



## Undoing Chile's Success

BY RICHARD W. RAHN

### NEW SOCIALIST POLICIES COULD IMPAIR SOUTH AMERICA'S STRONGEST ECONOMY

Why do very successful nations often adopt policies that lead to their undoing? After a revolution or major reform, some countries allow a high degree of economic freedom, establish the rule of law, protect private property rights and establish low tax rates with strict limits on government spending and regulation. The economy takes off, the citizens become far richer and then the government mucks it up, usually by attempting to redistribute income and expand state control.

Is Chile, which has been one of the bright spots in the world economy, falling into this pattern under socialist President Michelle Bachelet?

For the past three decades, Chile has outperformed the other South American countries and now has the highest per-capita income in South America, averaging approximately \$22,000 per year on a purchasing power parity basis. The World Bank lists Chile as a "developed economy," and it was the first Latin American country to become a member of the Organization for Economic Cooperation and Development. The average Chilean has a per capita income about three times higher than in 1983. Ian Vasquez, director of the Center for Global Liberty and Prosperity at the Cato Institute, recently noted that in Chile, "all welfare indicators have risen like no other part of Latin America.

Chile is not only a star in Latin America, but has been a star in terms of development around the world."

Chile began its march to success after the overthrow of Marxist Salvador Allende in 1973 by Gen. Augusto Pinochet. Allende nationalized many companies, including the copper industry. Inflation reached 140 percent, and the economy was sinking. Pinochet had little understanding of economics when he seized power, and after flailing about, he hired a group of free market economists collectively known as the "Chicago Boys."

The Chicago Boys began to free up the economy by removing many of the tax, regulatory, trade and other impediments to growth imposed by the socialists. According to the Annual Index of Economic Freedom in 1970, Chile had the least-free economy among those rated. By the early 1980s, Chile moved into the top half of the ranking, and by 2008 it was ranked as the fifth-freest economy in the world. Its ranking has slipped modestly in the past several years. In 2012, the latest year available, it was ranked as No. 10. Chile has been politically and economically stable, with governments swinging back and forth from moderate right to moderate left since the full restoration of democracy in 1990.

A unique and key component of Chile's reform was the creation of the world's first national privatized pension (social security) system in 1981. It was the brainchild of a brilliant young economist, Jose Pinera, who was serving as minister of labor and pensions at the time. Mr. Pinera recognized a fatal flaw in the pay-as-you-go system of Chile and most other countries, including the United States. For example, there was little link between what individuals put into the pension program and what they took out. In contrast, Mr. Pinera's plan linked benefits to contributions. The money that a worker pays into the system goes into an account that is owned by the worker, like a 401(k) plan. Because of its success, approximately 30 countries, including Sweden, have adopted variations of the Chilean pension model.

In addition to creating a fiscally sound national retirement program, Chile has restrained the growth of government, keeping it to about 23 percent of gross domestic product.

According to a number of studies, once government exceeds 25 percent of GDP, economic growth, job creation and the rate of improvement in the general welfare begin to decline. Unlike most European countries, Japan and the United States, Chile still has a low debt-to-GDP ratio. It has a low average tariff rate of 4 percent and a partial free trade agreement with the U.S. Chile welcomes foreign investment, has strong protections for private property and has a competent and independent judiciary.

Despite these successes, Ms. Bachelet is advocating an additional public pension system to bring "more competition" to the private investment firms that handle the pensions. At the same time, she is pushing "educational reform" measures, which would reduce competition in Chile's excellent education system. Finally, she has pushed through a large corporate tax increase, which can only reduce Chile's economic competitiveness. These changes will hurt economic growth.

Thomas Jefferson wrote that there is a tendency of governments to grow "at the expense of liberties of the people." There is a field of economics called "public choice," which explains how government bureaucrats operate in their own interests rather than the people's interests. Professor Mark Zupan of the University of Rochester argues that the growth of governments is partly a result of "self-capture" by political insiders, including government employees and interest groups. What is happening in Chile is neither surprising nor new. It is hoped that the forces and institutions of liberty and limited government will be sufficiently strong in Chile to prevent it from becoming another rich country gone bad, like Venezuela and Argentina.

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<http://www.washingtontimes.com/news/2014/dec/15/richard-rahn-michelle-bachelet-socialist-economy-r/>