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CHILE: THE ROAD TO JOY IS PAVED WITH OBSTACLES

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Chile, like many other countries in Latin America, is apt to strike the European observer as a country of vast economic potentialities which remain unexploited [...] Indeed, one's general impression is that the obstacles in the path of an accelerated improvement are neither natural, technical nor economic, but essentially political. (Kaldor 1956)

Introduction

The second round of the presidential elections in Chile marked a swing in the local political scenario. The coalition led by Gabriel Boric secured an unprecedented victory under the premise of delivering long-awaited reforms to a financially volatile, structurally fragile, and deeply unequal economic structure. This note sheds light on these three aspects of the Chilean economy, showing that its external and internal fragility feeds back on the excessive specialization and heterogeneity of the productive sectors, which in turn influence income and wealth distribution. It is argued that in order to carry out an effective progressive agenda, the newly elected government should avoid yielding to the "discreet charm" of the Chilean bourgeoisie and its core principles—which includes fiscal prudence, minimum government intervention, and financial liberalization.

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Two years after the *estallido social* (the name of the 2019 Chilean protest movement), Chile resembles the famous drawing of Joaquin Torres Garcia, Uruguayo painter and professor of the first half of the twentieth century who launched an autonomous South American artistic movement when he sketched the design of the "inverted" South American continent. "Our North is the South" ("*Nuestro norte es el Sur")*, as he wrote in his manifesto *Universalismo Constructivo* (Torres Garcia 1944), signaled a 180-degree turn not only in the way these countries were previously depicted, but also in their status as "peripheral" countries. Gabriel Boric Font, the newly elected president of Chile, was born in Chile's extreme south in the city of Punta Arenas, the capital of the Magallanes region, which is part of the Tierra del Fuego. Nominated in the second round after the run-off with the far-right candidate, José Antonio Kast, he managed to clearly prevail over all age groups under 70, with a gap of 28 percentage points among men under 30; a differential that in women of the same age group is even more important (68 percent versus 32 percent, which rises to 75 percent versus 25 percent in the metropolitan region of Santiago). All of this happened in the context of an increase in electoral participation (55.6 percent) that marks an important reversal of the trend seen in the two previous presidential elections (49.3 percent and 46.7 percent), improving the results of both the first round and the referendum for the new constitution (47.3 percent and 50.9 percent, respectively). The popular vote and (in particular) that of the most vulnerable sectors of Chilean society seem to have been what guaranteed Boric's success; not surprisingly, in the four communes of Santiago with the highest levels of multidimensional poverty (Cerro Navia, Conchalì, La Pintana, and Lo Espejo), the leader of *Convergencia Social* scored on average 70.8 percent of the votes, while in the exclusive neighborhoods of Vitacura, Las Condes, and Lo Barnechea the proportions are exactly reversed (83.27 percent, 73.49 percent, and 78.99 percent for Kast, respectively). To get an idea of how "exclusive" these neighborhoods are, their average per capita income in 2020 was 4.3 times that of the capital and 12.4 times that of the less well-off neighborhoods. If we consider the new president's political trajectory, formed in the student mobilizations of 2011 and elected congressman in 2014 in an independent party that then merged into the *Frente Amplio* (the main party of the *Convergencia Social's* winning coalition for this ballot), the result is even more surprising. His profile, as well as many of those of his government, represents a break not only with the dictatorship but also with the generation that came after it, from which Boric is now preparing to take over. To understand the extent of the reform and socioeconomic transformation that awaits the former "penguins"[2] in the coming times, it is useful to summarize some stylized facts for Chile.

External and Internal Financial Fragility

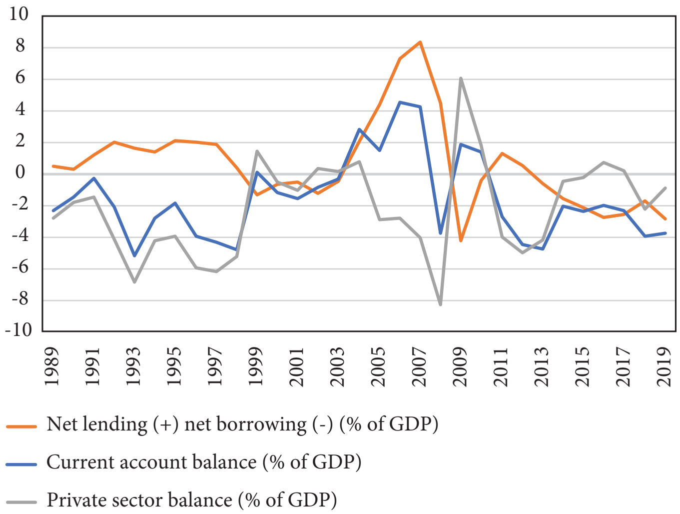
Chile has been pursuing policies of opening both the current account and capital account since before the region's other economies. This makes it possible for one to assess not only the short-term consequences of such measures, but also their long-term impact. For example, the country saw three increases in capital inflows (1973–82, 1989–2001, 2003–12) culminating in severe crisis episodes as these flows suddenly stopped or experienced strong reversals, similar to what happened in other countries in the region (Palma 2012).

During these surges, the consolidated private sector (enterprises + households) experienced increasing deficit positions, as we can see in Figure 1, representing Chile's financial balances for the period 1990–2017. This is particularly evident for the cycle that lasted until the Asian crisis, where a negative private stance coupled with a current account deficit led to the accumulation of foreign debt, as the two were financed mainly through capital inflows. In contrast, in the last cycle—which occurred from 2004 to 2013—the current account turned positive as the economy was enjoying an increase in export earnings triggered by the commodity price boom.

Interestingly, with a few exceptions (e.g., post-2008), the Chilean private sector has always been at the top left of Figure 2, i.e., mostly recording deficit positions for the entire period under consideration. This is in fact one of the characteristics of developing countries—more evident among those with low incomes but also present in emerging or middle-income countries such as Chile—namely that the private sector balance's path tends to oscillate between the first quadrant on the left and the upper part of the third quadrant, with rare incursions into the upper part of the second quadrant and even rarer passages into sectors where the private sector's net accumulation is positive (Ocampo, Rada, and Taylor 2009).

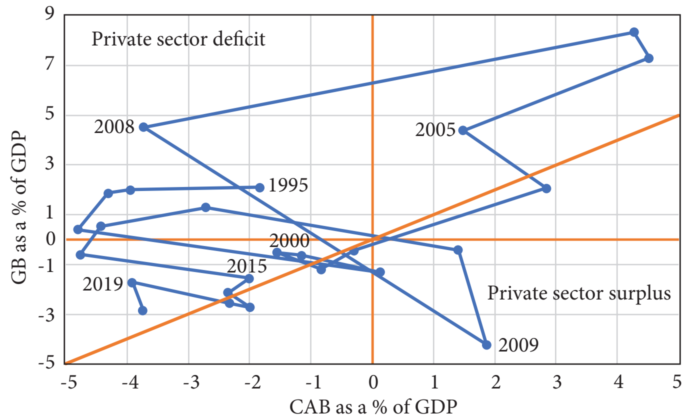
A similar picture can be drawn from the financial position (wealth) of the three institutional sectors, as shown in Figure 3, where it is clear that the aggregate private sector (financial, nonfinancial, and household) has recorded liabilities that almost

Figure 1 **Sectoral Balances for the Chilean Economy, 1990–2017**



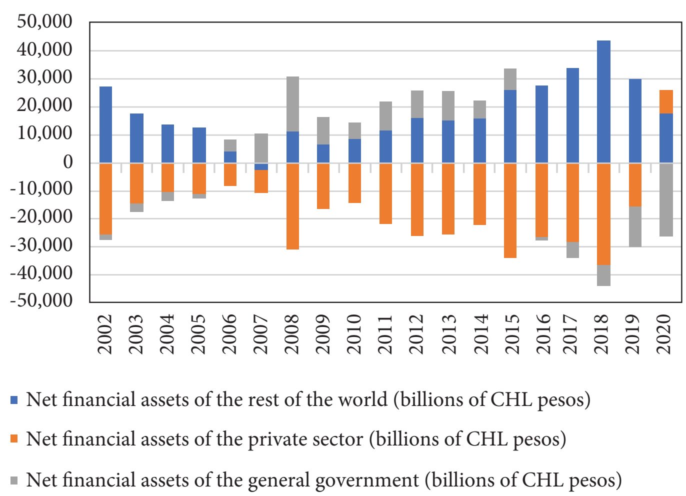
Source: Central Bank of Chile

Figure 2 **Private Sector Balance for the Chilean Economy, 1990–2019 (percent of GDP)**



Source: Central Bank of Chile

Figure 3 **Net Financial Assets for the Chilean Economy (billions of Chilean pesos)**



Source: Central Bank of Chile

entirely reflect the assets of economic agents abroad, with the exception of those for 2020. It is difficult to find evidence from these figures in favor of one of the most famous hypotheses in the external imbalances literature, namely that of the so-called "twin deficits" (Fleming 1962; Mundell 1963), according to which public sector imbalances cause those in the current account. Causality should instead be read from the external equilibrium to the internal one. More specifically, two (complementary) interpretations can be put forward: i) the fact that the current account is persistently in deficit due to the structure of trade, which imposes a consequent adjustment in the other two internal balances (so-called "structural gap hypothesis"; see Ocampo, Rada, and Taylor [2009]); and ii) the intermittent and procyclical nature of external financing, which leads the private sector to expose itself in foreign currency as soon as international conditions allow it, only to suffer the consequences of their withdrawal (the hypothesis of unstable external financing; see Ffrench-Davis [2006, 2018]).

If we look at the dynamics of foreign debt in Chile, the second explanation gains even more strength, given that the private sector's exposure went from 30.7 percent of GDP in December 2007 to 82.9 percent in March 2020 and that the nonfinancial sector represents 60 percent of that debt (Portales, Negront, and Perez Caldentey 2020). In addition, in the period 2010–19, Chilean companies increased their financial fragility by taking speculative or ultraspeculative (Ponzi) positions, measured either in terms of covering interest expenses (Mulligan 2013) or by taking into account their stock of short-term debt (Torres Filho, Marins, and Miaguti 2017). The highest levels of exposure are found in the real estate market, construction, and financial and insurance activities: economic sectors that have a poor capacity to generate foreign currency but at the same time can be the subject of short-term gains (Portales, Negront, and Perez Caldentey 2020). However, it would be wrong to attribute the increase in exposure to the rest of the world solely to the attitude of local economic actors.

Another element of procyclicality came from the inflow of portfolio investments, which, between 2003–14, reached an average of US$7.5 billion according to BIS data (2019). Over the same period, the value of the local currency closely followed the performance of commodity futures markets. With future prices rising from 2002 to 2007, implying bullish expectations for commodity markets, the Chilean peso followed the same pattern and, when futures prices stabilized (2009–13), the nominal exchange rate fluctuated around 470 pesos per US dollar—an appreciation of more than 30 percent of the currency in a decade (Nalin and Yajima 2021).

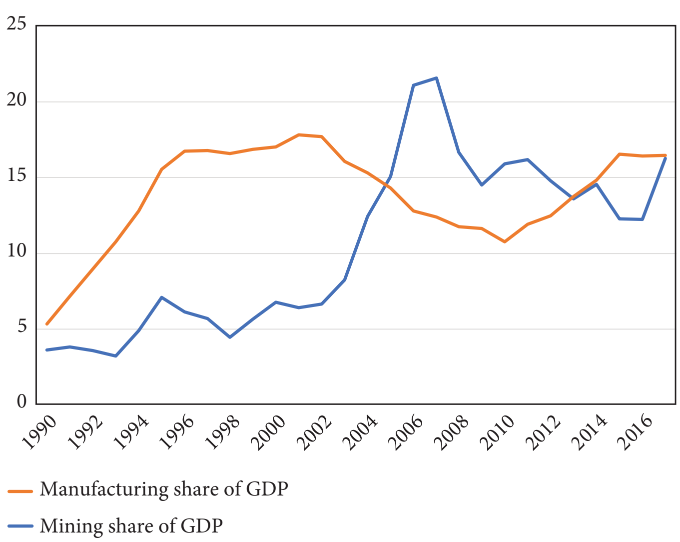
Specialization and Heterogeneity in the Production Structure

The structural gap hypothesis retains all of its validity for the Chilean case, given that Chile's economy is heavily dependent on natural resources, in particular on copper mining, whose percentage of total exports on average has always been above 50 percent since 2006. Moreover, the value of copper exports increased dramatically after 2004, averaging US$3.518 billion, significantly higher than the average of US$2.628 billion in years prior to this period. Most of the increase can be attributed to copper's price evolution, as shown in Figure 6; it can also be argued that the elasticity of exports of this raw material with respect to the price has increased, as claimed by De Gregorio (2006).

In turn, the manufacturing industry has lost ground over the past decade, as its contribution to GDP has essentially fell behind mining (Figure 4). As mining's contribution to GDP has increased over the past 30 years, productivity growth has progressively decreased since the 1990s, with an increase of 1.8 percent in the first decade of the new millennium and 0.8 percent in 2010–19 (Portales, Negront, and Perez Caldentey 2020). This seems to be due to the specialization in unrefined copper, indicating a strategy carried out by large private players in this sector to exploit the comparative advantages of high prices in commodity markets, paying little attention to strengthening productivity or backward and forward linkages with other sectors (Correa Matuz 2016). As a result, a typical feature of the "peripheral" economies has been maintained, that is, a heterogeneous and specialized production structure versus the "central" economies with a homogeneous and diversified one (Rodriguez 1977; Ocampo and Parra 2003). This has resulted not only in a generic loss of economic complexity in terms of products exported in accordance with the Hidalgo and Hausman (2009) index, but also in a much more worrisome stagnation in terms of innovative capacity, especially in the manufacturing sector.

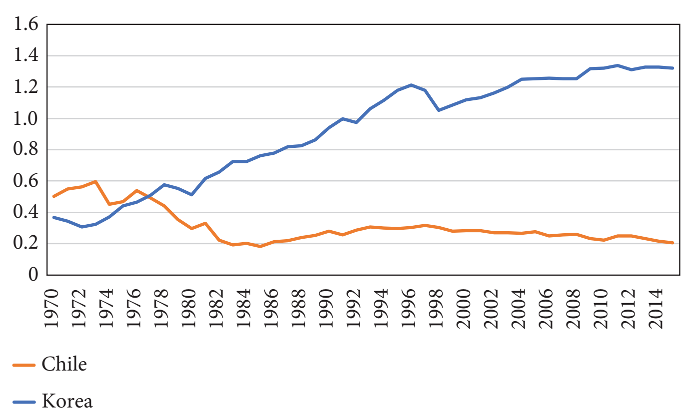
A useful comparison comes from an analysis of the index of engineering industries' relative participation in total manufacturing value-added, as shown in Figure 5 (CEPAL 2012).[3]

Figure 4 **Chile's Share of Mining and Manufacturing in GDP (percent)**



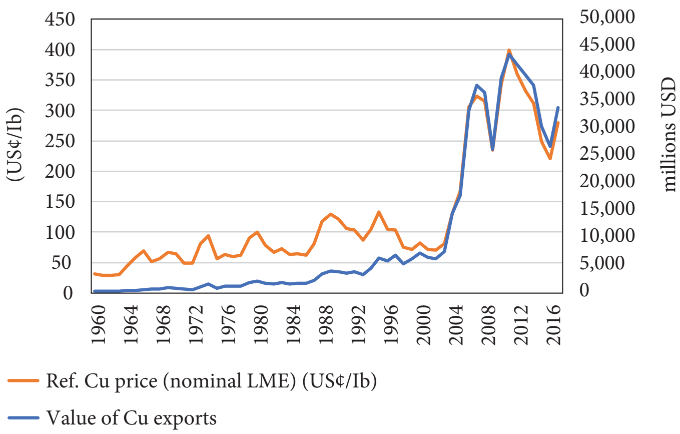
Source: CEPAL and Central Bank of Chile

Figure 5 **Index of Engineering Industries' Relative Participation in Total Manufacturing Value-Added (IPR), Selected Countries, 1970–2015**



Source: CEPAL and Central Bank of Chile

Figure 6 **Copper: Annual Price and Value of Export in Chile**



Source: Chilean Copper Commission

This index illustrates the evolution of the manufacturing sector's technological density with respect to a technological frontier, namely the United States. A country with a value lower (higher) than one will display a production structure more (less) unbalanced toward low value-added and will have better (worse) opportunities for economic convergence. The trend for Chile is strikingly straightforward. Since the 1970s, the ratio has progressively worsened, with an average of 0.3—meaning that the share of high-tech industrial activities relative to the rest of the economy has been equivalent to 30 percent of that of the United States for the 1970–2015 period. On the other hand, South Korea, starting from similar levels of manufacturing specialization, has progressively reduced its distance from the technological frontier, crossing the 100 percent threshold in the early 1990s and stabilizing at the 130 percent level in the post-2008 period.

Rents and Income Inequality

The issue that set off the *estallido social* was certainly that of socioeconomic inequalities. As pointed out by Nastasi (2021), at first glance the trend of the three main indicators used to assess one's personal economic condition—namely poverty rate, Gini inequality index, and per capita product—has shown a clear tendency toward improvement since the transition to democracy in 1990. Not surprisingly, the 2010 Nobel Laureate for Literature, Mario Vargas Llosa (2021), called the protests at the end of 2019 an "enigma." But what is the explanatory power of these data, especially with respect to the analysis of income distribution in a country with features such as those already mentioned? López, Figueroa, and Gutiérrez (2016) have demonstrated that correcting the index for tax evasion and capital gains—particularly those attributable to undistributed profits—changes the picture of income distribution significantly. For the period 2006–13, the average for the "corrected" Gini was 0.6 against 0.46 in the World Bank's estimates; even controlling only for tax evasion, the index rises to 0.53. The effect of these inclusions is even more evident in the share of income held by the richest 1 percent of the Chilean population: data from the Chilean tax authorities estimate that this percentile holds 19.75 percent of the income generated locally and with the addition of capital gains and evaded incomes this share climbs to 30 percent.

But what are the economic sectors that have made the lion's share of income distribution?[4] Without surprises, they have gone to natural resources. In the period 2005–14, rents extracted from mining amounted to almost US$39,000 million a year, with 40 percent of the total attributed to the ten richest private mining companies (Sturla Zerene et al. 2018). If we deduct the cost of taxes (historically very low for this activity), the share of total rents captured by these ten operators drops to 29.3 percent, about US$11,400 million on average in the nine years under

Table 1 **Official and Corrected Gini in Chile**

Indicator Name	2006	2009	2011	2013	Average
Gini index (World Bank estimate)	0.473	0.47	0.46	0.458	0.46525
Gini index (CEPAL estimate)	0.483	0.478	0.469	0.466	0.474
Gini index (CASEN estimate)	0.5	0.51	0.5	0.5	0.5025
Gini index (corrected for tax evasion)	0.5	0.56	0.54	0.54	0.535
Gini index (corrected for tax evasion and including fundamental business-accrued capital gains)	0.62	0.63	0.59	0.59	0.6075
Share of the richest 1 percent	20.5	19.9	19.4	19.2	19.75
Corrected for tax evasion	23.3	22.4	21.7	21.2	22.15
Corrected for tax evasion and including fundamental business-accrued capital gains	30.6	32.1	27.9	27.4	29.5

Source: CEPAL, World Bank, CASEN, and López, Figueroa, and Gutiérrez (2016) consideration. This figure is equivalent to 5.1 percent of the average GDP and 23.3 percent of the average public expenditure in Chile during the same period. This is even more relevant given that from a fiscal point of view, Chile, especially in the years following the return of democracy, maintained a budget surplus until 2013, with the notable exception of the early 2000s (due to the contagion of the Asian crisis) and 2008 (due to the response to the global financial crisis). However, since 2014, when the commodity bonanza apparently came to an end, the government has run budget deficits, revealing some of the economy's weakness. Indeed, rather than a countercyclical response to the slowdown, these deficits were mainly caused by the structure of tax revenues, which are excessively dependent on the mining sector's performance. Moreover, as Ffrench-Davis (2018) argues, the country has not committed to countercyclical fiscal policies, even after the 2001 reform that adopted a structurally adjusted or cyclical budget balance approach based on copper price fluctuations. As a result, the fiscal stance was shifted from a procyclical to neutral behavior, thus influencing the external shock response's effectiveness. Fiscal prudence, however, has generated financial imprudence among Chilean families, especially the poorest ones. In particular, in 2017, 74.4 percent of households in the bottom decile of the distribution used more than 25 percent of their monthly income to repay their debts, and for 47.2 percent of them these liabilities exceeded the value of their assets by 75 percent. For a third of these families, the time horizon to pay off their debts was more than 36 months (Portales, Negront, and Perez Caldentey 2020).

Conclusion

Chile, *la alegría ya viene* (Chile, the joy is forthcoming) was the slogan used in response to the rejection of the referendum through which Pinochet had tried to seek reelection in 1988. After three decades of financial openness, economic growth in some sectors, and maintenance of deep structural, regional, and distributive inequalities, Chileans have decided to exclaim *Chile Despierto* (Awaken Chile, the slogan of the 18-O demonstrations) to provide more opportunities for all. The search for happiness has led to abandoning the constitution of the 1980s that had strongly limited government intervention in the economy. The constituent assembly elected in 2020 to replace it embodies this willingness to bury a political (and economic) era. The forces that represented the political status quo after the dictatorship's end account for 40 percent of the representatives, while those without a direct party affiliation are equal to 41.1 percent (of which 10 percent are indigenous representatives).

In this complex scenario, one might not have imagined success for the former militants of the *Frente amplio* in the general elections, which saw them losing votes against Kast and the populist Franco Parisi, an academic and television personality who surprisingly amassed 12.8 percent of the vote via an online campaign on social media from his residence in Alabama (but then supporting the right-wing candidate for the second round). The result was the fragmentation of the Chamber and Senate, from which it became necessary for the second round of voting that was open to the forces of the former *Concertacion* (the center-left coalition led by former President Michelle Bachelet), which necessitated the "softening" of some positions of Boric's platform. The appointments of the 24 new ministers (including 14 women, with 7 of them under the age of 40), while embodying the change invoked by the protesters, also contain more "reassuring" profiles, among them Mario Marcel Cullell, former president of the Banco Central de Chile, with an impressive CV, including an MA degree from Cambridge, a position as the former general director of the treasury under various governments of the *Concertacion*, and experiences at the OECD and the World Bank. The prediction of a split between more moderate members of the president's closest circle—including Nicolas Grau, Boric's campaign chief economic officer who proposed the creation of a development bank modeled on the German KFW[5]—seems hasty. Although Marcel affirmed the need for an independent monetary authority and opposed further early withdrawal from private pension funds in Chile (Marcel 2021a, 2021b), he headed the commission to reform the social security system itself during Bachelet's first term.

In the coming months it will be understood whether the three major issues to be addressed (external vulnerability, fragile productive structure, and deep inequalities) will be a guiding light for the action of the executive or if they will yield to the "discreet charm" of the Chilean bourgeoisie, of which Palma and Marcel (1989, 264) wrote:[6]

> The property-owning classes of most developing countries—and certainly of Chile—are clearly not satisfied with having for their own consumption the same relative amount of resources as their counterparts in the industrial countries: they persist in trying to have the

same absolute amount. Indeed, they may not be very sophisticated in their forms of production—or in their politics—but they certainly are in their consumption. It will probably take more than reason or logic, even if it is of Kaldor's caliber, to change the "discreet charm" of this type of bourgeoisie.

Notes

1. The author wishes to thank Dario Guarascio for his useful comments to a preliminary draft. A shorter version has been published in Italian in EticaeEconomia.
2. The 2006 penguins' movement takes its name from the student uniform at Chilean secondary schools.
3. According the score it was attributed by the Atlas of Complexity Economics, Chile went from an absolute value of -0.01 in 2000 to -0.21 in 2019, while in relative terms in 2019 it was ranked 71st (out of 133) among countries characterized by a greater degree of complexity.
4. Associating the personal distribution with the functional one is not an error in this case. In fact, Latin American countries, and Chile among them, present a form of capitalism that resembles the one put forward by the "classical" economists, that is, wherein individuals at the top and bottom of the personal distribution receive two different types of income (Ranaldi and Milanovic 2021).
5. The German state-owned investment and development bank, based in Frankfurt.
6. The reference model is that of José Pinera, brother of the current Chilean president and minister of social security in the Pinochet years, which is still in force in the country, albeit with modifications. Through a system of individual capitalization (all borne by the worker, who pays 10 percent of their salary for a 30-year period), Pinera promised the payment of benefits equal to 70 percent of the value of the last salary received by the taxpayer. Nowadays, these savings are in the hands of an oligopoly of six private pension funds, the so-called AFP system. In recent years, the system has been the subject of strong protests by the Chilean population, which saw its pension incomes fall dramatically following the 2008 financial crisis. According to Gálvez and Kremerman (2020), in 2012 the value of contributions more than doubled compared to that of paid benefits, which for 90 percent of Chileans does not exceed half of the country's minimum wage, or just over €200. In contrast, the AFPs obtained diary profits for 2017 of about US$1.5 million dollars (note according to the Chilean Fundacion Sol) managing 95 percent of pensions, the equivalent of about 70 percent of Chilean GDP. These funds played a procyclical role in the crises of 1998–99 and 2008, making themselves responsible for the flight of capital of a value equivalent to 4.8 percent and 2.1 percent of GDP, respectively, in those same years.

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