

Chile's 'New Socialist' Bids for the Presidency

By Sebastian Edwards

The Wall Street Journal, Friday 4, June

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Chile's ruling coalition, Concertacion, held an open primary Sunday to choose its candidate for the December 1999 presidential elections. As expected, the winner was Ricardo Lagos, a former cabinet member in the government of Eduardo Frei and a socialist. What was surprising, however, was the wide margin by which he was elected: He won almost a million votes, twice as many as his rival, Senator Andres Zaldivar, from the once powerful Christian Democratic Party.

Mr. Lagos is now the front-runner for the December presidential elections, where he is likely to face the conservative mayor of Las Condes, Joaquin Lavín, and Congresswoman Gladys Marin, a former Communist.

Young voters seem to be particularly attracted to Mr. Lagos' progressive views on social issues. And his speeches on democratic values in the late 1980s endeared him to opponents of the former military regime that, led by General Augusto Pinochet, ruled the country from 1973 through 1990.

Domestic and international investors, however, have shown some concern about the possible effects of a Lagos administration on the Chilean economy. Two main issues seem to be in their minds: First, many

remember that Mr. Lagos supported the socialist administration of President Salvador Allende in the 1970s. During that period the banking sector was nationalized and government controls became pervasive, choking the economy, creating generalized chaos and runaway inflation. Second, Chile is currently facing a deep recession -- gross domestic product declined by 2.3% during the first quarter of this year, and unemployment is almost 9%. The Lagos camp does not seem to have a strategy for moving the country back into growth.

Mr. Lagos cannot deny his association with the Allende administration in the 1970s. At the time of the Pinochet coup in 1973 he was the ambassador-designate to Moscow. He has argued, however, that he has changed, has become a "renewed" and modern socialist and that he believes in the market system. His supporters have even tried to brand him as a local Tony Blair. He also displays his record as Minister of

Public Works in 1994-98 to show that he favors a deep involvement of the private sector in infrastructure investment and other key areas of the economy.

Stating his admiration for Tony Blair and the new socialist leaders in Europe is not likely to build investor confidence, however. In order to reassure the market, Mr. Lagos must openly embrace an economic program that ensures stability, and that would put the country back on the path of accelerating growth.

Supporting, in an unqualified manner, the independence of the central bank is an essential element of such a program. The Concertacion coalition candidate should go as far as committing himself to reestablishing a bipartisan balance in the Bank's Board of Governors. This balance, which is the key to maintaining central-bank credibility, was broken, for political reasons, by Mr. Frei in 1995.

Mr. Lagos has rightly argued that massive tax evasion has become a serious problem in Chile and he has vowed that his government would close loopholes and improve tax administration. Any plan for greater prosperity however, should include cutting average tax rates along with efforts to reduce tax evasion. The former would spur growth while the latter would increase fairness.

During the early months of the primary campaign Mr. Lagos' team intimated that he would support a broad privatization program that would include selling the copper giant Codelco. More recently, fearing that he would be labeled as a "neo-liberal," Mr. Lagos has backed off that suggestion. This is a mistake. Coldeco is inefficient and has been caught up in corruption scandals. Privatizing it would allow the country to take full advantage of its copper resources. Moreover, the funds generated by Codelco's privatization could be used to finance education projects, an area close to Mr. Lagos's heart.

The problem of job creation also needs attention. Building confidence in this area requires that Mr. Lagos openly acknowledge that, as the European experience has clearly shown, excessive labor regulation slows down employment growth. This may not be easy for him to do, since as minister of education in former President Aylwin's administration, he introduced labor legislation that gave special privileges to teachers' unions. But doing so will show that he has learned from the past. He should also commit himself to modernizing the privately managed social-security system. By allowing workers greater freedom to invest their retirement funds, and by increasing the coverage of the system -- currently standing at a low 62% -- the dual purpose of bolstering the

capital markets and improving social conditions would be achieved.

The trade front likewise needs courageous leadership. Senator Carlos Ominami, a member of Mr. Lagos' inner circle, has stated that exports'

should become, once again, the country's engine of growth. He has provided no details, however, on how a Lagos administration would pursue this objective. What is clear is that allowing trade agreements to dictate Chile's future would be a mistake.

Between 1975 and 1992 Chile successfully opened up to international competition at its own brisk pace, following an outward oriented development strategy. A further commitment to open trade -- by way of further unilateral tariff reductions -- will allow the country to capture new markets, expand exports, improve productivity and create jobs. This approach has two important policy implications. First, the country should not fall into the "trade-agreement trap," for example, by standing still while the U.S. debates fast-track. Second, it should be recognized that, with a mature, healthy and well-supervised banking system, there is no need for capital controls.

The future of the Chilean economy has implications that go beyond its borders. For years Chile has been the standard bearer of the Latin American market-oriented reform movement, and those reforms have been admired around the world. If domestic policies take a populist turn, international investors may indeed question the ability of the country to push the modernization agenda forward.

If, on the other hand, Mr. Lagos embraces a program that is pro-market as well as progressive on social issues, he will become a formidable candidate. He may, indeed, set a new precedent, that could influence Latin America's political landscape in the years to come.

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