The original sin in Chile’s successful history of development

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Since the end of the Pinochet dictatorship in 1990, Chile has been a success story of democratic consolidation and economic development. All economic indicators show significant progress. Democratic institutions are strong and getting stronger. Citizens are politically engaged and social movements are flourishing. The origin of the so-called Chilean miracle can be traced back to the neo-liberal economic model adopted under the Pinochet dictatorship, but the pragmatic and gradual approach to economic and institutional reforms championed since democracy was restored explains why Chile has successfully avoided the pro-cyclical boom and bust trend that has characterized most other Latin American economies in the last two decades. Though the quality of life of all Chileans has improved, high levels of inequality remain a dark spot in the otherwise most successful story of economic development and democratic consolidation in Latin America in the past three decades.

The origin of the Chilean miracle

Although it is an inconvenient fact for advocates of market-friendly policies, the Chilean economic model dates back to the brutal Augusto Pinochet dictatorship (1973–90). The original sin of the so-called Chilean miracle raises results from its illegitimacy of origin and the authoritarian conditions under which the reforms were first implemented. Moreover, it transforms Pinochet into the father of today’s Chile. As in the epic Star Wars film series, Chile can be described as a Luke Skywalker having to deal with the trauma of being the son of the villain Darth Vader. Building the strength to move past the traumatic origin—without forgetting the atrocities of human rights violations—has been a difficult task for Chile. While on the one hand the economic model has allowed it to lift millions out of poverty and has converted Chile into one of the most developed countries in Latin America, the legacies of human rights violations perpetrated by the military dictatorship still haunt Chileans and will always be an indelible mark on the nation’s history.

As Figure 12.1 shows, compared to Latin America and the rest of the world, the Chilean economy was an underperformer in the 1960s. In the 1970s and early 1980s the country experienced two severe economic crises. Since 1983—10 years into the authoritarian period—the Chilean economy entered into a stable growth pattern that has lasted for more than three
decades. In the early 1990s, after democracy was restored, the Chilean economy surpassed the Latin American average in per capita terms. More recently, during the first decade of the new century, the Chilean economy has grown to a per capita higher than the world economy average. As the growth trajectory of the economy began under military rule, the origins of the three-decade period of economic expansion cannot be disassociated from the controversial legacy of the Pinochet dictatorship. However, since Chile only surpassed the Latin American average after democracy was restored—and because the period of economic growth has survived the authoritarian regime by more than two decades—the credit for the successful performance of the Chilean economy must also go to the democratic governments that implemented reforms, in their own words, to transform the neo-liberal economic model into a socially oriented neo-liberal model, or as neo-liberalism with a human face.1

Figure 12.1 shows that while in the 1960s the Chilean economy barely grew and in the 1970s it followed a boom and bust trajectory, since the mid-1980s Chile has experienced gradual and sustained economic growth. More than impressive growth—which Chile has none the less enjoyed occasionally—the big story behind Chile’s success is its gradual and incremental growth path and the ability to avoid prolonged stagnation or recessionary setbacks. While the rest of Latin America continues to go through periods of rapid growth followed by stagnation or recession, Chile has moved forward as it has maintained a pattern of moderate growth and has successfully avoided declines.

Since the 1930s Chilean governments have championed import substitution industrialization (ISI) policies with mixed results.2 Protectionist policies fostered the emergence of an industrialized and manufacturing sector, but negatively impacted competitiveness. Protectionist policies favoured the organized labour sector to the detriment of the large majority of the population.
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that remained in the informal sector or in rural areas. The state strengthened its control over the formal sector with regulations and labour legislation that protected workers, but the limited dynamism of the private sector and the falling competitiveness of the Chilean economy prevented economic development and condemned a majority of Chileans to a life of poverty and destitution.

As Figure 12.2 shows, the Chilean economy presented a common pro-cyclical pattern in the 1960s, with boom and bust periods. After reformist Christian Democratic Party (PDC) Eduardo Frei was elected (1964–70), his government further deepened ISI policies, with the partial nationalization of the copper industry, and launched an ambitious agrarian reform initiative aimed at empowering the rural unorganized labour sector and reducing wealth inequality. Though Frei’s reforms brought inflation down, the economy continued to grow at a slow rate. Rapid population growth—triggered by massive migration to urban areas where living conditions and access to health and education were much better—further limited the effect of economic development. By 1970 the Frei ‘revolution in liberty’ reformist economic model was greatly discredited and most Chileans wanted change. In the 1970 election, the country was almost equally split three ways. Former conservative President Jorge Alessandri (1958–64) campaigned on a fiscally conservative and business-friendly platform. PDC candidate Radomiro Tomic campaigned on further defending Frei’s reformist policies and left-wing candidate Salvador Allende, the leader of a coalition comprising the Communist Party (PC), Socialist Party (PS) and other left-wing parties, campaigned on a revolutionary platform that would put the state at the centre of economic activity. Allende won with 36.6% of the vote, just above Alessandri (35.3%). Tomic ended in third place (28.1%). Though turnout was high (56.2%), it was

Figure 12.2 Inflation and per capita GDP growth in Chile, 1960–2011
Source: author with data from World Development Indicators, World Bank Inflation in 1971–1977 was 414%, 665%, 335%, 231% and 106%
lower than in 1964 (61.6%). Almost half of voting-age Chileans were still excluded from the political process.4

As no candidate received an absolute majority, the constitution mandated Congress to name the president from among the two candidates with the most votes. Following a complex negotiation with socialists and communists, the PDC voted for Allende, thus making him the first Marxist to be democratically elected in the world. The PDC required Allende’s commitment to limit the scope of his nationalization plans. As president, Allende moved swiftly to fully nationalize copper—pauldly nationalized under his predecessor. The Socialist president also pushed for significant wage increases and implemented aggressive expansionary policies that quickly overheated the economy and triggered hyperinflation. Allende faced the militant opposition of the business sector and the USA, which feared the effect of Allende’s democratic victory would combine with the influence of the 1959 Cuban revolution to make Latin America a fertile ground for revolutions and for the expansion of its Cold War enemy, the USSR.

Less than three years into his six-year term, in a bloody military coup on 11 September 1973, Salvador Allende’s Popular Unity government was overthrown by the military. The reasons for the democratic breakdown have been discussed extensively elsewhere.5 The role of the USA in destabilizing Allende6 and the political polarization that took place in those years7 have been cited as reasons for the military coup, but the impact of the failed economic policies implemented by the Popular Unity government cannot be ignored.8 As Figure 12.2 shows, the economy was in an undeniable state of crisis when Allende was deposed.

Claiming that the Allende government had violated the constitution and citing the growing economic crisis—with high inflation, price control, black markets and growing nationalization of the productive sector—the military took power. The military junta, led by the head of the army, General Augusto Pinochet, had a much clearer goal of what it stood against than a plan of what to do to put the economy back on its feet.

At the same time that it committed atrocious human rights violations against political opponents, the military government began to implement policies that sought to stabilize the economy. As Figure 12.2 shows, it took a few years to bring inflation down from its record levels of 1973. Although it first simply focused on reversing the nationalization initiatives implemented by Allende, the military government soon went further beyond and began to implement market-friendly policies that ended up becoming Pinochet’s biggest legacy.9

After the economy was stabilized, from the late 1970s until it ceded power to a democratically elected government in 1990, the Pinochet dictatorship implemented sweeping neo-liberal economic reforms.10 Promoted by a group of young economists trained in the 1960s at the University of Chicago (the Chicago Boys), the neo-liberal policies sought to reduce the role of the state in the economy. Thus, state enterprises were privatized, legislation that gave the government oversight powers was repealed and new legislation that promoted private and foreign investment was adopted. As Figure 12.3 shows, the size of the state began to decline rapidly after the country emerged from its 1973–75 recession.

The military was able to implement all the reforms under authoritarian rules, repressing the opposition and labour unions that were adversely affected by the market-friendly policies. The implementation of the reforms is intrinsically associated with the massive human rights violations that characterized the Pinochet regime: the overwhelming discretionary power the military had allowed General Pinochet to build a new institutional set-up. The 1980 constitution, custom-made for Pinochet, established a protected-democracy framework11 and also established the foundations for the market-friendly economic model.12 However, the constitution also became a trap for the military dictatorship. As even custom-made shoes bind, the 1980 constitution became the
roadmap for the restoration of democracy in Chile. In fact, though most of the authoritarian components of the 1980 constitution have been amended and modified since democracy was restored in 1990, the institutions and constitutional prerogatives on which the market-friendly economic model is based remain intact. In that sense, Pinochet remains the father of the neo-liberal economic model in Chile. The democratic governments that have ruled the country since 1990 have further deepened the model and have also legitimized it, by introducing reforms to reduce poverty, increase social spending and strengthen the regulatory role of the state.

The main tenant of the neo-liberal reforms implemented under Pinochet was that the state was an obstacle for economic development. Thus, by reducing the size of the state and limiting its functions, the *creative destruction* power of capitalism would be unleashed and economic growth would bring about development. As Figure 12.3 shows, after increasing in the 1960s, central government consumption expenditure substantially decreased under the authoritarian regime and remained low until democracy was restored. Since then, there has been a gradual upward trend, but it remains relatively weak compared to the rest of Latin America and to the world in general. As Chile’s growth has been driven primarily by the private sector and as the state has a limited role in affecting economic output, the Chilean model can be properly characterized as neo-liberal. The market-friendly focus on institutions and government policies is intrinsically associated with the growth experienced in the past three decades. However, as critics repeatedly argue, the limited role of the state on the economy has also allowed for income and social inequality to remain high. The cost of the economic expansion experienced by Chile has been high levels of inequality. That remains Chile’s largest social unmet challenge. If it is not addressed properly, it can also constitute a threat to Chile’s long-term stability and to the country’s chances of becoming the first Latin American country to enter the elite of industrialized nations.
The economic plan of the military focused on promoting market-based mechanisms and limiting the role of the state in economic activities and social interactions. As a result, the Chilean state today has a limited—and sometimes non-existent—role in areas where the state is the leading economic actor elsewhere, like elementary and secondary education or pensions. In Chile, the role of the state is mostly limited to a regulatory oversight power. Though some key public sector companies were not privatized under the military dictatorship (most notably the copper-producing CODELCO), the sweeping economic reforms implemented by the Chicago Boys substantially reduced the size of the public sector and limited the role of the state as an economic engine.

Today, the role of the state in Chile is limited. A Chilean child can be born in a private clinic paid for by her parents’ private health insurance. The child will attend private day care and spend her entire elementary and secondary school years in a private school partially funded by a public voucher programme. She will attend a private university. When she starts working, her monthly mandated retirement deduction will go directly to a private pension of her choice. She will drive an automobile on privatized highways and will pay her utility bills to private companies that bring electricity, gas and telecommunications to Chilean homes. When she dies, she will be buried in a private cemetery. She can go her entire life with minimal interaction with the state. To be sure, the state does have regulatory power over most sectors, but its regulatory muscle and its enforcement power are limited.

This neo-liberal paradise is built on an intricate set of institutional features put in place in the 1980 constitution. The constitution explicitly bans the state from participating in productive economic activity and establishes broad protections of private property. Though a number of key reforms were introduced by the military in the 1970s, the most important reforms were adopted after the 1980 constitution was approved and General Pinochet began an eight-year presidential term in March 1981.

The most important early reform in the 1970s was the Foreign Direct Investment Statute (Decree Law 600 of 1974), designed to attract foreign capital and to reverse the negative effect of the nationalization effort championed by Presidents Frei and Allende. By building an institutional set-up that protected foreign investment, the military government sent a clear signal of commitment to market-friendly policies. The reversal of several nationalizations enacted under Allende and the privatization of other public sector companies was also intended to attract foreign investors as the country was in dire need of capital. Low domestic savings and high government expenditures had stalled economic development. The stabilization phase in the mid-1970s set the foundations for more innovative and controversial reforms adopted later.

Among the important reforms implemented by the dictatorship in the 1980s were the educational overhaul that transferred schools from the national to municipal governments, the privatization of the pension system, the partial privatization of health care and the nationalization of public sector companies. Deregulation of several economic sectors also fostered the growth of private enterprises and restricted government’s ability to block private initiatives, though it also limited the regulatory power of the state to protect and enforce consumers’ rights.

**A case study: educational reform**

One of the most controversial reforms after the passage of the 1980 constitution involved education. In discussing it in detail, I explain the ideological tenants of all the reforms adopted under the military. The goal of the reforms was to reduce the discretionary power of the state, to introduce market mechanisms that would foster competition and establish incentives to reduce information asymmetries and level the playing field to reward meritocracy and productivity.
Prior to the dictatorship, the state had almost complete control of the educational system. Those with access to public education, especially tertiary education, received a good education, but access was limited. In fact, in 1960, while 80% of the population had received an elementary education (six years), 14% had completed a secondary education, and only 4% of those aged between 20 and 24 years were enrolled in tertiary education. By 1970 elementary education coverage reached 93% of children, secondary education 50%, and 9% of those aged between 20 and 24 years were enrolled in tertiary education. In 1980 95% had received an elementary education, 65% a secondary education and only 11% of those in the 20–24 age group were enrolled in tertiary education.

In 1973 the military government took control of eight universities (two public and six private). As universities had been a centre of political activism in the 1960s, the authoritarian government seized control of tertiary education and limited its political influence. Under military control, enrolment was frozen and funding was cut. In 1980 university funding was divided into two types, direct and indirect fiscal funding (AFD and AFI, respectively). AFD was complemented by AFI, a direct subsidy to universities associated with the 20,000 students with the best scores in entrance exams. By associating AFI funding with entrance exam scores, the government introduced incentives for universities to compete for the best students. The two public national universities were divided into smaller regional universities. Decree Law 3541 also allowed for the creation of non-profit private universities, for-profit private professional institutes (IP) and for-profit centres for technical formation (CFT), thus allowing for-profit tertiary education. Before 1980 there were six non-profit private universities, which were run by educational foundations (including some by the Catholic Church). The number of public and government-funded non-profit private universities increased from eight before 1980 to 20 by 1990 and government-funded IPs fluctuated from seven in 1984 down to two in 1990. A number of private universities, IPs and CFTs not funded by the government were also created after 1980. When democracy was restored in 1990, there were 40 private universities, 80 IPs and 168 CFTs.

In 1981 the government also introduced elementary and secondary education reforms. Public schools were transferred to municipal governments. A voucher system was established to fund elementary and secondary education. Private for-profit schools were allowed. A subsidy for each child was to be paid directly to the municipality or the private school owners. Competition was introduced between private and municipal schools. Since parents could choose which schools to send their children to, there would be market incentives for schools to offer quality education.

Public school elementary and secondary enrolment decreased from 80% to 60% between 1980 and 1990, while voucher school enrolment increased to 30% by 1990. The other 10% of children attended fully private schools. In 1990 elementary education coverage reached 95% of children and secondary education 78%. Since 2003, there was constitutionally mandated universal elementary and secondary school coverage. Voucher school enrolment continued to increase progressively under democratic rule. By 2008 it had reached 45%, the same share of children attending municipal schools.

One day before it left office in 1990, the military dictatorship passed a comprehensive education bill that incorporated all the changes made under Pinochet. The bill secured deregulation, guaranteeing the presence of private for-profit education at the elementary and secondary levels and ensuring the municipalization of education. As the bill required a supermajority vote for future changes (an organic constitutional bill that required a 4/7 majority of seating members of both chambers), it became especially difficult for the incoming democratic government to alter the educational system that had been designed and implemented under the dictatorship.

The expansion of tertiary education began after democracy was restored. In 1990, 249,482 college-aged Chileans were enrolled in tertiary education, 13% of the 18–24 age group. Of
them, 131,702 were enrolled in universities. Some 20 years later, in 2009, the number was 876,243 (30.8% of the respective age group). Five-fold growth brought the number of university students to 576,600 in 2009. Most of the increase came from growth in private university enrolment. In 1990 one in every six university students was enrolled in a private institution. In 2009 the number of students enrolled in private institutions (258,960) was almost identical to those enrolled in public institutions (276,683).22

Though first implemented under military rule, the market-friendly educational reforms were consolidated after democracy was restored in 1990. After Pinochet was defeated in a plebiscite in 1988, a coalition of centre-left political parties, the Concertación, led a successful transition to democracy. The Concertación won four consecutive presidential elections between 1989 and 2005. Concertación governments developed aggressive earmarked social spending policies to alleviate poverty. Since limited social spending was prioritized to help the poor, old policies that granted universal access to social services were replaced with new policies that focused spending on the lowest two quintiles of the population. The implementation of targeted social policies was considered too moderate or insufficiently universal by some critics.23 The Concertación defended them because of their more immediate and stronger effect on reducing poverty.24 Independent observers and right-wing think tanks agreed.25

The four Concertación governments (1990–2010) applied the same logic to education. They put the focus of social spending on promoting universal access to elementary and secondary education. Under President Patricio Aylwin (1990–94), educational policies ‘targeted individual schools directly with additional resources and disregarded (and at times interfered with) market mechanisms’.26 The focus of educational policies shifted from ‘access and quality in the 1980s to “quality and equity”, although equity was not a particularly important component in education policies instituted during the Aylwin administration’.27 The most important reforms were a teacher labour statute that protected employment and established a single pay structure for teachers in municipal schools, and a reform that targeted the worst performing primary schools. The shared financing mechanism top-up co-pay—which allowed parents to complement the government voucher in private but not in municipal schools—was also implemented under Aylwin.

Under President Eduardo Frei (1994–2000), educational reform focused on increasing teachers’ pay, transparency of school level test scores and the adoption of the extended school day for municipal and voucher schools. The reform required massive government investment in infrastructure for municipal and private schools. Formerly controlled by militants of Concertación parties, the Colegio de Profesores fell under the control of the Communist Party, a left-wing opposition party, in 1995.

Under President Ricardo Lagos (2000–06), a constitutional reform in 2003 made secondary education mandatory. In addition, the Lagos administration focused on promoting access to voucher schools to vulnerable students. Schools that received government subsidies had to accept a minimum of 15% of vulnerable students—defined as those from families so classified by the government’s social programmes scheme. Though there were plenty of mechanisms available to schools not to comply with that requirement, this reform sought to use the government subsidy to foster school integration. The government aimed to reverse the growing segregation by parents’ income in Chilean schools that resulted in lower-income families sending their children to municipal schools and middle-class families choosing voucher schools. The Lagos administration also introduced a teacher evaluation scheme. Though the government had tried since the early 1990s to introduce a mechanism to assess the quality of teachers, an effective opposition by the Colegio de Profesores derailed those efforts. Criticized as insufficient and only applied to municipal schools, the 2004 teacher evaluation reform constituted a major change in educational accountability. The government also introduced a more transparent mechanism to select
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municipal school principals, a move that undermined the power of unionized teachers but was cleverly passed using the argument that it would allow the removal of principals who had been appointed during the military dictatorship.

Shortly after Michelle Bachelet (2006–10) became the first woman president in Chile, student protests rocked the country, in May 2006. The movement started at public secondary schools and soon spread to other municipal and voucher schools. Soon after, the movement spread to public universities and other higher education institutions. As the government was slow to react, the movement soon dominated the political agenda and forced Bachelet to shuffle her cabinet on 14 July, replacing the ministers of the interior (her chief of cabinet), education and economics. Bachelet also appointed an ad hoc 81-member presidential advisory council on education, charged with drafting a proposal to reform the educational system at all levels. The committee eventually produced two reports, reflecting the lack of consensus on the role of the private sector in the provision of educational services, funding for private and public education, and the regulatory role of the state over private institutions.

In April 2007 Bachelet sent a legislative bill to Congress to replace the existing Organic Constitutional Law on Education (LOCE) with a new General Law of Education (LGE). In August 2009 the new LGE was promulgated (Law # 20.370). Although the legislation itself did not immediately change the institutional set-up, it did constitute a departure from the strict neo-liberal framework under which the educational system had evolved during the dictatorship and which had prevailed once democracy was restored. The LGE explicitly stated a number of values and principles that were put on the agenda by the student protests, such as equality, universal access to quality education, inclusion and participation. Yet, it did not include three key student demands, the end of for-profit education, the transfer of public schools from municipal governments to the national government, and the banning of student selection mechanisms by voucher schools. The LGE banned student selection up to the sixth grade, but in a way that made it unenforceable. Since it provided a new framework for education, a series of other reforms were triggered by the adoption of the LGE. Some of those reforms were introduced as bills during the Bachelet administration, but they were only approved under President Sebastián Piñera. Some of those bills are still making their way in the legislative process.

In January 2010 the candidate of the centre-right Alianza, Sebastián Piñera, won the presidential election, putting an end to the 20-year period of four consecutive Concertación governments. During Piñera’s (2010–14) first year in office, the government altered the legislative agenda to reflect its own priorities and ideology. As the distribution of seats in Congress also changed, giving the Alianza and its allies a slim majority in the House and keeping a Concertación majority in the Senate, the government’s need to bargain with Congress also affected the educational legislative agenda. A devastating earthquake a few days before Piñera’s inauguration also influenced government priorities. In education, reconstructing schools destroyed by the earthquake overtook educational reform as the first government priority in 2010. Student mobilizations—and in general other social expressions of discontent—decreased dramatically in 2010, in part due to the presidential honeymoon and also because of the earthquake that relegated other priorities.

In 2011 the student movement returned with renewed strength. Unlike 2006 the movement focused this time on tertiary education. Since 1990 tertiary education had evolved in the same direction of insufficient regulation and a mix of public and private providers that competed to attract students. Tertiary education enrolment increased rapidly from the early 1990s, from fewer than 200,000 to more than one million in 2011. The bulk of tertiary education growth came from professional institutes, technical centres and private universities. During the 1990s growth in private education was constrained by costs and regulations. Private institutions charged higher tuition than public and traditional universities, and regulations required them to
be under government supervision for several years before they could obtain ‘autonomy’, a classification that allowed them to open new sites and offer new degrees at their discretion.

The growth in private education put pressure on the government to expand the subsidized loan system (crédito fiscal) to private universities. However, the opposition of traditional and public universities forced the Lagos administration to implement an alternative funding scheme. A different government subsidized loan (crédito con aval del estado—CAE) was introduced for private universities in 2006. Unlike the crédito fiscal, the CAE was obtained from a private bank, not from the university itself. In addition, while the crédito fiscal has a fixed rate of 2% (in inflation-indexed unidad de fomento, or unit of account), the CAE had a 5.8% interest rate. Conditions for repaying the crédito fiscal were also more lenient than for the CAE.

In order to introduce an accountability mechanism, the new CAE legislation required universities to be accredited by the recently created National Accreditation Commission (CNA), an autonomous institution that replaced the old National Undergraduate Accreditation Commission (CNAP). To be eligible to receive the CAE, students had to belong to low-income families and attend accredited universities. There were five areas of accreditation: educational administration, undergraduate education, graduate education, research and community linkages, but only the first two were mandatory and required for CAE eligibility. Universities could receive accreditation from one to seven years. IPs and CFTs were not eligible for CAE loans.

Not surprisingly, universities rushed to obtain accreditation to be eligible for government-subsidized CAE loans. As a result of this new funding opportunity, enrollment in private universities increased dramatically after 2006. By 2011, when the student protests erupted under Piñera, thousands of students had already attended private universities and had pending loans with private banks accumulating interest. Since loans had to be repaid even if a student dropped out of school, for many low-income students their CAE loans became a burden rather than an upward mobility opportunity. As drop-out rates were high in private universities and higher among first-generation university students, access to CAE loans generated perverse incentives. Even among those who graduated, the cost of their degree at some private universities of low quality far exceeded their income potential. Thus, the expectation that a university degree would provide an opportunity for upward mobility did not materialize. In fact, recent research has shown that for those with some university education and for many with a university degree from a non-elite university, the returns of educational spending can be negative.28

Universities expanded their degree offerings to attract more students. Getting accreditation became a must for universities to grow. Though they are not legally allowed to profit, many universities engaged in profit making by expanding their programme offerings, attracting low-income students and getting them to apply for CAE loans. Even if those students dropped out after a few semesters, the university would still have collected their CAE-financed tuition. Repaying the loans would be the student’s obligation while universities kept their profit. Though all private universities must be non-profit foundations, several institutions have a parallel for-profit company that owns the buildings and rents them to the university to extract profit, or they extract profits by offering other services at above-market rates to the non-profit university owned by the same company.

Since CNA accreditation is a requirement for CAE eligibility, for-profit universities actively sought to obtain accreditation. Lax regulatory mechanisms and outright corruption in the CAN allowed many underperforming and low-quality schools to get accreditation. In addition, since students were allowed to get CAE loans to attend universities that were in the process of accreditation, a low-quality school could still extract rents from the state through student loans and offer below-par education to mostly low-income and underperforming students who were not admitted to higher-quality institutions. As the cost of higher education is not correlated with
the quality of education, many students ended up attending expensive schools that provided them with low-quality education.

The protests of 2011 were led by public university student federations. Thousands of students marched to protest against the educational system in place. Student leaders concentrated their criticisms on different components of the for-profit (préstamo) educational model. Private for-profit universities that were benefiting from CAE became the symbol of what was wrong with the higher educational system. Student protest demands included a combination of calls for expanding public education, improving the quality of education across all types of institutions, phasing out private for-profit schools and moving towards universal and free access to higher education. Though it agreed with the focus on improving quality and expanding access to low-income Chileans, the Piñera administration staunchly opposed expanding public higher education and defended the focalized nature of government-subsidized loans for higher education. Because some of the governments’ officials—including the education minister—had been involved in private universities suspected of hiding a for-profit scheme, and because President Piñera argued that education was a consumption good—enraging students who argued in favour of education as an inalienable right—there was little room for dialogue and negotiation. Protests continued throughout 2011, twice forcing Piñera to sack his minister of education.

The evolution of educational reform in Chile highlights the way in which the market-based reforms introduced by the military have been both modified but also legitimized after the restoration of democracy. By putting a focus on expanding access and earmarking public spending to benefit the lowest two income quintiles, the Chilean government has sought to correct market imperfections. However, by mending the reforms rather than undoing them, democratic governments have also further consolidated the market-based fundamentals of the Chilean economic model.

**Market-friendly institutional constraints**

Market-based reforms were also introduced by the military in the pension system, health, housing, transportation and in public works. After democracy was restored, a sophisticated build-operate—and-transfer scheme was designed to promote private investments in public works. That allowed public spending in public works to focus on socially relevant sectors that were not attractive to private investors.

The privatization of the pension system in 1982 and the adoption of an individual pension savings account sought to prevent the impending crisis of the existing generous but not widespread pay-as-you-go system. The new pension system represented a heavy cost for the public sector as the state continued to fulfil its commitment to those in the old system but stopped receiving contributions from those in the workforce whose pensions were not being saved in private for-profit pension fund companies. Information asymmetries unfavourable to workers and insufficient competition between the pension funds have generated widespread criticism of the system. As many of the workers who are now retiring had big gaps in their contributions, their accumulated pension funds are not sufficient to guarantee them a decent pension. In 2008 a pension fund reform that guaranteed a state-provided minimum pension was introduced. That created an additional burden for the state, although a sovereign wealth fund was also established, using excess revenues from copper exports.

A health reform in 2005 that introduced a state-guaranteed treatment for a basket of common illnesses also modified the existing strict market-based mixed private-public health provision scheme. In the past 20 years, several smaller reforms in housing policies and poverty alleviation policies also intended to correct market-based imperfections and to introduce
universally guaranteed minimum state-provided services for functions that were partially or fully privatized under military rule.

When democracy was restored in 1990, the incoming Concertación government was critical of the market-based mechanisms introduced by the dictatorship. However, the rapid economic growth the country was experiencing at the time and the institutional constraints left in place by the dictatorship in the constitution limited what the Concertación could do.

The conditions under which the transition took place were admittedly difficult. The military retained oversight power on several democratic institutions and General Pinochet stepped down from the presidency but remained as head of the army. Those limitations further restricted the range of action of the new government. As governments have to choose among different priorities, and because the Concertación wanted to avoid testing the strengths of democratic institutions, the Aylwin administration chose to focus on reducing poverty rather than on changing the foundations of the economic model. Thus, rather than pushing for reforms that would move the country away from the neo-liberal model, the Aylwin administration focused its efforts on social spending. Aylwin wanted to transform the economic model into what came to be known as the neo-liberal model with a human face. The Concertación governments embraced the social market economic model as its own. If Pinochet is the father of the economic model, under Aylwin the Concertación became a deserving stepfather.

The institutions left in place by the military were intended to block an electoral majority from introducing changes that could unilaterally change the economic model. Thus a number of counter-majoritarian provisions were put in place in the constitution. Although the constitution established a strong presidential system, Congress has an effective power to block the executive. A bicameral Congress is elected through an unusual electoral system. Each district elects two legislators and seats are assigned by proportional representation, but because only two seats are distributed in each district, the winning party must obtain twice as many votes as its competitors to gain both seats. Otherwise, one seat goes to the winning party and the other goes to the losing party. The electoral system can be described as an insurance against defeat. The winning party will find it difficult to transform its electoral majority into a seat majority. The losing party benefits as it retains half of the seats with only one-third of the votes. This counter-majoritarian feature was implemented by the outgoing dictatorship to prevent the Concertación from transforming its electoral majority into an overwhelming seat majority in Congress when democracy was restored. In addition, the constitution also provided for non-elected senators, who comprised 19% of the Senate. As those non-elected senators were appointed by the outgoing regime, the Concertación had a minority in the Senate despite having won a majority of the elected seats.

A number of other institutional features were put in place in the constitution to force the winning coalition to bargain with the losing coalition to implement reforms. Strong enforcement mechanisms were also put in place to facilitate compromise. The institutional set-up also fostered the emergence and consolidation of strong parties that had long-term horizons. As a result, political parties ended up negotiating with ideological opposites to change the status quo. From 1990 to 2005 a number of constitutional reforms were adopted that gradually eliminated authoritarian enclaves from the constitution and eliminated non-democratic features (including the non-elected senators). Those reforms further strengthened democratic institutions but also helped to legitimize the institutional set-up initially imposed by the authoritarian government.

To be sure, the Aylwin administration and subsequent Concertación administrations introduced corrective changes to focus social spending on the neediest. Earmarked spending was the Concertación’s response to the limited size of the public sector that the Pinochet government had ensnared in the constitution. Since public resources were scarce, the government sought to
spend almost exclusively on the lowest two quintiles of the population. The earmarked social spending policies produced impressive results in poverty reduction in the years following democratic restoration. As Figure 12.4 shows, poverty declined from 38.4% in 1990 to 20.5% in 2000. Since then, poverty has declined more slowly to reach 14.4% in 2011.

Reductions in inequality have been more difficult to come by. Figure 12.4 also shows that the Gini coefficient has barely moved since 1990. As the economy has grown steadily, the small decrease in inequality can be seen as good news. Inequality tends to increase during periods of economic growth. Despite a solid economic expansion, Chile did not see its inequality levels increase. The government’s effort to focus social spending on the lowest two quintiles helped to keep inequality at bay while the economy expanded and millions were lifted out of poverty.

However, the fact that inequality remains high poses a long-term threat to the success and stability of the Chilean economy and its democratic system. Since democracy is built on the premise of majority rule, high levels of inequality constitute an unstable equilibrium. If the majority of the people earn salaries below the mean, they will probably end up voting for candidates who promise redistribution. If social mobility is limited, the push for redistribution will be even stronger. The threat of confiscation for those whose salaries are well above the national mean will also feed instability.

The tax structure in place in Chile also limits the effect of social spending on reducing inequality. The most important tax in place in Chile is a value-added tax (VAT) that charges an across-the-board 19% tax on most goods and services. Although there is also a progressive income tax structure, the large majority of Chileans are exempt. Higher-income Chileans have access to a number of legal and semi-legal tax breaks and loopholes that reduce their effective marginal tax. Companies pay a 20% tax rate on their earnings, but they can also delay their payment if they reinvent their earnings.

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*Figure 12.4 Poverty rates and Gini Coefficient, 1990–2011*

Source: CASEN data, www.minidenodesdrellosocial.job.cl
As a result, the taxes people pay as a proportion of their income can actually be higher for those in the middle-income quintiles than for those in the top quintile. Those in the middle who consume all of their earnings end up paying a higher tax rate (19% VAT tax on all they consume) than those in the top income brackets. Those at the bottom also pay 19%, but they benefit from earmarked social spending. Thus, the lowest two quintiles pay 19% of their income in taxes, but they received a bulk of government social spending. Those in the middle two quintiles also end up paying 19% of their income, but they receive little by way of government subsidies. Those in the top income bracket take advantage of tax breaks for savings and investments and might end up paying a lower marginal tax than those in the middle. To be sure, they do not receive government subsidies either, but their contributions are lower than those in the middle-income brackets.

The 2011 student protests can also be understood as the revolt of the middle class. Those in middle-income groups took to the streets to protest against the economic model. Since the role of the state is limited to a weak regulatory function and to subsidizing those at the lowest end of the income ladder, those in the middle believe that they get the short end of the stick. They contribute at the highest tax rate and receive very little in return. As they took to the streets to demand stronger public sector presence in education—and polls also show support for a stronger public sector role in health, pensions, housing, labour rights protection and utilities—the Chilean middle class began to show its muscle. In a well-functioning democracy, interest groups and public opinion play an important role in influencing public policy and government spending. In Chile, the student protests of 2011 can be seen as a signal that the market-friendly economic model imposed by the authoritarian regime is in trouble. However, one can also interpret the social movements as an indication of the opposite. Precisely because the market-friendly model promotes competition and protects the rights of consumers, the Chilean citizenry—and especially those in the middle-income quintiles—has embraced the basic tenets of the model and has begun to push for their interests, wants and needs. The ability of the elites and policymakers to adjust the economic model to make it fairer to those in the middle who pay the highest tax rates and get little in return will determine if Chile can successfully move beyond its present level of development to become the first Latin American country to join the select club of industrialized nations.

Notes

Chile’s successful history of development


16 Ibid.


18 Ibid.


27 Ibid.

