



Citizen-Centered Approaches
to State and Market



The Development of Frameworks for Effective Policymaking in Chile

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I. Introduction

Chile's transformed from a profoundly conservative, poor country- which suffered the chaos of a failed socialist experiment and subsequent military dictatorship in the 1970s and 1980s- to an open, prosperous and stable market-democracy today. Measurement of almost any social and economic indicator for the country between the mid-1970s and the early 2000s shows an upward trend - democracy is now consolidated, human rights are enshrined in law, economic development has driven improved standards of living, and good governance underpins policymaking and implementation.

II. Background

General Pinochet took power in Chile through a coup d'état in September 1973. To counter the economic crisis, the military junta put in place a number of first-generation structural reforms (privatization, trade liberalization, tax and financial reform). Although these reforms laid the basis for positive change, they were often poorly implemented and costly.

During the military government, civil liberties and political and human rights were systematically repressed or violated. Elections in 1990 led to civilian rule, but the authoritarian constitution and the fact that Pinochet remained as head of the army constrained these governments. Although Pinochet was subsequently removed, he remains a deeply divisive figure at home as abroad - and whilst the country has moved on from the military regime that he headed, its legacy and memory are not yet fully resolved.

The socio-economic results achieved under these post-military governments were substantial- poverty declined from 44.8% of the total population in 1987, to 22.2% in 1998, while extreme poverty was reduced from 16.5% to 5.6% in the same period.

III. State Transformation

Key factors commonly understood to have driven Chilean transformation include:

- i) **Pathbreaking Policies.** A series of market-oriented economic reforms under Pinochet that began in the mid-1970s, and continued and deepened in the 1980s and 1990s, supported economic turn-around. Indeed, it was to some extent the radical reforms of the 1960s and early 1970s under Frei and Allende that allowed the military junta to push through such deep economic reform in the 1980s. During this period, Chile took advantage of a globalizing economy through fiscal discipline and an open trade regime, combined with carefully sequenced financial liberalization within a strengthened regulatory framework. This allowed the country to avoid deficits and debt servicing burdens, ensure that real interest rates remained low, and support reform through the requisite oversight.
- ii) **Governance Design.** By World Bank measurements of institutional governance, Chile was the best ranked Latin American country by 2002, ranking higher than many developed countries including Spain, Japan, Hong Kong and Italy.¹ There are numerous statistical studies that indicate that it is the quality of the country's institutions that have been the key factor underlying the transformation since the early 1970s. These institutions grew out of and drew upon a relentless focus on governance design to ensure efficiency and transparency, and institutional and organizational learning combined with a process to acquire the technical capabilities and skills to

¹ Kaufmann et al. "Governance Matters III: Governance Indicators for 1996-2002" (World Bank, 2003)

improve existing processes. Through governance processes, Chile has found a balance of cooperation and competition in an institutional context that builds reciprocity and collaboration through the “embeddedness” of the state.²

- iii) **Policy Functionality.** Chile has adopted best practices in public policymaking, with strict measurement and benchmarking rules and tools to ensure appropriate use of public resources. Implementation is carried out by the Budget Unit within the Ministry of Finance through a transparent system that is supported strongly by the government and public. Each institution must define its mission, strategic objectives, key products and services and appropriate measurement systems. Over 100 public agencies are subject to self-performance monitoring (but with random external audits) and bonuses are given to government employees when institutional goals are met. As a result, Chile receives high marks on international indices for civil service quality and transparency.
- iv) **Leadership and Management.** In Chile, leadership and visioning have been combined in several ways- throughout and subsequent to the transition, leadership has become structured around teams and parties, not the *caudillismo* that has undercut government functionality in many other Latin American countries. This has allowed the Concertación governments to place a strong emphasis on coalition programs and enduring power, generating a longer-term political horizon in comparison to political parties that have coalesced around charismatic leaders. Part of this is a clear sense, which has permeated the population in Chile, that objectives are limited and the resources for change are finite, and thus objectives must be realistic and manageable.
- v) **Virtuous Sequencing.** The key to positive change in Chile has been the continuity of reforms. For example, the creation of the PSA pension system first, and the privatization of large state-owned companies second, resulted in a “virtuous sequence” through incentivizing workers and increasing the return these workers received as a result of their pension investments in the newly privatized companies. The Concertación governments have also clearly understood the need to tackle reforms in a sequential manner in order to maintain positive momentum and move from improvisation to choreography. The Alywin government, for example, postponed addressing these difficult issues in its first 100 days, instead negotiating a tax increase with the conservative opposition, followed by changes to labor laws.³ This allowed for a sense of forward progress.
- vi) **Building Technical Capacity.** The transition in Chile was supported through the technocratic approach to governance that dominated this period. The rise of the technocracy is intimately related to the rise of the middle-class in Chile- and the sense that education should provide the path towards social enhancement, with science rather than religion guiding state affairs, and the creation of citizenship becoming the central focus of governance. From 1973 onwards a large number of research institutes, think tanks and NGOs grew as part of the challenge to the regime, and functioned as hubs for the development of capacity and ideas which came to ensure effective governance under subsequent administrations.
- vii) **Coherence and Consensus.** Rather than a sudden rupture with the past, many of the institutional arrangements and economic policies of the 1980s were kept in place even as the political nature of the country changed substantially. In the 1990s, dialogue between the new administration, citizens and the private sector was sealed by a social pact that enabled the creation of reciprocal trust based on a high degree of shared interests and views among Chilean stakeholders. A

² Perez-Aleman, P. “Learning, Adjustment and Economic Development: Transforming Firms, The State and Associations in Chile” (*World Development Vol.28, No.1*), p.43

³ Navia, P. and Velasco, A. *The Politics of Second-Generation Reforms*, in Pablo-Kuczynski, P. and Williamson, J. *After the Washington Consensus: Restarting Growth in Latin America* (Washington, DC: Institute for International Economics, 2003) p. 297

uniquely Chilean, historical ability to compromise based on good faith was also important, and the stability this produced ensured that the political and economic dimensions of the transition were mutually reinforcing, and generated a positive-sum rather than zero-sum pattern of thought.

IV. Market-Building.

Beyond the path-breaking economic policies outlined above, three examples of market-building/economic visioning in Chile are worth noting:

- i) **Management of Natural Resources.** Unlike many other resource-dependent developing countries which squander resource wealth through mismanagement, corruption or misconceived social programming, Chile has taken advantage of its copper windfalls through carefully designed and far-sighted instruments such as the Copper Stabilization Fund (CSF). The CSF, created in 1985, was based on the mandate that excess revenues be deposited to cover shortfalls when copper prices decline. The Economic and Social Stabilization Fund has now replaced the original CSF, and receives fiscal surpluses above 1% of GDP (above a one-off payment of approximately \$5 billion). The fund now totals around 10% of GDP, and has allowed Chile to spend more per capita as part of a recent fiscal stimulus plan (US\$4bn (2.8% of GDP) than most developed countries during the current financial crisis.
- ii) **Public-Private Partnerships.** The government initiated an aggressive concessions plan through a system of Build, Operate and Transfer (BOT) contracts, through which private companies build infrastructure and then have the right to charge the public for use. This has allowed the state to significantly expand new infrastructure without large fiscal deficits, and given private ownership, has improved standards in terms of construction and maintenance. In the late 1990s the government also needed to upgrade the country's ports in order to maintain trade levels and facilitate commerce. It granted long-term concessions to private investors in return for private upkeep and management of the ports. The higher rates charged by the private service providers have been offset by the more rapid processing procedures, which have left overall shipping costs lower and increased transfers to the government.⁴
- iii) **Developing Domestic Industry.** Successful transformation of the relationship between firms and the state in Chile occurred as a result of three key factors:
 1. the state becoming involved with the search for new ways to organize production, encouraging new standards of product quality and processes to upgrade the capabilities of Chilean firms- this conditioned the public debate and changed the nature of communication between the government and firms
 2. the government also redefining relations with business associations so as to focus on the efficacy of business operations, which in turn led the state to support new associations that could diffuse knowledge and promote collective learning
 3. relationships were transformed between customer firms and suppliers in production networks, with new institutional arrangements and capabilities of larger firms helping to upgrade small suppliers for the benefit of the system as a whole.⁵

V. Key Factors

Key factors that underpinned the Chilean transition included efforts to:

⁴ Aninat, C. Landregan, J. Navia, P and Vial, J. "Political Institutions, Policymaking Processes and Policy Outcomes in Chile" (Inter American Development Bank, February 2006), p.40.

⁵ Perez-Aleman, P. "Learning, Adjustment and Economic Development: Transforming Firms, The State and Associations in Chile" (*World Development Vol.28, No.1*), p.57

- i) **Utilizing Existing Assets.** After a brutal military regime, Chile experienced a deep lack of trust within society that has been slowly overcome through concerted investment in trust-building processes. This means the development of a conception of the future that is different to the past, through using rather than discarding the existing institutional and policy framework. The Concertación governments understood this point clearly, working through the existing constitution to come to power and maintain stability within the political system, while also recognizing that Pinochet's economic reforms were critical to maintaining economic growth and a compact with the business classes.
- ii) **Authority and Leadership.** State-building requires responsive, flexible and collective leadership that can facilitate cooperation and collective problem solving to address critical tasks. During the Chilean transition, the country's leadership generated belief that the state could enhance possibilities and opportunities, and created the conditions for positive change to take place through the use of national resources and thinking. A set of unified practices and behaviors, entrenched in the rule of law, created the sense of Chile as a common space in which the Chilean people could collectively move forwards. This was harnessed by the leadership of the Concertación governments to drive development, good governance and social justice.
- iii) **Learning Organization via Problem Solving.** Chile actively adopted a Problem-setting approach, which involves design rather than planning, and the development of context-specific innovations rather than mere adherence to existing institutions and mechanisms. Immediately post-Pinochet, the Aylwin government did not ask itself what the problems were that the country faced, but rather: "What does the government have to do in order to be a success?"⁶ This allowed for the development of a root cause analytical approach, through which policymakers questioned assumptions and methods within the system and generated alternative solutions, through reform of the pension system or public-private partnerships, for example.
- iv) **Building Systems.** During this period, Chile also developed learning organizations. Through the design process, ensured that institutions became learning organizations "skilled at creating, acquiring, interpreting, transferring and retaining knowledge, and at purposefully modifying behavior to reflect new knowledge and insights."⁷ The Chilean state developed a capacity to propose policies based on strategic and long-term priorities, and also a flexibility to learn from failures and replace inadequate policies with new ones. This has allowed for a continual adaptation which has ensured that policies, organizations and programs have not become entrenched in sub-optimal but unchangeable patterns as is so often the case elsewhere.
- v) **Expect a Long-Term Timeframe for Change.** The Chilean example indicates that creating effective state institutions is not a rapid or fixed-term endeavor, but is rather an extended and continual process, which requires ongoing change, refinement, adaptation, and feedback loops to ensure success. Too often in transitional contexts, external actors provide sporadic, short-term assistance based on their own budget cycles and priorities, and set overly-optimistic goals for under-resourced and poorly targeted projects.

VI. Conclusion

In the early 1970s Chile was a highly controlled, statist economy with political and economic problems so serious that they threatened to tear the country apart. Now, 40 years later, the transformation has been substantial, and Chile is seen as a model of good governance and free-market reform both within Latin America and around the world. The transition is not by any means complete- further progress may require

⁶ Interview with Eduardo Boeninger, Santiago, June 2009

⁷ Garvin, D. *Learning in Action: A Guide to Putting the Learning Organization to Work* (Cambridge: Harvard Business School Press, 2000) p.11

a new, more flexible social agreement as Chile moves away from elitist society and towards a more autonomous, meritocratic and individual-centered present. Chile does, however, hold some important lessons for other countries facing difficult transitional processes.