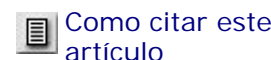




Cuadernos de economía
ISSN 0717-6821 *versión on-line*

Cuad. econ. v.40 n.121 Santiago dic. 2003



Cuadernos de Economía, Año 40, N° 121, pp. 792-795 (diciembre 2003)

EARLY 1930'S: A UNIQUE PERIOD IN FISCAL EVOLUTION?

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1. INTRODUCTION

The early 1930's brought significant institutional and policy changes, which then had a long lasting effect on the country's social and commercial life. New, powerful and highly discretionary instruments became at the disposal of the State which, combined with traditional tariffs, began to be used by it to regulate trade flows. Together with direct government investment in the production of good and services, they became the most important public policy instruments used to determine the development structure of the country in the following decades.

Chile also lost its monetary anchor during the Great Depression, making very significant inflationary price level expansions possible. In the case of specific goods, these price expansions then offered an opportunity for State interventions into the relative price structure. Whatever the precise underlying cause for such a policy, from 1932 onwards, government began to manage relative prices, for which the necessary legal framework, including strong enforcement instruments, was also approved in the latter year. At the same time, the above mentioned trade inhibiting instruments began to be used to make price controls viable. In particular, multiple exchange rates and the accompanying import quota system, gave price controls real content. Ongoing inflationary pressures transformed price fixing into a permanent and increasingly significant public activity.

The above mentioned government interventions began with the Great Depression, but it is important not to loose sight of the fact that the increasingly discretionary role of the State in the economy, especially its executive power, is of older data. For example, also in the 1920's, significant institutional redesign took place. The role of the market and Parliament in resource allocation decreased, while that of direct decisions and interventions by the executive branch of government increased. One example is the creation of the Central Bank in the middle of that decade, which transferred high powered money issuing decisions from the legislative branch to the Bank. Initially the latter had a broadly based board, including a private sector representative majority, but in the following decades public sector representatives began to dominate the board until that domination became complete in the 1960's. On the other hand, the imposition of a formal

Social Security System, also in the mid twentieth, limited strictly individual pension and health care decisions which formerly prevailed.

The fact is that in the 1920's and 1930's government intervention, specially by its executive branch, expanded vigorously, not only in the mentioned areas, but also in many others; some of it, like the creation of the unified police force or the office for banking supervision, would be permanent, but much had, *ex post*, a more experimental character. During the 1970's and 1980's, especially, the micro-management of trade flows, as well as that of relative prices, was abandoned in favor of more general instruments and policies.

The above paragraphs only intend to provide the reader with a flavor of the set of institutional changes which took place during and around the Great Depression. In what follows we concentrate exclusively on the impact of this relative increase in government intervention on fiscal expenditures and taxes, with the purpose of finding out if the Great Depression was or was not, a dividing line in this area.

2. FISCAL BEHAVIOR

As can be seen in [Table 1](#), between 1911 and 1913 total fiscal income over GDP reached 10.5 per cent, one half of it stemming from nitrate export tax proceeds. When import taxation is added, total trade based revenues reached about 85 per cent of fiscal income. This heavy dependence on trade related taxes may seem surprising to some, but it was quite common in the 19th century (see for example [Wallis \(2000\)](#), for the US).

TABLE I
FISCAL INDICATORS FOR SELECTED PERIODS 1911-1944
(% of GDP and % of Total Fiscal Income)

| | IF/ GDP | GF/ GDP | Current Income Total Income | Mining Tax Total Income | Domestic Direct Total Income | Domestic Indirect Total Income | Import Tax Total Income |
|-----------|------------|------------|--------------------------------|----------------------------|---------------------------------|-----------------------------------|----------------------------|
| 1911-1913 | 10.5 | 100 | 13.5 | 96.1 | 50.8 | 0 | 5.4 |
| 1914-1920 | 7.5 | 71 | 8.5 | 97.4 | 48.4 | 5 | 9.9 |
| 1921-1926 | 11.8 | 112 | 10.9 | 71.4 | 24.6 | 7.1 | 8.5 |
| 1927-1929 | 13.9 | 132 | 12 | 91.0 | 28.0m | 16.2 | 10.6 |
| 1930 | 15.4 | 147 | 13.9 | 95.0 | 19.8 | 16.4 | 10.0 |
| 1931 | 13.8 | 130 | 16.6 | 94.4 | 22.5 | 16.4 | 12.4 |
| 1932 | 9.3 | 88 | 9.7 | 81.9 | 1.0 | 22.0 | 16.2 |
| 1933 | 13.5 | 129 | 11.8 | 85.9 | 12.4 | 18.5 | 15.4 |
| 1934 | 12.9 | 123 | 10.4 | 81.3 | 4.3 | 16.3 | 17.3 |
| 1935 | 17.2 | 164 | 13.0 | 86.2 | 9.3 | 12.3 | 14.2 |
| 1936 | 15.2 | 145 | 12.6 | 86.6 | 10.9 | 14.5 | 13.4 |
| 1937 | 12.9 | 123 | 11.5 | 86.9 | 11.7 | 14.1 | 13.8 |
| 1938-1944 | 15.3 | 146 | 13.2 | 84.2 | 18.6 | 14.1 | 15.2 |

Source: Díaz, Lüders, Wagner (2003).

Note: IF/GDP: fiscal revenue as share of GDP (small numbers: 1911-1913 =100).

GF/GDP: fiscal expenditure as share of GDP.

It is not known how important the relative collection costs of different types of tributes are to explain the mentioned high concentration. However, there is no doubt that in the case of Chile the exploitation through export taxation of its market power in nitrate's in the late 19th Century and first decade or so of the 20th Century, contributed to this concentration.

Fiscal income level and composition in 1911-13 provide a general flavor of the same indicators over the previous two decades. Nothing would be the same in the future. In relation to 1911-1913, World War I

implied a drop in fiscal income to about 71 per cent of its former level, to a large extent due to the drop in export revenues. Measured in units of GDP, government became 29 per cent smaller during that war.

After World War I, during the 1920's, the share of fiscal income over GDP experienced a considerable expansion. By 1930 it already was 47 per cent above its pre-war reference, and at the trough of the Great Depression induced contraction, in 1932, that level was still slightly above the average reached during World War I years. Export tax proceeds fell very sharply during that Depression, bringing mining tax revenues down to 1% of GDP in 1932, from their pre-Depression peak of 28 per cent. Revenues stemming from import taxation were far less sensible. Although the tax base also experienced a dramatic drop during the Depression, aggressive import tariff increases in the early 1930's avoided part of the impact on fiscal revenues of that source.

In the 1920's, growth of government regulations was accompanied by a fast fiscal expenditure and revenue expansion. At the same time, important changes in its revenue composition took place, the government turning increasingly to domestic taxes, both direct and indirect. These trends were interrupted by the Great Depression, but not for long. Already in the second half of the 1930's, fiscal activity had reached again its previous peak, but taxes stemming from the exploitation of mining resources, now mainly capital taxes on copper production -nitrate export taxes having practically disappeared- accounted only for 18 per cent of total fiscal income, well below the 51 per cent they represented before World War I.

Without denying that the worldwide phenomena of the early 1930's had a significant fiscal impact, it is the profound changes around or confounded with the World War I years, which seems to be the really defining moment in the Chilean fiscal evolution, when this is understood as a clear break with the past. From then onwards, not only does governments size starts to grow, but its tax structure is also increasingly based on domestic tax revenues.

On the one hand it is the evolution of Chile's market power in the nitrate market and the corresponding policy reaction, non reaction, what explains the relative and absolute decrease in this source of public finance. But this phenomena cannot be considered as an explanatory element when it comes to the overall government size; for an understanding of the latter one needs to appeal to other aspects, political change mainly thru new electoral bases, income elasticity of certain public goods that is a simple consequence of development, new ways of thinking and ideology, technological change favouring public sector expansion, among other. Whatever the cause(s), the issue is not explored in this occasion.

The expenditure side of the picture is trickier to get by, the data less expressive and eventually subject to definitional changes we cannot account for, but of course, on this side of the fiscal accounts there are changes to be registered in the 1930s. As shown in [Tables 1](#) and [2](#) they also seem to fit into a more extended scenario, one stretching over various decades and do not coincide neatly or exclusively with the Great Depression. In the case of defense, also of justice and security spending there is little change brought about by the depression; health and education expands by much, but here growth fits nicely into an tendency which may be traced back to the beginning of the century. Infrastructure expenditures, on the other hand, disappear completely, but here again long run influences seem to be at work.

In synthesis in fiscal matters and measured as a fraction of GDP the depression impacts in the critical years 1931 and 1932, besides this profound but circumscribed expression there are underlying and extended tendencies. As said above there are specific regulatory innovations brought about by the GD which then will have a path breaking long period influence on the country's development style and structure, but in relation to fiscal matters the understanding of their evolution does require other ideas.

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