Dollarization in Chile: the next step forward, led by Walmart

After having systematically missed development opportunities during the first 3 quarters of the XX century, being on the verge of a civil war and military conflicts with neighboring countries in the 1970´s and having a successful transition to democratic governments in the 1990´s, Chile is again on the right track, almost irrespective of its political and entrepreneurial leaderships.

Big changes have occurred in this country, mainly explained out of desperation at poor economic results in the past and the then firm belief of a few ones that free markets and competition were the only way out of underdevelopment. Once the resulting effects have been noticed by the greater masses, it has conveniently been much more difficult to go back. And if ever in doubt, anyone could be reminded that at the end of the XIX century Chilean per capita GDP hovered around half of that of the US; today it is only one fifth of it.

But the same reasoning behind a "not to be disrupted" present accepted economic and political equilibria has also evolved into a disincentive to give more steps forward. In the meantime, interest groups have flourished everywhere, trying to get more of the economic pie than what they actually receive, without any consideration to the country´s interest. Labour and capital interests of this nature have abounded, and it seems that time is up to stop them. As experience should suggest us, enforcement of competitive rules is the only reliable path, and if not helped from domestic instances, so be it from outside ones. In this sense, it is symptomatic that while Chile has signed free trade agreements with the US, EU, Canada, Mexico and Korea, and expects to incorporate soon free trade agreements with Japan, India and China, all these commercial agreements essentially lack references and effective dispositions towards free trade of services – especially financial services - and the movement of human capital. They are just "goods agreements", whereas modern economies are more than 70% "service" economies.

Given the above, how then do we proceed to deepen economic integration in continental America, our natural economic habitat, with an efficient (i.e., competitive) world economic integration as a final objective? By promoting massive competition through international capital markets that would bypass local financial oligopolies, while simultaneously making unavoidable the needed flexibilization of domestic labour markets and immigration policies. Under this scenario, dollarization would just be a natural consequence in this convergence process. The primer, that of movement of capital "á la Walmart" – have you seen those increasing financial flows between Mexico and Mexican immigrants in the US via the now famous grocery store ? – using just internet and cash machines, is a simple but revolutionary means to make access to cheaper capital to the often postponed middle and low income groups possible. Needless to say, immigration walls and labour inflexibilities do not fit into this evolution.

Chile should take now these natural reforming steps because they further raise its living standard due to efficiency gains and create better economic growth conditions. Others will follow soon, if fairly evaluated. As to the present timing of these reforms, some figures that favor its case are as follows: (1) Chile´s central government expenditure accounts today for 20% of its GDP (US$ 115 billion), excluding private pensions (2,8% of GDP) and local governments (2,0% of GDP). A reasonable size that could well be 15% of GDP if resources were more efficiently used and focused on poor groups. (2) Consolidated net debt of central government and central bank is null, and this year fiscal surplus near 8% of GDP will transform it into a net creditor. (3) Present real exchange rate is within a historic range, with a clear tendency to revaluate against foreign currencies, consistent with its relative growth perspectives and policies. (4) Inflexible labour markets are reflected in unemployment rates persistently over 8% and employment participation rates close to 50% - US has over 60% participation rate -. Minimum wages are not the problem, but too high severance costs; labour contracts structured on an hourly basis and a correction in severance costs would do the trick. (5) Consumer loans at nominal costs over 40% per year relative to 20% in the US just mirror a non competitive capital market structure. (6) Foreign direct and portfolio investment in Chile amounts to US$ 80 billion and external debt is US$ 45 billion; Chilean direct and portfolio investment in foreign countries adds up to US$ 91 billion, including US$ 17 billion in central bank reserves. An integrated country, but only at a big corporation and central government level that selfishly benefits from historically low risk premia.

In other words, Chile as the perfect candidate for the Federal Reserve and financial Walmarts in order to accelerate the convergence process of our economies. The monetary base in Chile is at present exchange rates close to US$ 5,4 billion and the annual seignorage - profit from money creation - near US$ 505 mm. A mutual agreement between central banks could be reached over the distribution of this last seignorage figure, and just 1/3 of our central bank reserves would be necessary to dollarize its economy. An easy step that will certainly have deep long term effects, being the immediate ones having numerous Walmart replicas massively allocating money from low cost of capital regions to higher return / lower risk countries and populations, recreating a new capitalism for all, finally. In the longer term, an effective free trade area from Alaska to Tierra del Fuego would consolidate, as others would certainly follow this path, in their own interests. Economics, demographics and institutions increasingly point into this direction.

A new reforming challenge is so given to our authorities and those of the US, for the long term benefit of their peoples, and far from ideological positions. The American continent should have always been one integrated and efficient economy. Now the world is pushing us to be so. The next step, after this basic one, will have to be over the size of central governments and its effectiveness to alleviate conditions for the poor ones. Bill Gates and Warren Buffett are giving a good idea. And the next one, demographics, will get temporal solutions under ever bigger immigration flows, in and out of our countries, freely looking for their own destinies. America will gain the most if meaningful financial, labour and immigration freedom is given to those that crave for it.

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