivating grapes, for example, to better suit our needs. Exporting fresh fruits to distant markets needs a lot of technology in producing, handling, and marketing. In order to progress we need to discover new things. When I was a child, Japanese toys were considered cheap and of bad quality. But Japanese products went from low prices to high prices and high technology. That is what we must do.

Chile may be overvaluing its exchange rate lately, which I believe is one of the worst macroeconomic errors you can commit. It occurs because people want stabilization, but we should not resort to that. I also think that Chile has increased the size of the budget, and may be creating problems for the private sector. If these trends continue, we may see a slow decrease in the rate of growth, and if it reaches 4 percent, there will be problems with consensus in society.

Concerning external debt, Chile's reserves are about \$15 billion. Our total debt was about \$22 billion; GDP is about \$72 billion, and our exports in goods and services are close to \$20 billion. We don't have a high debt. We have about \$5 billion invested abroad. In fact, many Chilean friends told me to find something in Egypt to invest in, and to see how Egypt's stock market is performing.

Figure 10. Chilean Exports, Diversification by products, 1973-1994
Percentage of Total Exports



Source: Central Bank of Chile

Maybe our policies do not encourage local investment enough, and our investors look abroad too much, but it's a minor problem.

As for income distribution, I'm fully convinced that the major problems in Latin America were conceptually born in the typical dilemma of growth versus distribution. When I was a student, there were people teaching us that it is better to have less growth and a little more inflation in order to have better distribution and stability. I recognize that we have income disparities in Chile, but we have improved the situation of the poor, to a good extent. There was quite a consensus in

Chilean society that measures to promote equity through pushing wages up and closing the economy were wrong. We made a major effort to attack the cycle of poverty of the very poor, people who do not go to school or do not have enough nutrition. There is still poverty, but less poverty, and more hope. I appreciate your criticism, because I am critical too, but I feel much more comfortable speaking of Chile today, when after the change of government, our policies were maintained. That is not the last word, but it's important to point to our success.

(end)