

# A Chilean Perspective

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## Introduction

The World Bank's comprehensive report on sub-Saharan Africa (SSA), offers both a diagnosis of this area's problems as well as policy suggestions so as to overcome these problems and accelerate growth. This document makes important contributions to the debate on development issues, with special reference to Africa, but it suffers from a number of weaknesses. My criticism will focus on three different levels: a) forecast of the international environment; b) implicit belief in the existence of a coherent, 'correct' body of economic thinking, from which optimum policies can be deduced; c) insufficient consideration of the experience of other countries, which were in the 1970s already following policy packages similar to those being recommended by the Report for SSA as a whole. I shall draw, in particular, on the experience of the Southern Cone of Latin America, as countries in this region have pursued with great consistency and determination the type of policies (eg 'opening up') which the Report advocates.

## Forecast of the international environment

The forecast for the international environment implicit in the Report makes two basic mistakes. One is its excessive optimism. Another is its exaggerated emphasis, stemming from insufficient analysis of the international environment as a whole, on the impact which the price of oil will have on future international prospects.

The excessive optimism of the Report is implicit in some of its aid projections [World Bank 1981: Table 9.2]. Thus, even the low aid projection, (which implies an annual growth rate in real terms of 2.2 per cent for ODA flows in the 1980-90 period), may unfortunately be too optimistic in the present international economic and political environment. The high aid projection (which would imply an annual growth rate in real terms of 6.4 per cent for ODA flows in the 1980s) is currently extremely unrealistic. As many of the ensuing policy recommendations (ie of policies towards lowering tariff barriers) can be justified only if accompanied by large flows of aid, excessively

optimistic aid projections are not only inaccurate, but are potentially very misleading.

Perhaps even more importantly, the Report's projections for growth in world trade for the 1980s are also too optimistic. Projections [World Bank 1981: Table 3.4] that the volume of world trade in 22 non-fuel commodities of greatest importance to Africa, will increase by 2.9 per cent per annum during the 1980s (which is substantially higher than the 1.5 per cent annual growth for African non-fuel primary products in the 1970s) seem particularly unrealistic, given developments in world trade over 1980-82.<sup>1</sup> Again, such optimistic projections of growth in world trade are not only inaccurate, but are conducive to policy recommendations which place greater emphasis on export-led growth than the objective situation would recommend.

As Professor Lewis has pointed out [Lewis 1980] development theory has clearly lagged behind world trade trends since World War II. In the 1950s and early 1960s world trade was growing very rapidly. Influenced by the poor performance of trade in the inter-war period, however, economists stressed theories of development (eg 'two-gap model', structural inflation) which made more sense if world trade was stagnant. Only in the late 1960s was the rapid growth of world trade clearly perceived, leading to increasing emphasis on export-led development strategies. This emphasis was even greater during the 1970s, although the growth in world trade had by then practically *halved*. Export-led growth is an even less attractive proposition if world trade continues to grow at a mere one per cent per annum as it has during 1980 and 1981.

The Report attributes too much significance to the price of oil, as the main variable which determines the

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<sup>1</sup>It should be stressed that Africa was not alone in having such low growth in its 'non-fuel' primary exports during the 1970s. According to UNCTAD estimates published in the 1982 *Trade and Development Report*, between 1971-73 and 1977-79 the average annual growth in these exports for all non-oil exporting developing countries was a mere 1.5 per cent. The record for the 1980-82 period is even bleaker.

evolution of the international environment. Thus, its analysis of 'Prospects for the 1980s' begins as follows: 'the 1980s should be somewhat more favourable for African oil importers than the recent past. Much depends on the future path of oil prices, which is highly uncertain . . .' [World Bank 1981:22]. It would seem more accurate to say that, for SSA countries (as well as for others) much depends on the future evolution of the international environment, which is highly uncertain. The link between the level at which oil prices are set and the international environment are much more complex than the Report implies. Undoubtedly the rise in oil prices in the 1970s contributed to a serious deterioration in the international environment for less developed countries (ldcs) reflected in a deterioration in their trade balance. However, it is by no means clear that lower oil prices (or even a decline in real terms) in the 1980s will automatically lead to any improvement in the international position of SSA countries, even though it should obviously help to cut the import bill of oil-importing developing countries. In fact, it is increasingly evident that the very poor growth performance of the world economy, at least in the early 1980s, owes at least as much (if not more) to monetarist policies which are being pursued by the major industrial countries as to the direct impact of the 1979 oil price rise [see UNCTAD 1982 for a fuller discussion].

Finally, as regards projections of oil prices, like so many other forecasts of oil prices which were made in the late 1970s and early 1980s, the *Accelerated Development Report* has clearly over-estimated increases during the 1980s. An estimated three per cent annual increase in real terms for this decade is clearly too high and quite inconsistent with recent developments. Given the uncertainties which surround the future price of oil (and the very poor track record of recent forecasts), it seems doubtful that single forecasts for the price of oil, as adopted in the Report, have any value at all. In effect they serve only to project a false image of accuracy.<sup>2</sup>

### The existence of 'correct' economic thinking

Following a trend relatively common to many reports written by members of international financial institutions the *Accelerated Development Report* makes categorical policy proposals *as if* there were a coherent, 'correct' body of theoretical economic thought, rooted firmly in empirical evidence, which formed the basis of its proposals.

<sup>2</sup>Similarly, the *Accelerated Development Report* uses an excessively optimistic projection for African primary export prices in the 1980s without developing alternative more pessimistic projections.

In fact, the theoretical economic thinking the Report uses is by no means undisputed, either for less developed or industrial countries. As is widely known, even the more advanced industrial economies have been suffering from stagnation, combined with inflation during the last decade. The efforts of different governments to overcome these problems (either by following pure neo-classical prescriptions or adopting more pragmatic approaches) have been, on the whole, unsuccessful. 'Socialist' industrial countries also face serious economic problems (many of them similar to those of capitalist economies) and have been unable to find clear-cut policy solutions. As a consequence, within each country developed and less developed as well as internationally, the debate on economic analysis and policy remains wide open. A recent report to the Group of Twenty-Four clearly makes this point:

it is often assumed that the analysis on which policy judgements are based can itself be made reasonably objective and relatively free of controversy. Unfortunately, this is far from the case. Economic analysis has never acquired the precision of the natural sciences, and the issues between rival schools have not even been narrowed over the years. *On the contrary, the range of expert opinion on questions of economic policy is, if anything, wider today than at any time in the present century.*

[UNDP/UNCTAD 1981] — author's emphasis.

A similar comment made in the Introduction of the *Accelerated Development Report* and particularly a greater awareness of these issues throughout would have been desirable.

If a more eclectic approach had been taken, general diagnosis and somewhat simplistic across-the-board policy prescriptions could have been avoided. That the diagnosis is excessively general is evident where the Report states that:

it is now widely evident that the public sector (in SSA) is over-extended, given the present scarcities of financial resources, skilled manpower and organisational capacity. This has resulted in slower growth than might have been achieved with available resources, and accounts in part for the current crisis. [World Bank 1981:5]

Although specific sections of the Report which suggest ways of improving the efficiency of the state sector are undoubtedly of great value, sweeping statements and the policy to which these give rise clearly do not correspond either to 'objective' economic analysis or to categorical empirical evidence, and are therefore misleading. The Report assumes that in mixed economies the expansion of the government sector beyond a certain level inevitably diverts resources

from the private sector. Hence the rate of growth of productivity of the economy as a whole tends to be depressed. This argument is based on the belief that growth in the productivity of private sector production of traded goods and services is more rapid than in the public sector and other sectors producing non-trading goods and services, where the absence of market mechanisms and/or of international competition raises questions about the efficiency of resource use.

This type of reasoning, whether explicit or implicit, is based upon a number of questionable assumptions. The most important of these is that the public sector competes with the private sector not only in the sense of pre-empting supplies of scarce inputs, but also by generating outputs that substitute for private sector outputs. It is, however, clear that public sector output is to a large extent complementary to that of the private sector, and is often indispensable to it. In cases of complementarity, in particular, a shift of resources out of the public sector would in fact *slow down* productivity growth in the private sector and/or impede the production of certain goods and services in that economy. This is well illustrated by the experience of Chile since 1973, where the 'magic of the market forces' has been released by cutting back on public sector expenditure. One effect of this can be seen in the reduction of certain crucial services (such as road building and maintenance). This has involved both a reduction in the welfare of individuals *and* the productivity of the private sector. It is feared that if similar types of measures are applied in African economies (where the services provided by the state — particularly in respect of education, health and water — are perhaps even more crucial and irreplaceable than in the more sophisticated economies of Latin America) the damage would be potentially much more serious.<sup>3</sup>

As pointed out above, these criticisms do not conflict with the measures suggested in the Report to improve the efficiency of the state sector and/or parastatals. These reforms and others which are designed to improve efficiency may be long overdue.<sup>4</sup> Nevertheless criticism of the Report's insistence on a reduction (or slower growth) in government administered activities is justified, because this prescription is based on dubious assumptions. Last, but not least, it should be stressed that decisions concerning the size of the public sector are basically of a national political nature,

<sup>3</sup>It is true that in SSA an important part of the subsistence peasant economy, particularly in the more remote areas, is little affected by government services. I thank Dudley Seers for suggesting this point.

<sup>4</sup>Elsewhere [Griffith-Jones 1981a] I have argued for the particular need which socialist economies (or those with a large state sector) have for relatively prudent monetary and financial policies as well as satisfactory financial results in state enterprises.

although international financial institutions are of course free to offer their advice. The tone of the Report does not make this point sufficiently clear. It takes the liberty, for example, of recommending the transfer of education and health to the private sector. These are areas where decisions surely need to be taken at a national level, according to the priorities of those wielding power.

### **The experience of Latin America's Southern Cone**

In its diagnosis of the causes behind the malfunctioning of the economies of SSA and in its policy proposals, important parallels may be drawn between the Report's analysis of SSA countries and the analysis of ultra-orthodox economists in the Southern Cone of Latin America. As the latter have been dominant in influencing economic policy since the mid-1970s in this region (particularly in Chile, where such economic teams are generally known as 'the Chicago boys'), it is relevant to examine briefly the impact of their analysis and policies.<sup>5</sup>

Naturally lessons cannot be mechanically transferred from the experience of one continent to another. In particular several of the SSA countries have an important subsistence sector (in which very little, if any, economic activity is carried out on a commercial basis). The comments which follow are therefore of far greater relevance to those sectors of the SSA economies which are relatively more clearly integrated into the national and/or world market and which are also more affected by government activity. Indeed, it seems a further limitation of the Report that it does not distinguish sufficiently between the sectors of the economy more closely integrated into the market and those which are more isolated from it; nor does the Report stress sufficiently the important limitations of statistics for macro-economic aggregates, such as national income, in economies with large subsistence sectors. However, in spite of these important structural differences between the economies of SSA and those of the Southern Cone of Latin America, it seems important to examine here the contradictions emerging clearly from policy packages in the Southern Cone of Latin America, which are likely to repeat themselves in other contexts.

Ultra-orthodox economists in Chile — as well as in the rest of Latin America — have been very critical of the import substitution industrialisation model which has been pursued since the 1930s [see eg Ministry of

<sup>5</sup>The impact of ultra-orthodox policies in Latin America (as well as in other Third World countries) is examined in more detail in "'Monetarism': its effects on developing countries" [IDS 1981]. As is mentioned there the Chilean 'Chicago boys' received this name because of their common adherence to 'monetarist' doctrines acquired while studying at the University of Chicago and were advised and visited by Chicago's two leading monetarists — Professors Milton Friedman and Arnold Harberger.

Finance 1974, 1975]. They have been particularly critical of high tariff barriers and other trade restrictions, as well as the negative impact of these on growth in national productivity. The *Accelerated Development Report* [World Bank 1981:30] echoes this critique in respect of industrialisation policies pursued in SSA.

Since 1974 the Chilean Government has adopted a comprehensive and drastic programme of trade liberalisation. The central measure taken was that of reducing tariffs from an average of 94 per cent in 1974 to an average of 10 per cent in 1979 [Foxley 1980]. As a result, tariff protection in Chile is now probably the lowest in the Third World. At the same time, direct controls over imports were very rapidly dismantled in Chile.

The Chilean policy of import liberalisation was initiated at a time (1974/75) when the economy was faced with very severe balance of payments problems. In this sense the Chilean regime followed very closely the recommendations which the World Bank is now making for SSA. To quote the Report:

the 1978-80 deterioration in the terms of trade and the prospect of further increases in the cost of energy lends *greater urgency to policy change*. The big changes needed are: correction of overvalued exchange rates; improved price incentives; *lower and more uniform protection for industry; and reduced use of direct controls*.

[World Bank 1981:30] — author's emphasis

The experience of Chile shows clearly that if the economy is 'opened up' at a time of serious balance of payments difficulties, the only way to reduce external disequilibria in the short term is massive deflation, unless very large net external finance is available. In the Chilean case, official series show GDP declined by 14.3 per cent in 1975 and the rate of open unemployment (yearly average) shot up from less than five per cent in 1973 to 14.5 per cent in 1975. Even though this was in part a response to the need to reduce very high inflation, a very important factor behind the policy reform was the attempt to reduce a massive trade deficit in the short term exclusively by reducing aggregate demand and devaluation. If the Chilean Government had, when experiencing a severe crisis in its balance of payments, postponed import liberalisation (or even temporarily increased protection) then the cost in terms of decreased output and employment would have been much smaller [Foxley 1980]. In fact, several less developing countries which were best able to sustain growth rates in the mid-1970s (eg Brazil and South Korea), did so in part by responding to severe foreign exchange difficulties by temporarily increasing protection [Griffith-Jones 1981b]. Governments would on this count be

particularly ill-advised to initiate a programme of import liberalisation at a time when balance of payments difficulties are as severe as they are in most SSA countries at present. In this situation, if trade liberalisation is deemed desirable it would make more sense to apply measures which increase the profitability of exports *without creating a direct squeeze on import substitutes*. These could include selective export incentives or a reduction in tariffs on imported inputs for export production.

The Chilean experience of import liberalisation since 1973 (as well as less drastic attempts which have been made in neighbouring countries) also raises the problem of creating long-term contradictions. It is interesting to note that the problems of this policy in Chile were initially raised by opponents of the present regime, but criticism has now become more widespread, both on a national and international level. Indeed it is being voiced by former supporters or sympathisers of the government and its economic model. Some of the most severe criticisms of the Chilean model to be published by the international press have come from newspapers which enjoy close links with international financial circles. Thus a 1982 article in the *Financial Times* was entitled 'Chile's economic problems mount: free market policies under stress'. Another very critical piece published in the *Wall Street Journal* in the same year was headed 'Frayed miracle: Chile's economy is troubled'. The spread of criticism of the Chilean economic model to 'respectable' circles such as these surely implies that it is becoming increasingly clear that this type of model is not only socially unfair, but that it also contains economic and financial contradictions, which increasingly undermine its viability.

The adoption of extreme free market policies (of which trade liberalisation was an important element) has to date brought consequences such as a deterioration in income distribution, sacrifices in output growth, a process of de-industrialisation — reflected in a decline in the participation of industry in total output and a large increase in the rate of unemployment (which according to official Chilean figures, shot up to 19 per cent in March 1982, and which has since 1973 been well above historical averages). This economic model has also implied an increase in the propensity to import, so that whenever growth in the economy picks up (as it did in the 1977/80 period) a trade deficit emerges of a much larger magnitude in real terms than existed before trade liberalisation was introduced.

The primary concern of the international press — and of the international banks — is that such large trade deficits can only be handled if net external finance is available on a continual and massive scale (as

occurred in the Chilean case during 1977-81). Once sources of external finance cease to be forthcoming on such a large scale, as appears increasingly likely in Chile, the main option is recession (in Chile since 1981 more elegantly called 'automatic adjustment'), because direct measures such as import controls or increased economic activity by the state are inconsistent with the orthodox model.

In the case of SSA, the option of massive net external finance clearly does not exist. Private banks are not currently willing to lend large sums to these countries and the prospects for substantially increased aid are rather gloomy. The pursuit of policies which entail 'opening up' the economy (such as a rapid reduction of tariffs and of direct controls on imports) would be potentially even more damaging in the African context in the 1980s than in the Southern Cone of Latin America in the mid- and late 1970s, as the resulting increased trade deficits could not be financed, but would have to be compressed through recessionary measures. Given the low incomes of large sections of the African population, the amount of social and economic hardship this type of policy would cause would be far larger than that which has occurred in the Southern Cone of Latin America.

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