Economic Policy in Chile's New Democracy
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Abstracts

Public Opinion and the Future of U.S.-Panama Relations
Using survey data and interviews, this study examines Panamanian attitudes toward the United States and toward the central issues in U.S.-Panama relations. It also compares Panamanian attitudes with opinions toward the United States in the rest of Central America. The study finds that nationalism, system support, anticommunism, and, for the mass public, ideology are the most important variables in determining support for the United States. Elites are more nationalistic and less accommodationist toward the United States than the mass public. Concern about the politicization and misuse of the Panama Canal and adjacent lands has led many in the general public to support a continued U.S. military presence on the Isthmus of Panama.

Associations and Activism: Mobilization of Urban Informal Workers in Costa Rica and Nicaragua
Studies of Latin American civil society tend to assume that popular organizations promote "high-intensity" forms of political participation while political parties mainly encourage voting. This study compares the influence of these two forces in the urban informal sector. Association involvement, low in both samples, is related to "higher-intensity" participation, but the differential influence of associations and parties holds only for Costa Rica; Nicaragua's revolutionary FSLN has fostered a more politically active citizenry.

Economic Policy in Chile's New Democracy
The Aylwin and Frei administrations have taken a cautious approach in formulating economic policies. This article analyzes how they have maintained economic stability, fueled sustained growth, and coped with inflows of foreign capital. While achieving successes in macroeconomic policy, export development, and poverty alleviation, Chile also faces challenges, including high social inequality and the increasing difficulty of dealing with the effects of financial globalization.

Economic Policy in Chile's New Democracy

Kurt Weyland

As the first Latin American country to enact comprehensive market reform, Chile provides a particularly important case for evaluating the costs and benefits of the so-called neoliberal model.[1] Because the country has pursued market-oriented, export-driven policies for two decades, it is possible to assess these policies' lasting effect on economic stability, growth and development, social equity, and democratic consolidation. Moreover, the many Latin American nations that have switched to "neoliberalism" during the last decade may derive important lessons from Chile's experience.

The present assessment of Chile's economic policies focuses on the democratic governments of Patricio Aylwin Azócar (1990–94) and Eduardo Frei Ruiz-Tagle (1994–2000). It addresses several crucial theoretical issues.

- Under what conditions can new democracies enact and implement fiscally prudent, "conservative" economic policies, rather than giving in to pent-up demands, irresponsibly pursuing expansionary policies, and thus falling prey to economic "populism"? (Kaufman and Stallings 1989; compare Sachs 1989; Dornbusch and Edwards 1990)
- Do determined efforts to maintain economic equilibrium help or hinder growth and development? And does the market model allow for active developmental policies, executed by the state, that may be required to improve a country's comparative advantages and facilitate sustained growth?
- Do market-oriented economic policies enhance social equity by lowering poverty and reducing distributional inequality, or do they exacerbate social problems?
- Given these economic and social effects, will the market model remain compatible with democracy, or will rising tensions and discontent foreshadow instability, which in turn would undermine investor confidence and threaten economic success?

In essence, all these questions probe how tight are the constraints that the market model imposes on the economy, society, and politics. Is the insistence on economic stability compatible with other goals, especially growth and development, social equity, and political liberty?

The evidence discussed in this paper suggests positive answers to most of these questions. Sustained by the organizational strength and cohesion of the ruling center-left party alliance (the *Concertación de*

Partidos por la Democracia) and the Chilean state, the new democratic administrations adopted cautious macroeconomic policies that put a strong premium on maintaining economic equilibrium. Although it was a response partly to pressure from business and partly to lessons from the failure of "populist" economic experiments elsewhere in Latin America, this caution was also motivated by the economic stability and growing prosperity that Chile had achieved since the mid-1980s. Proceeding with the clear risk-aversion that people typically display when facing the prospect of gains, Chilean decisionmakers may have erred on the side of caution in their economic policies, which limited the opportunities for determined social reform, especially the redistribution of income.[2]

These cautious economic policies certainly brought considerable socioeconomic benefits. They contributed to a stellar record of sustained growth, limited the costs that inflation imposes on many people (especially the poor), and protected Chile from the boom-and-bust cycle caused by mobile international capital in Mexico and Argentina. They also allowed for a wide variety of active developmental policies, including improvement of Chile's infrastructure, financial support for small firms that developed new export products, training programs for workers, and a comprehensive educational reform. But the determination to maintain macroeconomic equilibrium also imposed some constraints on the effort to promote long-term development through an increase in the value-added of Chile's exports. For instance, the Central Bank, intent on further reducing inflation, permitted currency appreciation, which now threatens to make the country's manufactured exports less competitive.

Stability and growth also enhanced social equity. Above all, poverty diminished substantially as the income of vast sectors of the population—even many of the destitute—increased steadily. The important tax reform of 1990 and the additional revenues generated by impressive economic growth also allowed the government to increase social spending substantially, thus turning policy outputs—that is, the measures enacted by the government to address social problems—more redistributive. These measures, however, could not overtake the inegalitarian trends inherent in the market model. Chile's highly skewed income distribution, a crucial policy outcome, has not improved since the transition to democracy. The government's cautious approach and its reluctance to initiate conflicts with socioeconomic elites, especially private business and its political allies, impeded more determined redistribution, which might have come about through additional tax and labor reforms and a revamping of Chile's inequitable private health and social security systems. The persistence of severe inequality is the major blemish on the otherwise impressive record of the new democratic administrations.

Recognizing these accomplishments and reluctant to renew the fierce political power conflicts that imposed huge costs on the country

from the late 1960s to the late 1980s—that is, also displaying risk-aversion in the face of gains—a clear majority of Chileans have endorsed the government's cautious socioeconomic policies in both opinion polls and elections. Contrary to earlier fears, democracy and the market model have so far proven compatible. Continued social inequality, however, and the slow trickle-down of the fruits of growth compared to people's high expectations have fueled slowly rising discontent. Given the weakness of alternative political projects and forces, this *desencanto* is likely to lead not to radicalism but to resignation and withdrawal. Thus, although Chilean democracy does not face any frontal threat in the foreseeable future, its quality may suffer from growing apathy.

CAUTIOUS MACROECONOMIC POLICIES

Can new democracies adopt and sustain prudent economic policies that preserve macroeconomic equilibrium? Or do they capitulate to the pent-up demands of their followers, who, long excluded from power, insist on rapid compensation for the sacrifices the preceding dictatorship imposed on them? (See Kaufman and Stallings 1989.) Making such concessions risks initiating the feared "populist cycle," in which expansionary economic policies and drastic increases in social benefits cause a short-term boom but soon lead to exploding trade deficits and skyrocketing inflation; the surging economy raises the demand for imports much faster than exports can increase. The highest costs of this backlash fall on the poor (Sachs 1989; Dornbusch and Edwards 1990). This is what some observers expected would happen in Chile with the election of the Concertación (Dornbusch and Edwards 1994, 94).

Chile's new democratic leaders, however, deliberately avoided the populist cycle (Boeninger 1993; Flisfisch 1994, 25–26; Foxley 1993, 7, 17–19, 26–28). They had observed its devastating impact both in Chile's past, especially during the government of Salvador Allende (1970–73), and in other Latin American countries, especially neighboring Peru under Alan García (1985–90) (Sachs 1989, 19–20; Arriagada and Graham 1994, 249, 282). Conscious political learning from these dramatic failures provided an important motivation for the Aylwin administration to preempt or limit the demands of its supporters and followers so as not to endanger economic stability.[3]

The new government recognized the "social debt" left behind by the regime of Augusto Pinochet and determined to modify the economic model to address these problems, which included grave deficiencies in the public health and education systems. But it chose a gradualist approach that precluded immediate drastic improvements. For instance, social spending would increase only in fiscally responsible, noninflationary ways. The basic requirements of the market model would set the

parameters for social reforms, especially by limiting the available resources and by precluding redistributive conflict, which could trigger capital flight. The government encouraged private actors to proceed in similarly cautious ways, prodding them to negotiate compromises on controversial issues (*concertación*), such as tying wage raises to increases in labor productivity.

The need to gain the confidence of investors, who saw the advent of the center-left with trepidation, reinforced this determination to pursue cautious economic policies (Arriagada and Graham 1994, 243; Silva 1996, chap. 8; Haggard and Kaufman 1995, 257–66). Indeed, the artificial senate majority of business-connected right-wing forces gave established socio-economic interests considerable veto power over government policies, making it difficult and politically risky to deviate from economic orthodoxy. Only a mobilization of strong support in public opinion and civil society, which bore the risk of unleashing serious conflict, could have pressured the Right to give in to government initiatives (as it actually did on several occasions immediately after the democratic transition).

These factors, however, cannot fully account for the democratic government's cautious stance. The Aylwin and Frei administrations did have some room to choose how much pressure to put on their socioeconomic and political opponents. In principle, they could have made greater efforts to mobilize their supporters against the Right; instead, they privileged accommodation over confrontation. This cautious choice reflected a common tendency among decisionmakers who face positive prospects; namely, to adopt a very careful, even excessively cautious posture. Chile's economic stability and sustained growth in the late 1980s put the center-left coalition that took power in 1990 into the domain of gains and induced it to adopt a clearly risk-averse posture. Therefore, rather than rock the boat, the Concertación decided to seek further improvements, especially social reforms, with "prudence" (Flisfisch 1989, 361–69). This decision was not a foregone conclusion, despite the accumulated pressure; it inspired substantial debate within the coalition (Lagos 1993) and in the business community (Lizana 1993; Correa Gatica et al. 1993).

The organizational strength and encompassing nature of Chile's main political parties and coalitions, its major interest associations, and the state gave the democratic government the political capacity to enact these cautious policies (Olson 1982, 1986). Two leading parties of the Concertación, the Christian Democrats and the Socialists, maintained considerable internal discipline and control over their followers. These parties also enjoyed substantial influence in major interest organizations, especially trade unions and their encompassing peak association, the Central Unitaria de Trabajadores (CUT). In the long struggle against the Pinochet dictatorship, furthermore, center-left parties formed a strong, broad-based alliance, which limited the pursuit of narrow partisan interests and focused

first and foremost on broad systemic goals (Weyland 1997, 56–58). Seeking to maintain economic stability and ensure democratic consolidation, political and interest group leaders have often managed to moderate sectoral demands that could have led to "irresponsible" increases in public spending or to fierce social and political conflict. Finally, the relatively cohesive organization of the Chilean state, especially the effective coordination exercised by the General Secretariat of the Presidency and the Finance Ministry (Rehren 1993, 24–27), limited the influence that social groupings could attain by lobbying sectoral state agencies. Protected in these ways from "excessive" mass demands, economic policymakers have had the latitude to act mainly on technical criteria and to maintain macroeconomic equilibrium.

To guarantee economic stability and continued rapid growth, the Aylwin and Frei administrations pursued various goals (Rosales 1998; Marfán Lewis 1998b). These especially included low inflation, balanced budgets, a competitive exchange rate, and a sustainable deficit in the balance of payments. The Aylwin administration's most urgent task on taking office in March 1990 was to reduce inflation, which spending increases decreed by the Pinochet government for electoral reasons in 1989 had driven up to a dangerous (by Chilean standards) 27 percent. Yet the new government wanted to control inflation gradually (Banco Central 1997, 17–18), not via a shock program as Argentina, Brazil, and Peru had done. Drastic efforts to force down inflation rapidly would jeopardize growth and employment through exorbitant interest rates, erode the competitiveness of Chile's exports through excessive currency appreciation, and preclude equity-enhancing social policies with tough budget cuts.

The Aylwin administration therefore gave full support to the restrictive monetary policies initiated by Chile's autonomous Central Bank to lower inflation. The new government defended this increase in interest rates (Foxley 1993, 62) and contributed to the economic slowdown by enacting an important tax reform, which transferred 2 percent of the gross domestic product from private hands to public coffers. While reducing GDP growth to 3.3 percent in 1990 (Aninat 1997, 1), these conservative macroeconomic policies brought down inflation to 18.7 percent in 1991. In response to this quick success, the Central Bank and the government pursued more expansionary policies, and growth rose to 7.3 percent in 1991 and a very high 11 percent in 1992 (INE 1997, 178). To prevent the economy from overheating and further to reduce inflation (which was 12.7 percent in 1992), economic decisionmakers put on the brakes in 1993, despite the general elections scheduled for December of that year, which induced most Latin American governments to increase spending and promote growth. These adjustment efforts cut inflation to 8.9 percent in 1994, but also limited growth to 4.2 percent and drove up unemployment

from 6.2 percent of the work force at the height of the boom in late 1992 to 7.8 percent in the last quarter of 1994 (INE 1997, 95).

Unfortunately, as inflation came down, further reductions became ever harder to achieve. Intent on reaching the low levels that prevailed internationally, the independent Central Bank pressed for limitations on private and public spending, maintained high interest rates (Banco Central 1997, 13–14, 35–37), and accepted faster currency appreciation, which lowers the price of imports, an important cost factor in Chile's open economy. As a result, however, the country's exports became more expensive on international markets and the substantial cost of credit hindered new investments, especially by small and medium-sized firms that lacked access to international capital markets (Rosales 1998, 222). Because those firms participated disproportionately in the processing of Chile's raw materials and other manufacturing activities, the efforts to increase the value-added of the country's exports suffered. Thus, the accomplishments of Chile's macroeconomic policies in the early 1990s made further success more difficult at the end of the 1990s and aggravated the dilemmas inherent in the effort to optimize several goals rather than privileging one.

These goal dilemmas were exacerbated by an unexpected external shock: the massive influx of foreign capital in the early 1990s. Recessions in the First World and the perceived end of the debt crisis suddenly made Latin American countries attractive again to outside investors. Chile's record of economic stability and sustained growth and the new democratic government's acceptance of the market model, which eliminated political risk, turned the country into an especially promising investment target (Labán and Larraín 1994, 120).

Yet while most nations welcome foreign capital, which allows for investment and consumption beyond national means, Chile's new democratic government saw a huge infusion of capital as a threat to economic stability in the medium term. Absorbing this flow by accumulating foreign currency reserves would be very costly for the Central Bank; using it for increased private and public spending would be dangerous, in that it would raise Chile's balance of payments deficit to unsustainable levels. The torrent of foreign funds also threatened to cause an excessive appreciation of the Chilean peso and, in this way, to undermine export competitiveness (Marfán Lewis 1998b). Thus, Chile was about to suffer a variant of the "Dutch disease" in the era of financial globalization (Hojman 1995, 128–29). Its economic success was attracting voluminous capital that jeopardized export development, the main basis for future success.

To forestall these risks, the government in 1991 imposed, among other measures, unremunerated reserve requirements on all capital inflows (except foreign direct investment), and subsequently intensified them. These reserve requirements, in effect, created a tax that increased

progressively the shorter the maturity of a loan or portfolio investment (Aninat and Larraín 1996, 45–46; Agosín and Ffrench-Davis 1997, 306–16). These restrictions, which diverged from the neoliberal precept of free capital movement followed by the Pinochet regime, raised the cost of short-term investments to prohibitive levels, thereby discouraging speculation and immunizing Chile against the boom-and-bust cycles caused by highly volatile international capital movements, such as those that Mexico and Argentina experienced in the first half of the 1990s. Indeed, the fallout from Mexico's peso crisis was minor in Chile. Even the Asian financial crisis caused less damage in Chile—for instance, in depressing the stock market—than in other Latin American nations.

The adoption of these measures showed that a small, open economy could retain considerable defensive autonomy from global market forces and could shield itself from the most pernicious effects of financial globalization (*contra* Strange 1996).

Speculators found some loopholes, however, and a number of investors foresaw profits even after paying the implicit tax inherent in the reserve requirements. Capital inflows actually increased substantially in 1996 and 1997, pushing the exchange rate up to 7.7 percent in real terms during 1997 (Aninat 1998, 8). These developments made the government's restrictions seem to lose their effectiveness (Marfán Lewis 1998b). Since late 1997, however, the "contagion effect" of the Asian financial crisis has raised capital outflows and thereby eased the pressures on the exchange rate (Agosín and Ffrench-Davis 1997, 312–13, 319–20). But this reversal of capital movements has depressed the stock market, prompting the government to reduce the reserve requirements in 1998, eventually to zero. Thus the Chilean government has felt compelled to lower its defenses, at least temporarily, against the vicissitudes of financial globalization.

The new democracy also deviated significantly from the military regime in its budget policy. The dictatorship had slashed public spending, especially expenditures on social programs, and had lowered the tax burden to weaken the state and give the private sector freer rein. The Aylwin administration, precisely to forestall the populist cycle (compare Sachs 1989; Foxley 1993, 7, 17–19, 26–28), acted to alleviate the lingering social problems, and accordingly in 1990 promoted an important fiscal reform that sought to raise the tax burden by a substantial 2 percent of GDP.[4] Most of the proposed changes targeted business sectors and the upper middle class and thereby had a redistributive effect, but an increase in the distributionally neutral value-added tax was also indispensable. This was both a political and an economic issue. Defeated in the 1989 elections and willing to make some sacrifices to enhance the legitimacy of the market model, the Right gave its grudging consent to this important change (Marcel 1997, 67–71; Marfán Lewis 1993).

Because these fiscal reforms ended up raising the tax burden higher than planned—to as much as 4 percent (Marfán Lewis 1998b)—and because Chile's phenomenal economic growth greatly boosted tax revenues, the government, under pressure from business and right-wing parties, eventually agreed to bring taxes gradually back down, nonetheless maintaining the net redistributive effect of the 1990 reform (Weyland 1997, 44; Marfán Lewis 1998a, 569). Because of the country's sustained growth, the Aylwin and Frei governments always managed to achieve a budget surplus while they boosted social spending. Thus the orthodox principle of balanced budgets did not impede governmental efforts to alleviate Chile's "social debt."

Despite these efforts, however, many social problems, especially stark inequality, persisted. As a result, social and political discontent slowly rose, and debates on this issue intensified inside the Concertación. In this context, taxation again received attention in 1997 and 1998. Advocating more determined efforts to combat social ills and a more active state role in the economy (Villarzú 1998, 7–8; *El Mercurio* 1998), the general secretary of the presidency at the time, Juan Villarzú, proposed that over time, the tax burden should rise from the then-current 18 percent of GDP to about 25 percent. His recommendation triggered loud protests from business and the political right. In addition, Finance Minister Eduardo Aninat rejected Villarzú's "interference" in an issue area he claimed as his exclusive domain. Most important, the Asian financial crisis, with its contagious threat to investor confidence, seemed to make any controversy on tax raises inopportune, and President Frei shelved the issue in early 1998 (confidential author interviews, Santiago, June 1998). Thus the government's concern for the requirements of the market model hindered additional efforts to combat Chile's social problems.

Even so, the cautious economic policies have brought many benefits. Inflation declined geometrically from 27.3 percent in 1990 to 4.7 percent in 1998 (INE 1997, 246; *El Mercurio* 1999). Because the poor have few defenses against constant price increases, this reduction probably had an equity-enhancing effect. By limiting the private investors' uncertainty in planning their investments, price stability also contributed to economic growth, which averaged a superb 6.6 percent from 1990 through 1998. Sustained growth also lowered unemployment, which reached a mere 5.3 percent in the first quarter of 1998 (INE 1998a, 2), and led to a slow but steady increase in real wages, which rose by 22.4 percent between April 1993 and December 1998 (INE 1998b, 5; *El Mercurio* 1999).[5] Creating the preconditions for future growth, in 1996 the saving and investment rates reached 23.3 percent and an unprecedented 28.3 percent of GDP, respectively (Aninat 1997, 8; Marshall and Velasco 1998, 42–43).

The question that remains is what effects these cautious macroeconomic policies have had on long-term conditions, such as economic

development, social equity, and democratic consolidation. Has the government's caution imposed tight constraints on these important goals, or have the benefits outweighed the costs?

Active Developmental Policies

The market reforms imposed by the Pinochet regime made exports the engine of Chile's economic development. Throughout the late 1980s, most exports were primary commodities, but the country achieved considerable diversification in terms of the products sold and the buyer countries. Copper's traditional predominance diminished substantially, falling from 75.5 percent of export value in 1970 to 46 percent in 1990 (Díaz and Ramos 1998, 78). In the 1980s, forestry, fishery, and agricultural products, especially fresh fruit, made substantial gains. Among purchasing nations, Western Europe's participation faded from 61 percent in 1970 to 37 percent in 1990, as more of Chile's exports found their way to Asia and, to a lesser extent, other Latin American countries (Díaz and Ramos 1998, 78).

The new democratic regime faced the task of consolidating and extending this export model, which had helped to generate average GDP growth of 6 percent in the second half of the 1980s. Once again, this success, which contrasted markedly with the severe economic crises afflicting other Latin American countries during this period, put a premium on continuity rather than radical change. And once again, displaying risk aversion in the domain of gains, the Aylwin and Frei administrations decided to deepen and improve the export-driven development strategy rather than replace it.

Specifically, many of the Concertación's economic advisers regarded a primary export model as something less than the optimal development strategy. In their view, markets for raw materials had less capacity for expansion than those for industrial products, especially high technology. These markets were also subject to drastic fluctuations related to the business cycle. By exporting raw materials while importing finished goods, Chile left the benefits of industrial processing—generation of profits and capital for business, tax revenues for the state, and employment for workers—to other countries.[6] Concertación economists, especially Ominami and Madrid (1989) and Díaz (1995; Díaz and Ramos 1998), therefore advocated a determined effort to achieve higher value-added in Chilean exports and thereby reach a "second phase" of export development. The country should try to process its abundant raw materials; it should sell furniture and wine, not lumber and grapes, for instance.

The canons of neoliberal reform, however, severely limited the state's instruments for intervening in production. Sacrosanct policy principles, such as uniform, sectorally undifferentiated tariffs, precluded an "industrial policy" à la South Korea. The Chilean state lacked the

institutional capacity and—given the ideological commitment of many business elites to neoliberalism—the political support to shape the economy by nurturing specific sectors over others. The task of picking winning over losing sectors the neoliberal model assigned to the market. The policy instruments used by the state had to be sectorally neutral (see Aninat 1997, 12).

These constraints and the limitations stemming from Chile's size, natural resources, and relatively late entry into world markets made it impossible to follow the "Korean model" and pursue full-scale industrialization.[7] To prevent the country from remaining confined to primary exports, strategic policymakers therefore urged that Chile imitate the Nordic countries (Scandinavia and, in similar ways, Canada, Australia, and New Zealand), which had initially exported only raw materials, yet over time had begun to process those commodities and thereby to develop industrial exports (Díaz 1995, 82–83; Díaz and Ramos 1998, 98–101). This intermediate option between a free-market model and a heavily state-interventionist strategy would build on Chile's current advantages—namely, its wealth of natural resources—yet over time would improve those competitive advantages by adding physical capital, technology, and human capital to production processes. International markets, not the state, would decide what specific products Chile could export most profitably, but the state would promote export development. It would supply infrastructure, technology, investment capital (especially for small firms with difficult access to commercial capital markets), worker training, and general education inside Chile and would promote Chilean products and investment opportunities to foreign buyers and venture capitalists.

Because these contributions to upgrading Chile's export model would be public goods, the private sector, if left to its own devices, would be likely to undersupply them (see Olson 1971). Active state intervention was therefore required. The new democratic regime understood that the continued success of an export-oriented economy in competitive world markets depended on deliberate state action, not on market forces alone. The state should also use its bargaining power in international trade negotiations to open additional markets. Finally, the government's macroeconomic policies had to help keep Chilean exports competitive.

Some aspects of the cautious, fiscally conservative economic policies adopted by the Aylwin and Frei governments furthered this intermediate development strategy, but other features hindered it. On the one hand, economic stability was an indispensable precondition for domestic and foreign investment, and thus for any effort to upgrade Chilean exports. Controlling the influx of foreign capital, furthermore, limited the upward pressure on Chile's exchange rate, which threatened to make exports less competitive. On the other hand, the government's determination to maintain balanced budgets limited the resources it could allocate to its

market-support activities. The efforts to lower inflation by maintaining high interest rates and by letting the currency appreciate hampered the expansion of manufactured exports by making new investments, especially by small and medium-sized firms, unprofitable, and by raising the price of Chilean products in international markets (Rosales 1998, 222).

Considering these complex goals and constraints, the government sought to extend and deepen Chile's export development in a number of ways. First, the Aylwin regime further liberalized trade by lowering import tariffs from a uniform 15 percent to 11 percent in June 1991 (Marfán Lewis 1998a, 560–62). By diminishing the cost of importing capital goods and other production inputs, the tariff reduction made Chile's exports more competitive. Since 1996, the Frei government has tried to cut import duties further; but its insistence on compensating the resulting revenue loss through tax increases—as the Aylwin regime did in 1991 to balance the budget while increasing social spending—has created a stumbling block, given the tenacious resistance of the private sector and its right-wing allies in Congress to substantial tax raises. The Asian financial crisis has stiffened the international competition for Chilean exports, however, providing a new incentive to cut import duties. As a result, a bill passed in September 1998 lowered tariffs from 11 percent to 6 percent over five years and raised consumption taxes to cover part of the fiscal loss.

An interesting aspect of this debate is that business sectors that claimed to suffer disproportionately from intensified external competition and the increasingly overvalued exchange rate, especially traditional, nonexport agriculture and exporters of manufactures, seized the opportunity to propose differentiated tariffs that would provide them special protection. Ironically, the government staunchly defended uniform tariffs—one of neoliberalism's chief principles—while sectors of the political and economic right, usually tireless advocates of neoliberalism, fell prey to protectionist temptations.

The democratic government also used diplomatic means to guarantee Chile better access to important markets. The Aylwin administration supported further multilateral trade liberalization by signing the final agreements of the Uruguay Round of the General Agreement on Tariffs and Trade, which, among other provisions, liberalized trade in services, lowered nontariff barriers to trade, and strengthened the means of international dispute resolution. Through these negotiations, Chile achieved a number of concessions from its main First World trading partners that improved market access for its agricultural and industrial products (Sáez et al. 1995, 49–54).

As a new departure, Chile also sought regional economic integration, both with North America and with important South American countries. By granting some trading partners lower tariffs, such agreements diverged from the neoliberal effort to create uniform, neutral conditions for

international commerce. But once the movement toward regional economic integration was under way, Chile had little choice but to seek association so as not to be left out of the emerging new trading blocs (Ministerio de Hacienda 1993, 4, 9; see also Guzmán 1996, 3). Otherwise, Chile would suffer from the trade diversion that regional trade agreements often create by artificially lowering the cost of exports from member countries compared to those of nonmembers.

Still, it was unclear to Chilean policymakers which trading partners to privilege. Big business, which exported mostly raw materials and slightly processed primary products to First World markets, favored association with NAFTA. Small and medium-sized firms, which exported a disproportionate share of Chile's manufactured goods and fully processed raw materials, mainly to Latin American markets, advocated integration with MERCOSUR, which Argentina, Brazil, Paraguay, and Uruguay had founded in 1991 (Bayer 1998; CPC 1996, 7). The latter strategy would focus on markets with a greater potential for expansion and would buttress Chile's efforts to increase its manufactured exports, 30 percent of which were sold to MERCOSUR members in 1993 (Sáez et al. 1995, 61). At the same time, the great economic instability of the MERCOSUR countries, some of which had recently experienced hyperinflation and had only begun to enact market reforms, caused concern (Ministerio de Hacienda 1993, 4–5).

Some sectors, moreover, criticized any further opening to international trade. Traditional agriculture, which had low productivity (Rosales 1998, 222) and was therefore uncompetitive, feared for its very survival. Given the political strength of this sector, which was concentrated in certain regions and well represented in Congress, the government had to promise special, albeit temporary, protection and financial support to allow the sector to adapt its production methods. In 1993 and 1994, trade unions, especially the national peak association CUT, also voiced the fear that further import liberalization would threaten jobs and force down wages (Barrera 1996; Ruiz-Tagle 1996, 52–53). CUT therefore pressed for "social clauses" that would limit the costs of economic integration for workers (CUT 1993).

This important debate was temporarily "resolved" when President Clinton failed to persuade the U.S. Congress to grant him "fast-track" authority to negotiate a free-trade agreement with Chile. To avoid total exclusion (SECC 1996, 5–6), the Aylwin and Frei governments promoted an association with the emerging South American trade bloc. They remained cautious, however, because the MERCOSUR members were committed to principles that diverged from Chile's commercial policy; for instance, retaining fairly high, differentiated external tariffs (Agosín 1994, 6). Instead of seeking full membership, therefore, in 1996 Chile signed an association

agreement that provided for a gradual liberalization of trade with the MERCOSUR countries but allowed Chile to maintain its own tariff policy.

The government also implemented a host of programs designed to boost the competitiveness of the country's exports and to upgrade its comparative advantages. Many of the 65 "principal instruments of support for productive transformation" (Ministerio de Economía 1998) were aimed at small and medium-sized firms, with their manufactures and highly processed raw materials. These firms received a substantial export subsidy (which, in line with World Trade Organization rules, will have to be modified by the year 2003). The government also provided these companies support for importing capital goods, developing or acquiring technology, improving their management, and venturing into foreign markets. Over the course of the 1990s, the government greatly increased the resources for a number of these programs, especially in technological innovation and management modernization (CORFO 1997). In 1997, the total amount spent on all these activities, which were executed by a variety of public agencies, reached at least US$413 million; the export subsidy alone took up US$134.1 million (Ministerio de Economía 1998, 26).

The Economy Ministry created a Forum of Productive Development (*Foro del Desarrollo Productivo*) with representatives from government, business, and labor. Its public meetings, and especially its issue-focused commissions and study groups, sought to foster cooperation between the private and public sectors on important development issues. These included labor training and product quality control, a precondition for successful exports (Foro del Desarrollo Productivo 1994, 1997; Landerretche Gacitua 1995).

The new democracy made particular efforts to improve job training and general education in order to raise labor productivity. The appeal of Chilean products to foreign buyers should not stem from cheap labor, a strategy that would require permanently depressed wages. Instead, the work force should acquire an ever higher level of basic and applied skills in order to participate in increasingly complex, technologically sophisticated production processes.

The Aylwin and Frei governments therefore expanded and improved public job training programs, which provided fiscal incentives for private employers to educate workers. From 1989 to 1996, the number of workers who took part in subsidized training courses rose by 142 percent, to 451,934, equaling 8.5 percent of the work force (SENCE 1997, 13, 17). These tax subsidies, however, were used predominantly by large firms, often for training managerial personnel (Gutiérrez 1996, 10–11; Haagh 1999, 444, 450; Agosín and Ffrench-Davis 1998, 141). The Frei government therefore raised the fiscal incentives for small firms by enacting legal changes (SENCE 1998, 12–13). Whether small enterprises will take advantage of this legal modification, however, remains to be seen.

The important reform of general education also sought to improve the country's comparative advantages in the long run (Cox 1997; Angell 1997). Among the government's special efforts in this regard was to institute performance incentives for teachers (Montt Leiva 1995). Better-quality education would, among other goals, expand the pool of skilled labor and thereby facilitate the introduction of more complicated production technologies.

In assessing the results of these developmental policies, a caveat is in order. It is virtually impossible to ascertain the extent to which the many successes of Chile's export sector have resulted from government policies rather than from autonomous private sector decisions. The effectiveness of the state's fiscal incentives, for instance, is notoriously difficult to measure. Therefore, the following discussion can merely assess outcomes, not determine the impact of policy outputs on those outcomes.

During the 1990s, Chile achieved tremendous additional export growth. From 1990 to 1997, its sales abroad increased by 102.1 percent, rising from US$8.37 billion to $16.92 billion. This export expansion made a crucial contribution to the country's sustained growth during these years. Chile also succeeded in further diversifying its trade by raising the number of products shipped abroad, the number of exporting firms, and the number of buying countries (Díaz and Ramos 1998, 78; Rosales 1998, 211–12). Continuing the earlier trend toward regional deconcentration, the European Union's market share fell from 37 percent in 1990 to 24.8 percent in 1997, while the shares of Asia, North America, and Latin America (without Mexico) increased from 26 percent to 33.5 percent, 18 percent to 19.3 percent, and 13 percent to 18.6 percent, respectively.[8]

Chile's export growth has not been purely "quantitative" in nature, driven by the application of the same production processes to additional natural resources; that is, firms have not simply cut down more trees or caught more salmon. Instead of just doing more of the same, they have done new things better. The constant upgrading of productive processes has led to a tremendous increase in productivity. Labor productivity grew by an average of 4.1 percent per year from 1990 to 1996 (Rosales 1998, 217) and by 5.3 percent per year from 1994 to 1996 (Aninat 1997, 9).[9] These rates are far superior to the increases achieved in most other Latin American and First World countries (Rosales 1998, 220–21). This strong productivity growth has been crucial for maintaining the competitiveness of Chilean exports, especially in light of the continuing appreciation of the country's currency (Marfán Lewis 1998b).

Chile also advanced on the path to the "second export phase," increasing the value-added of its exports, though less than the advocates of this strategy had hoped. Sales of manufactured products and highly processed raw materials rose from 13.1 percent of the country's total export receipts in 1990 to 21.7 percent in 1996 (García 1998, 18). Exports of

products that involve some degree of processing or manufacturing rose from 32.7 percent of all sales abroad in 1990 to 40.9 percent in 1997 (computed from Banco Central 1998, 464). Over the course of the 1990s, however, exports of manufactured goods increased much more slowly. Their annual growth fell drastically from an average of 32 percent in 1991–92 to 8.2 percent in 1996–97 (ASEXMA 1998, 1). Exporters attribute this drop to the increasing overvaluation of Chile's exchange rate, which makes it ever more difficult to upgrade the country's exports (Marcos 1998; see also Díaz and Ramos 1998, 94–95). Thus the influx of foreign capital and the determination to lower inflation, which have caused upward pressures on the exchange rate, have hindered the efforts to increase export value-added.

The Impact of Economic Policies on Social Equity

The issue of how the Concertación's option for caution has affected its pursuit of social equity involves two specific questions. The first is how the insistence on macroeconomic equilibrium has affected policy outputs; that is, the measures to address social problems. The second is the impact of macroeconomic and developmental policies on policy outcomes, especially poverty and inequality.

After the initial resource boost generated by the 1990 tax reform (Ministerio de Hacienda, Dirección de Presupuestos 1993), cautious macroeconomic policies and the resulting economic stability and growth have continued to swell the public coffers and have thus permitted an enormous, steady increase in social spending. Between 1989 and 1997, expenditures by the public treasury on social programs more than doubled in real terms; spending in priority sectors, such as public health and education, which had suffered substantial budget cuts under the military regime, increased by 179.3 percent and 115.7 percent, respectively (computed from Ministerio de Hacienda, Dirección de Presupuestos 1998, 64).

The democratic government did not only "throw money at problems," however. It also introduced important conceptual and organizational modifications in social programs, deepening the focus on poor sectors, encouraging greater participation by beneficiaries, and introducing performance criteria in service delivery.[10] It disproportionately raised cash benefits for the destitute, such as welfare pensions, and made special efforts to improve medical attention and education for people living in poor urban neighborhoods and rural regions (Scott 1996, 179).[11] The education reform began with a program designed to "improve the quality of schools" in those areas (Angell 1997, 17). The Frei government even made a special effort to combat destitution itself, allocating additional financial resources for this purpose and trying to develop an integrated,

coordinated approach to poverty alleviation. But while spending on antipoverty initiatives did increase considerably (Hardy 1997, 60), the coordination effort failed, largely because of the entrenched power of sectoral ministries that resisted "interference" in their domains (CIS 1996, 4–5; Hardy 1997, 50–71, 88–98; Pizarro 1998).

Seeking to go beyond the military regime's provision of handouts to obedient "subjects," the new democracy promoted greater participation in the elaboration and implementation of its social reforms. On many occasions, the Aylwin and Frei governments consulted and negotiated with beneficiaries and service providers. For instance, the initial raises in public pensions and in the minimum wage were determined in tripartite negotiations (*concertación*) between the government, trade unions, and business. These negotiations did not always succeed, however. The government's relations with medical and educational personnel have been particularly tense, although Concertación politicians with influence in the Chilean medical association and the teachers' union have tried to mediate.

In a new departure, the Aylwin government also stimulated poor people to improve their own situation. For this purpose, it created a demand-driven social fund, the Solidarity and Investment Fund (*Fondo de Solidaridad e Inversión Social*, FOSIS), which supports projects proposed by groups of potential beneficiaries themselves. By asking poor people to identify their most pressing needs and suggest solutions, FOSIS embodies an innovative approach to social policy. And by focusing its support on productive development, such as microenterprises in the urban informal sector and small rural producers, FOSIS tries to enable poor people to achieve greater productivity and higher incomes in the market. Ironically, this program is a more market-oriented form of social policy than the paternalistic welfare measures instituted by the military regime. Compared to the government's other social programs, however, this one has remained small in personnel, activites, and budget (FOSIS 1994, 3, 7, 14, 19). The reason, again, is that established service ministries have proven much more powerful in the intrabureaucratic struggle over resources. Still, developmental policies such as support for small businesses, worker training, and general education have helped to augment the productive capacities of poorer sectors.

The Aylwin and, even more so, the Frei government have also sought to enhance the efficiency and "productivity" of Chile's social programs, especially after the early spending increases failed to improve the number and quality of services and user satisfaction as expected. Inspired by World Bank exhortations to "reform the state," experts in the Finance Ministry and some specialists in sectoral ministries have pushed for the introduction of performance criteria in the public sector. These initiatives have faced conceptual problems—for example, on how to measure the productivity of doctors—and have triggered opposition from service personnel (see, for

example, Colegio Médico 1994). Nevertheless, they have made and brought some progress, especially in the education system, the government's central reform program in recent years.

The effect of these social policy reforms and the macroeconomic policies on social equity in Chile has been mixed. On the positive side, poverty and destitution have diminished since the regime transition at a much faster rate than under the military dictatorship (Gatica and Ruiz 1993, 1–2). In 1990, 38.6 percent of Chileans had incomes below the poverty line, but only 23.2 percent did in 1996. Whereas 12.9 percent of the population was classified as indigent in 1990, a mere 5.8 percent remained in absolute poverty in 1996 (MIDEPLAN 1998b, 11). These parallel improvements and the disproportionate reduction in the poverty gap (MIDEPLAN 1998b, 25–27, 38–40) suggest that Chile's growing prosperity "trickled down" to most sectors of the population. Economic growth and social reforms benefited not only the "barely poor," who were easy to lift above the poverty line, but also many of the very poor, who lived in desperate circumstances and faced special obstacles to achieving better life chances.

On the negative side, social inequality has not diminished since the return of democracy. After an initial improvement in the early 1990s (Guardia 1995, 16–17; Magendzo and Vega 1994, 32), the distribution of monetary income deteriorated slightly.[12] As a result, the poorest 20 percent of the population received 3.8 percent of national income in 1990 and 3.9 percent in 1996. The poorest 40 percent received 12.3 percent in 1990 but only 11.9 percent in 1996 (Magendzo and Vega 1994, 32; MIDEPLAN 1998a, 74). The wealthiest 20 percent received 55.8 percent of national income in 1990 but 57.1 percent in 1996 (compare Guardia 1995, 16; INE 1998c, 11).

Taking into account the public expenditures that different social strata receive, both monetary subsidies and public services in health and education, social inequality is significantly less pronounced (Aninat 1997, 22–23). Still, inequality has not significantly diminished: the poorest 20 percent of the population received 5.9 percent of total income in 1990 and the poorest 40 percent received 15.7 percent (Magendzo and Vega 1994, 32); 6.1 percent and 15.3 percent, respectively, in 1996 (MIDEPLAN 1998a, 74). The wealthiest 20 percent received 52.5 percent in 1990 but 53.6 percent in 1996.

Econometric analyses suggest that about 80 percent of the poverty reduction achieved in the early 1990s resulted from economic growth (including employment creation), not from the improvements in income equality achieved during this period (Larrañaga 1994, 16). These calculations do not mean, however, that social policies have not had much beneficial effect. A number of reforms in social programs, such as improved worker training and support for microenterprises, were designed especially to enhance the productive capacities of the poor (Teitelboim 1994, 14–20). Thus Chile's sustained growth itself resulted

partly from the government's social initiatives. Also, each percentage point of economic growth contributed 50 percent more to poverty reduction under the new democracy (from 1990 to 1996) than under the outgoing military regime (from 1987 to 1990). This significant difference suggests that the social initiatives of the Aylwin and Frei governments account for about 40 percent of the observed diminution of poverty in the 1990s, while economic growth as such—that is, the type of growth instituted by the authoritarian regime—contributed the remaining 60 percent (Meller 1999, 10–12).

Economic stability, especially low inflation and controls on foreign capital inflows that warded off boom-and-bust cycles, helped to prevent a further aggravation of distributional inequities (compare Sheahan 1997, 20). The government's cautious macroeconomic policies avoided crises, which usually impose particularly high costs on the poorest sectors through runaway price increases and mounting unemployment. At the same time, crucial aspects of those contributed to further income concentration. For instance, the fairly high interest rates designed to lower inflation provided additional gains to large investors. The appreciation of the peso especially hurt small and medium-sized businesses that lacked access to international capital markets. Because many of these firms used labor-intensive production processes and produced manufactured goods and exports, their difficulties hindered employment generation and stifled wage raises, thereby hurting workers as well.

Yet the democratic government's responsibility for persistent inequality arose more from problems of omission than of commission. The government did not exhaust the existing margin of political maneuver for enacting equity-enhancing reforms, despite its undeniable accomplishments in this area. To avoid the political and economic risks created by redistributive efforts, the Frei administration focused on poverty reduction—that is, absolute equity—and deemphasized problems of inequality, or relative equity. The Aylwin government had enacted an important redistributive tax reform, a number of labor reforms, and substantial increases in the minimum wage (Weyland 1997, 41–48). Inequality had actually decreased in the early 1990s. The Frei administration, by contrast, has hesitated to design further tax reforms; internal disagreements have helped to weaken its unsuccessful labor reform initiative.

The Aylwin government certainly had a golden opportunity. The transition to democracy weakened conservative political and economic elites and induced them to consent to some sacrifices in order to "buy" legitimacy for the market model. By the mid-1990s, however, business and its right-wing allies in Congress thought they had made enough concessions and assumed a more intransigent posture. The right's artificial senate majority gave these forces veto power. Still, the very consolidation of democracy would also have permitted the Concertación to push harder for

additional redistributive measures and to use a deliberate "mobilization of bias" (Schattschneider 1975, 30) to put pressure on the right's institutional bastions.

Although the example of Chile's conflictive past and the need to maintain investor confidence precluded any radical tactics, the government could have exploited the right's "antisocial" intransigence in upcoming electoral contests. Indeed, as the disappointing results of the 1997 congressional elections suggest, the Concertación faced an electoral challenge not only from the Right, which pulled it toward moderation, but also from abstentionism, which more determined reform initiatives probably could have counteracted.

In sum, while the absolute standard of living of most poor Chileans has improved, pronounced social inequality has persisted under the new democracy. The Frei government, in particular, could arguably have made greater efforts to redistribute income. Excessive political caution, motivated by success in other areas, prevented it from taking this risk.

Future Challenges

While the "growth with equity" strategy has so far succeeded well on most counts (except for income redistribution), it faces a variety of important challenges that could threaten its sustainability. These problems stem from ever more powerful global market forces, stiffer international competition, environmental problems, and, potentially, the political repercussions of persistent social inequality.

The growing volume and volatility of transnational financial flows makes it difficult for a small, open economy such as Chile's to maintain macroeconomic equilibrium. As a result, the requirements of economic stability impose tighter constraints on developmental and social policies. For instance, the capital controls used successfully in the first half of the 1990s to deter short-term financial inflows seemed to become less effective after 1996, when capital imports surged, further boosting the exchange rate and thereby making Chile's exports less competitive (Agosín and Ffrench-Davis 1997, 312–13). Many business associations and Chile's economic minister expressed concern about this threat to further export development (CPC 1996, 5, 7; CPC 1998, 3; Lamarca 1998, 3–4; García 1998, 21; see also Agosín and Ffrench-Davis 1998, 139). But the Central Bank rejected any steps toward devaluation so as not to jeopardize its inflation target. Facing a clear conflict of goals, the powerful Finance Ministry was at a loss as to how to proceed (Ministerio de Hacienda 1998).

Whether Chile will be able to cope with these intensifying dilemmas is unclear. Established policy instruments may achieve limited success. For instance, liberalizing capital outflows (for example, Chilean investments in other Latin American countries) brings short-term relief against mounting

capital inflows and may also stimulate exports. But by making it easier for imported capital to leave, such financial liberalization may in the intermediate future attract more, and more volatile, capital imports (Labán and Larraín 1994, 139). Thus, maintaining both macroeconomic equilibrium and export competitiveness constitutes a serious challenge.

The fallout from the Asian financial crisis and from Brazil's economic troubles poses additional challenges to Chilean policymakers. Despite the country's sound macroeconomic policies and the protection provided by high foreign reserves, the contagion effects of the crisis could prompt speculative attacks on the peso that would create considerable uncertainty and thereby hinder investment and growth. Recessions in major export markets, such as Southeast Asia and MERCOSUR, and the resulting fall of international commodity prices, especially copper, have already depressed Chile's export earnings (*El Mercurio* 1999b). These problems put additional pressure on the balance of payments, which the Central Bank felt compelled to alleviate through determined adjustment measures, especially raising the real interest rate to 14 percent per year. These restrictive steps, in turn, lowered domestic growth to a projected zero to 2 percent in 1999 and increased unemployment to 7.2 percent nationwide, and a worrisome 11.4 in Greater Santiago, during the last quarter of 1998 (*El Mercurio* 1999a).

All these negative trends and prospects stimulated capital outflows, which induced the government to lift the reserve requirements on capital imports to boost the flagging stock market. With this move, economic policymakers relinquished, at least temporarily, an important control instrument, increasing the country's vulnerability to international financial forces. Thus the current phase of international turbulence has already caused a downturn in the Chilean economy, and it holds the risk of further deterioration, especially if Brazil's troubles worsen and drag down Argentina as well.

Even if Chile manages to keep the economic bases of its export success intact, it may face stiffer international competition. Motivated partly by Chile's superb growth record, many Latin American countries have enacted market reforms during the last decade. Some, such as Argentina, Mexico, and Peru, have begun to export products similar to Chile's, such as fresh fruit and wine. The tremendous productivity growth that Chile has achieved during the last decade has so far allowed it to stay ahead of competitors; but once other countries consolidate economic stability, attract large-scale investment, and absorb new technologies, they may well catch up and eventually out-compete Chilean producers. Invoking that very success in raising productivity, Chilean policymakers do not take this risk very seriously (Ministerio de Economía 1998). The Asian financial crisis, however, which has caused currency devaluations among that region's "superexporters" and Brazil, is exacerbating competition on

world markets. Still, Chile's active developmental policies and the long-term efforts to improve job training and general education may allow it to withstand this onslaught.

Particularly if the economic conditions for rapid development via export expansion hold, Chile may soon face severe environmental problems that could limit further growth. A large share of the country's exports is still based on primary products; therefore uncontrolled resource depletion threatens to undermine the country's productive potential in some areas, especially fishing and perhaps forestry (Clapp 1998, 30). Domestic and transnational environmental groups may pressure private enterprises and the government to combat environmental destruction, but protective measures would raise production costs and make Chile less competitive in international markets.

The government has indeed had to impose restrictions on some sectors; for instance, to prevent overfishing. As a result, exports of certain products, such as fish meal, have suffered (Banco Central 1997, 12). Other programs designed to alleviate environmental problems, however, have actually boosted export growth. The reforestation programs introduced since the 1960s have augmented Chile's wooded areas, reversed soil erosion, and, at the same time, allowed the country to export more forestry products (Meller et al. 1996, 265, 269). Moreover, Chilean enterprises in several export sectors, such as forestry, wood pulp, and salmon fishing, seem quite capable of adjusting to tougher environmental standards without becoming uncompetitive (Scholz 1996, 135–39). Whereas stricter environmental protection may hurt other export sectors that face greater adjustment problems, such as the wood products industry (Scholz 1996, 139–40), it may make the country more attractive for tourists, an important growth sector.

Certainly, it is difficult to quantify the cost of an environmental cleanup (see Meller et al. 1996, 267–69) and virtually impossible to assess the net effect of these counteracting economic prospects. But at this moment, there is no clear evidence that Chile's export model will encounter insurmountable limitations from worsening environmental problems (*pace* Clapp 1998, 30).

Finally, many observers see a challenge to "growth with equity" in the political repercussions of persistent social inequality. Social deficits, such as the sharp contrast in income between poor and wealthy Chileans, are seen to foreshadow intensifying social and political tension and turmoil, which in turn would scare off investors and thereby undermine further growth.

Social problems, however, do not automatically cause political radicalization (see Acuña and Smith 1994, 29–41; for Chile, Tironi 1990, esp. chap. 7). Considering that the remnants of Chile's hard-core left, assembled in the Communist Party, have not managed to propose any

realistic alternative to neoliberalism, renewed political polarization like that of the late 1960s and early 1970s is exceedingly unlikely. Indeed, the Communist Party has stagnated at a low vote share and has attracted these voters with isolated "populist" proposals (Roberts 1997, 328–29), not with a comprehensive, transforming social project. Thus, serious challenges from the radical left, which could trigger frontal attacks on democracy from the right, are not on the horizon. As a result, neither political polarization nor investor departure is likely to undermine the basic "growth with equity" strategy.

Even the detention of former dictator Pinochet in London and his indictment in the Spanish courts for alleged involvement in human rights violations is also unlikely to spark serious political polarization. Certainly this unexpected event, initiated in October 1998, has triggered some nationalist protests and political tensions. But 71 percent of Chileans claim that this issue "does not affect them at all" (*El Mercurio* 1998a). Many politicians—including the presidential "precandidates" with the best prospects, the Concertación's Ricardo Lagos and the opposition's Joaquín Lavín—have no interest in taking a confrontational stance, and the case apparently has not altered their electoral chances (*El Mercurio* 1998a, b).

A much more probable result of increasing social discontent is citizens' withdrawal into private life, political apathy, and electoral abstention. While Chilean democracy is not at risk, it faces the danger of involution as citizen participation may continue to atrophy. Opinion polls show that many Chileans have a disturbingly low opinion of the new democracy (Garretón, Lagos, and Méndez 1995, 4, 13; Latinobarómetro 1995, questions 21–27; Campero 1998, 418–19). It is unclear, however, whether this political discontent is a permanent state of affairs or a temporary problem typical of an immediate posttransition period. Spain, for instance, suffered from similar *desencanto* in the early 1980s, after completing the democratic transition that began with the death of Francisco Franco in 1975 (Linz and Stepan 1996, 89). As the heroic struggle against dictatorship ends and the reassertion of noble democratic values yields to the unappealing wheeling and dealing of group interests that characterizes democracy's day-to-day affairs, disappointment may set in. Yet when the earlier, exaggerated hopes about the dignifying characteristics of democracy fade away and expectations are readjusted to realistic levels, this *desencanto* usually eases. (For the cases of Spain, Portugal, and Greece, see Linz and Stepan 1996, 109–10, 142–43.)

A factor specific to the Chilean case makes this interpretation particularly plausible. The manifold restrictions that the outgoing Pinochet regime imposed on the new democracy are likely to lose force over time. With the old dictator's final retirement and the weakening of the Right's stranglehold on the senate, new reform initiatives will face fewer political obstacles. Thus the new government that takes office in the year 2000 will

have much more room to return to some of the Concertación's initial promises, which have been progressively deemphasized, especially by the Frei administration.

The 1999 electoral contest, especially the presidential campaign, will certainly influence the political repercussions of persistent social problems. If the Concertación's candidate, moderate left leader Ricardo Lagos, is elected president, which at this writing is the most likely scenario, the new government will probably make more determined efforts to alleviate social deficits. If the assumption is correct that such a strategy is politically and economically feasible, social discontent will probably diminish without serious adverse effects on economic growth and democratic stability. If the Concertación under Lagos's leadership loses the 1999 election, social discontent will continue to grow, but its political expression will be channeled into the parties of the Concertación, which, as the opposition, will assume a less cautious, more outspoken position. Chile's continuing social problems are therefore unlikely to cloud its economic and political prospects.

In sum, Chile faces a number of important challenges, macroeconomic, developmental, environmental, and sociopolitical. Ironically, some of these problems arise from the very success that Chile's economic policies have achieved so far. Economic stability and sustained growth have made the country highly attractive to foreign investors. The resulting influx of capital tends to cause an appreciation of the currency that may hinder further export development, especially increased raw material processing and manufacturing. Similarly, Chile's superb growth record has spurred other Latin American countries to emulate its export strategy; but this could create stiffer competition on international markets, which may drive down profits and wages, especially if Chile still limits its exports largely to primary products. Finally, many of Chile's environmental problems result from the country's tremendous export development, which continues to be based largely on primary products. Thus Chile has come to be plagued by the negative side effects of its great economic success.

In addition, success can cause complacency and excessive caution in coping with new challenges. This "bias toward risk-aversion in the domain of gains" may cause decisionmakers to shy away from innovation and experimentation and thus hinder future success. The significant reform initiatives in important areas, such as labor training and general education, provide reason for hope. But how well Chilean policymakers can cope with the other problems they face at the dawn of the new millennium remains to be seen.

NOTES

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1. In this article, "neoliberal" means a policy approach that insists on the strict maintenance of macroeconomic equilibrium and that depends on a largely unfettered market as the main engine of growth and development. It is important to note that Chile has never instituted a complete free-market model. Even the Pinochet regime did not privatize the copper firm CODELCO, thus keeping the country's decisive export sector under state control. Also, the tremendous expansion of exports came not only from market reforms but also from governmental incentives and subsidies (Schurman 1996, 96–98).

2. Psychological experiments have consistently shown that decisionmakers who confront different options of gains systematically deviate from strict expected-utility calculations by privileging risk aversion, whereas decisionmakers who face prospects of losses proceed in an exceedingly risk-acceptant fashion. See Kahneman and Tversky 1979; Payne et al. 1992; for Chile, Weyland 1996, 199–200.

3. The lessons of these failures were transmitted partly by foreign experts (e.g., Sachs 1989; Dornbusch and Edwards 1990). International financial institutions recommended alternative policy approaches (e.g., World Bank 1990). While this international diffusion of ideas probably influenced Chile's new democratic administrations, the country's solid macroeconomic situation gave them a large degree of autonomy in their decisionmaking.

4. A higher tax burden was seen as a necessary but, of course, by no means sufficient condition for alleviating social problems through additional expenditure programs.

5. INE changed its index for real wage increases in April 1993, so a consistent time series for the 1990s is unavailable.

6. Raw material processing in Chile is quite labor-intensive (Meller 1996, 30–31) and therefore, given the abundance of cheap labor, in line with the country's comparative advantages. On industrial processing, see the seminal discussion in Ominami and Madrid 1989. For excellent analyses of these and related issues, see Díaz 1995; Meller 1996; and Díaz and Ramos 1998.

7. For a comparison of East Asian and Latin American development strategies, see Gereffi and Wyman 1990, especially the chapters by Ranis, Wade, Schive, and Villarreal.

8. For 1990, see Ramos and Díaz 1998, 78; figures for 1997 computed from Banco Central 1998, 350.

9. The downside of this accomplishment is, of course, that additional economic growth creates few new jobs (Hojman 1996, 79).

10. For an official overview of the social programs enacted under the new democracy, see MIDEPLAN 1996.

11. Hojman argues (1996, 85–86) that social spending under the new democracy was barely—if at all—progressive because the expenditure share received by the poorest quintile was not much higher than its 20 percent share in the population. According to a strict definition of redistribution, however, any expenditure share that is higher than the poorest quintile's income share alleviates social inequality.

12. This improvement in relative equity was ascertained through different surveys, so it was probably not an artifact of measurement error. While the reduction of inequality was limited, it improved the life chances of many people, accounting for 17.5 percent of the decrease in the poverty headcount and 36.6 percent of the reduction in the poverty gap between 1990 and 1992 (Larrañaga 1994, 17).

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