THE NOTION OF THE STATE IN CHILE: SIX TOPICS *

Mario Góngora was an intellectual giant. His writings were pearls providing new and different insights each time they were read. His knowledge of Chilean history was probably almost unmatched.

While working on volume 6 of the *Historical Statistics of Chile: Government Services and Public Sector*, I read and reread Góngora's classic *Ensayo histórico sobre la noción de Estado en Chile en los siglos XIX y XX* (Santiago Chile: Ediciones La Ciudad, 1981). The six topics that follow, while written on the basis of and while collecting historical statistics of the Chilean state, were largely stimulated by Góngora's book. I had hoped to receive his comments. Instead, they are published as tribute to him and his enduring capacity to provide intellectual stimulus.

Topic 1. Aversion to Pay Taxes, In Particular Direct Ones

It cannot be claimed that Chileans have not been capable or willing to pay taxes. Capable to pay the have always been. Willing to pay they have been less so.

Indeed, Chile has been plagued ever since Independence by an aversion of its citizens to pay any taxes, but especially direct ones. The question is why? A major reason for this dislike and unwillingness to pay direct taxes is the perception, which is more than frequently born out by the facts, that what the taxpayer receives in return for his contribution is of little or no value. Stated differently, in the *quid pro quo* relationship between government services and taxes, the quantity and quality of government services delivered (*quid*) suffers from a gross imbalance in comparison to the taxes (*quo*) paid, with the taxpayer ending up as a loser.

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In order to further understand the nature and consequences of this imbalance, the following points are important. First, even though the Chilean taxpayer believes that certain public administration (legislative, judiciary, executive) and defense services must be provided, he is not always convinced that the quality of such services measures up to their cost. If public services cost five money units but similar ones are provided by the private sector for one money unit, the cost is considered excessive and a reluctance to pay taxes is stimulated.

From a slightly different perspective, if the taxpayer has an annual income of one unit of money but government employees earn ten units of money, the cost is again excessive in the sense that the income loss suffered by the taxpayer greatly exceeds the benefits gained from the provision of government services. In other words, when government manipulates its revenue-expenditure basket in a manner that either generates or aggravates plural labor markets and income (wage and salary) inequalities within the population, the willingness of low-income taxpayers to support the privileged caste of well-heeled government employees, including the military, may be stifled.

Second, taxpayers, and I mean here in particular the wealthy and well-to-do ones, are willing to provide the resources needed for health, education and welfare programs for the truly needy, including the old, sick, widows and orphans, but balk at tax payment when such services are provided to middle and upper-class income groups who have the capacity to pay and do not need to receive them either free or subsidized.

Third, a reluctance to pay taxes arises and, indeed, can be considered legitimate when they are used to provide non-public administration and defense goods and services below cost to privileged classes. There exists no economic or social justification for taxing the poor to provide the rich with free electricity, or tax on one group of high income households in order to provide another group of high income households with free health or education services.

Topic 2. Government Services Vicious Circles

The aforementioned circumstances are likely to give rise to at least three government services vicious circles. The first vicious circle arises when low quality government services stifle the willingness of people to pay taxes. The induced low tax payments prevent the provision of some basic public services thus further eroding the willingness of the population to pay taxes.

The second vicious circle emerges as a consequence of allocation by general government of tax revenues to support inefficient or unnecessary state autonomous enterprises rather than towards the provision of basic public administration services. This misuse of public funds reduces the willingness to pay as well as actual payment of taxes by the public and therefore erodes the resources available for the continued provision of the already neglected basic public administration services.

The third government revenue (tax) expenditure vicious circle arises when taxes are used to provide services to the rich rather than the poor. This pattern leads to a reduction in taxes paid which makes it even more difficult to provide basic services to the needy.

An escape from government services vicious circles would require, a) reduction in the cost of providing government services to levels that are in line with the prices prevailing in the input and output markets of Chile; b) adoption and adherence to the principle that tax revenues should not be used to support the provision of non-public administration and defense goods and services; c) reduction, or ideally, elimination of use of taxes to support services provided selectively to the rich, who are able to and do contribute to output, and redirect them to the needy, who require resources as well as incentives to participate in production. It can be said that a democracy is stable only if the three aforementioned conditions are satisfied.

Topic 3. Fiscal Policy and the Autonomous State Enterprises Segment

It is very common to examine the impact of fiscal policy on income and development. After all, fiscal policy is one arm and monetary policy the other arm of the pair of policies considered capable of maintaining price stability, full employment and balance of payments equilibrium.

However, not only in Chile but also elsewhere in the world, fiscal policy has become intertwined with and dependent upon the size, structure, financial needs and importance of the state-owned enterprises which are engaged in the production of goods and services outside public administration and defense. Thus, a) it is difficult, if not impossible, to speak of an autonomous or the pursuit of an autonomous fiscal policy when the fiscal and non-fiscal dimensions of the public sector are linked like Siamese twins and b) it is necessary to define the goals and scope of an autonomous public enterprises sector policy no only in terms of production, income distribution and capital formation of non-public administration and defense goods and services but also in terms of its impact on the pursuit of a truly autonomous and efficient fiscal policy. In other words, when a political apparatus wants to give rise to a fiscal (general government)— autonomous state enterprises combination it should be fully aware that it might be giving birth to inseparable Siamese twins even if it professes to do otherwise.

If, and to the extent that, fiscal and/or general government are closely linked to the public enterprise segment, the pursuit of fiscal and even monetary (money and capital), labor, social welfare and foreign exchange policies that are neutral in respect of the public and private enterprise segments may be difficult, if not impossible.

It might be just sheer coincidence that democracy, price stability, political compromise, fiscal and monetary restraint were destroyed or abandoned when the Chilean State stampeded into the enterprise segment of the economy during 1970-3. To use Mario Góngora's classic term, it can be argued that it was the "global planification" of takeover of the meso and mega private enterprise sector during 1970-3 that precipitated the demise of democracy. If stable democracy is to be restored in Chile, constitutional guarantees might be needed to prevent the State in the future from displacing private ownership in the enterprise sector.

Topic 4. Crowding Out: Its Seven Angles

The notion of crowding out is by no means a simple one. On the basis of the Chilean historical reality a number of variants can be developed with each providing distinct and useful insights into our understanding of the development process.

The first and simplest version of crowding out stipulates or hypothesizes that as general government borrows in capital markets the non-general government segment of the economy, namely private and public enterprises, are crowded out. Such a crowding out is in evidence in Chile throughout 1939-1973.

According to the second, slightly more general version, the competition is between the public and private sectors rather than between general government and the rest of the economy. Once again, as the public sector devours the financial resources of the economy, the private sector is crowded and starved out.

There can be significantly different implications between the first and second notions of crowding out. If the general government is a heavy net borrower, the competition is primarily between production of public administration and defense services, on the one hand, and the rest of the economy, on the other hand. In many respects it can be described as being a competition between government consumption, on the one hand, and private consumption and total (private as well as public) investment, on the other hand. Thus, in the first version one type of expenditure crowds out another and presumably the winner is government expenditure on consumption while the losers are private consumption and/or investment expenditure. In the second version, the emphasis is primarily on ownership. It is the publicly-owned segment producing consumer and capital goods that is crowding out the privately-owned segment of the economy producing consumer and capital goods. The process of competition for resources can be seen both in terms of expenditure (the share of public in total expenditure rises) and production (the share of state-owned in total production rises).

On the surface, and possibly in the very long run, it may be possible that there is no difference between state-and privately-owned production and investment. In reality, however, and as the Chilean historical experience indicates, there may be significant differences which affect the nature of and consequently give rise to additional concepts of crowding out.

According to the third notion of crowding out, when either general government or the public sector borrow, less productive social overhead investment is displacing direct investment in non-government industrial, mining and agricultural activities. The competition underlying the third notion of crowding out is then between overhead or other social investment preferred by government and direct investment profitable within a free national and international market order.

A fourth, and possibly narrower, notion of crowding out emphasizes a pervasive aspect of Chilean public investment, namely the preferred status of housing versus other types of investment. As either general government or the public sector borrow heavily in the capital markets, housing, investment crowds out non-housing investment. Although the immediate impact of such a strategy may be positive in terms of increased employment in construction activity, the medium-and long-term impact may be negative because other more productive types of investment are penalized.

This gives rise to the fifth notion of crowding out according t which "excessive" general government or public sector borrowing i displacing highly productive private investment projects in favor c low productivity ones pushed by politicians (and this includes dicta tors) in an effort to appease large numbers of their constituents.

According to a sixth notion of crowding out, in the competitio for resources between export-market oriented and domestic-marke oriented economic activities, the invasion of capital markets by eithe general government or the public sector tilts the balance against th export-oriented and in favor of the domestic-oriented activities. Ult mately, this gives rise to a binding foreign exchange constraint.

In terms of the efficient functioning of the capital markets an long term economic growth, a seventh concept of crowding out gain importance. According to this, excessive intrusion by either genera government or the public sector into the capital markets, crowds ou their financial intermediation function in favor of the new unilatera transfer function. In other words, the state can and has destroyed th capital markets when its demand for credit exceeds supply by a mar gin making dependence on the paper-money producing capacity o the Central Bank necessary. The manipulation of money and capita markets by the State to obtain resources which are a) used unpro ductively for consumption and b) are not repaid, either partially o fully, leads to the establishment of a cleptocratic unilateral transfe market which is crowding out the capital markets. As capital market are destroyed and cleptocratic relationships permeate the economy democracy is weakened and becomes unstable.

The aforementioned seven angles of crowding out are importan in understanding the role of the State in Chile as well as elsewher in Latin America, not only in inhibiting accelerated growth and equi table distribution of income but also in weakening the foundation of stable democracy.

Topic 5. Collision of Trends

Throughout 1830-1986 there exists an ever present collision c forces that are part of the public sector and intimately affect Chile political, social and economic destiny. One force or trend consists c the demand for services and favors offered by the State to the popu lation. This "demand" is expressed in the form of increased reques for 1) educational, health and welfare services, 2) more commodit type goods and services provided by state owned enterprises in competition or in place of private enterprises and 3) the demand for higher wages and salaries on the part of state employees both in general government and the decentralized sector. The ascendancy of the power of the "masses" in the ever rising urban centers leads to a democracy within which political parties compete in offering ever larger baskets of "public" goods and services to the electorate.

The increased demands upon public sector resources are not matched, however, by a corresponding increased supply of resources by the economic agents to the state. There prevails an unwillingness on the part of the population to pay taxes, on the part of the state to impose and collect taxes and on the part of savers to provide enough resources to cover deficits by the central and general governments or the public sector.

While policies of spending of any shape or form are justified as "social", even if they cater to the upper and middle classes, the necessary policies of extracting resources from households and firms (taxation) are almost always attacked as providing economic disincentives to effort and saving and ultimately ushering in stagnation.

It is not that taxes were not paid in Chile. It is simply that they were never enough to cover all expenses, even during the Frei and Pinochet administrations when rational economic thinking led to numerous correct economic policies.

It can be argued that the Chilean State has been too weak, especially during democracy, to establish a stable, non-inflationary balance between its revenues (supply of resources to the State) and expenditures (demand by the population for State resources) or that the Chilean population was too strong. Either way, the end product was an unstable and weak democracy that was destroyed in 1973.

The pressures giving rise to this perennial imbalance between government revenues and expenditures is likely to persist in the future. If a stable democracy is to be established and to survive, constitutional arrangements must be introduced that avert collision between the trend of ever higher demand for state-offered commodities and another trend of ever increasing resistance to contributing resources for the state-sponsored production of such commodities. Unless these opposite trends are reconciled, averted or prevented, a cleptocratic regime that undermines the economic, social and political foundations of a stable democracy is inevitable.

Topic 6. Solving the Social Problem

The primary goal of the establishment of the State in Chile and of its Central Government in particular was to provide the public administration and defense services needed for the orderly production of goods and services. As a consequence of the pusuit of this goal, the State emerged as the Protector, as the Arbitrator, as the Organizer of the relationships between productive agents.

The second goal by the state of solving Chile's "social problem" was gradually added as the need for equitable economic development became increasingly apparent. This second goal, which is linked to the idea of the benevolent despot, of enlightened government, of the communitarian and humanistic state, was basically compassionate. Erradication of extreme and absolute poverty become automatically part of good government. Recognition of the social problem is the first step. Its definition and analysis is the second step. Its solution is the third and final step.

It is in the second and third steps of dealing with the social problem where the greatest difficulties are encountered. For a wide spectrum of philosophies and authors, the responsibility of solving the social problem rests with the state. *De facto,* and even *de jure,* the most specific instruments used to solve it are a) establishment of state enterprises to produce "social" commodities and b) the transfer of resources to "deficit" units, that is to the needy whose income falls below the level of desired expenditure.

In spite of all good intentions and the corresponding proclamations, the "social" commodities produced are often, sometimes even preferentially, produced for the middle classes or even the rich, rather than the truly needy. And, furthermore, transfers are also to the middle-upper class establishment. Expansion of the state becomes synonymous with Middle Class Welfare. Chile's welfare state, originally perceived to solve the social problem aggravated it instead. Expansion of the public sector during 1880-1973 gradually created what can be called the Middle Class Walfare State.

Ironically, dismantling of the Middle and Upper Class Welfare State fell upon the Military Junta and the Pinochet Government. Since it eliminated numerous long established privileges, such as many transfers, it has antagonized numerous groups. Furthermore, although mostly rational and efficient in terms of economic criteria, the economic policies of the Pinochet years (1973-1986) never gained the legitimacy associated with democratic legislative, executive and judicial institutions. The challenge facing Chile in the coming decades is to channel its precious private and public resources towards a system rewarding producers and to resist pressures for a return to an order of economic castes shaped by privileges bestowed to them by the State. Only then will it be possible to solve the social problems of poverty, unemployment, inequality and marginalism in a rapid and efficient manner.