Inflation and Socio-political Conflict in Chile, 1955-1970

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Abstract

The fundamental objective of this thesis is to identify the factors responsible for the persistence of the Chilean inflation and, particularly, for the failure of the three main stabilization efforts which took place under democratic conditions in Chile, i.e. those implemented in 1956-57, 1959-61 and 1965-67.

In this thesis, the Chilean inflation of 1955-1970 is considered to have been, to a large extent, the result of the failure of the political system to accommodate conflicting demands within the limits of available resources.

The analysis of the literature about the Chilean inflation shows that the economic approaches fail to take socio-political factors into account, and that the literature which focuses on the non-economic aspects of the phenomenon is varied, less formalized and, in general, more concerned with the sociological aspects of the conflicts which existed in Chilean society than with the political and particularly the institutional aspects involved.

This thesis attempts to overcome these shortcomings by placing the Chilean inflationary process in its specific institutional and political context. This approach shows how important the contribution of socio-political analysis can be to the understanding of inflation, particularly in historically and geographically bound case studies.

The thesis concentrates considerable effort on the analysis of the connection between the cyclical pattern of the Chilean inflation, the

cyclical socio-political forces at work in the Chilean society and their institutional framework.

The thesis argues that under democratic conditions the inflationary propensity which existed in Chilean society had both an upper and lower limit. The analysis of the record for 1955-1970 shows that there were forces working in favour of price stabilization that became more powerful as inflation accelerated, but there were also countervailing forces favouring the continuation of inflation and these came to prevail as inflation decelerated. The cyclical character of the Chilean inflation was partly related to the cyclical pattern of the six year presidential terms which involved alternating periods of strong and centralized presidential authority and of power dispersal.

The Chilean inflation was the result of a society still searching for effective forms of social regulation, alternative to the traditional ones which started to collapse in the 1920s.

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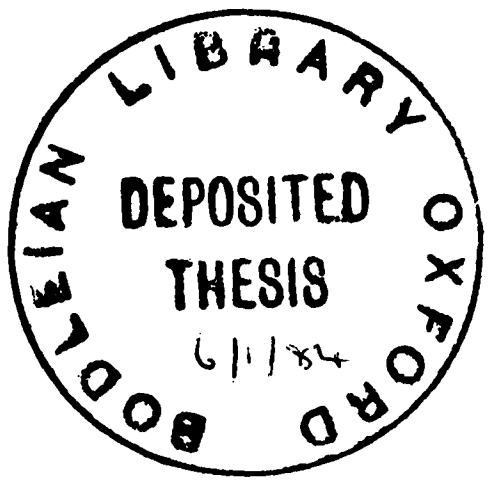

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ABBREVIATIONS

ANEF	National Association of Government Employees.
ASIMET	Metallurgical Industries Association.
CANAEMPU	Public Sector White-Collar Social Security Fund.
CAS	Consortium of Southern Agricultural Societies.
CEPCH	Confederation of Private Sector White-Collar Workers.
CCC	Central Chamber of Commerce.
CORFO	Development Corporation.
CPC	Confederation of Production and Commerce.
CTC	Confederation of Copper Workers.
CUT	Confederation of Chilean Workers.
ECLA	Economic Commission for Latin America of the United Nations.
EGDP	Expenditure of the Gross Domestic Product.
EMPART	Private Sector White-Collar Social Security Fund.
EMS	El Murcurio de Santiago (Chile's leading newspaper, conservative).
FRAP	Popular Action Front.
FRENAP	People's National Front.
FSC	Christian Social Falange.
GDP	Gross Domestic Product.
HAR	Hispanic American Report
IMF	International Monetary Fund.
INACO	National Institute of Trade
INE	National Institute of Statistics.
OAS	Organization of American States.
ODEPLAN	National Planning Office.

PADENA	National Democratic Party.
PAL	Agrarian Labour Party
PC	Communist Party.
PCSC	Social Christian Conservative Party.
PCT	Traditional Conservative Party.
PCU	United Conservative Party.
PD	Democratic Party.
PDC	Christian Democratic Party.
PDP	Popular Democratic Party.
PDR	Democratic Radical Party.
PL	Liberal Party.
PN	National Party (1960s)
PNA	National Party (1950s)
PR	Radical Party.
PS	Socialist Party.
PSP	Popular Socialist Party.
RPI	Retail Price Index.
SNA	National Agricultural Society.
SOFOFA	Society for the Promotion of Manufacturing.
SONAMI	National Mining Society.
SIDECO	Merchants Union (Retailers).
UN	United Nations.
US	United States of America.
WPI	Wholesale Price Index.
WSI	Wage and Salary Index.
WSR	Wage and Salary readjustments.

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General Introduction

A) Inflation

Inflation has become one of the most controversial issues, both in the academic and non-academic literature about economic matters, since the Second World War. In recent years, more and more attention has been focused on the non-economic aspects of the phenomenon, and a number of sociological and political accounts have been proposed.[1] These contributions, which are varied and controversial, have widened the perspective from which inflation is viewed.

It is beyond the limits of this thesis to attempt a detailed discussion of this socio-political literature about inflation which is not directly connected with the Chilean case. However, it is possible to stress some important points. First of all, the basic approach adopted in this thesis is that the analysis of the socio-political aspects of inflation does not provide an alternative view on how inflation happens, i.e. it does not offer a view alternative to the economic theories of inflation,[2]

1. A very important set of articles and a basic bibliography can be found in F. Hirsch and J.H. Goldthorpe (eds.), The Political Economy of Inflation, (London, Martin Robertson & Co. Ltd., 1978). See, also, Albert O. Hirschman 'The social and political matrix of inflation: elaborations on the Latin American experience', in Essays in Trespassing. Economics to Politics and Beyond, (Cambridge, Cambridge University Press, 1981) and Laurence Whitehead, 'The Political Causes of Inflation', Political Studies, 27, 1979, pp. 564-77.

2. The economic approaches to inflation can be found in M. Bronfenbrenner, and F.D. Holzman, 'A Survey of Inflation Theory', American Economic Review , 53, Sept. 1963, pp. 593-661, and D.E.W. Laidler and J.M. Parkin 'Inflation - A Survey; Economic Journal, 85, 1975, pp. 741-809. See, also John Fleming Inflation, (London, Oxford University Press, 1976) and for Latin American controversies: Dudley Seers, 'A theory of inflation and growth in under-developed countries based on the experience of Latin America', Oxford Economic Papers, XIV, 2, June 1962, pp. 173-195; Roberto Oliveira Campos, 'Two views on Inflation in Latin America' in Albert O. Hirschman (ed.) Latin American Issues, (N. York, Twentieth Century Fund, 1961), pp. 69-79, and Julio H.G. Olivera, 'On Structural Inflation and Latin American Structuralism', Oxford Economic Papers, XVI, 3, Nov. 1964, pp. 321-332.

but it complements the economic theory in explaining why it happens.[1]

The strength of the economic theories of inflation lies in their high degree of formalization which allows them to provide very detailed analytical material for policy-making. However, economists usually move from the activity of analysing to the activity of prescribing without taking into account the role of non-economic factors, or without doing it properly. As a result, their recommendations usually stress measures which would be economically effective in eliminating inflation if properly implemented. However, economic theories do not explain why those measures are not properly implemented or why they are not implemented at all. As a result, they cannot explain why inflation continues. As one of the most important contributions to the socio-political anlisis of inflation put it:[2]

> 'Economists themselves have been shy to venture outside their established field of professional expertise. Confronted by political and social disturbances, economists in this stance have slid easily and often unthinkingly into the assumption-cum-conclusion that the non-economic factors are the extraneous variables that can be expected in the end to adapt to an overriding and objective economic reality. Technical remedies are available and adequate; all that is necessary is for them to be accepted at the political and popular levels.'

1. For a criticism of a contribution which adopts the view that socio-political and economic theories of inflation are alternative and not complementary see, for instance, Colin Crouch, 'Inflation and the Political Organization of Economic Interests', in F. Hirsch and J.H. Goldthorpe, 1978, op. cit., pp. 217-8.

2. See Fred Hirsch and John Goldthorpe, 1978, op. cit., p. 2.

The purpose of this thesis is to contribute to the socio-political literature about inflation by analysing the socio-political aspects of a particular case, the Chilean inflation of the period 1955-1970. Before going into a more detailed account of the aspects of the Chilean inflation which will be covered, it is useful to provide a basic characterization of this inflation.

The most inclusive definition of inflation is that of a process of reduction in the purchasing power of the monetary unit in terms of an appropriate basket of goods.[1]

In an open inflation, in which direct price controls are negligible, this definition would be tantamount to saying that inflation is a process of increase in the price level, i.e. an increase in an appropriate average of the prices of goods in terms of money. In this case, inflation can be measured using a price index.

When there is 'repressed' inflation[2] and prices do not increase as much as they would in the absence of the existing controls, the purchasing power of money decreases either because some goods are exchanged in black markets at higher prices, or because part of the money held by families or other economic units cannot be spent at all, or because part of the money has to be spent buying goods which are not perfect substitutes of those desired, or even because those goods under price controls have to be rationed in some other way and that often involves increased effort (hence, a cost) on the part

1. There are numerous definitions of inflation but this seems the best one among those which attempt to identify the phenomenon itself, apart from its causes. See, for instance, M. Bronfenbrenner and F.D. Holzman, 1963, op. cit., pp. 597-9.

2. The classic analysis of this kind of inflation is H.K. Charlesworth, Economics of Repressed Inflation, (London, George Allen and Unwin, 1956).

of the buyer. This kind of inflation is much more difficult to measure with a price index, let alone an official price index which is not likely to include data concerning black markets.

However, even the measurement of an open inflation can be controversial The more varied the rates of increase of different prices are, the more dependent on the specific set of prices and weights chosen the measurement is. The more differentiated the economy is, and the more unequal (in quantitative terms) and varied (in qualitative terms) the distribution of wealth, income and consumption are, the more varied the prices relevant for each firm and for each household would be and the less likely would be to find a generally accepted measure of inflation.[1]

In Chile, however, only once during the 1950's and 60's did criticism against the existing official price indexes reach the level of seriously challenging the official figures by producing an alternative index. That occurred towards the end of the period,[2] and the alternative index was never accepted by the experts on the Chilean inflation in general. Economists almost always used the official figures, or marginally corrected ones (see, for instance, Table A.1, Statistical Appendix), in their analyses. One could speculate that such a phenomenon might have had something to do with the so called 'Chilean legalism' which seemed strong in those years. It may have been, also, the result of a lack of material and human resources on the part of the institutions that could have been interested in producing an alternative (universities, political parties, unions and business organizations). Most likely, it was the result of a combination

1. Changes in the structure of the expenditure of the relevant economic units (households or firms), changes in the quality of goods over the years, and other factors can also affect the accuracy and acceptance of price indexes.

2. See J. García and H. Freyhoffer, La tasa efectiva de la Inflación en Chile entre 1961 y 1968 y el comportamiento de los agentes económicos, (Santiago, Instituto de Economía, Univ. de Chile, 1970).

of these factors and the relative failure of the anti-inflationary attempts of each Government. Governments were not interested in challenging their own figures and the opposition must have not found it profitable to focus the debate on technicalities.

Although some direct price controls over essential goods were in force during the period, and sometimes there were shortages of some goods in some areas, they were neither so significant nor so persistent as to make the overwhelming majority of the analysts of the Chilean inflation pay much attention to them. Hence, it seems safe for the purpose of this study to assume that inflation in Chile was open during the period under scrutiny.

The Chilean inflation of the 1950's and 1960's was not only open but also considerable and persistent. It was neither a creeping inflation nor a hyperinflation but a double-digit inflation with a cyclical pattern closely correlated with the periods of success and failure of the anti-inflationary attempts of each government.

Table I.1

Annual increases in the price indexes (Dec.-Dec) (%)

		Retail Price Index (RPI)		Wholesale Price Index (WPI)	
		Official	Corrected	Official	Corrected
Government:					
Ibañez:	1952	56.1	49.8	35.2	34.6
	1954	71.1	58.7	65.3	66.6
	1955	83.8	88.7	82.8	85.2
	1956	37.7	44.6	45.9	46.1
	1957	17.3	23.7	34.5	32.1
	1958	32.5	24.6	25.3	28.6
Alessandri:	1959	33.3	33.1	25.2	27.9
	1960	5.4	5.4	1.6	1.3
	1961	9.7	9.4	1.6	1.6
	1962	27.7	28.6	26.8	29.4
	1963	45.4	45.9	45.4	40.1
	1964	38.4	40.4	43.7	45.4
Frei:	1965	25.9	27.3	24.5	29.2
	1966	17.0	17.9	19.7	20.9
	1967	21.9	22.8	19.8	21.4
	1968	27.9	29.1	33.1	34.1
	1969	29.3	30.6	39.4	39.4
	1970	34.9	36.2	33.7	33.7

Source: See Ricardo Ffrench-Davis, Políticas Económicas en Chile 1952-1970, (Santiago, Ed. Nueva Universidad, 1973), Table 32, columns 4 and 6, p. 246, and Table 30, columns 1 and 2, p. 243.

Inflation rose during the first half of President Ibañez' Government and fell during the stabilization program in 1956-57 only to rise again until President Alessandri's stabilization which produced the post-war lowest levels of inflation in 1960-61. Inflation rose again during the second half of that Government, fell during the first two years of President Frei's stabilization program and, finally, started to rise again from 1967 onwards.

B) The contribution of this study

In this thesis, the analysis of the Chilean inflation is focused on the political factors and the social and political conflicts which are connected with them. In other words, the analysis focuses on the socio-economic structure, the organizations representing the economic interests of each sector, the political parties, the state and the political system which regulates the access of the different sectors to its institutions.

Socio-political factors are useful to explain at least three major elements in the inflationary process:

i) The role of the state and the political system as a direct source of inflationary pressures, i.e. in the monetary, fiscal and other areas in which they can be considered directly responsible for creating inflationary pressures.

ii) The role of the state, the political system, and especially the Government, as a centre of anti-inflationary activity, explicit - as in the stabilization programs - or not, as in the case of regulative devices which restrain inflationary pressures, even if they are not normally thought of as being anti-inflationary measures.

iii) The role of the unions and the private sector price-setters, whose bargaining power and expectations are significantly affected by socio-political factors.

The analysis will focus on two aspects:

a) The basic institutional structures, i.e. the more permanent features and the long-run trends of the socio-economic structure, the relevant state institutions and the political system.

b) The political process, its cycles and their connection with the evolution of inflation.

The Chilean case is a particular interesting one, for a number of reasons. First of all, because the country combined the existence of a long-standing democratic system fairly developed for Latin American standards, with a very vulnerable economic structure, i.e. one which frequently developed considerable sectoral inbalances requiring huge adjustments.

Secondly, because even though the Chilean inflation was a long and persistent one, it managed to avoid hyperinflation until 1973 when the democratic system broke down and was replaced by a military dictatorship.

Thirdly, because the Chilean inflation has been the subject of some of the classic works about the Latin American inflations, and because Chile was the most important centre of elaboration of the 'Latin American structuralism' and one of the focuses of the controversy between it and the 'monetarist' approach whose major advocate was the International Monetary Fund (IMF).[1]

1. Among the 'classic' works about the Latin American inflation are Osvaldo Sunkel, 'La Inflación Chilena, un enfoque heterodoxo', in O. Sunkel et al, Inflación y Estructura Económica, (Buenos Aires, Paidos, 1974), pp. 15-52 (originally published in El Trimestre Económico, 100, Oct.-Dec. 1958, pp. 577-99), Arnold Harberger, 'The Dynamics of Inflation in Chile', in C. Christ, (ed.), Measurement in Economics, (Stanford, Stanford Univ. Press, 1963), pp. 219-50, and Albert O. Hirschman, 'Inflation in Chile', in Journeys Towards Progress. Studies of Economic Policy-Making in Latin America, (N. York, Twentieth Century Fund, 1963), pp. 161-223.

Fourthly, because neither Latin American structuralism nor monetarism proved themselves to be viable and effective in curbing inflation permanently, the question about what went wrong with the stabilization attempts of the 1950's and 1960's being, to a large extent, still open.

The period 1955-1970 is particularly important in that the three main attempts at stabilization (under democratic conditions) in the history of the country were implemented. After 1970, internal economic and political crisis combined with a sharp fall in the international price of copper, Chile's main export, and the change in the international situation created by a number of factors including the international monetary crisis, the increase in the rate of inflation in the more developed countries, and the oil crisis which reinforced the other factors. Chile suffered the combined effect of the crisis of her political system and the domestic and international economic crisis, the result being the end of the democratic system regulated by the Constitution of 1925 and the first 'hyperstagflation' in the history of the country, one which took more than five years to bring under control.[1]

The socialist (marxist) Government of President Salvador Allende, from 1970-1973, was a short period of intensive political struggle. Controlling inflation ranked somewhat low in the priorities of the Government which was particularly concerned with accumulating political strength to implement a social revolution. Consequently that period must be analysed separately and is, therefore, left out of this thesis.

1. For the Chilean inflation throughout the political and economic crisis experienced by the country in the 1970s see Joseph Ramos, 'Inflación persistente, inflación reprimida e hiperstanflación: lecciones de inflación y estabilización en Chile' in Cuadernos de Economía, 43,1977, pp.65-108; Laurence Whitehead, 'Inflation and Stabilization in Chile 1970-77', in R. Thorpe and L. Whitehead (eds.), Inflation and Stabilization in Latin America (London, Macmillan, 1979), pp.65-109, and Alejandro Foxley, 'Stabilization Policies and Stagflation: The cases of Brazil and Chile', World Development, VIII, 11, Nov.1980, pp.887-912.

C) General Outline of the Thesis

Chapter One presents a basic view of the socio-economic structure of the country and identifies the socio-political actors which are significant from the point of view of the inflationary process.

Chapter Two discusses the literature about the Chilean inflation. In doing so, special attention is paid to the evolution of the different approaches, their controversies, and the way in which they treated socio-political factors.

Chapter Three attempts to provide a basic theoretical framework to analyze the socio-political aspects of the Chilean inflation based on the characteristics of the Chilean political system. In doing so it draws from the discussion in Chapter Two and the more recent academic literature in English about the socio-political aspects of inflation.

Chapter Four is devoted to the Government of President Carlos Ibañez (1952-1958) and the stabilization attempt which started at the end of 1955. The objective is to provide a comprehensive account of the connection between the socio-political evolution and the inflationary process.

Chapter Five does the same with the Government of President Jorge Alessandri (1958-1964) and the stabilization attempt started at the beginning of 1959.

Chapter Six is devoted to the Government of President Eduardo Frei (1964-1970) and the stabilization attempt started at the beginning of 1965.

These three chapters provide the basic socio-political material to account for the regularities of the inflationary process and are a complement to the institutional analysis which is predominant in the following chapters.

Chapter Seven analyses the monetary system, exploring its structure and the way in which socio-political factors contributed to make inflation possible through its operation. It also includes a section about the role of the IMF in the Chilean stabilizations.

Chapter Eight is devoted to the fiscal system, including the budgetary process, public expenditure, taxation and public financing in general. Particular attention is paid to the role of the Government and Congress in each of these aspects.

Chapter Nine analyses the role of the unions, and of increases in wages, salaries, and other labour costs, these being the main causes of the Chilean inflation according to the businessmen organizations.

Chapter Ten analyses the role of the monopolies, oligopolies and non-competitive features of the Chilean economy in the inflationary process, the 'market power' of these sectors being the main cause of inflation according to the opinion of the unions and their leadership, at least until they adopted a broader 'structuralist' view.

The General Conclusion provides a synthesis of the main findings of this study.

Chapter One

The Main Socio-Political Actors

A) Introduction

The purpose of this Chapter is to provide a basic, introductory, characterization of the sociopolitical actors which played the main roles in the Chilean inflationary process, namely the business organizations, the labour movement and the political parties.

It is important to stress that these were the main socio-political actors and that other actors such as the colleges of university professionals, the students, the bureaucracy, the Armed Forces, the Church, organizations of shanty-town dwellers and regional pressure groups also played some inflationary role. However, these sectors were significant mainly as pressure groups concerning public expenditure, a specific aspect of the inflationary process which will be analysed in Chapter Eight without going into such detail as identifying which particular sector was pressing for which particular aspect of public expenditure to be increased. Only when the activities of some of these specific actors becomes crucial to explain some inflationary episode or aspect they will appear in the corresponding Chapters.[1] In fact, even the characterization of the business sector, the labour movement and the political parties will not be complete until the very end of this thesis, once a number of aspects which cannot be dealt with in this introductory characterization have been discussed in more detail.

1. A characterization of the Armed Forces, the Church and the Students as interest groups can be found, Ben G. Burnett, Political Groups in Chile. The Dialogue Between Order and Change, (Austin, University of Texas Press, 1970), Chapter Three, pp.42-90. For the state bureaucracy see, Peter Cleaves, Bureaucratic Politics and Administration in Chile, (Berkeley, University of California Press, 1974), and James Petras, Politics and Social Forces in Chilean Development, (Berkeley, University of California Press, 1969), Chapter Eight.

B) A Basic View of the Socio-Economic structure

Quantitative analyses of the Chilean socio-economic structure are rather scarce and almost always based on official data - mostly from censuses - adapted in some way or another.[1]

In order to have some general quantitative idea of the socio-economic sectors, broadly defined, Table 1.1 (below) provides summarized data about Chile's occupational structure in non-extreme years of the period under scrutiny. A more detailed analysis is beyond the limits of this section but some quantitative idea is required because of the importance which will be attached, in subsequent Chapters, to the relation between the more egalitarian aspirations embodied in the political system (and particularly in the electoral system) and the more oligarchic character of the Chilean economy in the socio-political analysis of the inflation of the 1950s and 1960s, a point which will be introduced in more detail in Chapter Three.

The business sector was represented by very powerful business organizations, controlled the Liberal and Conservative parties and had significant political influence in the Radical and Christian Democratic parties, on top of their ability to influence Government policies due to their economic power, in other words, due to the fact that the overall economic performance of the country depended upon their 'confidence' and the decisions that they consequently took. This sector was not homogeneous or monolithic. In the case of the largest firms in the economy there were close connections in terms of ownership which amounted to the existence of powerful 'economic

1. See for example, Manuel Castells, La Lucha de Clases en Chile, (Buenos Aires, Siglo XXI, 1974). This author provides a more detailed analysis based on a marxist theoretical framework but the same official sources of data used by everybody else. See particularly pp.43-124.

TABLE 1.1

Sectoral Structure of the Employed Population 1960 and 1965
(thousands)

	Employers	Self-employed	White Collar Workers	Blue Collar Workers	Relatives Domestic and others	Total
Agriculture:						
1960	13.6	166.0	21.4	452.0	57.7	711.1
1965	8.9	194.5	26.2	415.1	83.4	728.1
Mining:						
1960	0.8	2.8	12.6	76.1	0.2	92.5
1965	1.0	3.1	18.0	71.1	0.2	93.4
Manufacturing:						
1960	8.3	94.1	58.5	248.2	3.5	412.6
1965	8.6	115.4	78.4	297.3	7.0	506.7
Construction:						
1960	0.9	14.1	8.9	106.3	0.3	130.5
1965	0.9	23.4	15.6	142.5	0.7	183.1
Electricity Gas and Water:						
1960	a/	0.2	4.2	6.4	a/	10.8
1965	a/	0.1.	7.5	4.9	a/	12.5
Transport:						
1960	2.5	20.1	48.2	49.5	0.6	121.2
1965	5.2	30.1	59.7	52.0	0.6	148.0
Commerce and Financial:						
1960	7.1	130.7b/	85.1	30.9	6.5	260.3
1965	11.1	136.8b/	110.6	30.7	15.0	304.2
Other Services:						
1960	3.5	46.3c/	244.6d/	67.3d/	216.3e/	578.0
1965	4.3	72.7c/	279.2d/	73.0d/	199.3e/	628.6
Total:						
1960	36.7	473.3	483.5	1037.1	285.4	2317.0
1965	40.0	576.5	595.2	1086.6	306.4	2604.6

a/ : Less than 50.
b/ : The overwhelming majority, here, are 'vendors', and a considerable proportion of them are 'disguised unemployed'.
c/ : Very heterogeneous. Includes professionals, 'disguised unemployed' etc.
d/ : Here there are at least 40% of civil servants plus 20% of Armed Forces.
e/ : Includes domestic servants 214.5 and 193.3 in 1960 and 1965.

Source: ODEPLAN, Balances Económicos de Chile 1960-1970, (Santiago, Odeplan, 1971), Table 3, pp.91-2.

groups' with presence in a number of economic sectors (economic concentration and its role in inflation is discussed in Chapter Ten), but in the case of medium-size and smaller firms, sectoral boundaries were more important. There were also social cleavages concerning social prestige, and the remnants of the old aristocracy, particularly connected with agriculture, formed a more closed sector, inaccessible except by marriage, while new sectors, particularly of industrialists, merchants and financiers which made fortunes either through business, politics or both, were more open to all who were economically powerful enough, were less prejudiced about ethnic and religious aspects, and were more varied from the political point of view.[1]

At the other end of the socio-economic ladder around 55.0% of the employed population were classified as 'blue-collar workers' and 'relatives', most of them unorganized, particularly the 'domestic workers', non-remunerated 'relatives' and manual workers in agriculture, which accounted together for around 30% of the total employed population and had almost no organization until the late 1960s. Although blue-collar workers were a very heterogeneous sector, taking into account sectoral and other differences, they were more homogeneous than other sectors from the point of view of their income distribution (see Table 1.2, below), despite the heterogeneous character of the economy, particularly evident in the differences in productivity between different sectors, different industries and different firms.

The 'self-employed', which accounted for around 21.0% of the total, were a very heterogeneous category with very little analytical value. Some of them were 'disguised unemployed', some owned very small - uneconomical

1. See Federico G. Gil. The Political System of Chile, (Boston, Houghton Mifflin Company, 1966), pp.23-4.

businesses and worked as wage-earners on a part-time basis, some of them were professionals, and some others were prosperous small businessmen. But, the overwhelming majority of them were in the income brackets in which most blue-collar workers were (see Table 1.2, below), and were almost totally unorganized.

Traditional paternalistic forms of social control were still considerably important in agriculture during the period under scrutiny but this was precisely the period in which these traditional forms of control started to collapse, a process greatly accelerated by the Agrarian Reform in the second half of the 1960s. Migration from the rural to the urban areas was considerable throughout the 1950s and 1960s and the share of the urban population increased from 60.2% to 76.0% between 1952 and 1970. These migrants were mostly unskilled workers who found it very difficult to get a stable urban job. Hence, a considerable proportion of the 'disguised unemployed' which were among the 'self-employed' with lower levels of income were, in fact, recent rural 'immigrants' who had abandoned a sector in which traditional forms of social control persisted and were still to find their place in the urban society.

As to the 'white-collar' workers which accounted for around 22.0% of the total, it must be stressed that in Chile, this was a legal category, and that several powerful groups of blue-collar workers (obreros), particularly skilled ones, succeeded in being re-classified as white-collar (empleados), the result being more prestige and a number of other benefits especially concerning social security.

The distinction had important political consequences because it provided a device for accommodating the demands of some workers without creating as much pressure from other sectors as it would have been the case if the distinction had not been widely accepted in society.

TABLE 1.2

The Income distribution of the self-employed, white- and blue-collar workers, 1967 (%)

Income brackets[a/]	Self-employed		White-Collar		Blue-Collar	
	Population	Income	Population	Income	Population	Income
0-1	47.8	14.3	8.6	2.1	66.0	40.2
1-2	26.7	21.2	37.3	18.3	27.8	40.3
2-3	10.2	13.0	21.5	17.3	4.1	9.5
3-4	5.9	11.1	13.7	15.0	1.4	7.0
4-5	2.5	7.3	5.3	7.7	0.5	3.0
5-10	5.0	18.0	10.4	23.6	0.2	0.0
10+	1.9	15.0	3.2	16.0	-	-
Total	100.0	100.0	100.0	100.0	100.0	100.0

a/ : The unit is the minimum salary (sueldo vital)

Source: CEDEM, Univ. de Chile, Encuesta Nacional 1967, in Isabel Heskia, 'La Distribución del Ingreso en Chile', in CEPLAN, (eds.) Bienestar y Pobreza, (Santiago, Ed. Nueva Universidad, 1974), Table 8, p.30.

This sector was politically very important because it included the best educated among wage- and salary-earners, white-collar workers were relatively well organized, they were as numerous as non-agricultural blue-collar workers and, above all, because they had a long history of political influence, particularly through their presence in the centre parties, starting with the coalitions which challenged the power monopoly of the old oligarchy and which inaugurated, in the 1920s, a period of broader-based politics.

Due to the nature of the concept of 'economically active population' which is used in most countries to estimate the labour force, an important sector of workers are left out, namely those who are usually called 'housewives' which perform tasks that are not different from those of the 'domestic workers' and many other workers belonging particularly to the service sector. Women accounted for approximately 23.0% of the total

economically active population throughout the 1960s, a high proportion of them (39.0% in 1960 and 33.0% in 1970) being 'domestic workers' and non payed 'relatives'.[1] In short, around 85.0% of women, i.e. more than 40.0% of the total electorate towards the end of the 1960s were confined to the world of domestic work.

C) The business organizations

The oligarchic character of the most powerful business organizations was very clear. In general, they excluded small businessmen from their membership and their organizational structure favoured their being controlled by 'the few'.[2] The Society for the Promotion of Manufacturing (SOFOFA) was, undoubtedly, the most important business organization during the period under scrutiny. However, it claimed to have only around 2,200 members in 1967-68, which was approximately the equivalent to the manufacturing firms with more than 20 employees, (i.e. medium and large firms). Outside SOFOFA, the Association of Medium and Small Industry and Artisanry of Chile (AMPICH), established only in 1953, had around 28,000 members.

The old and aristocratic National Agricultural Society (SNA), dominated by large landowners of the Central Valley, claimed to have 4,500 members by 1964. Medium size landowners of the Southern region, which had rejected its oligarchic character, organized in 1944 the Consortium of Southern Agricultural Societies (CAS), but small farmers had no organization until the late 1960s.

The third most powerful business organization was the Central Chamber of Commerce (CCC), a national organization coordinating regional chambers all of them controlled by the largest firms, and particularly wholesalers

1. Calculations based on data from the 1960 and 1970 Censuses, Instituto Nacional de Estadísticas.
2. See David F. Cusack, 'The Politics of Chilean Private Enterprise under Christian Democracy' (Univ. of Denver, Ph.D. thesis, 1970), pp.41-65, and Genaro Arriagada, La Oligarquía Patronal Chilena, (Santiago, Ed. Nueva Universidad, 1970), passim.

and import-export merchants. Retailers were organized separately in organizations such as the Retailers Union (SIDECO) and the Confederation of Established Retail Commerce and Small Industry of Chile.

The three main organizations, the SOFOFA, the SNA and the CCC, together with the National Mining Society (SONAMI) and the Construction Chamber were the only five members of the overall business organization, the Confederation of Production and Commerce (CPC). This organization tried to broaden its membership only in the late 1960s seeking support among small businessmen in order to defend private enterprise which they considered to be threatened by the left at the time.

There were also sub-sectoral organizations, the most important one being a member of SOFOFA, the Metallurgical Industries Association (ASIMET) which was considered to be a highly efficient organization with considerable influence in SOFOFA itself.[1]

These business organizations and the 'economic groups' which existed in the Chilean economy (characterized by its high degree of economic concentration, see Chapter Ten), were the centre of private economic power in Chile. All the business organizations had considerable financial power, published periodicals and considerable quantities of other printed materials, had fairly developed research resources (particularly SOFOFA and SNA) and two of them (SONAMI and SNA) owned broadcasting stations which headed two of the most important national networks. Moreover, all of them were well represented in a number of very important Boards of Directors in the Public Sector, particularly in the Central Bank, the State Bank and the Developing Corporation (CORFO), the agencies concerned with credit to the Private Sector, while in the case of smaller businesses only Retail Merchants were represented and only in the State Bank.

1. David F. Cusack, 1970, op.cit., p.44.

D) The Labour Movement

Although the analysis of the role of the labour movement in the Chilean inflation and the most relevant aspects of its development during the period under scrutiny are discussed in Chapter Nine, a basic characterization is needed before the discussion about the socio-political aspects of inflation starts.

The level of unionization varied considerably among sectors and among different kinds of firms. The level was higher in the case of industrial monopolies than it was in competitive firms. Because of the existing legislation it was almost impossible to organize unions in agriculture until the second half of the 1960s and it was also impossible to organize plant unions in firms with less than 25 employees. This was an important limiting factor because the other type of unions authorized by the legislation, the professional (craft) unions, which included members from various firms, were generally smaller and weaker, i.e. not a satisfactory alternative to the plant unions.[1]

As a result of these restrictions and due to the characteristics of those sectors, the level of unionization was low not only in agriculture but also in commerce and construction.

Unions were not allowed in the Public Sector but public employees were organized in 'associations' which were very active. In practice, public employees were highly organized[2] and very active in the labour movement.

The level of unionization was also high in mining, manufacturing and public utilities (electricity, gas, water).

1. See Alan Angell, Politics and the Labour Movement in Chile, (London, Oxford University Press, 1972), p.48.
2. Ibid., pp.53 and 67-8.

Miners were the most traditional and militant sections of the labour movement, although they were very far from being an homogeneous sector. In fact, this sector included the very powerful Confederation of Copper Workers (CTC), which represented one of the best paid sections among wage- and salary-earners, and was the most powerful organization in the labour movement because of the crucial importance of copper in the Chilean economy,[1] and the Miners Federation which represented very militant but not that well paid miners such as those in the coal and nitrate industries.

Federations were not allowed to participate in collective bargaining and since the union themselves were financially weak the federations were even poorer (see Chapter Nine, also).

The CUT was by far the main confederation in the Chilean labour movement and although there were attempts to challenge its position from time to time, they were never successful. The CUT had been established in 1953 as a result of a concerted effort to overcome the divisions of the labour movement which had been caused by rivalry between the Socialists and the Communists.[2] This rivalry continued throughout the 1950s and I960s creating a number of difficulties to the confederation. On top of that, Governments did not recognize it as a legal organization and seldom negotiated with it in practice, and the union leaders who belonged to the centre parties (Radicals, Christian Democrats), frequently complained about the tactics used by the Socialists and the Communists which controlled the organization. In more than one occasion the Christian Democrats and Radicals refused to participate in the election of the National Directive Council of the organization, thereby weakening its representativeness. In fact, throughout most of the period under scrutiny, the Confederation

1. See Manuel Barrera, El Conflicto Obrero en el Enclave Cuprífero, (Santiago, Instituto de Economia, Univ. de Chile, 1973).
2. See Jorge Barría, Trayectoria y Estructura del Movimiento Sindical Chileno, 1946-1962, (Santiago, INSORA, Univ. de Chile, 1963), Chapter Two, pp.34-60.

of Private Sector White-Collar Workers (CEPCH), which was controlled by the centre parties, was not a member of the CUT. In contrast, the organizations of the Public Sector white-collar workers, which had contributed very decisively to the creation of the CUT, continued to be members.

E) Left, Right and Centre

The system of proportional representation which was used in Chile to elect Senators and Deputies (the one developed by the Belgian Victor d'Hont at the end of the 19th Century) tended to encourage political fragmentation. Moreover, while electoral pacts were allowed, so that political parties were able to retain their identity during a campaign while pooling their votes with others, party proliferation tended to be very pronounced. This was particularly the case at the beginning of the 'ibañista earthquake' (see Chapter Four), when there was a generalized weakening of the traditional political parties. Between 12 and 16 parties had some parliamentary representation in the 1930s and 1940s but they increased to 32 in the 1953 parliamentary elections.[1] However, after the collapse of the 'ibañista' movement this tendency was reversed. The elimination of the electoral pacts in the parliamentary elections (for Deputies since 1958 and for Senators since 1962) encouraged this process of 'political concentration' which was centred around six main political forces: on the right the Conservatives and the Liberals, on the left the Socialists and Communists, and on the centre the Radicals and the Christian Democrats, although a relatively important, though decaying, party formed by former 'ibañistas', the National Democratic Party (PADENA), continued to play a significant political role until the mid 1960s.

1. German Urzúa V., Los Partidos Políticos Chilenos (Santiago, Ed. Jurídica de Chile, 1968), pp.73-94.

Chilean political parties were not personalist parties but ideological and class-based ones, this last characteristic being particularly important in the case of the right-wing and left-wing parties. As a result of this, political parties consistently supported the demands of the socio-economic sectors which were closely connected with them so that accommodation between conflicting demands frequently required political transactions between different political parties, and political competition between the parties themselves tended to make accommodation more difficult.

Since Chilean political parties were ideologically and socio-economically based, they had to adopt some position concerning Chilean inflation and economic policy in general.

Before the christian social movement developed, the Conservative Party (in the 1960s called United Conservative Party, PCU) had been the party of the Catholic Church. This was one of its two main sources of electoral strength, the other being the ability of the large 'aristocratic' landowners which were predominant in the party, to control the rural vote by using their influence and some degree of electoral bribery.[1] The old 19th century differences with the Liberal Party (PL) had disappeared to a large extent by the end of the 1940s. The Liberal Party had been traditionally open-minded about change but they shared with the Conservatives their strong adherence to the system of free private enterprise, their opposition to excessive state intervention in the economy, their strong anti-communism, and their preference for a stronger Congress vis-à-vis the Executive branch.[2] Although 'aristocratic' landowners were also important in the Liberal Party - as urban businessmen were in the

1. See German Urzúa V., 1968, op.cit., pp.127-9 and Federico G. Gil, 1966, op.cit., p.249.
2. Ibid., pp.245-55 and Ben G. Burnett, 1970, op.cit., pp.178-81.

Conservative Party - they were not predominant. Moreover, its electoral support was more balanced between urban and rural areas than that of the Conservative Party.[1]

Both parties were strongly oligarchic, not only in the sense that they were closely connected with Chile's business oligarchy but also because, as in the case of the business organizations, their organization was oligarchic in nature, all the power being concentrated in the hands of a few political leaders, invariably members of the economic élite.

The Radicals were, originally, in the 19th century, the radical wing of the Liberal Party and became the party of the middle sectors at the beginning of the 20th century. In the 1950s, after fourteen years in control of the Presidency of the Republic during which they consistently implemented a policy of state promoted industrialization and economic growth, the Radicals had a very diversified base of support. However, the bulk of it came from white-collar workers and professionals (in both the private and public sectors) and middle sectors in general, the same being the case with its membership. Although the party had significant support among southern landowners, managers, industrialists and even financiers, and some of them were prominent members,[2] its more democratic organization prevented the kind of absolute control these sectors had in the case of the Conservative and Liberal Parties.[3] These social characteristics of the party were reflected in a broad doctrinal 'umbrella' which allowed the Radicals to practice a policy of changing alliances with the right and the left, and sometimes even with sectors of both.

1. See Federico G. Gil, 1966, op.cit., pp.254-5.
2. See, for example, German Urzúa, 1968, op.cit., pp.159-62 and Enzo Faletto and Eduardo Ruiz, 'Conflicto Político y Estructura Social' in Centro de Estudios Socio-Económicos (CESO), Univ. de Chile (ed.), Chile Hoy, (Santiago, Siglo XXI, 1970), p.214 and 223.
3. See Ben G. Burnett, 1970, op.cit., pp.204-10.

This 'umbrella' tolerated variations ranging from right-wing sectors, particularly characterized by a very strong anti-communism, to a socialist-left-wing which became stronger and stronger in the second half of the 1960s when the party suffered the impact of the Christian Democratic challenge for the centre of Chilean politics. In general, the party supported state intervention in the economy and state education, it was strongly anticlerical and in the 1950s and 1960s opposed any restrictions on the legislative prerogatives of Congress. In the 1960s, the party increased its connections with the Socialist International while there was considerable internal activity in favour of transforming it into a modern social democratic party.

The Christian Democratic Party (PDC) was the result of the union of the Christian Social Falange, other Conservative splinter groups, and some former '<u>ibañistas</u>' which joined the new party; all shared corporatist ideas. They rejected the negative effects of the capitalist system and also rejected the marxist concept of the class struggle, stressing the need to develop solidarity, particularly by increasing the level of participation of the workers and the poor in society.[1] Although the middle sectors were also predominant in the membership of this party, as in the Radical Party, they were a different 'generation' of professionals, skilled workers and white-collar workers who had not been captured by the Radical Party due to historical and ideological reasons. Moreover, the Christian Democrats managed to expand their electoral support among sectors which the Radicals had never reached effectively, particularly the rural workers and the recent immigrants from the rural areas which had become shanty-town dwellers in the largest urban centres.[2]

1. See James Petras, 1969, <u>op.cit</u>., pp.198-203.
2. See Enzo Faletto and Eduardo Ruiz, 1970, <u>op.cit</u>., pp.224-5.

Both the Christian Democrats and the right-wing parties always obtained a significantly higher share of the female vote than their share of the male vote, in contrast with the marxist left which experienced the opposite situation.

The Christian Democrats wanted to 'technify' government and to introduce major socioeconomic and political reforms which are discussed in more detail in Chapter Six. In contrast, with the Radicals, Liberals and Conservatives, they wanted a stronger Executive branch. Moreover, they wanted to increase state intervention in the regulation of the economy because - as the Radicals and the marxist left - they did not believe in the soundness of the free market forces in Chile.

The marxist left included the Socialist and Communist parties. The Communist were a very disciplined party which considered itself to be the Chilean section of the international communist movement. It had firm support in traditional blue-collar sectors of the labour movement such as the nitrate and coal miners, considerable support among urban industrial blue-collar workers in general and was the strongest force in the CUT throughout most of the period under scrutiny.[1] The Communist Party was outlawed in 1948 and remained illegal until 1958, but throughout the 1950s, and even more clearly after its return to legality, the party rejected insurrectional tactics and continued trying to work in the context of the institutions of the Chilean democratic system, as it had done in the period 1935-1947.[2] The party consistently sought to achieve a broad alliance with the Socialists and the centre parties in order to form a government that would implement a program of 'national liberation' as a first stage in a peaceful road to socialism.

1. See Alan Angell, 1972, op.cit., p.218.
2. See Ernest Halperin, Nationalism and Communism in Chile, (Cambridge, Massachusetts, the M.I.T. Press, 1965), pp.43,55 and 60.

The Socialists were a less disciplined and more varied party, both socially and ideologically, always ready to adopt the brands of 'heterodox' marxism or even non-marxist socialist and anti-imperialist ideas rejected by the Communists. The Socialists also had firm support among important sectors of blue-collar workers but they were stronger than the Communists among white-collar workers and middle strata in general.[1] Throughout the period under scrutiny, the Socialists rejected any alliance with the main centre parties which would subordinate the marxist parties. The Popular Action Front (FRAP) with the Communists and the National Democratic Party (PADENA) was accepted, but not an alliance with the Radicals or Christian Democrats. The basic position of both Communists and Socialists was that the economic problems of the country were the result of its basic capitalist structure and that nothing significant and lasting could be done without changing that structure or at least starting a major process of change.

The FRAP never obtained more than one third of the vote in a parliamentary election, but it usually did better in presidential elections. Ironically, the alliance always rejected increases in the powers of the Executive branch, thereby condemning themselves to be either a permanent opposition or a weak Government.

F) The Businessmen's and Union's approaches to the Chilean Inflation

The 'businessmen's approach' to the Chilean inflation was essentially a cost-push approach. The main causes of inflation were considered to be the excessive increases in wages, salaries, and social security benefits, both in the Private and Public sectors of the economy, and the increases

1. See Enzo Faletto and Eduardo Ruiz, 1970, op.cit., p.225.

in taxation and the credit expansion required to finance them.[1] This was a view which was basically supported by the Liberal and Conservative parties. This approach shared with 'monetarism' (see Chapter Two) their strong economic liberalism, their support for free private enterprise and their advocating less state intervention in the economy, but more businessmen strongly opposed the monetarist recommendation of restricting credit expansion fairly severely,[2] (the reasons behind it are discussed in Chapters Seven and Ten). If anything had to be restricted, it would have to be the fiscal deficit and wage increases, they consistently argued. Business organizations did not always agree on economic policies. For instance, the Construction Chamber was more inclined to support a high level of public expenditure - because construction was highly dependent on the level of public investment, particularly in public works and housing programs - the National Mining Society (SONAMI), and the exporters in general, were the only ones committed to preventing an overvaluation of the domestic currency and, given the existing inflation, were usually on the side of devaluation, and the National Agricultural Society (SNA) would have liked a higher level of support from the other organizations when fighting state controls on prices of essential 'wage-goods' such as foodstuffs, and later on in fighting the Agrarian Reform. However, there was a basic overall consensus on the need to reduce the public deficit without increasing taxation. Restricting current expenditure, particularly on wages, salaries and social security benefits, was the obvious choice from their point of view.

1. See, for instance, SOFOFA, 'El proceso inflacionista estimulado por proyectos de ley y por medidas oficiales que agravan la situación económica de Chile', (Santiago, SOFOFA, 1951), p.5; and Jorge Alessandri, La Verdadera Situación Económica y Social de Chile en la Actualidad, (Santiago, Confederación de la Producción y del Comerico, 1955), passim., and SOFOFA's position in EMS, 26 March 1958, p.5 (the whole page).
2. See statement by the president of SOFOFA, Walter Muller in EMS, 14 Jan.1953, p.19, and Jorge Alessandri, 1955, op.cit., p.36.

In recommending this, the 'businessmen's approach' clashed head on with what could be called the 'unions' approach', which was consistently supported by the left and particularly by the left-wing of the Radicals, the Socialists and the Communists. For a long time the unions blamed inflation on the monopoly power of the largest firms, the excessive expansion of credit channelled to speculative activities and the high level of tax evasion.[1] Consequently, they advocated more state controls on prices and the allocation of credit, and stronger penalties against tax evasion and speculation. Their central demand was always indexation, i.e. they always fought for wage and salary readjustments at least equal to the rate of inflation. Union leaders did not accept the argument that a falling rate of inflation could increase average annual real wages.[2] Their opposition to wage restrictions and to accepting the blame for inflation was strengthened by the development of the 'structuralist' approach (see Chapter Two) which was rapidly adopted by them and welcomed by the left in general.[3]

1. See letter sent by the CUT to the Klein-Saks Mission in EMS, 6 Jan. 1956, pp.1 and 19 and Jorge Barría, Historia de la CUT, (Santiago, Ed. PLA, 1971), pp.54 and 73.
2. See, for instance, Oscar Nuñez, Chile visto por sus trabajadores, (Santiago, Ed. PLA, 1964), pp.72-3.
3. See Oscar Nuñez, ibid., pp.13-17. He was the leader of the CUT at the time. See, also, Socialist Senator Salvador Allende's analyses of inflation in Senate Proceedings, 19th Ordinary Session, 18 Dec. 1957, in EMS, 20 Dec. 1957, pp.36-7, and 23rd Special Session, 3 March 1959, in EMS, 6 March 1959, pp.20-3, in which he claims that ECLA and the Universities support with their technical studies what the left had always advocated.

Chapter Two

The Literature about the Chilean Inflation

A) The 1950 Foreign Missions

If there is the need to establish a starting point for the post-war controversy about the Chilean inflation, the best choice seems to be 1950.

In October 1949, the Government of President Gabriel González (the last Radical president), which wanted to implement anti-inflationary measures, invited a United Nations technical mission to advise the Government on the subject. The preference for a UN mission, instead of an IMF one, illustrates the priorities of the Radical Governments of the period 1939-1952, for the differences between the economic views which were predominant in each of these international organizations, particularly concerning the avoidance of deflation, were already clear.[1] The IMF let it be known that it was not pleased with the Chilean Government's choice, because they felt that monetary stability was their own area of competence and responsibility and, as a result, the Government invited an IMF mission too, trying to achieve some degree of cooperation between the two missions when they arrived in the country.

While the UN Mission was headed by two Scandinavian professors (Professor Lindahl of Upsala Univ. and Professor Iversen of Copenhagen Univ.) the IMF Mission was headed by the Director of Research of the Organization himself (Mr. E.M. Bernstein) and included highly ranked members of its research staff. Despite the desire of both the Chilean Government and the UN Mission for a joint report, the Executive Board

1. See Albert O. Hirschman, 'Inflation in Chile', in Journeys Towards Progress: Studies of Economic Policy-Making in Latin America, (New York, Twentieth Century Fund, 1963), pp. 189-92.

of the IMF rejected the idea. The uncompromising attitude of the IMF was also evident in the fact that, taking advantage of being the last to publish the report, the Fund's Mission included a very severe criticism of the other report stating, among other things, that it was incomplete, lacking of empirical support and that its proposals were totally inadequate. The fact that two post-war international organizations, already well established, confronted each other in this way on the subject of anti-inflationary policy, was an event not without political consequences. For, even though neither the IMF's nor the UN's recommendations were implemented by President González' Government - due to major changes in the general political situation - the controversial character of the literature about the Chilean inflation and the two basic camps defined in the 1950 confrontation remained throughout the 1950's and 1960's.

The UN Mission's report emphasized the need to reduce inflation without reducing the standard of living of the population, not even in the short run, and warned of the possibility of a severe crisis as the most likely result of 'placing sole reliance upon the rigorous application of one measure such as credit contraction'.[1] Their central idea was that inflation had become a self-perpetuating process, fed back by inflationary expectations, and that the main task was to stop the inflationary spiral without hurting wage-earners and avoiding a reduction in investment. In order to achieve this, they proposed a general price freeze based on massive price controls and state intervention, leaving some limited room for correcting serious distorsions in relative prices inherited from the past inflation. The key redistributive element was the recommendation of leaving wages and salaries out of the freeze, allowing them to adjust to the lower rate of inflation, the difference being absorbed by reducing profits, in the same way that the proposed increases in direct taxation would be

1. United Nationas, Technical Assistance Administration, Report of the UN Economic Mission to Chile 1949-1950, (New York, UN, 1951), pp. 1-4.

2. ibid., pp. 4-5.

To prevent an increase in consumption the UN Mission proposed a forced savings scheme which included 5.0% deductions from wages and salaries and a supplementary income tax for those receiving income from other sources, both to be treated as a three year loan collected during a period of eighteen months in 1950-51 and paid back in 1953-54 including a positive real interest.

Monetary expansion would be reduced by reducing the demand for credit, not its supply. This would be the result of smaller wage and price increases and higher interest rates, although the latter would not be allowed to increase too much in real terms to prevent a fall in the level of economic activity.[1]

The long-term recommendations, which were very lengthy, included administrative reforms, improvements in the system of national accounts in order to facilitate forecasting and planning, budgetary and tax reforms, and the adoption of counter-cyclical fiscal policies of a 'Keynesian' character.[2]

The UN Mission argued that state planning was essential if the system of free private enterprise was to survive and stated that the degree of state involvement in the economy was a matter open to political preferences. Moreover they argued that their recommendations should be 'at least as acceptable to those who believe in free private enterprise and competition as to those who advocate state ownership and government planning'.[3] This claim was proved to be too optimistic in the Chilean political situation in 1950, and since neither the unions, which were on the offensive - particularly the white-collar ones, -, nor the business sector liked the Mission's ideas, it was politically too costly for the Government to implement them.

1. ibid., pp. 11-3,
2. ibid., pp. 14-38.
3. ibid., pp. 1 and 16.

B) Monetarism in Chile

The IMF Mission's report was not an example of the narrow-minded monetarism which is so often used to portray this approach and which frequently leads to focus the attention on sterile analytical exercises such as the attempts at determining the direction of causality between the money supply and the price level on the basis of econometric analyses of statistical series on both variables.[1] Although the report argued that there was in Chile a close correlation between monetary expansion and price increases - allowing for the effect of increased production - and that, in that sense, the Chilean inflation could be explained fairly well in terms of the Quantity Theory of Money, the report immediately added that this was too simple an explanation for a complex phenomenon, that the originating cause of inflation was almost always non-monetary in character and that inflation could be described, in general, as the result of the efforts of some sectors of the economy to increase their share of the total available resources, the increase in the money supply being a permissive condition.[2]

The core of the IMF's Mission's view and of their criticism of the UN Mission's recommendations can be seen clearly in the following quotation:[3]

> 'Inflations of this type are abetted rather than caused by increases in the money supply. Nevertheless, the money supply represents the nerve center of all inflations - particularly inflations of great magnitude - and is a vital spot at which they can be attacked.

1. See, for instance, Susan Wachter, 'Latin American structuralist and monetarist inflation theories: an application to Chile', (Boston Univ. Ph.D. thesis, 1974), pp. 70, 73 and 195.

2. See IMF,'Mission to Chile. A Report on the process of inflation in Chile together with recommendations',(New York, mimeo., 1950)pp. 11, 13 and 99. The report states that the cause of the inflation may be said to be monetary in the narrowest sense if the banks actually solicit loans, i.e. 'push credit', see p. 14.

3. ibid., pp. 99-100.

> Ideally, the Chilean inflation could be ended by cutting off its sources one by one. Individual acts of investment, the Government budget, foreign transactions, proposed wage increases and price increases could all be investigated and any plans inconsistent with a stable price level nipped in the bud. But this is a counsel of perfection. To follow it would require weighing the justice of each individual claim against real resources, as compared with every other claim. This would place an impossible strain on human judgement and would present too much an opportunity for pressure groups to make themselves felt.
> If the possibility of stopping the Chilean inflation depended on the success of such procedures, it would probably never be stopped'.

The IMF Mission was clearly saying that the political system was incapable of adjudicating conflicting economic claims without generating inflation. In fact, past state intervention in the economy was considered to have been one of the main contributing factors concerning the existing inflation.[1]

The recommendation to increase the role of the market in adjudicating conflicting demands could not be seen as a purely technical proposal. Certainly it could not be viewed that way by the social sectors which had less economic power in the markets and that relied on their political leverage for offsetting their economic disadvantage. But there was another aspect of the IMF recommendations which was rejected even by the business organizations which were the backbone of economic liberalism in Chile. This was the recommendation to implement very restrictive measures on credit expansion. The Mission argued that the restriction should be 'sufficiently incisive to effect a radical change in the psychology of the community' and that 'this would mean that it would have to "really hurt" in many individual cases'.[2] Moreover, the report stated that inflationary

1. ibid., pp. 26 (Government finance), 32 (wages), 34-8 (social security) and 72-80 (foreign trade and foreign exchange).

2. ibid., p. ii.

price expectations could not be broken as long as deflation and unemployment were regarded as such transcendent evils that they could not be faced even temporarily and in small measure.[1] To be effective, credit restriction should force businessmen to sell goods at prices lower than they had anticipated, often at a loss, it should make it financially impossible for them to increase wages and it should create a minimum of unemployment severe enough to accomplish its objective.[2] Not only was this approach predictably unpopular with the left, it was also unappealing to many Chilean politicians of the centre and right. Consequently, it cannot be too surprising that the only politicians that ever wanted to implement monetarist policies of this sort had been some of the '<u>ibañistas</u>' and among them, some of the most authoritarian, (see Chapter Four).

The same approach which exaggerated the inability of the political system to accommodate conflicting demands without inflation and which claimed to be recommending measures which were feasible because they did not rely too much on the political system, asked the Government to hold the line against pressure from probably almost every organized sector in Chilean society.

Although the IMF continued insisting on this brand of monetarism, it was extremely unpalatable from the point of view of most socio-economic sectors and of most politicians.[3] However, a watered down version which

1. <u>ibid</u>., p. 99

2. <u>ibid</u>., p. 100

3. See FMI (IMF), <u>Diagnóstico y tratamiento de la Inflación Chilena</u>, (Santiago, Ed. Universitaria, 1953). The same ideas of the 1950 Mission report can be found in David Grove, 'The Role of the Banking System in the Chilean Inflation', <u>IMF Staff Papers</u>,, II, 1, Sept. 1951, pp. 33-59 and in E.M. Bernstein and I.G. Patel, 'Inflation in relation to Economic Development', <u>IMF Staff Papers</u>, II, 3, Nov. 1952, pp. 363-98.

did not emphasize the need of experiencing the rigours of a recession, eventually managed to enlist enough support to provide the basis for the political realignment which led to the first major stabilization attempt implemented in Chile after the Second World War, the one launched at the end of 1955 with the prominent participation of the Klein-Saks Mission. In fact, most of the measures implemented during that stabilization attempt had been already advanced by the Central Bank in a special report on the Chilean inflation prepared for Congress.[1] Both, in this report and in the stabilization attempt which followed, considerable restrictions on monetary expansion were among the central measures but, instead of relying mainly on the market forces for curbing the wage-price spiral, a number of very strong direct measures were included which required more state intervention in the economy, not less, at least in the earlier stages of the attempt. However, even this version of monetarism faced considerable political difficulties in the general political conditions which prevailed in Chile at the time, and could not be sustained as an effective policy for very long (see Chapter Four).

In the 1960's monetarism was strengthened in Chile by the influence of a number of U.S. economists who came to the country as part of a special program of cooperation between the Catholic University of Santiago de Chile and the University of Chicago. This program, which started in 1956, also included the sending of Chilean students to do post-graduate courses in Chicago.[2]

1. See Banco Central de Chile, 'Exposición del Directorio del Banco Central de Chile relacionada con la Situación Económica y Financiera del País', (Santiago, Banco Central de Chile, Julio, 1955).

2. See, for instance, EMS, 1 June 1980, section D, pp. 12-3, for a report on the Chilean 'Chicago Boys'.

Their monetarism was not significantly different from the IMF's one but they developed the formal aspects of monetary analysis very considerably, particularly the econometric aspects,[1] and contributed to diversify the sources of influence of the approach. However, monetarism had to wait until the 1970's, (after the last democratic government which Chile had was overthrown), in order to have a second chance. This time it was going to be full-hearted monetarism, not the watered down version.[2]

The use of quantitative techniques was not a mere instrumental factor for the new kind of 'domestic' monetarism which was the result of the influence of Chicago. They even divided the 'economic' literature on the Chilean inflation in two areas: econometric studies concerning the economic aspects of the phenomenon and juridical studies concerned with the institutional aspects of the monetary system.[3] Of course, their main rivals of the 1950's and 1960's, the Chilean 'structuralists', were most of them automatically excluded. The uncompromising attitude of the monetarism of the IMF at the beginning of the 1950's was, if anything, more pronounced in the Chilean monetarists of the beginning of the 1970's.

1. The classic work is Arnold Harberger's 'The Dynamics of Inflation in Chile' in Carl F. Christ et al (eds.) Measurement in Economics, (Stanford, Stanford Univ. Press, 1963) pp. 219-50. Also, Martin Bailey, 'La Creación del Dinero en Chile 1943-1956', Economía, 57, 4th. Quarter 1957, pp. 15-33; John Deaver, 'La Inflación Chilena como un impuesto', Santiago, mimeo, CIEUC, 1957, and his 'The Chilean Inflation and the demand for money' (Univ. of Chicago, Ph.D. thesis 1961), later published in D. Meiselman (ed.) Varieties of Monetary Experience, (Chicago, Univ. of Chicago Press, 1970), pp.7-67.

2. See Philip O'Brien 'The New Leviathan: The Chicago School and the Chilean Regime 1973-1980', (London, mimeo, World University Service, 1981).

3. See 'Introducción to the special issue about inflation of Cuadernos de Economía, Catholic Univ. of Santiago de Chile, 20, April 1970, p. 1. This issue was the first set of Chilean monetarist works ever published and it is not a coincidence that it happened during the 1970 presidential campaign, after the monetarists failed to persuade former President Jorge Alessandri, who was the right-wing candidate again, to adopt their ideas. See Phillip O'Brien, 1981, op. cit., p. 7.

C) Latin American Structuralism in Chile

Throughout most of the period under scrutiny the main alternative approach to monetarism was the Latin American structuralism (which will be referred to as structuralism, to save space, from now on). The origins of this approach are as complex as the approach itself is varied. Some elements can be found in an 'embrionic' state in the 1950 UN Mission's report, in some works published in the early 1950's in Chile[1] but, most of all, in the early studies of the Economic Commission for latin America (ECLA).[2] In fact, its origins can be traced back to what Eduardo García called 'early structuralists', namely those who explained Chile's 19th century inflation in terms of foreign trade problems.[3] It seems worth noting that following García's view it is possible to establish even some connection between Latin American structuralism and the ideas of the German economists who stressed the sociological and historical character of the German inflation of the 1910's and 1920's, and who rejected the monetarism of the early quantitative theory of money.[4]

1. See, for instance, Sergio Molina, 'Control de Precios e Inflación' in Aníbal Pinto et al, La Inflación: Naturaleza y Problemas, (Santiago, Ed. del Pacífico, 1951), pp. 102-4, Pedro Irañeta, 'La Depreciación Monetaria en Chile', in ibid., p. 158, and Hermann Max, 'Diagnóstico de la Inflación en la América Latina', Economía, 40, Oct. 1952, pp. 22 and 32-3.

2. See ECLA, Economic Survey of Latin America 1949, (N. York, ECLA, 1951), pp. 263-4;ECLA,. Economic Survey of Latin America 1954, (N. York, ECLA, 1955), pp. 23-32 and ECLA (CEPAL), 'Algunos factores de la aceleración del proceso inflacionario en Chile', Boletín Económico de América Latina, I, 1, Jan. 1956, pp. 45-52.

3. See Eduardo García, 'Inflation in Chile: a quantitative analysis' (M.I.T., Ph.D. thesis, 1964), pp. 13-4.

4. See Constantino Bresciani-Turroni, The Economics of Inflation, (London, Allen and Unwin Ltd., 1937), pp. 42-3.

The central idea of the structuralist approach was that certain basic features of the economic structure generated inflationary pressures which could not be eliminated, in fact they could be made worse, by an anti-inflationary policy focussing only on the financial aspects of the phenomenon, i.e. by a monetarist one or any other kind of financial orthodoxy which stressed financial discipline instead of structural reform as the cure for inflation. Structuralists did not make too much effort to acknowledge the distinctions between different shades of monetarism and between monetarism and other forms of conservative financial orthodoxy such as those which were part of the 'businessmen's approach' already discussed in Chapter One.[1] In general, they viewed the controversy as one between two broad approaches, and all those recommending to attack the symptoms rather than the real causes of inflation were on the other side.

For structuralists economic development was not a merely quantitative process, i.e. not merely economic growth, but a qualitative process in which fundamental structural change played a crucial role. The process of economic growth-cum-structural change was the main priority, stability being a consequence of it rather than a precondition.[2] Hence, any anti-inflationary policy which sacrificed economic development, even if temporarily, on the grounds that stability should be achieved first as a key to subsequent economic development (and monetarists recommended such a policy, though not 'businessmen') was rejected by them.

1. Among the exceptions see Gonzalo Martner, 'La Inflación Chilena en el pensamiento y la acción', Panorama Económico, No. 192, pp. 209-305 and 319 and No. 193, pp. 363, 365-6; and Enrique Sierra, Tres Ensayos de Estabilización en Chile. Las Políticas aplicadas en el decenio 1956-1966, (Santiago, Ed Universitaria, 1970), pp. 73-5 and 90.

2. See Aníbal Pinto, 'El Análisis de la Inflación: Estructuralistas y Monetaristas', Economía, 79, 2nd. Quarter 1963, p. 29.

However, most structuralists did not sympathize with the view, considerably widespread in Chile in the 1940's, that inflation was an effective mechanism for financing economic development,[1] although some of them did, thereby providing the base for some misconceptions about the approach.[2] No doubt, all shades of structuralism shared this basic source of internal tension between their aspiration to achieve stability and the need to find mechanisms to channel resources towards those sectors playing the crucial roles in economic development. This aspect of the approach allowed its critics to point out that there was a considerable degree of 'tolerance' towards inflation among structuralists. Their lack of short-term policies alternative to the ones which they criticized did not help them in this area either.[3] To some extent their position looked as the opposite to that of the monetarists: instead of postponing economic development, they seemed to postpone price stability.

There can be little doubt that a balanced view of the structuralist approach in general must recognize that there certainly was some degree of 'tolerance'. If inflation was unavoidable until structural reforms became effective, moreover, if imposing short-term stability at any cost was considered to be harmful from the point of view of economic development

1. The influence of that view can be seen in Jaime Barrios, 'Política Monetaria, Inflación y Desarollo Económico', in Aníbal Pinto et al, 1951, op. cit. pp. 75-6, and Luis Escobar Cerda, 'Inflación y Capitalización, Economía, 58, First Quarter 1958, p. 1, Harold Pilvin, 'Algunos Aspectos del proceso Inflacionario durante el Desarrollo Económico', Economía, 48, Sept. 1954, p. 19.

2. See Martin Bronfenbrenner and Franklyn D. Holzman, 1963, op. cit., pp. 610-11. They identified Latin American Structuralism with 'tolerating' inflation in order to achieve rapid economic growth. See also the criticism to the persistence of this view among some structuralists in Julio H. Olivera, 'On Structural Inflation and Latin American Structuralism', Oxford Economic Papers, XVI, 3, Nov. 1964, p. 332.

3. See Joseph Grunwald, 'La Escuela Estructuralista, Estabilización de Precios y Desarrollo Económico: el caso Chileno', El Trimestre Económico, 111, Jul.-Sep. 1961, pp. 478-82, and Aníbal Pinto, 1963, op. cit., p. 29.

and, consequently, from the point of view of long-term stability, then some degree of inflation had to be tolerated for some time. It cannot be surprising, therefore, that structuralist ideas which were already taking form during the inflationary acceleration of 1953-1955 (see Chapter Four), had not provided any credible alternative to the monetarist recommendations of the IMF, the Central Bank and the Klein-Saks Mission, in order to overcome the inflationary crisis, and that the approach had only developed and consolidated as a response to the effects of the 1956-1958 stabilization effort.

Structuralism was not as homogenous as most of the formalizations through which it became known world-wide tended to suggest. Moreover, since most of the internationalization of the approach was the work of economists, both Latin American and from the developed countries, the process of internationalization tended to favour the more 'economicist' versions, i.e. those which either neglected or mistreated socio-political aspects subordinating them to the economic ones. As a result of this, a number of analysts have adopted the view of reducing the approach to a few central economic aspects, and have contrasted it with the socio-political approaches which stress distributional conflict as the main factor explaining inflation.[1] Although it may be useful to distinguish between the structuralist aspects proper and other aspects 'imported' by the structuralists from other approaches, the fact is that the brand

1. Clear examples of this view are Tomás Reichmann, Inflación y Economía Chilena: variaciones econométricas sobre un tema político (Santiago, Instituto de Economía, Univ. de Chile, 1974) pp. 22-3 and David R. Konkel, 'The Social and Political causes of inflation in Chile', (UCLA, Berkeley, Ph.D. thesis, 1977), pp. 24. For a study restricting Latin American structuralism to one economic bottleneck - agriculture - see Susan Wachter, 'Latin American Structuralist and Monetarist Inflation Theories: An application to Chile', (Boston Univ., Ph.D. thesis, 1974), p.16.

of Chilean structuralism which became predominant in the academic literature about the subject was one which was not 'complementary' with the socio-political approaches but one in which they were treated in a particular way. This was Osvaldo Sunkel's version, whose taxonomy based on the distinction between 'basic' (structural), 'cumulative' and 'circumstantial' causes of inflation and 'propagating factors' which are not to be considered as causes of the phenomenon, became the classic structuralist formalization.[1] Basic or structural inflationary pressures are mostly economic rigidities and bottlenecks such as a limited and unstable capacity to import, agricultural stagnation, too low rates of saving and investment, lack of basic infrastructure, widespread monopolies and extreme instability, inflexibility and regressiveness of the tax system. 'Cumulative' pressures are those generated by inflation itself such as distortion in the allocation of resources and inflationary expectations which reinforce the inflationary process. Sunkel's circumstantial pressures seem to be 'conjunctural' manifestations of basic (structural) pressures - if they were it would be difficult to understand why they would need to be classified separately - but from a different angle they also seem to be what is commonly known in economic theory as 'exogenous' factors, i.e. those which are not explained by the theory in question even though they affect the theory's object. It is interesting to point out that among the 'circumstantial' pressures Sunkel included natural disasters, sharp changes in international trade and, this being most significant from our point of view, massive increases in public expenditure explained by political factors.[2] This unsatisfactory treatment of very crucial

1. See Osvaldo Sunkel, 1974, op. cit., p. 19.

2. ibid, p. 20.

political aspects is even more clearly evident in the case of the 'propagating factors' which - Sunkel insists - are necessary for the basic (structural) pressures to be translated into the kind of persistent and double-digit inflation which existed in Chile, but cannot cause inflation.[1] They are the factors which allowed each sector to fight for its share in the total of real available resources, namely the ability of the unions to obtain wage and salary readjustments, the ability of the businessmen to increase their prices and their level of borrowing from the banks and the ability of the Government to finance its expenditure by several means. As Juan Noyola, the economist from whom Sunkel adopted these concepts, put it, the 'propagating factors' are the result of the inability of each of these sectors to shift the burden of the basic inflationary pressures to the others.[2]

The idea that the distributional struggle propagated but did not cause inflation in Chile can also be found in a sort of 'genetic' version of the structuralist approach in which the Chilean inflation of the 1950's and 1960's was considered to be the result of a distributional struggle 'born' in the context of the effects of the Great Depression. In other words, the emphasis was placed on the structural (economic) origin of the struggle itself.[3] It is rather surprising to find some of the most important structuralist studies insisting on the

1. ibid., pp. 19, 21

2. See Juan Noyola, 'El Desarrollo Económico y la Inflación en México y otros países Latinoamericanos', Investigación Económica, 4th. Quarter 1956, pp. 608-9.

3. See ECLA, 'Inflation and Anti-Inflationary Policy: the Chilean case and those of México and Argentina', Economic Survey of Latin America 1954, (N. York, ECLA, 1955), pp. 29-30.

secondary, subordinated and non-causative character of socio-political factors and, at the same time, constantly referring to works such as those of Henri Aujac and Aníbal Pinto who placed these factors either at the centre of their approach to inflation or at the same level of the economic rigidities and bottlenecks.[1] For Aníbal Pinto and other structuralists social and political aspects were always crucial in their own right[2] and inflation was seen as the result of the 'non-correspondence' between the political and the economic development of the country[3] (Pinto's contribution is discussed in more detail in the next section). In other words, this was a more 'comprehensive' brand of structuralism which included, rather than subordinated, the 'distributional struggle'.

Some of the structuralist contributions were clearly 'economic' but not 'economicist' in the sense that they did focus on economic aspects but they did not attempt to subordinate socio-political aspects. The most clear example of this brand was Kaldor's cost-push theory based on increases in the price of foodstuffs originating in agriculture and foreign trade and being transmitted to the economy as a whole through wage increases,[4] a view later adopted by structuralists in general.

1. See Henri Aujac, 'L'influence due comportement des groupes sociaux sur le developpment de l'inflation', Economie Appliquee, 4, 1950, pp. 280-300., and Aníbal Pinto, 'Perspectivas del proceso inflacionario en Chile', Comercio Exterior, VI, 11, 1956, pp. 541-4.

2. See, for instance, Jaime Barrios, 'Consideraciones Acerca de la Inflación en Chile', Economía, 58, 1st Quarter 1958, p. 59.

3. Aníbal Pinto, Chile, un caso de Desarrollo Frustrado (Santiago, Ed. Universitria, 3rd. ed. 1973), pp. 208-9.

4. See Nicholas Kaldor, 'La Inflación Chilena y la estructura de la Producción', Panorama Económico, 180, pp. 738-40 and 746, and his Essays on Economic Policy, (London, Gerald Duckworth and Co., 1964), ii, pp. 267-77. Susan Wachter, 1974, op. cit., p. 16, argues that this is the core of the structuralist approach.

Despite all this variety, it was the 'Sunkelian' brand of structuralism the one which became predominant in the international academic literature.[1]

To the variety of diagnoses corresponded a variety of economic policies, although they were all characterized by a considerable degree of distrust in the soundness of the market forces and a generalized increase in the level of intervention of the state in the regulation of the economy not only concerning short- and medium-term policies (such as price controls, qualitative controls on credit, investment policies, foreign exchange policies etc.) but, also, concerning the long-term structural reforms which they proposed (the most generally proposed being the agrarian and tax reforms, and those concerning export promotion and diversification). The structuralist reforms required considerable political power and so, despite the fact that structuralists did not promise hardship for almost everyone in the short-run as the monetarists did, their political task was also a formidable one, the difference being the intended and most likely coalition that would support them. While monetarists claimed that their policies would benefit the less organized and less powerful majority which suffered from the 'inflationary tax', it is clear that it could be very harmful to them in the short- or medium-run. Moreover, it would seem to be not too harmful in the short-run and very beneficial in the long-run to those with more market power, i.e. to those better prepared to survive increased competition and credit shortages (see Chapter Ten also). Monetarism was particularly harmful both in the short- and long-run to those who had managed to counterbalance private market power, to a certain extent, by using the power of the state (see following section). On the other hand, structuralists would

1. See, for instance, Dudley Seers, 'A Theory of Inflation and Growth in Underdeveloped Economies, Based on the Experience of Latin America', Oxford Economic Papers, 14, June 1962, pp. 173-95, particularly the Appendix on the structuralist literature; Julio H. Oliviera, 1964, op. cit., footnote 2.

have clearly liked a broad coalition in which only a few largest landowners and the few in the highest brackets of the income distribution likely to be affected by the agrarian and tax reforms, would be excluded. The problem was that there was no guarantee that the increase in state intervention would not affect some of the prospective allies also.

D) The Socio-political approaches to the Chilean Inflation

Aníbal Pinto's approach was not a socio-political one in the sense that he combined his socio-political views with the economic aspects stressed by the dominant version of the Latin American structuralism. However, since his own contribution seems to have been to resist the structuralist tendency to subordinate the role of the socio-political factors to the economic ones, it seems appropriate to discuss his contribution in this section. Pinto argued that since the Chilean oligarchy lost its power monopoly in the 1920's, no other social sector had been able to establish a clear hegemony. Although the middle strata gained access to the political and economic power of the state, their position was precarious because the bulk of the economic and social power remained elsewhere and because the parties which represented them 'occupied' but did not 'control' the centres of political power, their position being dependent on a policy of changing coalitions, first with the left and the labour movement and later on with the right. The oligarchy managed to retain most of its economic and social power by avoiding extreme confrontations, by making some concessions and even by accepting in its own ranks some of the individuals with newly acquired economic and political power. As a result of the absence of an hegemonic sector, stable and effective government was not possible and the distributional

conflict remained unsolved in the sense that no power was in the position to make society as a whole to accept a more or less determined income distribution. Pinto described the situation as a 'tie' which stimulated each sector to make attempts at increasing its share provoking reactions from other sectors and leading to never ending actions and reactions. The Great Depression reduced the ability of the economy to accommodate the increasing demands of several socio-economic sectors and the persistence of foreign trade and agricultural difficulties made their own additional contribution to the inflationary process.[1] Pinto focused the socio-political aspect of his approach on the historical and sociological factors behind the inexistence of a power capable of promoting price stability. He did indicate that the inflationary accelerations and decelerations of the period 1940-1954 (which he analysed) were connected with changes in the political situation,[2] but he did not attempt to systematize the connection and did not analyse the role of the political institutions.[3] In other words, his contribution to the structuralist approach was 'sociological' rather than 'political'.

A more recent contribution on the same lines of Pinto's one was that of David Konkel[4] who stressed the monopolistic character and the political influence of both organized labour and business, which prevented Governments from sustaining any effective anti-inflationary policies. Konkel argued the existence of a 'stabilization cycle' in which mounting inflation created the conditions in which powerful interest groups accepted some sort of anti-inflationary policy, while the necessarily negative

1. See Aníbal Pinto, Chile, un caso de desarrollo frustrado. op. cit., pp. 195-212.

2. ibid, pp. 206-7.

3. He did not do it in subsequent works either, see 'Raíces Estructurales de la inflación en la América Latina', in his Inflación, raíces estructurales (México, F.C.E., 1973), and particularly pp. 24 and 33-5.

4. David R. Konkel, 'The Social and Political causes of inflation in Chile', (UCLA, Berkeley, Ph.D. thesis, 1977).

effects of the stabilization on the level of economic activity weakened the Government's ability to resist the pressure and sustain the policies.[1] This attempt at systematizing the connection between the inflationary accelerations and decelerations and political factors can be seen as an improvement compared with Pinto's analysis. However, Konkel's 'stabilization cycle' is a simplification which cannot explain the medium- and short-term evolution of the Chilean inflation. As it will be argued in Chapter Three and demonstrated in subsequent Chapters, mounting inflation was not the only cyclical factor which created political conditions in which a stabilization could be attempted, and Governments did not lose support mainly because their stabilization attempts restricted economic activity. In fact, they lost support even when they managed to expand the economy at the same time that they reduced inflation. This was mainly due to political factors which Konkel failed to take into account. His cyclical model reduces the changes in the political situation to mere effects of inflation and stabilization themselves, the result being a very elegant self-perpetuating mechanism, but one which does not correspond to Chilean experience. Moreover, his idea that a 'full-scale stabilization program will be initiated only when the desire of economic interest groups for increased income is outweighed by their concern about rising inflation'[2] misses a crucial political aspect of any inflation, namely that there are very important sectors which are not powerful enough to protect their income shares from an increase in inflation, and that a democratic and competitive political system provides mechanisms for

1. ibid., pp.4-5 and 107.
2. ibid., p.4.

their dissatisfaction to have increasing leverage when inflation reaches critically high levels even if the more organized sectors which are the engine of the distributional struggle are still not convinced of the need to accept some sort of anti-inflationary policy. Here, again, Konkel fails to treat the role of the political system adequately.[1]

Pinto's idea of a 'tie' is also present in Tom Davis' rather condensed political interpretation of eight decades of Chilean inflation[2] in which the failure of successive Governments to implement effective measures against inflation in the period 1931-59 is explained in terms of a 'political tie' between the right-wing parties, which had enough power to block any attempt to increase direct taxation, and the Radicals and the left, which had enough power to protect the real level of wages and salaries of public employees and organized workers in general, while the most important firms in the Private Sector had enough power in the Central Bank to secure an expansion in the amount of credit extended to them equivalent to the expansion in credit extended to the Government.[3] It is interesting to point out that more than a decade before Konkel's contribution, Davis stressed the existence of a number of sectors which suffered from inflation and which were not politically as powerful as they were numerous because of their socio-economic characteristics: non-unionized wage- and salary earners, self-employed, small businessmen and exporters (affected by the combination of inflation and the foreign exchange policy). Moreover, he argued that a Government could not be

1. Apart from this central weakness Konkel's contribution has a number of less important, though still significant ones, among them his view that monetarism and structuralism are not incompatible, and that much of the Chilean inflation literature seems to stem in part from an oversimplified view of inflation, ibid, p. 24.

2. See Tom Davis, 'Eight decades of Inflation in Chile, 1879-1959; a political interpretation', Journal of Political Economy, LXXI, 4, August 1963, pp. 389-97.

3. ibid., pp. 392-3.

based on such a fragmented and unorganized base in order to implement a stabilization without being immediately threatened by totalitarianism.[1] Since he was mainly interested in the long-term aspects of inflation, and, particularly in its persistence, he does not explore its cycles and the connections that might exist between them, his sociopolitical view and the characteristics of Chile's political institutions. This is rather surprising because he clearly stresses that the main inflationary aspect of his 'political tie' is the failure of successive Governments to achieve office supported by a majority mandate which would enable them to act effectively against inflation. The 'inflationary tax' is more convenient for those sectors with enough power to protect themselves from inflation and, consequently, monetary expansion and inflation continue unchecked. He is a basically monetarist analyst exploring the causes of bad Government and finding them in the existence of a 'political tie' whose sociological foundations he makes fairly clear but whose political aspects he does not analyse. Not surprisingly, he adopts Frank W. Fetter's classic monetarist interpretation of the Chilean inflation of the period 1879-1925 in which inflation is considered to be the result of the political and economic power of the heavily indebted landed aristocracy which benefited from inflation in paying off their mortgages.[2]

Hirschman's 'Inflation in Chile'[3], the most famous socio-political study of the Chilean inflation, which covers almost the same period of

1. ibid., p. 393

2. Frank W. Fetter, Monetary Inflation in Chile, (Princeton, Princeton Univ. Press, 1931), pp. vii and 183.

3. Albert O. Hirschman, 'Inflation in Chile', in Journeys Towards Progress. Studies of Economic Policy Making in Latin America (N. York, Twentieth Century Fund, 1963), pp. 161-223.

Davis' work but with a far more detailed analysis, starts precisely with a severe critique of Fetter's approach. He finds it not to be supported by the historical evidence which would show that Governments made every possible effort to restore monetary stability, the reasons for their failure being a number of specific historical episodes such as the War of the Pacific (1879-82), the Chilean Civil War of 1891, and the depression caused by the revaluation which accompanied the return to gold in 1895-1898. However, he does not explain why the revaluation was implemented or, indeed, why Governments of the period 1891-1915 were run by 'decision-avoiders' who did nothing to control the huge 1905-1907 monetary expansion caused by the business boom started in 1904.[1]

Although this is not the period this thesis is concerned with, this discussion is important in order to understand Hirschman's contribution in general. Because, unless he was arguing that the cause of the monetary expansion which he seems to accept as the direct cause of that inflation, was self-explaining bad Government and/or technical mistakes - incidentally, a more monetarist position than monetarist Fetter's one[2] - the only reason for not attempting a socio-political explanation seems to have been his having commited himself against complementing his political history with some degree of analysis of its social background by declaring total war on what he saw as one of the main appeals of Fetter's position, namely that:[3]

> 'It satisfied the detective turn of mind that makes us jump to the conclusion that he who has the motive for the crime must necessarily be the criminal. Inflation benefited certain social classes; hence inflation was planned and organized by these classes, a proposition that is even more plausible when it is recalled that these very classes controlled the country's destiny'.

1. ibid., pp. 169-73.

2. See John H. Goldthorpe, 'The Current Inflation: Towards a sociological Account', in Fred Hirsch and John H. Goldthorpe, 1978, op. cit., p. 188.

3. ibid., p. 169.

Of course, he is criticizing a vulgarization of socio-political analysis in which ruling social classes 'plan' and 'organize' inflation, a position which seems unfair to attribute to Fetter or, indeed, to any other serious analyst of the Chilean inflation. And he jumps from there to offer no socio-political explanation of the pre-1925 inflation at all. The same sort of historico-political approach seems to be his explanation for the persistence and increase in inflation occurred in the period 1939-1952. Bad Government ('complacency toward inflation'),[1] bad policies, and the effects of the Second World War and the Korean War are offered as explanations. But, then, we are told that 'the Central Bank had long preached the doctrine - quite a convenient one for the commerical banks which dominated its board of directors - that the budget deficit was the root of inflation'.[2] So that, after all, the 'detective turn of mind' seems to be legitimate in some cases, the problem being that there is no indication about which would be the criteria to discriminate.

His approach changes again when coming to analyse President Ibañez' Government (1952-1958). Now a factor never stressed before, his 'weak and unreliable support in Congress' becomes the main explaining factor due to his 'unwillingness to assume dictatorial powers'.[3] This factor is considered important, again in the case of President Alessandri's Government which he was only able to analyse until mid-term.[4]

In the end, he adopts a variety of what he calls 'the "sociological" theory according to which inflation is due to the excessive claims of various groups against the national income.[5] In order to explain the

1. ibid., p. 187
2. ibid., p. 189
3. ibid., p. 193
4. ibid., p. 218
5. ibid., pp. 199

Chilean inflation of the 1940' and 1950's his version stresses 'cultural' factors, concerning social behaviour towards open conflict and towards compromise.[1] Inflation is considered to be 'a device for the coexistence of several groups who are not hostile or do not feel strong enough to engage in out-and-out revolutionary battles or civil war over the distribution of the social product, yet are not friendly enough either to agree on any one pattern of dividing up the product among themselves This is at least one interpretation that can be given to the Chilean inflation of the last twenty years'.[2] Although inflation can lead to more bitterness and hostility it can also be a good buffer by providing a substitute for other forms of conflicting behaviour. This, he argues, was the Chilean case.[3]

As to the economic aspects of the Chilean inflation, he makes it very clear that he rejects the structuralist approach on the grounds that it is just another example of connecting a pressing problem (inflation) with particular social and economic problems which some sectors want solved, i.e. a device to enlist support for the implementation of social and economic reforms which, otherwise, would not be perceived as urgent.[4] He does not acknowledge any significant link between basic socio-economic factors such as those pointed out by the structuralists and socio-political conflicts.[5] This is consistent with his view that the distributional

1. ibid., pp. 208-9.

2. See Albert O. Hirschman, Journeys Towards progress, op. cit., p. 259.

3. See his 'Inflation in Chile', op. cit., p. 221. See, also his more recent: 'The social and political matrix of inflation: elaborations on the Latin American Experience' in Essays in Trespassing Economics to Politics and Beyond (N. York, Cambridge Univ. Press, 1981), pp. 197-203.

4. ibid., pp. 213-6.

5. He changed his views on this link later on. See Albert O. Hirschman, 1981, op. cit., p. 184.

aspect of these conflicts is not necessarily the crucial one, and that it is conceivable that inflation could persist in a country in which the resulting income distribution would not be different from the one which would exist if there was stability. The gratification for each sector is mainly its ability to engage in conflictive behaviour and to demonstrate its power and antagonisms to other sectors, rather than anything else.[1] Consequently, when inflation increases the cost of this game increases and some sort of device must be found in order to implement anti-inflationary policies without any basic change in attitudes. This would explain the role of foreign missions such as Klein-Saks. However, as will be shown in subsequent Chapters of this thesis, the implementation of stabilization policies was not always the result of mounting inflation, and the political system, rather than some external device such as the Klein-Saks mission, played a crucial role in creating the conditions to make their implementation possible. However, Hirschman did not attempt any systematic analysis of this aspect.

1. See ibid., p. 200 and Albert O. Hirschman, 'Inflation in Chile', 1963, op. cit., p. 209.

E) Summary

Monetarism and Latin American structuralism were alternative and incompatible approaches both from the economic and political points of view. While the former stressed the basically sound character of the Chilean economy and the need to implement policies which allowed the market forces to do the job which - it was stressed - the political system could not do, the latter distrusted the soundness of the Chilean market forces and relied considerably more on the political system not only for regulating the economy but also to create the conditions required for implementing the structural reforms.

Despite the importance of their views on the role of the political system for their own diagnoses and recommendations, the bulk of both monetarist and structuralist literature neglected the analysis of the political aspects of the inflationary process.

Moreover, the few attempts at socio-political analysis of the Chilean inflation of the period between the Great Depression and the end of the 1960's, focused mostly on 'sociological' rather than 'political' aspects, all of them stressing the role of the distributional struggle among different socio-economic sectors - viewed from various different angles - as a crucial inflationary factor.

Consequently, the role of the political institutions and the political process in the Chilean inflation remained still waiting to be properly systematized, the purpose of the next Chapter being to outline the basic approach of this thesis concerning those aspects.

Chapter Three

A Basic Socio-Political Framework

A) Introduction

The purpose of this Chapter is to outline a basic socio-political framework for analysing the Chilean inflation with special emphasis on the political aspects involved, which are the ones most neglected in the literature discussed in the previous Chapter.

Particular emphasis will be placed on the role of the political institutions in the process of achieving accommodation among different socio-economic sectors. Inflation is basically seen as the failure of the political system to achieve such accommodation without allowing inflation to continue. Of course, inflation is a complex phenomenon and even the most effective political system - from the point of view of achieving accommodation - could be unable to prevent inflation completely due to the limited effectiveness of the tools of economic policy and the limited capacity to forsee some significant changes in the economic conditions. However, the kind of double-digit persistent inflation which existed in Chile cannot be explained by such factors. Indeed, in the 1950's and 1960's it cannot be explained either by pointing to ignorance and/or complacency on the part of Governments. Fighting inflation was a high priority in the 1950's and 1960's and Governments had a fairly clear idea about what should be done to stop it, even if each Government held a different view on the subject. As will be seen in the next three Chapters the difficulties were not mainly technical but socio-political. Socio-political factors reduced the coherence of the stabilization attempts and made them difficult to sustain.

However, while rejecting the 'economicism' of those who fail to deal with the socio-political aspects involved in the phenomenon, it is at the same time necessary to avoid the other extreme position which would be to fail to recognize the role of the economic aspects of the phenomenon in the process of accommodation itself. It is particularly important to reject Hirschman's dismissive view of the structuralist approach which he cannot see as contributing in any significant way to his socio-political approach to inflation.[1] This is, of course, the result of his 'cultural' or 'behavioural' version of the distributional struggle because as soon as the substance of this struggle is given its proper place - i.e. as soon as the 'income shares' aspect of it is stressed - the economic factors which affect the rate of growth, the stability and the composition of the country's income become very relevant.

The job of accommodating conflicting demands is not the same in a growing economy and in a stagnant one, and it is not easy at all in one in which huge losses suddenly occur (either because of falling production or worsening terms of trade) and huge sacrifices have to be distributed by the political system, a point consistently made by Pinto's brand of structuralism.[2] However, taking these factors into account does not mean that the political side can be neglected. In fact, the importance of the factors traditionally stressed by the structuralists will be questioned in the following Chapters.

1. See Albert O. Hirschman, 'Inflation in Chile', 1963, op. cit., pp. 213-7.

2. See Aníbal Pinto, Chile un caso de Desarrollo Frustrado, 1973 op. cit., pp. 194-5.

B) Democracy versus Oligarchy. The Basic Conflict

The basic factor explaining the institutional weaknesses which contributed to the persistence of the Chilean inflation was the conflict between the fundamentally egalitarian character of the political system and the extremely concentrated distribution of income, wealth, opportunities and power in general which characterized Chile's economy and society. If power rather than political power is seen as the crucial concept - i.e. if a political economy is attempted - the above mentioned features of the Chilean economy and society can be seen as oligarchic features.

Social conflict was not the result of Hirschman's appetite for conflict. It was the result of a growing appetite for equality in a society in which the collapse of the old forms of social control had started in the 1920's promoted by forces which already rejected the status quo. The process of new forces being 'awakened' by the activity of those in need of allies to fight the old power continued until the very end of the period under scrutiny and even afterwards, during the decisive socio-political crisis which led to the collapse of the democratic system in 1973. President Arturo Alessandri started this process in the 1920's and the Popular Front (at the end of the 1930's and the beginning of the 1940's), the 'ibañismo' and the Christian Democratic 'Revolution in Freedom' can all be seen as major milestones in that process.

However, this was a complex process in which not every aspect of society developed in the same direction and at the same speed. The process tended to create an acute and persistent 'asymmetry' between the distribution of economic and political power. The bulk of the contribution of the Private Sector to overall economic performance in terms of production, savings, investment, export efforts, technological improvement and

employment (though less in the case of this aspect) depended on decisions taken by, and in accordance with the interests of, a tiny proportion of the total population. In other words, the overwhelming majority of the population had no reason to feel responsible for the consequences of those decisions. Under the old traditional forms of oligarchic social control of the 19th century this did not matter very much. But they had started to collapse in the 1920's.

Since social regulation through the mechanisms of the market did not offer any guarantee of improvement towards more equality for the great majority of the population (given the characteristics of the Chilean economy), the role of the political system as a complementary, or even alternative source of socio-economic change and socio-economic regulation was crucial.

However, neither was the economy 'totally oligarchic' nor was the political system 'totally democratic'. That could not have been possible without leading to an intolerable level of social tension. From the point of view of this thesis it is particularly important to recognize that the conflict between democracy and oligarchy was also present inside the political system and inside the institutions of the state itself, as will be shown in other Chapters.

New emerging sections of the business sector were able to benefit from the more egalitarian character of the political system by participating in coalitions with white-collar workers, professionals and small businessmen, and even some sections of blue-collar workers. The same happened with these middle strata which were also able to take advantage of those more egalitarian features to counterbalance the power of the business sector elements in the coalition using the support of blue-collar workers.

At the same time, the oligarchic aspects of the political system, and the leverage of the economic power of the business sector in general, limited the ability of the middle strata to subordinate the business sector element in the coalitions, and limited the ability of the Government in general to use its political power in implementing policies opposed by the business sector. No Government could afford a collapse in 'business confidence', particularly if it was not prepared and/or capable of increasing the level of state involvement in the economy fairly dramatically.

The middle strata also benefited from the less egalitarian aspects of the system when allying with some sections of blue-collar workers. While benefiting from their support, they were also interested in 'keeping their distance' and regulating the distribution of benefits accordingly. A clear example of this phenomenon was the existence, persistence, and the social effects of the legal distinction between white-collar workers (empleados) and blue-collar workers (obreros).

Pinto has described the overal situation as a 'tie' which Davis transformed into a 'political tie'. However, the asymmetric character of the resources of power controlled by each social sector suggest that the concept could be misleading, particularly that of a 'political tie'.[1]

1. See Aníbal Pinto. 1973, op. cit., p. 202, and Tom Davis, 1963, op. cit., pp. 392-3.

C) The Chilean Political System

Although the Constitution was juridically 'presidential', and gave the Executive branch considerable legislative and administrative powers restricting those of Congress,[1] the political system as a whole, including the electoral and party system, worked in practice in a rather different way. In short, the system had some built-in 'incongruencies' which favoured the interests of those who did not want a too strong Executive that could threaten to intervene radically in the economy and society. These features can be described as incongruencies because they undermined both the 'presidential' and egalitarian aspirations which the system was supposed to have crystallized. These incongruencies reflected, first and foremost, the compromises reached between the emerging middle sectors and new sections of the economic élite and the old artistocratic oligarchy which lost its power monopoly during the 1920's, a period which led not only to the Constitution of 1925 but also to a number of crucial laws concerning economic and social regulation such as the budget law, the labour code, and the legislation concerning the monetary system.

The basic built-in incongruency was the existence of an electoral system which promoted party proliferation and political fragmentation and which did not guarantee in any way that the President would have a majority in Congress.

Since presidential elections, which took place every six years, were never held together with parliamentary ones, each of these two branches of the state reflected the balance of political forces at a

1. See Mario Bernaschina, Manual de Derecho Constitucional, (Santiago, Ed. Jurídica de Chile, 1955), i. 62, and Frederico G. Gil, 1966, op. cit., pp. 92-4.

different moment in time. Moreover, the all important upper chamber, the Senate, was only partially renovated so that every four years while a whole new lower chamber had to be elected, only 20 or 25 out of a total of 45 senators were elected.

Due to the electoral calender there were two kinds of Government which alternated. Some Governments had parliamentary elections only four months after they had taken office (i.e. six months after the presidential election) and one and a half before the next presidential election. Such Governments were always considered fortunate because they were in a position to secure a strong position, at least in the lower chamber (this was the case with Presidents Ibañez, 1952-1958, and Frei, 1964-1970). The other Governments inherited a Congress with a lower chamber elected a year and a half before the presidential election and either 20 or 25 senators elected five and a half years before. These were clearly conservative devices which prevented rapidly growing movements such as '<u>ibañismo</u>' or the Christian Democrats from having a favourable Congress, i.e. a majority in both Chambers.

An opposition majority in any of the chambers could always 'bury' a Bill by rejecting it <u>in toto</u>. If it was the chamber in which the Bill had started it could not be discussed again for a whole year. if it was the revising chamber, the other could insist, but it needed two thirds of the votes. In other words, it was impossible without collaboration from some sector of the opposition.

The importance of this legislative weapon did not lie in the possibility of using it all the time to block every legislation. The opposition could not afford to do that, politically, unless they decided that there was enough support in the country for such extreme tactics to be used against the Government. If the Government abused its veto powers, which

were very strong, - Congress needed two thirds of the vote in each chamber to over-ride an Executive veto - it was always possible for the opposition to 'bury' subsequent legislation in toto, thereby punishing the Government and rendering its veto powers totally useless. Hence, this extreme congressional weapon was a powerful deterrent which forced Governments into seeking compromise with sectors of the opposition. Despite their considerable legislative and administrative powers, no Government was able to implement its policies without some level of collaboration from some sectors of the opposition.

Political fragmentation led to the President of the Republic being sometimes elected with a rather precarious plurality - as in 1958 and 1970 - and sometimes with a considerable proportion of his electoral support being 'tactical voting', i.e. votes aimed at keeping somebody else out of the Presidency - as in 1964 - a pheomenon which was less significant in the case of parliamentary elections because of the existence of a system of proportional representation.

This factor clearly undermined the relative strength of the Government vis à vis Congress. The fact that elected Presidents had to be ratified by an absolute majority in Congress did not alter this situation significantly, i.e. it was not a device which provided Governments with a stable majority in each chamber. Traditionally, Congress always ratified the election of the candidate with the largest plurality.

Congress also had considerable delaying powers, the exception being the annual budgetary legislation which was regulated by special constitutional clauses. Although the President had powers to declare a Bill to be urgent - limiting each legislative stage to a maximum of thirty days - in practice, as in the case of the veto pwers, he could

not use them against the opinion of the majority of the chamber concerned without risking the Bill in question being rejected in toto, while the opposition would publicly argue that such a very important Bill needed much more careful study. Moreover, a controversial Bill - and given the political conditions which prevailed in Chile many of them were controversial - frequently went through seven legislative stages, each of them time consuming (particularly the first two).[1]

If Governments had a majority in one chamber it was important for them to have at least one third of the vote in the other one in order to prevent a Bill, having not been rejected in toto, to be successfully modified by the opposition, although there were constitutional restrictions on the rights of amendment of Congress concerning financial legislation, this being a matter of considerable controversy throughout the period under scrutiny (see Chapter Eight).

It is true that Governments only needed on third of the votes and only in one chamber to be juridically able to use their veto powers effectively. However, apart from the above mentioned congressional deterrent which prevented them from risking a major confrontation with the opposition in Congress, there was a more crucial political factor,

1. First stage in the originating chamber, second in the revising one. If anything was modified there was a third stage in the originating chamber and if this one insisted (by a simple majority) there was a fourth stage in the revising chamber which could insist (by two thirds of the vote), the originating chamber being still able to over-ride the revising one if insisting with two thirds of the vote. Then the Bill was sent to the President for the sixth stage in which he decided either to enact it or to veto some of its articles. If there were vetoes Congress was still in a position to over-ride them in a seventh legislative stage if two thirds of the votes in each chamber rejected the vetoes.

namely that the political costs involved in using their veto powers were usually considerable. After all, the opposition usually approved legislation which was popular on balance and the Government's options were either to veto it or to allow the opposition to claim victory.

Ministers were appointed by the president of the Republic and were not answerable to Congress but they were not in a position to defy it either, because the lower chamber had powers to suspend them while being tried by the Senate for crimes as open to juridical controversy as, for instance, not having implemented the law or having violated it.

The President also had ample powers of appointment concerning other public officials but in many crucial public agencies there was a very strong presence of representatives of Congress (until 1961) and the business organizations in their Boards of Directors, the most relevant case, from the point of view of this thesis, being that of the Central Bank in which the Government was in a minority position, and the labour movement had only one representative, this being another aspect of the oligarchic elements present in the state.

The powers of the Government vis à vis the congressional opposition were both more limited than what they theoretically or juridically appeared to be, and they were variable because their actual use depended on the general political situation.

Political fragmentation and competition among political parties were at the heart of the relative weakness of Chilean Governments, particularly in the period under scrutiny, after the 'ibañista earthquake' (see Chapter Four), when the politics of changing and broad alliances of the 1930's and 1940's became clearly worn out. This historical element was evident in the contrast between the pragmatism - or opportunism - of the old centre - the Radicals - and the strong tendency to reject alliances with either the oligarchic right or the marxist left of the Christian

Democrats. And it was also evident in the higher priority which Communists and Socialists gave to their own alliance, placing it before any agreement with other - centrist - forces.

D) The Socio-political Character of the cyclical pattern of the Chilean Inflation

The cyclical pattern of the Chilean inflation is a fundamental aspect of the phenomenon because it reflects the tension between the forces which were working in favour of price stability and the forces which were working against it.

The basic inflationary propensity of a society which was still searching for effective new forms of social regulation, solid enough to avoid inflation, was not an absolute inflationary propensity.

The political system may not have been able to avoid inflation, but it certainly had some institutional characteristics which were effective enough to perform two basic functions:

i) To prevent hyperinflation, i.e. to make it politically impossible or, at least, almost impossible. In other words, a 'limiting function'.

ii) To create political conditions in which major anti-inflationary attempts could be implemented. In other words, a 'stabilizing function'.

As it will be clearly shown in the analyses of the monetary and fiscal institutions (in chapters Seven and Eight), some of the very factors which could be described as sources of Government weakness were responsible for preventing the possibility of an inflationary escalation led by aggressive inflationary fiscal financing such as the ones which caused the most famous hyperinflations of the 20th. century. Chilean Governments were not strong enough to increase taxation as they would

have wanted but they were not institutionally and politically capable of using alternative more inflationary sources of financing without restrictions. In fact, they needed congressional approval to use any source of financing beyond certain limits and those limits did not allow an hyperinflation to develop.

The second function was even more important not only because it was evidently the one responsible for the cyclical character of the Chilean inflation, or at least for most of it as will be shown below, but mainly because it was the one which reflected the existence of powerful political forces working in favour of stability and not just limiting the degree of instability.

The contrast between the 'limiting' and 'stabilizing' functions of the political system concerning inflation can be clearly seen, also, in the differences between the two main cyclical forces which explain the cyclical pattern of the Chilean inflation, namely, the 'inflationary cycle' and the 'political cycle' which in Chile can be more properly denominated as the 'presidential cycle'. And it is worth stressing that neither the former nor the latter is Konkel's "stabilization cycle' discussed in the previous chapter. As it was argued in that chapter, Knonkel's 'stabilization cycle' fails to deal with the role of the political system in a satisfactory way from the point of view of explaining Chile's inflation in the period under scrutiny.

The 'inflationary cycle' can be described as a socio-political mechanism which generates anti-inflationary pressures when inflation increases and which makes them disappear when inflation falls below some kind of 'normal' level. In Chile this 'normal' level seems to have

been around an annual rate of 20.0% to 25.0% in the 1950's and 1960's.

It seems reasonable to suggest that those sectors which were better protected against the redistributional effects of an inflationary acceleration were not the ones which reacted more rapidly and more strongly in the direction of pressing the Government to take immediate anti-inflationary action. First of all they were busy protecting themselves from the acceleration and concentrated most of their efforts in that direction both in the economic and in the political systems. As can be seen, the argument here is very far from anything that could be charged with being the result of the need to satisfy a 'detective turn of mind'. The mechanism is more complex but the conclusion is relatively simple: the more organized and powerful socio-economic sectors would not react very strongly against an inflationary acceleration unless the phenomenon reached a level in which they would not be able to escape its negative effects either, or their own economic and political power was threatened by the accompanying political crisis which would be likely to develop. Hence, the role of the competitive political system which existed in Chile was crucial in 'organizing' the protest of the less organized and less powerful sectors in society, not necessarily by literally 'organizing' and mobilizing them - a process which was probably more important in the long-run than during an inflationary cycle - but by providing 'representatives' for their protests. After all, no matter how influential the most powerful interest groups were in the political parties, these depended on the support of the electorate in general, and the majority of the Chilean electorate were unorganized sectors. To the extent that an inflationary acceleration created a political crisis, it generated the conditions which led to effective anti-inflationary action of some sort or another, thereby producing the downwards phase of the cycle.

However, because of the very essence of this cyclical mechanism this downwards phase did not lead to stability. In fact, as has been already suggested, it lost most of its drive once the 'normal' level of inflation was reached. The 'inflationary cycle' was a limiting factor, not one capable of generating stability.

In contrast, the cyclical socio-political forces behind the political or 'presidential' cycle were relatively independent from inflation, the degree of independence being one of the aspects of the Chilean inflationary experience which will be analysed in the next three chapters which discuss the three Governments of the period under scrutiny.

During presidential campaigns - which were very long in Chile, varying from one to one and a half years - a large proportion of the population became convinced that there was a relatively rapid solution to the economic and social problems of the country and that the key to it was to elect a new President of the Republic. Of course, different people chose to support different candidates but the overall feeling was one of hope.

This widespread feeling of hope benefited the elected President because a significant proportion of the electorate which had not voted for him turned to support him immediately after the election. The first months of the President's term in office were always the period in which he was stronger, not only vis à vis the opposition but also vis à vis his own party or coalition. This pheonomenon created the political conditions required for the Government to be able to implement anti-inflationary policies.

The effectiveness of such anti-inflationary attempts (those being the result of a change of Government rather than an inflationary and political crisis), depended on a combination of economic and political factors which affected the adequacy, internal coherence, and the ability to cope with changes in the economic conditions of the policies actually implemented. But the most crucial factor was the extent to which the Government was able to sustain or, if necessary, correct, the anti-inflationary policies.

The idea that every stabilization attempt necessarily imposed so much restrictions on the level of economic activity and so much hardship on the majority of the population that inevitably eroded the power of the Government to sustain it, is a simplification which does not correspond to Chile's inflation and stabilizations of the period under scrutiny, a point already argued in the previous Chapter. Governments lost support even when they managed to make stabilization compatible with a generally good economic and social performance. This was due to a number of reasons which varied according to each case, but the most crucial one was that a considerable proportion of their intitial support was not solid. Governments were not in a position to fulfil the initial expectations of their supporters, and when disenchantment began to grow, the basic weakness of Chilean Governments, already discussed in the previous sections, began to show more and more. In Chile, even municipal elections and parliamentary by-elections were considered to be tests of strength for the Government and the opposition. Given that elections were very frequent, the political attrition of the Government showed very rapidly. Opposition parties and powerful interest groups became more aggressive, the formal powers of the Executive branch became less effective in reality, and conflict developed inside the party or coalition supporting the Government.

When Governments weakened, inflation increased until either the election of a new President or an inflationary (and political) crisis created the conditions for a new stabilization attempt.

Chapter Four

Inflation and Stabilization during President Ibañez' Government 1952-1958

A) Introduction

The first major stabilization attempt in Chilean history was implemented during the Government of President Ibañez.

Although the attempt started at the end of 1955, it is necessary to begin with the analysis of the inflationary acceleration which occurred during the first half of this Government, between 1952 and 1955, because it was during that period that the conditions which made the stabilization both necessary and possible were created.

The pattern of the inflationary process, during this Government, was completely the opposite to the pattern of the phenomenon during the subsequent two Governments. Inflation increased during the first half, reaching record levels in 1955, and decreased during the second half, as a result of the stabilization effort, although the level of inflation which had existed before the acceleration was not fully restored.

Therefore, it is important not only to explain how the inflationary acceleration and the socio-political processes which accompanied it contributed to make the stabilization possible, but, also, to explain why this acceleration happened at the beginning of a new Government.

B) The 'Ibañista Earthquake'

Although 'double-digit' inflation had been only occasional before the 1940s, it became a common feature during the period of Radical Presidents, from 1939 to 1952, reaching annual rates of more than 20% in six out of fourteen years.

Average inflation was around 20% during the last Radical Government, from 1946 to 1952, and the annual rate was increasing towards the end of the presidential campaign of 1952, reaching more than 25% (see Statistical Appendix, Table A.1). In fact, if the uncorrected official Retail Price Index (RPI) is used, and this was the only one available at the time, the annual rate of inflation had been around 25% throughout most of the electoral campaign.

During the campaign, the Executive and Congress had joined forces to enact several laws which increased wages, salaries and social security benefits, including the establishing of automatic salary readjustments for Government employees which, even though they did not stipulate increases amounting to the full rate of inflation during the previous year, constituted a very considerable inflationary legacy for the next Government.[1]

This wave of new social legislation did not bring electoral success to its sponsors. The electorate rejected the candidates of the more traditional political parties and turned to support, massively, the independent candidacy of former dictator General Carlos Ibañez, which was supported by the Popular Socialists, the Agrarian Labour and a number of very small 'ibañista' groups.

1. The automatic WSR ranged from 90% of the increase in the RPI, for the lowest paid, to 25%, at the other end of the scale, Law 10, 343, 28 May 1952. White-collar workers in the Private Sector, earning less than four times the Minimum Salary, were entitled to 100% of the RPI increase but calculated on the basis of only one Minimum Salary, Law 7295, October 1942.

Ibañez, then 74, was well-known for his anti-party, anti-oligarchic, anti-communist, nationalistic and authoritarian position and, during the campaign, he had not done anything to dispel his image as a prospective dictator.[1] The economic record of his first Government, in 1927-1931, showed him as a very inflexible defender of economic orthodoxy. In fact, his resignation, in July 1931, had been the result of the political crisis caused by the economic effects of the Great Depression, effects which had been considerably increased by the Government's failure to take adequate measures and to abandon the reliance on the automatic mechanisms of the gold exchange standard.[2]

However, after two decades of party politics. changing coalitions and increasing inflation, his political image had become a very valuable asset and, while the parties which supported him had only obtained around 15% in the general parliamentary election in 1949, Ibañez won in September 1952 with 46.8% of the total vote, the right-wing candidate of the Liberals and Conservatives being second with only 27.8%.

Ibañez argued that the solution to the Chilean inflation was well-known and that the country only needed the will and power to carry out an anti-inflationary effort. His campaign was based on a "nebulous catch-all' general platform[3] and he did not want to commit himself to any more definite program.

1. See J.L. Pisciotta, 'Development Policy, Inflation and Politics in Chile, 1938-1958: an essay in Political Economy' (Univ. of Texas at Austin, Ph.D. Thesis 1971), pp. 170-1.

2. See A.O. Hirschman 'Inflation in Chile', op.cit., p.179.

3. See D.W. Bray 'Chilean Politics during the Second Ibañez Government' (Stanford Univ. Ph.D. Thesis 1961), pp. 16-9.

His position was consistent with the very heterogeneous character of the forces which supported him. These forces included authoritarian right-wingers which had been quite prepared to accept leftist participation during the campaign but which, from the moment the new Government took office, sought a political alliance with the traditional right-wing parties in order to implement a stabilization program. They also included the marxist Popular Socialist Party (PSP) which was competing with anti-ibañista marxist parties - the Socialist Party (PS) and the, then illegal, Communist Party (PC) - for the support of important sectors of workers, particularly blue-collar workers. The 'ibañismo' also included a variety of populists, inside and outside the Agrarian Labour Party (PAL), some of them authoritarians who favoured the closure of Congress.[1]

Not surprisingly, the beginning of the new Government was rather confusing. The first Cabinet was very heterogenous and lacked of political consistency, while, at the same time, every 'ibañista' politician was trying to capture the independent support which the president had obtained, and there was a 'mushrooming' of new political parties organised to fight the general parliamentary election which was going to be held only four months after the Government had taken office, in March 1953.

In the meantime, the President, instead of waiting seven and a half months for a more favourable Congress, chose to take advantage of his recent victory and image and asked Congress to grant him broad Extraordinary Powers to enable him to implement economic and administrative measures aimed at curbing inflation without having to fight over every detailed piece of legislation in Congress.

1. See M. Cavarozzi, 'The Government and the Industrial Burgeoisie in Chile 1938-1964 '(Univ. of California, Berkeley, Ph.D. Thesis 1976), pp. 120-1 and 274-6.

The political battle which followed was one of the main factors in the electoral campaign[1], and the opposition, which could not risk a major confrontation with the Government at such an early stage, chose to make the most of their Congressional power in order to reach some compromise. In fact, they managed to introduce a number of important restrictions in the law, including the exclusion of the Board of Directors of the Central Bank from any reorganization, and considerable restrictions on the capacity of the Government to remove civil servants from their jobs[2] (the full implications of such measures from the point of view of the politics of inflation are analysed in Chapters Seven and Eight, respectively).

The general parliamentary election in March 1953 was won by the '_ibañistas_', who increased their support to 50% of the total vote, although they were one seat short of both a majority in the Lower Chamber and the minimum third required in the Senate (see Table 4.1, below).

However, given that the opposition included right-wing, centre and left-wing parties there would have been some scope for cooperation from some sectors of the opposition, had it not been for the tendency of the Government to attack the political parties in the opposition as a whole, thereby creating the conditions for them to unite against the Government.

1. The highlight of the campaign from the point of view of the '_ibañistas_', however, was the visit of President Perón of Argentina, in February.

2. See René Montero, _Confesiones Políticas_, Santiago, Ed. Zig-Zag, 1959, p. 180 and _EMS_ 23 Jan. 1953 pp. 9-11 and 30 Jan. 1953 p. 13.

The two major weaknesses of the Government in terms of Congressional support were this excessive hostility towards the opposition and the divisions and conflicts inside the 'ibañismo'. In fact, the Government was not going to be able to implement sustained economic policies until inflation, and the plitical crisis which accompanied it, created the conditions for the Government to solve their internal conflicts and change the relations with the opposition, or at least one sector of it.

Table 4.1

Electoral Results in the September 1952 Presidential and March 1953 Parliamentary General Elections.

	Presidential 1952	Parliamentary 1953	Deputies Total	Senators New	Senators Total
Liberals (PL)	27.8	10.6	22	4	11
Conservatives (PCT)		10.1	16	3	6
Conservatives (PCSC)		4.8	2	0	1
Falange (FSC)		2.9	3	0	1
Democrats (PD)		1.5	1	0	0
Radicals (PR)	19.9	13.4	19	4	10
FRENAP (PS/PC)	5.5	5.0	8	1	1
Pop. Socialists (PSP)		8.8	19	3	4
Agrarian Labour (PAL)		15.2	28	5	5
Other 'ibañistas'	46.8	26.0	26	5	5
Other	-	1.8	3	0	1
Total	100.0	100.0	147	25	45

Source: Official figures, Registro Electoral

Seats: J.L. Pisciotta, 1971, op. cit. Table 13, pp. 264-8.

C) The failure of the left-wing 'ibañistas'

Open conflict inside the Government started quite soon, and a month after the election the Popular Socialists withdrew from the Cabinet, offering to maintaining their Congressional support only if certain conditions were met.[1] During this Government there were going to be frequent changes in the Cabinet not only due to major political readjustments but, also, because the President had to repay political debts to a large number of individual politicians. Thus, continuity was not a characteristic of the Cabinet during this Government and the average period in office of a Minister, throughout the six years, was less than seven months.[2]

Not surprisingly, it was not Finance Minister J.B. Rosetti, a key factor in the negotiations with the opposition which led to the enactment of the Extraordinary Powers, but the next Finance Minister, the Popular Socialist Felipe Herrera, the first which was able to implement anti-inflationary measures in the context of that legislation. The Government had already used that legislation to give more powers to the Central Bank, particularly to allow it to impose qualitative and quantitative controls on credit, to vary reserve requirements

1. The Popular Socialist Minister of Labour had been implementing a pro-workers policy but he clashed with Ibañez when supporting workers against a conspicious 'ibañista' tycoon. See Edecio Alvarado, El Turco Tarud, (Santiago, Ed. Terriotorio. 1970) pp 67-8.

2. See D.W. Bray, Stanford Univ. Ph.D. Thesis 1961, op. cit., p. 3.

and to control the volume of rediscount. Moreover, the Government had created a State Bank, a National Institute for Trade (INACO) for regulating foreign trade and centralizing Public Sector Purchases, and had broadened the functions of the department in charge of price controls. In short, if there was some continuity at the beginning of the Government, its main feature was the development of new devices aimed at increasing state intervention in the economy.

In fact, business organizations were campaigning very strongly against the increase in State intervention and particularly against a project of law concerning 'economic crimes' such as speculative hoarding and violation of price controls, which had been proposed by the Government.

It is important to stress that these general features of the economic policies of the Government were not the result of the influence of the Popular Socialists alone.[1] On the contrary, most of the measures had been proposed and implemented by other sectors in the Government.[2]

However, when the Finance Minister, the Popular Socialist Felipe Herrera, tried to implement effective measures against inflation, everybody in the opposition, including the left, opposed them, and vast sectors of the 'ibañismo' deserted him. His package of policies was a compromise between orthodox economic policies, of the kind advocated by the IMF, and leftist concern about the living conditions of the wage-earners. He was the first Minister to implement measures in the direction of eliminating the system of multiple exchange rates, and he was also the first to implement quantitative restrictions on the monthly rate of expansion of credit. At the same time, he decreed

1. The PSP came back to the Cabinet for a second time after the conflict concerning the former Minister of Labour was over.
2. Particularly the Agrarian Labour leader Rafael Tarud and the leader of the authoritarian group which published a periodical called El Estanquero, Jorge Prat.

a price freeze for approximately 300 essential items, which was largely ineffective, as usual, and obtained from Congress legislation to give compensation to wage- and salary-earners in terms of increases in wages, salaries and family allowances. These compensatory measures were needed because the increases in a number of nominal exchange rates were going to cause price increases affecting essential goods.

The business organizations had welcomed the foreign exchange measures but they did not like the general approach of the new Minister. In fact, conflict erupted when the Finance Minister, addressing the lower Chamber, argued that the notion that social progress had been financed by reducing the resources available for private capitalization, should be discarded, and that only a very small proportion of the workers, the best organized, had obtained benefits during the past decade. He, then, went on to argue that a radical Tax Reform reducing indirect taxation and increasing progressive income taxes, was needed, and that he intended to use the newly acquired powers of credit control of the Central Bank, very firmly.[1]

Again, increasing taxation and restricting credit expansion were not unorthodox measures against inflation, but the business sector did not like the idea of making sacrifices in the context of what they regarded as socialist policies implemented by a marxist Minister. In that, they were supported by the right-wing Liberals and Conservatives, while the Radicals increased their opposition due to the Minister's implication that the social record of their Governments had not been as good as they wanted everybody to think it had. Even the marxist

1. See 'Exposición del Ministro de Hacienda Felipe Herrera ante la Cámara, 14 July 1953' in Felipe Herrera, ¿Desarrollo Económico o Estabilidad Monetaria?, (Santiago, Ed. Jurídica, 1958), pp. 55-88.

FRENAP (PS/PC) campaigned against the measures, although they emphasized different aspects, rejecting the foreign exchange measures, asking for more radical redistributive measures, and denouncing the existence of right-wing authoritarian politicians inside the Government.[1]

In fact, the whole opposition united to fight a by-election for a Senator in the Province of Santiago (approximately 36% of the national electorate), focusing the campaign on the defense of Congress and the democratic system against Government threats, and the rejection of foreign - Peronist - intervention. Moreover, they accused the Government of having failed to use the Extraordinary Powers, which Congress had granted them for six months, for implementing effective anti-inflationary measures, and of having disorganized the civil service, increased inflation and caused uncertainty.[2] In a clear demonstration of the conflicts within 'ibañismo', the supporters of the Government failed to unite, fought the campaign divided behind three candidates and lost, despite having obtained a little more votes than the candidate of the opposition. Since the official PSP-PAL candidate came last among the 'ibañistas', the Cabinet had to resign.[3]

The new Finance Minister, Guillermo del Pedregal, was very well-known as an advocate of unrestricted and cheap credit in order to support economic development. Hence, the quantitative restrictions on credit expansion, introduced less than a month before, did not survive the change in the Cabinet.

1. Senate Proceedings, 22nd. Ordinary Session, 25 August 1953, in EMS 28 August 1953 pp. 7 and 19.

2. See EMS 5 Sept. 1953 p. 11.

3. See EMS 8 Oct. 1953 p. 13.

However, the fact that inflation increased from an annual rate of around 30% to around 70% during his eight months in office[1], from October 1953 to June 1954, cannot be explained by the lack of monetary restrictions. In fact, this monetary policy only ratified, rather than caused, this increase in the rate of inflation. The average monthly rate of inflation had reached 7% during the third quarter of 1953, (during the previous Finance Minister), and it was 5.9% in the second semester as a whole, i.e. the equivalent to an annual rate of almost 100%. Inflation was only around 50% during 1953 because there had been a very low rate of inflation during the first semester, when the Government had not implemented any special anti-inflationary measures yet.

The high inflation which started in July 1953 can be explained by the simplification of the multiple exchange rates system which in practice involved a considerable devaluation. For approximately 60% of the imports the devaluation was more than 80%.[2] Moreover, copper exports fell during 1953 due to the post-Korean War situation in the international market, and this affected the country's capacity to import and the contribution of this sector to the fiscal revenue. As a result, even though the Government managed to restrict the increase in fiscal expenditure (particularly by reducing public investment) the fiscal deficit, which was already high in 1952, continued to increase.[3]

Finance Minister Herrera was unable to implement the Tax Reform, credit restrictions did not last and price controls were not effective. At the same time, the domestic price of imports, wages, salaries and

1 If the official RPI, available at the time, is used, the increase was from 31.2 to 82.5%. However, using the correction introduced by the Central Bank in Nov. 1959, the increase was from 27.8 to 70.8%.

2. See Ricardo Ffrench-Davis, Políticas Económicas en Chile 1952-1970, (Santiago, Ed. Nueva Universidad, 1973)p. 258.

3. President Ibañez' government was the only one, among the three governments which are analysed here, that did not increase public expenditure dramatically at the beginning of their term in office, (See Chapter Eight).

social security contributions had, all, increased considerably. In fact wages, salaries and social security contributions generated an additional cost-push, on top of the one caused by the devaluation (See Chapter Nine also). Thus, the increase in the rate of inflation was the result of the economic and political resistance to income redistribution which the sectors threatened by Minister Herrera's approach to distributing 'sacrifices', were able to implement.

The new Finance Minister, Guillermo del Pedregal, had only come to preside over a situation which he had not created and he was neither technically nor politically capable of solving. He was a symptom of the disease, not its cause.

The Government blamed Congress for interfering with their economic policies but the real problem was that neither the President of the Republic himself, nor any other sector of the 'ibañismo' was capable of providing the kind of leadership which was required to overcome the internal conflicts between Government supporters, and to use the Congressional power they had. The Government lacked precisely what the President had offered during the presidential campaign.

When the President tried to broaden the support of the Government by inviting the prestigious leader of the small Christian Social Falange, Senator Eduardo Frei, to negotiate the formation of a new Cabinet, he found that he was not in a position strong enough to resist pressure from the Agrarian Labour Party and other 'ibañista' groups which did not want to loose their Cabinet posts and resented the prospect of a 'technical' Cabinet which was what Senator Frei had asked for.[1]

1. Senator Frei had asked for a 'technical' Cabinet and free hand to implement fiscal and monetary measures but, of course, the President could not give him what he himself did not have. For Senator Frei's conditions see Ernesto Wurth, Ibañez, Caudillo Enigmático,(Santiago, Ed. del Pacífico, 1958,) pp. 291-2.

   For the PAL attitude, see EM S 5 June 1954, pp. 1 and 15.

D) The failure of the Authoritarian 'ibañistas'

After the failure in his attempt to broaden the political base of the Government, President Ibañez turned to the authoritarian sectors which supported him and formed a Cabinet of 'estanqueristas'[1], military officers and independents, in which the key political figure was the new Minister of Finance, and former President of the State Bank, the leading 'estanquerista' Jorge Prat, well-known for advocating a variety of 'shared sacrifices' imposed from above.

This change in the Cabinet opened a period of six months (the second semester of 1954) in which the degree of conflict between the Executive and Legislative branches increased almost continuously, with the Government creating a committee to study a Constitutional Reform aimed at reducing the powers of both Congress and the General Controllership, and the opposition campaigning united against the authoritarian features of the new Cabinet.[2]

Finance Minister Prat reintroduced quantitative controls on credit expansion and implemented other restrictive monetary measures which reduced the increase in high-powered money so much that private banks found it difficult to make full use of the authorized levels of expansion.[3] In spite of the increasing level of conflict between the Government and the opposition, the Minister also managed to get some increases in taxation which compensated some of the effects of inflation on direct taxation collected with a lag, and did not alter the Tax structure in any significant way (See Chapter Eight).

1. Authoritarian group which published a periodical called El Estanquero.

2. See, for instance, a public declaration from the opposition denouncing the campaign of the Government to discredit Congress, in EMS 31 July 1954 pp. 1 and 19.

3. See Ffrench-Davis, 1973, op. cit. pp. 121-2 and R. Zahler et al, Estadísticas Monetarias de Chile 1940-1975,(Santiago, Dpto. de Economía, Univ. de Chile, Publicación No. 70, 1979,) p. 84.

These measures were not effective in reducing inflation, which continued with an average monthly rate of around 4.5%.

After three months in office, Finance Minister Prat announced, in mid-September, that the Government would send a complete legislative package for 'Economic Rectification' to Congress, aimed at curbing the wage-price spiral 'as recommended by the IMF'.[1] To start this anti-inflationary effort the Government asked for an IMF Mission to advise on further steps toward the elimination of multiple exchange rates.

The nominal foreign exchange rates had remained more or less constant since the devaluation in July 1953,[2] while the accumulated inflation had reached around 85% in October 1954 (more than 100% if the official RPI available then, is used). Hence, the Government implemented a new devaluation of a little more than 80% which had been studied jointly with the IMF Mission, and immediately afterwards announced the Plan for Economic Rectification which was based on wage and salary readjustments only for the minimum wage and salary and restricted to 60% of the previous increase in the RPI, in 1955, and 80%, in 1956. Strikes were to be forbidden, there was to be compulsory arbitration and pensions were to be granted only after 35 years of actual work. On the other hand, blue-collar workers were to have, at last, a minimum wage and there was to be a massive program of low-cost housing. Businessmen were to face the continuation of quantitative restrictions on credit expansion, price controls, increased taxation and restrictions on the distribution of dividends. The program would be regulated by a Junta for Economic

1. See EMS 11 Sept. 1954 p. 15 and 24 Sept. 1954 p. 19.

2. In fact the exchange rate which applied for the US dollar had remained constant but not the others, the result being further distorsions in the foreign trade structure.

stabilization with Government, unions and business organizations representatives, similar to one which had been proposed by Minister del Pedregal at the beginning of the year.[1]

Everybody rejected the Plan. Business organizations, because they rejected increases in taxation and considered the Plan to amount to an increase in State interventionism. The unions, because they rejected the restrictions on wage and salary readjustments and the suspension of the right to strike. In fact, the announcement of the Plan only contributed to increase the degree of tension, which was already high due to the fact that Government had taken advantage from the annual Congressional recess to decree the State of Siege justifying this measure by pointing to the level of social unrest which the Government blamed on 'the subversive activities of the Communists'. The Government had asked Congress to pass Extraordinary Powers to deal with the situation, but no opposition party, except for the Traditional Conservatives, had accepted that they were needed, and it had been then that the Government had waited for the recess to decree the State of Siege.[2]

The plan for Economic Rectification did not survive the political crisis which developed in December 1954, when the new Interior Minister, Olavarría Bravo, refused to implement the ending of the State of Siege which had been voted by both houses of Congress. Finally, the State of Siege was ended in exchange for the withdrawal from Congress of a

1. The whole Plan can be found in EMS 22 Nov. 1954 p. 23 and 23 Nov. 1954 p. 19.

2. The Minister of the Interior General Parra justified the measure by listing three 'offensive' public speeches by union leaders and political opponents and pointing to the level of strike activity. In fact, 0.7% of the labour force were striking at the time. See Olavarría Bravo, Chile entre dos Alessandri, (Santiago, Nascimento, 1962), ii. 274.

Constitutional impeachment against the Minister involved, the whole Cabinet was reorganized and Minister Prat was not retained. In short, the authoritarians had failed also.

E) 1955 and the Inflationary Cycle at work

At the beginning of 1955, President Ibañez turned back to the Popular Socialists but negotiations to form a Cabinet broke down. Then, he tried his archi-enemies, the Radicals but they also turned him down. Finally, he organized a Cabinet dominated by the Agrarian Labour Party (PAL) which came to preside over a situation of great political anxiety, high inflation and rumours of a pro-Ibañez military conspiracy.

In the meantime, 'ibañismo' was disintegrating, conflict between different sectors had become more and more violent,[1] and its electoral support had collapsed. In January, in a by-election for a Deputy in the First District of the province of Santiago (approximately 15% of the national electorate), the opposition united, with the exception of the Traditional Conservatives, and won the election increasing their vote from 39.3%, in March 1953, to 64.9%. The 'ibañista earthquake' was already over.

1. For instance, former Minister Prat resigned his post as President of the State Bank when the PAL launched a violent attack against his policies. See EMS 11 March 1955 p. 1.

The increasing unpopularity of the Government and the overwhelming rejection of a military takeover by all the political parties in the opposition, the business organizations and the unions, provided the conditions for the conspiracy to be denounced and destroyed.[1]

The President had only one alternative left if he was to serve out his term, and that was to compromise with some sector of the opposition.

Since the beginning of the Government, some right-wing sectors of the 'ibañismo' had been trying to build an alliance with the traditional right-wing parties. In fact, those activities had been one of the ingredients in the Cabinet crises in October 1953 and March 1954.[2] Ibañez had been the presidential candidate of the right-wing parties in 1942, so that a right-wing alliance including Ibañez was nothing new.

Now, it was their turn, and things were made easier by the prospect of a Mission of U.S. experts, with impeccable right-wing record, coming to the country to advise the Government on the implementation of measures to stabilize the economy.

Since the beginning of the year the Government had been negotiating with the U.S. consulting firm Klein & Saks which had previously sent a Mission to Perú, by the end of the 1940s, in order to advise the right-wing dictatorship which ruled in that country at the time. The firm had a reputation of having good connections with the U.S. Republican administration and the U.S. financial institutions,[3] so that the international

1. The examples of the firm attitude of all these sectors are numerous. See, for instance EMS 25 March 1955 pp. 1 and 23.

2. See M. Cavarozzi, 1976, op. cit. pp. 274-6.

3. See A.O. Hirschman, 'Inflation in Chile', op. cit., p. 202.

financial support which seemed necessary to implement an effective anti-inflationary program, was considered easier to obtain with the help of such a Mission.

However, there can be very little doubt that the Mission was more than a mere device to attract foreign resources. Moreover, its role in facilitating the right-wing coalition which supported the stabilization attempt, cannot be reduced to a mere effect of its contribution to improve the prospect of foreign support, as Cavarozzi suggests.[1] What the Mission provided was a limited but crucial guarantee that the kind of economic policies which the right-wing parties and the business organizations wanted implemented, i.e. policies aimed at reducing State intervention in the economy, were not going to be abandoned by the Government in the middle of the stabilization. If the Government departed from the liberal economic policies which they wanted, conflict with the Mission's advice would become evident and the Government would be left in a very uncomfortable position. That is why the business sector and the right-wing parties also welcomed the announcement by the Government, that the new Finance Minister Oscar Herrera, a key figure in the negotiations between the Government and the right-wing parties, was going to remain in that post, and as Minister of Economy, for a long time.[2]

As Hirschman rightly suggests[3], the Mission also contributed to the right-wing coalition by making it possible for each side to claim

1. See M. Cavarozzi, 1976, op. cit., p. 288.
2. See EMS 4 October 1955 pp. 1 and 19.
3. See A.O. Hirschman, 'Inflation in Chile', op. cit, p. 204.

that they were following the advice of foreign 'impartial experts', without having to concede anything to the other side after years of fighting against each other. However, the contribution of the Mission to the coalition must not be exaggerated. Collaboration between the Government and the right-wing political parties started well before the arrival of the Klein-Saks Mission, particularly concerning measures against the activities of the unions and the CUT. In this important area neither side seem to have needed to disguise their collaboration, and both seem to have found plenty of justification in pointing to their 'partriotic duty' at a time of national crisis and the need to stop'communist subversion'.

With inflation at an annual rate of around 75% and no economic growth since 1953, there was a growing feeling of urgency which helped to overcome the hositility and the accumulated bitterness between the two right-wing sectors. In other words, the Mission was a useful device but the political will which made it possible was a result of the inflationary and political crises themselves.

In mid-September 1955 when the Mission began arriving in Santiago, the Senate had already approved the granting of Extraordinary Powers to the Executive in order to deal with the increasing level of social unrest. When the centre-to-the-left opposition managed to delay them in the Lower Chamber, the Government did almost the same as in 1954, taking advantage from the Congressional recess to decree the State of Siege in six provinces. But this time the opposition was not united to fight against it, and no major Constitutional conflict followed.

F) The First Major Stabilization Attempt

The Klein-Saks Mission did not publish a comprehensive program at the beginning and preferred to develop its recommendations step by step. However, its economic liberalism was clear from the beginning, and it was not difficult to guess the subsequent measures which the Mission was going to recommend. In fact, most of the measures recommended by the Mission had already been suggested, and in some cases implemented, in 1953-54.

The first battle of the stabilization effort was fought around a project which restricted wage and salary increases to 50% of the increase in the RPI during the previous year. The project also included tighter price control for essential goods, administrative measures to reduce public expenditure and other measures about family allowances and the minimum wage, but the proposal which met more opposition was the restriction on wage and salary increases. However, against the opposition from the CUT, the two Socialist Parties, the Radicals and the Christian Social Falange, the project was approved with 55% of the vote in the Lower Chamber. But the battle was not over. Due to disagreement with recent measures concerning the determination of some controlled prices, the Liberals withdrew their party instructions to vote in favour in the Senate, and after two tied votes, the project was approved by only one vote which was provided by a Christian Social Conservative Senator who was persuaded to attend the next vote and to defy his party instructions. The project had been saved but the Liberals had also signalled their intention to make the most of their Congressional power and to influence the economic policies effectively.

Since the CUT had announced an indefinite national stoppage starting less than a week later, the Government closed the Extraordinary Period of Legislation,[1] and taking advantage, yet again, of the Congressional recess, decreed a nationwide State of Siege for two months, and jailed a considerable number of prominent union leaders. These measures and a certain degree of 'strike fatigue' explain the complete failure of the stoppage and the inability of the unions to oppose the legislation effectively. Thus, the new law was promulgated by the Government shortly afterwards. The first battle of the new stabilization attempt had been won by the Government.[2]

The second offensive of the stabilization attempt was launched in the foreign exchange area. Having the victory over the unions and the centre-to-the-left opposition in their hands, to show as a guarantee of effectiveness, the Government started to negotiate a set of loans with the IMF and some US financial institutions. These loans were aimed at creating a fund to support measures in the direction of a free foreign exchange rate which had been proposed by the Klein-Saks Mission. They received immediate and strong support from the business organizations, the Liberals and the Conservatives. In the meantime, the tightening of the quantitative controls on credit expansion and other measures aimed at reducing the rate of monetary expansion were postponed until the foreign exchange reform and the measures concerning foreign trade,

1. Congress did not meet between September and May unless convoked by the Executive branch. This was called Extraordinary Period of Legislation.

2. See 'Informe del presidente al Primer Congreso Nacional Ordinario de al CUT', 1957, quoted in Jorge Barría, Trayectoria y Estructura del Movimiento Sindical Chileno,Santiago, INSORA, Univ. de Chile, 1963, pp. 103-4.

had already been secured. These measures included one of the main new devices proposed by the Mission : the replacement of the system of import quotas by a system based on a list of permitted imports combined with advanced import deposits which varied according to the kind of item. This device complemented the restrictions on credit expansion by absorbing money which, otherwise, would have been available for other uses.

The IMF approved the foreign exchange measures and agreed on a stand-by arrangement which, together with loans from the US Treasury and some US private banks, provided a stabilization fund amounting to 20% of the average annual imports in the previous two years.

However, when the monetary and foreign sector measures were implemented in April, inflation had already fallen considerably. In fact, the monthly rate had been very high in January, at the beginning of the attempt, reaching 9.2%, (although the official index available at the time did not register such an increase, but only 3.6%). As a result, January 1956 had the record level of annual inflation (measured by either the official or the corrected RPI: 84.3% and 105.3% respectively), but as a result of the sharp fall in the monthly rates from February onwards, the annual rate of inflation had fell by one third in three months (reaching 59.3 or 71.0% in April). In other words, the monetary measures came to reinforce this trend but the direct measures affecting the wage-price spiral were the ones which started it.

This combination of measures prevented the devaluation implemented in April - which amounted to an average 65% for visible trade[1] - from causing the disastrous inflationary effects that the devaluations implemented by Finance Ministers Felipe Herrera and Jorge Prat in 1953 and 1954 had caused. Thus, inflation continued to fall after the devaluation.

1. See Ffrench-Davis, 1973, op.cit., p.77.

There had been another reason to postpone the devaluation to April, and that was the general municipal election which took place at the beginning of that month. This election, however, lacked political significance given the circumstances, and there was a record level of abstention, particularly in the Capital. The results confirmed the collapse of the support for the 'ibanistas', and the recovery of the traditional parties, but they also showed that the left had done very badly, most probably because it had not been able to campaign with full strength due to the general political situation.[1]

The right-wing parties were very successful throughout this period not only because they managed to avoid political erosion, despite their participation in the stabilization attempt, but also because they managed to block or water down those measures which they, and the business sector, did not want implemented. In fact both a project of anti-monopoly legislation and a project of legislation against speculative hoarding and violations of price controls were successfully stopped, and the Tax Reform sent to Congress in April was only promulgated in August, seven months later than the wage and salary readjustment which was supposed to finance, Congress having reduced the increase in taxation on real estate and rejected the indexation of direct taxation collected with a lag, i.e. income tax.

1. Repressive measures continued to be implemented. See Senate Proceedings, 10th. Ordinary Session, 18 April 1956 in EMS 21 April 1956 p. 13.

G) Stabilization, General Elections and the Inflationary cycle

Although the annual rates of inflation were still high after six months of stabilization, between January and July the inflation had only been 10.4% (or 12.6% if the official RPI is used), which was a tremendous improvement on the 47.2% (35.9%) registered in the previous semester.

However, the foreign exchange situation had deteriorated, and although the situation was not critical, the prospects were not good, so the Mission was recommending new measures to restrict imports.[1] Consequently, from the point of view of the stabilization attempt, a relaxation of the restrictions on credit expansion was becoming less and less acceptable precisely when the pressure to do so, from the business organizations, was increasing.

The pressure from the unions, which demanded compensatory wage and salary increases, was also increasing throughout the year, and all these pressures were becoming more and more difficult to check as the next very crucial general Congressional election, to be held in March 1957, came closer. Since the inflationary process seemed already under control, other objectives increased in importance.

The election was crucial not only because 40% of the seats in the Senate and a completely new Lower Chamber was going to be elected but, also, because the next presidential campaign was likely to start very soon afterwards.

1. See, for instance, 'Memorandum to the President of the Central Bank of Chile', 17 August 1956 in Mision Klein-Saks, El Programa de Estabilización de la Economía Chilena y el trabajo de la Misión Klein-Saks,(Santiago, Ed. Universitaria, 1958),Appendix, Chapter 12, pp. 72-78.

The Agrarian Labour Party was trying to increase their presence in the Government, and particularly in the Cabinet, so that there were considerable pressures from this and other sectors for President Ibañez to reorganize the Cabinet.

Thus, when Minister Oscar Herrera, one of the architects of the right wing coalition and the 'strong-man' behind the stabilization, opposed increases in wages, family allowances and other compensatory benefits on the grounds that there were no resources available to finance them, the President asked him to leave his post as Minister of Economy - remaining only as Finance Minister -, a move which led to his resignation.

Hirschman's suggestion that Ibañez replaced Oscar Herrera because of political jealously does not seem justified. Neither does his suggestion that in Chile, this always happened between Presidents of the Republic and strong Finance Ministers leading stabilization efforts.[1] In fact, the evidence points to an explanation which is precisely the opposite to the one suggested by Hirschman. It was not their popularity but their unpopularity, the personal political 'wear and tear' occurred in the process of implementing measures resisted by sometimes wide and sometimes narrow but powerful sectors, that led to their replacement.[2] Minister Oscar Herrera had to resign because his capacity to resist pressures had decreased and a more flexible approach was needed to accommodate demands before the general election.

1. See A.O. Hirschman, 'Inflation in Chile', op. cit., pp. 210-11.

2. The same happened with Finance Minister Jorge Alessandri in 1949-50 and with the Minister of Economy, Mining and Finance Roberto Vergara in 1959-60.

The Chilean electoral system, i.e. the degree of competitiveness among political parties and the high frequency of general elections,[1] undercut the strength of the Finance Minister well before the end of the Government's term in office.

The general Congressional campaign of 1956-57 was very intensive. 'Ibañistas' such as the Agrarian Labour Party wanted to get more credit for the degree of progress made against inflation while, at the same time, they wanted to show more concern and flexibility about the protests from business organizations and unions. The Government was even studying a reduction in the interest rates and this astonished the Klein-Saks Mission because they were still considerably negative in real terms.[2] The Liberals and Conservatives wanted to look less close at the Government and they made the most of the replacement of Minister Herrera, arguing that there was justifiable concern about the continuation of the stabilization effort, particularly because one of the aspects which they considered crucial, the implementation of public expenditure cuts, was still on paper. The Radicals, Falangists, and the FRAP focused their campaigns on the lack of economic growth and the battle around the annual wage and salary readjustments at the end of 1956, in which they were also supported by the Agrarian Labour Party. After an intensively fought legislative battle, the right-wing majority in the Senate and the prospect of the Executive using its veto powers forced the opposition into accepting a compromise on a readjustment equivalent to four fifths of the increase

1. In the period 1952-1970 there were no general elections only in 1954-55, 1959, 1962, 1966 and 1968, and although some of them were Municipal elections, even these affected economic policies because most of them were considered important tests of political strength, 1956 being an exception.

2. See 'Exposición ante la Comisión Mixta de Presupuestos del Congreso Nacional, 6 Nov. 1956' in Misión Klein-Saks, 1958, op. cit., pp. 126-7.

in the RPI 'i.e. 30% instead of the 25% proposed by the Government), which still was a very good result from the point of view of the Government, considering the circumstances. Moreover, this increase applied only in the case of the Private Sector, while the Public Sector obtained only the 25% proposed by the Government.

The electoral results in March 1957 confirmed the total collapse of the 'ibañismo' which was left with only a handful of Senators and Deputies, very far from the minimum third required in each Chamber, and without a majority even if supported by the Liberals and Conservatives (see Table 4.2).

Table 4.2

Electoral Results in the March 1957 Parliamentary Election

		Seats in Congress	
	Votes (%)	Deputies	Senators
Traditional Right (PL/PCU)	29.1	57	16
Christian Social (PCSC/FSC)	13.2	17	1
'Ibañistas' (PAL and Other)	11.7	13	6
Radicals (PR)	21.5	37	9
FRAP (PSP/PS/PD/PC/PLA)	17.7	21	9
Other (PNA and Independents)	6.8	8	4
Total:	100.0	147	45

Source: Official figures, Registro Electoral

Seats: J.L. Pisciotta, 1971, op. cit., Table 13, pp. 264-8.

No further progress in the anti-inflationary effort was politically possible, and the country had to wait a year and a half for a new Government with enough strength to attempt new measures. In fact, whichever index is used, inflation did not change very much between Jan-Feb. 1957 and the end of the Government, oscillating around an annual rate of approximately 30%, i.e. around 50% higher than the rate of inflation which had prevailed before the 1953-55 acceleration (the average rate of inflation in 1947-52 was approximately 20%). In other words, the rate of inflation was too close to what could be considered a 'normal' rate, at the time, to promote political cooperation so close to a presidential election.

The unpopularity and internal weakening of the Government provided the background for a violent outburst of street rioting in the Capital Region only a month after the March 1957 parliamentary election, the immediate cause being an increase in urban transport fares decreed by the Government. The Interior Minister, Colonel Videla, contributed to the riots by withdrawing the police from the streets. As a result, the Cabinet was reorganized. Not surprisingly, the new Cabinet proposed Congressional involvement in any increase in controlled prices higher than 25% but, as could be expected, the proposal got nowhere in Congress.

The reduction of subsidies on controlled prices, including transport fares, finally occurred in July, after a change in the attitude of the Government which established contacts with the unions which had organized a Coordinating Committee - together with the student unions - in order to fight the increases. As a result, street violence was avoided but measured inflation regained impetus for a couple of months, although a new acceleration was avoided as a result of considerable

reductions in food prices during the last quarter of 1957. (See Statistical Appendix, Table A.1).

Since several attempts at freeing prices had failed either because the general economic situation was unsuitable or because the monopolies and other forces restricting competition were ready to take advantage of the new freedom, and imposed very high increases,[1] the Government was still trying to obtain anti-monopoly legislation from Congress by the end of their period in office. However, even though very similar legislation was going to be approved by the same Congress at the beginning of the next Government, it was not possible at the tail end of this Government, which had lost most of its credibility.

During the presidential campaign, President Ibañez seemed more concerned about posterity than anything else. After all, he was 80 and knew that his political life was ending. He did not want inflation to increase again but he also wanted some degree of reconciliation with the centre-to-the-left opposition. Hence, he cooperated with these sectors in enacting an electoral reform aimed at reducing electoral bribery, practised particularly by the right-wing parties in the rural areas, and new legislation on Internal Security which included the legalization of the Communist Party after ten years of illegality.

1. See EMS, 6 Dec. 1956 p. 33, 6 May 1957 p. 3, 16 July 1957 p. 1 for clear examples in the case of essential goods such as bread, milk and rice.

H) Summary

The Government of President Ibañez started with an inflationary legacy which included an annual rate of inflation of around 20%, new restrictions on the possibility of reducing public expenditure due to benefits approved during the presidential campaign, and the existence of considerable import restrictions combined with multiple exchange rates, which amounted to 'postponed' inflationary pressures from the point of view of a Government which was going to try to implement a liberalization of the foreign sector.

Monetarism was very influential in Chilean policy-making during this Government, but the abortive attempts at stabilization in 1953 and 1954 combined orthodox monetarist measures with other measures which did not belong to the economic liberalism which was behind the monetarism advocated by the IMF. As a result, the business sector had two reasons to oppose those attempts instead of one. They not only rejected the prospect of a deflation but also the prospect of the state increasing its intervention in the economy.

Hence, it was only in the context of the inflationary and political crises of 1955, that monetarism was able to overcome the socio-political barriers which had destroyed previous attempts. Instead of everybody opposing it, the business sector and the right-wing political parties agreed to support an orthodox stabilization effort, including credit restrictions, after the Government gave some guarantees that economic liberalism would be consistently implemented.

However, the right-wing coalition which made possible the implementation of the anti-inflationary policies did not last long. The political system did not manage to absorb the increasing level of pressure exerted by the organizations representing both businessmen and workers without destroying the political arrangement which had made the stabilization attempt possible. This was the result of a combination of factors including the competitive character of Chilean politics, the proximity of crucial general elections, and the fact that the contribution of inflation itself to the creation of the political conditions required to fight it, became less significant when the phenomenon seemed to be again around its 'normal' level and/or 'under control'.

The charistmatic and authoritarian populism of President Ibañez was not effective in creating the political conditions required to achieve the stability which he had promised. This was a direct result of the lack of internal consistency of the 'ibañista' movement and its insistence in attacking the opposition parties as a whole, particularly during the presidential campaign and the first two years in office. Thus, the main political assets of 'ibañismo' during the presidential campaign - its broad appeal and its anti-traditional party image - became its main weaknesses once the movement achieved office. The Government was able to implement a stabilization attempt only when the internal situation was clarified- by moving to the right - and cooperation from some sectors of the opposition was secured.

Chapter Five

Inflation and Stabilization during President Alessandri's Government, 1958-1964

A) Introduction

The second major stabilization attempt in Chilean history was not the result of an inflationary and/or political crisis.

This time, the main event leading to the implementation of the anti-inflationary policies was the election of a new President of the Republic who, unlike his predecessor, was able to take advantage of the considerable degree of popularity and goodwill which surrounded all Presidents at the beginning of their term in office.

In this case, then, the pattern of inflation was different from the one observed in 1952-1958. A very spectacular anti-inflationary success was followed by a not less spectacular crisis leading to the collapse of the economic and political foundations of the attempt.

Therefore, it is important to explain why the initial success, despite being so spectacular, could not be sustained, why the effects of the crisis were so devastating and why there was no serious attempt to implement a new, corrected, version of the anti-inflationary policies after the crisis.

B) The Structure of Chilean Politics at the Beginning of President Alessandri's Government

If the presidential campaign of 1952 can be regarded as being the end of a period in which the traditional political parties, i.e. the Conservatives, Liberals and Radicals, fought each other supported by the new political forces which were emerging, the presidential campaign of 1958 can be considered the beginning of a new period in

which those new political forces became major political alternatives themselves. The Christian Democratic Party (PDC) and the Popular Action Front (FRAP), both founded in the context of the 1956-57 stabilization attempt and the 1957-1958 general elections, were the result of two parallel processes of convergence, one experienced by the christian social forces and the other by the marxist forces. And these two new forces were the ones which captured the support of most of the disbanding 'ibañistas'.

The right-wing Liberals and conservatives never fully recovered from the 'ibañista earthquake', nor from the comparable phenomenon which happened after president Alessandri's Government, in 1964-1965, when the Christian Democrats won the presidential election, and implemented major socio-economic reforms which undermined the foundations of the right-wing vote.

The Radicals, which recovered almost completely in electoral terms, had already become the 'old centre', as opposed to the new, Christian Democratic, centre, and they never recovered their capacity to play the left-wing parties against the right and against each other.

The 1958 election was won by the right-wing candidate supported by the Liberals and Conservatives, with the candidate of the left-wing FRAP a close second and the Christian Democrats doing well enough to establish themselves as a real alternative (see Table 5.1, below).

Table 5.1

Electoral Results in the September 1958 Presidential Election compared with the March 1957 Parliamentary one.

	Votes (%)	
	1957	1958
Alessandri (Conservatives/Liberals)	29.1	31.2
Bossay (Radicals)	21.5	15.2
Frei (Christian Democrats)	13.2	20.5
Allende (FRAP: Communists/Socialists/ PADENA)	17.7	28.6
Others	6.8	3.3
Blank/Void	-	1.2
Total	100.0	100.0
Total votes (thousand)	878.3	1250.4
Abstention (%)	31.6	16.5

Source: Offical figures, Registro Electoral.

The winner, Jorge Alessandri, a right-wing independent, was the most prominent exponent of the 'businessmen's approach' and, apart from being the son of former President Arturo Alessandri, the Liberal statesman who was the most outstanding politician in the first half of the twentieth century in Chile, he had been, also, for fifteen years the President of the Confederation of Production and Commerce (CPC), the overall business organization, and a former Finance Minister during the

last Radical Government. In fact, he had been forced to resign at the beginning of 1950 when the unions, and particularly the white-collar workers' unions, had managed to block his proposal of a wage-freeze.

He was a conservative businessman and an advocate of economic liberalism but he was, also, a very strong critic of monetarist views on stabilization.[1] In fact, nobody had advocated monetarist policies during the campaign, while both the socialist (FRAP) and Christian Democrat candidates, who accounted for almost half of the total vote, clearly criticized the previous stabilization attempt from a structuralist point of view.[2] Ideological divisions and political competition among the centrist and left-wing candidates had led to the victory of the only candidate who was in favour of economic liberalism and less state intervention in the economy. Since he had obtained less than one third of the total vote and just managed to gather the minimum third of the seats required in the Senate and the Chamber of Deputies (see Table 4.2, above), the new President had no alternative but to seek the cooperation of one of the centre parties. This was particularly necessary in the case of President Alessandri because, as a right-wing president, the likelihood of the opposition uniting against him was high. In fact, the FRAP, Radicals and Christian Democrats, despite their divisions, had concentrated their attacks on Alessandri during the campaign, and with some help from president Ibañez they had been able to enact an

1. See J. Alessandri, 1955, op. cit., pp. 31-6 and EMS 27 Oct. 1957, p. 35.

2. Senator Frei's position can be found in EMS 26 July 1957 p. 21, (the whole page), and Senator Allende's in Senate Proceedings, 19th Ordinary Session, 18 Dec. 1957 in EMS 8 Jan. 1958, pp. 11-13.

electoral reform aimed at reducing the level of electoral bribery very drastically, especially in the rural areas (where it favoured the landlord). Also new legislation on internal security which ended the ban on the Communist Party which had been established by the Law for the Permanent Defense of Democracy enacted in 1948.

President Alessandri found much needed centrist support in the Radical Party which had considerable interest in protecting its supporters in the Civil Service, and was used to the pragmatic politics of changing coalitions and which, in general, represented middle sectors which had improved their economic position during the Radical Government, of 1938 to 1952, and, as a result, had become more conservative.[1]

The Radicals did not enter the Cabinet, which was dominated by businessmen rather than politicians. They argued that their 'independent collaboration' was aimed at offsetting pro-business influence in the Government.[2] Hence, in implementing his 'businessmen's approach' to stabilization, President Alessandri's problem was not to overcome strong opposition unions (see Chapter Nine also) but to accommodate their demands when supported by the Radical party. This was especially the case with the white-collar workers whose agitation had caused his resignation from the post of Finance Minister in 1950.

1. See James Petras, Politics and Social Forces in Chilean Development, (Berkeley, Univ. of California Press, 1969), p. 137.

2. See HAR, XII, 2, Feb. 1959, p. 108.

C) The Anti-inflationary Policies of President Alessandri's Government

Like the monetarists, the new President wanted an economy freed from excessive state intervention and regulated by free market forces but, in contrast with them, he rejected credit restriction and did not accept the need for a fall in economic activity, rising unemployment and the bankruptcies, that were the price of stabilization according to monetarist views. Not surprisingly, his approach was popular not only among businessmen but also among politicians supporting the Government interested in avoiding the unpopularity of massive economic hardship.

Moreover, the Government did not contemplate an immediate withdrawal of the state from many of the economic roles which the business sector and the right-wing parties had criticized in the past. What could be described as the short term economic policy of the Government, was, in fact, a mixture of gradual liberalization (without any significant privatization) and a somewhat Keynesian approach to economic reactivation, with public investment playing a crucial role. Alessandri even accepted the risk of causing an initial increase in inflation.[1]

There were four major areas of agreement on economic policy between the new Government and both the IMF recommendations and the previous stabilization attempt, these being:

i) The need for considerable restrictions on wage and salary increases.

ii) The need for a reduction in current public expenditure and a 'non-inflationary' financing of the public deficit.

iii) The need for a liberalization of the foreign trade regime and the abolition of multiple exchange rates.

iv) The need for a reduction in state controls over domestic markets.

1. See President Alessandri's address devoted to the economic policy of his Government, broadcast through a national network on 15 Dec. 1958, in EMS 16 Dec. 1958 pp. 1 and 14.

Although it was not a theme in his campaign, it was very clear from previous statements that President Alessandri advocated restrictions on wage and salary increases not only in order to reduce inflation, but, also, to redistribute income towards profits.[1]

By 'non-inflationary' financing of public expenditure he meant avoiding tax increases, both to reduce cost pressures and to prevent reductions in supply due to falling incentives. The public deficit should be financed in ways that would not create additional demand for domestic production, i.e. preferably by foreign loans and by domestic loans backed by the repatriation of foreign exchange which would increase the capacity to import. The more orthodox 'non-inflationary' alternative of financing the deficit domestically and reducing the amount of financing available to the private sector to compensate for it was, obviously, unacceptable for a Government which rejected credit restrictions, particularly those that would hurt the private sector.

The liberalization of the foreign trade regime and the foreign exchange policy were aimed at providing incentives for domestic producers to increase efficiency - due to the competitive effect of imports - and, also, at providing incentives for foreign investment and for capital repatriation, on top of other incentives such as increased domestic profitability and reduced state intervention in the economy.

1. His major essay on the economic problems of the country was J. Alessandri, La Verdadera Situación Económica y Social de Chile en la actualidad,(Santiago, CPC, 1955). See, especially, pp. 9-10 and 22-3.

Apart from their long-run effects, foreign resources would allow a larger increase in the total supply in the short-run by increasing the capacity to import, making it possible for economic expansion and stabilization to take place simultaneously.

A new unified and constant nominal exchange rate (NER) was going to become the very symbol of stability,[1] a powerful influence on inflationary expectations, a factor reducing uncertainty for foreign investors and an incentive for the private sector to borrow abroad. Moreover, the Government wanted a considerable devaluation before the constant NER was established, so that no new devaluation would be required to compensate for the inflation which was expected to take place until an adequate degree of stability was reached.[2]

As far as credit was concerned, the Government expected the market to find its own equilibrium. The monetary policy was aimed at avoiding the creation of excessive amounts of high-powered money, by abolishing the rediscounting activities of the Central Bank, finding alternative ways of financing the public deficit and channeling most of the incoming foreign exchange towards imports. It was assumed that the amount of credit would follow the needs of the economy and that the fall in the rate of inflation would reduce the rate of credit expansion, i.e. a direction of causality opposite to the one argued by the monetarists.

Summarizing, the anti-inflationary policy of President Alessandri's Government was based on the foreign sector and on measures directly affecting the wage-price spiral such as restrictions on wage increases and falling inflationary expectations.

1. See Mensaje del Presidente de la República al Congreso Nacional, 21 May 1960, p. 45.

2. See President Alessandri's broadcast, Second Part, 16 Dec. 1958, in EMS 17 Dec. 1958, pp. 17 and 21.

D) The First Stage of the Stabilization Effort

Given the crucial role which was to be played by the foreign sector, the news that the international price of copper was increasing very firmly provided an auspicious sign at the beginning of the new Government.[1]

The Government did not attempt to implement the stabilization itself from the beginning. During the first eight months in office, all efforts were concentrated on creating the conditions for the actual stabilization to take place. Thus, even though inflation was increasing throughout this period, reaching an annual rate of around 40% by mid-1959, these first eight months were, without any doubt, the first stage of the stabilization effort.

First of all, the Government moved immediately to eliminate the multiple foreign exchange rates and, after a 25% devaluation implemented in two stages in December 1958 - January 1959, a constant unified nominal exchange rate was established.[2]

1. See EMS 22 Oct. 1958 p. 1 and 18 Jan. 1959 p. 5.

2. See EMS 28 jan. 1959 p. 13.

The Government had intended a larger devaluation, of around 30%,[1] but the Board of Directors of the Central Bank dominated by representatives of the private banks, business organizations and right-wing parties did not agree (see Chapter Seven). A larger devaluation would have meant a better deal for foreign investors and for those repatriating capital, and more effective financing of the public deficit, given the importance that foreign loans were to have. It would also have eased the difficulties of the private sector in borrowing abroad and given a better deal for exporters, but it would have also meant larger increases in the cost of imported raw materials, equipment and components and the possibility of inflation getting out of control from the start, due to the impact of the devaluation on the cost of living. These negative aspects of the devaluation cannot be denied, but it is also clear that the Directors opposing a larger devaluation were either right-wingers (representing private banks, other shareholders and Congress) or rival politicians (representing Congress), whose main concern seems to have been to capitalize on their opposition to a measure which was likely to have unpopular effects in the short-run. The unions Director also opposed the larger devaluation. The political parties supporting the Government made every effort to advertise their presence in the Board and to publicize their instructions to their members concerning the devaluation, an attitude which was interpreted by the President of the Republic himself as a sign of the politicians resenting the presence of strong independent figures in the Cabinet.[2]

1. Some sources reported that the Government had intended an even larger devaluation of around 50% but the Government publicly denied this information. See Senate Proceedings, 16th Ordinary Session, 6 Jan. 1959 in EMS 7 Jan. 1959, p. 19.

2. See President Alessandri's broadcast, Third Part, 17 Dec. 1958, in EMS 18 Dec. 1958 pp. 1 and 20.

The other major initiative during this first stage was a bill 'for Economic Consolidation' which included legislation concerning almost every area of economic policy.

The bill included changes in taxation in the direction of increasing the importance of the Sales Tax without increasing the total revenue significantly; a tax amnesty for unreported capital held abroad on condition that it would be invested in Government bonds denominated in U.S. dollars;[1] changes in legislation aimed at allowing the implementation of a gradual liberalization of the imports regime; legislation aimed at eliminating restrictive practices reducing domestic competition (see Chapter Ten); the introduction of a new monetary unit, the Escudo (starting on 1 Jan. 1960 and equivalent to 0.95 U.S. dollar, given the constant NER); incentives for the use of current and deposit accounts in the banks; an extension of foreign exchange operations undertaken by the banking system (including deposits denominated in foreign exchange); special powers delegated by Congress to enable the Executive to implement various administrative and financial measures (including a new system of short-term fiscal financial management based on a mechanism of overdraft in the State Bank and the creation of a system of Building Societies to promote savings and private construction); a supplementary Fiscal Budget particularly concerned with the financing of a wage and salary readjustment, which was also included, and capital expenditure; and a number of other miscellaneous measures.[2]

1. These bonds were called bonos-dólar and were, later, the subject of accusations of corruption made by the opposition when their holders profited from foreign exchange speculation made possible by the way in which the Government managed its economic policies.

2. See EMS 13 Jan. 1959 pp. 1 and 12 and 16 Jan. 1969 pp. 13 and 16.

Despite its controversial aspects, the bill contributed to improve the credibility of the Government's approach to economic management.

Initially the Government proposed a wide variety of wage and salary readjustments for different sectors, most of them below the increase in the RPI during the previous year. Later, however, these readjustments were increased as a result of negotiations between the President of the Republic and the political parties supporting the Government. In practice the outcome was not significantly different from the increase in the RPI, on average. Although a national meeting of the CUT in February 1959 authorized the N.E.C. to call a national strike if necessary , a very strong reaction from the authorities convinced the CUT leadership that it was too early to challenge the new Government, after having failed in a couple of meetings with the President to persuade him to change his mind about the role of wage and salary increases in inflation.[1] Thus, it was the Congressional power of the Radical Party, rather than the power of the CUT or the unions in general which weakened the Government's stand on wage and salary increases. Originally the Government had expected the devaluation and radjustment to be absorbed during the first semester of 1959, so that the fall in the rate of inflation could start well before the next wage and salary readjustment was discussed. Then, with some evidence of anti-inflationary success in the hands, the Government hoped to be able to implement its full view on wage and salary increases, overcoming the Radical Party's resistance.

1. See CUT, Memorial al Congreso Nacional, 20 Oct. 1958 quoted in Jorge Barría, 1963, op. cit. p. 123, ibid. p. 122, and EMS, 23 Dec. 1958, 23 Dec. 1958 p. 19.

Since the foreign sector was to play such a crucial role in the economic policy, immediately after Congress had approved the Law for Economic Consolidation Finance Economy and Mining, Minister Roberto Vergara, the 'strong-man' of the stabilization attempt, went to the United States to complete negotiations concerning loans from the IMF, AID and eleven private banks, for a total of 120 million U.S. dollars, the equivalent to 30% of Chile's annual imports at the time.

The initial stage of the stabilization effort was characterized by a tremendous effort to promote optimism, especially among the business sector. On his return from the negotiations Minister Vergara argued that U.S. investment in Chile would increase by several hundred million dollars in the following three years due to the climate of confidence created by the Government.[1]

Hence, by mid-1959 the Government had created the basic conditions for the initiation of the stabilization effort, and the only major defeat had been its failure to implement a devaluation large enough to guarantee the stability of the constant nominal exchange rate. Ironically, this defeat had taken place not in Congress or in a general election, in which its closest supporters were certain to lose without Radical support, but in a Board of Directors in which business representatives and right-wing supporters of the Government were the overwhelming majority.

1. See EMS, 24 July 1959 pp. 1 and 16.

E) The Anti-Inflationary Campaign of 1959-1960

One of the most outstanding features of this stabilization attempt was its timing. President Alessandri knew only too well from his previous experience as a Finance Minister during the last Radical Government, in 1949-1950, that starting with a major battle over limiting wage and salary increases could destroy the whole attempt at the very beginning.[1] Without Radical support he would not have stood a very good chance of getting his bill 'for Economic Consolidation' passed by Congress. As a result, he could not repeat the 1955-1956 sequence of anti-inflationary battles.[2]

This time it was not the business organizations and the right-wing parties that had to be persuaded to support an anti-inflationary attempt, as in 1955-1956. On the contrary, the key obstacle was the Radicals.

The Government enjoyed much more support from businessmen and their organizations than any previous Government in the previous two decades. There were close contacts between Ministers and other top officials and the representatives of the business organizations, and there was active participation of these organizations in the design and discussion of the economic measures that the Government implemented.[3] In return for this influence, business leaders urged their members to cooperate with the Government recommending, among other things, that, in deciding about prices, firms should avoid the excessive margins

1. See A.O. Hirschman, 'Inflation in Chile', op. cit., pp. 218-9.

2. A.O. Hirschman, ibid., is wrong in suggesting that the option was open and the Government rejected it only to avoid losing the support of wage- and salary-earners.

3. See B. Stallings, Class Conflict and Economic Development in Chile 1958-1973,(Stanford, Stanford University Press, 1978), p. 80 for the case of SOFOFA. Another outstanding example was that of the CCHC participation in the design of the housing program.

of protection against cost increases which had been usual in the past.[1]

Inflation in 1959 was concentrated in the first semester, and reached in July an annual rate of 44.1% which was almost 50% higher than the rate of inflation inherited from the previous Government and also higher than the rate expected by the Government, although no target was ever made public and the fact was only recognized later on.

During the second semester, the gradual liberalization of the foreign trade regime, the success in the negotiations of the foreign loans and the intensive campaign for self-restrain on the part of price-setters,[2] began to bring the rate of inlation down, reinforcing the fall in inflationary expectations.

The rest of the population were not asked to participate in this campaign as producers and the relations between the Government and the unions continued to be very tense. However, the population, as a whole, was asked to participate in the campaign as consumers. A very intensive campaign of consumer education against unjustified price increases was launched by a 'self-appointed' Committee for the Defense of Consumers, supported by the business organizations and the Government.[3]

The Committee published lists of firms adhering to the campaign and pledging not to increase their prices. Each advertisement concentrated on a particular trade, e.g. bakeries, and included the prices concerned. Moreover, the Committee denounced individual firms which had increased their prices excessively and promoted boycotts against them, with full support from the business organizations.

1. See, for instance, the cases of SIDECO and the CCC in EMS 17 July 1959 p. 15 and SOFOFA in EMS 20 Jan. 1959 p. 15.

2. See report on the meeting between Minister Roberto Vergara and the representatives of all the business organizations at the beginning of the stabilization campaign, in EMS 29 July 1959 pp. 1 and 14.

3. The Committee appeared for the first time in August, see EMS 11 Aug. 1959 p. 21.

It is worth noting that milder attempts to enforce price controls under other Governments had always been opposed by the same business organizations on the grounds that they threatened free private enterprise. This time, of course, there was a difference, not because there was less pressure upon the individual firm but because the business organizations were in control.

As a result of this campaign, inflation fell very sharply during the last quarter of 1959. In fact, the official RPI fell by 0.3% during that quarter. Seasonal factors did not explain this result because all the components of the index fell. Thus, the annual rate of inflation fell from more than 40% by mid-1959 to 33.3% at the end of the year, although this rate was still higher than the one inherited from the previous Government which was around 30%, (see Table A.1, Statistical Appendix).

It was in this context that the Government decided to fully implement its wage policy, declaring that a 10% radjustment would be enough to sustain the real purchasing power of wages and salaries in 1960, given the rapidly decreasing inflation. In fact, that was only true if inflation was completely eliminated, i.e. zero inflation during 1960, and this was the target announced by the Government.[1]

1. 'Exposición del Ministro de Hacienda, Economía y Minería don Roberto Vergara ante la Comisión Mixta de Presupuestos del Congreso Nacional' en EMS 24 Dec. 1959 pp. 1 and 16.

Since the Radicals, indeed the whole opposition and the unions rejected this wage policy, the Government sent no legislative proposal to Congress, but instead decreed a 10% bonus for the Public Sector and recommended the same percentage for the Private Sector, asking the employers to absorb the increase, a request which was accepted by the business organizations.[1]

On 1 January 1960 the new monetary unit, the Escudo, equivalent to 1,000 pesos, became effective. The psychological effects of this change were not insignificant and its influence on inflationary expectations reinforced the effects of a number of other measures, including a three months rent-freeze decreed by the Government. All this was aimed at sustaining the complete stability reached in the last quarter of 1959.

At the beginning of March, with the RPI having fallen 1.3% during the last four months, the campaign of the Committee for the Defense of the Consumer turned into a National Crusade for Price Stability sponsored by SIDECO, one of the main organizations representing retailers. The Crusade was fully endorsed by the Government and thousands of retailers adhered to it, commiting themselves to reject any price increase, to denounce suppliers who increased prices openly or disguised the increases, and to implement the wage increase recommended by the Government

This anti-inflationary offensive took place in the context of a campaign for the general municipal elections scheduled to take place at the beginning of April. Despite the election and much publicized opposition of the Radicals to the wage policy of the Government, President Alessandri managed to persuade them not to join forces with the opposition

1. See SOFOFA's position in EMS 17 Jan. 1960 p. 9.

2. See report on the launching of the Crusade in a meeting in which Minister Vergara explained the economic policy of the Government, EMS, 8 March 1960 pp. 1 and 16.

in Congress to approve a higher wage increase for the Private Sector. Such a move would certainly have led to a confrontation between Congress and the Government, with the President of the Republic being forced to use his veto powers to save his policies.[1] This could have also affected his relationship with the Radical Party to the point of a total collapse of the coalition supporting the Government. Thus, although the stabilization effort was not successful enough to convince the Radicals to support the wage policy of the Government the timing did favour conditions in which the President was able to neutralize the Radicals by standing firmly.

The CUT was not capable of organizing an effective resistance. This was partly because they had been politically weakened by the conflicts between the marxist parties, which overwhelmingly controlled the organization, and the Radicals and Christian Democrats, who in December 1959 had refused to participate in the election of the new National Executive Committee in the Second National Congress of the confederation. It was also because the organization was largely dependent on party support and its leadership had strong party commitments which increased at the time of each general election.[2] As it happened in this case, the campaign against the 10% wage and salary readjustment organized by the unions was seriously disrupted by the effects of a wave of earthquakes in late May.

The earthquakes destroyed what was officially estimated as the equivalent to around 9% of the annual GDP, most of it dwellings and public buildings, i.e. half a year of gross investment, and the fiscal

1. The President could have saved his policies because Congress would not have been able to override his veto without some Conservatives or Liberals supporting the opposition in each chamber, two thirds being required.

2. See Jorge Barría, 1963, op. cit., p. 126, and EMS 9 Dec. 1959 p. 19.

losses were estimated to be around 5% of the total revenue.[1] Moreover, the emergency situation caused additional public expenditure and despite a real increase of 15% in revenue from taxation in 1960 - mainly due to the stabilization and the huge increase in imports - the deficit also increased due to an increase of 20% in fiscal expenditure.

In the very short run, the earthquakes contributed to the continuation of the stabilization effort by generating more national solidarity and reducing the level of socio-political conflict. Moreover, the Government managed to avoid any immediate effect on inflation by decreeing a price-freeze. The annual rate of inflation continued to fall well after the emergency was over, going down from almost 12% before the earthquakes to 5.4% at the end of the year.

This annual rate was the lowest since 1938 and less than one sixth of the rate at the beginning of the year. Thus, despite failing to achieve the very ambitious target of zero inflation, the Government scored the most spectacular anti-inflationary success of the period 1952-1970.

The stabilization was so successful that it seemed to have absorbed the impact of the earthquakes. In fact, inflation reached single figures immediately after the earthquakes and remained there for more than two years, (see Table A.1, Statistical Appendix).

1. Installations and equipment accounted for around 96% of the total losses, including a 73% of dwellings and public buildings. See EMS 29 Jan. 1961 pp. 33 and 38. The comparison with the gross domestic investment is based on the more recent figures for 1960-1961 calculated by ODEPLAN instead of the old, and very different CORFO estimates.

F) Economic Performance and Political Success, 1959-1960

The April 1960 general Muncipal election was the first major electoral test for the political parties supporting the Government, after fourteen months in office and after eight months of intensive anti-inflationary campaign.

Although the Expenditure of the Gross Domestic Product (EGDP) grew by only 0.6% in 1959, i.e. a fall of 3.0 in per capita terms, manufacturing grew by around 14% and Agriculture, which had had a very good year in 1958,sustained that performance.[1] Unemployment, although still high at 7.3%, showed a significant improvement if compared with the 9.5% registered in 1958.[2] Hence, the efforts to end the stagnation experienced by the Chilean economy during the inflationary acceleration and the stabilization of 1954-1958[3] had already begun to show some results before the election, while the level of imports had started to increase very rapidly during the second semester of 1959, thereby supplementing the domestic supply very considerably.[4]

Against the background of this mixed performance, the two main aspects which were going to be judged in the election were the Government's policy on wage and salary increases and the degree of success in combatting inflation. Stability - the President had argued - was the key to economic development, and, as a result, whatever the performance in 1959 in terms of economic growth, what mattered most was the anti-inflationary performance.

1. See Ffrench-Davis, 1973, op. cit., Table 34 p. 252 and p. 44, Vittorio Corbo, Inflation in Developing Countries. An Econometric Study of the Chilean Inflation, (Amsterdam, North-Holland, 1974), Table 4.2, p. 104, and B. Stallings, 1978, op. cit., Statistical Appendix, Table A.13 p. 253.

2. The unemployment rate in the Greater Santiago, the only one available, was 7.4% in June 1959 and 7.3% in March 1960.

3. In 1954-58 the EGDP grew 9.9% against a 13.4% increase in the total population and, although every annual rate was positive, the highest was only 3.5%, i.e. 0.9% in per capita terms.

4. See Ffrench-Davis, 1973, op. cit., Table 13, p. 86.

Although at the time of the election inflation over the previous twelve months was still above 20%, the rate in the first six months of the stabilization campaign was only 2.6%, (i.e. an annual rate of 5.5%), a performance which confirmed the extremely optimistic expectations promoted by the anti-inflationary campaign.

Table 5.2

Electoral Results in the General Municipal election of April 1960 compared with the 1957 Parliamentary and 1958 Presidential General Elections. (% of the vote).

	1957	1958	1960
Conservatives/Liberals	29.1	31.3	29.5
Radicals	21.5	15.2	20.0
Christian Democrats	13.2	20.5	13.9
FRAP (Socialists/Communists/PADENA)	17.7	28.6	23.9
Others	18.5	3.3	8.3
Blank/Void.	-	1.2	4.4
Total	100.0	100.0	100.0
Total votes (thousand)	878.3	1,250.4	1,229.5
Abstention (%)	31.6	16.5	30.5

Source: Offical figures, Registro Electoral .

The electoral results showed a consolidation of the vote of the parties supporting the Government, i.e. no erosion in their electoral support took place. In fact, compared with the Presidential election, they recovered most of the vote lost to the other candidates. However, these results would still not be good enough for the President to secure a more favourable Congress in the next general Parliamentary elections

due in March 1961.

G) Stabilization, General Elections and the Inflationary Cycle

In 1960, even though the economy was expanding a little faster than in 1959, the growth rate was still very modest and the level of unemployment, instead of decreasing, registered a small increase.[1] The manufacturing sector did not grow at all in the first semester of 1960, compared with the same period in 1959, nor did it improve in the second semester.[2] In fact, the main contribution to the increase in total supply came from the huge increase in imports which had begun at the end of 1959 and which reached a level of 30% in real terms in 1960 compared with 1959, i.e. a contribution of 3.9% to the increase in the total supply.[3]

1. The EGDP grew by 3.1% in 1960, i.e. 0.5% in per capita terms while unemployment in the Greater Santiago reached 8.0% in June, instead of the 7.0% that could have been expected taking into account the 7.3% registered in march and seasonal factors. See Ffrench-Davis, 1973, op. cit. Table 34 p. 252 and Instituto de Economía, Univ. de Chile, 'Ocupación y Desocupación', several issues.

2. See V. Corbo, 1974, op. cit., Appendix A, Table A.3 p. 250.

3. See Ffrench-Davis, 1973, op. cit., p. 45.

On top of the competition from imports, the rapid inflationary deceleration increased the real cost of domestic credit very dramatically, from an average of -2.0% in 1958-1959 to 21.7% in 1960,[1] and most private firms, which had always depended very heavily on bank credit to finance working capital - and had benefited from inflation - were finding it increasingly costly to continue doing so.[2] As a result, the business organizations started to put pressure on the Government for a rectification of these difficulties. No doubt, some increase in the real cost of credit was considered not only unavoidable but, also, desirable, by a Government which wanted to promote efficiency through the operation of the free market forces. However, the actual increase had been excessive and was largely the consequence of oligopolistic practices by the banking system which meant there was no reduction in interest rates even though the banks were accumulating excessive reserves.

The Government was reluctant to intervene, partly because in the first semester of 1960 the rate of monetary expansion was still considered to be too high - between 15.0 and 18.0%, depending on the concept of monetary supply used[3] - and partly because, as the President of the Republic had said very clearly, the aim was to promote borrowing abroad (see Section C in this Chapter). However, inaction on a matter which affected so much the very sectors supporting the Government was politically difficult. But the Government's view prevailed, the high real cost of domestic credit persisted despite a parliamentary campaign leading to the march 1961 election, and indeed it continued until inflation

1. Calculations based on the average bank rate, see Ffrench-Davis, 1973, op. cit., Table 54, p. 298.

2. See Jorge Marshall, 'La Estabilidad Monetaria en Chile, 1959-1960', Revista de Economía Latinoamericana, Caracas, 10, 1963 p. 75.

3. See R. Zahler et al., 1979, op. cit., Table 1, pp. 72-3.

increased again from 1962 onwards. The Government even held out against an attempt by Congress to impose an interest rate ceiling which would have reduced the real cost of credit by almost a third, and which was vetoed by the president of the Republic.[1]

The 'strong-man' of the stabilization, however, was not as lucky as his policies. There had been a certain degree of hostility towards Minister Vergara even from the political parties most commited to supporting the Government. This was partly due to his habit of dealing directly with the business organizations, by-passing the traditional intermediation of the political parties, and partly because he had had to implement unpopular measures (a number of them against the advice of the political parties) as any Minister leading a stabilization effort would have been likely to do.

Despite a spectacular anti-inflationary success, this hostility increased during the campaign for the March 1961 general parliamentary elections and the Minister came under strong attack when he insisted on requesting that the Government restore his proposed tax increases in order to finance part of the reconstruction required after the earthquakes. It was his opinion that it was not going to be possible to finance this with foreign loans. These tax increases had been proposed to Congress as one of the elements of a Reconstruction Bill which included authorization for the Government to borrow very heavily abroad as the main source of financing. But the Senate reduced the tax increases to one third of the original proposal, the main arguments being that the foreign loans were going to be enough and that the Minister was

1. Even the right-wing Senators who supported the Executive veto in the Senate, following instructions from their parties, registered their support for the idea of reducing the real cost of credit substantially. Senate Proceedings, 6th. Special Session 10 Oct. 1961, in EMS, 19 Oct. 1961, pp. 29-9.

trying to finance the ordinary fiscal deficit using funds provided by the Reconstruction Bill. Finally, Minister Vergara resigned, and three different persons were appointed as Ministers of Finance, Economy and Mining. Although one of his closest collaborators, Eduardo Figueroa, was appointed as Finance Minister, there was no 'strong-man' in the new Cabinet and prominent members of the Conservative and Liberal parties were included for the first time.[1] In the words of the president of the Conservative Party, the first stage of stabilization and moral recovery was over and a second stage of economic development was about to begin.[2] Despite this setback, as has been already demonstrated with regard to interest rates, the Government managed to sustain even some of the most unpopular politices. In fact, using its veto powers, the Executive managed to restore a considerable proportion of the domestic financing originally proposed in the Reconstruction Bill, obtaining, in the end, two thirds of the original proposal, i.e. twice as much the amount approved by the Senate. This outcome pleased the new Minister of Finance.[3]

With regard to wage and salary increases, the Government finally decided to propose a Bill legalizing the 10% increase implemented at the beginning of the year. Then, four months before the parliamentary elections, in November 1960, the Labour Committee of the lower Chamber increased the readjustment from 10% to 33% with the Radicals, Christian Democrats and the FRAP voting in favour. Since the readjustment was

1. See EMS, 'La Semana Política', 18 Sept. 1960, p. 11.

2. See EMS, 16 Sept. 1960 p. 23.

3. See Senate Proceedings, 8th. Special Session, 19 Oct. 1960, in EMS, 21 Oct. 1960, pp. 26-7, and 9th. Ordinary Session, 19 Oct. 1960 in EMS, 22 Oct. 1960 pp. 27-9. See, also, EMS 22 Oct. 1960 p. 1 and 18.

retroactive to January 1960 and the actual readjustments had been fairly close to 10% in the Private Sector, a 33% would have led to a total collapse of the stabilization effort. The President, instead of using his veto powers - which required the Conservatives and Liberals to stand firm behind them, a very unlikely event in the context of a parliamentary campaign - withdrew the Bill from Congress and addressed the country through a national broadcasting network to defend his position.[1] The CUT stepped up its campaign against the 10% readjustment. Public demonstrations and violent clashes with the police were followed by a quite successful national stoppage which led to the CUT sending a defiant memorandum to the President of the Republic, demanding adequate increases.

However, even in this increasingly tense political situation, the President insisted on his views. He reached an agreement with the pro-Government parties and sent back a new Bill which stipulated a 15% readjustment (and the equivalent to that in the Public Sector) though not computable for social security contributions, therefore costing only 10% to private employers.[2]

In fact, given that inflation was not likely to reach the zero inflation target, and was around an annual rate of 5%, the 15% increase was just enough to sustain the average purchasing power of wages and salaries comparing 1960 with 1959.

Hence, the political parties supporting the Government, and especially the Radicals, had been given something to show to the electorate in terms of concessions obtained from the Government, while, at the same time, the latter could claim success in sustaining its policies.

1. See EMS, 4 Nov. 1960, pp. 1 and 18.

2. See Ffrench-Davis, 1973, op. cit., pp. 205-206.

Thus, despite the proximity of the very crucial parliamentary elections, and despite the effect of the 'inflationary cycle' - which had already reduced the priority of anti-inflationary efforts if compared with other economic and social goals (if not in the President's mind at least in those of the politicians supporting him) - the Government was still capable of resisting the pressures. The resignation of Minister Vergara had of course been part of the price paid to do so.

Table 5.3

Electoral Results in the March 1961 General Parliamentary Election compared with the April 1960 Municipal election, and changes in the number of Seats in Congress

	Votes		Seats			
	1960	1961	Deputies		Senators	
	Municip.	Parliam.	Total	Change	Total	Change
Conservatives/ Liberals	29.5	30.4	45	-6	14	-2
Radicals	20.0	21.4	39	+2	13	+4
Christian Democrats	13.9	15.4	23	+6	4	+3
FRAP (PS/PC/PADENA)	23.9	29.5	40	+19	12	+3
Other	8.3	-	-	-21	2	-8
Blank/Void	4.4	3.3				
Total	100.0	100.0	147		45	
Total votes (thousand)	1,229.5	1,385.7				
Abstention (%)	30.5	25.5				

Source: Offical Figures, Registro Electoral.

The electoral results confirmed the success of the political parties supporting the Government in retaining their following after twenty eight months in office. Given the rather poor performance in terms of economic growth, this result can only be explained by the anti-inflationary success and the contribution to investment and consumption made by the huge increase in imports registered in 1960.

However, as a result of the disappearance of a number of small parties, especially 'ibañistas' (which still existed in the previous parliamentary election, in March 1957) the strength of the two parties most commited to support the economic policies of the Government decreased in both Chambers, so that now a Presidential veto might be overridden unless he obtained Radical support. Not surprisingly, negotiations to bring the Radicals into the Cabinet started immediately after the election and, by mid-1961, a National Convention of the Radical Party dominated by the party's right-wing, decided to move from 'independent collaboration' to participation in the Government. The party stipulated that Agrarian, Tax and customs duties reforms and adequate wage and salary readjustments must be implemented.

These Radical proposals were made not only against the background of a new emphasis on economic development, prompted by the rather poor growth performance of 1959-1960, but, also, in the context of the Alliance for Progress which had been launched in March by the new U.S. government. The Radicals could claim that they were the party of economic development, reform and progressive income redistribution and, at the same time, that their policies would make it easier for the Government to obtain the foreign resources which its strategy of economic development with stability required.

Finally, after somewhat lengthy and tense negotiations, agreement was reached and a new 'political' Cabinet was formed, with five independents (including the Finance Minister, though not Eduardo Figueroa), four Radicals (Foreign Relations, Economy, Agriculture and Health), two Liberals and two Conservatives.[1] As a result of the agreement a number of committees were established to study the reforms advocated by the Radicals, and a Bill readjusting wages and salaries was sent to Congress. The readjustments proposed in the Bill did not amount to an increase in the average real purchasing power of wages and salaries in general, so that the President was still succeeding in resisting Radical pressures. However, the Bill included the reintroduction of automatic readjustments, equal to the increase in the RPI from January 1963 onwards,[2] even though restricted to the minimum salary (sueldo vital) and minimum wage.

This change in the wage policy was a clear defeat for the President. If inflation continued at the very low levels registered throughout 1960 and 1961, the defeat would not have major practical consequences because a further reduction in inflation would mean only very small increases in the average purchasing power of the wages and salaries of the lowest paid (e.g. a reduction from 7.0% to zero inflation would only mean a little more than a 3.0% increase). However, if inflation increased again, any attempt to implement a new stabilization effort would be much more difficult.

1. See EMS, 'Revista Noticiosa Semanal' 27 Aug. 1961, p. 29.
2. There was an automatic readjustment at the beginning of 1962 also but only equivalent to 50% of the previous increase in the Retail Price Index (RPI).

This fact illustrated very well the new situation. The President of the Republic was still in control, his policies had not suffered any major set-back after three years in office, i.e. by mid-term, but the political base of his Government, instead of getting stronger, had become more vulnerable or less adequate to cope with any major economic problem requiring considerable adjustments.

H) The Foreign Exchange Crisis

The new Cabinet did not have to wait long to be tested by a major economic crisis. Only four months after the Cabinet change, the Government had to suspend foreign exchange operations for three weeks, import restrictions were reintroduced and a new system of dual exchange rates was established in order to prolong the existence of the constant nominal exchange rate which had been the 'symbol' of the stabilization since 1959. In fact, the new 'brokers rate' which applied only to tourism and capital movements, was left free and immediately reached a little more than 40% above the 'bank rate' which remained constant. Since the devaluation at the beginning of 1959, the accumulated inflation had been apprximately 48%, and given that the constant nominal exchange rate established then was more or less an equilibrium rate[1] the Chilean Escudo had become overvalued by more than 40%.

Not surprisingly, exports remained more or less constant between 1959 and 1961, especially those from sectors other than mining which were more likely to be affected by the foreign exchange policy. Since

1. See R.H. Leftwich, 'Exchange Rate Policies, Balance of Payments and Trade Restrictions in Chile', Economic Development and Cultural Change, 14,Feb. 1966, p. 407.

mining exports did not increase either, the huge increases in imports (30% in 1960 and 11% in 1961) had to be financed with foreign loans. But despite an 83.3% increase in the foreign debt from the end of 1959 to the end of 1961, the foreign exchange reserves of the country fell very rapidly.

In fact, this problem had been manifest since the second semester of 1960,[1] but the Government, which was always waiting for a huge inflow of foreign capital to materialize, did not take any significant corrective measures. Consequently,during the first seven months of 1961, (i.e before the change in the Cabinet) the Central Bank lost 94.4 million U.S. dollars,[2] i.e. 86% of all its international assets - including liquid assets and gold - or the equivalent to two months of imports, and, again, no significant measure was taken by the Government. The Government's goal of attracting foreign capital became more and more inconsistent with the foreign exchange policy and, instead of a capital inflow, an outflow of capital developed, which increased enormously in 1961 due to speculative purchases of foreign exchange caused by expectations of an unavoidable devaluation.[3] However, the political battle around the devaluation was to be very long and costly, both in economic and political terms.

The Balance of Payments crisis which had led to the foreign exchange crisis, had not been caused by a sudden fall in the international price or the amount of copper exports, even though their stagnation had done little to help. The crisis was the result of the very economic policies which had allowed the Government to achieve the spectacular stabilization,

1. See IMF, Annual Report 1960, 1961 p. 30.
2. See Central Bank of Chile, Monthly Bulletin, 407, Jan. 1962, p. 94.
3. See Instituto de Economía, Univ. de Chile, La Economía de Chile en el Período 1950-1963, Santiago, 1963, i. 205, footnote 138.

i.e. cheaper and abundant imports and the 'symbol' of stability. And even though former tri-Minister Vergara had tried to implement a larger devaluation than the one approved by the Board of Directors of the Central Bank, the fact is that even if no additional inflation had been caused by it - a very unlikely outcome - the percentages proposed by the Minister would not have been consistent with a constant nominal exchange rate and the foreign trade liberalization.

I) Foreign Exchange Crisis and Political Crisis. The Politics of Devaluation

Since the beginning of the foreign exchange crisis the Radical Party decided to oppose any devaluation and to withdraw its members from the Cabinet if such a measure was implemented in order 'to defend the purchasing power of the national currency'.[1] Moreover, the Radicals tried to dissociate themselves from the crisis by accusing the Central Bank authorities of negligence, a move which generated a strong reply from the President of the Bank, who argued that the Bank had kept the Government informed of the evolution of the Balance of Payments situation.[2]

However, the Radical Minister of Economy, a structuralist, was among those advocating a drastic devaluation, and there was considerable pressure from the IMF, the Central Chamber of Commerce (CCC), the Importers Association - which rejected the restrictions on imports - and other powerful organizations in favour of a devaluation.[3] The industrialists organization (SOFOFA) supported the devaluation and was only concerned about finding some way of protecting those who had

1. See EMS, 29 Dec. 1961, p. 23.
2. See EMS, 9 Feb. 1962, p. 13 and 16 Feb. 1962, p. 15.
3. Among them, of course, the national Mining Society (SONAMI).

debts in U.S. dollars.

But the Radical Party was not alone in opposing the devaluation. The Popular Action Front (FRAP) and the CUT were strongly against it and even the Liberals and Conservatives were very reluctant to accept it and suggested alternative measures to avoid it.

Consequently, public confusion increased and the level of support for the Government rapidly declined. In a parliamentary by-election for a Deputy in the First District of Santiago at the beginning of September, the candidate of the ruling coalition obtained only 45% of the vote, the first sign of serious political attrition in almost four years, since in March 1961 the three ruling parties had obtained 53.4% of the vote in the same District (which accounted for approximately 15% of the national electorate). In fact, the candidate of the Government won only because the opposition did not unite.[1]

Although President Alessandri had agreed with the Radicals that no major change would take place before their national Convention to be held in mid-October, later on he decided that it was impossible to wait any longer. On 8 October 1962 the Central Bank announced that there would be a devaluation but left the actual amount to be announced, a clear sign of the authorities' concern about a potential eruption of popular discontent. Three days later, after a broadcast in which the President of the Republic blamed excessive increases in luxury imports and tourism, speculative capital flight and the conditions put forward by the U.S. Government which had delayed the arrival of much needed credits, the Central Bank established a freely fluctuating rate which led to a 33% devaluation by mid-October.

1. See HAR, XV, 9, Nov. 1962, p. 838.

The Government had taken almost ten months to implement the devaluation, which was the only measure consistent with its predominantly liberal economic views and the objective of attracting more foreign capital. Throughout 1962 the foreign exchange situation remained very critical, the Government could not use IMF resources to improve it, and the much publicized inflow of foreign capital expected from the Alliance for Progress was in fact only a quite modest one.[1] In practice, the Government had helped to create totally unrealistic expectations about the speed and amounts of foreign capital which the Alliance was going to provide,[2] and had failed to face the facts of the Balance of Payments situation.

In December 1962, two months after the devaluation, President Alessandri went to the United States to discuss Chile's participation in the Alliance for Progress while, at the same time, Chilean officials negotiated a stand-by arrangement with the IMF. Chile's ambitious ten-year Development Plan, costing 10,000 million U.S. dollars (20% in foreign aid) had been approved by the Alliance for progress in mid-1962 but the Agrarian Reform, which was then being discussed in the Chilean Congress, had been criticized for being too mild, and the U.S. contribution to the Plan depended on the U.S. Congress approving the 470 million U.S. dollars which a mission of AID and U.S. State Department officials had recommended.[3]

It is not too difficult to explain why President Alessandri's Government would not implement more than a very mild Agrarian Reform,

1. In fact the inflow of foreign capital had been very large already in 1961 and it was smaller in 1962 and again in 1963. See Ffrench-Davis, 1973, op. cit., Table 46 p. 279.

2. See, for instance, the Foreign Minister statement after the negotiations with a U.S. Mission, EMS, 9 March 1962, p. 18.

3. Ibid. and HAR, XV, 10 Dec. 1962, p. 951.

land-owners being very influential not only in the Conservative and Liberal parties, but, also, in the Radical Party which had proposed the specific reform which the Government was backing. Hence, very dramatic changes were not likely in this area, at least until a new Government came into office. But the crucial point is that even if this difficulty had not existed, it would have been totally unrealistic to expect these resources - which were meant for new investment - to finance the Balance of Payments deficits which had been created by huge increases in consumer imports, tourism, capital flight and foreign exchange speculation. In other words, the Alliance for Progress was not an alternative to a devaluation, and President Alessandri was not justified in including its delays among the causes of the devaluation.

The critical foreign exchange situation required either extremely restrictive policies on imports and foreign exchange or milder restrictions combined with some support from foreign or international financial institutions aimed specifically at overcoming the crisis. After the devaluation, it became possible for the Government to request support from the IMF. However, this came in the form of a stand-by arrangement which made 40 million U.S. dollars available to Chile though only from the end of April 1963 onwards - after the general Municipal election -, with 'phasing', i.e. a limit to monthly drawings, and subject to no increases in the level of import restrictions already implemented.[1]

By January 1963,further devaluation brought a 72% fall in the exchange rate which led to a rapid and total collapse of the stablization.

1. See J.K. Horsefield and M. de Vries, The International Monetary Fund 1945-1965, Washington, IMF, 1969, i. 571.

The annual rate of inflation, which had stayed around 10% through the first eight months of 1962, jumped to more than 18% in October, almost 28% in December and continued to increase until it reached 53.6 a year after the devaluation, remaining between 45 and 50% until the end of the Government. In other words, the Government which produced the most spectacular stabilization was the one which finished with the highest inflation. And this was not a mere coincidence because, to a large extent, the stabilization had been possible by postponing inflationary pressures, by exhausting the foreign exchange reserves of the country and accumulating foreign debt in order to finance the increase in the expenditure of the social sectors whose support the Government required.

J) Electioneering and Economic Policies

The sense of political timing of the Radicals was very peculiar. First, they entered the Cabinet to preside over a crisis which caused the total collapse of the stabilization, and second, after a long, rather hopeless and very damaging resistance against devaluation, they signed an agreement with the Conservatives and Liberals the very day in which the devaluation started, creating a Democratic Front in order to fight the next presidential election which would take place two years later. Moreover, the agreement stipulated that the presidential candidate would be chosen on the basis of the electoral results in the next general Municipal election, in April 1963, i.e. within six months.

From then on, the behaviour of the Radicals was anything but consistent. The Radical Ministers resigned after the devaluation but the party instructed them to withdraw their resignations a couple of days later. The Radical Deputies supported the compensatory wage and

salary increase of 15% proposed by the Government, but seven Radical Senators (out of 13) and two Liberals (out of 10) voted with the opposition to increase it to 25% in the case of the Private Sector. This change was later reversed by the Lower Chamber, but only after a major political confrontation between the President of the Republic and the Senate majority. A National meeting of the Radical Party, a couple of days after the crisis had been solved, decided not to punish anybody. Not surprisingly, therefore, relations between the President of the Republic and the Radicals became more and more tense. Less than two months before the Municipal election, the Radicals requested the implementation of a price-freeze, a review of some recent price increases and stronger measures against speculation (At the time, the annual rate of inflation had already reached 30%). After a meeting with the president, and despite the Radicals having announced complete acceptance of their proposal, the Government issued a very vague, restricted and totally ineffective price-freeze decree, and the President himself denied that the Radicals had been the authors of the measure. It was clear that the President was not prepared to serve the electoral objectives of the Radical Party.

Notwithstanding the odd timing and inconsistencies, the Radicals managed to avoid electoral losses, even in the context of very acute economic and political crises, (see Table 5.4, below). While the Liberals and Conservatives lost considerable support, the Christian Democrats were the clear winners becoming the party with the largest electoral support.

Table 5.4

Electoral Results in the April 1963 General Municipal Election compared with the March 1961 Parliamentary one

	March 1961	April 1963
Democratic Front:		
Conservatives (PCU)	14.3	11.0
Liberals (PL)	16.1	12.6
Radicals (PR)	21.4	20.8
Christian Democrats (PDC)	15.4	22.0
Popular Action Front (FRAP):		
Socialists (PS)	10.7	11.1
Communists (PC)	11.4	12.4
Other (non-marxist)	7.4	5.8
Other	-	0.9
Blank/Void	3.3	3.4
Total	100.0	100.0
Total votes (thousand)	1,385.7	2,068.5
Abstention (%)	25.5	19.5

Source: Official Figures, Registro Electoral .

The Christian Democrats had also consolidated their position as the non-marxist alternative to the crumbling Democratic Front which they accused of being incapable of managing the economy adequately. They claimed that only they could implement the reforms which the Government itself and the Alliance for Progress had been advocating.

After these results, the Government was totally unable to implement any significant anti-inflationary measure throughout 1963 and 1964 and so, as has been already mentioned, inflation stayed in the 45-55% region between the Municipal and the Presidential elections, i.e. for sixteen months.

K) The Presidential Campaign and the Collapse of the Coalition Supporting the Government

The long 1963-1964 presidential campaign started as a contest among three candidates representing the Democratic and Popular Action Fronts and the Christian Democratic Party, but ended as a battle between the two forces which had opposed President Alessandri's Government.

The main theme of the campaign of Senator Durán, the Radical candidate of the Democratic Front, was the need to stamp out the communist threat represented according to him - by the Popular Action Front (FRAP) which included the Communists, the Socialists, the National Democratic Party (a non-marxist organization of ex 'ibañistas') and some very small groups. In fact, former President of the Republic Gabriel González Videla, who had outlawed the Communists in 1948, was elected President of the Democratic Front and became 'generalissimo' of this campaign. This kind of militant anti-communism had become more fashionable after the Missile Crisis of October 1962, and found additional justification in the radicalized rhetoric of important sectors of the FRAP, influenced by the Cuban Revolution.

On top of that, the economic crisis had increased the level of militancy of the unions, leading to a very successful national stoppage organized by the CUT a month after the devaluation, in which an estimated 30 to 45% of the total labour force participated,a record by Chilean standards.[1] Since the Socialists and Communists were very prominent among union leaders, this factor also contributed to provide justification for the Democratic Front's campaign against 'communist subversion', which also served to distract attention from their responsibility for the crisis. However, the left of the Radical Party was dissatisfied with the campaign and a considerable number of Conservatives and Liberals did not like the Radical candidate.

At the beginning of 1964 the Democratic Front as a whole engaged in the same kind of electioneering practiced by the Radicals over a considerable period. Their opportunism showed not only during the discussion of the legislation concerning wage and salary readjustments but, also,in obtaining from the Government the decreeing of a totally ineffective price-freeze decree similar to the one decreed the previous year. This time, however, these practices seemed to have lost effectiveness. In a by-election for a Deputy in a southern province in which the Democratic Front had obtained 48.5% of the vote in April 1963, their candidate received only 32.6% of the vote, in March 1964, and lost. The winner was the Socialist candidate of the FRAP which increased its vote from 30.0 to 39.2%. Ironically, the most favoured were the Christian Democrats who came third increasing their vote from 21.5 to 27.2%. As a result of this catastrophic defeat the Democratic Front collapsed and the Conservatives and Liberals turned to support Senator Frei in order to prevent a victory of the FRAP.

1. See EMS 20 Nov. 1962 p. 1 and El Siglo, 20 Nov. 1962 p. 1 and 3.

The Christian Democratic presidential candidate Senator Eduardo Frei had consolidated his position as a major challenger campaigning on the basis of a very comprehensive program of reforms presented as an alternative to both the status quo which the ruling coalition had been incapable of modifying, and the marxism of the FRAP.

L) Summary

The 1959-1960 stabilization was different from the previous one in many respects, most importantly because in 1959 the attempt was not launched in response to an inflationary and political crisis. This time the effort was made politically possible by the start of a new Government commited to achieve stability.

Even though the Government rejected monetarist policies and attempted to achieve both stabilization and rapid economic growth together, the growth of the economy during the first two years was rather poor. This was partly due to the adjustments that took place in 1959, partly to the effects of the May 1960 earthquakes, and partly to the competitive challenge from imports which increased very rapidly.

The foreign sector provided most of the economic resources required to implement the stabilization but it also provided a source of additional political leverage for those domestic sectors, led by the President of the Republic, which favoured policies geared to the attracting of foreign capital. These domestic sectors, and particularly the business organizations, provided the socio-political and economic power required to make a success out of the anti-inflationary campaign. This campaign together with the role assigned to the foreign sector, provided the alternative to demand restriction and to massive price controls as a means to stabilization.

However, the spectacular anti-inflationary success was not enough to increase the electoral support of the right-wing political parties which provided the political backbone for these economic policies. Even though they avoided electoral decline for almost three years, the political system prevented them from sustaining their Congressional strength and the Government became more and more dependent on the centrist political party that was least commited to support the economic policies of the Government.

However, until the foreign exchange crisis erupted, the President of the Republic managed to sustain his policies, which were really supported by only a minority of the electorate. To a large extent, the crisis was the result of postponed inflationary pressures which had accumulated throughout 1959-1961, but the effects of the crisis were increased by the very long time taken by the Government to adopt effective corrective measures.

In a country like Chile, with an economy so vulnerable to Balance of Payments fluctuations, the Government should have been prepared for such a crisis. In this case the Balance of Payments problems were not the result of external factors - caused, for instance, by variations in the price of copper - but were due to the economic policies of the Government themselves. The Government was technically and politically unable to correct the situation and to implement a 'second stage' of its economic strategy. The constant NER was too inflexible because even a minor devaluation meant a complete change of policy. The alternative policy, the reintroduction of considerable import restrictions, contradicted the economic liberalism of the Government's main backers and was unacceptable for the international financial institutions whose support the Government required. Of course, a technical alternative compatible with a constant NER was a considerable deflation, but this was politically impossible and was not even contemplated.

Both technical and political difficulties arose, the latter attributable to disagreements inside the Government and the coalition supporting it. As a result, the measures required to overcome the crisis were implemented too late, the effects of the crisis were magnified, the scope for accommodation among the forces supporting the Government was reduced and the economic and political strategies of the Government collapsed.

In contrast with president Ibañez' Government, this Government ended with an inflationary acceleration. Consequently, both the presidential campaign and the rapid increase in the rate of inflation contributed to create the political conditions needed for the next anti-inflationary attempt to be launched. In other words, the 'inflationary' and 'presidential' cycles worked together. However, the 'presidential' cycle was the dominant one, because the inability of the Government to do something effective about inflation in 1963-1964 was, to a large extent, a result of the political conditions created by the very long presidential campaign itself.

Chapter Six

Inflation and Stabilization during President Frei's Government, 1964-1970

A) Introduction

The third major stabilization attempt in Chilean history was also the result of the 'presidential cycle', as had been the case with the previous one. In this case, however, neither the initial stabilization nor the increase in the rate of inflation which followed the collapse of the attempt were as spectacular as they had been in the case of President Alessandri's Government.

The gradual character of the stabilization was the result of an emphasis on the wish to avoid damaging the country's growth prospects and the need to secure the implementation of structural reforms which were aimed at creating the conditions for long-term stability.

This stabilization attempt illustrates the very great difficulties involved in combining stability with the kind of socio-economic and socio-political change advocated by a more comprehensive version of the Latin American structuralist' approach. Therefore, it is crucial to analyse the interplay between the implementation of the program of structural reforms and the implementation of the short-term policies. This should be done not only in economic, but also in political terms.

B) The General Program and Strategy of the Christian Democrats

President Frei was elected in September 1964 with 55.7% of the total vote, the highest majority in the period of the Constitution of 1925 (1932-1973) and 10% more than the total vote obtained by the

Christian Democrats, Conservatives and Liberals in the March 1961 and April 1963 general elections.

The candidate of the FRAP obtained 38.6%, i.e. a little more than 9% in excess of the FRAP vote in the same abovementioned elections, while the polarization caused by the campaign left the Radical candidate with only 4.9%, less than a quarter of the Radical vote in the previous four non-presidential general elections.

Hence, President Frei' victory was largely based on tactical voting rather than on any definite electoral rejection of the other parties, as it had been the case with president Ibañez. As a result, it seemed a little more difficult for Frei's party to repeat such a good electoral performance in the next general parliamentary election of March 1965, which was to take place (as it had been the case in 1952-1953) only four months after the new Government took office.

The socio-political strategy of the Christian Democrats was very different from that of the Radicals, the other major centre party which had controlled the Presidency of the Republic between 1938 and 1952 on the basis of changing coalitions. The Christian Democrats were determined to become a very large centre party, representing a very wide spectrum of support, with the bulk of their support coming from social sectors which had not previously been organized or politically active, i.e. unorganized urban labour, predominantly unemployed or underemployed shanty town dwellers, non-working women, rural and urban self-employed and rural wage-earners, these sectors accounting for the overwhelming majority of the population (see Chapter One). The main objective was to reduce the support of both the traditional oligarchic right-wing parties and the marxist left-wing parties, and to take advantage of the crisis and expected collapse affecting the 'old centre', the Radical Party.

This strategy put the Christian Democrats in a position which was somewhat similar to that of the 'ibañistas' twelve years earlier, in other words, they were a threat to every other political party, even though they did not threaten the political system as Ibañez had done. On the other hand, due to their strategy, the Christian Democrats had become more and more resistant to the formation of relatively permanent political coalitions. They wanted to be above the traditional left, right and centre, a new party for the new country in which 'everything would have to change', as one of their main slogans stated.

Even if they did not manage to obtain more than 40% of the vote, they would stand a very good chance of building a very strong majority in Congress, and even an absolute one, and of winning every subsequent presidential election because of the division of their opponents. Consequently, they also wanted a stronger Executive branch. While President Ibañez had shown that the electorate might desert the traditional parties, the objective of the Christian Democrats was to achieve a realignment of the votes on a more permanent basis.

The long-term objective of the Christian Democrats was a 'communitarian' society, an alternative to both communism and capitalism which was never defined very clearly, partly because it was thought it would develop more or less 'naturally', i.e. without state imposition, and partly because there were some important differences of interpretation among Christian Democrats themselves.[1] However, the general idea was to eliminate the existing separation between capital and labour starting with increasing the participation of the workers in the management and ownership of the firms in which they worked and in the running of the state, and with encouraging Christian attitudes towards labour among employers.

1. See President Frei' position in S. Gulisasti, Partidos Políticos Chilenos, (Santiago, Nascimento, 1964, 2nd ed.) p. 215. Others saw it as a more dliberate process, see, for instance, Bosco Parra, Visión Comunitaria de la Economía, (Santiago, IDEP, 1966).

Until the communitarian society had been achieved, and while the traditional forms of private property still existed, the objective was to promote solidarity as an alternative to class warfare, and to do so by creating the conditions in which cooperation and accommodation would be more easily attained. In this sense, their program can be described as a version of the more comprehensive brand of 'latinamerican structuralism' which never reduced economic development and stability to a matter of merely removing economic bottlenecks.[1]

The program of the 'first' Christian Democratic Government included the following outstanding projects:

i) The 'Chileanization' of the Great Copper Mining sector, a project of partnership between the State and the U.S. companies operating in that sector, which accounted for around 55% of the total exports of the country and between 15 and 20% of the total tax revenue.[2] Imports were to increase in an expanding economy, no matter how positive the contribution of the Agrarian Reform to reducing them, so that increasing copper production and exports, by providing special incentives and agreeing on a massive investment program with the companies, was a key measure (la viga maestra[3]) in the program of the Government.

ii) An Agrarian Reform coupled with new legislation on agricultural workers unionization both designed to create a more productive agriculture and a solid socio-political base of support for the Christian Democrats in the rural areas, where the Conservatives, Liberals and Radicals had been traditionally strong.

1. The most important Christian Democratic exponent of this brand of structuralism, and one of the key advisers to President Frei until his death in 1965, was Jorge Ahumada.

2. See R. Ffrench-Davis, 'La importancia del Cobre en la Economía Chilena' in R. Ffrench-Davis and E. Tironi (eds). El Cobre en el Desarrollo Nacional (Santiago, Ed. Nueva Universidad, 1974) p. 25.

3. See, for instance, Ercilla, 12 May 1965 p. 19.

iii) Promoción Popular, i.e. the organization, education and mobilization of sectors which had not had an active social and political presence in the past, particularly in the urban areas. This program was particularly aimed at shanty town dwellers and non-working women in general, the former to be organized through Neighbourhood Councils (Juntas de Vecinos) and the latter through Mothers' Councils (Centros de Madres).[1]

iv) The development of worker's participation in the ownership and management of the firms, the first step being a reform of the Labour Code introducing voluntary affiliation, allowing more than one - parallel - union to exist, allowing civil servants to have legally recognized unions, increasing the degree of freedom in the financing of the union activities and increasing the strength of Federations and Confederations. The aim was, clearly, a stronger union movement but freed from the traditional control by the Communist and Socialist parties.[2]

v) An educational reform aimed at modernizing this sector. This was likely to affect the influence of the Radicals in the State sector of eduction.

vi) A Constitutional Reform aimed at strengthening the powers of the Executive branch, thereby increasing the capacity of the existing and subsequent Christian Democratic Government to retain strong leadership over this new and massive mobilization.

1. See, for instance, James Petras, 1969 op. cit., pp. 230-7.

2. See Alan Angell, 1972, op. cit. pp. 193-4 and Ernst Halperin, 1965, op. cit., p. 198.

C) The Anti-Inflationary Strategy of President Frei's Government

The anti-inflationary strategy of President Frei's Government contained three main elements:

i) The abovementioned program of reforms aimed at creating the conditions for long-term sustained price stability combined with rapid economic development.

ii) A medium-term stabilization program aimed at moving towards stability while the reforms were implemented, i.e. before they became effective.

iii) A system of short-term economic policy management including quantitative models and institutional arrangements designed to make possible a more informed choice of targets, the evaluation of the economic performance and the implementation of opportune corrections when needed.

This comprehensive approach to stabilization represented a major technical improvement not only from the point of view of the structuralist approach itself, but, also, from the point of view of Chilean economic policy-making and policy-management in general.

The medium-term stabilization program, announced at the beginning of the Government's term in office stated that inflation would be reduced from an annual rate of approximately 40%, inherited from the previous Government, to 25% at the end of the first year (1965), 15% at the end of the second, and 10% at the end of the third year in office, the implication being that very low levels of inflation, fairly close to zero, could be reached in a few years, well before the next presidential election, and could be sustained from then onwards due to the positive effects of the structural reforms.[1]

1. See Sergio Molina, El Proceso de Cambio en Chile, (Santiago, Ed. Universitaria, 1972), p. 75 and Ffrench-Davis, 1973, op. cit., pp. 53-5.

The stabilization would be achieved without reducing economic growth. The aim was to maintain the average rate of growth of the EGDP of the period 1961-1962 which had been 5% (a target which was possible at the beginning due to the existence of idle capacity), and to increase the rate of investment in order to make possible higher rates of growth when the stabilization had been completed and the reforms had become effective.

Frei preferred a gradual stabilization, in contrast to Alessandri, because he wanted to provide enough room for the distortions in relative prices to be corrected and because he did not want to implement the very unpopular wage and salary readjustments, lower than the previous increase in the RPI, which the 1955-56 and 1959-60 stabilization attempts had included. Wage and salary increases equal to the increase in the RPI created an upper limit to the speed of the stabilization determined by the maximum increase in their average purchasing power which was compatible with the programmed income redistribution. For the first year, the real increase in wages and salaries was going to be around 5%. Thus, the whole increase in the income per capita, which was programmed to be 2.5% was going to be channelled to the wage and salary-earners, who accounted for a little more than half the total income.[1] Once total stability had been achieved, i.e. within four or five years, the level of real wages and salaries would have increased by approximately 20% compared with the 1964 average level.[2]

1. See J. Cauas 'Política Económica de Corto Plazo' in Banco Central de Chile, Estudios Monetarios II, (Santiago, 1970) p. 38.

2. See Ffrench-Davis, 1973, op. cit., p. 210.

The selection of medium-term and short-term targets and the management of short-run economic policy were based on a set of quantitative tools including a model concerned with estimating the impact of cost factors on prices,[1] a model to determine the demand for money which corresponded to the programmed increases in prices and production, and a number of other estimates concerned with other macroeconomic areas. The main objective was to determine the monetary and fiscal policies compatible with the inflationary and growth targets, in other words, those which would not create additional inflationary pressures or recession.

In order to manage these economic policies, the Government established an Economic Committee at Cabinet level,[2] which would meet on a weekly basis and would review, on a monthly basis, an Annual Operating Plan which would include the macroeconomic assumptions and targets decided on the basis of the above mentioned quantitative procedures. The plan would be discussed in July-August of the previous year, after the Finance Ministry, the Central Bank and the national Planning Office (ODEPLAN) had produced the three reports which would provide the basic material for the work of the Committee.[3] This meant that when the Budget was sent to Congress in late August, the corresponding Operating Plan would already have been decided.

The Committee and the Operating Plan provided a safety device to prevent situations such as the one which had caused the crisis in 1961 leading to the collpase of the previous stabilization effort.

1. See J. Cauas 'Stabilization Policy - The Chilean Case', Journal of Political Economy, 4 (July-August 1970), pp. 815-825.

2. The Committee included the President of the Republic, the Ministers of Finance, Economy, Agriculture, Mining and Labour and the heads of the Development Coporation (CORFO), the State Bank, the Central Bank and the National Planning Office (ODEPLAN).

3. See P. Cleaves, Bureaucratic Politics and Administration in Chile, (Berkeley, Univ. of California Press, 1974), pp. 84-6.

Indeed, the stabilization program of President Frei's Government showed a considerable amount of technical learning from previous experiences. In order to avoid the traumatic effects of a foreign exchange crisis or a major devaluation, a 'crawling peg' nominal exchange rate was to be established and a very gradual liberalization of the foreign trade regime was to be implemented. The existence of an integral program, including annual targets, was also expected to produce a positive effect on expectations. In other words, it was a sort of 'gradualist' equivalent to the constant nominal exchange rate which had played much the same role in the previous, 'abrupt', stabilization effort.

However, the constant NER and the very considerable foreign trade liberalization of the previous attempt had also played a major role in providing a source of competition for domestic monopolies and oligopolies. Not surprisingly, president Frei's stabilization would rely considerably more on price controls. The objective of developing more effective and more comprehensive forms of State intervention in the process of setting prices was clearly stated.[1]

In fact, while the two previous stabilization efforts had moved in the direction of creating the conditions for increased economic liberalism (the traditional right-wing political parties and the business organizations being the main socio-political forces involved in both cases) the new stabilization attempt, and the new economic policies in general, were characterized by increased state intervention in almost every area. Here again, then, as in the case of the dirigisme of the Radicals in the 1940s and of some 'ibañistas' during the first half of President Ibañez Government, a government whose social base did not include the most crucial sources of private economic power, would rely more on State intervention.

1. See, for instance, Ercilla, 2 June 1965. p. 17.

However, since the Christian Democrats did not consider State interventionism to be desirable as a permanent feature, the implication was that the centralization of power in the Executive was needed only in order to overcome resistance to the changes that they would implement. Sooner rather than later the new social organizations that would be created, would provide the institutional base for a decentralization, thereby completing the redistribution of social power.

This aspect was particularly clear in the case of the main direct measure implemented in order to bring the wage-price spiral down to the programmed levels of inflation, i.e. price controls. It is worth remembering that the Alessandri Government had been able to promote a very succesful anti-inflationary campaign, which enjoyed full support from the business organizations and amounted to what could be described as the private equivalent to very strict price controls. But the Frei Government, given its program, was not in a position to have that kind of support. Hence, Frei's stabilization - which was meant to be a temporary effort, i.e. ending once stability had been achieved - required considerably increased price controls, with the new organizations participating in the policing of the controlled prices. As a result, the National Campaign against Inflation launched by the Government and led by a Christian Democratic congressman[1] would be seen by the business sector as a hostile campaign causing more and more resentment, particularly among retailers.[2]

1. The Campaign was launched at the beginning of June 1965, ten days after the recently elected congressmen were sworn in. Thus, it can be seen as a direct consequence of the 'Christian Democratic Earthquake' which is discussed in the next section.

2. By mid-1966, after a year of campaigning, the Central Chamber of Commerce organized a 'Merchants Day' celebration which turned into a massive mobilization against excessive control by the Government and harassment by the new organizations which had been created by the Government.

D) The Christian Democratic 'Earthquake'

With the March 1965 general parliamentary election in prospect, President Frei's Government moved very quickly. Even before taking office, a special commission went abroad to start renegotiating the foreign debt which otherwise threatened to absorb approximately 50% of the country's exports receipts in 1965.[1]

Before the parliamentary election, the Government sent to Congress a package of Bills which included the following initiatives directly concerned with the short-term aspects of the stabilization program:

i) A general wage and salary reajustment equal to the increase in the RPI in the twelve months before the readjustment, excluding those earning more than six times the minimum salary, and including restrictions on the rights of unions to petition, negotiate and strike.

ii) A reform of labour legislation along the lines already mentioned in section B, above.

iii) The legalization of Promoción Popular, aimed at making possible the channelling of resources towards the development of the new organizations.

iv) Authorization for the Government to reorganize the Executive branch, which was clearly aimed at reducing the increase in Public Expenditure required to implement the Government's program and to provide Civil Service jobs for its own supporters.

v) A new tax on wealth of 1.5 to 3.0% of the total value of the vehicles, real estate, shares in stock companies and in the ownership of other kinds of firms. Also, readjustability, according to the RPI, of those income taxes that were not paid on a pay-as-you-earn basis.

1. The Government managed to reduce it by one half in 1965, 'Mensaje del Presidente al Congreso Nacional' 21 May 1965, reported in EMS, 22 May 1965, p. 1.

The legislative package also included initiatives concerned with the structural reforms, in other words, concerned with the long-term conditions required to secure stability. These were a Constitutional amendment on property rights in order to make way for the future Agrarian Reform, a Constitutional amendment widening the electoral franchise, a Constitutional amendment increasing the Executive powers over financial matters and over conflicts with Congress in general, and a Bill authorizing the Government to negotiate the 'Chileanization' of the U.S. companies operating in the Great Copper Mining Sector.

Partly because some of the Bills were sent to Congress too late - notably the reform of the Labour Code concerning the unions - and partly because the Christian Democrats did not have enough Congressional strength to overcome the centre-to-the-right opposition to some of them and the centre-to-the-left opposition to others, none of the Bills were passed before the March 1965 election. This situation reinforced the effectiveness of the very intensive electoral campaign conducted by the Christian Democratic Party which emphasized the need of 'a Congress for Frei'.

The electoral results confirmed the existence of the 'presidential cycle', showing the tremendous amount of support that Presidents could obtain at the beginning of their terms in office, the marxist Communists and Socialists being the only parties which managed to survive the 'Christian Democratic earthquake' intact, (see Table 6.1 below).

Table 6.1

Electoral Results in the March 1965 General Parliamentary Election compared with the March 1961 Parliamentary and September 1964 Presidential elections

	Seats				Percentages		
	Senators		Deputies		1961	1964	1965
	Total	Change	Total	Change			
Conservatives (PCU)	2	-2	3	-14	14.3		5.2
Liberals (PL)	5	-5	6	-22	16.1		7.3
Christian Dem. (PDC)	13	+9	82	+59	15.4	55.7	42.3
Radicals (PR)	9	-4	20	-19	21.4	4.9	13.3
Socialists (PS)	7	-1	15	+3	10.7	38.6	10.3
Communists (PC)	5	+2	18	+2	11.4		12.4
National Dem. (PADENA)	1	+1	3	-9	7.4		3.1
Others	3 a/	-	-	-	-	-	3.2
Blank/Void					3.3	0.8	3.0
Total	45	-	147	-	100.0	100.0	100.0
Total votes (hundred of thousand)					13.9	25.3	23.6
Abstention (percentages)					25.4	13.2	19.4

a/ One former Radical (leftist), one former Communist (maoist) and one member of the national Vanguard, a small group supporting the Government.

Source: Offical figures, Registro Electoral.

Although the Christian Democrats obtained less votes than the 'ibañistas' in 1953, they did better in terms of seats because they did not fight the election divided. As a result, the Government could count on a comfortable majority in the lower Chamber. However, due to the fact that only 20 out of a total of 45 seats in the Senate were contested in March 1965, and given that the Christian Democrats carried-over only one Senator elected in 1961, they did not even manage to gather a blocking one third in the Senate, despite having won 60% of the seats contested. Of course, the opposition would have to unite against the Government to defeat it, either by rejecting a Bill as a whole in the Senate - the Government not having two thirds in the lower Chamber to insist -, or by gathering two thirds of the vote in the Senate to impose their criteria. The Government could still use the veto powers of the Executive in order to secure a victory - the opposition had two thirds of the vote in the Senate, but would also need two thirds in the lower Chamber to override presidential vetoes - but this situation meant that the Senate could delay the enactment of the legislation considerably.

To overcome this problem the Government would have to negotiate with the opposition, particularly in the Senate. Apart from that, the main political problem facing the Government was the need to avoid the kind of internal indiscipline caused by political conflict and/or electoral manoeuvering that had sapped the strength of previous Governments. To cope with this, shortly after the election, the Government reached an agreement with the Christian Democratic Party. This stipulated that a Bill agreed between the Government and the Party leadership could not be modified by Christian Democratic Senators or Deputies in Congress.

E) The Political cost of a structuralist program

During 1965 and 1966, the Government sought - and to a large extent achieved - collaboration from the Conservatives and Liberals (which merged and created the National Party on 1 May 1966) in order to overcome Radical, Socialist and Communist opposition to some of the restrictive clauses included in the legislation concerning wage and salary readjustments. However, the Government did not manage to restrict the rights of the unions to petition, negotiate and strike, as the Bills on wage and salary readjustments originally intended. This was not, of course, due to lack of support from the right-wing parties but was the consequence of considerable opposition from inside the Christian Democratic party itself, and particularly from its union leaders.[1]

The same kind of opposition caused the postponement of the reform of the Labour Code. Although the Second Congress of the Christian Democratic Party insisted on the importance of this reform, internal opposition continued to be too strong. The centre-right alliance which backed the reform won the election of the new Executive Board, but only with 55% of the vote against 45% obtained by the left-wing. This was too narrow a majority to proceed with the reform of the Labour Code. Without this legislation and without support from the Christian Democratic leaders themselves, all the attempts at developing a new confederation controlled by the party ended in failure and the predominance of the CUT in the labour movement was never seriously challenged.

1. See Jorge Barría, Historia de la CUT, (Santiago, PLA,1971)pp. 132-3 and Alan Angell, 1972, op. cit., p. 199.

As a result of these failures the Government increasingly found itself in the very unsatisfactory position of having made possible considerable increases in real wages and salaries without having capitalized politically in return. Since relations between capital and labour remained essentially the same, these wage and salary increases combined with other factors, such as the amendment on property rights being discussed in Congress, reduced the incentives for private investors, thereby increasing the need for public investment (see next section). Moreover, due to the fact that no significant steps were taken towards workers participation in the ownership and management of the firms, the Government did not have more room than any previous Government for successfully promoting wage restraint among the unions.

The Government considered the 1965 increase (which was above 10% in real terms) to be excessive. In fact, it was twice as much as the Government had programmed. Although in 1966 it tried to bring them back in line with the stabilization program, it failed again and by the end of that year the Government abandoned its policy of general readjustments in line with the increase in the official RPI over the previous year.[1] However, in 1967, real wages and salaries continued to increase above programmed levels.[2] Thus, throughout the first half of its term in office, the Government did not manage to implement the kind of fine tuning which the medium-term program and the short-term operating plans had assumed to be possible.

1. See Ministry of Labour, 'Circular No. 1256', 27 Feb. 1967, quoted in Jorge Barría, 1971, op. cit., pp. 134-5.

2. See Ricardo Ffrench-Davis, 1973, op. cit., Table 75 p. 345 and Chapter Nine of this thesis.

Despite the wage and salary increases the left-wing opposition was fairly successful in promoting the view that the Government was hostile towards the unions and as wedded to wage restraint as the previous Governments had been. In fact, taking into account the official Wages and Salaries Index (WSI), which represented the situation of the more organized sectors and was the only general index available at the time, the 1965 real increase had fallen short of compensating for the reductions which real wages and salaries had suffered during the inflationary acceleration in 1963-1964. That acceleration had reduced their average purchasing power to the level of 1960, the year in which very restrictive policies were accompanied by an abrupt stabilization. Since then, the GDP per capita had increased by 11.4%,[1] and with the Government target being an additional 2.5% in 1965 (which was actually exceeded), the 5.0% increase in wages and salaries which had been programmed was not as generous as it looked. Moreover, as usual, there was some controversy about the accuracy of the official RPI as an estimate of the increase in the cost of living.

The left was also helped by the fact that President Frei's Government was no exception concerning the use of the police and the Armed Forces against those participating in illegal strikes and public demonstrations. Despite differences of opinion between the Socialists and the Communists - the former being more strongly against collaborating with the Government - both parties were interested in demonstrating that the 'Revolution in Freedom' promised by the Christian Democrats was neither a revolution nor a road to more freedom for the ordinary worker.

1. For the GDP see Ricardo Ffrench-Davis, 1973, op. cit., Table 34, p. 252, and for the population figures the more recent estimates after the 1970 census produced by the Latin American Demographic Centre in Santiago, quoted in J.C. Méndez (ed.) Chilean Economic Policy, (Santiago, Budget Directorate, 1979), p. 331.

In mid-1965 there were violent clashes between the police and dockers who were protesting against massive dismissals of workers in the state owned Docks Company in Valparaiso, Chile's largest port. The powerful Confederation of Copper Miners (CTC) was one of the sectors of the union movement most active against the Government policies and organized a thirty seven days long national strike in October-November 1965. This forced the Government into granting a number of benefits demanded by the CTC that had been previously agreed between the Government and the left-wing opposition in the Senate, during discussions of the 'Chileanization' Bill, and which had thereafter been rejected in the lower Chamber by the Christian Democratic majority. Then, the most important labour clash took place in March 1966 when the Army was sent to take the union's headquarters in the third largest copper mine which was on strike in support of another strike which had already lasted more than two months in the second largest copper mine in the country.[1] The battle which followed left nine strikers dead and several injured, and caused considerable damage to the already tense relations between the Government, on one side, and the unions and left-wing opposition parties on the other.[2]

However, no matter how justified the Government may have been in trying to end a strike which was very damaging for the country's economy, the fact is that the hard anti-strike line adopted by the President only increased the hostility of the unions.

1. Together they accounted for one third of the total copper production in the country.

2. See Manuel Barrera, El conflicto en el Enclave Cuprífero, (Santiago, Univ. de Chile, 1973) pp. 72-80 and A. Angell, op. cit., p. 200.

Despite these conflicts, the Communists and Socialists supported the Christian Democratic proposals concerning the tax on wealth, the amendment on property rights and the new Agrarian Reform, which were opposed by the right-wing parties. These proposals, and the considerable increase in state intervention in the economy, led to increased criticism from the business organizations.

In contrast to its aggressive stance towards the traditional union movement, the Government had frequently invited high ranking officials of the business organizations to discuss the anti-inflationary policy and other crucial matters.[1] The Christian Democrats tried to increase their influence inside the business organizations themselves by arguing that their reforms, far from being a threat, were the only hope if free private enterprise was to survive. These arguments were not always well received. After a year and a half of continuously deteriorating relations, the Confederation of Production and Commerce (CPC), the overall organization of the business sector sought more influence in the Government. In mid-1966, and even though Government supporters were far from being predominant in the organization, the CPC elected a new pro-Government president, a prominent member of the Christian Businessmen organization (USEC), who proposed the organization of a well prepared national convention of all businessmen to lay the foundations of a new way of defending private enterprise, on the basis of a 'humanistic', christian social inspired, concept.[2]

1. See, for instance, EMS, 17 May 1965 p. 1 and Ercilla, 21 July 1965, pp. 14-15.

2. See David F. Cusack 'The Politics of Chilean private Enterprise under Christian Democracy', (Univ. of Denver, Ph.D. thesis, 1970), pp. 22.4.

However, neither the property rights amendment nor the new Agrarian Reform were either suspended or modified as a result of this move. So in 1967-1968 the organization of the national convention turned into a campaign for the defense of the traditional concept of private enterprise. This occurred in a context of the political polarization which is discussed in section H, below.

Thus, the Christian Democrats did not achieve any significant success in persuading either the unions or the business organizations to accept the reforms which were the first step in the road towards a new relation between capital and labour. Moreover, the more the traditionally organized sectors in society rejected the policies of the Government, the more the left- and right-wing and the centre opposition found it politically profitable to be uncooperative and to promote hostility towards the Government. At the end of 1965 the rival oppositions signalled this change in the situation by uniting against the Government and rejecting some proposals included in the Budget for 1966. These were not crucial items and the Senate approved some of them at a later legislative stage, but the Government had been warned that the opposition did not intend to remain at the mercy of the Government's tactic of playing the extremes off against each other.

F) The General Economic Performance of the Structuralist program, 1965-1966

Despite the difficulties faced by the Government in trying to keep wage and salary increases in line with its program, there were some factors which made a positive contribution to the stabilization throughout 1965-1966.

First of all, a 'circumstantial' contribution by exports which increased very rapidly due to the Vietnam war which caused a huge increase in the international price of copper, its effect being reinforced by the fact that, at the same time, the Chilean Government moved copper exports away from the U.S. producers' price and towards the higher London Metals Exchange price.[1] Exports had increased by 16.0% in 1964 (U.S. dollars of constant value), reaching a record level, but they increased again by 13.0 and 23.0% in 1965 and 1966, i.e. a 62.0% increase in three years.[2]

Secondly, the renegotiation of the foreign debt also had a positive impact on the capacity to import. The total combined effect in 1965 of the increase in exports and the renegotiation being equivalent to 40% of the 1964 exports.

Thirdly, the domestic prices of imports of fuel, food and raw materials increased far less than other prices due to a combination of factors related to international prices, the foreign exchange rate and changes in tariffs, thereby resulting in substantial cost reductions. The import component of the Wholesale Price Index (WPI) increased by only 38.0% in 1965-66, against a 62.0% increase for the national component and 47.2% in the Retail Price Index (RPI). The actual contribution

1. See Ricardo Ffrench-Davis, 'La importancia del Cobre en la Economía Chilena', op. cit., p. 45 and Table 7, p. 46.

2. See Ricardo Ffrench-Davis, 1973, op. cit., Table 51, p. 289.

of import prices was approximately as planned.[1]

In fact, the whole Balance of Payments situation improved. During 1965 there was a surplus equivalent to 10.0% of total imports, so foreign exchange reserves increased, and the increase of the foreign debt slowed. The same happened in 1966 the surplus being twice the 1965 level.

Thus, the 1964-65 stabilization was not introduced in response to a Balance of Payments crisis. Skidmore has suggested that this is what usually prompted stabilization measures in post-war Latin America.[2] But this generalization does not hold for Chile, either in 1955, or 1959 or 1965. Moreover, in 1965 the stabilization was not implemented at the expense of worsening the Balance of Payments situation as had been the case in 1959-1961, so that there was some room left for accommodating an eventual fall in the copper price, though that actually did not materialize until the end of the Government's term in office.

Concerning economic growth, the EGDP grew by 5.0 and 7.0% in 1965 and 1966, more than the annual 5.0% which had been programmed for each year. Considering the positive effect of improving terms of trade, i.e. the GDP instead of the EGDP, the performance was even more impressive, the annual increases being 6.1 and 10.1 respectively. The rate of unemployment in the country as a whole, fell from 7.0% in 1964 to 6.1% in 1966.[3]

However, there were fiscal difficulties which led to some reductions in public expenditure on housing. This affected the construction sector from 1966 onwards.

1. Vittorio Corbo, 1974, op. cit., overestimates the contribution by using the official WPI without corrections, see p. 77 and Table A.2 p. 250. See the corrections in Ricardo Ffrench-Davis, 1973, op. cit., Table 30, p. 243 and Table 33, p. 248.

2. Thomas Skidmore, 'The Politics of Economic Stabilization in Latin America', mimeo, Woodrow Wilson Centre for Scholars, Washington, 1979.

3. For the GDP and EGDP, see Ricardo Ffrench-Davis, 1973, op. cit. Table 34, p. 252. Unemployment from ODEPLAN, 1971, op. cit., p. 84.

The fiscal problems were not the result of any structural inability to rise taxes or sudden reduction in the revenue from imports and exports, as could have been expected from a structuralist point of view. Indeed tax revenue from the Great Copper Mining Sector increased by 22.5 and 57.8% in real terms in 1965 and 1966 and the total tax revenue increased by 26.5 and 22.3%, i.e. a record 54.7% real increase in the first two years of the Government's term in office, compared with only 26.5% in 1960-1961 and a fall of 2.0% in 1953-1954, (see Chapter Eight also). This was a tremendous success for the Government in terms of centralizing resources in order to finance its programs. However, there was also an increased burden on the taxpayers, and especially those in the higher income-brackets who were particularly affected by the considerable increases in personal direct taxation.

Despite these increases, the fiscal situation did not improve significantly and tax revenue continued to finance only around three quarters of the total expenditure in 1965, as had been the case, on average, throughout the previous Government. The cause was a huge increase in fiscal expenditure, particularly on housing, agriculture and eduction. These sectors increased their share in total outlays from 26.5% in 1964 to 30.0% in 1965. In fact, the expenditure on housing increased by 70.0% in real terms in 1965, partly due to the housing program having started 20% more houses than what had been programmed.

The fiscal problem of President Frei's Government was not structural, at least not in the way in which structuralist economists have usually described it. President Frei's fiscal problem was a result of the huge expansion in public expenditure required to finance the program of reforms and the fact that the fiscal system did not provide the devices which were needed to keep such an expansion under control,

particularly at the beginning of a Government. Once the expansion had taken place, however, the Government, in trying to correct the situation, was faced again with a downward inflexibility of public expenditure and an upward inflexibility of taxation. (see Chapter Eight). Fiscal difficulties were also connected with the excessive wage and salary increases already mentioned. Civil servants obtained increases in excess of the general readjustments enacted at the beginning of each year. A number of special readjustments were given to sectors which were demanding the correction of injustices produced in the previous Government.

Finally, a very important factor from the point of view of the long-term viability of the stabilization, was the financial capability of the Government when it came to compensating for the fall in the rate of private investment which occurred in 1965-1966. Fiscal difficulties were very important here. While public sector investment on fixed capital (gross) increased by 11.1 and 10.7% in real terms in 1965 and 1966, the private sector component fell by 1.4 and 7.9% respectively, so that the rate of investment (in terms of the GDP) fell from 15.5% in 1964 to 14.1% in 1966. By 1966 public investment accounted for 55.0% of total investment directly, and financed another 10.0% by providing resources to the private sector.[1]

Since the economy was expanding and there were no credit restrictions or excessive competition from imports, the bad performance of private investment can only be explained as an effect of the structural reforms and redistributive measures, which represented a threat for private investors.

1. ODEPLAN, 'La Inversión Pública en el período 1961-1970', (Santiago, June 1971), Table 1.

Consequently, the Government had a triple fiscal problem: first, it had to finance the economic reforms; second, it had to finance the programs aimed at expanding its social base; and, third, it had to finance the fall in private investment and the excessive wage and salary increases caused by the sectors which the Government had failed to win over. Thus, after two years in office, the key to the continuation of the stabilization program, from the economic point of view, was to find ways of controlling wage and salary increases, financing more investment and reducing the fiscal deficit. In fact, these were the three major economic objectives of the Forced Savings Scheme proposed by the Government, which led to the decisive battle of the stabilization effort at the end of 1967. However, before going into that, it is worth reviewing the evolution of the stabilization itself and the general political situation in the country.

G) Structualism, Polarization and Electoral Attrition

During the first two years, Frei's anti-inflationary record was quite good. The annual increase in the RPI went down from 38.4% in 1964 to 25.9 and 17.0% in 1965 and 1966, which was a performance not very far from the announced targets of 25.0 and 15.0%. Moreover, taking into account that the target for 1966 had been modified to 16.7% at the end of 1965[1] (even though it was not made public at the time) the performance was even better.

1. See Jorge Cauas, 'Política Económica de Corto Plazo', op. cit., pp. 34-5.

However, whatever its economic and political advantages, a gradual stabilization such as this one, was not nearly as spectacular as Alessandri's early achievements and it was more difficult for the public to 'feel it'. Consequently, there was more controversy about the degree of success of the stabilization. There was also dispute over the accuracy of the official RPI as an estimate of the actual increase in the cost of living. As a result, the stabilization was not popular enough to prevent erosion of the Government's electoral support. In contrast with President Alessandri's first two years in office, factors other than the declining rate of inflation were more important, such as general economic performance, the mobilization of previously passive social sectors and the political events surrounding the implementation of the Government's program.

A year after the Christian Democratic 'earthquake', a very important by-election took place in Valparaíso, a Christian Democratic stronghold, close to the capital and with 10% of the total national electorate. The electoral results showed that something was not working in the Government 's strategy. The Christian Democratic vote went down from 57.2% - in March 1965 - to 49.8% in March 1966, while the FRAP increased theirs from 22.0% to 28.4%. Since some of the Radicals rejected the alliance of their party with the Conservatives and Liberals and voted for the FRAP, the results can be interpreted as a first sign of electoral polarization, with the left-wing Radicals voting for the FRAP, and some March 1965 Christian Democratic voters going back to support the traditional parties in the centre-right alliance.

After the election, while the Second Christian Democratic Congress (already mentioned in a previous section) ratified the Government's program and strategy, the Radicals began to move rapidly towards the left. They decided to support a left-wing candidate in the event of an election for the Senate presidency and they campaigned for the April 1967 general municipal election on the basis of very intensive effort to recover their left-of-centre image.

The April 1967 general election was very important because it provided the first major electoral test for the Government. The campaign was fought in the context of rapidly increasing conflict between the Government and the unions caused by the implementation of mild but noticeable restrictions on wage and salary increases.[1]

1. The unions' offensive included a violent strike in the national Health Service which paralyzed many hospitals and led to violent clashes between demonstrators and the police. These events resembled those in August-September 1963 when another violent NHS strike led to a defeat of the Government in Congress and provided the Radicals with the justification for leaving the Cabinet in order to fight the presidential campaign. A very complete account of the 1963 strike can be found in Ben G. Burnett, 1970, op. cit., pp. 234-45.

Moreover, the relations between the Government and the business organizations had become very tense due to the amendment on property rights which was in the last legislative stages.[1]

In the last week of 1966, the former presidential candidate of the FRAP, Socialist Senator Salvador Allende, was elected President of the Senate after the Christian Democrat who was the president was defeated on a vote about a procedural matter concerning the discussion of the property rights amendment. Only three weeks later, the Senate refused authorization for the President of the Republic to visit the United States of America, insulting his office and damaging his credibility abroad.

The Government and the Christian Democratic Party reacted very strongly and the campaign turned into a contest between the FRAP and the Radicals, portraying themselves as the defenders of parliamentary prerrogatives, unions' rights and wage-and salary-earners' interests, the Government and the Christian Democratic Party campaigning on the basis of attacking the left-wing opposition in the Senate and with a mixture of leftist and centrist platforms put forward by different sectors of the party, and the new National Party campaigning as the only true defender of private property.

The results confirmed the electoral attrition suffered by the Christian Democratic Party and the considerable increase in the Communist and Socialist vote which had been already present in the above mentioned by-elections, (see Table 6.2 below).

1. As an example, on 24 Nov. 1966 the Executive Board of the SOFOFA rejected by 31 votes against 19 a motion condemning their president for having insulted the President of the Republic by criticizing his policies in a public meeting in which he was present. See EMS, 25 Nov. 1966 p. 1.

Table 6.2

Electoral Results in the April 1967 General Municipal Election compared with the April 1963 Municipal and March 1965 Parliamentary General Elections

	Municipal April 1963	Parliamentary March 1965	Municipal April 1967
Nationals (PN)	23.6 a/	12.5 a/	14.3
Christian Democrats (PDC)	22.0	42.3	35.6
Radicals (PR)	20.8	13.3	16.1
Socialists (PS)	11.1	10.3	13.9
Communists (PC)	12.4	12.4	14.8
Other FRAP	5.8	3.1	-
Others	0.9	3.2	3.1
Blank/Void	3.4	3.0	2.2
Total	100.0	100.0	100.0
Total votes (thousand)	2,068.5	2,353.1	2,343.3
Abstention (%)	19.5	19.4	27.3

Source: Offical Figures, Registro Electoral

a/ Conservatives and Liberals together.

The results cannot be explained by pointing to the anti-inflationary performance either in terms of effectiveness or in terms of sacrifices demanded from the population in order to achieve stability.[1]

1. See the criticism of D.R. Konkel's contribution in Chapter Two. See also D.R. Konkel, 1977, op. cit. 4-8 and 107.

Chilean Governments have lost their initial support for a number of reasons. In the case of President Frei it was because some of his initial support was rather volatile, being the result of a 'political earthquake' rather than long-term allegiance and the implementation of his program involved considerable political cost.

Besides, it was not just a matter of electoral erosion. The nation was experiencing a very intensive process of political polarization. The Nationals were a new kind of right-wing party with a new style characterized by the use of massive mobilizations of middle sectors and a patriotic rhetoric in which the commitment to the preservation of the democratic regime was less pronounced than it had been in the case of the traiditional Conservatives and Liberals.[1] The Socialists had adopted a more violent rhetoric clearly influenced by the Cuban Revolution,[2] and the Radicals moved decisively towards the left by electing a new left-wing national Executive Committee and adopting a more radical socialist program in mid-1967. In fact, only the Communists had not radicalized, sustaining their policy of collaboration from the opposition in the context of their strategy of peaceful road towards socialism.[3] Consequently, the relations between the Communists and Socialists had become very strained not only because of the question of collaboration with the Government but, also, because of disagreement about associating themselves with the Radicals, which the Socialists also rejected.

1. As an example, the Executive Board of the National Party was jailed and later charged with sedition in connection with some public statements criticizing the Government policies concerning the Armed Forces and its handling of a boundary conflict with neighbour Argentina, although, later they were acquitted by the Courts. See EMS 1 Sept. 1967 p. 1.

2. Senator Altamirano, the leader of the pro-Cuban sectors in the Socialist Party, who had recently attended the Conference of the Latin American Organization of Solidarity (OLAS) in Habana, was charged with defaming the Armed Forces and promoting violence, was stripped of his parliamentary immunity and later sentenced to two months in jail. See EMS 13 Sept. 1967 p. 1 and 26 March 1968, p. 1.

3. See Ben G. Burnett, 1970, op. cit., pp. 278-9.

The Government was also facing difficulties due to polarization inside the Christian Democratic Party. The left-wing dominated Political-Technical Committee of the party had prepared a very radical report to be presented in the next national meeting of the party (Junta Nacional), in July 1967. It advocated more state involvement in the management of the economy, a reorganization and democratization of the financial and industrial power, an acceleration of the Agrarian Reform, and effective people's participation at all levels.[1] The report became the basis for an alliance between the 'rebels' - the left-wing sector which advocated an intensification of the 'revolution in freedom' and held socialist views - and the 'third-liners' (terceristas) who were the party centre. As a result, the pro-Government right-of-the-centre sector (oficialistas), was defeated in the election of the new Executive Board by 55.0% against 45.0% of the vote, thereby reversing the balance of forces which had existed in the 1965 and 1966 elections.[2] From then on, even the necessary agreement with the party leadership required to secure party discipline in Congress would become difficult for the Government to maintain.

The mobilization and organization of previously passive social sectors had been aimed at changing the traditional structure of Chilean politics dominated by the conflicts between the more organized sectors, represented by the business organizations and the unions. Instead, those very conflicts were now threatening the unity of the Christian Democratic party and the collaboration of the party with the Government.

1. See Jaques Chonchol et al, 'Proposiciones para una Acción Política en el período 1967-1970, de una vía no capitalista de desarrollo', in Política, Economía y Cultura, No. 239, 28 July 1967, supplement.

2. The views of the three groups can be found in Política y Espíritu, No. 235, Aug-Sept. 1966 pp 55-97.

While the reforms concerning the relation between capital and labour outside agriculture had not been implemented yet, the newly mobilized sectors were demanding more benefits, making accommodation even more difficult than before.

H) The Decisive Battle of the Stabilization Program: The Forced Savings Scheme

Historically speaking, it is possible to trace the origins of this scheme back to the U.N. Mission report in 1950 (see Chapter Two also). The idea of a Forced Savings Scheme had been discussed inside the Government since December 1964, at the very beginning of its term in office.[1] However, it had been rejected because it was considered to be politically inconvenient before the Government had consolidated its support. In fact, this turned out to be a great political mistake because, although 1964 was evidently too early - with the general parliamentary elections still to come - waiting three more years led to a worse outcome. The scheme was finally proposed by the Government in mid-October 1967 without any previous consultation with the new left-wing leadership of the Christian Democratic party. Originally, the scheme consisted of a general wage and salary readjustment equal to the increase in the official RPI in 1967 which was estimated it would reach 20.0%. Of this amount, one half would be paid into personal accounts in a 'Workers' Capitalization Fund' to be used in financing public investment.

1. See Sergio Molina, 1972, op. cit. p. 144 and Ricardo Ffrench-Davis, 1973, op. cit., p. 216.

After a short period of intensive negotiations with the Christian Democratic party, during which every other political party voiced its opposition to the scheme, the proportion to be paid by the employees into the Fund was reduced to one quarter of the total readjustment (i.e. 5.0% out of the total 20.0%) and the official proposal announced in Congress by the Minister of Finance Sergio Molina, included an additional 5.0% to be paid by the employer into the employee's account.[1] The bonds, which would represent the contribution, could be used to pay debts related to the purchasing of housing either through the Public or Private Sector financial schemes, and they would also carry a guaranteed annual interest above inflation.

The Fund would be administered by a General Council of fifty members, including seven workers appointed by the President of the Republic and forty three union leaders appointed by the Minister of Labour taking into account the membership and geographical distribution of the unions. On top of that, there would be an Executive Committee including four representatives from the Government - among them the head of the National Planning Office, ODEPLAN, who would act as president - and three representatives from the workers. As an obvious complement, no wage or salary increase exceeding the statutory limit would be permitted, and both the rights to negotiate and to strike would be suspended. In other words, the traditional union movement would become almost totally superfluous while an alternative organization would become active in representing wage- and salary-earners interests. The scheme excluded the Armed Forces, the Police, the Judiciary and, understandably, the pensioners.

1. 'Exposición sobre el estado de la Hacienda Pública del Ministro de Hacienda don Sergio Molina', 7 Nov. 1967 pp. 22-6.

To balance the contribution of each sector to the savings effort, publicly quoted companies would have to re-invest two thirds of their profits either in their own businesses or in inflation-proof savings certificates issued by the Central Bank.[1]

No doubt, the scheme was an attempt to correct both the macroeconomic imbalances and the delays in implementing the union reform.[2]

As the Government should have anticipated, the Socialists, Communists and the CUT rejected the scheme from the beginning and coined the term 'chiribonos', a combination of the words 'chirimoyo' (an idiom meaning a cheque without funds) and 'bonos' (bonds), implying that the scheme was just a manoeuvre to reduce the wage and salary readjustment. However, again, the Communists adopted a more flexible attitude and, in a meeting between union leaders and the Ministers of Finance, Sergio Molina, and Labour, William Thayer, the Communist President of the CUT announced that he would be prepared to reconsider his attitude towards the scheme if union representatives were appointed in directive positions in the National Planning Office (ODEPLAN), the Development Corporation (CORFO), the Superintendency of Banks, the National Health Service and several other public agencies. The Radicals considered the scheme to be coercive and regressive, and accused the Government of ignoring foreign capital, capital flight, speculation, and of doing nothing to improve private investment.[3]

1. See Jorge Barría, 1971, op. cit., p. 138.
2. As had been the case with the reform of the Labour Code, the unions side of the scheme was a contribution of the Minister of Labour William Thayer. For his views see William Thayer, Trabajo, Empresa y Revolución, (Santiago, Zig-Zag, 1968).
3. See El Siglo, 17 Nov. 1967, quoted in Peter Cleaves, 1974, op. cit. pp. 121-2.

Inside the Christian Democratic Party, the National Council voted against the scheme and forced its modification. By then, the Economic Committee had accepted the exclusion of the poorest 15% of the workers from the scheme and changing the contribution of the others from 5% to a scale from 3.7% to 7.0%.[1] It would be a mistake to see this confrontation between the party and the Economic Committee as a confrontation between the full time politicians and the independent 'técnicos'. No doubt, the party was the political organization while the Committee was the high command of the Government 'técnicos' concerned with economic matters. However, the 'técnicos' were not outside the party and although there were a number of independents collaborating with the management of the economic policy, a very considerable proportion of the 'técnicos' were members of the party and had taken positions in terms of the conflicts inside the party. Moreover, the Economic Committee was not a purely technical device. On the contrary, it was a high command, of which the President of the Republic himself and the Ministers of such politically sensitive areas as Labour, Agriculture and Mining were also members. After all, the forced savings scheme was not a mere technical-economic proposal purely aimed at correcting some macroeconomic imbalances. In short, the Economic Committee was the instrument of the 'oficialistas' in a situation in which the party was controlled by their left-wing rivals. In a country as politicized as Chile was at the time, this was not a special characteristic of this sector of the 'técnicos'. In other words, independent 'técnicos', let alone 'technocrats'[2]

1. See EMS, 17 Nov. 1967, p. 1.

2. For a discussion about the differences between 'técnicos' and technocrats see Lourdes Sola, 'The Political and Ideological constraints to economic management in Brazil 1945-63', (Oxford Ph.D. Thesis, 1982), p. 12.

were not that abundant.[1]

On the other side of the socio-political spectrum, the Confederation of Production and Commerce (CPC), which had already launched its campaign for the defense of private enterprise (see Section E), rejected the scheme because the wage and salary readjustment would cost 25.0 instead of 20.0% to the employers, more than the rate of inflation expected for 1967, and because they had not been consulted in advance. Moreover, the business organizations did not like this further expansion of the state intervention in the economy, and neither did the National party which also accused the Government of having created a device to disguise new taxation.[2]

On 27 and 28 November 1967, the President defended the scheme through a national network of radio and television. At the time, the leadership of the Christian Democratic party had decided to postpone the completion of the first legislative stage in the lower Chamber, due to a very important by-election of a Senator in the southern, agrarian, constituency of Bío-Bío, Malleco and Cautín. The election, held in mid-December, was won by the Radical candidate, officially supported by the Communists and unofficially by the local Socialists. However, he obtained only 37.2% of the vote against 39.5% obtained by the three parties only nine months before. The Christian Democrats lost considerable electoral support again, obtaining only 36.7% against 42.1% in April. In fact, the real winners were the Nationals which came third but scored an impressive increase from 15.7% to 23.0% campaigning against the Agrarian Reform. Clearly, right-wing Radicals and Christian Democrats had decided to reject the new left-wing leaderships of their parties.

1. The subject was already being discussed in the mid-1950s in the context of the controversy about the role of the Klein-Saks Mission and the lack of 'impartial experts' in the country. See A.O. Hirschman, 'Inflation in Chile', op. cit., p. 210.

2. See El Diario Ilustrado, 3 Feb. 1968, p. 2, quoted in Peter Cleaves, 1974, op. cit., p.121-2.

It was in the context of this new defeat that the Christian Democratic party held an extraordinary national meeting (Junta), in which, after a very dramatic showdown between the left and the President of the Republic himself, a motion supporting the Government defeated a critical one presented by the Executive Board by 58% against 42%. The Board resigned but the new situation was not very much better for the Government, for the new Board was elected with only 20% of the total entitled to vote, the others having abstained or left the meeting. This new internal party situation did not help the Government to overcome the opposition of both left and right in the Senate, so that three weeks after the Junta, the Government was forced to withdraw the Bill from the Senate to avoid a defeat that would have buried the scheme for at least one year. As a result, the Minister of Labour resigned and was then followed by the whole Cabinet, by mid-February.

The new Cabinet was clearly designed to try to obtain support from the right-wing opposition and to improve relations with the business sector which was about to have its very carefully prepared and much publicized national convention in April. Prominent in the Cabinet were the Interior Minister, responsible for law and order, a Christian Democratic businessman - Edmundo Pérez Zujovic - and the new Finance Minister, Raúl Sáez, an engineer with long experience as a Public Sector manager who had been a member of the Committee of 'Nine Experts' which advised on the implementation of the Alliance for Progress. Sáez had also been the principal negotiator with the U.S. Copper companies at the beginning of the 'Chileanization', and a prominent participant in the design of President Frei's program, in charge of industrial development and foreign investment. Immediately, both Ministers made public their views on the important role played by private enterprise in the economy. The National Party (PN) reacted favourably, welcoming the change.

At the beginning of March 1968, the Government proposed a watered down Bill restricting the scheme to those wage and salary increases in excess of the increase in the RPI during the previous year - in the case of the private sector - and to the highest paid third of the public sector employees (excluding the Armed Forces and the Police) which were asked to contribute a little more than one third of their readjustment.[1] However, the opposition still rejected the Bill and only when the Government decided to totally exclude the private sector from the scheme the Communists joined the Christian Democrats to vote in favour of the Bill in the Lower Chamber. The Finance Minister, who had not been consulted about the modification, caused a major row in the Cabinet and later resigned. But immediately afterwards the Communists announced that they would not join the Christian Democrats again in the Lower Chamber in order to gather the two thirds required to rescue the Bill if the Senate rejected it (an event which was most likely because the Socialists, Radicals and Nationals had an absolute majority in the Senate), unless public sector employees were also excluded from the scheme. In the end the Government was forced to eliminate the scheme altogether and had to reduce some of the increases in taxation included in the Bill, in exchange for the abstention of the Nationals when the Bill was voted in general in the Senate. The law finally promulgated was not significantly different from previous legislation on wage and salary readjustments enacted by this Government.

1. See Ercilla, 6 March 1968, pp. 6-7.

The decisive battle of the stabilization program had been lost by the Government.

There can be very little doubt that an earlier attempt would have had a better chance of succeeding. In 1967, both the Government and the Christian Democratic Party (PDC) had already suffered considerable political attrition which showed in their electoral performance and the divisions inside the party. This situation encouraged both the right-wing and the left-wing oppositions to become more aggressive and less cooperative, because they were trying to capitalize on the disenchantment and frustration of vast social sectors which were the causes of the political attrition of the Government. However, it seems also reasonable to suggest that the scheme would have probably been very difficult to get through Congress even immediately after the 'Christian Democratic earthquake', because the Radicals, Socialists and Communists had enough votes to defeat it in the Senate - and prevent the Lower Chamber from insisisting - and, also, because there had always been considerable opposition to the scheme inside the Christian Democratic Party (PDC) itself, particularly from labour leaders and left-wingers. Despite its structural weaknesses (see Chapter Nine), the labour movement had enough political influence both in the party supporting the Government and in the left-wing opposition to make it very difficult for the Government to succeed in enacting the implementing a scheme which threatened the power of its traditional leadership, particularly when the scheme included restrictions on the wage and salary readjustments actually disposable for the worker to spend as he or she wished.

Perhaps a different scheme, based on some agreement with some sectors of the left-wing opposition might have been more viable, but this would have certainly required a change in the general strategy of the Christian Democrats.

From the fiscal point of view, it is also quite clear that the scheme would have been an additional burden for the employers on top of the already huge increase in fiscal revenue which had taken place in 1965-1966 (approximately 55.0% in real terms, 48.0% when large copper companies are excluded) and that they would have tried to shift the burden to their customers. If the employers had been able to shift two thirds of their contribution to the scheme - as seems to have been the case with the 'payroll tax' which financed social security benefits (see Chapter Nine) - then their actual contribution would have been no higher than the 'payroll tax' which they would have otherwise payed in the absence of the scheme.[1] Hence, the question would have been whether the Government would have been able to prevent that 'shifting' and its inflationary effects by using very tight price controls, a policy which would have increased tension between the Government and the business sector even more.

1. The employee contribution to the scheme was exempted from social security contributions.

I) Economic Performance, Polarization and the Presidential Cycle

Inflation stayed between 17.0 and 20.0% throughout the twelve months which preceded the battle about the Forced Savings Scheme, but it jumped to a new level at the beginning of 1968 and stayed there, i.e. between 25.0 and 29.0% throughout the year. In the original medium-term program the target for 1967 was 10.0, but the expected rate, at the beginning of 1967, had been recalculated at 13.1%. Since the actual rate was 21.9% the performance could be considered a failure, even though not the kind of catastrophic failure which had been the result of the collapse of the stabilization effort of the previous Government.

After the defeat on the Forced Savings Scheme, the Government actually abandoned any attempt at reducing inflation and concentrated its efforts on trying to achieve the best possible general economic performance without causing an inflationary acceleration.[1]

This policy was fairly successful in the sense that inflation oscillated around a level of 30.0% throughout 1969 and until the next presidential election at the beginning of September 1970 (see Table A.1, Statistical Appendix).

However, after a very poor 2.3% increase in 1967, the EGDP grew by an average annual rate of only 3.1% in 1968-1970, while unemployment remained more or less stable, around 4.9% in the country as a whole, until it started to increase in 1970.

1. See Ricardo Ffrench-Davis, 1973, op. cit, p. 61.

The fiscal situation improved and tax revenue, which had only financed around three quarters of the fiscal expenditure in 1964-1965, financed 90.0% in 1969 and 86.0% in 1970, while real expenditure continued to grow so that the total 1964-1970 increase reached 91.3% against a 26.0% increase in the EGDP.[1] Net foreign exchange reserves which had been negative between 1960 and 1967, reached a level of approximately four months of imports in 1969-1970, partly due to the still high price of copper, and partly due to excessive borrowing abroad which the Government did not manage to control.

From the political point of view, it is important to stress that the Government did not attempt to use these resources in order to implement a major liberalization of imports or the reintroduction of a constant nominal exchange rate which would have contributed considerably to slow down inflation before the presidential election. In fact, it was the only one, among the three Governments discussed here, which left a better foreign exchange reserves situation than the one inherited from the previous Government.

This mixed economic performance, however, did nothing to prevent the continuous erosion of the electoral support of the Government in the context of increasing polarization.

In the March 1969 general parliamentary election, most of the Christian Democratic losses went to the extreme right and left, (see Table 6.3 below). Moreover, the polarization continued afterwards, and while the Radical Party expelled its right-wing, some of the 'rebels' left the Christian Democratic Party to form the United Popular Action Movement (MAPU), which later joined the Radicals, Socialists and Communists in the Popular Unity.

1. ibid, Table 34, p. 253 and Table 68, p. 332.

Table 6.3

Electoral Results in the March 1969 General Parliamentary Election compared with the March 1965 General Parliamentary Election

	Vote (%)		Deputies	Senators
	1965	1969	1969	1969
Nationals (PN)	12.5	20.0	34	5
Christ. Dem. (PDC)	42.3	29.8	55	23
Radicals (PR)	13.3	13.0	24	9
Communists (PC)	12.4	15.9	22	6
Socialists (PS)	10.3	12.2	15	4
Popular Soc. Union	-	1.6	-	1
Others	6.3	3.4	-	2
Blank/Void	3.0	4.0		
Total	100.0	100.0	150 a/	50 a/
Total vote (thousand)	2,353.1	2,406.1		
Abstention (%)	19.4	25.8		

Source: Official Figures, Registro Electoral

a/ Deputies and Senators increased from 147 to 150 and from 45 to 50.

The presidential campaign started only a few months after the parliamentary election and overshadowed almost every other political factor. As an example, the Minister of Economy, who had announced a number of fiscal, monetary and administrative measures to reduce inflation at the end of July 1969, resigned only five weeks later to become the top manager of the presidential campaign of the Christian Democratic candidate.

The only major exception was a military movement to protest against the way in which the Government had treated the economic demands of the Armed Forces. The movement culminated with a rebellion led by one of the leaders of the protest, an Army General who had been asked to retire by the High Command, which took over a major military installation in Santiago, demanding the resignation of the Minister of Defense, the Commander in Chief of the Army, an increase in salaries and better equipment. In fact, since at least May 1967, there was military unrest connected with economic demands and this new outburst was the result of the Government not having honoured previous agreements reached in order to defuse the protests. Although the Finance Minister protested that there were no resources available, the Government was forced into accepting a special readjustment for the Armed Forces, even though the rebel leaders were later tried and expelled from the Army. This special readjustment which was approximately three times the rate of inflation, increased fiscal expenditure by more than 7.0% in 1970, or the equivalent to almost one third of the total fiscal expenditure on investment in the same year.

The military movement illustrated both the degree of weakness of the Government, in the last stages of the 'presidential cycle', and the extent to which the radicalization of the different political forces had contributed to make the use of illegal means, to further particular interests, more frequent. It also cast some doubts on the Chilean Armed Forces' reputation for discipline and respect for the democratically elected powers of the State. Only a month later, the Judiciary went on strike and obtained more than twice as much the general readjustment which, for the first time, had been agreed between the Government and the CUT.

This recognition of the CUT by a Government, for the first time since 1953, was only possible because the organization had given full support to the Government and the democratic system during the crisis. However, the truce did not last long and, within a couple of weeks, the CUT was trying to organize a national strike to protest against a Constitutional Amendment increasing the powers of the Executive branch vis-à-vis Congress. This reform came too late to help the Christian Democratic Government and, ironically, it was enacted against the opposition of the very political sectors which were about to win the next presidential elections, i.e. the political parties which had formed the Popular Unity and supported Senator Allende.

In September 1970, the Popular Unity narrowly defeated the right-wing parties whose presidential candidate was former President Jorge Alessandri. The Christian Democrats came third, failing to benefit from tactical voting as had been the case in 1964, though still obtaining the support of a respectable 27.8%.

Now it was the chance of the left, the only sector present in the 1958 presidential campaign which had not won a presidential election. What followed, however, was a process of continuous radicalization and polarization leading to economic and political crises which created the conditions for the Military Coup in September 1973. During the period 1970-1973 the objective of stabilizing the economy ceased to be a major priority, and all the Government's efforts concentrated on the implementation of a very radical program of socio-economic change and the accumulation of political strength in order to overcome the opposition of the Nationals and Christian Democrats. The result was hyperinflation and, finally, the destruction of the democratic system by the Armed Forces.

J) Summary

The structuralist anti-inflationary strategy of President Frei's Government was a combination of two major elements, a program of structural reforms aimed at creating the conditions for long-term stability, and a medium-term program of stabilization aimed at eliminating inflation within four or five years without reducing the rate of economic growth and increasing, at the same time, the real purchasing power of wages and salaries.

The long-term program was not just about eliminating economic bottlenecks or rigidities. In fact, there was a very comprehensive strategy including the development of new relations between capital and labour, the organization and mobilization of previously passive social sectors and the development of a new and very strong centre party which would be the main political support of the program and the exponent of the new kind of solidarity which would be promoted.

In the medium term, the Government rejected both the use of monetary restrictions and the use of the foreign sector as the main anti-inflationary elements. Credit expansion, devaluation, imports liberalization and almost every major policy instrument became the subject of a program. Consequently, the attempt made a major contribution to the development of more sophisticated quantitative tools and institutional arrangements, particularly in the area of short-term economic policy management which was vital for the medium-term stabilization program.

As a result of all these developments, the Government was able to prevent major economic crises and to remain fairly in control even after the collapse of the medium-term stabilization program. However, the lack of cooperation from either of the two main organized sectors in Chilean society, the business sector and the unionized labour, proved to be very

damaging for the performance of the medium-term program and the effectiveness of the short-term policies. The Government and the Christian Democrats did manage to mobilize and organize massive social sectors which had been previously passive in socio-political terms. However they did not provide enough additional support in order to overcome the problems created by the traditionally organized sectors in society. In fact, their new demands increased the pressure on the fiscal situation and created more difficulties for the accommodation of conflicting demands.

The Government never had more support than at the beginning of its term in office. This does not mean that its socio-political strategy was a failure. In fact, the Christian Democratic Party continued to be the largest party with an electoral support oscillating between 25.0 and 30.0% until 1973, when the democratic system was destroyed. However, it seems fairly clear that the Government should not have waited in implementing some of the most crucial reforms concerning the relation between capital and labour outside agriculture, not only because the chances of implementing them successfully would have been higher, but also because their positive effects would have increased the chances of success of the medium-term program and the chances of attaining long-term stability. It is true that the general economic performance of the Government was not bad, not even towards the end of the 'presidential cycle', and that major reforms were implemented increasing the chances of success in the future, but it is also true that there were extremely favourable 'circumstantial' factors, such as the export situation, which were not likely to remain, and that social and political conflicts became more intractable than ever before.

Chapter Seven

Monetary Institutions, Monetary Policies, Inflation and Stabilization

A) Introduction

The reason for starting the series of Chapters about particular aspects of the Chilean inflation with one on monetary institutions and monetary policies is that money occupies a special place in the analysis of inflation. By definition, inflation is a generalized and sustained increase in nominal (monetary) prices, i.e. the amount of money required to purchase representative baskets of goods and services in the markets. There are deep disagreements on the role which monetary expansion plays in causing or merely reflecting the inflationary process. It is, however, clear that, particularly in cases of double-digit inflation such as Chile's, inflation cannot be sustained for very long unless accompanied by increases in the quantity of money, i.e. the money supply.

For the monetarists, of course, the key point was that the Chilean inflation, indeed any inflation, would not have been possible without the increase in the money supply, that this was the cause of the excessive demand of goods and services of the Government and the firms and, consequently, of the excessive increases in wages. Monetary policy is therefore placed at the centre of any serious attempt at stabilization and the main task of the monetary authorities is to create a restrictive environment in which prices could not rise.[1]

1. See, for instance, IMF Mission Report, 1950, op. cit., pp. 99-100, E.M. Bernstein and I.G. Patel, 'Inflation in relation to Economic Development', IMF Staff Papers, 2, Nov. 1952, p. 368, and E.M. Bernstein, 'Wage-price links in a prolonged inflation', IMF Staff Papers, 6, Nov. 1958, pp. 323.

Structuralists recognized that monetary expansion played a role in the inflationary process, but they argued that the structural factors which were the ultimate causes of inflation could not be removed by attacking the monetary aspects of the phenomenon. Moreover, they argued that restrictive monetary policies could only worsen the economic situation by producing stagnation without stability.[1] Monetary expansion was considered to be a 'propagating factor', i.e. one which enabled the business sector and the Government to cope with the financial problems created by structurally determined cost increases and reductions in the tax revenue, and not one which financed excessive demand. Monetary expansion ratified the price and wage increases but it was not their main cause, (see Chapter Two, also).

The role of monetary expansion in the Chilean inflation cannot be discussed adequately by analysing the monetary policy and the monetary institutions in isolation. To a large extent, the above mentioned controversy will be under discussion not only in this Chapter but also in the next three ones which analyse the fiscal problem, the role of increases in labour costs and the role of the market power of the largest firms in the Chilean inflation. However, in order to understand the role of the monetary factors it is necessary to explore, first, the politics of monetary regulation and the social factors behind it. This is the purpose of this Chapter.

The chapter includes a section which analyses the role of the Internatinal Monetary Fund (IMF) in the stabilization efforts. This is not to suggest that the Fund only influenced monetary policy. It is included here because the IMF is an international monetary institution, responsible for promoting stable international monetary arrangements.

1. See, for example, Aníbal Pinto, Ni Estabilidad ni Desarrollo. La Política del Fondo Monetario Internacional, (Santiago, Ed. del Pacífico, 1960).

B) The Chilean Banking System

During the period under scrutiny, the Chilean monetary system included the Central Bank (which is discussed in the following section), and what was called the banking system which included a very large State Bank created in 1953, when a number of state credit agencies merged, and a variable number of private commercial banks, (see Table 7.1, below).

Table 7.1

The Chilean Banking System

Loans Outstanding 1955-1970

Selected years (as a % of the total)

	30.06.1955	30.06.1962		30.06.1970	
	d/c	d/c	f/c	d/c	f/c
A. - Private (National)	45.6	47.1	64.8	37.6	44.0
a.1. - Chile Bank	17.5	22.0	31.8	15.1	21.0
a.2. - 2nd to 5th largest	21.7	16.4	20.2	15.6	17.6
a.3. - Other banks	6.4	8.7	12.8	6.9	5.4
B. - Private (Regional)	9.0	6.6	6.5	7.6	3.6
b.1. - Osorno Bank	4.4	3.2	4.2	2.7	1.1
b.2. - Other banks	4.6	3.4	2.3	4.9	2.5
C. - Private (Foreign)	6.1	5.7	7.0	8.5	5.4
D. - State Bank	39.3	40.6	21.7	46.8	47.0
Total	100.0	100.0	100.0	100.0	100.0

d/c : domestic currency
f/c : foreign currency
a.1 : the largest private bank
a.2 : Sudamericano, Credito e Inversiones, Español and Edwards
a.3 : three banks in 1955, eight in 1962 and five in 1970
b.1 : the largest regional bank
b.2 : eight banks in 1955, seven in 1962 and ten in 1970
C. : three banks in 1955 and 1962 and five in 1970

Source: Central Bank of Chile, Monthly Bulletin .

The extremely high degree of concentration in the banking system can be illustrated by the fact that the five largest private banks and the State Bank accounted for 78.0 to 79.0% of the total loans outstanding throughout the whole period (calculation based on Table 7.1, above).

The largest private banks were a crucial element in the 'economic groups' which provided the nucleus of the business oligarchy which controlled the business organizations and the right-wing political parties (see Chapter Ten, also). In some cases old banks had provided the platform for financial groups which later expanded to other sectors of the economy (the cases of the Chile, Sudamericano, Español and Edwards Banks). In others, a powerful industrial group had created a bank in order to consolidate its economic power (the cases of the Panamericano, Continental, Crédito e Inversiones and Trabajo Banks).[1]

The main field of operations of the private commercial banks was the acceptance of demand and time deposits and the granting of short-term credit. The State Bank was the only one authorized to accept savings deposits and, as a result, was able to grant long-term loans to a larger extent than the others.[2]

Between 1953 and 1960, the Government only had eight out of twenty members of the Board of Directors of the State Bank, although it could expect support from some of the four representatives of Congress. The business organizations had six representatives and the labour movement two (one white-collar and one blue-collar). From 1960 onwards, however, the Government was in a majority position with nine out of sixteen members, the business organizations had five and the labour movement continued to have two.[3]

1. Ricardo Lagos, La Concentración del Poder Económico. Su Teoría Realidad Chilena, (Santiago, Ed. del Pacífico, 6th ed., 1965), pp. 114-5.
2. Emile Den Dunnen, The Chilean Banking System, (Santiago, IBRD/INSORA, 1964), pp. 12-3.
3. See Central Bank of Chile, Monthly Bulletin, 304, June 1953, pp. 156-51 and Trigesimoquinta Memoria Anual, 1960, 1961, pp. 193-221.

C) The Central Bank of Chile. Historical Background

The Chilean Central Bank was established in the second half of 1925, at a time of rapid and considerable institutional change in which a new Constitution, new labour legislation, new legislation about the Government budget and new monetary and general banking laws were also enacted.[1] These institutional changes represented a new balance between the Chilean oligarchy and the emerging middle sectors which had supported President Arturo Alessandri during his first Government started in 1920.[2]

The original charter of the Central Bank and the monetary and banking laws were designed by a foreign mission headed by Professor Kemmerer, from Priceton University, who headed similar missions to a number of other countries.[3] Previous proposals discussed in Congress since 1913 had all failed to enlist enough support to be enacted but the mission did not face such a problem because the Armed Forces had previously closed Congress and President Alessandri decreed the reforms. The Government expected that the participation of the mission in the design of the reforms would provide Chile with access to the New York financial market which looked very promising.[4]

1. For the monetary reforms see Frank W. Fetter, Monetary Inflation in Chile, (Princeton, Princeton Univ. Press, 1931), pp. 158-69 and 178.
2. See John J. Johnson, La Transformación Política de América Latina: Surgimiento de los Sectores Medios. (Buenos Aires, Hachette, 1961), Chapter Five.
3. See Robert N. Seidel 'American Reformers abroad: The Kemmerer Missions in South America 1923-1931', The Journal of Economic History, XXXII, 2, June 1972, pp. 520-545.
4. See Albert O. Hirschman, 'Inflation in Chile', op. cit. pp. 176-8.

The original charter of the Central Bank stipulated a Board of Directors which had ten members: three representatives of the Government, three representatives of the private banks (one of them representing the foreign ones operating in Chile), two representatives of the business organizations, one representative of the private stockholders (different from the banks) and one representative of the labour movement. The aim was to prevent overall control by either the Government or the private banks.[1] In practice, however, given the high degree of concentration which characterized the Chilean economy in the 1950's and 1960's, the charter gave the business oligarchy the control of the Board.

The Central Bank was given the exclusive rights to issue notes payable to the bearer on demand, either in gold or demand drafts on London or New York, the limit being a reserve requirement of 50% in gold.[2] The principal instruments of monetary control would be the rediscount of commercial paper and open market operations. Credit to the Treasury and other public institutions was limited to a maximum of 20% of the total amount of capital and surplus of the Bank, but at least six directors had to be in favour of granting it. Eight directors were needed to exceed that limit, the absolute maximum being 30% of the capital and surplus. No doubt, this was a very clear safety device against the kind of hyperinflation experienced by several European countries in the period 1921-1923.[3]

This system of 'gold exchange standard' was short-lived because only five years after having been established, the Chilean economy was struck by the Great Depression.

1. See Frank W. Fetter, 1931, op. cit., p. 175.

2. Basic information about the original charter of the Chilean Central Bank can also be found in Cecil Kisch and W.A. Elkin, Central Banks, (London, Macmillan, 1932), Appendix.

3. See, Fred Hirsch and Peter Oppenheimer, 'The Trials of Managed Money: Currency, Credit and prices 1920-1970', in Carlo M. Cipolla (ed.), The Fontan Economic History of Europe, 5 (2), p. 673.

D) The Legacy of the Great Depression

Chile was one of the countries most severely affected by the collapse in world trade at the end of the 1920's. Between 1925 and 1929 exports had been the equivalent to around 43% of the Chilean domestic product (excluding services) while imports accounted for approximately one half of the total supply of goods.[1] Manufacturers accounted for 85% of total imports in the period 1920-1929, while copper and nitrate accounted for more than 80% of total exports.[2] Foreign trade was the source of almost one half of the total fiscal revenue, (excluding the State Railways). Between 1929 and 1932, exports and imports fell by approximately 87%, the fiscal revenue from foreign trade fell by 79% and the total fiscal revenue fell by a little more than 59%.[3]

The monetary authorities contributed to amplify the effects of the depression by strictly following the gold standard doctrines. They attempted to correct the Balance of Payments deficit through deflationary measures while Chile's international reserves were falling very rapidly. In fact, they were reduced by one half in 1931.[4] The economic and political crises led to the resignation of president Carlos Ibañez whose dictatorial Government had strongly supported the financial orthodoxy practised by the Central Bank. Although restrictions on foreign exchange operations were immediately introduced and convertibility was supended in July 1931, the authorities tried to defend the parity of the Chilean peso until March 1932, i.e. six months after the devaluation of the pound.[5] Finally, reserve requirements

1. See CEPAL, Estudio Económico para América Latina 1949, 1951, p. 294.
2. See Adolfo Ruffat, 'La Política Monetaria y el Sector Externo en Chile entre las dos Guerras Mundiales', mimeo., Univ. de Chile, 1969 Table A7, p. 36.
3. ibid, pp. 19-20, 57 and 109.
4. Central Bank of Chile, Monthly Bulletin, 40, May 1931, p. 79.
5. See Law 4973, 31 July 1931, and Albert O. Hirschman, 'Inflation in Chile', 1963, op. cit., p. 179.

in gold or convertible foreign exchange were eliminated and, from April 1932 onwards, the issue of notes became completely dependent on the credit policy of the Central Bank concerning both the Public and Private sectors.

Without reserve requirements in gold, the rediscounting operations of the Central Bank did not have a regulating device which would prevent an excessive expansion of credit to the Private Sector. Moreover, the dominant theory in the Central Bank was the 'commercial loans' or 'real bills' theory which argued that the discounting of short-term commercial paper for the purpose of purchasing inventories was basically sound because the credit expansion would correspond to an expansion in the volume of trade. This theory did not provide any device for distinguishing between real and nominal increases in the volume of trade and, consequently, credit could expand passively, ratifying price increases.[1]

The effects of the Great Depression and the new ideas and practices which were being adopted by economic policy-makers all over the world affected Chilean policy-making very considerably. After a period of conservative fiscal and monetary policies in 1932-1938 (during the second Government of president Arturo Alessandri), Chilean economic policy-making changed sharply. With the beginning of the Radical Governments in 1939, monetary policy became a lower priority and everything was subordinated to the goal of achieving a rapid industrialization and high rates of economic growth.

The Radical Governments not only did not implement any effective monetary policy in order to restrict credit expansion to the Private Sector but they repeatedly enacted special legislation authorizing increases in 'high powered money' which provided financing for Public Sector institutions concerned with promoting economic development.[2]

1. For a criticism of this theory see, for instance, Harry Hutchinson, Money, Banking and the United States Economy (Englewood Cliffs, N. Jersey, Prentice-Hall, 3rd. ed., 1975) pp. 89, 91-2.

2. See Banco Central de Chile, 1955, op. cit., pp. 3-6.

As a source of public financing, monetary expansion was politically more convenient than increasing taxation because its effects were more diffused. Consequently, within certain limits, it was easier to enact the required legislation.

Since successive Governments enacted this kind of legislation, their minority position in the Board of Directors of the Central Bank cannot be considered to have been an effective restrictive device by itself. Governments were ultimately restricted by their limited ability to enlist enough Congressional support to be able to enact this kind of legislation. The Private Sector was not restricted because of its majority position in the Board but also because the Government did not attempt any effective monetary policy, let alone a stabilization one (this point will become clearer in the next section). Thus, Governments shared their increased access to credit expansion with the private Sector, a situation which represented a complex balance between the middle sectors which were predominant in Government and the business oligarchy. This situation did not change significantly with the inclusion of four representatives of Congress in the Board from 1946 onwards. If anything, this change reduced the restrictive effectiveness of the Board of Directors even further.

E) The Attempts at Reforming the Central Bank

While the business sector wanted to reduce the ability of the Government to impose monetary expansion on the Central Bank by enacting legislation, Governments wanted to increase their control over the Central Bank and to reduce what they considered to be negative influences. Of course, this had a different meaning for different Governments.

President Ibañez wanted to increase the powers of the Central Bank but bringing, at the same time, its Board of Directors under Government control. However, the Senate excluded any reorganization of the Board from the Extraordinary Powers granted to the Executive at the beginning of the Government's term in office.[1] Despite this setback, the Government was able to enact new legislation increasing the powers of the Central Bank concerning the determination and control of maximum bank interest rates and introducing a new instrument of monetary control : direct quantitative and qualitative controls on credit.[2] However, these new powers were not used effectively until 1956, because of the inability of the Government to generate a stable Cabinet commited to a sustained anti-inflationary policy, (see Chapter Four). Ceilings on credit expansion were implemented in September 1953 and eliminated in October, and when they were reintroduced in June 1954 the Central Bank was not able to enforce them properly because of the lack of penalties to be imposed on the banks violating the ceilings.[3] Although it is clear that the business sector did not like the ceilings and that it managed to reduce the restrictiveness of the Government proposals when they were discussed the voted in the Board[4], it would be a mistake to blame everything on the presence of the business sector in the Board. Without a comprehensive anti-inflationary effort a more restrictive monetary policy would have caused considerable falls in the level of economic activity, given the monopolistic and oligopolistic features of the Chilean economy (see Chapter Ten, also) a point made not by the structuralists but by the Klein-Saks Mission itself.[5]

1. See EMS, 21 Jan 1953, p. 11 and 22 Jan. 1953, p. 15.
2. Central Bank of Chile, Monthly Bulletin, 304, June 1953, pp. 156-61.
3. See Ricardo Ffrench-Davis, 1973, op. cit., p. 122.
4. See, for instance, the report of the president of SOFOFA to the Board of his organization in EMS, 4 Jul. 1954 p. 3.
5. See Mission Klein-Saks, 1958, op. cit. p. 216.

At the beginning of 1954 the Government announced a new proposal for reorganizing the Board of the Central Bank giving the President of the Republic powers to appoint nine out of a total of fifteen directors, including the representatives of the business organizations and the labour movement (the other six would be two representatives of the private banks and four of Congress). This proposal was strongly opposed by the business sector and was never even sent to Congress.[1]

The next proposal was made public by the Klein-Saks Mission in 1958, towards the end of its stay in Chile, too late to reach the stage of even becoming a Bill. The Mission recommended changes aimed at creating a strong Central Bank freed from the influence of both the Government and the business sector. The main proposal was to transform the old Board into a merely advisory committee while the decisions, implementation and control of the monetary policy would be transferred to a small 'technical' council which would include the Minister of Finance, two officials appointed by the Government with Senate approval and for long periods in office and two more appointed by the previous three.[2] No doubt, this was a proposal on the lines of a 'supreme court of finance' which has traditionally being suggested as the best alternative by those who argue that Governments cannot be trusted with the direct exercise of the monetary power which is part of their sovereignty.[3] However, it was also an attack on the

1. See EMS, 19 March 1954 p. 3 and 25 March 1954, p. 15.

2. See Mision Klein-Saks, 1958, op. cit., pp. 25-6.

3. See M. Parkin, 'The Politics of Inflation', Government and Opposition, 10. Spring 1975, p. 201, and Alfred J. Clifford, The Independence of the Federal Reseve System, (Philadelphia, Univ. of Pennsylvania Press, 1965), p. 33.

monetary power of the business sector and, consequently, it did not get any support from the two sectors more interested in monetary matters.

Ordinary wage- and salary-earners were never too much concerned about monetary policy in general and credit policies in particular. This was not surprising because they did not have any direct access to credit in any case. However, there was one aspect of the monetary policies decided in the Central Bank that attracted enormous attention from them: the foreign exchange policy, or to be more specific, the devaluations. In fact, this subject was the cause of the most serious confrontation between the Board of Directors of the Central Bank and the Government.

Ironically, this major confrontation occurred at the beginning of a Government in which the business sector and the right-wing parties, which were in a majority position in the Board, were also most influential in the Government, (the episode has been discussed in Chapter Five). Since most of the opposition to the proposal of the Government came from the four Congress representatives, the labour movement representative and the representative of the private stockholders, President Alessandri, who had obtained unlimited powers to reorganize the Central Bank from Congress, increased the Government representatives from three to four, introduced a gradual elimination of the private stockholders - and, therefore, of their representative - and later on, in a different piece of legislation, eliminated all the Congress representatives in public agencies, including those in the Central Bank. As a result of these changes, the Board was reduced from fourteen to eleven members (with the prospect of becoming ten in the future) but, as could have been expected of President Alessandri, the business sector remained in a strong majority position.[1]

President Frei wanted to nationalize the Central Bank,[2] thereby

1. See Banco Central de Chile, Trigesimoquinta Memoria Anual 1960, 1961, pp. 168-92. The Law eliminating the representatives of Congress was promulgated later on, in September 1961.

2. See Ricardo Ffrench-Davis, 1973, op. cit., pp. 138 and 141.

eliminating the majority position of the business sector in the Board. This proposal was another example of his Government's determination to centralize control over resources (fiscal and monetary) and to increase the role of the state in the regulation of the economy. The centre-to-the-right opposition majority which existed in Congress at the beginning of this Government rejected the request of Extraordinary Powers made by President Frei, and the Bill had to be withdrawn from Congress to avoid a defeat which would have buried it for one year. However, the Government did not insist after the ' Christian Democratic earthquake', partly because it had to concentrate its legislative efforts on other more important Bills but mainly because, despite some delays, the Board of Directors of the Central Bank was not a singificant obstacle for the implementation of its monetary policy.[1] No doubt, the Board could not afford a confrontation with a Government which had threatened to reorganize it, was implementing credible and consistent economic policies - monetary policy included - and had not only a very strong majority in the Lower Chamber but also a good chance of enlisting left-wing support from the opposition in the Senate in order to get a reorganization of the Central Bank through Congress.

The majority position of the Private Sector in the Board remained until most of the private banks were nationalized during the next Government of President Salvador Allende, in 1971. With a majority in the Board and control over most of the secondary monetary expansion, this Government had more access to monetary expansion as a source of financing for the considerably expanded Public Sector which resulted from the nationalizations. Since other sources of financing were closed, the risk of an hyperinflation increased considerably and inflation reached record levels.[2]

1. See Ricardo Ffrench-Davis, 1973, op. cit., p. 141.

2. For an anlysis of inflation in 1970-73 see Laurence Whitehead, 1979, op. cit.

F) Monetary Expansion and Inflation

It has been already mentioned that all schools of thought agree that the kind of considerable and persistent inflation experienced by Chile was necessarily accompanied by a considerable and persistent monetary expansion. In fact, between 1952 and 1970 the money supply (measured by M1 : currency held by the public plus demand deposits, excluding Public Sector Deposits) increased 385 fold, prices (the General Price Index included in Table 7.2, below) increased 170 fold whereas production (measured by the GDP) only doubled. Thus, M1 increased approximately 13% more than the money value of output (the 'velocity of circulation', to use the technical term, fell by 11.5% over these 18 years).

Table 7.2

Monetary Expansion, Prices and Production, 1953-1970

	Dec.-Dec. Increase			Average Increase		
	HPM	M1	GPI	M1	GPI	GDP
1953	50.7	42.3	39.7	40.6	24.2	6.1
1954	38.9	43.5	64.0	44.6	57.0	0.0
1955	61.3	71.9	86.4	62.0	78.0	2.7
1956	41.8	40.3	45.6	48.4	64.8	1.2
1957	25.9	28.0	29.3	31.6	35.6	0.9
1958	34.4	34.4	27.0	25.8	26.2	2.5
1959	44.7	32.5	29.6	38.4	35.3	1.7
1960	46.3	30.6	2.7	25.6	7.1	3.7
1961	10.0	12.5	4.2	18.8	3.0	6.1
1962	74.3	29.0	29.1	22.0	10.3	5.7
1963	7.8	34.1	42.0	39.5	48.2	4.0
1964	64.6	51.3	43.7	41.1	41.3	4.8
1965	40.8	65.1	28.6	58.6	29.3	6.5
1966	59.0	38.9	19.9	48.2	24.4	10.1
1967	22.0	25.1	21.9	27.8	20.3	1.2
1968	37.8	38.3	32.4	30.3	29.5	3.5
1969	46.4	35.2	36.5	41.7	35.0	5.5
1970	57.0	66.2	34.5	52.5	35.4	3.4

HPM: High Powered Money. GDP: Gross Domestic Product
M1: Currency held by the public plus Private Sector demand deposits.
GPI: General Price Index combining the corrected RPI (1/3) and WPI (2/3), the weights being approximately the ones corresponding to the shares of households and firms in the monetary balances.
Sources: HPM and M1 calculated from data in Roberto Zahler et al, Estadisticas Monetarias de Chile 1940-1975,(Santiago, Departmento de Economía, Univ. de Chile, 1979), Table 2, pp. 81-8 and in Central Bank of Chile, Monthly Bulletin. GPI and GDP from R. Ffrench-Davis, 1973, op. cit., pp. 247-9 and Table 34, p. 252.

The disagreement starts when trying to determine whether the money supply played an active or passive role in the inflationary process and when discussing the role of the Private and Public sectors in the expansion.

As to the first problem, the econometric evidence which has been provided seems highly controversial, above all because the basic approach has been to try to decide whether the increase in prices 'causes' the monetary expansion or vice versa, throughout a long period of time taken as a whole. It seems more reasonable, judging from the evidence about the way in which the monetary system operated in Chile, to see both factors as being mutually dependent, recognizing that in some episodes the money supply increased because the banks reacted passively to the pressures coming from the Government and the firms which were already facing acute financial difficulties due to cost increases, while in other cases the increase in the money supply may have played a more active role by financing increases in demand in excess of the increase in costs.

The evidence included in other Chapters, and particularly in Chapter Nine, suggests that monetary expansion was not the main cause of the increases in inflation which started in 1953, 1962 and 1967. Moreover, in the cases of 1953 and 1967, labour cost increases played a major role and they cannot be explained by previous monetary expansion. Of course, if one assumes that monetary expansion is the only relevant cause of inflation - and monetary restriction its only effective cure- such connections can always be made, but for our purposes such an approach begs the most interesting analytical questions.

In 1953, monetary expansion was only 31.0% in the first eleven months of the year, and the twelve month rate of increase in money supply was around 35.0% in October and November, far less than the increase in prices which had reached a twelve month rate of increase of 45.0% in November

and had registered monthly rates of increase which averaged 6.5% in July-November, (see Statistical Appendix, Table A.2). Most of the monetary expansion took place in the last days of the year, when the inflationary acceleration had already taken place, and it was the result of the Government having been forced into using high powered money as a source of financing for a bonus which was paid to public employees at the end of the year.

In the case of 1965-1966, the money supply increased considerably more than prices (see Table 7.2, above), although M1 seems to exaggerate the increase (see Statistical Appendix, Table A.5, which includes alternative money supply series). However, production was increasing very much, expected inflation was decreasing, and some institutional changes in the rural areas and in the banking practices (restrictions on overdrafts) required an increase in the quantity of money, so that there were several factors contributing to increase the demand for money. Without taking into account the fall in expected inflation and using the estimates about the effect of the institutional changes provided by Ricardo Ffrench-Davis,[1] the demand for money can be estimated to have increased approximately 100.0% between 1964 and 1966 which is approximately the increase in M3 in the same period (see Statistical Appendix, Table A.5) (M3 : currency held by the public plus total demand deposits, including both Private and Public Sectors).

1. ibid., Table 64, p. 322.

The 1962 case is more controversial. The constant nominal exchange rate (NER) established in 1959 fell in real terms mostly because of the high 1959 inflation which was the result of the adjustments promoted by the Government before the stabilization started (devaluations, wage and salary readjustments, elimination of price controls, etc). This overvaluation of the domestic currency and the liberalization of imports which was also implemented, made a very crucial contribution to the Balance of Payments crisis which led to the 1962 traumatic devaluation and the inflationary acceleration which followed. Very little of this can be blamed on monetary expansion, although there is some evidence that prices increased more than what the Government expected - during the period of adjustment in 1959 - due to an excessive expansion in credit to the Private Sector, (see Table 7.3, below). However, it is evident that the considerable monetary expansion which took place in 1960, at a time of very low inflation, and which was mainly the result of a very large expansion in the credit to the Public Sector (both before and after the May 1960 earthquakes), (see Table 7.3, below), could not have possibly been absorbed by increases in the demand for money and that it must have contributed to increasing the demand for imports and, consequently, the Balance of Payments problems. In short, monetary expansion seems to have been one of the factors contributing to the accumulation of pressure - in the Balance of Payments situation - which led to the inflationary acceleration at the end of 1962.

If, as structuralists argued, monetary expansion was not the main cause, let alone the only cause, of the Chilean inflation, a more restrictive monetary policy would have been likely to cause falls in production and employment, especially due to the very pronounced monopolistic/oligopolistic characteristics of the Chilean economy (see Chapter Ten, also). However,

while the dominant structuralist view stressed the need for removing the economic rigidities and bottlenecks which were considered to be the real causes of inflation, this thesis' view is that more importance should have been given to the political aspects involved.

The key to stabilization was in the political ability of the Government to implement comprehensive anti-inflationary policies. The removal of economic rigidities was not only politically difficult but, also, not enough to create the conditions for long-term stability.

A more restrictive monetary policy would not have removed the economic rigidities stressed by the dominant version of structuralism. Neither would it have contributed to improve the ability of the political system to achieve accommodation among different sectors. Moreover, the scaling down of conflicting demands through the rigours of induced recession which, as the IMF made it explicit in the report of its 1950 mission to Chile, was the way monetarism saw monetary restraint really worked to reduce inflation, was politically impossible in a competitive democratic system such as the one which existed in Chile.

G) Credit Expansion and the Public and Private Sectors

In the 1960's the Central Bank accounted for around 90.0% of the bank credit to the Treasury, 70.0% of the credit to the other Public Sector institutions (85.0% for the Public Sector as a whole) but only around 10.0% of the credit to the Private Sector, while the rest was provided by the commercial banks, i.e. the State Bank and the private banks.[1] In other words, most of the participation of the Public Sector in the expansion of credit took the form of an increase in high powered money, while the private Sector relied mostly on the secondary monetary expansion by the commercial banks. Since Governments were not able to solve the financial problems of the Public Sector (see Chapter Eight), their increasing concern about preventing excessive monetary expansion led them to try to offset the effects of the expansion in high powered money by restricting the secondary expansion. This was the purpose of the ceilings on credit expansion used by president Ibañez Government and the increases in the reserve requirements which were implemented by President Alesandri and president Frei. The business sector always resisted this restrictive policies as much as it could, concentrating its efforts on blaming the Government for the contribution to monetary expansion of the increase in its obligations with the Central Bank.

It is clear that the total credit extended to the Public Sector by the Central Bank and the commercial banks consistently increased more rapidly than total credit to the Private Sector, (see Table 7.3, below). Between 1952 and 1969, the share of the Public Sector in total obligations with the banks increased from a little more than 28.0% to approximately 56.0%, i.e. it almost doubled. However, most of this increase can be

1. Calculations based on data in E. Den Dunnen, 1964, op. cit., Table I and II, pp. 6-7 and Central Bank of Chile, Monthly Bulletin.

explained by the fact that the Public Sector grew considerably more than the economy as a whole. Between 1952 and 1969, public expenditure in real terms increased by 270.0% while real GDP increased by only 90.0% . While the share of the Public Sector in total bank credit increased by 96.8% (from 28.4% to 55.9%), the ratio between public expenditure and the GDP increased by 93.4% (from 24.4 to 47.2%).[1] Consequently, the huge redistribution of domestic credit was based on changes in the economy as a whole, and were not the result of the Government's ability to impose restrictions on the private Sector.

The redistribution of domestic credit was not compensated by the evolution of foreign credit. In 1958 the Public Sector accounted for approximately two thirds of the foreign debt while in 1970 - not taking into account the copper companies which had been 'Chileanized' - the Public Sector share increased to almost 95.0%.[2]

1. Calculations based on data in Instituto de Economía, Univ. de Chile, La Economía Chilena en el período 1950-1963, (Santiago, Univ. de Chile, 1963), ii. 165, and Central Bank of Chile, Monthly Bulletin.

2. Calculations based on data in A. Sanfuentes, 'Algunos Antecedentes sobre la Deuda Externa de Chile', Comentarios Sobre la Situación Económica, 3, 1972, Table 9, p. 243.

Table 7.3

Domestic Credit Expansion, 1953-1970 a/

(annual rates of increase, %)

	Sector				Sector		
	Public	Private	Total		Public	Private	Total
1953	82.2	47.6	57.5	1962	97.7 b/	22.6	52.9
1954	25.6	43.0	37.3	1963	30.4	32.5	31.4
1955	38.5	43.2	41.8	1964	47.3	41.4	44.4
1956	61.5	48.9	52.6	1965	43.7	36.2	40.2
1957	50.0	48.4	48.9	1966	36.7	29.3	33.2
1958	55.4	24.2	34.0	1967	36.3	29.8	33.4
1959	47.4	61.2	56.2	1968	27.4	36.3	31.2
1960	51.4	18.5	29.8	1969	33.5	28.5	31.3
1961	33.3	33.6	33.5	1970	35.4	26.6	31.5

a/ Consolidated domestic credit including the Central Bank, the State bank and the private commercial banks.

b/ The increase was only 26.9% in the first ten months of the year but a huge increase occurred after the traumatic devaluation in October, due to the compensatory wage and salary readjustments.

Source: Central Bank of Chile, Monthly Bulletin.

In the case of the Private Sector, credit was extremely concentrated. It has been estimated that only 0.2% of the total number of debtors accounted for 23.0% of the total credit and that 2.7% accounted for 58.1% in 1967.[1] The most powerful bank stockholders - i.e. the 'economic groups' (see Chapter Ten, also) - concentrated the bulk of the bank credit and benefited considerably from its very low cost which was actually negative at times of high inflation. This subsidy to the borrowers can be estimated to have reached the equivalent to 3.1% of the total GDP in 1955, 2.4% in 1964, and 0.4% in 1970, the years of highest inflation in each of the three Governments being analyzed here.[2] In the case of 1964, for instance, the subsidy amounted to the equivalent to almost 19.0% of the total tax revenue or the equivalent to almost 45.0% of the total investment financed by the private Sector.[3] In short, until Frei's Government,bank credit was a huge redistributive mechanism channelling resources from deposit holders and small bank stockholders - who lost their share in potentially higher bank profits[4] - to the most powerful stockholders.

The subsidy decreased in the period 1965-1970 because President Frei's Government increased the real cost of credit by increasing the level of taxation paid by the borrowers on top of the interest rates. As a result, the increase in the real cost of credit implemented by this Government did not favour deposit holders and small bank stockholders but the poorest 60.0% among Chilean households which were the ones who

1. See Oscar G. Garretón, 'Concentración Monopólica en Chile', Cuadernos CEREN, Univ. Católica de Chile, 7, 1971, pp. 146-7.

2. Calculations based on data in R. Ffrench-Davis, 1973, op. cit.,.Table 34 p. 252 and Table 56, p. 303.

3. Calculation based on ODEPLAN, 'La Inversión Pública en el Período 1961-1970', Santiago, June 1971, Table 3.

4. See Pedro Jeftanovic, 'Investigación sobre el impacto de la Inflación en las Utilidades Bancarias en Chile', (Santiago, CIEUC, 1961) quoted in R. French-Davis, 1973, op. cit., p. 119.

benefited most from public expenditure.[1] Moreover, this was another example of this Government's ability to centralize resources.

H) The Role of the IMF

The International Monetary Fund played a very prominent role in Chilean policy-making, particularly in the period 1953-1964. This international organization was undoubtedly the source of the monetarist ideas which became so influential in the Central Bank of Chile during the first half of the 1950's and which were adopted (and adapted) by some of the most prominent left-wing and right-wing 'ibañista' Finance Ministers in the period 1953-1958. Finance Ministers Felipe Herrera and Jorge Prat adopted the foreign exchange and credit policies recommended by the IMF but not the economic liberalism which was behind these policies and the other ones recommended by the Fund. It was not until 1956, during the period of the Klein-Saks Mission, that economic liberalism and a reduction in state intervention was accepted as a goal of the economic policy of the Government, and only then was the Government able to enlist the support of the business organizations and the right wing parties in order to implement a more effective package of anti-inflationary policies which included considerable monetary restrictions.

Centre-to-the-left opponents of the IMF's monetarism, concentrated their efforts on accusing the Fund of being a major instrument of foreign intervention in domestic economic affairs,[2] and of being responsible for the economic stagnation suffered by the Chilean economy in the period 1953-1962 in which the GNP, GDP and EGDP per capita increased by less than 1.0%.

1. See Alejandro Foxley, Eduardo Aninat and Jose P. Arellano, ¿Quiénes se benefician de los Gastos Públicos ?, Estudios CIEPLAN, 10, May 1977, Table 15, p. 58.

2. See for instance, Socialist Senator Aniceto Rodríguez' participation in the debate on the role of the IMF which took place in the Senate in 1959. Senate Proceedings, 4th Ordinary Session, 10 June 1959, in EMS, 12 June 1959, pp. 21-3.

Centre-to-the-left sectors saw the IMF as the main factor explaining the continuity of some of the most fundamental policies implemented during the 1956-1958 stabilization effort, after the Klein-Saks Mission left the country and a new Government took office in 1958.[1] This view exaggerates the role of the IMF. First of all, because there were not only similarities but also major differences between the 1956-1958 stabilization effort and the one started in 1959 (see Chapters Four and Five) and, secondly, because there was a major domestic factor which could also explain the continuing emphasis on foreign exchange, foreign trade and price liberalization and on restrictions on wage and salary increases, namely the economic liberalism and the hostility towards the unions of the Chilean business sector and the right-wing political parties which supported both President Ibañez' and president Alessandri's stabilizations.

There never was a major clash between the IMF and the Chilean Government during the 1950's and 1960's, as for example happened to the Brazilian Government in 1959 and the Colombian Government in 1966, not even in the case of president Frei's Government whose approach to stabilization and economic policy in general was so different from that of the Fund. In fact, this Government sought and obtained support from the IMF for the renegotiation of the Chilean foreign debt which was successfully completed at the beginning of 1965, and the IMF approved the monetary, foreign trade and fiscal policies which the Government intended to implement.[2] It was the Christian Democratic Government itself that decided to take advantage of the very good Balance of Payments situation which prevailed

1. See, as an example, Aníbal Pinto, 1960, op. cit. pp. 9-10.

2. The 1965 and 1966 letters of intent can be found in the Monthly Bulletin of the Central Bank of Chile, 443, Jan. 1965 and 456, March 1966. This were the first ones published by the Central Bank since 1956.

during most of the period 1965–1970, and to show its independence by announcing in late 1966 that it would not use IMF and AID credit in 1967. In fact, due to some temporary Balance of Payments difficulties the Government had to change this policy in 1968 (see Table 7.4, below), but, later on, the policy of reducing the country's debt with the Fund continued.

Table 7.4

Use of IMF resources, 1955–1970

Selected Years (millions of current US dollars)

	Chile's quota (1)	Loans outstanding (2)	(2)/(1)
1955	50.0	12.5	0.25
1957	50.0	31.0	0.62
1959	75.0	41.7	0.56
1961	100.0	88.6	0.89
1963	100.0	116.0	1.16
1965	100.0	125.0	1.25
1966	100.0	110.0	1.10
1967	100.0	95.0	0.95
1968	125.0	110.2	0.88
1969	125.0	88.2	0.70
1970	158.0	41.0	0.26

Source: Banco Central de Chile, Balanza de Pagos 1970, p. 79 and IMF, International financial Statistics.

It is true that the influence of the IMF on the country's economic policy-making depended considerably on the Balance of Payments situation. From this angle, President Frei's Government was in a better position than the previous two Governments. What has very little support from Chile's experience in the 1950's and the 1960's is the image of the IMF being able to impose an anti-inflationary policy on Governments facing acute Balance of payments difficulties. This was certainly not the case either in 1955, 1959 or 1965, the origin of the stabilization efforts being domestic rather than foreign, (see Table 7.5, below).

Table 7.5

Balance of Payments Situation 1954-1966, Selected Years

	Annual increases, (%)			B. of P. deficit (millions of current US dollars)
	Copper Price	Exports	Imports	
1954	-14.0	2.8	-2.5	-6.4
1955	29.8	27.9	13.3	37.3
1956	3.9	2.1	-4.3	-24.4
1958	-10.3	-11.0	-6.3	-20.0
1959	21.7	29.3	-0.3	24.6
1960	2.4	2.7	13.4	-39.0
1964	7.5	17.7	8.4	22.7
1965	19.0	15.2	0.4	59.7
1966	27.5	26.7	25.6	121.7

Source: Ricardo Ffrench-Davis, 1973, op. cit., Table 48, Column 1, p. 284 and Table 50 p. 288, and calculations by the author.

In the case of the stabilization effort which started at the end of 1955, not only the export performance had been very good throughout the year but since mid-year a number of very optimistic forecasts about the future international price of copper had been published. The same happened immediately before President Alessandri took office in 1958, so that the good 1959 export performance had been also forecasted.[1] In the case of 1965 the situation looked even more promising and although the Government had to solve the problem of the renegotiation of the foreign debt with IMF support there is no doubt that the stabilization program which was implemented was the one the Government wanted.

1. See EMS, 26 July 1955, p. 1, 30 July 1955 p. 1, and 18 August 1955, p. 1 and 23 Oct. 1958, p. 1.

I) Summary

The role of the monetary system in the Chilean inflation was a complex one. First, the monetary institutions limited the Government's capacity to use increases in high powered money as a source of financing. Consequently, Governments depended on Congress for being able to enact special legislation waving those restrictions from time to time. Since Governments never had unconditional majorities in Congress they were not in a position to enact such legislation too frequently. Moreover, the amounts which were authorized were always clearly stipulated. Hence, the monetary and political systems reduced the possibility of a hyperinflation caused by Government financial policies very considerably. Second, the Government had to share the monetary expansion with the business sector not only because of its inability to impose restrictions on secondary monetary expansion - while benefiting from its access to the increase in high powered money - but, also, because such a restrictive policy would have created a very critical economic and political situation unless the restrictions were accompanied by a fall in the rate of increase in prices, i.e. unless an effective and comprehensive anti-inflationary policy was implemented. In other words, given the rate of inflation, the monetary system was seldom a factor contributing to reduce it. In fact, when such a role was attempted in 1956-57, the effects were economically and politically very damaging and the policies were, therfore, short-lived. The 1959-61 and the 1965-66 attempts at stabilization did not rely on monetary restriction as a central anti-inflationary measure.

Monetary expansion seems not to have been the main cause of the increases in the rate of inflation which started in 1953 and 1967. In the case of 1962, however, monetary expansion seems to have played a more active role, not in the inflationary acceleration itself, which

was clearly caused by the huge devaluation which took place during the last quarter, but in the accumulation of pressure illustrated by the deteriorating Balance of Payments situation which led to the devaluation.

Increasing inflation subsidized credit and benefited those with more access to it. Since they were the ones which controlled the Board of Directors of the Central Bank which had the power to determine maximum bank interest rates, the subsidy was only reduced when the Government had the power to overcome business sector opposition and was willing to implement effective measures in order to increase the cost of bank credit.

The business sector managed to enlist enough support in Congress to block the attempts at reforming the Board of Directors of the Central Bank of those Governments which wanted to control the Board. Consequently the Board remained under business sector control until the private banks were nationalized in 1971. However, the Board was not a major obstacle for the implementation of the monetary policy of the Government when the threat of a reorganization had enough credibility.

As to the IMF, it is clear that it had considerable influence in Chilean policy-making, particularly before 1965, but it would be an exaggeration to suggest that it was the main factor explaining the similarities between the 1956-57 and 1959-60 stabilization efforts, let alone to suggest that it imposed the (unpopular) anti-inflationary policies on the Governments, taking advantage of the existence of Balance of Payments difficulties.

Chapter Eight

Taxation, Government Expenditure, the Budgetary Process and Inflation

A) Introduction

Government expenditure and its financing have always been one of the central subjects in the controversies about inflation and stabilization. In Chile, monetarism and the 'businessmen's approach' consistently blamed them for inflation, the former stressing their role on the demand side while the latter stressed their role on the costs side. Structuralists, however, although recognizing that the high levels of fiscal deficit and the way in which it was financed were inflationary factors, also stressed the merely 'propagating' character of Government expenditure. They viewed the Public Sector as one among several claimants on resources trying to protect its share in total real resources threatened by inflation itself.

Governments consistently blamed Congress for 'interfering' with Government finances, the implication being that by centralizing more financial powers in the hands of the Government sounder fiscal policies could be effectively implemented, thereby reducing their contribution to inflation.

This Chapter analyses the evolution of Government expenditure, and particularly the major increases that occurred from time to time, the evolution of the financing of Government expenditure and the institutional framework in which Governments and Congress operated during the period under scrutiny.

B) Government and Fiscal Expenditure

Fiscal expenditure increased by 204.0% in real terms during the period 1952-1970, i.e. more than trebled, increasing from being the equivalent to 15.3% of the GDP to 22.5%. The main increases occurred in 1959-60 and 1965-66, at the beginning of President Alessandri's and President Frei's Governments,[1] although there were also considerable increases in 1961-62 and towards the end of president Frei's Government (see Table 8.1, below).

Table 8.1

Annual Increase in Real Fiscal Expenditure, 1952-1970

Government	Ibañez		Alessandri		Frei	
	FE	GDP	FE	GDP	FE	GDP
1953	3.8	6.1	1959 12.1	1.7	1965 23.9	6.5
1954	-4.8	0.0	1960 19.1	3.7	1966 14.1	10.1
1955	7.3	2.7	1961 9.4	6.1	1967 0.5	1.2
1956	-5.7	1.2	1962 13.5	5.7	1968 8.8	3.5
1957	4.4	0.9	1963 -5.5	4.0	1969 4.6	5.5
1958	0.4	2.5	1964 -2.7	4.8	1970 18.2	3.4

Source: Calculations based on data from Ricardo Ffrench-Davis, 1973, op. cit., Table 34 (GDP), p. 252, and Table 67 (FE: Fiscal Expenditure), p. 329.

Governments always blamed Congress for their fiscal problems, but the evidence in Table 8.1 tends to show that fiscal expenditure increased most when Governments were stronger, at the beginning of their terms in office, when they were in a better position to resist pressure from Congress.

1. Peter Cleaves is mistaken when he states that there was a 51.2% increase in real terms in 1953, at the beginning of President Ibañez Government. Neither the proposed nor the approved or the executed budget increased by that percentage in 1953. The same is true of the 52.7% and 45.1% he reports in the cases of 1960 and 1965. See Peter Cleaves, Bureaucratic Politics and Administration in Chile, (Berkeley, Univ. of California Press, 1974), Table 2. p. 26.

President Ibañez did not attempt a major increase in fiscal expenditure. In fact, he wanted to reorganize the civil service in order to solve the fiscal difficulties inherited from the previous Government. However, Congress limited the Extraordinary Powers which he was given at the beginning of 1953, one of the most important limitations being the very severe restrictions on his ability to dismiss civil servants, most of them supporters of the political parties now in the opposition. On the other hand, the Government needed to accommodate the requests for employment from its own supporters so that there was very little room left for the kind of drastic reorganization that would have been needed in order to make a significiant contribution to the fiscal situation. The fiscal situation worsened considerably in 1953 even though fiscal expenditure increased by only 3.8%, and the fiscal deficit increased from 13.2% to 17.8% of total expenditure mainly because of a very considerable fall in the tax revenue from the copper sector caused by the sharp fall in exports at the end of the Korean War.

During the period 1952-1957, fiscal expenditure remained almost stagnant. It increased by only 0.5% from 1952-3 to 1954-55 and decreased by 0.3% in 1956-57, (calculations based on Table 8.1, above). This was the background against which 'Sunkelian' structuralism stressed that the nominal increases in Government expenditure were only a 'propagating' factor, i.e. a result of the downward rigidity of fiscal expenditure in real terms. However, this was hardly the case from 1959 onwards, when Government expenditure was clearly not merely defending its share against the effects of inflation, i.e. 'propagating' it, but playing a much more 'aggressive' role in the distributional struggle.

In President Alessandri's case, despite his commitment to reduce the level of state involvement in the economy, a huge increase in fiscal expenditure occurred because he tried to use somewhat 'Keynesian' measures in order to reactivate the economy which had grown very little during the previous Government. In fact, the GDP per capita was slightly lower in 1958 than in 1952. On top of that, the May 1960 earthquakes required further increases in Government expenditure during the years which followed. Consequently, while average current expenditure increased by 18.0% in real terms from 1956-58 to 1959-61, capital expenditure increased by 60.0%.

The case of president Frei's Government was even more clearly not one in which the fiscal difficulties could be explained by the traditional structuralist view, a somewhat ironic finding given that the economic policies of that Government were structuralist ones. The huge increase in fiscal expenditure which took place in 1965-66 was the result of the Government's efforts to implement its ambitious economic and social programs. As to the role of Congress, it is clear that it had very little to do with the increase. In fact, there was considerable overspending during the implementation of the budget, particularly in the case of the housing program.[1]

Once the huge increases at the beginning of each Government had taken place, the new higher levels of expenditure became also downwardly rigid, indicating that a 'ratchet effect' was in operation. But it would be very difficult to decide whether these high levels of expenditure were economically and socially unavoidable, and in that sense structurally rigid, because this inevitably leads to the problem of determining what is unavoidable, if anything, in a less developed country attempting to operate a democratic system.

1. See Ricardo Ffrench-Davis, 1973, op. cit., p. 176.

It seems useful to distinguish short-term rigidity, i.e. rigidity during the fiscal year or once the Government is commited to a certain level of expenditure, and medium-term rigidity, i.e. rigidity preventing reductions in the level of expenditure from one year to the next. These are clearly two different concepts. The first one is the one which is relevant when analysing the effect of sudden falls in the tax revenue due to falls in exports or increases in inflation when the tax system is vulnerable to such changes (see section D, below). In the short-run it was very difficult to implement expenditure cuts because of a number of reasons such as the need to change some legislation which made some spending to be mandatory and the technical difficulties involved in stopping programs abruptly. It is in the case of medium-term (downward) rigidity that socio-political factors seem to be more important, as will be shown later on.

As to the 'electoral cycle', the basic three assumptions for the mechanism to work are: (i) that it is possible to boost output and employment, at least for a while, by a monetary or fiscal stimulus, but at the cost of a higher eventual rate of inflation; (ii) that there is a lag between the effects of a monetary or fiscal boost on real activity and its inflationary consequences and (iii) that the memory of the electorate is subject to fairly rapid decay, so that Governments lose less from high unemployment early on their period of office than they gain from low unemployment nearer the day of the election.[1]

In Chile, the second assumption clearly did not work, because in the late stages of the 'presidential cycle' Governments were not in a

1. See Samuel Brittan, 'Inflation and Democracy', in Fred Hirsch and John H. Goldthorpe (eds.), 1978, op. cit., p. 168, referring to William D. Nordhaus, 'The Political business Cycle', Review of Economic Studies, 42, 1975. pp.167-90.

position to achieve expansion without generating considerable additional inflation, even in cases in which there was considerable idle capacity. In 1958 the Government did not attempt any electoral cycle because the '_ibañista_' movement had collapsed long before the presidential campaign started and there was no candidate preferred by '_ibañistas_' in general (they split between the Socialist and the Christian Democratic candidates). Moreover, President Ibañez was more interested about posterity than anything else and he wanted to end what was surely his last Government with an acceptable record on inflation. In 1964, inflation eroded the real value of fiscal expenditure and, although an acceptable level of economic growth was sustained throughout the 1963-64 inflationary acceleration, increased dissatisfaction with the high level of inflation and the policies of the Government in general led to the collapse of the coalition supporting President Alessandri fairly early in the year. Since both candidates left with a real chance belonged to the opposition, the record of the Government was not electorally too relevant.

The case was different in 1970 because the Christian Democrats did have a candidate with a fairly strong chance of winning until the very end of the campaign, when it became clear that neither the right nor the left were willing to support the centre candidate for tactical reasons. Moreover, there was a huge increase in fiscal spending in 1970, (see Table 8.1, above). However, a more detailed analysis suggests a different explanation for this increase. It was the result of huge increases in wages, salaries and social security benefits caused by mounting labour unrest combined with a military rebellion at the end of 1969 which was stifled by the Government, but led to a special pay increase for the Armed Forces which accounted for approximately two fifths of the total increase in fiscal expenditure in that year. Instead of a Government

trying to generate an electoral cycle, the situation rather looked as a Government being forced to increase fiscal expenditure as a result of increasing pressure from several powerful sectors. In any case, despite some considerable level of idle capacity estimated to be around 25.0% in the case of manufacturing firms with more than fifty employees,[1] and even though inflation remained almost at the same level of 1969 on average, production increased significantly less than the 1960's average which was 5.1% (calculation based on Table 8.1, above) and unemployment increased. (See Table 8.2, below). In other words, no electoral cycle every materialized.

Table 8.2

Economic Growth, Inflation and Unemployment, 1952-1970

Governments	First Half				Second Half			
		GDP	GPI	U		GDP	GPI	U
Ibañez	1953	6.1	24.2	-	1956	1.2	64.8	6.9
	1954	0.0	57.0	-	1957	0.9	35.6	6.4
	1955	2.7	78.0	-	1958	2.5	26.2	9.5
Alessandri	1959	1.7	35.3	8.9	1962	5.7	10.3	5.2
	1960	3.7	7.1	7.4	1963	4.0	48.2	5.1
	1961	6.1	3.0	6.6	1964	4.8	49.3	5.2
Frei	1965	6.5	29.3	5.4	1968	3.5	29.5	6.0
	1966	10.1	24.4	5.3	1969	5.5	35.0	6.1
	1967	1.2	20.3	6.1	1970	3.4	35.4	7.1

GDP: Gross Domestic product, Annual Increase (%), as in Table 8.1.
GPI: General price Index (RPI (1/3) and WPI (2/3)), annual average increase, see R. Ffrench-Davis, 1973, op. cit., Table 33, p. 248.
U : Rate of unemployment in Greater Santiago, 1956-58 from ibid, Table 2, p. 38, 1959-1970 from Instituto de Economía, Ocupación y Desocupación, various issues, (1959 is the average of the first semester, the second is not available).

1. See ODEPLAN, 'Plan Anual 1971', Santiago, Marzo 1971, p. 6.

The Christian Democratic Government could have made use of the very considerable increase in international reserves which took place in the period 1967-70 in order to increase imports, consumption and investment, reducing inflation at the same time, but it seems clear that electoral considerations were not paramount and that the goal of improving Chile's foreign exchange position was at least as important. In fact, imports increased by less than 3.0% in US dollars of constant purchasing power in 1970.

Whatever the doubts about whether Governments tried to create electoral cycles, the evidence in Table 8.2 (above) clearly shows that unemployment did not fall at the end of the Governments and the rate of increase in the GDP was not particularly high. In any case, every presidential election was won by an opposition candidate in the period 1952-1970.

Parliamentary elections (held every four years between 1953 and 1969) were also important, but due to the Chilean electoral system every other Government they were either too early or too late in the 'presidential cycle' for the Government to be able to orchestrate any effective 'electoral cycle'. The same applies to the general municipal elections in 1963 which was particularly important for reasons which were discussed in Chapter Five. In the period 1952-1970 the exception was the March 1961 parliamentary election. However, despite the efforts of the Government to reactivate the economy the results were rather poor in 1959-60. Stabilization rather than reactivation of the economy was the main achievement of the Government. Most of the considerable increase in consumption and investment which took place, particularly in 1960, was based on a huge increase in imports which benefited mostly the well-to-do, helping the centre-to-the-right coalition to consolidate its electoral support rather than expanding it among other sectors.

C) The Budget and the Budgetary Process. An Introduction

In principle, the budget of any organization should provide the best possible estimate of the inflow of resources and the clearest possible account of the priorities for spending those resources according to the goals of the organization and the programs which the organization considers best for fulfilling those goals. These priorities would allow the organization to curtail expenditure in less important areas if resources did not reach the expected level. Furthermore, in a large and complex organization, the budget should be a frame of reference for controlling the implementation of the programs and activities of each department and an instrument for achieving the clearest possible view of the opportunity costs involved in allocating specific amounts of additional resources to specific programs.

Of course, the Government budget cannot be treated as if it was just the budget of a larger or more complex organization because it reflects the goals and choices adopted by the nation which are the result of the balance of forces and the compromises between different social sectors worked up through the political system. Therefore, as the general political situation changes so will budget priorities. However, even in the more 'adversarial' environment of a political system, a budget should be as informative as possible not only in order to allow those in power to make better decisions but, also, to increase the level of accountability of those authorities to the electorate. The Government budget and the budgetary process should play an informative and educational role not only in the case of congressmen but also in the case of the political parties in general and the public, or at least those more active in public affairs.

Since the Chilean inflation was to a large extent the result of the failure of the political system to accommodate conflicting demands within the limits of available resources, the contribution of the budget and the budgetary process to the general awareness of the opportunity costs involved in each demand and each concession is an important aspect worth analysing.

In Chile, although the budget Bill was frequently sent to Congress accompanied by proposals of tax reform, strictly speaking the budget was concerned with expenditure and was based on estimates of the fiscal revenue during the next year. As will be seen in the following sections, the budget itself, as a document, and the budgetary process, (i.e. the preparation, approval, implementation, audit and evaluation of the budget) had several features which reduced their contribution to the process of reaching accommodation through the political system.

The fiscal budget did not include a very important part of the Public Sector which concerned autonomous institutions such as the State Universities, the National Health Service, the Social Security System, the Muncipal authorities, the autonomous public enterprises and other autonomous agencies. In other words, the fiscal budget only included those activities performed by the Central Government. Those institutions which were not included in the fiscal budget had to send their own budgets to the Ministry of Finance which approved them and, when necessary, modified them by decree, i.e. without being discussed in Congress. At the beginning of the 1950's, fiscal expenditure accounted for around 65.0% of total consolidated public expenditure, while by the end of the 1960's it was down to around 47.0% (see Table 8.3, below). However, given that the fiscal budget included the contribution of Central Government to the financing of the decentralized institutions and given its importance particularly

in the case of direct public expenditure, its financial significance was larger than what the above mentioned percentages suggest.

Table 8.3

Fiscal and Public Expenditure Compared, 1952-1970, Selected Years

(fiscal expenditure as a % of public expenditure)

	1952	1960	1968
Current Expenditure	72.7	55.1	48.2
Wages and Salaries	64.4	52.8	47.4
Social Security	80.7	33.4	26.6
Other		81.5	77.2
Capital Expenditure	47.9	61.2	46.3
Direct Investment	81.0	76.4	64.8
Indirect Investment	0.0	0.0	0.3
Debt Amortization	47.1	55.5	48.6
Total Expenditure	64.1	55.8	46.8

Source: 1952: Calculations based on Instituto de Economía, 1963, ii, op. cit., Tables 168 and 204, pp. 132 and 165, reclasifying debt amortization in order to make it comparable with 1960 and 1968.

1960-68: Dirección de Presupuesto, Balance Consolidado del Sector Público and ODEPLAN, Balance Económicos de Chile 1960-1970, (Santiago, Ed. Universitaria, 1973).

Public sector financing was a constant source of financial difficulties because Governments were always trying to keep inflation down - even when they did not implement comprehensive stabilization policies - and one of the areas in which they were able to signal their commitment to stabilization was price controls, particularly of Public Sector prices.

Governments could not afford to infringe their own inflation targets by allowing for the 'catch up' of Public Sector controlled prices. Public enterprises were expected to set an example. Consequently, financial difficulties arose and the Government tried to hold the line on prices by providing additional financing from the fiscal budget or by supporting public enterprise borrowings from the Central Bank and the commercial banks.

Public enterprise financing is a complex subject that cannot be dealt with directly in this thesis, but various Chapters touch on the major aspects. Thus, Chapter Ten discusses price controls, this Chapter discusses the fiscal aspects, and Chapter seven discussed the monetary aspects.

The Social Security System, a major area of the Public Sector which was mostly outside the fiscal budget (see Table 8.3, above) raises similar problems, although it has some specific characteristics concerning the existence of special taxation (social security contributions), an aspect which is touched in Chapter Nine.

For reasons of space this thesis focusses on the central aspect of fiscal control which was the regular fiscal budget requiring congressional approval.

The Chilean fiscal year corresponded to the calender one. Before 1925, the discussion and approval of the budget was a major weapon in the hands of a Congress dominated by the oligarchy, but the Consitution of 1925, although it stipulated that Congress would retain the right to discuss and approve the budget, also stipulated that the Executive should send the Bill to Congress four months before it was due to take effect and that if Congress did not approve it within that period the Bill would be enacted automatically.

The budgetary process for any year started the preceding March, when the Budget Bureau of the Finance Ministry produced provisional rough estimates of revenues in the next year, and ended in the April, following the year in question,[1] with the publication of the final report by the General Controllership of the Republic (La Contraloría General de la República), an autonomous agency one of whose main functions was to audit the budget.[2] The budgetary process can be summarized as follows:-

Year 1	January:	The budget law for the current year was published.
	March:	The Budget Bureau produced rough estimates of Year 2 revenues.
	April:	The Contraloría published the report on the execution of the Year 0 budget.
		The Budget Bureau communicated the spending cailings for Year 2 to each department or agency.
	May/Jun:	Preparation of the budget for Year 2 in each department or agency.
	Jul/Aug:	Analysts of the budget Bureau examined the proposals made by each department and agency.
		The Finance Ministry started transferring resources from some budgetary items to others in the current (year 1) budget, using the degree of flexibility which was allowed during the execution.
	31 Aug:	The draft budget for Year 2 was sent to Congress, including an estimate of revenues.

1. Good descriptions of the Chilean budgetary process at the beginning and the end of the period under scrutiny can be found in Albán Lataste, El Proceso Presupuestario Fiscal Chileno, (Santiago, Instituto de Economía, Univ. de Chile, 1958) and in Peter Cleaves, 1974, op. cit., Appendix.

2. For a historical and juridical approach to the evolution of this institution see Raúl Arrieta, The Contraloría General de la Republica in the Chilean Political System: A case study in the Control and Scrutiny of Executive Power, (Oxford Univ., Ph.D. thesis, 1979).

Sep/Dec: The budget for Year 2 was discussed in Congress. The Finance Ministry reported on the state of fiscal finances before the Joint Budgetary Committee of Congress. The Government sent the final version of the Bill to Congress, the Oficio Final, including revised revenue estimates and some changes in proposed expenditures.

31 Dec: The implementation of the current (Year 1) budget ended, and the implementation of the next budget (already approved) began.

D) The Politics of preparing and Evaluating Fiscal Budgets under Inflationary Conditions

The preparation of the fiscal budget, which took place inside the Executive branch, can be understood as a transaction between the Finance Ministry 'having a near monopoly over economic and financial subsidies' and another kind of resource: information'.[1]

Information about the performance of the agencies and programs was scattered and inadequate. The budget did not include information about targets on the 'productivity' of fiscal expenditure and the Finance Ministry faced considerable difficulties in trying to introduce Planning programing Budgeting Systems (PPBS) first in the national Health Service, at the beginning of the 1960's and in trying to extend it to the Public Sector as a whole later on. Some of these were technical difficulties concerning the identification of adequate estimates of 'productivity' but there was, also

1. See Peter Cleaves, 1974, op. cit., p. 38.

considerable bureaucratic resistance because administrators felt threatened by a new device designed for evaluating their performance.[1] Congress did not have enough staff to attempt any alternative analysis of the budget and the Information Bureau of the Senate, created in 1959, depended on the information sent by the agencies and Government departments themselves for its studies.[2] Finally, the Contraloría, which was charged with the responsibility of auditing the budget and publishing the results, concentrated on the juridical aspects of the accounts and did not provide any economic analysis of the information. Although all Public Sector institutions included representatives of the President of the Republic in their Boards (frequently occupying the top executive posts) their main concern was seldom to help the finance Minister to take resources away from them in order to allocate them more efficiently somewhere else. Financial discipline required a very considerable degree of political discipline inside the Government and this was difficult to achieve even in cases such as the beginning of a one party Government such as President Frei's one in 1965-1966, because different sectors of the party had different ideas about the balance between different programs, i.e. about the Government's priorities, and bureaucratic tactics such as rationing information and pressing for more resources in every possible way were used not only by the bureaucrats as such but by the politicians who were frequently engaged in political struggles inside the Government itself. This kind of pheonomenon was much more pronounced in the case of coalition governments such as those of President Ibañez - especially during the first half of its term in office - and President Alessandri, particularly from 1961 onwards.

1. ibid. pp. 51-2, and Instituto de Organización y Administración, (INSORA), Univ. de Chile, 'Los Presupuestos por Programas en las actividades Públicas: Su aplicación a una institución estatal' (Santiago, INSORA, 1964), pp. 173-83.

2. See Oficina de Informaciones del Senado (OIS), 'Disposiciones legales y labor que desarrolla la OIS', Boletín de Información General, OIS, 18, 31 May 1967.

The Budget Bureau of the Finance Ministry also had major problems on the revenue side because the structure of the tax system made it very dependent on foreign trade (between a quarter and a third of the total tax revenue came from the copper sector and imports, see Section F, below), and because, until 1965, a considerable proportion of the income tax was not readjusted according to the inflation that occurred between the moment in which the income had been earned and the date in which the tax was collected, which was a year after on average. This were two aspects stressed in most structuralist anlaysis of the Chilean inflation at the end of the 1950's and the beginning of the 1960's. In the case of copper, which was the main source of instability in Chile's foreign trade, the changes in tax revenue from year to year were particularly sharp in the period 1953-1962 (see Table 8.4, below). From 1962 to 1970, this source of tax revenue registered large increases but only minor annual falls, i.e. there was a strong upwards trend and, as a result, although it did not cease to be a major source of difficulties for estimating future revenue the actual results were consistently better than the estimates used in the budget.[1]

Table 8.4

Annual Changes in Tax Revenue from the Copper Sector, 1953-1970

(In real terms, as a % of the previous year revenue (A) as a % of previous year fiscal investment (B) and as a % of previous year total tax revenue (C))

	A	B	C		A	B	C
1953	-51.4	-27.1	-8.1	1962	34.7	12.3	3.6
1954	40.5	21.6	5.0	1963	-0.2	-0.1	-0.0
1955	23.2	16.7	4.0	1964	3.1	1.2	0.4
1956	35.5	26.5	6.6	1965	22.4	9.0	3.1
1957	-29.4	-30.3	-7.4	1966	59.9	21.0	8.0
1958	-22.9	-28.0	-5.8	1967	-4.3	-2.0	-0.7
1959	55.7	28.3	6.7	1968	-3.7	-1.7	-0.5
1960	- 3.5	- 2.0	-0.6	1969	18.8	8.4	2.6
1961	- 9.8	- 9.2	-2.8	1970	23.5	12.2	3.6

Source: Calculations based on R. Ffrench-Davis, 1973, op. cit., p. 329.

1. See Cristián Ossa, 'El Cumplimiento del programa Fiscal y el Proceso Inflacionario' in Central Bank of Chile, Monthly Bulletin ,486, August 1968, Table 6, p. 643, for the period 1962-1967.

The instability of this source of revenue had considerable political significance because the introduction of new taxation was as controversial as the estimates about future revenue from the existing ones were disputable (see Section F, also).

In the case of the income tax, it was estimated that the real value of the revenue which was not collected on a pay-as-you-earn basis fell by 1.0% for each 1.0% increase in the annual rate of inflation.[1] Since the revenue concerned accounted for approximately 15.0% of the total tax revenue at the time, inflationary accelerations such as those in 1953-1955 and 1962-1963 can be estimated to have reduced the real value of this taxation by amounts equivalent to 5.0% of the total tax revenue in 1954, 3.0% in 1955 and almost 6.0% in 1963. However, Governments were unable to anticipate or recognize these falls because it would have required to anticipate the increase in inflation, and to recognize it publicly in advance. As a result, Governments delayed proposals for increasing taxes until the situation became clearly critical and then asked Congress either to approve supplementary taxation, often of a temporary character, which was equivalent to a partial readjustment, or to ratify increases in high powered money by transforming short term obligations with the Central Bank into long term ones, or a combination of both.

1. See Kenneth Ruffing, 'The Effects of Inflation on the Yield and the Structure of the Fiscal System in Chile', (Columbia Univ., Ph.D. thesis, 1971), quoted in M. Mamalakis, The Growth and Structure of the Chilean Economy: from Independence to Allende, (New Haven, Yale Univ., Economic Growth Centre, 1976), p.115.

E) Congress, the Fiscal Budget and Fiscal Expenditure

In Chile, as in many other countries, the Executive branch not only exercised considerable powers in the preparation and execution of the budget but also benefited from the difficulties faced by Congress in exercising its legislative prerogatives. Lack of time and resources to examine the budget proposals, restrictions on the right of amendment and powerful procedural tools used by the Executive, reduced the ability of Congress to influence the budget very considerably, even though in Chile Governments seldom enjoyed the support of a disciplined majority in any of the two chambers and never in both.

Congress only had four months to study the budget and the characteristics of the document, the general lack of information about the 'productivity' of fiscal expenditure, and the lack of staff and other resources needed to produce a complementary analysis of the document, did not help to overcome the limited time available.

Both the draft budget and the estimate of revenues which accompanied it were very detailed documents mainly concerning the juridical aspects involved, and they added up to something in the region of one thousand pages of figures, juridical information and definitions. In order to discuss this, each chamber appointed eleven members to form the Joint Budgetary Committee which existed only during the September-December phase of the budgetary process and operated on the basis of several sub-committees dealing with parts of the document. Given that Congress was not allowed to increase the proposed expenditures either by adding new items or increasing the existing ones, the committee made a list of 'suggested amendments' which was sent to the Government. Some of these 'suggestions' were included in the final version of the Bill, the Oficio Final, which was usually approved with only minor modifications by Congress.

A very comprehensive study of this procedure during the period of President Frei's Government found that the combination of underestimating future revenues at the beginning - draft budget - and delaying the Oficio Final, was part of the strategy of the Finance Ministry in order to allow for accommodation to take place in a restrictive milieu.[1] Consequently the changes in the budget from the August draft to the version finally enacted in December cannot be blamed on congressional pressure only. In any case these changes were not the ones which explained the huge increases in fiscal expenditure which took place during this period, (see Table 8.1, above). In fact, as section B in this Chapter showed, President Ibañez' Government (which was very weak in terms of congressional support) was the only one in which fiscal expenditure remained almost constant.

Only the members of the Joint Budgetary Committee had any chance of studying the budget in more detail and, as a result, they had a public image of being 'experts' on financial matters, particularly those who were also members of the permanent Finance Committees of each chamber which dealt with the financial aspects of every Bill. In the case of the Senate, there was a high degree of continuity in the membership of the Finance Committee over the years[2] so that experience, if not expertise, was not in short supply in there. Congressmen in general were able to score politically during the budgetary process by making sure that locally important expenditures were included among the 'suggested amendments' which were sent to the Government before the Oficio Final. When they were accepted, they were able to claim victory but even if they were rejected by the Government, congressmen belonging to the opposition were able to accuse

1. See Peter Cleaves, 1974, op. cit., pp. 42-4.

2. See Weston H. Agor, The Chilean Senate. Internal Distribution of Influence, (Austin, University of Texas Press, 1971), Table 29, p. 88.

the Government of not taking any notice of the local problems. In the case of congressmen belonging to the parties supporting the Government, they were always able to find some convenient explanation such as blaming the opposition, excessive 'centralism' or even their allies.

Although all these practices did not affect the budget very much, and in themselves they were probably inflationary only marginally, they were a contributing factor to the fact that, on balance, the budgetary process did not do enough for the ordinary citizen's understanding of the financial problems and options faced by the Government. In fact, it can be argued that its contribution was very limited even in the case of the understanding of the better informed citizens, politicians in general and even congressmen in general.

Outside the budgetary process, there was considerable legislative activity which also had financial consequences for the Government. The Constitution stipulated that neither the Executive nor Congress were allowed to modify expenditures and taxes established by other general or specific laws through the Budget Law. This was the area in which Congress was in a better position to exercise its legislative prerogatives. However there were also limitations here. Congress was not allowed to initiate legislation on wage and salary increases and the creation of new jobs in the fiscal sector, neither it was allowed to increase proposals made by the Government in these areas. Moreover, any fiscal expenditure approved by Congress had to be properly financed. However, there were loop-holes in these restrictions. Since the 1943 Constitutional Amendment limited congressional prerogatives on fiscal sector wages, salaries and jobs, it remained controversial whether or not social security benefits were also included.[1]

1. See Alejandro Silva Bascuñan, 'El nuevo régimen de iniciativa exclusiva del Ejecutivo', in Gustavo Lagos et al, La Reforma Constitucional de 1970, (Santiago, Ed. Jurídica de Chile, 1970), pp. 89-90.

In the case of the clause stipulating that every new expenditure should be properly financed the problem was that sometimes Congress approved new expenditures indicating the ordinary sources of revenue of the next budget as the source of financing for them. Consequently, the clause was rather ineffective as a restrictive device.

The Executive never liked any of the congressional practices which reduced governmental room for maneuvering on the expenditure side, neither were they ever satisfied with the level of taxation approved by Congress, not even in the case of President Alessandri who had been a very prominent campaigner against the existing levels of taxation as a businessmen leader before coming President. Consequently, they consistently campaigned against congressional 'interference' with Government finances. Although it is true that Governments themselves, and not Congress, were the ones responsible for most of the increases in fiscal expenditure, there can be little doubt that Congress was not a restrictive factor either, and that it also contributed to the increases even if in a smaller scale. It seems reasonable to argue that, given that Governments were the ones which suffered most, politically, as a result of bad economic performance, it would have been an improvement from the fiscal point of view to have increased their financial powers because they had good reasons to try to balance their eagerness to spend with their need to achieve economic stability. Moreover, they would have had to face their responsibility more fully, Congress not being a scapegoat anymore. Of course, Congress should have retained the restrictive side of its powers, i.e. those which enabled it to reject or reduce expenditures proposed by the Government.

Those who opposed a Constitutional reform increasing Executive powers - and although there were opponents in all political parties the left was more consistently against it throughout the period under scrutiny - argued that Governments already had considerable powers. In fact, they only needed on third of the Deputies or the Senators to prevent any undesired increases in expenditure or reductions in proposed taxation by using the veto powers of the Executive branch. However, although this was juridically true, it would not work if a Government attempted to use it frequently because there was always at least one chamber in which the opposition had a majority position and the Government never had two thirds of the seats in the other chamber in order to be able to insist if a Bill was rejected in general. In other words, if the Government used the veto, the opposition was in a position to block subsequent legislation and bury it for at least one year, and then it could do it again. No Government was in a position to rule without some degree of cooperation from the opposition in Congress. Moreover, if Governments were seen as the cause of the elimination of benefits already approved by Congress or as the cause of tax increases which had been rejected, their political attrition would have been even more rapid than what it usually was during the 'presidential cycle'. Governments could not afford to be always the power imposing taxes and stopping benefits not only because those directly affected were likely to increase their support for the opposition. In addition vast sectors of the population considered the benefits obtained by the more organized sectors as a victory for them also, because it increased the likelihood of they themselves being able to obtain the same benefits in the future. Moreover, either they did not link the increases in expenditure with the increases in taxation (traditional or through inflation) that they would have to bear, or they thought the prospect of future benefits outweighed the increased burden,

or even they thought the taxation side of the fiscal problem should be solved independently, by reducing tax evasion and increasing taxation to the well-to-do. In Chilean society those who clearly and consciously benefited from lower fiscal expenditure and lower taxation were very few (see Table 8.5, below), so that there was not much to gain from adopting a restrictive line on spending. However, these few were politically and economically powerful enough to resist what they considered to be excessive increases in taxation and, as a result, made it very difficult for the Government to finance the increases in expenditure which were so difficult to stop.

Table 8.5

The Combined Effect of Taxation, Social Security Contributions and Public Expenditure on Income Distribution, 1969 a/

Income b/ Brackets	Households	Original Income Distribution	Distribution after considering the effect of Government c/ Alternative I	Alternative II
0 - 1	29.8	7.6	10.5	11.8
1 - 2	31.6	20.1	22.6	23.2
2 - 3	17.6	18.9	18.9	18.8
3 - 4	7.4	11.2	11.1	10.9
4 - 5	4.5	8.7	8.2	8.0
5 - 6	2.9	7.1	6.4	6.1
6 - 8	2.7	8.0	7.4	7.1
8 - 10	1.5	5.9	5.1	4.8
10 +	2.0	12.5	9.8	9.3
Total	100.0	100.0	100.0	100.0

a/ This is the only year in which a detailed study is available.
b/ The unit is the Minimum Salary (MS)
c/ Alternative I distributed general expenditures according to the original income distribution while Alternative II distributed them according to the distribution of the households per bracket.

Source: Alejandro Foxley, Eduardo Aninant, José P. Arellano, 'Net Incidence of Government Expenditures, Taxation and Social Security', (Geneva. ILO, WEP 2-23/WP 53, Feb. 1977) Table 2, p. 3.

President Ibañez announced a Constitutional reform in 1954 but it never reached Congress because he knew that the opposition would have buried it.[1] President Alessandri consistently blamed Congress for 'interfering' with Government finances but confined himself to make the gesture of proposing a Constitutional reform only a few weeks before the next presidential election, when there was no chance of discussing it before the next general parliamentary elections which would take place six months after the presidential one. It was President Frei that seriously attempted to enact a reform and sent a Bill at the very beginning of his term in office. However, the Government had to withdraw the Bill from Congress because of opposition from the other parties and postponed it for four years concentrating its efforts on other Bills which were considered more urgent. Towards the end of the Government's term in office, when the prospect of a victory in the next presidential election weakened the opposition of the right - though not the opposition of the left - the reform was finally approved. Ironically, the Radicals, Socialists and Communists which opposed it were the ones which supported the next President of the Republic. Among other very important amendments concerning mechanisms to overcome conflicts between the Government and Congress in general, the reform stipulated that the President would enjoy exclusive initiative in all matters already included in the Constitution plus those of discontinuing, reducing and condoning taxes or other contributions, their interests and penalties, postponing or consolidating their payment, establishing general or specific exemptions, determining minimum wages and salaries in the Private Sector and granting or increasing pensions and other economic benefits.[2]

1. See, for instance, EMS, 11 July 1954, pp. 19 and 23.

2. See Gustavo Lagos et al, 1970, op. cit., particularly p. 85.

Thus, the historical trend towards concentrating financial powers in the hands of the Executive, which was started by the Constitution of 1925 and reinforced by the 1943 amendment, continued, although none of the three Governments which are under scrutiny in this thesis were able to benefit from more powers than those already available in the mid 1940's.

However, the 1970 Constitutional reform did not have much chance of showing whether it was an effective improvement concerning fiscal matters and political matters in general. After all, the reform does not seem to have had too much impact in the events which led to the military coup and the destruction of the democratic regime in 1973.

F) The Politics of Taxation

The Chilean tax system was characterized by its fairly regressive character, its high degree of instability, the high level of tax evasion and the predominance of forms of taxation whose incidence was, at least apparently, relatively diffused. These characteristics and the highly concentrated income distribution made it very difficult for Governments of whatever political complexion to construct a broad consensus in favour of restricting Government expenditure.

It has been sometimes argued that the reason why it was so difficult to have a coalition against increasing Government expenditure was that Chileans wanted to increase the level of taxation on the foreign copper companies and that, as a result, they were not prepared to practice self-restraint. However, the evidence shows that most of those who advocated those increases also advocated increases in direct taxation to the well-to-do in Chilean society in general. In fact, Governments had to balance their need for more revenue with their need to avoid major economic problems in the areas of investment and production in general not only in the case of the copper sector. In fact, if anything, they had to be more careful concerning the copper sector because it was a crucial sector not only from the point of view of production, exports and fiscal revenue but, also, from the point of view of attracting new foreign investment.

In order to understand the politics of taxation in more detail it would be desirable to have at least an approximate idea of the incidence of each specific tax. Since the structure of each tax changed over the years and the structure of the economy and society also changed, it would be better to provide estimates about tax incidence in several years, the more the better. In practice, the only detailed study available in the Chilean case focuses on 1969,[1] a year which cannot be considered to be

1. See Alejandro Foxley, Eduardo Aninat and José P. Arellano, 'The Incidence of Taxation',(Geneva, ILO, WEP 2-23/WP 51, 1977).

representative of the whole period under scrutiny. However, it is possible to assume, on the basis of additional socio-political and economic information, that in previous years, and particularly before 1965, the tax system was not as progressive as in 1969.

In Chile, indirect taxation was regressive and direct taxation was progressive while total taxation, excluding taxes on the copper sector and import duties, could be considered to have been progressive, had it not been for the fact that the high incidence of indirect taxation on the poorest 30.0% of the households offset the progressive effect of direct taxation in the case of that sector, (see Table 8.6, below).

Table 8.6

The Incidence of Taxation, 1969 (%)

Income a/ Brackets	Households	Pre-Tax Income	Total Taxation	Indirect Taxation	Direct Taxation
0 - 1	29.8	7.6	7.6	10.5	1.9
1 - 2	31.6	20.1	18.1	21.3	11.6
2 - 3	17.6	18.9	17.3	19.6	12.8
3 - 4	7.4	11.2	9.6	10.4	8.1
4 - 5	4.5	8.7	7.7	7.5	8.1
5 - 6	2.9	7.1	7.0	6.4	8.2
6 - 8	2.7	8.0	7.8	6.8	10.0
6 - 10	1.5	5.9	6.5	6.1	7.3
10 +	2.0	12.5	18.2	11.4	32.0
Total:	100.0	100.0	100.0	100.0	100.0

a/ The income brackets are based on the Minimum salary (MS) as a unit.

Source: Alejandro Foxley, Eduardo Aninat and José P. Arellano, 'The Incidence of Taxation', (Geneva, International Labour Office (ILO), WEP 2-23/WP 51, 1977), Table A-1 and A-2, pp. 48-54.

Direct taxation was more progressive both because of its rate structure and because its burden could not be shifted to someone else as it was the case with indirect taxation. In the case of the sales tax, which was the most important indirect tax (see Table 8.7, below), those who spent a higher proportion of their income, i.e. those earning less, were the ones who paid more, not only because of the above mentioned shifting but also because households in the lower income brackets did not spend a significantly lower proportion of their income in items classified as luxuries which were taxed with higher rates.[1]

The business sector, the well-to-do and the right-wing political parties opposed increases in taxation in general but, as could be expected, particularly in the case of direct taxation. Wage- and salary-earners and consumers in general did not like increases in indirect taxation, and particularly in the general rate of the sales tax, because they knew they led to higher retail prices. When they proposed sources of financing for reducing the fiscal deficit, both the unions and the left-wing parties preferred increases in the income tax paid by capital owners and in property taxes. The considerable political power of the well-to-do in Chilean society can be illustrated by the high level of indirect taxation which persisted throughout the whole period. However, two qualifications must be made. First, that total taxation increased enormously in real terms and, secondly, that once indirect taxation had been established and developed, the political cost of a complete tax reform which would reduce indirect taxation and increase direct taxation was enormous. Consequently, only marginal changes were possible.

1. ibid, pp. 32-3.

Table 8.7

The Structure of the Tax Revenue, 1955-1970,

Selected Years, (%)

	Indirect Taxes				Direct Taxes			General
	Sales	Imports	Other	Total	Copper	Other	Total	Total
1955	20.3	14.0	22.1	56.4	19.9	23.7	43.6	100.0
1958	19.3	15.0	26.4	60.7	12.0	27.3	39.3	100.0
1961	20.5	22.2	21.6	64.3	10.0	25.7	35.7	100.0
1964	25.7	14.7	18.8	59.2	13.3	27.5	40.8	100.0
1967	26.4	11.0 a/	17.8	55.2	15.4	29.4	44.8	100.0
1970	26.6	11.4 a/	20.1	57.1	19.0	23.9	42.9	100.0

a/ Import duties paid by the Public Sector were eliminated by law.

Source: 1955-58: Instituto de Economía, Univ. de Chile, La Economía Chilena en el período 1950-63 (Santiago, Univ. de Chile, 1963), ii, Table 189, p. 153.
1961-70 : Dirección de Presupuesto, Balances Consolidados del Sector Público.

The importance of indirect taxation increased considerably during the period 1955-1958 due to a huge fall in the direct taxation paid by the copper sector, which was not offset by increases in other sources of direct taxation (see Table 8.8, below, also). The fall was the result of a very sharp decrease in the international price of copper which fell by 61.0% from 1956 to 1958. Indirect taxation continued to increase in importance during the first half of President Alessandri's Government (1958-1961), although direct taxation on non-copper sectors did increase considerably in real terms, i.e. by 35.5% in three years (see Table 8.8, below), contrary to what could be expected of such a Government. However, most

of the increase can be explained by the effect of the spectacular stabilization which took place in 1959-60 on the real value of income taxes not collected on a pay-as-you-earn basis and, also, by the supplementary taxation introduced by the Government after the May 1960 earthquakes. During this period, most of the increase in indirect taxation was due to the huge increase in imports - approximately 50.0% between 1959 and 1961, measured in current US dollars - which was a direct result of the foreign exchange and foreign trade policies of that Government.

Table 8.8

Real Increases in Taxation in each Government, 1952-1970 (%)

Governments:		Indirect Taxes	Direct taxes Copper	Other	Total Taxes	GDP	Inherited Deficit a/
Ibañez	1952-1955	13.2	3.5	-8.4	5.3	9.0	17.8
	1955-1958	13.2	-37.0	21.1	5.1	4.7	17.1
Alessandri	1958-1961	53.1	20.7	35.5	44.4	11.9	22.1
	1961-1964	-10.7	37.0	13.1	0.2	15.2	29.8
Frei	1964-1967	62.8	87.2	72.9	69.3	18.6	18.5
	1967-1970	36.1	62.7	6.7	31.5	12.8	8.7

a/ Fiscal expenditure not financed by current revenue as a percentage of the total tax revenue. Figures for the last year before the period in question.

Source: The same as in table 8.8 and GDP calculated from Ricardo Ffrench-Davis, 1973, op. cit., Table 34, p. 252. Real increase calculated using the GPI (corrected RPI (1/3) combined with corrected WPI (2/3)).

Import duties also explained the fall in indirect taxation which occurred in 1961-64, and had it not been for the introduction of new taxation on copper - for the first time since 1955 - and a 10.0% increase in the international price of this metal,[1] the total tax revenue would have fallen, despite the 15.2% increase in the GDP which occurred in the same period.

During the first half of president Frei's Government, direct taxation increased more than during the previous two Governments,the main contributing factors being the introduction of a new tax on wealth and the gradual introduction of readjustability for the income tax which was not paid on a pay-as-you-earn basis. Moreover, the high rate of economic growth which was achieved, particularly in 1965 and 1966, also contributed. Although smaller, the increase in taxation during the second half of this Government was also very large. However, copper and indirect taxes were the ones which accounted for most of the increase, while non-copper direct taxation increased even less than the GDP. This reversal in the trend observed during the first half was the result of a combination of two main factors : first, that important sectors of the Government were convinced that it was not desirable to increase the tax burden any more and, second, that despite the continuation of the huge increases in the tax revenue from copper the Government still needed additional resources to finance its expenditure. As a result, instead of increasing direct taxation and risking a further deterioration in the relations between the Government and the business sector (and the well-to-do in general) the Frei Government resorted to the traditional practice of increasing indirect taxation.

1. See Ricardo Ffrench-Davis, 'La Importancia del Cobre en la Economía Chilena', in Ricardo Ffrench-Davis and Ernesto Tironi (eds.) El Cobre en el Desarrollo Nacional, (Santiago, Ed. Nueva Universidad, 1974, pp. 40 and 46.

The increases in the tax revenue shown in Table 8.8 tend to support the argument that Governments were not prevented by Congress interference from obtaining the resources needed to solve their fiscal difficulties, particularly not from 1958 onwards. The increases in the tax revenue were larger than what was needed to eliminate the inherited deficits and to increase fiscal expenditure by a higher percentage than the GDP (see the three last columns in Table 8.8, above). This is, of course, not to argue that balanced budgets would have been the only sound fiscal policy but to stress that the magnitude of the deficits could have been reduced very considerably without being too restrictive on the expenditure side. However, this was only done by President Frei's Government which inherited a deficit equivalent to 18.5% of the total tax revenue and reduced it to 8.7% by 1967 and 7.1% at the end of its term. President Ibañez inherited a 17.8% and increased it to 22.1% while President Alessandri reduced it but only from 22.1 to 18.5%.

The instability of the tax revenue from the copper sector has already been discussed in section D of this Chapter. However, it is important to stress here one of its major consequences in terms of the politics of taxation. Since the annual changes in this source of revenue were enormous, estimating next year's tax revenue was a very difficult task. This was a technical problem with major political consequences because it undermined the whole process of introducing new taxes and increasing the existing ones. The need for increases in taxation was more controversial because the Government's estimates about tax revenue from copper were always disputable,[1] much in the same way as the amount of prospective foreign loans was at the beginning of the 1960's, a factor which was also used as a justification for resisting tax increases.[2] Another source of fiscal difficulties - which

1. See, for example, the case of the debate about the 1956 tax 'reform', in EMS, 22 June 1956, p. 19.

2. See Senate Proceedings, 32nd Special Session, 26 Aug. 1960, in EMS, 2 Sept. 1960, p. 26.

as the previous one was also pointed out by the structuralists - was in fact that until 1965, while the copper sector paid its income tax in foreign exchange and on a quarterly basis and wage- and salary-earners paid most of it (the cedular income tax but not the 'global complementary' one) on a pay-as-you-earn basis, the rest was paid on the following year and it was not readjusted for inflation. This can be estimated to have accounted for approximately 15.0% of the total tax revenue. Thus, real tax rates were lower than nominal ones for those sectors and, more important, they were variable according to inflation. This situation changed when President Frei's Government introduced partial readjustments in 1965 (half the increase in the RPI) and later increased them until full readjustments were reached in 1967. Thus, the protection, indeed the benefits, from inflation obtained by the well-to-do were reduced during this Government both in the case of subsidized credit - discussed in the previous Chapter - and in the case of direct taxation, and this is likely to have promoted a less 'tolerant' attitude towards inflation among those who lost these benefits.

However, there was a major weakness in the Chilean tax system which was not reduced significantly throughout this period. This was the high level of tax evasion. Evasion was estimated between 50.0% and 80.0% in the case of the sales tax towards the end of the 1960's,[1] and approximately 60.0% in the case of the income tax, excluding copper.[2] In the case of

1. See Alejandro Foxley, Eduardo Aninat and José P. Arellano, 1977, op. cit., p. 37

2. See Ronald Gold, Income Tax Evasion in Chile: An Estimate', Inter-American Economic Affairs, 22:4, Spring 1969, p. 66.

the sales tax, those who benefited most were small businessmen, while in the case of the income tax, evasion benefited mostly the professionals and business profits.[1] Wage and salary-earners benefited less because they paid the same retail prices, even when the seller did not pay the Inland Revenue the sales tax which was included, and because their income tax was under more control because of the pay-as-you-earn system. Consequently, tax evasion tended to be regressive on balance. The Inland Revenue, which was responsible for detecting tax evasion organized an Intelligence Division only at the end of 1961 but the first conviction for tax evasion took place only in February 1965.[2] There was legislation against tax evasion before that, but it was not used very effectively, partly because of lack of resources to detect it, partly because penalties were not too strong and partly because it was not easy to detect evasion due to the extreme complexity of the tax system itself and especially the large number of specific exemptions which were the accumulated result of the activities of both Congress and successive Governments in accommodating local and/or sectoral interests.

1. See Alejandro Foxley, Eduardo Aninat and José P. Arellano, 'Net Incidence of Government Expenditure, Taxation and Social Security', (Geneva, ILO, WEP 2-23/WP 53, Feb. 1977), p. 28.

2. See Norman Nowak, Tax Administration in Theory and practice with special reference to Chile, (New York, Praeger, 1970), p. 119.

The high level of tax evasion increased the burden for responsible tax payers, desmoralized them and, also, weakened the possibility of doing something radical about it. Reducing evasion was not mainly a matter of increasing the tax revenue. It seems reasonable to argue that a significant reduction should have had to be accompanied by some reductions in the tax rates in general not only to get support from tax payers but also to prevent opposition on the grounds that the move was only aimed to increase the centralization of resources in the hands of the Government. Reducing tax evasion was mainly about increasing the effectiveness of the political system in regulating the structure of the incidence of the tax system.

Although the fiscal budget could not be enacted without adequate financing, i.e. it had to be a balanced budget, and any other legislation which generated new expenditure had to be properly financed also, the instability of the tax revenue already discussed in previous sections and practices such as indicating the revenue corresponding to a future budget as the source of financing for the legislation being enacted and, from 1959 onwards, the inclusion of potential sources of financing - such as prospective foreign loans - in the estimates about revenue,[1] transformed these statutory requirements in merely formal ones.

When the fiscal difficulties became critical the alternatives were always either to introduce supplementary taxation, often of a temporary character, or to legislate postponing the amortization of Government obligations with the Central Bank - already increased during the year - i.e. increases in high powered money, or to authorize new increases in these obligations.

1. See Instituto de Economía, 1963, op. cit., Anexo 3, 'La Reforma Presupuestaria de 1959', i, particularly p. 257.

Table 8.9

The Sources of Financing of fiscal Expenditure, 1958-1970

(as % of the total)

	Current Revenue			Debt		
	Direct Taxes	Indirect Taxes	Other a/ Sources	Domestic Loans	Foreign Loans	TOTAL
1958	30.8	47.6	4.3	10.0	7.3	100.0
1959	29.6	47.3	3.8	10.2	9.1	100.0
1960	26.7	47.1	4.2	19.0	3.0	100.0
1961	26.9	48.6	3.5	10.0	9.6	100.0
1962	25.7	44.1	3.9	14.9	10.9	100.0
1963	27.3	47.0	4.1	6.5	14.7	100.0
1964	33.3	44.9	4.2	8.7	8.9	100.0
1965	34.2	42.0	4.2	8.0	11.6	100.0
1966	37.2	44.0	4.9	5.2	8.8	100.0
1967	39.4	48.5	3.8	5.8	2.5	100.0
1968	35.4	50.9	4.1	7.0	2.6	100.0
1969	36.2	52.9	4.0	3.9	1.8	100.0
1970	38.4	51.1	3.7	6.1	0.7	100.0

a/ Sales of goods and services, income from investment, etc.

Source: Calculations based on data from the Dirección de Presupuesto, found in Jorge Marshall, 1963, op. cit. Table 7, p. 54 (for 1958-59) and Balance Consolidado del Sector Público de Chile, op. cit., (for 1960-70).

The range of options included foreign loans which made it possible to increase imports and postpone inflationary pressures until the Balance of Payments situation deteriorated - a source of financing which was used extensively particularly during president Alessandri's Government (1958-1964), (see Table 8.9, above); domestic loans - mostly increases in high

powered money (see previous Chapter, Section G) - which were a form of taxation with more diffused incidence, at least apparently; indirect taxation, whose incidence was still more diffused than the one of direct taxation and, finally, direct taxation itself. To a large extent, those options which seemed to have more diffused effects were the most inflationary ones, either in the long-run (as foreign debt) or in the very short-run (as indirect taxation). In fact, inflation was precisely the mechanism which diffused their effects in most of the cases, so that those having more power to protect themselves in the markets (including more access to bank credit), were the ones likely to suffer less when the more inflationary options were used. From this point of view, President Frei's Government not only reduced the subsidies implicit in very cheap bank credit and non-readjustable income taxes - which have been discussed already - but it also reduced the importance of foreign and domestic debt as a source of financing of fiscal expenditure, (see Table 8.9, above). However, as has already been analysed, while direct taxes were the ones which increased most during the first half, this progressive aspect was reversed during the second half of the Government, when its left-of-centre reformism lost momentum and the polarization experienced by Chilean society affected the Christian Democrats very considerably, with the party being more to the left and the Government being more to the right of the political struggle, on balance.

G) Summary

Although Governments always blamed Congress for their financial difficulties, they seem to have been the ones which were responsible for the most crucial increases in fiscal expenditure which took place during the period under scrutiny. In general, Governments tried to increase taxation and expenditure at the beginning of their terms in office, when they were stronger, the exception being President Ibañez who did not attempt a major increase at the beginning and struggled against inflation to be able to finance the existing level of expenditure later on.

Only President Frei's Government (1964-1970) made significant progress in reducing the fiscal deficit by using part of the huge increases in tax revenue occurred in that period to that effect.

The structuralist view of the fiscal problem and of its role in inflation seems to correspond to the experience of President Ibañez Government which was the period in which most of the classic works of this approach were written. However, the approach is less useful in explaining what happened during the next two Governments because Government expenditure ceased to be a merely 'propagating' factor in the 1960's and taxation ceased to be upwards rigid. Moreover, in the second half of the 1960's, some of the main weaknesses of the tax system which the structuralists had stressed, ceased to be a problem, even though in the case of the fiscal effects of the instability of foreign trade this was only a temporary situation, the difficulties reappearing after 1970.

The 'electoral cycle' did not operate in Chile,as Nordhaus would suggest, in the case of most general elections, particularly presidential and parliamentary ones, because they occurred either too late in the 'presidential cycle' to allow Governments to expand the economy without causing immediate increases in the rate of inflation or because they occurred too early for the Government to have enough time to try to generate a 'cycle'.

The fiscal budget and the budgetary process did not make a positive contribution to the understanding of the financial problems of the Government by politicians in general and those sections of the public better informed and more active in public affairs, let alone the public in general. This factor plus the weakness of the tax system, (and particularly the high level of tax evasion), and the highly concentrated income distribution, reduced the potential base of support for a more restrictive policy on expenditure. The benefits obtained by the few - the more organized sectors - were seen by the many as a step towards their own success in obtaining them.

Bureaucratic resistance inside the Executive branch itself was also a major problem in trying to control expenditure, and it frequently combined with political disagreements about Government priorities inside the Government itself, reducing the degree of financial discipline inside the Executive branch.

Apart from the high level of tax evasion the tax system was characterized by the high level of indirect taxation, which had an apparently more diffused incidence than direct taxation, although there is evidence which shows that it was also more regressive. To a large extent, this phenomenon reflected the success of the well-to-do in Chilean society in resisting increases in direct taxation. Moreover, this was one of the aspects of the inflationary bias of the political system, concerning fiscal financing, given that it tended to favour sources of financing whose incidence was more diffused precisely because their burden was distributed through inflation itself.

Chapter Nine

Wage and Salary Increases and Inflation

A) Introduction

Wage and salary increases were always the subject of considerable public attention and controversy. They were not only the focus of major political battles concerning the mostly annual legislation about wage and salary readjustments for the Public and Private sectors, but also one of the crucial ingredients - usually the most crucial - in the hundreds of industrial disputes between employers and employees which occurred every year (see Table 9.1 below).[1]

The dominant theme in the 'businessmen's approach' to inflation, during the period under scrutiny, was that wage and salary readjustments and the increases in the general and special taxes required to finance the expansion of the Social Security system, were the main factors behind rising costs and fiscal deficits, the two main causes of inflation in Chile according to the approach (see Chapter One).

Most wage- and salary-earners rejected such an interpretation, for obvious reasons, but so did the two approaches which dominated the academic and professional controversies about the Chilean inflation in the 1950's and 1960's, i.e. Latin American structuralism and monetarism.

1. The importance of wage and salary readjustments in industrial disputes in Chile can be seen in Fernando Onfray, 'El Conflicto Colectivo', (Santiago, INSORA, Univ. de Chile, 1966), pp. 41-6, quoted in Manuel Barrera, El Sindicato Industrial como Instrumento de lucha de la Clase Obrera Chilena, (Santiago, Instituto de Economía y Planificación, Univ. de Chile, 1971), pp. 139-45. See, also, Crisóstomo Pizarro, 'El Rol de los Sindicatos en Chile', Estudios CIEPLAN, No. 22, March 1978, Table 4, p. 40.

Monetarists argued that Chilean unions did not have enough power to cause autonomous general wage and salary increases, and produced some controversial econometric evidence supporting the idea that wage and salary increases played a merely 'transmitting' role.[1]

A number of econometric tests aimed at assessing this view from an impartial point of view found no conclusive evidence about the existence of a wage-push,[2] although some of them identified a change in the situation after 1964, during the Christian Democratic Government, even though the econometric treatment of this change was rather unsatisfactory from a theoretical point of view.[3]

The limitations of such studies are the result of their insistence in trying to identify a permanent - somewhat 'structual' - wage-push, while, as will be shown later on, the actual contribution of wage and salary increases to inflation was more 'conjunctural', i.e. the result of a combination of factors which were not permanent.

An attempt at dealing with the more 'conjunctural' aspects of the Chilean inflation was that of Joseph Ramos' approach which emphasized

1. See Arnold Harberger, 1963, op. cit., p. 246. The evidence was controversial because the series used was the legal minimum salary which did not represent the movements of wages and salaries in general very well. See Table A.3, Statistical Appendix.

2. See P. Gregory, Industrial Wages in Chile, (Ithaca, Cornell Univ. and N. York State School of Industrial and Labour Relations, 1967), p. 51; R. Koot, 'A test for demand-pull or wage-push inflation: The Chilean case', Social and Economic Studies, XVII, 2, 1968, p. 154; J.R. Behrman, 'Price determination in an inflationary economy, the dynamics of the Chilean inflation revisited', in R. Eckaus and P. Rosenstein-Rodan, (eds.), Analysis of Development Problems: Studies of the Chilean Economy, (Amsterdam, North-Holland, 1973), p. 395.

3. See V. Corbo, 1974, op. cit., pp. 167-8, who deals with the change by introducing a 'dummy' variable.

the role of expectations about the rate of inflation.[1] He accepts wage-pushes, demand-pulls and other factors as possible causes - either original or reinforcing - but argues that only expectations can be accepted as an explanation for the persistence of the phenomenon in Chile.[2] Wage-push cannot explain the persistence of the phenomenon in the Chilean case, because the unions were too weak to be capable of causing it, he argues.[3] In this he agrees with the monetarists but, instead of recommending monetary restrictions as the central measure, he argues that the key measure is to reduce the expected rate of inflation and that monetary and fiscal austerity must only accompany this process, avoiding excessive restrictions that would be likely to cause a fall in the level of economic activity and an increase in unemployment.[4]

As a short-term approach to stabilization, Joseph Ramos' view does not differ too much from the one behind the actual stabilization policies implemented by the Christian Democratic Government in 1965-1967, the main difference being that he does not believe in the effectiveness of the legislation on wage and salary readjustments - of the kind which was used at the time - from the point of view of the stabilization effort.[5] Consequently, it is difficult to understand why he overlooked the fact that the increases in real wages and salaries which occurred in 1965-1967 could not be explained by an 'unexpected' fall in inflation. In fact, in a later study he recognizes that the inflationary deceleration in 1964-1967 was caused, mostly, by expectations, but he still does not recognize the possibility of a wage-push acting against the

1. Joseph Ramos, Política de Remuneraciones en Inflaciones Persistentes. El Caso Chileno, (Santiago, Instituto de Economía y Planificación, Univ. de Chile, 1970).
2. ibid., p. 60, footnote 18.
3. ibid., p. 68.
4. ibid., pp. 69 and 74-5.
5. ibid., pp. 27-8.

stabilization program.[1]

From the socio-political point of view, Joseph Ramos' approach has the major weakness of failing to explore both the nature of the process through which employers and employees expectations about inflation determined actual wage and salary increases and, also, the nature of the assumed unions' weakness.

Expectations about inflation are not likely to be the same on both sides, nor they are likely to be a single figure - but a range with associated probabilities - or to be necessarily declared from the beginning of a negotiation. Consequently, the outcome cannot be considered to be independent from the relative strength of the bargaining sides, and it is very unsatisfactory, particularly from the point of view of inflation, to assume that competition in the labour market determines a level of nominal wages and salaries which corresponds to their 'real' level,(i.e. that determined by the marginal productivity of labour) and to the expectations about inflation of the employers.[2]

It is not just due to differences of opinion about expected economic performance that expectations may differ. Wage-earners are concerned about the prices of wage-goods, i.e. the cost of living, while employers are concerned about the prices of the goods or services they produce and/or sell. Consequently, unless changes in relative prices are considered insignificant, the differences between employers' and employees' expectations cannot be ruled out.

1. See Joseph Ramos, 'Inflación Persistente, Inflación Reprimida e Hiperstanflación. Lecciones de Inflación y Estabilizacion en Chile', Cuadernos de Economía, 43, 1977, p. 72. In a footnote in page 67, he recognizes that the strength of the unions increased after 1965 but he does not draw any conclusion from that.

2. See Joseph Ramos, 1970, op. cit., p. 27 and Joseph Ramos, 1977. op. cit. pp. 67-68 and particularly footnote 3 in p. 68.

In fact, the role of changes in the ratios between prices relevant to employers and those relevant to employees is one of the crucial elements of the structuralist approach to the role of wage and salary increases in inflation. According to the structuralist - 'Kaldorian' - view, wage and salary increases 'propagated' to the whole economy the increases in the prices of wage-goods - particularly food-stuffs - caused by the rigidities and bottlenecks of the economic structure, particularly in agriculture and the capacity to import. However, while some structuralists assumed generally strong unions, others emphasized the variable character of their strength, associated with changes in the political situation.

It is this variable character of the power of the unions and its connection with the changes in the general political situation that makesit possible to explain the 'conjunctural' character of the wage-pushes in Chile. In fact, the main wage-pushes which occurred in the period 1952-1970 cannot be seen as merely 'propagating' factors. On the contrary, as will be shown later on, there is no reason for combining the 'Kaldorian' and 'socio-political' elements present in the structuralist view as if they were inseparable, at least not as far as explaining the wage-pushes in the period under scrutiny is concerned.

In short, neither the assumption of permanently weak unions nor the assumption of permanently strong unions seem justified in the Chilean case, in the period under scrutiny. The nature of the unions' strength has to be explored in more detail than the anlaysts of the Chilean inflation have usually done, for the rigidities and bottlenecks in agriculture and the foreign sector do not seem to be the only source of wage-pushes. These are the subjects discussed in the following sections. No doubt, there is, also, a long-run connection between

increases in wages, salaries and social security taxes and inflation, due to their effect on income distribution, savings, investment and economic growth. However, the analysis of this long-run economic connection is beyond the limits of this thesis.

B) The Socio-Political Evidence

The first factor which has to be taken into account in order to understand the role of the unions in the Chilean inflation, is the effect of the Labour Code on the strength of these organizations. This legislation dated from 1924 and was essentially restrictive, with the state playing a crucial role in controlling key aspects of union life.[1] With the exception of special legislation for the copper miners in the large U.S. companies, enacted in 1955 and 1966 at the time of the new deals between the Chilean state and the companies, and the 1967 legislation promoting the unionization of the workers in agriculture, the legal framework for the overwhelming majority of the unions which existed in the period under scrutiny was the one inherited from the 1920's.[2]

Apart from forbidding in practice unionization in agriculture - due to legislation enacted in 1947 - the Labour legislation severely limited the power of the unions by prohibting the participation of organizations different from the single firm unions in the collective bargaining process, thereby excluding sectoral, regional and national federations and promoting fragmentation. Moreover, the legislation severely restricted the economic capacity of the resulting relatively small unions, which were not allowed to create funds to support strike

1. See Manuel Barrera, El Sindicato Industrial como instrumento de lucha de la clase obrera Chilena, 1971, op. cit., pp. 10-1.

2. See Alan Angell, 1972, op. cit., p. 57.

action or to finance full-time union officials and technical advisers.

The Federations and the overall confederation of Chilean workers (the CUT) were even poorer, and the latter was not recognized as a legal organization until 1970, although it had had some recognition from the Government, in practice, in 1953 - at the beginning of President Ibañez' Government, when the CUT was established - and at the end of the period, in 1969-1970, after the CUT supported the democratically elected Government of President Frei against a military movement which threatened to develop into a coup d'etat.

The fragmentation and the economic weakness of the unions increased the influence of the political parties in their activities. The parties were a source of technical, financial and political support and, in a country in which the state played a very important role in the regulation of the economy, they were the best available channels to reach the centres of decision-taking in Congress and the Executive branch.[1]

Apart from the illegal character of the CUT, the organizations in the Public Sector were not recognized as legal unions, which meant that a very considerable proportion of union activities were illegal, given the size and the high degree of 'unionization' in the Public Sector (see Chapter One). Moreover, due to the restrictive and somewhat cumbersome character of the legislation concerning industrial disputes, a considerable proportion of the strikes in the Private Sector were also illegal,[2] (See Table 9.1, below). Consequently, the intervention

1. See Alan Angell, 1972, op. cit., pp. 59, 62, 210, and Crisóstomo Pizarro, 1978, op. cit., p. 30.

2. See Arnoldo Camu, Estudio Crítico de la Huelga en Chile, (Santiago, Ed. Jurídica de Chile, 1964), pp. 12-3.

of the Government and the state in general was very crucial. In fact, the Government also had an important role in the legal conflicts, through its influence in the Juntas of Conciliation which intervened in the conflicts before any legal strike could take place.

As a result, the power of the unions was not only determined by structural factors such as the restrictions imposed on their organization and financial power, or by conjunctural economic factors such as the level of unemployment but, also, by the changes in the balance of political forces and the general political situation. In other words, a right-wing/anti-union political atmosphere made it considerably more difficult for the same unions, under the same Labour Code, to fight for their demands.

When the Government supported the employers and implemented the restrictive aspects of the legislation more strictly, the unions were left in a very weak position, the clearest example in the period under scrutiny being 1955-1956 (see Chapter Four). On the other hand, when the Government was more favourable, as in 1953, or even when it had mixed feelings towards the unions, as in 1965-1970, their strength increased considerably, (see Chapter Six). Of course, strong opposition parties supporting the unions also contributed to increase their strength because it became politically more costly for the Government to be too hostile. The best possible situation for labour was that of a Government competing with the opposition to win the support of the organized wage- and salary-earners, which was, to a certain extent, the situation in 1953 and 1965-1970.

Of course, it is not easy to isolate the effect of this political factor on the power of the unions, because hostile Governments were, also the ones which sometimes implemented policies creating adverse conditions for the unions from the purely economic point of view, the result being

a tougher attitude towards union demands from the employers, also. As examples, in 1956 the Government was very hostile towards the unions, and at the same time, adopted policies which increased unemployment considerably (from around 4.9% in 1955 to 6.9% in 1956)[1], while the case of 1965-1967 the opposite occurred (and unemployment fell from 7.0% in 1964 to 4.7% in 1967).[2]

However, no matter how difficult it is to isolate the effect of the general political situation on the unions, it will become clear, from the evidence included in the following sections, that political factors offset the structural weakness of the unions at some points, and that when that occurred the wage-push became possible.

C) The General Evolution of the Unions, 1952-1970

There are two clearly different periods in the evolution of the unions from 1952 to 1970. Until 1964, there was no expansion in membership. In fact, official statistics show a fall of almost 8.0% between 1952 and 1964,[3] but these figures have to be treated with caution because only from 1956 onwards did the Ministry of Labour exclude from the statistics the unions which had been inactive according to the law.[4] In any case, membership falls very clearly after 1956 also.[5]

1. See R. Ffrench-Davis, 1973, op. cit., Table 2, p. 38. These are figures for the Greater Santiago, the only ones available.

2. See ODEPLAN, 'Plan de la Economía Nacional: Antecedentes sobre el Desarrollo Chileno, 1960-1970', (Santiago, ODEPLAN, 1971), p. 84, figures for the country as a whole.

3. Calculations based on data in Manuel Barrera, 1971, op. cit., Table 1, p. 12.

4. ibid., p. 13

5. Calculations based on data in ibid., Table 1, p. 12. See, also, Manuel Barrera, 'Desarrollo Económico y Sindicalismo en Chile, 1938-1970', (Santiago, VECTOR, 1979), p. 27.

In contrast, from 1964 to 1970 membership more than doubled (the official figures show an increase of 122.0%), and even without including unions in agriculture which experienced a huge increase due to the enactment of new special legislation, the increase in membership of the other unions was enormous (69.0%).[1]

Official figures exclude the organizations in the public sector which were not recognized as legal unions. Excluding them, union membership reached a level of approximately 20.0% of the labour force by the end of the 1960's, and including them around 32.0%.[2]

Table 9.1

Conflicts and Strikes involving legal unions,

Annual Averages 1953-1964 and Annual Figures 1965-1970

	Total Conflicts	Total Strikes	Illegal Strikes (%)	Total Strikers (1,000's)	Illegal Strikers (%)	Days Lost (1,000's)
1953-55	1,669	262	77.0	108.7	68.3	1,153
1956-58	1,207	116	84.0	57.9	85.6	694
1959-61	1,636	242	76.0	87.7	70.5	854
1962-64	1,701	459	83.8	113.0	82.8	880
1965	2,931	723	79.5	182.4	77.2	1,902
1966	3,181	1,073	87.2	195.4	83.6	2,015
1967	3,763	1,114	77.2	225.5	73.3	1,990
1968	4,044	1,124	80.2	303.8	77.0	3,652
1969	n.a.	1,277	n.a.	362.0	n.a.	1,179
1970	n.a.	1,819	87.6	656.2	86.0	2,815

Sources: Estadística Chilena-Sinopsis and Síntesis Estadística
Official figures: ILO, Yearbook of Labour Statistics 1971, Table 27, p. 240 and Alberto Cuevas, 'La Experiencia de la CUT (1953-1973): Una Visión Crítica', Chile-América, 84-85, 1983, Table 1, p. 36.

1. ibid, Table VI, p. 35
2. Calculations based on Alan Angell, 1972, op. cit., Tables in pp. 51 and 53, Manuel Barrera, 1979, Table VI, p. 35 and Active Population data from the Latin American Demographic Centre, Santiago, Chile, quoted in J.C. Méndez, 1979, op. cit., p. 331.

These huge increases in membership were a clear indication of the favourable change in the general political situation, from the point of view of the unions, which was also reflected in the level of union activity if measured by the number of conflicts, strikes, strikers involved and days of work lost, (see Table 9.1, above).

D) Wages, Salaries and the Cost-Push: The Information Available

Data about wages and salaries for the period under scrutiny is neither easy to find nor very homogeneous. Different studies use different sources and, often, complicated statistical corrections has been made in order to make the data more homogeneous and representative. It is quite reasonable to argue that Chilean society did not have generally accepted statistics on wages and salaries which could be used as a point of reference in public debates. In fact, national controversies on wages and salaries usually focused on the evolution of the legal minima, i.e. the Minimum Salary (MS) (Sueldo Vital), the Minimum Agricultural Wage (MAW) and the Minimum Industrial Wage (MIW), which applied in the cases of industry and commerce, and on the legislation which readjusted them and readjusted wages and salaries in the public sector (sometimes this legislation readjusted wages and salaries in the private sector in general, also). This legislation will be discussed later on.

The Minimum Salary (MS), which applied in the case of white-collar workers in the private sector, was established in 1937, at a time of increasing mobilization of this and other middle sectors against the orthodox economic policies of the second Government of President Arturo Alessandri, a mobilization which later contributed to the formation of the Popular Front (Radicals, Socialists and Communists) which won

the presidential election at the end of 1938. However, despite frequent left-wing presence in the changing coalitions which backed the Governments of the Radical Presidents in the fourteen years from 1938 to 1952, blue-collar workers had to wait until President Ibañez Government to have minimum wages. The Minimum Agricultural Wage (MAW) was established in 1953, at the beginning of that Government, and the Minimum Industrial Wage (MIW) in 1956, as one of the measures included in the stabilization package and aimed at reducing the unpopularity of the overall wage policy implemented (the series can be seen in Table A.3, Statistical Appendix).

The most inclusive available series concerning Private Sector wages and salaries are the one based on wages reported by blue-collar workers asking for sickness subsidies from the largest blue-collar social security fund (Servicio de Seguro Social), which can be called Private Sector Wages (PSW),[1] and the one calculated by Ricardo Ffrench-Davis including wages and salaries reported by blue- and white-collar workers to the Private Sector social security funds, (including the Servicio de Seguro Social , which accounted for around 83.0 to 85.0% of the total Private Sector workers covered by social security). This more inclusive series can be called Private Sector Wages and Salaries (PSWS),[2] (see both series in Table A.3, Statistical Appendix).

1. Joseph Ramos, 1970, op. cit., Appendix I, Table 6, p. 104; the limitations of the series he discusses in pp. 91.4.

2. R. Ffrench-Davis, 1973, op. cit., Table 74, column 4, p. 344; corrections made and limitations of the series he reports in pp. 343-4.

The two series are reasonably similar but show major discrepancies in 1954, 1961-1962, 1964 and 1967. Since they cover different populations, these discrepancies do not necessarily mean that one of them is inaccurate. However, an alternative Private Sector wages series, based not only on the Servicio de Seguro Social but also on other small blue-collar social security funds - though only available for 1960-1970 - suggests that the PSW series overestimates the increases in 1961-1962 and 1967.[1] Consequently, the analysis which follows is mostly based on Ricardo Ffrench-Davis' series (PSWS).

From 1960 onwards there is an official Wages and Salaries Index (WSI) established in order to provide information for the readjustment of housing mortgages. Although this series includes both the Private and Public Sectors, it excludes the less organized and lowest paid sectors, i.e. agriculture, commerce, construction and manufacturing firms with less than 20 employees.[2] Therefore, this series is not an alternative to the PSWS series, and will be used as a complement (see Table A.3, Statistical Appendix).

E) Wages, Salaries and the Cost-Push. The Evidence

Identifying cost-pushes on the basis of statistical series is always a very controversial exercise. If wages increase, prices follow rapidly and the monetary and fiscal policies adapt passively in order to avoid creating demand restrictions, statistical series, and especially

1. See series calculated by ODEPLAN in Isabel Heskia, 'La Distribución del Ingreso en Chile', in CEPLAN (eds.), Bienestar y Pobreza, (Santiago, Ed. Nueva Universidad, 1974), Table B-1, p. 55.

2. See 'Indice de Sueldos y Salarios', in Central Bank of Chile, Monthly Bulletin, 443, Jan. 1965, pp. 23-7.

annual series, are not likely to tell a significantly different story from the one which would correspond to a demand-pull in which prices and wages had reacted rapidly. That is why the inconclusiveness of the econometric tests already mentioned in a previous section cannot be surprising in the case of a persistent inflation such as Chile's in the 1950's and 1960's.

By introducing the general political situation into the analysis it is possible to discriminate between periods in which the structurally weak unions could be expected to have overcome their weakness and periods in which they are not likely to have been able to cause a wage-push.

There are two periods in which real wages and salaries increased without this being attributable to an unexpected fall in the rate of inflation. These were periods in which the Government was competing with the left-wing opposition which controlled the leadership of the unions in trying to expand the union movement, namely 1953 - in which the left-wing of the '<u>ibañismo</u>' had considerable influence in the Cabinet and the Government in general - and 1965-1970, during the Christian Democratic Government.

Real wages and salaries also increased significantly in 1957 and 1961, (see Table 9.2, below), - the 1964 increase is more controversial, for the official WSI representing the more organized sectors registered a fall in the context of a very considerable inflationary acceleration - but in none of these two years can the general political situation be considered favourable for the unions. In 1957, real wages and salaries increased as a result of a relative relaxation in the very restrictive wage policy implemented at the beginning of 1956 as one of the key measures of the stabilization effort. The increase was only a partial recovery from the losses suffered by wage- and salary-earners in the

three previous years (1954-1956), while relations between the Government and the unions did not improve significantly compared with the very bad state in which they were in 1956, (see Chapter Four).

Table 9.2

Annual Changes in Real Wages and Salaries, 1953-1970, (%)

		Purchasing Power a/		Cost Effect b/	
		PSWS	WSI	PSWS	WSI
Acceleration	1953	9.3	-	9.0	-
" "	1954	-17.8	-	-17.2	-
" "	1955	- 6.6	-	- 8.0	-
Stabilization	1956	- 1.8	-	0.4	-
" "	1957	6.8	-	5.4	-
Constant Inflation	1958	- 3.0	-	- 3.3	-
General Adjustment	1959	- 2.4	-	- 2.2	-
Stabilization	1960	2.2	-	4.8 c/	-
Slight Acceleration	1961	6.7	7.4	10.8	11.5
" "	1962	2.8	0.4	5.1	2.6
Acceleration	1963	- 4.4	- 7.7	- 4.8	- 8.1
" "	1964	5.4	- 4.0	3.2	- 6.0
Stabilization	1965	10.4	13.5	10.0	13.0
" "	1966	11.0	11.4	8.9	9.3
Constant Inflation	1967	5.6	14.4	4.6	13.2
Slight Acceleration	1968	1.4	- 0.6	0.6	- 1.4
" "	1969	5.8	6.7	3.7	4.7
" "	1970	-	9.5	-	8.3

a/ Calculations by the author using the corrected Retail Price Index. See R. Ffrench-Davis, 1973, op. cit., Table 32, p. 246.

b/ Calculations by the author using a General Price Index (excluding imports), with a 0.60 weight, and the Retail Price Index, with a 0.40 weight, and which is assumed to represent the evolution of the prices which are relevant from the point of view of the employers.

c/ It probably overestimates the cost effect. The 15.0% readjustment enacted for that year represented an increase in labour costs of only 10.0% because it was excluded from social security contributions, i.e. employee's contribution and the payroll tax.

In the case of 1961 there is no reason to assume that the unions had increased their strength either, particularly if compared with 1959-1960.

It is true that after the March 1961 general parliamentary election, the Radicals decided to become part of the Cabinet and that the negotiations which followed led to a general wage and salary readjustment retroactive to 1 July 1961 but : (i) the readjustment was equivalent to only 16.6% of the corresponding legal minimum, for everybody, i.e. approximately 10.8% on average for the blue-collar workers in the private sector (agriculture excluded), and 6.6% for the white-collar workers;[1] and (ii) the average nominal rate of increase in wages and salaries was around 14.0 to 15.0% throughout 1960-1961.[2] Consequently, the Radicals do not seem to have had much of an impact with their late 1961 retroactive readjustment.

What has to be explained is why the increases in wages and salaries failed to fall below that 14.0 to 15.0% level despite inflation being only 5.4% and 9.7% in 1960 and 1961 (offical uncorrected RPI, the one available at the time, Dec.-Dec.) and 11.6% and 7.7% in the same years if the annual averages - instead of Dec.-Dec. - rates are taken in account. Two explanations seem possible, or a combination of both:

a) The 14.0 to 15.0% level of readjustments had not increased real wages and salaries very significantly in 1960 (see Table 9.2, above), and the Government had 'ratified' that level of increases at

1. Calculations based on the ratio between average and minimum wages (excluding agriculture) and average and minimum salary. Data for 1960 in Isabel Heskia, 1974, op. cit., pp. 33, 39 and 53. and R. Ffrench-Davis, 1973, op. cit., Table 71, p. 340.

2. The PSWS series increased by 13.9 and 14.5% in 1960 and 1961 (annual averages), and the official WSI increased by 15.5% in 1961. There is no annual average increase available for 1960, but surveys for the Manufacture sector show increases of 15.1% both in 1960 and 1961 (April-April). See Central Bank of Chile, Monthly Bulletin, 450, Aug. 1965, p. 1098.

the end of 1960 by enacting a readjustment of 15.0% retroactive to Jan. 1960. Consequently, and given that inflation was not expected to fall even further in 1961 - it had been extremely low for Chilean standards in the previous year -,employers may have not felt that the readjustments had to be lower than those in 1960. However, since average annual inflation (and not Dec.-Dec. inflation) was lower in 1961, as has been already mentioned, real wages and salaries increased more than the previous year. In short, this was a case of wrong expectations, as could have been argued by Joseph Ramos (see the Introduction to this Chapter).

b) The real cost of bank credit (interests plus taxation on credit operations less inflation) increased enormously in 1960-1961, and after having been negative for many years it reached a level of approximately 20.0% in both 1960 and 1961. Consequently, it seems reasonable to argue that the financial cost of a strike had increased considerably, from the point of view of the employers. In other words, the high real cost of credit may have been a favourable factor for the unions and may have created the conditions for some sort of wage-push on top of the cost-push that the high cost of credit itself caused in a country in which private firms had become so dependent on bank credit for financing their operations.[1] No doubt, in a different country in which the unions had more financial power and financed their strikes themselves, higher financial costs would have also affected them to a certain extent. But in Chile strikes were financed on the basis of sacrifice on the part of the strikers and their families, and solidarity from other unions and political organizations.

1. See Jorge Marshall, 'La Estabilidad Monetaria en Chile, 1959-1960', Revista de Economía Latinoamericana, Caracas, No. 10, 1963, pp. 74-5.

The idea of employers accepting wage and salary increases higher than inflation because of economic circumstances - rather than mistaken expectations about inflation - is also supported by two other factors. First, wage- and salary-earners had still not recovered from the losses of the period 1954-1956, and from that point of view, and taking into account the evolution of the GDP per capita as a rough estimate of the average productivity of labour, (see Table 9.3, below), these increases could only be considered as being the cause of a wage-push in the sense that employers refused to absorb the increases. If the cost of going into a conflict had increased, it seems reasonable to expect that employers had decided to make some concessions. Second, due to the foreign exchange and foreign trade policies of the Government, the domestic prices of imported inputs did not increase at all in 1960-1961, while the combination of the RPI and the national component of the WPI (see Table 9.2, above, footnote b/) increased by 12.3% (annual averages) in those two years. As a result, there was considerable room for accommodating real wage and salary increases.

In fact, precisely because of the effect of cheaper imports both in terms of costs and competitive challenge, and despite the wage increases and the cost-push caused by the higher cost of bank credit, inflation remained very low - in single figures - until mid-1962 when the foreign exchange crisis was already six months old and the much feared devaluation was imminent[1] (see Chapter Five). And it was the effect of this crisis and the devaluation which followed that caused the acceleration in 1963-1964.

1. The official RPI increased 7.7% (annual average) in 1961 and the average of the first semester of 1962 was 9.9%. The official WPI increased 0.8% and 3.1% respectively (averages).

In other words, if there was a wage-push (and that remains controversial as has been already mentioned), its effects and the effect of other cost and demand inflationary factors were postponed by the foreign sector policies. Inflationary pressure accumulated and exploded in 1962 taking the form of a huge devaluation. And the contribution of wages and salaries to that accumulation of pressure is, to say the least, difficult to be determined, if not impossible.

In the following two sections the analysis concentrates on the two major cases of wage-push were caused by the existence of political conditions that were favourable for the unions.

F) The 1953 Wage-Push

It was the new political situation created by the presence of the Popular Socialists in the Cabinet of President Ibañez' Government in 1953 that explains the increase in the strength of the unions, not a change in their structure. The Popular Socialists wanted to develop the union movement using their governmental power and they were competing with the other Socialist Party and the, then illegal, Communists for the support of the union movement. Moreover, 1953 was a year in which other left-wing 'ibañista' sectors were also influential in the Government so that the period can be described as a generally left-wing populist one.

The very considerable increases in wages and salaries which occurred in that year were accompanied by measures implemented by the Government which clearly caused a wage-push.

The Social Security system was mainly financed, in the case of the private sector, by contributions from the employees and employers, the latter being the most considerable and amounting to what could be called a 'payroll tax'. In 1952 the payroll tax amounted to 5.7% of the basic wage in the case of blue-collar workers, although in reality it was less than that due to practices such as reporting lower wages than the real ones - some of the most important benefits were not connected with the contributions made - and due to legal restrictions.

However, as one of the measures to compensate workers for the effects of a simplification of the foreign exchange rate system, the Government created a system of family allowances for blue-collar workers which increased the payroll tax to 13.5% in 1953 and 24.2% in 1954.[1] No doubt, this measure caused an enormous increase in labour costs, on top of the already considerable increases in wages, and just at a time in which the effects of the devaluation, which was part of the foreign exchange simplification, were being felt. In other words, private sector firms faced both a wage-push and an imports cost-push.

The measures which the Government implemented in order to limit the price increases, however, were totally ineffective, partly because they were technically inadequate - a price freeze was decreed but no institutional changes to overcome the traditional ineffectiveness of price controls were implemented - but mostly because the Government was politically unstable and Cabinets changed too frequently, destroying the consistency of the policies, (see Chapter Four).

1. See R. Ffrench-Davis, 1973, op. cit., Table 73, p. 342.

Despite the ineffectiveness of these measures, wages and salaries increased considerably in real terms in 1953. If the effect of the new family allowance scheme for blue-collar workers is added, it becomes evident that the increase in earnings more than compensated the effect of the devaluation on the cost of living. Some structuralist studies stressed the role of the devaluation in the inflationary acceleration which started in the second half of 1953, pointing to the merely 'compensatory' character of the wage and salary increases.[1] However, others recognized that the increase in labour costs had played a more inflationary role and that the devaluation explained only a fraction of the phenomenon.[2]

Since the left-wing populists which were so influential in the Government in 1953 were in a rather precarious political position, the redistributional effect of the measures which they promoted was short-lived and was rapidly wiped out by the inflationary acceleration which followed in 1954 and 1955 (see Table 9.2, above). Thus, by 1955-1956 the cost effect of the 1953 increases in wages and social security benefits had been partly shifted back to the workers themselves and partly shifted forward to the buyers, i.e. consumers and investors. In fact, if one assumes that wages and salaries increased by a similar percentage (so that the Private Sector Wages and Salaries (PSWS) series in Table 9.3, below, is assumed to represent the evolution of wages), the increase in the payroll tax from 5.7% in 1952 to 25.9% in 1955

1. See, for instance, David Felix, 'Structural Imbalances, Social Conflict and Inflation', Economic Development and Cultural Change, VIII, 2, Jan. 1960, p. 125, and ECLA, Economic Bulletin for Latin America, 1, 1956, p. 50.

2. See Instituto de Economía, Univ. de Chile, La Economía de Chile en el período 1950-1963, op. cit., i, 49 and 61.

would seem to have been totally shifted - back and forward - so that labour costs were not higher in 1955 (if compared with 1952) even without taking into account the insignificant increase in average productivity roughly measured by the GDP per capita. This kind of interpretation is consistent with the assumptions about payroll tax shifting made by Chilean social security experts. In fact, the most comprehensive study on the subject assumes that four fifths of the payroll tax are shifted forward and the remaining fifth is shifted back to the employees themselves through the labour market.[1]

1. See Alejandro Foxley, Eduardo Aninat and J.P. Arellano, 'What does Social Security do to incomes?',(International Labour Office (ILO), World Employment Programme Research, WEP 2-23/WP 42, Geneva, July 1976) p. 26 and Table 10, p. 43.

Table 9.3

Real Wages and Salaries and the GDP per capita 1952-1962

(1960 = 100.0)

	PSWS a/	GDP p.c.	PSWS/GDP p.c.
1952	114.8	101.5	1.131
1953	125.2	105.3	1.189
1954	103.6	102.8	1.008
1955	95.3	103.0	0.925
1956	95.7	101.7	0.941
1957	100.9	99.9	1.010
1958	97.6	99.8	0.978
1959	95.4	98.9	0.965
1960	100.0	100.0	1.000
1961	110.8	103.5	1.071
1962	116.5	106.8	1.091

a/ Calculations based on R. Ffrench-Davis, 1973, op. cit., Table 74, p. 344, and the General Price Index described in Table 9.2, b/.
GDP from ibid., Table 34, p. 252 and Total population from J.C. Méndez, 1979, op. cit., p. 331.

G) The Wage-Push in 1965-1970

After 1964, there were considerable and sustained increases in real wages and salaries. In contrast with 1956 and 1959-1960, the deceleration at the beginning of the stabilization effort was not accompanied by falling real wages and salaries. Moreover, the increase in inflation in 1968-1970 was less violent than those in 1954-1955 and 1963-1964, and it did not wipe out the previous gains made by wage- and salary-earners. In fact, real wages and salaries continued to increase in 1969-1970, (see Table 9.2, above). The initial increases cannot be explained in terms of 'unexpected' falls in the rate of inflation, because the Government had considerable credibility at the beginning of its term in office and it had announced a program of medium-term, gradual, stabilization, which included clear annual targets. The actual performance was not very far from the target in 1965 (25.9% and 25.0% respectively), so that the target announced for 1966 (15.0%) could not have been considered to be too different from the actual rate of inflation.

The increases in real wages and salaries from 1965 onwards exceeded not only what had been programmed but also what the Chilean economy could afford without losing the battle against inflation. Tighter price controls and more austere monetary and fiscal policies might have allowed the stabilization to continue, enforcing the redistribution of income which the excessive increases in wages and salaries had produced. However, this would have only increased the level of tension between the Government and the business sector, which was already very high due to the implementation of some of the structural reforms, and business' 'confidence' would have been reduced further. In other words, the magnitude of the redistribution was incompatible with the stabilization

- and with economic growth - given the economic and social conditions which characterize a mixed economy such as Chile's.

It is true that the official Wage and Salary Index (WSI) and the legal minima (Minimum Salary - MS-, Minimum Agricultural Wage - MAW- and Minimum Industrial Wage - MIW -) had registered considerable falls in 1963 and 1964 (see Table A.3, Statistical Appendix), and that in 1965 and 1966 the WSI had not even manged to catch up with the increase in average productivity since 1960, as measured by the GDP per employed person (see Table 9.4, column 6, below). Since the MS and the MIW had done even worse than the WSI which represented the more powerful sectors of the labour movement, the critics of the Government, and particularly the left-wing opposition did not lack statistical ammunition to support their attacks. After all, these were the only series available at the time (see, also, Chapter 6, section E).

Table 9.4

Real Wages and Salaries and Average Productivity, 1959-1970

(1960 = 100.0)

	MAW (1)	MIW (2)	MS (3)	WSI (4)	GDP p.e.p. (5)	(4)/(5) (6)	PSWS (7)	(7)/(5) (8)
1959	89.5	108.7	108.7	-	-	-	95.4	-
1960	100.0	100.0	100.0	100.0	100.0	1.000	100.0	1.000
1961	114.9	124.1	120.5	111.5	105.0	1.062	110.8	1.055
1962	119.1	129.6	125.9	114.4	108.7	1.052	116.5	1.072
1963	106.1	109.0	105.9	105.1	110.4	0.952	110.9	1.005
1964	105.1	105.4	102.4	98.8	112.9	0.875	114.4	1.013
1965	127.0	111.9	108.8	111.7	117.2	0.953	125.8	1.073
1966	137.2	111.5	108.6	122.1	126.1	0.968	137.1	1.087
1967	140.3	108.2	105.4	138.2	123.3	1.121	143.4	1.163
1968	132.9	102.5	99.8	136.2	125.5	1.085	144.2	1.149
1969	126.4	97.5	94.9	142.6	131.4	1.085	149.6	1.139
1970	149.5	114.5	90.5	154.5	133.2	1.160	n.a.	-

Sources: MAW, MIW, MS, PSWS, GDP, from R. Ffrench-Davis, 1973, op. cit., Table 34, p. 252 and Table 74, p. 344.
Employed Population from J.C. Méndez, 1979, op. cit., p. 331.
Calculations based on the General Price Index described in Table 9.2, b/.

However, there can be little doubt about the fact that in 1967 real wages and salaries surpassed the index of GDP per employed person. The non-agricultural legal minima (the MS and the MIW), continued to lag behind but there is evidence that less and less wage and salary earners were affected by these minima.[1] In fact, if the index representing the average wage and salary in the private sector (PSWS) is taken into account, it would seem that there was no lagging behind average productivity in the 1960's. However,this series, which was calculated from wages and salaries reported to the social security funds, has a number of limitations,[2] and it seems rather surprising that average wages and salaries had done better than those of the more organized sectors of wage- and salary-earners during the inflationary acceleration of 1963-64.

In any case, if the existence of a wage-push might still be disputed, for 1965-66, there can be no room for doubt about 1967. And it is worth remembering that 1967 was the year in which the rate of inflation stopped falling, remaining more or less constant throughout the year (see Table A.1, Statistical Appendix), and the stabilization ended.

In contrast with 1953-4, the 1967 wage-push was not accompanied by increases in the 'payroll tax' paid by private sector employers to finance social security benefits. In fact, the payroll tax remained constant in 1965-1967 and increased very slightly, less than in the previous two Governments, in 1968-1970, (see Table 9.5, below).

1. See, for instance, Isabel Heskia, 'La Distribución del Ingreso en Chile', 1974, op. cit., which analyses the distribution of income in Chile using the social security funds data.

2. The weaknesses of this series are discussed in R. Ffrench-Davis, op. cit., 1973, pp. 344-5.

Table 9.5

Social-Security 'payroll tax', 1952-70

	Blue-collar workers (Servicio de Seguro Social) (as a % of taxable wage)	White-collar workers (Caja de Empleados Particulares (as a % of taxable salary)
1952	5.7	33.8
1953	13.5	33.9
1954	24.2	34.0
1955	25.9	35.1
1956	25.8	36.1
1957	28.4	37.4
1958	32.6	39.3
1959	35.9	39.3
1960	37.1	39.4
1961	37.5	39.8
1962	37.5	39.8
1963	37.6	39.9
1964	38.1	40.9
1965	38.2	42.0
1966	38.2	42.0
1967	38.2	42.0
1968	38.8	43.3
1969	39.1	44.0
1970	39.6	45.0

Source: R. Ffrench-Davis, 1973, op.cit., Table 73, p.342.

As for the structuralist view on the wage-push, it seems clear enough, as in the case of 1953, that the 1965-1970 wage and salary increases were very much more than a merely 'propagating' factor. To be so, they should have never exceeded the increases in the Retail Price Index (RPI) which included the effect of agriculture and the capacity to import on food prices. Even though it could be argued that food prices had increased more than the average during the inflationary acceleration in 1963-1964 (see Table 9.6, below) and that wages and salaries had not recovered from the losses suffered during that period (a point which has been already discussed in this section), the facts are that they recovered before 1967 and that food prices increased less than the other consumer goods included in the RPI in 1965-1967.

Table 9.6

Retail food prices and Wholesale agricultural prices compared with Retail Prices and Wholesale Prices (national) a/ in general, 1960-1970 (1960 = 1.000)

Retail Price Index Food/Total				Wholesale Price Index (WPI) (national component) Agriculture/Total			
1960	1.000	1965	1.106	1960	1.000	1965	1.029
1961	1.026	1966	1.092	1961	1.010	1966	1.040
1962	1.068	1967	1.076	1962	0.987	1967	1.001
1963	1.139	1968	1.069	1963	1.061	1968	0.965
1964	1.120	1969	1.065	1964	1.002	1969	1.029
		1970	1.109			1970	1.040

a/ Excluding imported goods.
Source: Official RPI and WPI, Central Bank of Chile, Monthly Bulletin

The political conditions which favoured the wage-push in 1965-1970 have already been discussed in previous sections and in Chapter Six. However, it is important to stress, here, that the Christian Democratic Party (PDC) failed to displace the marxist (Socialist/Communist) leadership of the unions. In trying to do so, and given its limited strength inside the traditional labour movement, the Christian Democratic Party frequently resorted to intervening from above, using legislation and the resources of the state which they controlled from the Government. Of course, the most outstanding example was the forced savings scheme proposed in 1967, but the annual laws on wage and salary readjustments in 1965, 1966 and 1967 were also good examples. . Apart from trying to restrict the rights of the unions each year, without any success, the Government implemented a policy of wage and salary readjustments equal to the increase in the official RPI in the previous twelve months, this having been a traditional demand of the labour movement, particularly during the stabilization efforts in 1956-57 and 1959-61. In other words, the Government tried to give wage- and salary-earners what they had always wanted, protection against inflation. Moreover, it had programmed for real increases in wages and salaries produced by the stabilization itself. But, again, everything was decided and implemented from above and, since the marxist parties recognized the Christian Democratic threat from the beginning, the chances of obtaining some collaboration from the leadership of the unions decreased constantly. The combination of this aspect and the readjustments policy provided the foundations for the wage-push. Since no readjustment below the statutory one was legal, and this Government was not likely to overlook violations of the legislation by the employers, negotiations between the unions and the employers concentrated on demands above the statutory minimum.[1] In those firms or industries in which the unions were stronger

1. ibid, p. 213.

and/or economic conditions were more favourable (increasing productivity profits, etc.) the actual increases were higher than the statutory ones. In fact, they were higher even in the case of Central Government employees, as can be seen in the following section (see Table 9.9). In the case of traditionally weaker sectors of wage- and salary-earners the readjustments policy and the more favourable political conditions contributed to allow them to obtain at least the statutory minimum, and in some cases more than that, particularly when employers tried to prevent the unionization of their employees by making some concessions, (it is worth remembering that the expansion of the unions was very considerable from 1965 onwards). Not surprisingly, then, the average increases exceeded the statutory ones.

H) The Politics of Statutory Wage and Salary Readjustments and its Educational Role

Some analysts have argued that statutory wage and salary readjustments were not required in order to protect wage- and salary-earners because actual increases were usually higher than statutory ones and even when there was no legislation at all, as in the case of 1960 (until the very end of the year in which a retroactive readjustment was enacted), wages and salaries managed to do rather well. Consequently, market forces were considered to have been a better protector for wage- and salary-earners than legislation was.[1]

However, the evidence presented in the previous sections seems to contradict such a generalization. Statutory readjustments seem to have played an important role under certain political circumstances

1. See Joseph Ramos, 1970, op. cit., pp. 18-9 and 27 and Sergio De Castro, 'Análisis de la Política Salarial en el período 1960-1961', Cuadernos de Economía, 28 Dec. 1972, p. 64.

such as those in 1965-1970. Hence, to argue that the legislative battles concerning the readjustments had no significant economic consequences and were rather 'symbolic'[1] seems less than justified.

Statutory readjustments were usually intended as a lower limit, as a minimum readjustment for those who would have obtained less than that if left by themselves in the market. That is why most of the time they only readjusted the legal minima and did not provide any general readjustment for the private sector. The situation was different in the case of the public sector in which the legislation was needed not only as a lower limit but to stipulate the actual readjustments themselves.

When intended as an upper limit, as in 1956-1957 and in 1965-1970 (particularly in 1966 and 1967), the law stipulated only indirect controls such as the rejection of excessive wage and salary increases as justification for the readjustment of controlled prices. In some cases the Government instructed the official Juntas of Conciliation to reject excessive demands, a measure which took advantage of the statutory character of their intervention in every industrial dispute, which was a prerequisite for the dispute to remain legal. These indirect mechanisms of control were not effective enough and the statutory readjustments were not very successful as upper limits. In fact, when the Government tried to enact legislation including tighter controls - the forced savings scheme in 1967 - the opposition inside and outside the political party supporting the Government was too much (see Chapter Six). However, the legislation on wage and salary readjustments cannot be described as totally ineffective as an upper limit. In 1956-57, for instance, even though the actual readjustments were higher than the statutory ones, the increases were restricted significantly (see Table 9.7, below).

1. Joseph Ramos, 1970, op. cit., p. 15, footnote 11.

Table 9.7

Statutory Wage and Salary Readjustments as an Upper Limit

Selected Years, (%)

	Statutory Readjustment	Actual Increase (PSWS)	Increase in corrected RPI	
			A	B
1956	46.5	61.7	64.7	88.7
1957	25.0 - 30.2	38.1	29.3	44.6
1967	17.0	26.1	19.4	17.9

A: Annual average in the same year

B: Dec.-Dec. increase in the previous year

Sources: Table A.4 Statistical Appendix and R. Ffrench-Davis, 1973, op. cit., Table 32, p. 246 and Table 74, p. 344.

Legislation on general wage and salary readjustments was relatively complicated and varied. Even a simplified summary such as the one in Table A.4 (Statistical Appendix) is too complex to enable the public in general to make comparative analyses. In other words, the simplicity which was required in order to educate public opinion on inflation, stabilization and accommodation of conflicting demands, was not there. This factor reduced accountability and widened the scope for political malpractice, particularly just before crucial elections. Practices such as announcing a readjustment and playing down the fact that it did not apply to the wage or salary as a whole allowed some politicians to create the minimum level of confusion required to be able to claim

that they had both been truly defending the interests of everybody (both employers and employees), and had been reconciling desirable goals (both stabilization and social progress).

In other cases, politicians took advantage of the legislative process to propose huge increases which were approved in one of the Chambers, knowing that there was no chance of such increases being accepted in the other Chamber or by the Government which could use its veto powers. This kind or practice was very useful in the case of politicians supporting the Government and wanting to score politically (electorally) without upsetting its policies. The left-wing opposition was always prepared to support such moves which enabled them, also, to score politically by reaffirming their commitment to support wage- and salary-earners' demands almost unconditionally. Particularly good examples of this are the legislative battles at the end of 1956 and 1962, before the very crucial general elections of March 1957 - parliamentary- and April 1963 - municipal - (see Table 9.8, below, and Chapters Four and Six for the analyses of the above mentioned elections).

Table 9.8 Wage and Salary Readjustments through the Legislative Stages. Selected Cases

	1957		1960		1962		1969	
Next General Elections:	March 1957		March 1961		April 1963		March 1969	
Increase in the official RPI since last readjustment:	37.7%		18.0%		11.1%		27.9%	
Sectors:	PRIVATE	PUBLIC	PRIVATE	PUBLIC	PRIVATE	PUBLIC	PRIVATE	PUBLIC
1st Government Proposal:	25.0 a/ (19.10.56)	25.0 (19.10.56)	10.0 b/ (15.10.60)		15.0 c/ (13.11.62)	15.0 (15.10.62)	27.9 (16.12.68)	By decree (31.08.68)
2nd Government Proposal:	-	-	15.0 d/ (14.12.60)	15.0 e/ (14.12.60)	15.0 f/ (5.12.62)	-	-	-
3rd Government Porposal:	-	-	-	-	15.0 (10.01.62)	-	-	-
1st stage: Lower Chamber	48.0	25.0	15.0	15.0	15.0	15.0	MS and MIW Increase more	Approved
2nd stage: Senate	30.2	25.0	15.0	15.0	g/	15.0	Approved	Rejected
3rd stage: Lower Chamber:	30.2 (wages) 48.0 salaries)	25.0	15.0	15.0	15.0	15.0	Ratified	Insisted
4th stage: Senate	30.2	25.0	15.0	15.0	15.0	15.0	-	Approved
5th stage: Lower Chamber:	30.2	25.0	15.0	15.0	15.0	15.0	-	Ratified
Government veto	-	-	-	-	-	-	Rejected	-
Congress on veto	-	-	-	-	-	-	Approved	-
Readjustment enacted	30.2 (29.01.57)	25.0 (30.01.57)	15.0 21.12.60)	15.0 (21.12.60)	15.0 19.01.63)	15.0 (17.12.62)	27.9 (31.12.68)	By decree (19.12.68)

a/ Klein-Saks Mission originally proposed 15.0%; b/ Gov. withdrew Bill after Lower Chamber increased it.
c/ Gov. withdrew Bill when Radicals decided 25.0%; d/ Actual cost for employers: 10.0%.
e/ Readjustment equivalent to 15.0% f/ Gov. withdrew Bill again after Senate increased it.
g/ Gov. withdrew Bill for the third time when Senate insisted in increasing the readjustment.

As can be seen in Table 9.8, above, the above mentioned practices were not used in the case of the public sector readjustment because Congress had powers only to reduce or reject the Government proposals concerning this sector, but not to increase them.

However, Congress was not the only source of problems concerning the readjustment policy of the Government. Governments themselves were not able to enforce their own policies and were often unable to resist pressure from the labour organizations in the public sector. The practice of granting special readjustments to specific sections of public employees was very frequent, the result being average increases well above the general statutory readjustment. This did not contribute at all to the credibility of the wage policies of the Government, particularly when they were intended as upper limits.

Table 9.9

Wage and Salary Increases in the Public Sector 1953-1970 (%)

	Statutory	Actual a/		Statutory	Actual b/
1953	4.5-16.0	35.0	1960-63	35.0-54.2	111.0
1954	10.4-37.2	72.2	1964	35.0	41.2
1955	16.2-58.3	97.3	1965	38.5	45.0
1956	41.0-46.5	30.9	1966	25.8	37.1
1957	25.0	5.8	1967	15.0-20.0	41.8
1958	20.0	14.0	1968	20.0	23.5
1959	22.0-41.0	40.2	1969	20.0-27.9	46.0
			1970	29.3	61.3 c/

a/ Average earnings of Central Government employees. Instituto de Economía, Univ. de Chile, 1963, op. cit., ii, Table 6 p. 48. Because it is based on the number of employees included in each Budget Law it underestimates the increases when the number of non-filled vacancies increased, as was probably the case in 1956 and 1957 during the stabilization effort.

b/ Central Government component of the official Wage and Salary Index.

c/ The official WSI excluded the Armed Forces, thereby not capturing the huge special readjustment they obtained in 1970.

I) Summary

The socio-political evidence supports the view that Chilean unions were structurally too weak to be held responsible for the kind of permanent wage-push assumed by the businessmen's approach to inflation. However, the evidence suggests that wage and salary increases did not play a merely 'propagating' or 'transmitting' role, as both 'Kaldorian' structuralists and monetarists have assumed. Changes in the general political situation affected the power of the unions very significantly thereby creating the conditions for wage-pushes.

From 1965 onwards, even though the structure of the non-agricultural unions remained the same, the labour movement experienced a huge increase which illustrated a more permanent change in the political conditions from the point of view of the unions. In contrast with the period 1952-1964, in 1964-1970 real wages and salaries increased during the stabilization attempt and during the increase in inflation which followed.

The legislative battles concerning statutory wage and salary readjustments involved political practices that were not helpful to the education of public opinion about either the regulation of the economy, or the accommodation of conflicting demands or the struggle against inflation. Hence, on balance, the political system did not create the conditions for increasing accountability in this area. Moreover, the available statistics on wages and salaries were inadequate and contributed very little to reduce the level of confusion about the subject. All these factors favoured the persistence of malpractices in this area.

Stautory readjustments seem to have been fairly effective as lower limits - as minimum readjustments - but not as restrictive devices stipulating upper limits for the increases.

Chapter Ten

Monopoly, Oligopoly and Inflation

A) Introduction

The role of monopolies in Chilean inflation was one of the favourite themes in the unions' approach to inflation and, also, in the left-wing parties' views on the subject, (see Chapter One). However, they were not the only ones who stressed the non-competitive character of the Chilean economy. Most structuralists, a number of other non-monetarist analysts of the Chilean inflation[1] and even some monetarists[2] underlined the monopolistic/oligopolistic character of the economy and, particularly, industry. In fact, even the businessmen's approach to inflation recognized the need for more competition - in the case of President Alessandri's views, competition from the foreign sector - and, therefore, this was a matter of consensus rather than disagreement.

However, not every approach treated this feature of the Chilean economy as a significant factor from the point of view of inflation, the clearest example being the monetarists which, apart from not being all in agreement on the existence of the problem, concentrated almost exclusively on the demand side of the markets.

The inflationary role of monopolies, oligopolies and, in general, restrictions on competition, is not as uncontroversial, from a theoretical point of view, as Chilean public opinion may have thought. Consequently, agreement on the existence of widespread non-competitive conditions does not necessarily mean agreement on their inflationary significance.

1. Among these Vittorio Corbo, 1974, op. cit., p. 37 and Tomás Reichmann, 1974, op. cit., p. 33.

2. See Arnold Harberger, 1963, op. cit., p. 245.

On one hand, it is true that under non-competitive conditions, the use of price-setting methods which reduce the lag between cost increases and price increases is more likely than under more competitive conditions at any given level of demand. When there is more competition, cost increases are more likely to be absorbed by the firm, the level of production is likely to be reduced and price increases are only likely to occur after a considerable number of firms have reduced their supply - or abandoned the market - thereby creating a shortage in the market.

Moreover, if monopolies and oligopolies are in a better position to increase their prices very rapidly, they are also less likely to resist cost increases, and this can be very relevant in cases in which more resistance would have been likely to reduce the increases as, for instance, in the case of resistance to the demands of their own labour force. After all, in a non-competitive situation a firm may risk losing more by provoking a labour dispute than by selling a reduced quantity at higher prices.

On the other hand, it has been also suggested that such cost-based price-setting practices may contribute to reduce the inflationary impact of increases in demand. If firms react to them by increasing production and demanding an increased quantity of inputs - instead of increasing prices - they would be, actually, postponing the price increases until their costs increase as a result of price increases in more competitive sectors of the economy.[1] However, it seems reasonable to suggest that, although this kind of phenomenon may be likely during a 'creeping' inflation - annual rates of around 2.0% or less -, it would be extremely unlikely in the case of considerable and persistent inflation such as the Chilean one. In the

1. See Gardner Ackley, 'Administered Prices and the Inflationary Process', American Economic Review, Proc., 49, May 1959, pp. 419-30.

latter case the failure to increase prices rapidly, in response to increasing sales, could be very damaging financially, because stocks sold at non-increased prices would have to be replaced, sooner rather than later, at increased costs. In fact, in the Chilean case the evidence gathered by economic analysts suggests the existence of rapid price increases in response to both costs and demand increases.[1] Moreover, given the persistent character of the Chilean inflation, firms got used to anticipating cost and demand increases or, in other words, to taking decisions on the basis of the rate of inflation they expected.[2]

The combination of market power (of monopolies, oligopolies and other forms of restriction on competition) and decisions based on expectations can create considerable difficulties in terms of stabilization policies. Oligopolies, monopolies and explicit agreements on prices such as those characterizing cartels, tend to make it more difficult to correct price overshooting. Consequently, anti-inflationary policies have to be very convincing from the beginning or be faced, later on, with the dilemma of either endorsing the increases or accepting some degree of recession as a cost of enforcing the stabilization program.

The significance of oligopolies and monopolies does not disappear if numerous small firms exist in an economy. First, if monopolies and oligopolies are present in key areas of the economy they are likely to affect the economy as a whole. Second, oligopolistic firms may coexist in the same market with several smaller firms. This is what Sylos Labini has

1. See Vittorio Corbo, 1974, op. cit., p. 66.
2. See Joseph Ramos, 1977, op. cit., p. 67.

called 'relatively concentrated oligopoly' to distinguish it from the classic 'concentrated oligopoly' in which only a few firms of similar size exist.[1]

Sylos-Labini argues that the size of the market and the limited technological alternatives available (technological discontinuity) determine the existence of residual shares of the market which are unprofitable from the point of view of large firms using the most developed technology which is assumed to be based on large scale production. As a result, smaller firms can be present in the market coexisting with the larger - oligopolistic - ones.

In the Chilean case there is another factor which is, most probably, even more important. The shortage of new capital and the limited capacity to import - the Chilean economy did not substitute imports of equipment from the 1930's onwards and continued to be dependent on imported equipment[2] - determined that in a considerable number of cases (textiles being a very good example), not even the largest firms were up to international standards and there was room left for new large firms to enter the market. Consequently, the coexistence of firms of very different sizes and technologies were not only a matter of market size but a result of a more complicated combination of factors which characterized the development of the Chilean economy.

In fact, these characteristics of the Chilean economy - which are also present in the other less developed countries - are likely to have increased the inflationary role of the largest firms in the period under scrutiny. If the resources needed to develop new firms were scarce, the risk of new competitors entering the market was lower, thereby making an agressive price policy more likely.

1. See Paolo Sylos-Labini, Oligopolio y Progreso Técnico, (Barcelona, Oikos-Tau, 1966), pp. 47, 53-4.

2. According to ODEPLAN's National Accounts, 78% of the Gross Domestic Investment in Equipment and Machinery was imported in the period 1960-1970.

On top of the effects of economic concentration, the effects of specialization must also be taken into account. In one industry not every firm produces the same products. Some specialize on a particular range, others specialize on different ones. This specialization is likely to be somewhat connected with the kind of firm concerned, i.e. its size, technology etc., so that at product level, monopolies and (concentrated) oligopolies are more likely. Moreover, different brands of the same product - or almost the same product - are usually considered by consumers to be much more different than they really are due to the effects of publicity. In other cases, retail commerce being the clearest, location is important. If these and other aspects concerning product differentiation are taken into account, monopolies and (concentrated) oligopolies are likely to be even more common.[1]

Of course, no firm, not even a monopoly, can increase its prices without paying the penalty of selling less in a stable economy. But during an inflation - and particularly a considerable and persistent one, the market power of the 'price leaders' enable them to set the pace of inflation, and they would not lose sales if the whole economy follows and the authorities adopt a passive or ratifying policy (monetary, fiscal, etc.) to avoid recession.

Hence what market power does to inflation is to increase the 'aggressiveness' of the price setters and to reduce the likelihood of the Government being able to correct excessive price increases without causing undesirable effects such as a fall in the level of economic activity and rising unemployment. If some key prices rise and they are downwards rigid, then the Government would have to allow other prices to adjust to the change thereby ratifying

1. Sylos-Labini, 1966, op. cit., pp. 27-8 and 69-72.

the increases, unless it is prepared to accept huge distorsions in relative prices and to hold on until subsequent inflation corrects them gradually (assuming that the firms with more market power can be induced to accept those corrections). In practice, the economic and social costs of that 'inducement' may be considerable depending on the policies which are implemented to do it. In Chile, there was much evidence of the kind of 'price leadership' mentioned above. Due to persistent inflationary conditions and the difficulties in terms of setting prices that such a situation generates, firms usually set prices on the basis of other firm's prices which they considered relevant.[1] This kind of practice, based on what could be called relatively inflexible relative prices, certainly increases the significance of the monopolistic/oligopolistic factors already discussed.

B) Monopolies and Oligopolies in Chile. The Evidence

The degree of competition is basically a microeconomic concept. What would be needed in order to have a clear picture would be a good by good and service by service analysis which would be, of course, very complicated and painstaking. In fact, all available studies about the non-competitive character of the Chilean economy are based on data about economic concentration at a rather aggregate level. However, the degree of concentration was so high - see, for instance, Table 10.1 about manufacturing below - that the only possible conclusion is an even higher degree of concentration at the level of individual products.

1. See Tomás Reichmann, 1974, op. cit. , p. 30.

Table 10.1

Economic Concentration in Manufacturing, 1960. Gross Output of the largest firms as a percentage of the total

	Number of firms:	1	2	3	5	10
Sub-sectors:						
20	Food	6.9	10.7	13.8	18.1	42.0
21	Beverages	42.3	48.6	54.2	61.5	68.8
22	Tobacco	92.3	92.5	92.5	-	-
23	Textiles	9.3	17.4	24.1	32.6	45.6
24	Clothes	3.6	6.4	8.3	11.4	16.7
25	Wood	7.0	13.6	15.8	19.3	26.3
26	Furniture	37.2	41.7	44.5	48.6	56.2
27	Paper	86.2	87.7	88.7	89.7	91.3
28	Printing	13.2	16.4	19.6	24.5	31.7
29	Leather	11.7	20.9	29.9	43.0	60.1
30	Rubber Products	78.3	81.6	84.2	88.1	92.6
31	Chemicals	17.9	22.8	25.5	29.7	38.2
32	Petroleum	93.3	93.8	94.2	94.5	-
33	Non-metallic Minerals	22.4	36.0	44.4	59.4	64.5
34	Basic Metals	47.5	51.8	53.8	55.4	56.9
35	Metal Products	16.8	19.3	21.7	25.7	31.7
36	Non-elec. Machinery	10.8	17.3	20.6	26.0	34.1
37	Electric Equipment	18.1	30.2	37.4	50.0	63.0
38	Transport Equipment	8.0	14.8	20.8	26.1	33.9

Source: Ricardo Lagos, La Industria en Chile: antecedentes estructurales, (Santiago, Instituto de Economía, Univ. de Chile, 1966), Appendix B-3.

In fact, the existence of monoplies was evident in cases such as those tobacco, paper, specific construction materials, specific metal products, chemicals, etc., and also in the case of public utilities such as telephones and the distribution of electricity. It is important to point out, at this stage, that Public Sector monopolies such as those in the production of petroleum (ENAP), electricity (ENDESA) and beetroot sugar (IANSA), the Post Office and the railways (Ferrocarriles del Estado) should be considered separately from the point of view of inflation and stabilization because their prices were more affected by political considerations, their financing was different and, consequently, their response to stabilization efforts - as far as prices are concerned - was more controllable from the point of view of the Government, even if the limitations imposed by bureaucratic and party politics inside the State are taken into account.

In the middle of the period under scrutiny, in 1963, only 3.0% of the manufacture firms employing more than five workers, (only 190 firms), controlled more than one half of the total production (value added), almost 6.0% of the total capital and around 45.0% of the labour force employed by the total.[1]

1. See Sergio Aranda and Alberto Martínez, 'Estructura Económica: Algunas características fundamentales', in Centro de Estudios Socio-económicos, Univ. de Chile (eds.), Chile Hoy, (Santiago, Siglo XXI, 1970) p. 70, and Sergio Ramos, Chile:¿una economía en transición?, (La Habana, Casa de las Américas, 1972), p. 128.

In mining, although it must be pointed out from the start that the sector was export-orientated and less relevant from the point of view of domestic markets, only three firms controlled more than 75.0% of the total copper production, six firms controlled more than 80.0% in the case of iron and one firm controlled more than 75.0% of the total production of coal, by the end of the 1960s.[1]

In the case of commerce, only 12 large firms (0.5% of the total) controlled 43.0% of the total sales in the wholesale sector in 1967, while 70 firms controlled more than three quarters. The retail sector, however, was considerably more competitive. There were more than 100,000 firms, the largest 30 controlled only 5.5% of the total sales and another 4,801 medium size firms controlled an additional 20.6%.[2] The contrast between the structures of the two sectors suggests that the retailers were in a rather vulnerable position, particularly when anti-inflationary policies based on demand restriction were implemented.

Restrictions on competition were not only the result of monopolies and oligopolies. In some cases, small firms implemented agreements on prices through specialized business or professional organizations (e.g. chemists, bakers). Sometimes these practices were the result of their activities concerning the securing of minimum standards of quality in a particular trade. In other occasions, the organizations had become concerned about price-setting as a result of the need to negotiate readjustments of controlled prices with the Government. Consequently, as will be shown later on, they became an obstacle for the lifting of price controls because once the price had been freed they were able to exercise their market power. In other words, price controls also restricted competition and, to a certain extent, in sectors in which the problem was not economic concentration but colussion, they can be seen as contributing to create the very conditions which justified their existence.

1. Sergio Ramos, ibid., pp. 131-4.
2. ibid., p. 135 and Table II, p. 136.

Economic concentration was not only a sectoral phenomenon in Chile. Large firms in different sectors were connected through their owners, the result being the existence of a handful of very powerful 'economic groups' which in most cases included considerable participation, if not control, in one of the oligopolistic private banks.[1] Consequently, large firms had easier access to bank credit not only due to their size or solvency but also because of their connections. As a result, they benefited more than any other sector from the negative real cost of credit which existed in the 1940's and 1950's and, again, during the inflationary acceleration in 1963-1964, (see Chapter Seven).

These economic groups were also the sectors with more political influence, because they were very powerful inside the business organizations and the right-wing political parties, and they controlled crucial economic resources from the point of view of the success of the economic policies of any Government, and, also, from the point of view of the financing of political activities.

1. The most comprehensive study of the Chilean 'economic groups' as they were at the end of the 1950's is Ricardo Lagos, La Concentración del Poder Económico. Su Teoría. Realidad Chilena, (Santiago, Ed. del Pacífico, 6th. Ed., 1965), especially pp. 121-60.

Perhaps the most outstanding exponent of the power of the economic groups was President Jorge Alessandri (1958-1964), himself a businessman with very prominent positions in a number of large firms including monopolies in the paper and non-metallic minerals manufacturing sectors, and a member of the 'sub-group' Alessandri-Matte which had considerable presence in three large private banks.[1] Before becoming a Senator in 1957 and a presidential candidate immediately afterwards, he was the president of the overall business organization, the Confederation of Production and Commerce (CPC) for fifteen years. Although he was an independent, his father had been a prominent Liberal statesman, twice President of the Republic (1920-1925, 1932-1938), and one of his brothers was also a Liberal Senator and a former presidential candidate in 1946.

This was the sector which led the opposition to price controls and direct intervention of the State in the economy, in general. However, their economic liberalism was all they had in common with the monetarists, whom they also opposed very strongly.

1. See Ricardo Lagos, 1965, op. cit., pp. 126-9.

C) Economic Concentration and the price side of the wage-price spiral

Apart from measures specially designed to affect expectations about inflation, the main policies implemented in Chile in order to bring the price side of the inflationary spiral under control and to achieve reductions in the rate of inflation in the short-run, were:

i) Restrictions on the expansion of bank credit combined with restrictions on the increases of costs, particularly labour costs.

ii) Competition from imports, increased as a result of a reduction in restrictions and tariffs and a complementary foreign exchange policy, combined with restrictions on the increases of costs (labour) and reductions in other cost increases (imports).

iii) Direct involvement of the business organizations and the business sector in general in the implementation of very intensive stabilization campaigns, designed to curb price increases abruptly without using state intervention (price controls). This kind of policy was also accompanied by restrictions on cost increases.

iv) Direct state intervention in the markets in the form of price controls.

v) Legislation against practices restricting competition.

In the following sections, these measures are discussed in the context of the monopolistic/oligopolistic character of the Chilean economy and the political influence of large firms and 'economic groups'.

D) Economic Concentration and Monetary Restrictions

At the centre of the monetarist recommendations on stabilization was the idea that credit restrictions would have to 'really hurt' in order to bring about the necessary changes in plans and attitudes required to achieve stability.[1] A buyers market would teach firms to be more cautious concerning increases in the prices of what they sold and to be firmer in rejecting increases in the prices of what they bought. The lesson would be taught by a limited and temporary, but 'hurting', recession which would cause those being too slow to learn considerable trouble and even bankruptcy.

At first sight, it would seem that the above mentioned features of the Chilean economy would necessarily lead to the conclusion that monetary restrictions would mostly hurst the smaller firms because the larger ones could escape the overall restrictions on credit expansion due to their connections with the banking system, and because they would be in a position to take advantage of their lower average costs to do better in a buyers market. However, access to credit and lower costs were not the only factors that mattered. The more concentrated a specific market was, the more likely to affect the larger firms considerably the reductions in demand were, because the buffer provided by smaller firms would be smaller.

Moreover, because of their involvement in banking, 'economic groups' did not like the kind of state intervention in the regulation of credit which statutory ceilings on credit expansion involved, even though they themselves had considerable influence in the regulating agency, i.e. the Central Bank (see Chapter Seven). Consequently, the 'businessmen's approach'

1. See IMF, 'Mission to Chile', 1950, op. cit., p. ii.

to inflation, which was championed by the business oligarchy, rejected monetarism very strongly. Thus, in Chile almost all sections of the business sector were against monetarism. The initial influence of monetarism, particularly during the period 1953-1958, was mainly the result of the IMF having been able to enlist the support of the staff of the Central Bank and some key 'técnicos ibañistas', such as Felipe Herrera, on the left, and Jorge Prat, on the right, and it was also the result of the power of the IMF itself. Moreover, attempts at monetary restriction were short-lived, both in 1953 and 1954 and only when the Government agreed to negotiate a comprehensive package of measures with the right-wing parties, clear representatives of the business sector, monetary restrictions were implemented more effectively (see Chapter Four).

E) Economic Concentration and Foreign Trade Liberalization

The liberalization of the foreign trade regime, and particularly the import regime, was not a matter of consensus among Chilean businessmen. Some sectors were more vulnerable to potential competition from imports than others, after more than two decades of import substitution and considerable protection. Other sectors stood to benefit more than others from potentially cheaper imports of raw materials, spare parts and equipment in general.

The National Mining Society (SONAMI), the Central Chamber of Commerce (CCC) and other merchants' organizations, including the importers and exporters associations, were all in favour of a very considerable liberalization, for obvious reasons, but the situation was more complicated in the cases of the both very powerful National Agricultural Society (SNA)

and Manufacturers Society (SOFOFA), and also in the case of smaller organizations in agriculture and manufacturing, and especially the Consortium of Southern Agricultural Societies (CAS) which did not belong to the SNA, and the very important Metallurgical Industries Association (ASIMET) one of the most important members of SOFOFA.

In the case of agriculture there were always fears that the domestic markets would be flooded with very cheap agricultural and cattle products particularly from Argentina. In fact, the business organizations in this sector led the battle against the project of a customs union with Argentina which was agreed, in principle, between Presidents Ibañez and Perón in 1953.[1] In the case of manufacturing, some industries wanted cheaper imports of equipment, spare parts and raw materials which would have substituted domestic production of industries such as the metallurgical one. Consequently, the subject of tariffs was frequently a source of conflict inside the organization.[2]

President Alessandri, the very representative of the business sector, managed to implement a considerable liberalization as part of his stabilization effort partly because some sectors remained protected by special regimes but mostly because the liberalization was sold to those who were more hesistant to accept it as one element in a package which promised not only stability but also a huge inflow of foreign capital.

As a device for increasing competition in the domestic markets the liberalization of the foreign trade regime proved very effective but very inefficient. It proved very effective because there can be little doubt

1. See EMS, 28 March 1953, p. 3 (the whole page).
2. See, for instance, B. Stallings, 1978, op. cit., pp. 86-7.

that it made a major contribution to the 1959-1961 spectacular stabilization (see Chapter Five). But it proved very inefficient because the resources which were used in order to achieve a higher degree of competition - foreign exchange - were extremely scarce and dear from the point of view of the country, even though they were relatively cheap in the foreign exchange market as a result of the constant nominal exchange rate (NER), and inflation. In other words, the Chilean foreign sector was not capable of providing the competitive challenge which was required without accumulating enormous inflationary pressures which had to be released later, during the same Government - devaluation and reintroduction of import restrictions - or during subsequent Government which inherited a huge foreign debt.

F) Direct price regulation

While monetary restrictions and foreign competition were measures which operated through the market forces (demand and supply), direct measures such as price controls and private sector campaigns against price increases (such as the one in 1959-1960) were based on socio-political forces, i.e. the power of the state, business organizations and other organizations.

No doubt, the power to control prices was never totally independent from the market forces. That would have required a totally different mechanism of rationing. No campaign against price increases can succeed if an excess of demand persists and, even though price controls can be enforced to the point that they become largely independent from demand and supply, the result would be the typical effects of 'repressed inflation' in which shortages are widespread, black markets flourish and official price indexes cease to be representative of the prices actually being paid in an increasing proportion of cases.

Direct measures could not solve the problem of inflation by themselves in a market economy. Sooner or later shortages developed and controlled prices had to be readjusted. This had considerable political costs from the point of view of the Government which was seen by many as being directly responsible for the price increases which were decreed.

Excessive reliance on price controls which proved to be largely ineffective was one of the main features of Chilean anti-inflationary policy-making in the 1940's.[1] This situation continued until mid-1954 when a major simplification took place and the effort was concentrated on controlling the price of some fifty essential items. From then onwards, price controls were used much more effectively when there was the political will to do it, as in 1956, and particularly from 1965 onwards. When this did not exist, they were used as ineffectively as in the past, thereby discrediting them. The best example of this were the price freezes decreed by President Alessandri in 1963 and 1964, (see Table 10.2 below).

1. See A.O. Hirschman, 'Inflation in Chile', 1963, op. cit., p. 185.

Table 10.2

Price Freezes 1953-1970 a/

	Dates		Inflation: Monthly and 12 months rates b/						
			Previous months				Subsequent months		
	Decree	Freeze c/	-3	-2	-1	Decree +1	+2	+3	
1953	11 Jul. 53	15 Jun. 53	0.4	1.2	2.2	3.2	7.2	6.5	9.1
			15.0	13.9	10.3	13.1	18.0	24.4	31.2
1956 d/	25 Jan. 56	16 Nov. 55	6.0	6.1	4.2	3.6	1.0	1.3	2.3
			76.0	80.2	83.8	84.3	78.0	69.5	59.3
1960 e/	25 May 60	25 May 60	0.1	0.5	-0.9	0.3	-0.1	2.3	1.5
			25.4	20.4	15.1	11.8	9.2	7.3	6.5
1963	19 Feb. 63	15 Feb. 63	6.3	1.6	3.2	5.8	3.0	2.5	3.6
			25.9	27.7	29.6	36.0	39.2	42.5	46.3
1964	21 Feb. 64	15 Feb. 64	4.0	3.0	1.4	9.8	4.7	2.8	1.0
			43.4	45.4	42.8	48.2	50.6	51.0	47.2

a/ Although they were announced as such they were never real freezes.

b/ Official uncorrected Retail Price Index.

c/ The prices were frozen at their level on this date.

d/ As one of the elements in the 1956 stabilization effort.

e/ Short freeze after the earthquakes and during the stabilization.

The opposition of the business sector to the implementation of effective price controls is clearly illustrated by their opposition to any legislation concerning increased penalties for 'economic crimes' such as the violation of price controls and speculative activites. Business organizations and the right-wing parties managed to block Bills on 'economic crimes' both in 1953 and 1954. In 1956, in the middle of the stabilization effort, they managed to gather enough support to defeat a new Bill in Congress.[1] Consequently, it is not surprising that President Alessandri had reduced price controls to a minimum in 1959 - house rents, transport fares, public utilities tariffs - relying in the short-run on the effectiveness of a campaign in which the business sector participated actively (see Chapter Five), and in the longer-run on the contribution of the foreign sector. Even though the President promised to use price controls to prevent an inflationary acceleration after the traumatic devaluation at the end of 1962, the 1963 and 1964 price freezes were decreed for pure electoral reasons and included so many exceptions that they were not really price freezes at all.

President Frei introduced much more effective price controls as one of the central elements in his medium-term stabilization program, in which stabilization, economic growth and income redistribution towards wage- and salary-earners were to take place simultaneously. Given the redistributive goals of the program and the rejection of a policy based on the foreign sector, price controls had to be a very important element, and the Government worked consistently towards increasing their effectiveness.[2]

1. See EMS 13 June 1956, p. 19.

2. For the intensification of price controls after Law 16, 464, 25 April 1966, see De la Cuadra, 'El Control de Precios en Chile', Santiago, CESEC, undated, quoted in V. Corbo, 1974, op. cit., p. 74.

The political will to use price controls effectively was accompanied by the Government's recognition of the limitations of such a measure in a market economy. President Frei's Government used price controls in order to 'lead' inflation down, not to 'repress' it, the difference between these two cases being the existence of a comprehensive stabilization program.

Price controls could only work if the Government had access to more and more detailed information about costs and production processes in the firms under control. In the past, price controls had not been very effective, among other reasons, because Governments had a very limited capacity to argue with the firms involved and businessmen concentrated more on doing public relations activities in the political system than in increasing productivity and reducing costs. After all, when controlled prices were implemented by Governments which were not too committed to enforce them and/or were responsive to business sector's pressure, it was easier to get them readjusted upwards.[1] This problem was even more serious in the case of a gradual stabilization, such as President Frei's, in which some crucial relative prices - imports, agricultural products - were programmed to change significantly. Consequently, price controls had to leave room for changes in the relative prices of those products which would be affected differently by those changes, because of their different cost structure. Thus, more and better information about private firms was required and this clearly increased the level of discontent among businessmen. Businessmen had tolerated price controls in the past only as an emergency measure,[2] but they were less prepared to do so with a Government whose commitment to the traditional

1. See Sergio Molina, 1972, op. cit., p. 126.

2. Particularly in the case of the 1956 stabilization and after the May 1960 earthquakes which threatened the stabilization which was, then, progressing.

concept of free private enterprise was doubtful. Hence, price controls remained a source of tension between the business sector and the Government, a situation which not only involved political costs from the point of view of the latter, but also economic costs resulting from the effects of reduced business sector 'confidence'.

Price controls allowed the Government to limit the increases in inflation that followed the defeat of the forced savings scheme in 1967-1968. Again, they were mainly used in order to eliminate 'cumulative pressures' coming from factors operating in the inflationary spiral itself, and not as a 'repressive' device. This was particularly important in a period of increasing inflation in an economy in which monopolies and oligopolies were so predominant and price overshooting was so much more difficult to correct. By avoiding excessive distorsions in relative prices - both during the stabilization and during the period of 'relatively contained' inflation which followed - the Government reduced the political costs of the readjustments which were decreed from time to time.

From the Chilean experience in the period 1952-1970 it is possible to conclude that price controls were the most efficient device from the point of view of reducing the contribution to inflation of the price side of the wage-price spiral, i.e. much more efficient than a very drastic liberalization of the foreign resources which wasted valuable resources and could not be sustained. It was not the price control aspect of the 1965-1967 stabilization program that failed. However, to be effective controls required a Government committed to use them properly and technically capable of doing so, and from this point of view, their viability was very much determined by political factors. The efficiency of price controls ultimately depended on the ability of the political system to generate the kind of Government which would use them properly.

It is important to stress that in this section the analysis has been focused on the role of price controls as an anti-inflationary instrument when dealing with a considerable inflation such as Chile's, i.e. not a 'creeping' inflation. Since stabilizations have always been short-lived in Chile[1] and the double-digit inflation has always survived the attempts against it, the question of whether it would be possible to reduce inflation to a very low level - i.e. less than three per cent a year, for instance - and to sustain that degree of stability, has not arised as a practical question. And it is at this level that the traditional 'Latin American structuralist' idea about structural imbalances being the cause of a deep rooted inflation seems to remain more valid. Even after demonstrating that the upward inflexibility of fiscal revenue was a political matter, and one which could be overcome within the existing structures, after arguing that the downward inflexibility of fiscal expenditure was not really explained by the urgency to prevent an imminent revolution, and after arguing that the role of wage increases was not merely to 'propagate' or 'transmit' pressures originating in economic rigidities and bottlenecks, it still remains a valid argument that some very basic features of the Chilean economy made long-term stability to be almost impossible.

An economy in which imports were so crucial and exports so unstable could not remain stable unless the impacts received from the foreign sector were absorbed without increases in the price level. But this required changes in relative prices to be achieved by increasing some prices and reducing others, and given the monopolistic/oligopolistic character of the Chilean economy, this was very unlikely.

1. This is also true in the Chilean experience after 1970. Neither the fall in the rate of inflation achieved in 1971 by the Popular Unity Government nor the one-digit inflation achieved in 1981 by the Military Government persisted, more than one year or two.

The Agrarian Reform, the huge increases in fiscal revenue, the incentives for the development of non-traditional exports and for the development of copper exports, were important steps towards reducing some bottlenecks and the vulnerability of the economy, but the instability of the international markets remained as a threat and the monopolistic/oligopolistic character of the Chilean economy was not tackled.

Unless one reduces the structural problems of the Chilean economy to the stagnation of agriculture and the fiscal rigidities, it is not acceptable to argue that structural problems had disappeared by the end of the 1960's. In fact, some of them had diminished only 'conjuncturaly' (the restrictions on the capacity to import) and others were under a degree of control which caused considerable tension (the monopolies and oligopolies). This is a distinction which Vittorio Corbo fails to make.[1] The Chilean economy seems to have been condemned to suffer a considerable degree of inflation until a more diversified and stronger exports sector was developed. And this was not a short-term matter. In the meantime socio-political conflicts became more intractable and the difficulty of accommodating conflicting demands increased enormously, let alone the difficulties caused by trying to absorb a major impact from the foreign sector.

The inescapable conclusion of this anlysis is that either price controls would have had to remain as a more or less permanent feature in the regulation of the Chilean economy, or an alternative method of regulation would have had to be devised. It is not within the limits of this thesis to discuss such an alternative here, nor it seems reasonable to embark on a discussion of the long-term effects of persistent price controls in an economy in which private enterprise and free markets play a crucial role. However, it is

1. See Vittorio Corbo, 1974, op. cit., p. 15.

possible, indeed necessary, to point out that persistent price controls would have demanded very much from the political system and Governments in particular. As in 1965-1970, price controls could not reduce inflation and prevent new outbursts unless some accommodation between conflicting demands was reached not only to distribute the benefits of economic growth, but, especially, the losses suffered as a result of international or domestic economic difficulties.

The next section deals with the limitations of the anti-monopoly legislation enacted in Chile during the period under scrutiny.

G) Anti-Monopoly Legislation

Once the first stage of his stabilization had been completed, President Ibañez' Government tried to eliminate price controls. One of the main difficulties faced by the stabilization effort was caused by the activities of very specialized business organizations acting almost as cartels in the markets of some essential goods. Their main activity consisted in taking advantage from the lifting of controls by increasing prices very considerably and at the same time making agreements which restricted price competition.[1]

It was against this kind of restrictive practices and following the advice of the Klein-Saks Mission that the Government sent what was described as an anti-monopoly Bill to Congress.[2] However, this legislation was not enacted during this Government.

1. The most outstanding cases were those of bread, milk, and rice, see EMS, 12 Dec. 1956, 7 May 1957 and 16 July 1957, frontpages.

2. See Misión Klein-Saks, El Programa de Estabilización de la Economía Chilena y el trabajo de la Misión Klein-Saks, (Santiago, Ed. Universitaria, 1958), pp. 18, 88-9.

The Bill was not opposed by the Liberals and Conservatives, the traditional right-wing parties so closely connected with the business oligarchy. On the contrary, they supported it very strongly, and repeatedly demanded its enactment and implementation.[1] In fact, it was the Government itself and some of its own 'ibañista' supporters that did not do enough to get the legislation enacted, most probably because they, and not the traditional right-wing parties, were closely connected with the socio-economic sectors which were most likely to be affected by the legislation, i.e. medium size and small businessmen. The Bill was sent to Congress in January 1956 and after being withdrawn and resubmitted a couple of times, it was finally left in Congress to be discussed in October 1957. However, when the Government's term in office ended a year later the Bill was still blocked.

The existence of right-wing support for the Bill is not surprising since it did not include any specific measures dealing with the market power of 'economically based' monopolies and oligopolies, i.e. those resulting from the high degree of concentration in the Chilean economy,[2] and the right-wing political parties expected to be able to use this legislation as a major weapon against state monopolies. David Konkel is totally inaccurate when describing this Bill as a 'deconcentration proposal' ignored by a 'conservative-dominated Congress', and by suggesting that the failure of the Bill was the most notable example of the capacity of the 'conservative agricultural-industrial coalition' to block 'anti-trust' legislation.[3]

1. See EMS, 13 March 1956, pp. 1 and 19, 27 April 1956 p. 21 and 5 June 1958, p. 23, for instance.

2. The Bill can be found in EMS, 26 April 1956, p. 23.

3. See David R. Konkel, 1977, op. cit., p. 69. Konkel's contribution is discussed in Chapter Two.

In fact, it was the next Government, in which business organizations were most influential, that finally enacted legislation almost identical to the one already discussed.[1] This legislation was used only against a handful of organizations and firms including the Bakers Association, the Slaughtermen's Union, the Flour Mills Association (central region), the College of Chemists and a firm which owned four cinemas in a southern provincial town. These and other two or three minor cases were all the activities of the 'Anti-Monopolies Commission' during its first three years of work, from 1959 to 1962. When excessive increases in prices set by monopolies such as the Chilean Tobacco Company occurred, the Government confined itself to criticizing the increase and to point out the need for new legislation in order to deal with cases in which products could not be declared 'essential' and, therefore, price controls could not be applied.[2] The beer monopoly was another such case. In short, the legislation enacted during this Government was never a real threat for the monopolies and oligopolies which existed in the Chilean economy. No other legislation of this kind was enacted in the period 1952-1970.

Strong Governments with a considerable capacity to intervene in the economy by using effective price controls and other devices, remained as the only major possible threat which monopolies and oligopolies could face in Chile, particularly when those Governments were not too influenced by the business oligarchy. However, the same competitive features of the political system which allowed new democratic forces to develop and to challenge the oligarchic forces, were the ones which limited the strength of their Governments and/or made it short-lived.

1. See Law 13.305, April 1959, in EMS, 5 and 6 April 1959 pp. 19, 24-5.
2. See EMS, 30 April 1961, p. 21.

H) Expected Inflation, Economic Concentration and Stabilization

There can be little doubt about the importance of expectations in the operation of any economy. Economic decisions are seldom based on certainty and those who take them have to decide which is the most likely set of relevant conditions. Certainty is infrequent not only because decisions are, obviously, always about the future but, also, because the access to much needed information - for instance, about other firms, the Government, the customers, etc. - is usually costly when not unattainable. In fact, these are two aspects of the same problem.

In the Chilean case it seems reasonable to assume that the expectations which mattered most, concerning inflation, were those of the largest firms which acted as pace setters. This makes the econometric method of estimating expected inflation on the basis of past experience - the one usually used in studies about Chile[1] - totally unacceptable. 'Price leaders' are likely to have been much more sophisticated, and to have taken into account Government policies, Government strength, the foreign sector prospects and other factors not likely to follow a trend. Hence, a number of cyclical and 'circumstantial' factors had to be weighed and, as a result, the effect of expectations of measures such as the announcement of an anti-inflationary program at the beginning of a Government's term in office, was fairly dramatic.[2] Thus, forecasting expected inflation may be an exercise closer to forecasting public opinion than econometricians have been prepared to accept, the crucial difference being that not every opinion matters equally in the case of inflation, particularly in an economy like Chile's.

1. A summary of the econometric models for estimating expected inflation in Chile can be found in V. Corbo, 1974, op. cit., pp. 181-3.

2. See, for instance, Marcelo Selowsky, 'El Costo de Desacelerar la Inflación : problemas conceptuales y ordenes de magnitud para Chile', Cuadernos de Economía, 20 April 1970, p. 33.

When Governments had more credibility, either because of being at the beginning of the 'presidential cycle' or because of having been able to create a new situation in which their policies became more credible (for instance, as a result of a new coalition of foreign support, etc.) their announcements were more effective in influencing general expectations. Consequently, the implementation of the anti-inflationary policies generated less tension in the sense that demand restrictions 'hurt' less, price controls were less 'repressive' and, in general, the cost of the stabilization in terms of production, unemployment and investment was lower. In other words, political factors affecting expectations played a crucial role in the economics of stabilization. When Governments lost their credibility either because of a major economic crisis caused by their own policies, as in 1961-1962, or due to their inability to implement the stabilization policies as programmed, as in 1965-1967, expectations ceased to be a positive factor and they became a source of great difficulties for the economic policies of the Government. The economic cost of attempting to reduce inflation became higher because anti-inflationary policies had to become more 'repressive' or 'hurt' price setters more. In fact, one of the achievements of the 1968-1970 period was the ability of the Government to use price controls as an instrument for reducing the negative 'cumulative' effect of expectations after its 1967-1968 defeat (forced savings scheme), thereby reducing the cost, in terms of unemployment, economic growth and investment, of preventing an inflationary acceleration such as the one which had occurred in 1963-1964.

I) Summary

The monopolistic/oligopolistic character of the Chilean economy increased the cost of relying on the market forces for fighting inflation. Moreover, the political influence of the business sector, and particularly of the business oligarchy closely connected with the monopolies and oligopolies, was a huge obstacle in the way of attempts at direct state regulation of prices.

The two main policies implemented in the period under scrutiny in order to deal with the market power of monopolies and oligopolistic firms were price controls and the liberalization of the foreign trade regime. Cheaper imports proved a very effective contribution to stabilization in the short-run not only as a source of competition but, also, as a positive effect on costs. However, they wasted valuable resources - scarce foreign exchange - and their contribution could not be sustained. In the end, they led to a Balance of Payments crisis which forced a devaluation, the reintroduction of import restrictions and put an end to the stabilization. Moreover, they left a legacy of foreign debt which reduced the room for subsequent attempts considerably.

Price controls had always been rather ineffective in the past, but the situation changed when the Government combined political will to use them effectively with technical expertise to implement them properly. Learning from experience, they were not used as a 'repressive' measure against inflation, but as a device to 'lead' prices down in the context of a comprehensive stabilization program. Consequently, when other aspects of the program failed, inflation increased again, although price controls contributed to eliminate some 'cumulative' pressures operating in the inflationary spiral, thereby reducing its magnitude.

State intervention remained as the only viable policy to control the market power of the monopolies and oligopolies because not even with the very favourable export situation which existed in the second half of the

1960's was the Chilean economy in a position to afford the use of foreign exchange resources which an effective foreign competitive challenge involved. Moreover, despite the progress made in the second half of the 1960's towards the elimination of the rigidites and bottlenecks which had been stressed by the structuralists as the basic causes of the Chilean inflation, the foreign sector continued to be vulnerable to changes in the international markets - and particularly the copper market - and the Chilean economy continued to be characterized by its high level of economic concentration and the considerable amount of market power which a few large firms and 'economic groups' had. Consequently, the economy was still likely to suffer impacts from the foreign sector which would have been very difficult to absorb without inflation due to the downwards rigidity of prices under generalized non-competitive conditions. Hence, persistent price controls and a considerable degree of state involvement in the regulation of the economy, in general, and prices, in particular, seemed the only viable effective alternative.

However, such an involvement demanded very much from the political system in terms of effectiveness to achieve accommodation and ability to bring expertise and experience into the state intervention in the regulation of the economy. Strong Governments commited to control the market power of the monopolies and oligopolistic firms - and therefore relatively independent from the socio-political power of the business oligarchy - seem to have been a major political requirement of effective anti-monopoly action but the same competitive character of the Chilean political system which allowed new democratic forces to develop and challenge the power of the oligarchy, limited the strength of every government very severely.

General Conclusion

The Chilean inflation of the 1950s and 1960s was, to a large extent, the result of the failure of the political system to accommodate conflicting demands within the limits of available resources.

Monetarists argued a similar point. Indeed, it was their main justification for recommending to transfer most of the burden of the function of scaling down conflicting demands from the political system to the markets. They assumed that the political system was not capable of making any major contribution to the performing of this function other than supporting a sustained implementation of 'correct' monetary and fiscal policies, that is to say, those policies which would allow the market forces to eliminate inflation and to provide lasting price stability. But monetarists did not explore the political system, not even to analyse the likelihood of the system being able to perform the task which their policies required of it. Their theoretical approach did not permit them to take politics into account, in addition to which it was their view that the sacrifices required in order to achieve stability would be small and only temporary, and that the benefits which would be the result of price stability would more than compensate those sacrifices. The structuralist critique of monetarism was focused on this aspect, arguing that the sacrifices would be neither small nor temporary because of the specific characteristics of the Latin American economies in general, and those of the Chilean economy in particular. Long-term stability without permanent economic stagnation could only be achieved if some basic, structural, bottlenecks and rigidities were eliminated, so that an effective anti-inflationary program would have to be much more comprehensive. But, despite the fact that the political system would necessarily play a very

complex and crucial role in the implementation of such a program, structuralists did not provide a satisfactory analysis of the socio-political aspects involved either. (This is particularly true of those structuralists whose contributions have been generally accepted as the most representative version of this school of thought.) As a result, the controversy between monetarists and structuralists remained mostly in the field of economic theory.

However, neither the failure of the watered down monetarist attempt at stabilization which was implemented in 1956-1957, nor the failure of the very comprehensive structuralist attempt which was implemented in 1965-1967 was due to economic reasons. The economic stagnation and the sectoral falls in economic activity caused by the monetarist attempt cannot be explained away as economic mistakes or unexpected side-effects of the policies implemented. The difficulties encountered by the structuralist attempt in implementing its short-term and medium-term policies were not caused by economic bottlenecks or rigidities.

In the case of monetarism it is clear that whatever its intellectual merits and its subsequent influence on Chilean economic policy-making (since 1973) its view point was not all that widely accepted during the heyday of Chilean democracy. In democratic conditions no stabilization attempt was politically viable unless it included some short-term rewards for its supporters. The monetarist insistence in the healthy properties of deflation did not provide a very promising framework for any coalition strong enough to support an effective monetarist stabilization in a democracy.

In the case of structuralism, the main problem was the high degree of tension between the economic and political costs of the structural reforms, and the ability to implement the medium-term stabilization program. In contrast with monetarist policies, structuralist ones did provide

clear short-term rewards to a very broad coalition of social sectors. However, the competitive character of the Chilean political system reduced the effectiveness of these rewards both because a considerable proportion of those who benefited were not actually supporters of the Government, and because demands increased more rapidly than the Government's ability to meet them. The structuralist attempt at stabilization is the best demonstration that the distributional struggle involved more than merely 'propagating' factors. The distributional struggle was itself a cause of inflationary pressures which would not be necessarily eliminated as a result of removing the rigidities and bottlenecks which caused other inflationary pressures. In fact, a socio-political analysis of the structuralist experience of 1964-1970 shows that a structuralist program of stabilization would require the support of social sectors which had to be organized and mobilized and which would then become the source of new demands which would make distributional conflicts more intractable. The analysis also shows that the factors traditionally stressed by the structuralist approach did not explain the inflation of 1964-1970. Tax revenue was certainly not upwards rigid, increases in the cost of living was not enough to explain the increases in wages and salaries (i.e., they were not merely 'propagating factors'), increases in public expenditure were not explained by the need to keep pace with inflation (i.e., they were not a 'propagating factor' either) and the Balance of Payments did not create any difficulties, on the contrary, the capacity to import and the fiscal revenue from foreign trade both increased.

Monetarist recommendations were bound to increase the level of socio-political conflict because those suffering most from the effects of the monetary restriction were not likely to blame the market forces and remain socio-politically passive. Even the watered down monetarist stabilization

implemented in 1956-1957 showed the high level of conflict and social unrest generated by such policies and the extent to which they had to be complemented by very strong repressive measures.

It seems reasonable, then, to conclude that both monetarist and structuralist policies showed a tendency to increase the level of social conflict. In other words, all stabilization policies placed strain on the political system, and demanded a high level of skill in conflict management.

The Chilean political system was not able to deal with conflict without resorting to inflationary devices. The state institutions were themselves a result and a reflection of a basic conflict between the more egalitarian aspirations embodied in the fundamentally democratic character of the policital system and the oligarchic elements which played a major role in the compromises which led to them being established in the 1920s, and which were still present in the economy and particularly in the business sector. This conflict between democracy and oligarchy manifested itself in a number of crucial aspects of the state institutions:

i) The basic weakness of Chilean Governments which was the result of the combined effect of the system of checks and balances embodied in Chile's presidential system and the political fragmentation encouraged by the electoral system. This basic weakness limited the ability of the Government to implement measures which would threaten the economic power of the business oligarchy and its presence in the state institutions themselves.

ii) The power of the business oligarchy in the state institutions and particularly in the monetary institutions.

(iii) The weaknesses of fundamental state institutions such as the tax system which, instead of providing a strong source of

legitimacy for the intervention of the political system in the regulation of society, particularly in scaling down conflicting demands through political processes, were plagued with unfairness, in this case due to the high level of tax evasion and other factors which reduced the effective level of taxation paid by the well-to-do.

iv) The very poor contribution of some of the most crucial forms of political regulation of the economy and society to the democratic education of the population, that is to say, to their understanding of the options involved and their ability to contribute to the elimination of bad political practices. This was particularly clear in the case of the budgetary process and the legislation about wage and salary readjustments.

As a result of these weaknesses there was a strong inflationary bias in the political system and the above mentioned state institutions. Demands were not scaled down directly to the level required to achieve accommodation, sacrifices were not imposed directly, and conflicts were postponed instead of being solved. Inflation provided an indirect way of denying what had been previously conceded, an indirect way of distributing burdens and a mechanism for postponing distributional conflicts. However, one of its most outstanding features in the Chilean case of 1952-1970, namely its cyclical pattern, hold the clues for the identification of other crucial aspects of the connection between socio-political factors and inflation.

The cyclical pattern of the Chilean inflation reflects the existence of forces working in favour of price stability and forces working against it. The inflationary propensity of Chilean society was not absolute. The political system was not able to avoid inflation but it certainly

had some institutional characteristics which were effective enough to perform two basic functions: to prevent hyperinflation (a 'limiting function'), and to create political conditions in which major anti-inflationary attempts were implemented (a 'stabilizing function').

Some of the very factors which can be described as sources of Government weakness prevented the possibility of an inflationary escalation led by aggressive inflationary fiscal financing such as the one which caused the most famous hyperinflations of the 20th century.

Chilean governments were not institutionally and politically capable of increasing their expenditure and financing it by resorting to monetary expansion beyond certain limits, and those limits did not allow a hyper-inflation to develop. What were those limits? Since increasing inflation tended to increase fiscal problems cumulatively, the above mentioned restrictions contributed to increase the urgency of anti-inflationary measures from the point of view of the Government. Moreover, an inflationary acceleration was usually accompanied by a political crisis.(the most clear examples being 1954-55 and 1963-64). The competitive character of the political system provided mechanisms for the dissatisfaction of the less organized and less powerful sectors, which were less able to protect themselves from the redistributional effects of the acceleration, to have some political leverage. In those circumstances a major re-alignment of political forces to prevent the situation getting out of control usually occurred (the right-wing parties playing a major role both in 1955 and 1964). Thus, institutional and socio-political factors limited the increase in the rate of inflation and created the conditions for an anti-inflationary effort. This was the 'inflationary cycle' at work. However, the lower limit of the cycle was not stability because long before that had been reached, the forces which had made possible

the stabilization attempt lost their drive. This depended on a combination of factors, some of then endogenous (the 'normal' rate of inflation) and some of then exogenous from the point of view of the 'inflationary cycle' (an important election or any other important political event which could erode the political base of the attempt prematurely). In short, the 'inflationary cycle' was a socio-political mechanism which kept inflation alive within certain limits. But this was not the only cyclical force at work in the Chilean inflation of the period analysed in this thesis. There was also a 'presidential cycle', a political cycle which, in contrast with the above mentioned cyclical force, was relatively independent from inflation.

Presidential campaigns regenerated hopes among the population in general and the elected President benefited from this phenomenon because a significant proportion of those who had not even voted for him adopted a generally favourable attitude towards the new Government. Chilean Presidents were never stronger than during the first months of their terms in office. They were stronger vis-à-vis the opposition, Congress and their own supporters. This phenomenon enabled them to implement effective anti-inflationary policies even if there had not been a previous inflationary acceleration. In other words, further stabilization based on the 'presidential cycle' could follow the progress already made as a result of an 'inflationary cycle' leading to rates of inflation far below the 'normal' ones. This was what happened in 1955-1960, a period in which a stabilization based on the 'inflationary cycle' reduced the rate of inflation towards the end of a Government and was followed by a new attempt at stabilization after a new Government took office in 1958, the result being annual rates of inflation below 10.0% throughout the best part of 1960-62.

The opposite was not possible, i.e. the 'inflationary cycle' did not provide forces which could renew the fight against inflation once the 'presidential cycle' had lost its drive. In fact, the 'inflationary cycle' worked against the 'presidential cycle' when Governments managed to achieve low levels of inflation because price stability became a lower priority and there was increasing pressure in favour of concentrating the efforts of the Government on other economic goals, some of them in conflict with sustaining the level of stability already achieved.

However, both cyclical forces could work together in favour of creating the conditions for a stabilization attempt. This was, to some extent, the case in 1963-64, when the inflationary acceleration and the accompanying political crisis, even though they were not as severe as those in 1954-1955, led to a realignment of political forces which took place in the context of a presidential campaign, the result being that both cyclical forces contributed to make possible the stabilization program which began in 1965.

The 'presidential cycle' was not a merely limiting force from the point of view of inflation. It was a force working in favour of price stability although one which was neither strong enough nor lasting enough to achieve it.

Governments tried to make the most of their initial strength and they increased the level of taxation and expenditure very considerably at the beginning of their terms in office (President Ibañez being the exception). One of the main factors which contributed to the widespread feeling of hope which surrounded a new Government was the fact that it was frequently a new political force which won a presidential election for the first time and had promised to implement a number of new programs. However, such a new Government needed to provide Public Sector jobs to

a considerable number of its supporters while the parties which had previously controlled the Presidency resisted any attempts at dismissing their own supporters, using their congressional power. Moreover, new Governments were anxious to implement the economic and social programs which they had promised and this was also a source of considerable pressure on the expenditure side. Hence, despite their ability to achieve very considerable increases in the tax revenue at the beginning of their terms in office, Governments made very limited progress in the areas of solving their considerable fiscal difficulties.

Although the 'presidential cycle' provided a crucial anti-inflationary mechanism, its very nature limited its effectiveness. The initial increase in support enjoyed by the President was very volatile and sooner or later the basic weakness of the Government which was to a large extent a result of the characteristics of the Chilean political system became more and more evident. Governments lost support not only when their anti-inflationary policies imposed sacrifices on a considerable proportion of the population but even when they managed to reduce inflation at the same time that they increased the rate of economic growth and implemented redistributional policies in favour of the overwhelming majority of the population. Initial expectations were too high to be fulfilled and the very competitive character of the political system contributed very much to stir up frustration. Disenchantment replaced hope sooner or later and the anti-inflationary effort could not be sustained, corrected or renewed until a new Government took office possibly two or three years after the collapse of the previous stabilization. In the meantime, inflation increased again.

None of the three attempts at stabilization of the period between 1955 and 1970 were launched due to the IMF stepping in as a result of

a Balance of Payments crisis. No doubt the IMF had considerable influence because of being the key to foreign exchange resources which were needed to implement foreign exchange reforms, to liberalize the foreign trade regime and to supplement domestic savings. In fact, the very severe Balance of Payments crisis of 1961-1962 did not increase the ability of the IMF to promote its anti-inflationary policies in Chile. Instead of stabilization the crisis led to a sharp inflationary acceleration. Although the forces which made the stabilizations possible were domestic, foreign support was a very important factor in the three stabilization attempts because the prospect of an increased inflow of foreign capital was a powerful argument particularly in the case of the business sector. With the Alliance for Progress, structuralists were also able to benefit from this factor.

Another consequence of the above mentioned explanation of the cyclical pattern of the Chilean inflation is that Governments were not in a position to operate Nordhaus' electoral cycle in Chile, particularly in the case of presidential elections. By the time of the next presidential election, the Government was either unable to promote economic expansion without causing an immediate increase in the rate of inflation (because inflation was already increasing) or the political link between the Government and any of the presidential candidates was too tenuous (because a major realignment of political forces had taken place). Due to Chile's electoral calendar, the 'electoral cycle' could not be orchestrated in the case of most parliamentary elections either, because they were either too early (there was not enough time to do it) or too late (inflation was already increasing) in the 'presidential cycle'. In any case, economic expansion without increasing inflation did not necessarily lead to an increase in electoral support, the best example being the inability of

the Christian Democratic Government to prevent a fall in its electoral support in 1965-1966. The cyclical pattern of the Chilean inflation was not the result of Government manipulation of the economy for electoral purposes.

The 'presidential cycle' reflected the relative weakness, though also the relative strength and potential, of the main mechanism of centralization of power which the Chilean democratic political system had, namely the Presidency of the Republic. Attempts at strengthening the powers of the Presidency during the three Governments analysed in this thesis succeeded only towards the end of the period when the prospect of winning the next presidential election and the effects of the Christian Democratic experience convinced the right-wing opposition of the need to have a stronger Presidency. Ironically, but understandably, the left did not support the Constitutional amendment. Ironically, because they were the ones which won the next election. Understandably, because the Chilean left was more interested in preserving its parliamentary and extra-parliamentary powers of opposition than in creating the conditions which would enable it to become a strong Government. In this it was no different from the other political sectors of Chile's fragmented political system. The difference was that the others were more confident of winning the next presidential elections.

What then is the relationship between the kind of explanation offered in this thesis and the economic analysis of inflation?

Economists confronted with the sort of socio-political analysis which is offered in this thesis usually respond by incorporating them as additional factors. However, the analysis offered in this thesis shows that socio-political factors cannot be grafted in. To some extent a socio-political explanation competes with the economic ones. This can be illustrated in the case of crucial inflationary factors.

For example, in the case of the character and role of the wage-push it is clear that both the structuralist - 'Kaldorian' - version (which stressed its 'propagating' character) and the other economic versions, which were all looking for a permanent or sustained wage-push, failed to capture the very essence of this phenomenon in Chile, namely the fact that the unions were structurally or institutionally weak but managed to overcome their weakness when there were favourable political conditions. As a result of this, they were neither permanently strong nor permanently weak. Not surprisingly, almost every econometric test of the wage-push was relatively inconclusive.

A similar example is provided by the analysis of the role of expectations in the inflationary process, a very crucial factor in the monetarist approach and in the economic analysis of inflation in general. In fact, this is perhaps an even better example than the one provided by the wage-push because the conflict between the high degree of formalization and rigour of economic analysis and the need to take into account the kind of factors stressed in this thesis is by far clearer. There can be little doubt that the mathematical models which tried to explain and forecast expectations on the basis of past experience failed to deal with the effect of major political events such as a change of Government or a realignment of political forces.

This is not to say that a socio-political analysis along the lines of the one provided by this thesis offers fully adequate answers to all the questions raised by the need to explain inflation. Socio-political analysis does not dispense with economic analysis. Both are needed, and the relative importance of the contribution of each of them depends on the nature of the question being asked.

The issue addressed in this thesis was the causes and limits of the inflationary process in Chile from 1955 to 1970, i.e., an historically

and geographically bound case study. The socio-political perspective is of the greatest value when addressing such historically and geographically bound case studies, whereas more abstract economic analysis is more appropriate for thinking about regularities of the inflationary process which do not depend on particular institutional and historical circumstances.

Table A.1 : Annual rates of increase in the Price Indexes, 1952-1970, (%)

Year	Retail Price Index (RPI)				Wholesale price Index (WPI)				General Price Index (GPI)		
	Official		Corrected		Official		Corrected		GPI 1		GPI 2
	A	B	A	B	A	B	A	B	A	B	B
1952	12.1	22.2	21.2	21.7	20.9	24.0	23.7	24.4	22.9	23.5	24.9
1953	56.1	25.3	49.8	26.0	35.4	23.0	34.6	23.3	39.7	24.2	26.3
1954	71.1	72.2	58.7	59.1	65.3	56.9	66.6	55.9	64.0	57.0	57.9
1955	83.8	75.1	88.7	76.3	82.8	76.3	85.2	78.9	86.4	78.0	78.3
1956	37.7	56.1	44.6	64.7	45.9	63.1	46.1	64.8	45.6	64.8	61.0
1957	17.3	26.8	23.7	29.3	34.4	43.2	32.1	38.8	29.3	35.6	31.0
1958	32.5	25.9	24.6	25.2	25.3	25.5	28.2	26.7	27.0	26.2	25.7
1959	33.3	38.6	33.1	39.0	25.2	30.0	27.9	33.4	29.6	35.3	38.8
1960	5.4	11.6	5.4	11.4	1.6	5.3	1.3	4.9	2.7	7.1	8.7
1961	9.7	7.7	9.4	7.3	1.6	0.8	1.6	0.9	4.2	3.0	3.3
1962	27.7	13.9	28.6	13.9	26.8	8.3	29.4	8.5	29.1	10.3	11.4
1963	45.4	44.3	45.9	46.5	45.4	53.7	40.1	49.0	42.0	48.2	47.2
1964	38.4	46.0	40.4	47.2	43.7	50.6	45.4	50.4	43.7	49.3	50.3
1965	25.9	28.8	27.3	29.8	24.5	24.4	29.2	29.0	28.6	29.3	30.3
1966	17.0	22.9	17.9	23.7	19.7	22.9	20.9	24.8	19.9	24.4	26.1
1967	21.9	18.1	22.8	19.4	19.8	19.3	21.4	20.7	21.9	20.3	20.6
1968	27.9	26.6	29.1	27.7	33.1	30.5	34.1	30.4	32.4	29.5	28.7
1969	29.3	30.6	30.6	31.9	39.4	36.5	39.4	36.5	36.5	35.0	34.5
1970	34.9	32.5	36.2	34.1	33.7	36.1	33.7	36.1	34.5	35.4	35.6

A : Annual rate of increase (Dec.-Dec.). B : Average annual rate of increase.

Source: RPI, WPI and GPI 1 from Ricardo Ffrench-Davis, Políticas Económicas en Chile 1952-1970 (Santiago, Ed. Nueva Universidad, 1973), Tables 29,30,32 and 33, pp. 242-8. The General Price Index (GPI 1) combines the corrected RPI (1/3) and WPI (2/3).
GPI 2 : Calculated by the author combining the national component of the WPI and the RPI (weights : 0.60 and 0.40 respectively).

Table A.2 : Official Retail Price Index (RPI)[1], monthly (M) and twelve months (TM) rates of increase, 1952-1970, (%)

		Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
1952	M	1.1	1.1	1.1	4.2	7.1	0.9	2.8	0.9	3.6	3.5	-0.8	-3.4
	TM	14.8	14.6	15.9	19.3	24.7	25.9	26.4	22.0	25.0	21.4	20.4	23.9
1953	M	6.1	-0.8	-2.5	0.0	0.0	2.6	9.2	5.3	6.5	4.8	7.8	1.8
	TM	30.1	27.7	23.2	18.2	10.4	12.1	19.1	24.3	27.8	29.4	40.7	48.2
1954	M	2.4	-3.5	4.2	8.0	4.8	4.1	3.4	5.7	2.7	4.8	6.6	2.7
	TM	42.0	39.2	48.7	60.7	68.4	70.8	61.8	62.3	56.5	56.5	54.8	56.2
1955	M	0.8	2.6	8.1	11.9	4.9	4.7	3.1	4.6	7.7	6.5	8.1	4.0
	TM	53.8	63.5	69.5	74.5	74.6	75.6	75.0	73.2	81.7	84.6	87.2	89.4
1956	M	9.2	0.9	0.2	1.6	2.3	3.3	1.7	4.3	4.6	2.7	8.7	-1.1
	TM	105.3	101.8	87.1	71.0	66.9	64.7	62.5	62.1	57.4	51.9	52.8	45.4
1957	M	-0.7	-1.4	0.9	2.3	2.8	3.3	6.6	5.8	0.1	-0.5	0.1	3.8
	TM	31.0	27.9	28.8	29.6	30.1	30.2	36.5	38.5	32.5	28.4	18.2	24.1
1958	M	-3.3	3.3	2.8	2.8	2.8	1.3	1.1	2.5	2.3	2.3	2.6	1.6
	TM	21.9	27.7	30.2	30.9	31.0	28.4	21.8	18.0	20.6	23.9	26.8	24.3
1959	M	3.2	4.5	4.7	3.7	3.3	2.2	4.2	2.2	1.4	2.5	-2.1	-0.6
	TM	32.7	34.2	36.7	37.8	38.7	39.9	44.1	43.6	42.4	42.8	36.3	33.3
1960	M	1.3	0.1	0.5	-0.9	0.3	-0.1	2.3	1.5	1.1	0.2	-0.1	-0.9
	TM	30.9	25.4	20.4	15.1	11.8	9.2	7.3	6.5	6.1	3.7	5.8	5.4
1961	M	1.8	0.4	0.7	0.6	0.7	0.4	1.2	1.1	1.3	0.9	-0.1	0.2
	TM	5.9	6.2	6.4	7.9	8.2	8.8	7.6	7.3	7.5	8.3	8.4	9.7

(cont'd on next page).....

Table A.2 (cont'd).....

		Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
1962	M	1.7	0.9	0.6	0.2	0.9	1.4	0.9	1.4	2.7	6.4	6.3	1.6
	TM	9.5	10.0	9.9	9.5	9.8	10.9	10.6	10.8	12.4	18.4	25.9	27.7
1963	M	3.2	5.8	3.0	2.5	3.6	1.6	2.5	2.8	4.5	1.4	4.1	3.0
	TM	29.6	36.0	39.2	42.5	46.3	46.5	48.8	51.0	53.6	46.4	43.4	45.4
1964	M	1.4	9.8	4.7	2.8	1.0	2.2	2.3	2.5	2.5	3.4	-1.1	1.8
	TM	42.8	48.2	50.6	51.0	47.2	48.2	48.0	47.5	44.7	47.5	40.0	38.4
1965	M	1.3	2.1	3.6	6.9	1.8	0.1	0.6	2.2	0.9	1.9	1.7	0.4
	TM	38.2	28.5	27.2	32.2	33.2	30.4	28.2	27.8	25.9	24.1	27.5	25.9
1966	M	2.6	2.9	2.3	1.4	1.0	2.0	2.1	1.5	3.5	-0.3	-1.4	-1.7
	TM	27.5	28.5	26.9	20.4	19.5	21.7	23.6	22.8	25.9	23.2	19.5	17.0
1967	M	2.8	2.7	1.8	2.0	2.2	2.3	2.3	0.1	2.8	0.8	0.1	0.1
	TM	17.2	16.9	16.3	17.0	18.5	18.9	19.0	17.4	16.6	17.9	19.7	21.9
1968	M	5.7	2.7	1.5	2.5	2.3	3.0	2.8	1.2	1.2	1.4	1.3	-0.4
	TM	25.3	25.3	25.0	25.6	25.6	26.4	27.1	28.4	26.5	27.1	28.6	27.9
1969	M	4.9	5.4	3.1	3.1	2.6	2.3	1.2	1.6	0.5	0.4	0.8	0.3
	TM	27.0	30.4	32.4	33.2	33.6	32.8	30.7	31.2	30.2	28.9	28.4	29.3
1970	M	6.8	5.1	3.5	2.4	2.1	2.0	1.9	2.5	2.7	0.9	0.6	0.0
	TM	31.7	31.2	31.8	30.9	30.3	29.8	30.8	32.0	34.9	35.6	35.3	34.9

1. Official Retail Price Index recalculated on the basis of the 1957 weights, and corrected in the case of December 1957 as suggested by R. Ffrench-Davis, op. cit., p. 244.

Source: Central Bank of Chile, Monthly Bulletin.

Table A.3 : Real Wages and Salaries (purchasing power)[1], Indexes and Annual changes 1952-1970
(Indexes : 1960 = 100.0; changes : %).

	(1) MS		(2) MIW		(3) MAW		(4) WSI		(5) PSWS		(6) PSW	
1952	154.8	-	-	-	-	-	-	-	117.4	-	106.5	-
1953	152.8	-1.3	-	-	-	-	-	-	128.4	9.3	116.9	9.7
1954	147.4	-3.5	-	-	107.5	-	-	-	105.5	-17.8	104.5	-10.6
1955	132.7	-10.0	-	-	91.4	-15.0	-	-	98.5	-6.6	103.4	-1.0
1956	117.4	-11.5	113.8	-	82.4	-9.8	-	-	96.8	-1.8	97.8	-5.5
1957	118.3	0.7	114.6	0.7	85.8	4.1	-	-	103.4	6.8	102.1	4.4
1958	113.3	-4.2	112.6	-1.7	84.8	-1.2	-	-	100.3	-3.0	104.4	2.3
1959	111.0	-1.7	111.4	-1.1	91.8	8.2	-	-	97.8	-2.4	102.4	-2.3
1960	100.0	-10.2	100.0	-10.2	100.0	9.0	100.0	-	100.0	2.2	100.0	-2.0
1961	116.0	16.0	119.5	19.5	110.6	10.6	107.6	7.6	106.7	6.7	115.1	15.1
1962	118.6	2.2	122.0	2.1	112.0	1.4	108.0	0.4	109.7	2.8	131.7	14.5
1963	100.2	-15.5	103.1	-15.5	100.4	-10.5	99.7	-7.7	104.9	-4.4	120.9	-8.2
1964	99.0	-1.2	101.8	-1.3	101.6	1.2	95.7	-4.0	110.5	5.4	117.3	-3.0
1965	105.5	6.6	108.5	6.6	123.2	21.3	108.6	13.5	122.0	10.4	135.5	15.5
1966	107.4	1.8	110.2	1.6	135.7	10.1	121.0	11.4	135.4	11.0	149.1	10.1
1967	105.3	-2.0	108.0	-2.0	140.1	3.3	138.1	14.4	143.0	5.6	173.1	16.0
1968	100.5	-4.5	103.1	-4.5	133.8	-4.5	137.6	-0.6	145.0	1.4	-	-
1969	97.5	-3.0	100.1	-3.0	129.8	-3.0	146.9	6.7	153.4	5.8	-	-
1970	94.0	-3.6	119.7	19.6	155.3	19.6	160.8	9.5	-	-	-	-

1. Calculated using the corrected Retail Price Index.

Sources: Minimum Salary (MS), Minimum Agricultural Wage (MAW), Minimum Industrial Wage (MIW), and Private Sector Wages and Salaries, calculated on the basis of data found in R. Ffrench-Davis, op. cit., Table 74, p. 344.
Official Wage and Salary Index (WSI), from Central Bank of Chile, Monthly Bulletin, Private Sector Wages (PSW) from Joseph Ramos, 1970, op. cit., Appendix I, Table 6, p. 104 and calculations by the author using average annual increases in the RPI for Sept.-Sept. periods, which are the ones corresponding to the series.

TABLE A.4: Legislation about Wage and Salary Readjustments, 1956-1970
(readjustments in terms of the 'increase in the RPI' (IRPI) in the periods indicated in each case)

Year	Promulgated in:	Effective from:	(A) Public Sector	(B) Private Sector
1956	Jan.1956	Jan.1956	0.44-0.50 IRPI 31 Dec.1954/ 15 Jan.1956	Minimum Salary as in (A), Wages: 0.50 IRPI at the end of each contract.
1957	Jan.1957	Feb.1957	0.66 IRPI 31 Dec.1955/31 Dec.1956, (less for those with other special benefits)	Minimum Salary and Wage 0.80 IRPI 31 Dec.1955/31 Dec.1956. Others at the end of contract.
1958	Feb.1958	Feb.1958	1.16 IRPI 31 Dec.1956/31 Dec.1957	Minimum Salary as in (A) Minimum Wage, 1.33 IPRI in the same period. Others as in (A).
1959	Apr.1959	Apr.1959	0.60-1.12 IRPI 31 Mar.1958/ 31 Mar.1959	Minimum Salary and Wage: 1.00 IRPI others 0.76-0.95 IRPI same period as in (A).
1960	Dec.1960	Jan.1960	0.83 IRPI 31 Mar.1959/31 Dec.1959, on average	No increase for the Minima, others as in (A).
1961	Oct.1961	Jul.1961	Equivalent to 0.17 of the Minimum Salary for everybody.	As in (A); Minimum Wage 1.17 IRPI 31 Dec.1959/30 Jun.1961.
1962	Dec.1962	Oct.1962	0.44 IRPI 31 Jun.1961/31 Dec.1962.	
	Jan.1963	Oct.1962		As in (A).
1963	Oct.1961	Jan.1963	1.00 IRPI in previous year.	As in (A), with upper limit.
1964	Oct.1961	Jan.1964		As in 1963.
	May 1964	Jan.1964	0.77 IRPI in previous year.	
1965	Apr.1965	Jan.1965	1.00 IRPI in previous year.	As in (A).
1966	Apr.1966	Jan.1966	1.00 IRPI in previous year, but only up to a limit.	As in (A).
1967	Jan.1967	Jan.1967	0.88-1.18 IRPI previous year.	Only the Minima as in 1966.
1968	May 1968	Jan.1968	0.91 IRPI in previous year.	1.00 IRPI in previous year.
1969	Jan.1969	Jan.1969	0.72-1.00 IRPI previous year.	1.00 IRPI in previous year.
1970	Dec.1969	Jan.1970	1.00 IRPI in previous year.	As in (A).

Sources: Monthly Bulletin, Central Bank of Chile and Ricardo Ffrench-Davis, 1973, op.cit., pp.200-19.

Table A.5

Monetary Expansion, 1953-1970, (%)

	Annual Increase (Dec.-Dec.)				Average Annual Increase	
	HPM	M1	M2	M3	M1 A	M B
1953	50.7	42.3	40.7	54.5	40.6	40.3
1954	38.9	43.5	38.6	43.3	44.6	44.5
1955	61.3	71.9	67.6	64.4	62.0	59.8
1956	41.8	40.3	43.1	44.0	48.4	50.7
1957	25.9	28.0	31.7	28.6	31.6	32.5
1958	34.4	34.4	35.7	32.2	25.8	25.2
1959	44.7	32.5	48.2	23.5	38.4	38.7
1960	46.3	30.6	34.8	46.8	25.6	25.6
1961	10.0	12.5	15.6	12.3	18.8	20.4
1962	74.3	29.0	35.5	40.4	22.0	20.5
1963	7.8	34.1	29.7	32.0	39.5	39.2
1964	64.6	51.3	48.0	56.8	41.1	39.6
1965	40.8	65.1	52.0	49.9	58.6	57.5
1966	59.0	38.9	43.7	37.0	48.2	50.3
1967	42.0	25.1	27.5	22.3	27.8	28.9
1968	37.8	38.3	37.7	44.6	30.3	29.1
1969	46.4	35.2	37.0	38.6	41.7	42.1
1970	57.0	66.2	49.3	57.9	52.5	49.9

HPM : High Powered Money.
M1 : Currency held by the public plus demand deposits (excluding Public Sector ones) (Dinero privado).
M2 : M1 plus quasimoney.
M3 : M1 plus Public Sector demand deposits, (Dinero Total).
M1 A: Average twelve month increases in a calendar year.
M2 B: Average twelve month increases in Nov.-Nov. periods.

Sources: HPM : Roberto Zahler et al, Estadísticas Monetarias de Chile 1940-1975, (Santiago, Departamento de Economía, Univ. de Chile, 1979) Table 2 pp. 81-8.
M1 and M2 : Juan C. Méndez, 1979, op. cit., Table III. 1, pp. 360-1.
M3 Calculations based on data from Roberto Zahler et al, op. cit., Table 1, pp. 63-80 (His M1 series has a discrepancy with those of the Central Bank and other works in the period 1959-1963).
M1 A and B : Ricardo Ffrench-Davis, 1973, op. cit., Tables 62 and 63, pp. 319-20.

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