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# **FROM FINANCIERISTIC TO REAL MACROECONOMICS: THE CASE OF CHILE IN THE 1990s**

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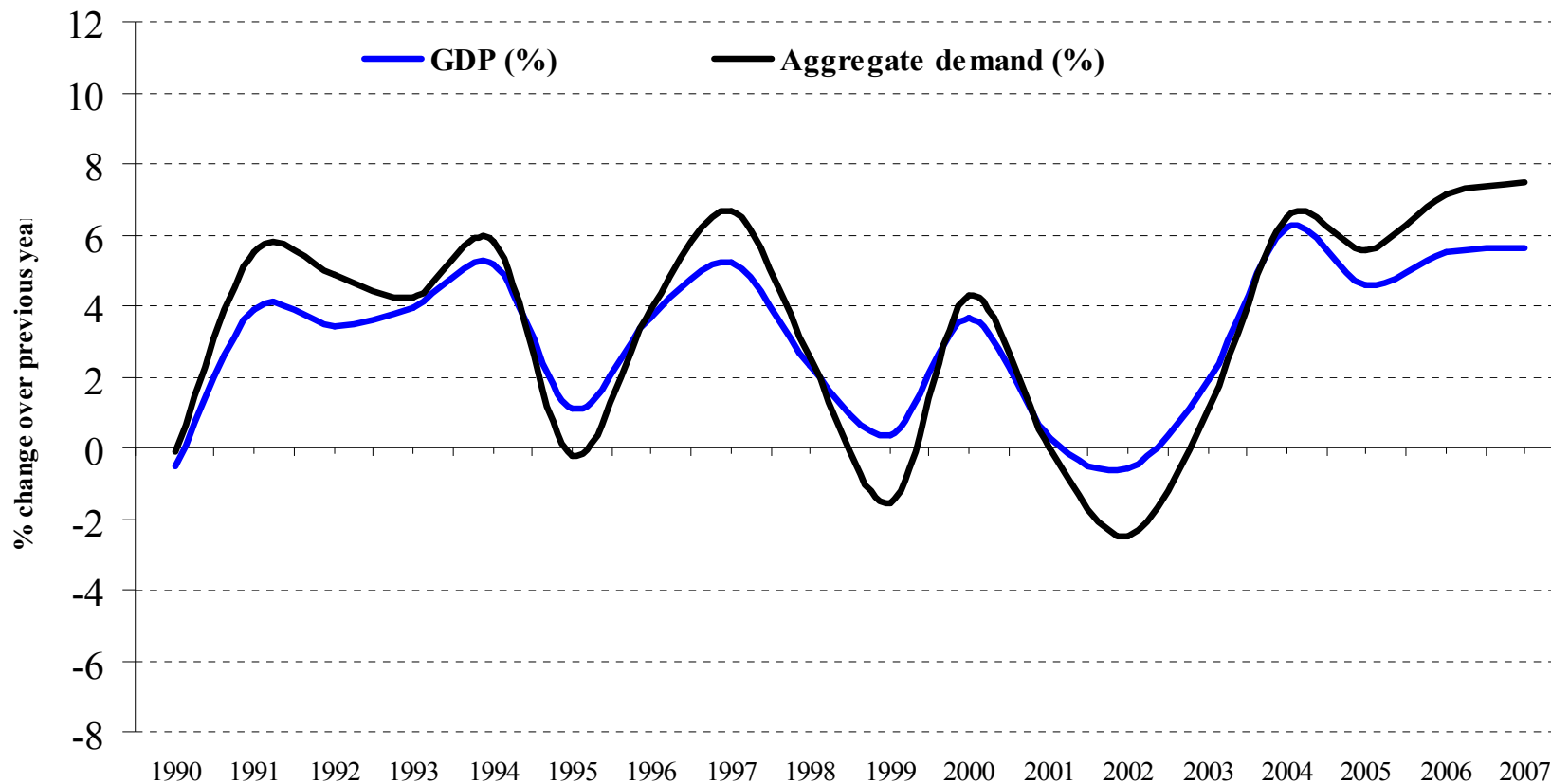
# **TWO-PILLAR MACROECONOMICS WITH REAL INSTABILITY**

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- Conventional “Washington Consensus” or Neo-Liberal wisdom states that macroeconomic balances are achieved with inflation under control and fiscal budget balances, in a framework of full capital account liberalization.
- However, LACs have achieved low inflation and improved fiscal balances, but high GDP instability.

# GDP in a Roller-Coaster. Demand-Led changes in GDP. (90-09)

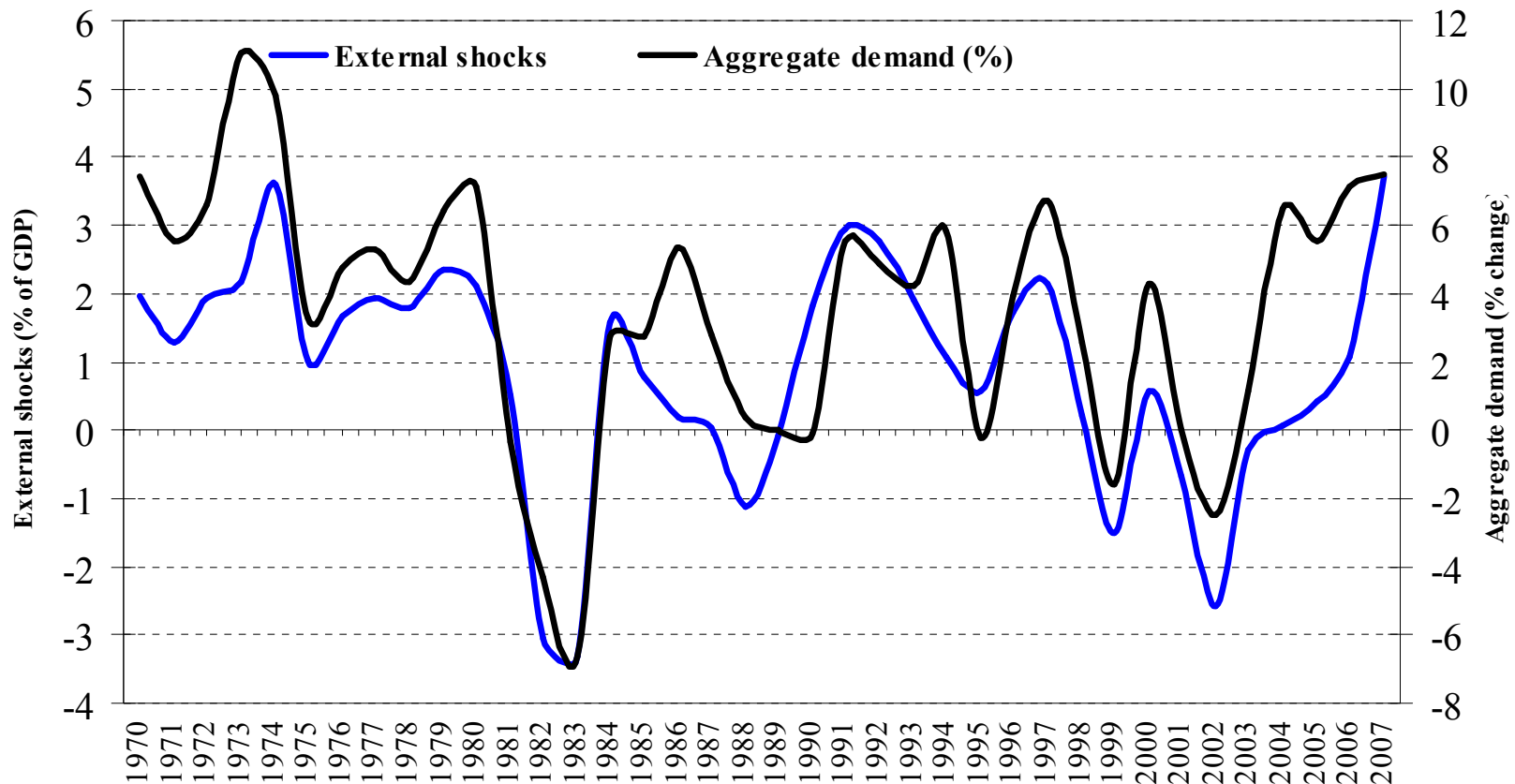
Latin America (19): Growth of GDP and aggregate demand, 1970-2007  
(% change over previous year)



Source: ECLAC data. Includes 19 countries.

Cyclically volatile financial flows and terms of trade have led fluctuations in aggregate demand and on GDP. In fact, producers of GDP (Labor&Capital) have faced a roller-coaster.

Latin America (19): Aggregate demand and external shocks, 1970-2007  
 (% change over previous year; % of GDP)



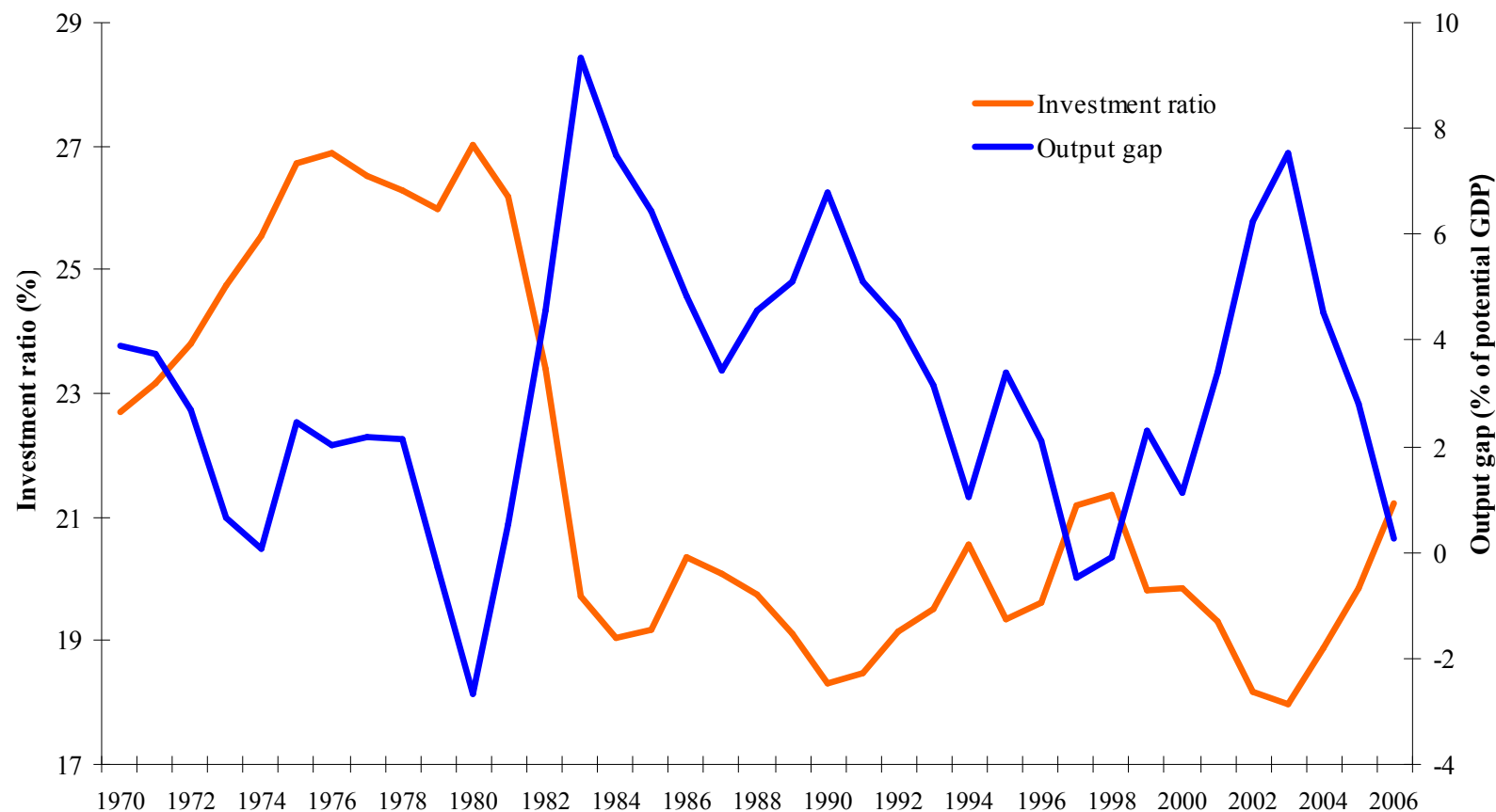
Source: ECLAC data. Includes 19 countries.

EXT: external shocks, represents additional resources from abroad, resulting from net transfers (capital inflows plus factor payments) and the improvement of the terms of trade. Measured as a share of GDP.

However, high real instability generates underutilization of potential GDP, what reduces actual TFP, worsens labor markets, and is a significant explanation of reduced productive investment ratio.

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Latin America (9): output gap and investment ratio, 1970-2006  
(prices of 1995)

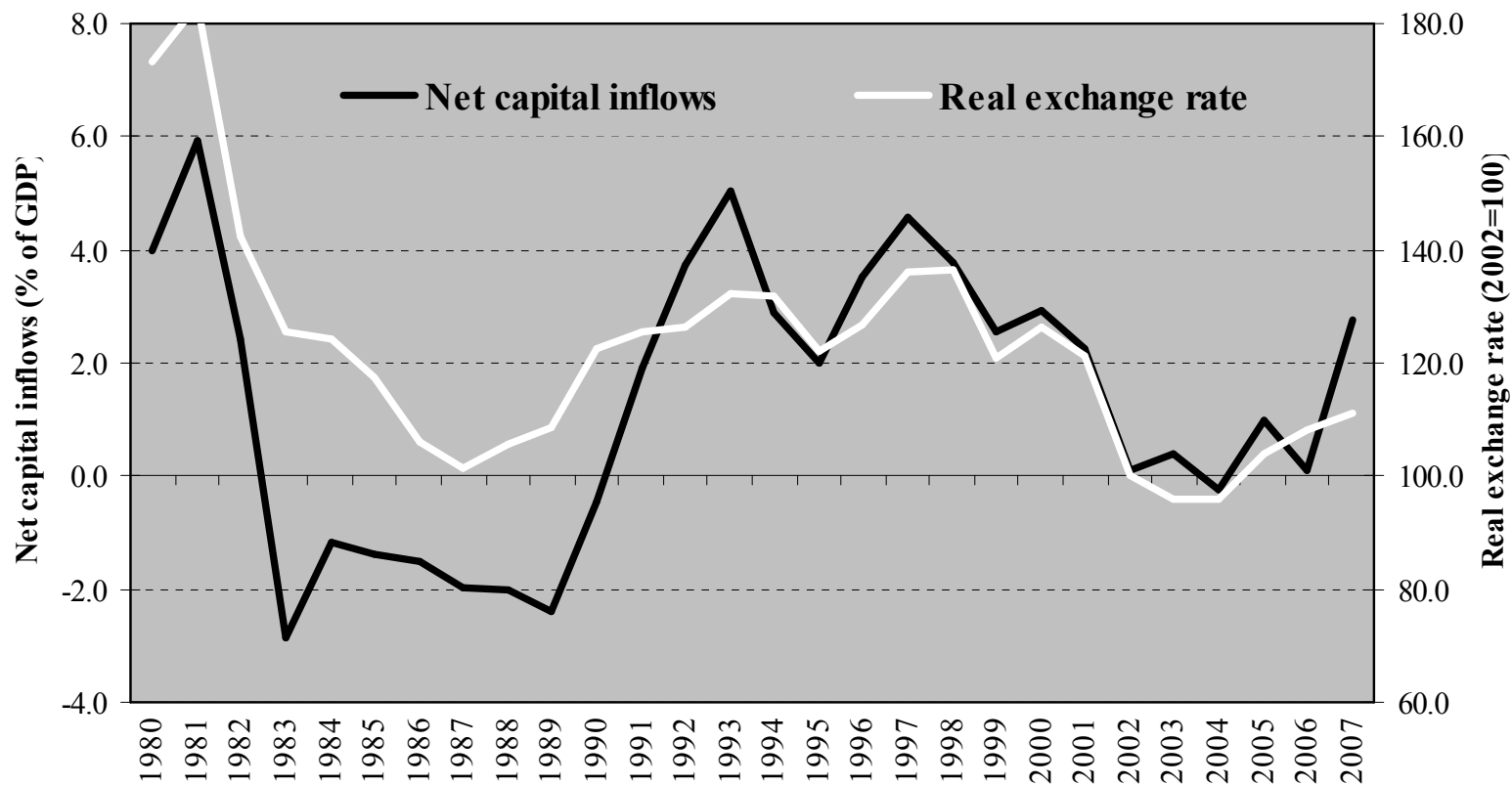


Source: ECLAC and updates of figures in Hofman and Tapia (2004).

Averages for Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru and Venezuela. The investment ratio measures the ratio between the fixed capital formation and the GDP. The output gap measures the difference between potential and actual GDP as a share of potential GDP.

Capital flows have determined RER behavior in Latin America. RER medium-term instability has tended to weaken value-added in exports and its links with the rest of the domestic economy.

**Latin America (19): Net capital inflows and real exchange rate, 1980-2007**  
(% of GDP; indice 2002=100)



Source: Author's calculations based on ECLAC figures. Real exchange rate defined in terms of dollars per unit of local currency.

# CAPITAL FLOWS HAVE EXPANDED SHARPLY

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➤ Dominant feature of globalization

➤ Volatility: Medium-term cycles.

Boom in 1990-94

Bust in 1995

Boom in 1995-97

Bust in 1998-99

Boom in 2000

Bust in 2001-2003

Some boom in 2004-2007, with Terms of Trade shock

▶ Main feature of Latin America's macroeconomic situation in the last 25 years.

# MEDIUM-TERM CYCLES OF CAPITAL FLOWS

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- Weak link with GKF.
- Even FDI, because of a surge in M&A, rather than of greenfield investment.
- Volatile capital inflows have generated macro instability, discouraging GKF of domestic agents.

# Financial Liberalization in LA Lead to Regressive “Financierism”

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- Boom in financial savings without an increase in domestic savings (crowding-out).
- Cause: Financial markets dominated by short-termists.
- Consequence: Large output gaps between actual and potential GDP.
- Pro-cyclical reaction of macroeconomic policies, worsens employment and SMEs.

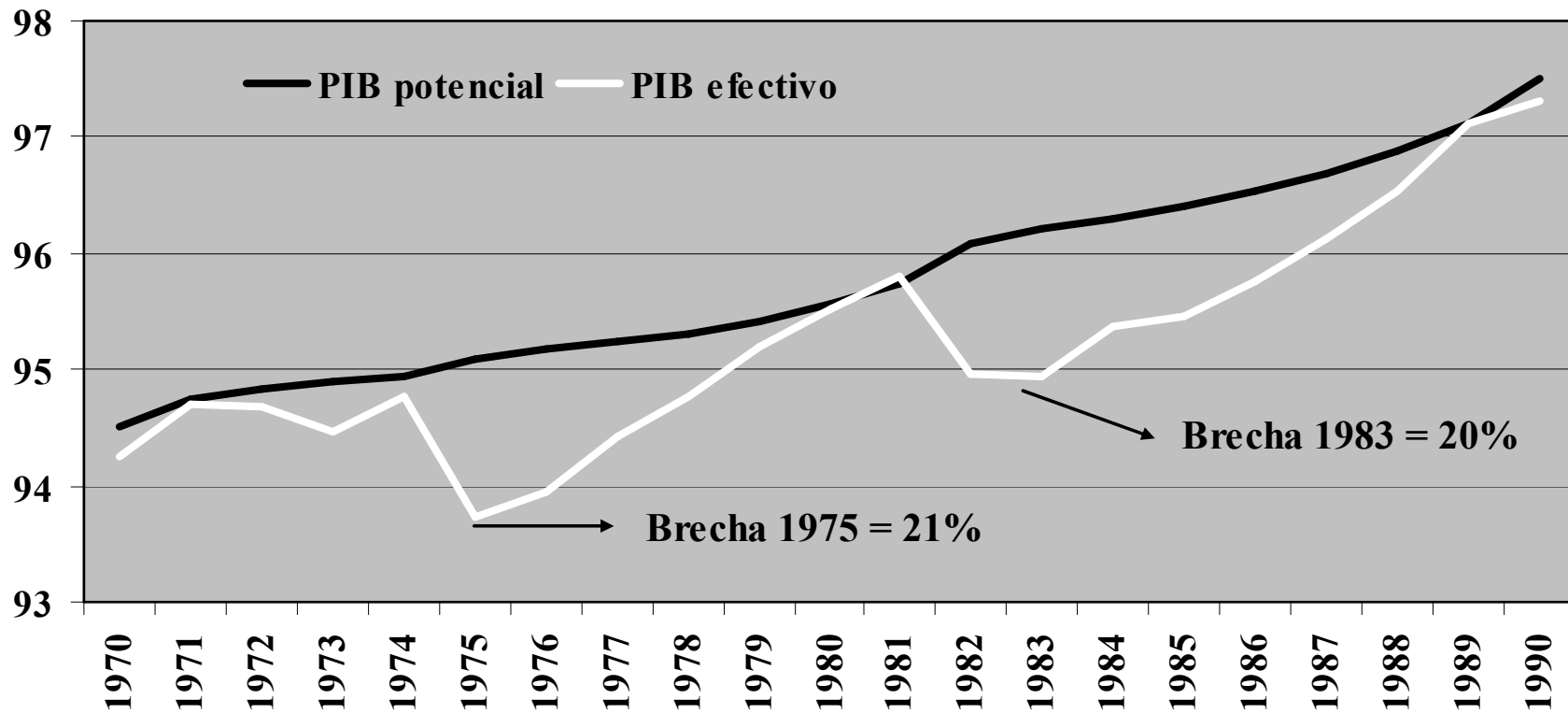
# Toward Real Macroeconomic Balances: 3 PILLARS

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- Two pillars: Low Inflation and Fiscal Balance.
- Third pillar: Aggregate Demand Management, consistent with Potential GDP.
- Requires well-Aligned Macroprices (Exchange Rate, Interest Rate).
- Requires Counter-cyclical Regulation of Financial Flows.

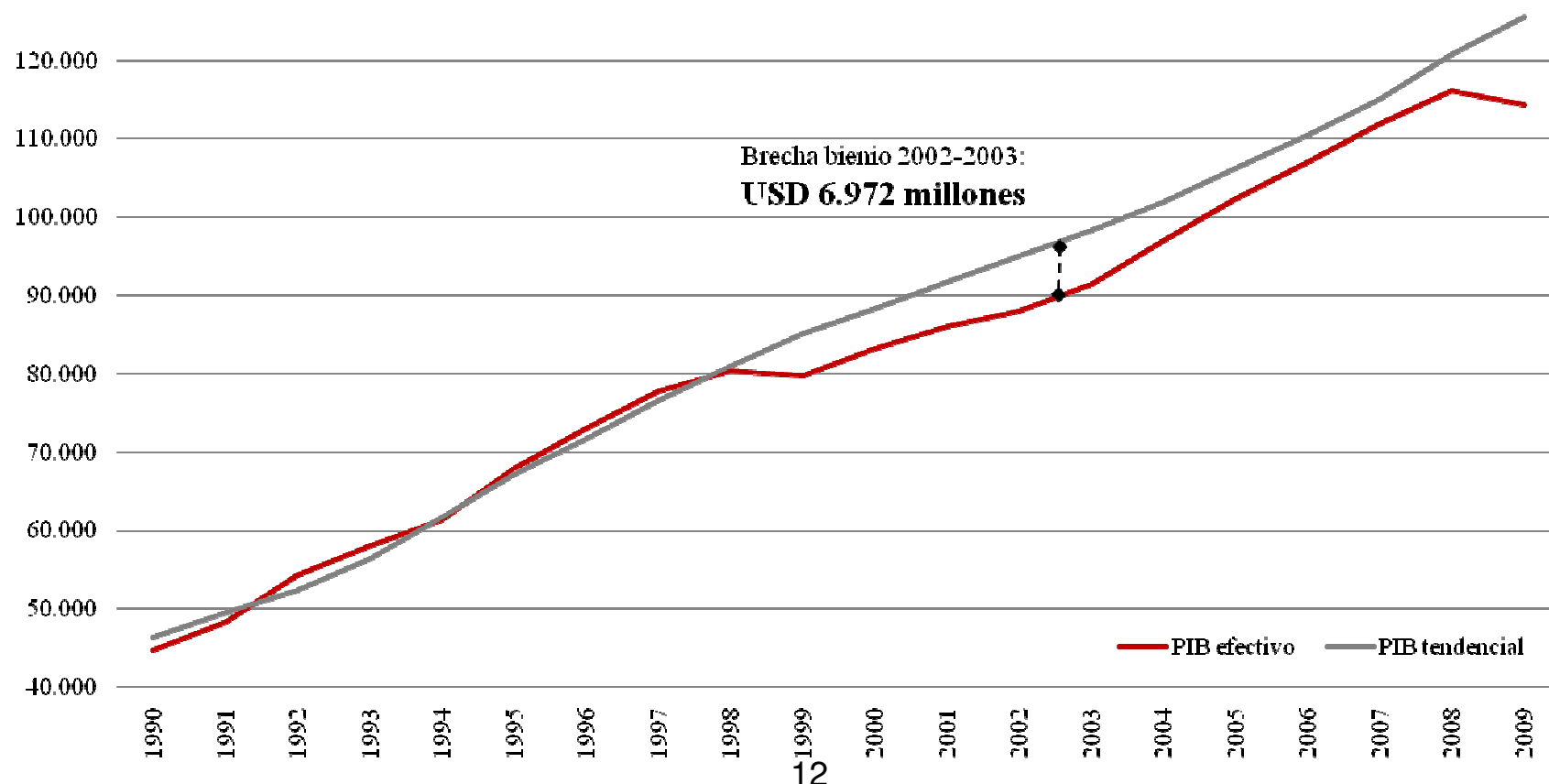
# Chile: Sharp disequilibria of the real economy in 1974-89

**PIB efectivo y potencial, 1970-90**  
(escala logarítmica, 1996=100)



# Progress in macroeconomic policies in early 1990, weakening since 1996, and adoption of approach in fashion of capital account opening and free ER since late 1990s

**PIB efectivo y PIB potencial, 1990-2009**  
(Millones de USD2009)



Fuente: Basado en Ffrench-Davis, Ricardo (2008), *Chile Entre el Neoliberalismo y el Crecimiento con Equidad*, actualizado en base a datos de Banco Central de Chile

Real macroeconomic instability has focused in the domestic economy: that is in GDP non-exported. It is area more intensive in SMEs and employment.

## Exportaciones y Crecimiento Económico

Tasas de crecimiento, promedios anuales (porcentaje)

	PIB	Exportaciones <sup>a</sup>	PIB no exportado
1961-70	4.4	3.6	4.5
1971-73	1.2	-4.1	1.7
1974-81	3.0	13.6	1.5
1982-89	2.9	7.8	1.7
1990-98	7.1	9.9	6.4
1999-2003	2.6	5.5	1.7
2004-07	5.3	7.7	4.3
1974-89	2.9	10.7	1.6
1990-2007	5.4	8.2	4.6

**Fuente:** Basado en cifras oficiales del Banco Central de Chile y Marcel y Meller (1986). Se trabajó con series reales a precios constantes de 2003. Las exportaciones incluyen bienes y servicios. <sup>a</sup> Las diferencias con respecto al cuadro VII.1 se explican por fuentes y metodologías distintas. <sup>b</sup> El PIB no exportado es igual al PIB menos el valor agregado interno (en Chile) de las exportaciones. Los insumos importados contenidos en las exportaciones se estimaron mediante la participación porcentual en el PIB de las internaciones de bienes intermedios y de capital en cada año.

# Nonetheless, progress in fiscal policy, toward structural balance. Initially, progressing from pro-cyclical to a neutral approach, and in 2009 to a counter-cyclical approach

1. Gran progreso es la adopción del concepto de balance estructural. Permite hacer política fiscal contra-cíclica, lo que es imprescindible para lograr equilibrios macroeconómicos reales.
2. EL objetivo central es usar efectivamente L y K disponibles. Ello se logró con eficiencia en 1990-97. En 1999-2003 hay una subutilización sustancial de la capacidad productiva. Ésta es sentida con fuerza creciente por el sector privado, en particular la PYME. Esta subutilización es un desequilibrio macroeconómico real.
3. El Balance Estructural se debe medir en función de un nivel de producto potencial (en vez del tendencial) y con un precio del cobre de largo plazo.