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From Its Past and Present, Chile Is Poised to Provide a Better Future for Its People

Introduction

In this introductory chapter, we provide a glimpse of Chile today – what it offers economically, socially, and in terms of democracy, as well as the challenges it faces in those dimensions. The focus of this book is on the political economy of the post-Pinochet transition in Chile, when the country tried to restore its democracy and keep the economy going along (largely) neoliberal lines, moderated by mildly improved levels of social protection and restricted by a constitutional charter oriented toward limiting political diversity, protecting the economic model, and ensuring the primacy of markets and the profit-motive over the state and social rights. The model yielded acceleration in the rate of economic growth that as of 2010 put Chile on top of the Latin American region, along with Argentina, in per capita income levels. The Chilean economic model launched in the mid-1970s pioneered, in a developing-country context, free-market and privatization policies, thus positioning Pinochet, along with Reagan and Thatcher, as one of the early political backers of free-market economics. Later, many Latin American countries, Central European countries, the former Soviet Union and the former Soviet bloc countries, and even China embarked on some variant of neoliberal economics, viewed as the solution to world economic and social challenges and the route to prosperity, progress, stability, and human welfare. The recent international financial crisis triggered in 2008–2009 and originated in the centers of world capitalism, such as the United States and some European countries; its aftermath – stagnation, debt problems, fiscal deficits, and unemployment – has started to shatter the dominance of market fundamentalism, both in economic theory and in public policy.

The OECD Route

In Santiago, Chile, on January 11, 2010, after twenty years of post-Pinochet transition, President Michelle Bachelet signed a membership agreement allowing Chile into the Organisation for Economic Co-operation and Development (OECD); Chile thus entered the club of thirty-one countries considered the elite economies in the world.[1] Of course, Chile's membership in the OECD is a testament to Chilean progress in the past twenty years, although for a developing country to be a member of a club of fundamentally rich countries has evoked some odd feelings.[2] As argued in this book, Chile has been on the move both economically and democratically. This does not imply, however, that in that same time span, the country has made the reforms necessary to include *all* its people under the umbrella of economic progress. In fact, despite the restoration of democracy with its limits and shortcomings in 1990 and the rise of per capita income (around US$14,000 in 2010), Chile is a country with inequality levels (of income, wealth, territorial development, access to social services, and so on) well above OECD standards and remains a case of economic development still distant from the prototype of the more mature, advanced countries that belong to the OECD. We believe, however, that the time is ripe for Chile to take the next step toward national "greatness" and further democratization if it can shed the harness of free-market dogma that serves well the economic interests of the elites but postpones opportunity for all.

A Diverse and Rich Economic Geography

Chile is that slender slice of land on South America's western edge that has an almost 3,000-mile coastline of the Pacific Ocean – a geographic

[1] Chile ratified the agreement on May 10, 2010. Twenty countries (eighteen European countries plus the United States and Canada) originally signed the Convention on the Organisation for Economic Co-operation and Development on December 14, 1960. As of 2011, thirty-four countries including Asian and Latin American countries have become members of the Organisation.

[2] Mexico and Turkey are two other developing countries that have chosen to enter the OECD.

advantage for trade. Bordered by Peru on the north, Bolivia and Argentina on the east, and Cape Horn on the southern tip of the South American continent, Chile is a country of diverse topological beauty. On its eastern border, Chile is separated from Argentina by the rugged Andes Mountains. Along the greater expanse of that range, Chile stretches through five major regions, each offering distinct ecological richness – and together offering a breadth of natural-resource exports and a burgeoning tourist industry.

Its arid Northern Tier (Norte Grande) contains the Atacama Desert, one of the driest deserts in the world, protected by the Andes from the prevailing winds and thus rainfall. It is here that Chile's large copper-mining industry is located, which along with other mineral deposits gives the desert its ochre hues. Just south is the Near North (Norte Chico), a semiarid region whose valleys provide broad ground for cattle raising and, more recently, fruit growing. Between the Andes and a range of coastal mountains (the Cordillera de la Costa) lies the belly of Chile – the Central Valley (Chile Central) – whose fertile land is home to Chile's agriculture, including its extensive wine vineyards, and most of its major cities, including its capital city, Santiago. The southern portion of Chile's Central Valley also contains depleted agricultural land that has been reforested for lumber, especially for the cellulose and paper industries. The southern tier of the country contains the South (Zona Sur) and the Far South (Zona Austral), which, moving southward, are home to pristine turquoise lakes formed from hundreds of rivers descending from the Andes (ideal for freshwater farming of various species of trout and salmon), rolling hills (ideal for raising cattle and producing milk, cheese, and butter), old-growth forests (augmenting its productive lumber industry), and then a continental coastline that features inlets, fjords, thousands of archipelago islands, and snow-tipped mountains. Both zones in the South attract a large number of tourists throughout the year, contributing to Chile's emergent service industry.

Santiago, the capital, located in the Central Valley, is home to approximately 40 percent of the country's population. In fact, according to the most recent census, 87 percent of Chile's citizens reside in urban areas, bunched largely in the Central Valley, southward from Santiago. The largest concentration of economic activity is in the Region Metropolitana, the greater Santiago area, another manifestation of the economic and administrative concentration of the country. Obviously, this urban congestion has its attendant problems, to which all urbanized areas are prey – pollution, overcrowding, crime, class segmentation (including large pockets of poverty), and other quality-of-life issues. Alongside the natural beauty of Santiago is the city's human geography – in which neighborhoods are stratified starkly by topography. The rich and the upper-middle class reside in the Barrio Alto (the higher parts of the city), and the working and lower-middle classes reside in the lower elevations of the city, where the factories are also located. This living arrangement is a microcosm of the pervasive inequalities that exist throughout the country.

Economic Progress: Contrasts, Contradictions, and Social Needs

Yet today, Chile is considered one of South America's most stable, (formally) democratic, and prosperous nations. It often ranks high in the major indexes used internationally to judge a country's performance, including economic freedom, perception of government corruption, global peace, global competitiveness, and prosperity. Among *all* countries worldwide, it usually scores in the top thirty in these same categories. In fact, according to the 2010 Index of Economic Freedom elaborated by the (conservative) Heritage Foundation, which measures liberalization in areas like trade, business, investment, the financial sector, monetary policy, property rights, the labor market, and the level of corruption (the Index is shy on labor rights and working conditions, however), Chile ranks 10th overall among 183 countries.

As mentioned before, in the Latin American and Caribbean region, Chile has one of the highest per capita GDP (in purchasing power parity), along with Argentina. Per capita GDP, however, overstates average living standards, as it is very unevenly distributed. It is here that dissimilarity with developed nations become apparent in the Chilean model. Its export base, albeit dynamic and vigorous, is heavily reliant on exhaustible natural resources; its private, for-profit pension fund system contributes to the development of capital markets, but a reduced number of pension fund management companies form the market and charge significant fees and offer limited coverage; and competition by the state or other agents is stifled by a powerful lobby.

Inequality is high by international standards and well above those of the OECD.

Chile also has an ample export base (although manufacturing exports are still not fully developed) and is highly committed to free trade, with an extensive and diverse trade network. It has the largest, most lucrative copper industry in the world whose benefits largely accrue to foreign corporations owing to a very liberal concessions system to exploit copper in Chile, ample agricultural products and seafood, a range of forestry and wood products, and a major niche in the international wine market. It has also entered into free-trade agreements with the European Union and a host of nations, including the United States, Japan, China, and Australia.

Nevertheless, its export composition does rely heavily on trade in commodities with volatile international prices. A concern is how long the Chilean export strategy can continue to rely so heavily on natural resources; for example, copper exports accounted for more than 50 percent of total exports in 2010, and primary products accounted for 68 percent of exports, with main industrial products consisting of processed food, cellulose, paper and wood, and chemical products. At some point, sustainability will become an issue, whether in the form of resource depletion or environmental/ecological consequences.

Chile is also ahead of the curve for extractive-industry countries that yield high returns for companies that enjoy low royalty and very favorable tax rates for nonrenewable natural resources. Low tax rates for foreign companies is a controversial policy given the relatively low share of copper-industry profits internalized by the Chilean state, particularly at times of record prices. Currently, no more than one-third of the copper industry is still state-owned (by the government conglomerate CODELCO, Corporación del Cobre down from approximately two-thirds by 1990 in a steady process of de-nationalization of the copper sector), and the capital-intensive and monopolistic nature of the industry means that it does not provide a substantial job-creating mechanism either within the industry or around it (in the form of value-added business support and supply services). Furthermore, like most extractive industries, its success depends on the worldwide price for copper, which fluctuates according to speculative mechanisms and changes in world demand.

In 2006, President Michelle Bachelet created an Economic and Socialization Fund to provide excess copper revenues for use during economic downturns – a fund not necessarily established by all countries where GDP relies heavily on extractive industries. As of December 2010, Chile has accumulated approximately US$13 billion in copper-driven reserve funding. In fact, in January 2009, President Bachelet earmarked more than US$1 billion of that fund to help middle-income families and smaller businesses endure the global financial crisis, US$500 million of which went to Chile's state-owned Banco Estado to provide credit for qualifying businesses and the other half to a fund that was to subsidize home purchases by middle-income families, thus creating more jobs in the construction industry. During the recession year of 2009, Chile spent nearly US$9 billion of the stabilization fund for countercyclical demand policies, and even so, GDP contracted by 1.7 percentage points in that year.

Chile also has in place a privatized pension system (AFP, Administradoras de Fondos de Pensiones) that is compulsory and against which the state cannot compete by offering pension fund management services. The AFP system is considered to have helped boost the country's capital market because it has encouraged domestic investment and savings. Nevertheless, the AFP charges high fees (compared with a public system) to contributors, a practice that ultimately diminishes pensions upon retirement. Similarly, Chile's private pension system has comparatively low coverage rates, reaching only those who are formally employed, which as of the first quarter of 2011 was only approximately 66 percent of the working population. Nevertheless, the reforms of 2008 extended universal minimum pension benefits, but they were funded by the state. Moreover, only six private AFP companies manage the retirement savings of millions of Chileans who neither have a voice nor participate in how those funds are used. Still, in spite of the pension reform of 2008, the state is prevented from running its own pension fund managing company, which could provide additional competition to the AFPs.

Since 1987, Chile's official poverty rate has fallen from 45.1 percent to 15.1 percent (in the United States, it ranges between 10 and 16 percent, varying annually); its "extreme poverty rate" fell from 17.4 percent to 3.7 percent. Some significant questions remain, however, about the true extent of the country's poverty reductions, as the official statistics are based on an outdated household-expenditure survey of the mid-1980s that measured consumption shares (even though there is a more updated version) and thus probably underestimates the poverty line, diminishing the share of the population below the poverty line. A study updating poverty lines (Larraín, 2008) for the 2000s using more recent consumption patterns shows poverty rates that are *twice as* high as the official poverty line. Chapter 5 analyzes this theme in more detail.

Moreover, Chile lags behind other countries on many environmental, technological, and social indicators. For instance, it is "vulnerable" on the SOPAC/UNEP Environmental Vulnerability Index; it does not place well on the Yale University/Columbia University Environmental Sustainability Index, and in both the World Economic Forum's Networked Readiness Index and the UN e-Government Readiness Index, Chile ranks outside the top thirty. The country spends less than 1 percent of GDP in research and development and, most woefully, is number 7 in Latin America and the Caribbean and number 48 (of 134 countries overall) in the World Economic Forum's Global Gender Gap Index (version 2010).[3] Particularly controversial has become the way it deals with the environmental impact of large investment projects such as Hydro-Aysen (a mega water-based energy generation project in Chilean Patagonia), which has given rise to popular criticism and rejection by environmental groups and the population at large. Chile's development strategy needs to enhance productive employment, environmental protection and restoration, and accessibility to information technology needs, and must unleash the market potential of Chile's small- and medium-sized businesses, which employ close to 80 percent of Chile's working-age population.

The Chilean development experience is rich and controversial. As hinted, each of these particular achievements also has its downside. But again, one cannot take away Chile's economic progress and its elevation to OECD status, although this move can create a sense of complacency and distract the country from its many pressing development

[3] The Networked Readiness Index is an international assessment of the impact of Internet Communications Technology (ICT) on the development process and the competitiveness of nations; and the e-Government Study Index measures the extent to which government provides accessible, valuable information on government policies, procedures, and processes on its Web sites.

needs. For these achievements, Chile can perhaps thank neoliberal, free-market economic policies – but with bitter irony. Since the mid-1970s, under the watchful eye of the U.S. government (in its broadest sense), free-market policies were first implemented as an experimental economic revolution under the military regime of General Augusto Pinochet, before Ronald Reagan and Margaret Thatcher popularized them as liberating economic imperatives. From the United States came the premier free-market economist Milton Friedman, who helped Chilean economists implement the neoliberal model under his attentive eye and with guidance from colleagues, mentors, and graduates of the University of Chicago's School of Economics. It was Professor Friedman himself who, in a self-congratulatory gesture, coined the phrase "the economic miracle of Chile."

Among the free-market-reform legacies implemented by Pinochet and his "Chicago Boys," which continued and exacerbated during the two decades of center-left governments, is excessive income inequality, which, at least since 1987, has persistently hovered between 53 and 56 percent, as measured by the Gini coefficient, a level that puts it among the top 10 percent in the world. This level is higher than most of its Latin American counterparts (except Brazil and a few others), higher than most countries and regions of the world (on par with four countries in sub-Saharan Africa), and much higher than what is typically considered by economic observers to be economically efficient. As a reference point, the OECD average Gini coefficient is close to 38 percent (the index ranges from 0 to 100, with lower numbers meaning lower inequality). In turn, as documented in Chapter 7, Chile has its own share of billionaires, who compete in the rankings of *Forbes* magazine with the super-rich of developed economies and emerging markets. Economic elites have become extremely rich and politically influential in Chile, and this process continues today.

In many respects, the Chilean social contract with its people – defined by its income inequality and many other social indicators – is disconcerting when it otherwise scores well along various economic dimensions. And it is counterintuitive in a country whose population has a "common cause" democratic experience in which both laborer and professional alike endured authoritarian regime rule from 1973 – the year of the military coup – to 1989, when the first democratic elections were held. Since then, four Concertación administrations have guided uneven economic progress under a version of the neoliberal model, complemented with more active social policies. But if Chile is to become a true "miracle" – to the extent that "economic miracles" exist – then it cannot continue to perpetuate an income gap and huge wealth disparities that could eventually polarize what is considered to be a cohesive society and that effectively thwarts building a middle-class and democratic society.

As the reader learns more about the economic and social landscape of Chile and its imminent challenges, some questions and issues will arise as threads that might be woven into a resolution.

Is Chile "tied to the hip" of Latin America in general, whose inequality is higher and percentage of middle class lower than in other nations and regions throughout the world? Or does Chile lag in and of itself because it is not yet unleashed from strict adherence to the neoliberal paradigm?

Why did the four social-democratic (Concertación*)* administrations that came after the Pinochet regime choose to maintain, on the whole, albeit with some variations, economic and social policies so close to the spirit of the Washington-consensus paradigm? Under the neoliberal paradigm that fostered rapid wealth accumulation largely for the rich, what types of jobs have been created? Did those administrations foster entrepreneurial activity at all levels? Did they integrate small businesses into economic progress? Exactly how did they respond to the income-inequality and middle-class dilemmas? For instance, one sign of an empowered middle class and a fairly treated working class is the existence of labor unions and civil society organizations that ideally should protect wage and compensation gains by laborers and workers.

Why has there been such a concentration of wealth during the last quarter-century or so in Chile? Who owns the wealth in Chile? Do the wealthy maintain their wealth because of an ineffective tax structure, monopolistic behavior, the nature of the global free market, or ineffectiveness or apathy by government? Why have they not created more jobs?

In Chile's free-market economy, does the fact that its copper industry and other mineral resources are largely owned by foreign companies that enjoy very favorable tax treatment contribute to income inequality, a concentration of wealth, and a phantom middle class, and if so, to what extent?

What should be made of the indexes in which Chile does not rate favorably: environmental vulnerability and sustainability, gender equality, unemployment, education and health, crime and violence, and social stratification?

In contrast, Chile has one of the highest ratios of military spending to GDP in the Latin American region: 3.5 percent (around US$6 billion), according to the Swedish International Peacekeeping Research Institute, SIPRI, which collects data on defense spending worldwide.[4] As a reference point, government spending in education was 4.4 percent of GDP in 2009. As of 2010, Chile was still devoting 10 percent of the gross revenues of CODELCO to the armed forces (this allocation is not scrutinized in parliament owing to a "confidential" law, the Ley Reservada del Cobre). This practice has certainly contributed to Chile's relatively high percentage of military spending. The center-right Piñera government has vowed to prepare legislation to phase out this law (in place for several decades) and replace the funding of the armed forces with a more transparent and accountable budgetary mechanism. The extent to which the armed forces, a powerful enclave in Chilean society, will receive fewer (or perhaps more?) resources after the eventual phasing out of the Ley Reservada remains to be seen.

Features of the Post-Pinochet Democracy

As we discuss in Chapters 2 and 7, Chile after the Pinochet regime is a case of an incomplete and "low-intensity" democracy. For nearly fifteen years after the departure of the military (between 1990 and 2005), nearly one-third of parliament was composed of nonelected, appointed senators; the president of the country could not remove the higher ranks of the armed forces; and the constitution ruling the

[4] Military spending in Argentina is 1% of GDP; in Brazil, 1.6%; in Bolivia, 2%; in Venezuela, 1.3%; and in the United States, 4.7% (see SIPRI 2011). According to the Chilean Budget Office (DIPRES), however, defense spending in 2009 was just 1.2% of GDP. For definitions of military spending and its international comparability, see http://www.sipri.org/research/armaments/milex/resultoutput/sources_methods/definitions.