PART 2

Empirics

CHAPTER 4

Authoritarians under Siege

Chile's Democratic Rebirth

For anyone well versed in Chile's much-heralded transition from authoritarian rule in 1989, the allegation that this was a well-insulated transition will hardly come as a surprise. Such insulation was in many respects the hallmark feature of this country's political changing of the guard (Valenzuela 1992; Arriagada and Graham 1994). Indeed, the very term *authoritarian enclave* had its genesis in the numerous pockets of de facto control that General Augusto Pinochet's military government retained after leaving formal power (Garretón 1989).

But although it is now virtually de rigueur to invoke the Chilean case when noting the institutional irregularities characteristic of new democracies (Karl and Schmitter 1994; Haggard and Kaufman 1995), analyses of their origins are few and far between. While many scholars recognize the onset of democracy as the triggering event, there is no comprehensive explanation linking specific features of Chile's democratization process to the extent of insulation observed.

Accordingly, chapters 4 and 5 represent a departure from previous scholarship on the Chilean transition on two grounds. First, my objective is not to describe but rather to explain the forces that gave rise to these biased institutional forms. I elucidate why—not just empirically but also theoretically—Chile constitutes a baseline case for our understanding of insulation in the transition from authoritarian rule.

Second, rather than privileging the military sphere in my analysis, I instead turn to the economic arena and, specifically, to central bank reform. For while central bank autonomy invariably makes it onto the "top ten list" of major institutional reforms enacted in the twilight of Chile's authoritarian rule, there have been no detailed political studies of how this reform evolved. In light of the central bank's pivotal role in ensuring, or imposing, the basic pillars of Chile's much-touted economic model, it would seem to be a particularly worthwhile candidate through which to trace the course of the authoritarians' institutional legacy.

With these objectives in mind, in the next two chapters I apply the theoretical argument developed in previous chapters to the Chilean central bank

reform of 1989. While chapter 4 sets the stage for the reform by documenting the intensity and proximity of the democratic threat, chapter 5 evaluates the magnitude and persistence of the insulation response. I contend that the perceived threat to Chile's incumbent authoritarian elites was sufficiently strong and immediate to warrant the creation of one of the most autonomous central banks in the developing world.

The present chapter unfolds as follows. The first section, "Reform Background: Chile's Neoliberal 'Revolution,' " provides an overview of the neoliberal economic project carried out by Chile's authoritarian regime and the nature of the capitalist support base underpinning this model. Having established the authoritarians' vested interest in a set of market-oriented policies, in the second section, "Reform Timing: Questioning the Credibility Logic," I examine the 1989 Chilean central bank reform as an expression of these interests. Here, I dispute the official economic arguments invoked to explain this reform in order to provide evidence that its motive and timing were political. The third section, "Reform Motive: Transition, Fear, and the Drive to Insulate," documents the nature of the political threat to which I attribute the decision to insulate. Faced with the prospect of an imminent transition and the resurgence of a powerful center-left opposition, exiting authoritarian elites began to fear for the fate of their economic project under democratic rule.

Reform Background: Chile's Neoliberal "Revolution"

Before we enter into a detailed analysis of the events surrounding the Chilean central bank reform of 1989, a word is in order on the broader economic context in which it was carried out. For to understand the impetus behind the reform, it is important to establish both the profoundly pro-capitalist nature of Pinochet's economic project and those specific interests that it sought to protect.

The Economic Model: Pinochet's Foundational Project

The military government of General Augusto Pinochet came to power in September 1973 amid a crisis of massive proportions. Three years earlier, Salvador Allende's left-wing Popular Unity (Unidad Popular [UP]) government had been elected to office and had initiated a transition toward socialism. Under Allende, the banking system and all major copper mines were nationalized, while the expropriation of large manufacturing firms and agrarian reform were accelerated. But the socialist experiment quickly soured. Classically populist economic policies yielded soaring inflation rates of over 600

percent and growing fiscal deficits (see table 4.1), while massive strikes, extensive shortages, and plummeting investment all led to a collapse in production. As economic tensions grew, Chile's classically tripartite political system became increasingly radicalized. In this climate of profound macroeconomic imbalances, political polarization, and increasing violence, the Chilean military staged a coup to overthrow the Allende government.[1]

In the short run, the military's objective was to restore order to the country. But it was quickly evident that this was not merely a short-term coup d'état designed to wrest power from the left but, rather, a long-term "foundational" project to fundamentally restructure Chile's economy and society (Moulian 1992). In the economic realm, this meant transforming an import-substituting, regulated, statist economy into an export-oriented, free-market economy. In political terms, it translated into prolonged authoritarian rule,

TABLE 4.1. Selected Domestic Macroeconomic Indicators for Chile, 1971–89

Year	Growth in GDP	Unemployment	Inflation	Fiscal Deficit as as % of GDP[a]	Investment as % of GDP
1971	9.0	3.9	28.2	10.7	18.3
1972	–1.2	3.3	255.4	13.0	14.8
1973	–5.6	5.0	608.7	24.7	14.7
1974	1.0	9.5	369.2	3.5	17.4
1975	–12.9	14.8	343.3	0.9	15.4
1976	3.5	12.7	198.0	–0.6	12.7
1977	9.9	11.8	84.2	–0.1	13.1
1978	8.2	14.2	37.2	–1.5	14.5
1979	8.3	13.6	38.9	–3.3	25.6
1980	7.8	10.4	31.2	–4.5	17.6
1981	5.5	11.3	9.5	–0.8	19.5
1982	–14.1	19.6	20.7	3.5 (8.8)	15.0
1983	–0.7	14.6	23.1	3.2 (7.5)	12.9
1984	6.3	13.9	23.0	4.3 (9.1)	13.2
1985	2.4	12.0	26.4	2.5 (9.8)	14.8
1986	5.7	8.8	17.4	2.1 (5.0)	15.0
1987	5.7	7.9	21.5	0.2 (1.5)	16.4
1988	7.4	6.3	12.7	–0.1	17.0
1989	10.0	5.3	21.4	–1.2	18.6

Source: For growth in GDP, unemployment, inflation, and fiscal deficits data, the source is Corbo and Fischer (1994, 32). For investment data, the source is Dornbusch and Edwards 1994, 112.

[a]A minus sign indicates a surplus. The figures in parentheses include an estimate of the quasi-fiscal subsidies channeled though the central bank (Larrañaga 1989).

1. For a detailed account of the breakdown of democratic rule in Chile, see Sigmund 1977; Valenzuela 1978.

which was seen as the only way to achieve a "technical firmness in decision-making" that would ultimately pave the way for a society rooted in "individual freedoms" (Valdés 1995, 30–31). The goal in both cases was to rout out any vestige of the country's previous economic model and democratic political system, which were seen as having led to economic mismanagement and political demagogy (Valdés 1995, 29). One cannot underscore enough the importance of Allende's three-year socialist experiment for understanding subsequent political events in Chile: it furnished the rhetorical enemy against which the entire transformational project would be directed over the course of the next seventeen years.

In explaining the authoritarians' "revolutionary" mission to modernize Chile, most authors have tended to emphasize its ideological underpinnings. In particular, they point to the group of U.S.-trained Chilean economists who developed and disseminated the monetarist prescriptions that shaped economic policy under early military rule (Montecinos 1988; Valdés 1995). It is certainly true that within the heterogeneous coalition of civilians, economists, and business elites who advised the military regime during the first decade of authoritarian rule, the so-called Chicago Boys held a particular pride of place (Valenzuela 1991, 54–60). To the extent that they offered a development model that was distinct from the traditional marxism or interest group politics of Chile's past, they found a receptive audience within the military leadership, who appropriated the model as their own (Silva 1996, 97–135; Moulian 1992). But while the authoritarians undoubtedly believed in the scientific correctness of their neoliberal project (Valdés 1995, 31–32), it would be a mistake to separate the technical logic of this economic model from the capitalist interests underlying it. Rather, the two were intimately intertwined.

In their effort to safeguard a functioning market-based economy, the authoritarians sought first and foremost to make the resurgence of a powerful anti-capitalist movement unlikely—if not impossible—in the future (Garretón 1986, 154). Despite the regime's universalistic rhetoric in which it presented itself as existing over and above the interests or pressures of any specific group or sector, there is no question that this model fundamentally benefited—and held its key constituency within—the Chilean business class (Moulian 1992). The central role accorded the private sector in the new model was clearly visible during the 1973 coup, when business groups conspired with the Chicago Boys in drafting the blueprint document that would serve as the basis for the initial set of reforms (Valdés 1995, chap. 11; Silva 1996, 85–88). Even in subsequent periods where economic policy ran directly counter to the interests of specific sectors, business would remain a consistent ally of the military government. In effect, Chilean entrepreneurs established a tacit quid pro quo with the Pinochet regime: a blank check of political support in exchange for the assurance that they would never again revisit the

rampant violation of property rights witnessed under Allende (Frieden 1991a, 143–77).

In addition to assuring the continued well-being of the private sector, Chile's authoritarian government also had a more direct personal interest in securing the success of a market-oriented economic model. As Silva (1991, 99–100) notes, the Chicago Boys themselves—or entrepreneurs closely linked to them—were the top executives of the vast financial-industrial conglomerates that expanded rapidly between 1974 and 1978, gaining control of some of the country's most dynamic economic sectors.[2] This economic relationship was further soldered through the free flow of personnel between the public sector and these so-called economic groups (*grupos*) (Meller 1984). Because of these strong links to the country's main centers of financial and industrial power, the government thus had a vested interest in implementing a set of policies that would enable the groups to prosper. More to the point, Chile's extensive state-owned natural copper endowment also meant that the military government would be a direct beneficiary from a program of economic adjustment based in the liberalization of trade (Geddes 1994b, 207).

In sum, Pinochet's neoliberal economic project was executed both in benefit of and in tandem with powerful capitalist actors inside and outside the state. In what follows, I describe in more precise terms the nature of this support base. While the exact composition of dominant capital interests changed over the course of Chile's seventeen-year military rule, the regime can be consistently classified as "market oriented" by the criteria established in chapter 3.

The Interests behind the Model: Economic Actors under Military Rule

The economic policy program of Chile's authoritarian regime is generally divided into two periods. During the first phase of so-called radical neoliberalism (1975–82), the government pursued a two-pronged agenda that combined orthodox stabilization with profound economic restructuring.[3] Without a doubt, the government's principal economic support bases during this initial reform process were the large financial-industrial conglomerates noted

2. By 1978, the three conglomerates to whom many top policymakers were linked—Cruzat-Larraín, Banco Hipotecário de Chile (BHC), and Edwards economic groups—controlled 53 percent of the private sector banking system's total assets and 42 percent of its dollar credit, as well as 71 of the 250 largest Chilean firms, which amounted to 40 percent of those firms' total assets (Silva 1991, 100).

3. I borrow this term from Montero (1993). Other authors use the terms *authentic* (Silva 1991) or *internationalist* (Muñoz 1992) to refer to this phase of neoliberalism. It has been examined in detail by a variety of authors. See, among others, Cieplan 1982; Vergara 1985; Foxley 1986; Edwards and Edwards 1991.

earlier. Because of their privileged access to foreign credit, these groups were well positioned to benefit from the liberalization of the economy. In particular, they were able to use their domination of the financial intermediation of foreign loans to expand the growth of the financial sector and to modernize selected industries (Frieden 1991a; Hastings 1993).

Three areas of the economy benefited during this early phase of liberalization: banks; non-traded-asset markets such as financial services and real estate; and traded goods where Chile had a clear comparative advantage but had previously faced negative effective protection, such as primary production and some traditional manufacturing industries. In contrast, the regime's reversal of previous import substitution and regulation had a negative impact on those sectors that had come to rely on protectionist programs, especially within the manufacturing sector (see table 4.2). The net balance of these winners and losers within the industrial sector at the end of the 1970s is seen in figure 4.1. Not surprisingly, the economic groups and their conglomerate affiliates tended to dominate ownership within the economy's most successful sectors.[4]

TABLE 4.2. Chile: Sectoral Economic Trends, 1974–82 (sectoral output and employment as % of total)

	1974	1979	1982
Primary			
Output	17.7	17.1	13.3
Employment	25.6	24.0	23.5
Manufacturing			
Output	29.5	21.2	18.9
Employment	19.5	16.7	14.1
Commerce			
Output	14.1	16.7	15.6
Employment	11.6	15.6	16.8
Financial Services			
Output	5.3	8.1	11.2
Employment	1.9	2.7	3.6

Source: Frieden 1991a, 163. Copyright © 1991 by Princeton University Press. Reprinted by permission of Princeton University Press.

4. Note, for example, that in 1978, the Cruzat-Larraín group had 33 firms in real estate, construction, and investment companies; 6 in financial services; 10 in commerce; 16 in agriculture, forest products, and mining; and 34 in industry—especially wood products, pulp, and paper; copper products; seafood; food products; and beverages. In the same year, the Vial/BHC group had 20, 9, 3, 9, and 15 firms, respectively, while its manufacturing affiliates were primarily in metalworking, appliances, and food products (Frieden 1991a, 166–67).

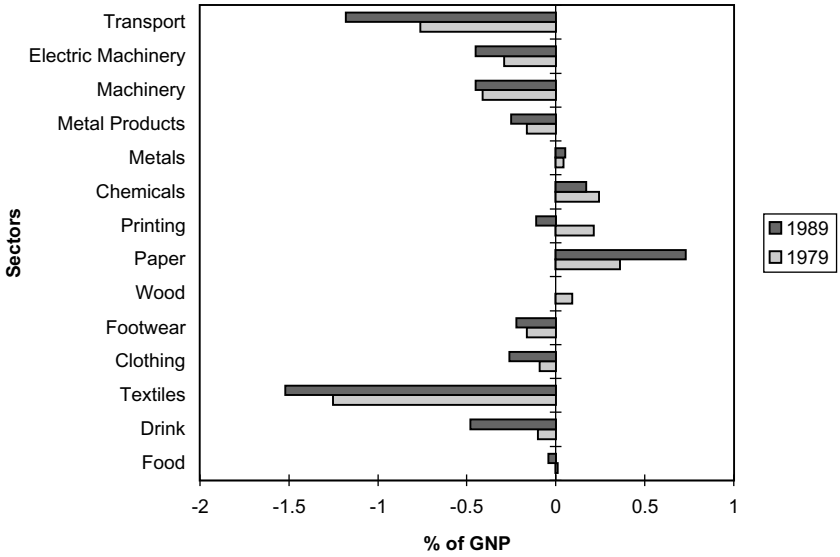

Fig. 4.1. Chile: Industrial restructuring by sector (% of GNP). (From Valdes 1992, 65.)

At the end of the first phase of neoliberal economic reforms, the military regime appeared to have achieved what it had set out to do. The economy had been radically transformed from one where public ownership was dominant to one where nearly all economic activity was in the hands of the private sector. At the same time, growth had fluctuated consistently between 5 and 10 percent from 1977 to 1981, and inflation—once as high as over 600 percent—was down to under 10 percent in 1981. But all was not as it seemed. Chile's "boom" in the 1970s had been sustained largely through a heavy reliance on foreign savings. In 1981–82, Chile's total foreign debt represented 50 percent of GDP, and amortizations plus interest payments were approximately 85 percent of Chilean exports, compared with 42 percent for 1975–80 (Arriagada and Graham 1994, 246). In 1982, a combination of recession, the abrupt termination of external credit, and a major devaluation of the currency weakened the repayment capacity of large segments of Chilean borrowers, erupting into a financial crisis of massive proportions (Muñoz 1985; Arrellano 1988; Larraín 1989).

The 1982 crisis had pronounced and immediate economic effects. GDP growth fell by 19 percent, and unemployment skyrocketed to nearly 20 percent. In order to salvage the severely overindebted financial sector, the government took over 70 percent of the Chilean banks, absorbing all of their debt

(Frieden 1991a, 61). It also repurchased approximately 50 percent of the enterprises that had been privatized in the 1970s. For the first time since the military took power in 1973, there were massive public protests, as organized labor, middle-class groups, and resurgent political parties took to the streets to rally forces against the economic and political project of the authoritarian regime (Huneeus 1985; Garretón 1986).

For our purposes, however, the 1982 crisis was significant because it triggered a pronounced shift in domestic economic policy coalitions. With the collapse of orthodox monetarism and abundant foreign finance, the large financial conglomerates of the 1970s lost much of their momentum, many entering into bankruptcy. In their place, a new coalition for "pragmatic neoliberalism" surfaced, whose major protagonists were drawn from the more traditional business associations (Montero 1993, 52–54; Silva 1996, 173–213). As the regime gradually recovered from the economic crisis of 1982–83, this group of capitalists became the motor behind a new economic model: one anchored in the orthodox stabilization and economic restructuring of its more radical predecessor but peppered with selective inducements and mild forms of protection.[5]

In particular, the second phase of neoliberalism generated a core constituency of large-sized firms with substantial ties to international markets. Over a twenty-year time span, Chile's export sector had more than doubled its relative size, climbing from 12 percent of GNP in the decade of the 1960s to nearly 30 percent of GNP in the mid-1980s (Ossa 1993a, 387). Within the tradables sector, the locus of economic dynamism was its natural resource sectors (mining, forestry, fishing, and nontraditional agriculture). Over the course of the 1980s, natural resource–based exports expanded their productive potential by more than 16 percent of what would have occurred without trade liberalization.[6] In contrast, those branches of industry previously associated with import substitution industrialization (ISI) in Chile (e.g., textiles, automobile parts, and electronic parts) suffered a contraction equivalent to

5. Pragmatic neoliberalism softened its predecessor by offering price protection for some depressed areas of agricultural production, encouraging a preferential exchange rate for exports, and helping banks to repatriate their assets while at the same time drafting much more restrictive bank regulations. For a more detailed discussion of the policies of this period and their effects, see Fontaine 1993; Wisecarver 1993; Bosworth, Dornbusch, and Labán 1994.

6. By 1985, these sectors accounted for approximately 85 percent of the country's total exports. While Chile's natural copper endowment was pivotal in this regard, the real source of the economy's dynamism lay in nontraditional natural resource exports. Nontraditional exports in the agriculture, forest, and fisheries sectors rose from 3.7 percent of total exports in 1970 to 30 percent in 1990, while copper's participation declined from 75 percent to 45 percent during the same period (Meller 1992, 39).

nearly 60 percent of what their productive potential had been before liberalization occurred (see fig. 4.2). To provide some idea of the magnitude of this change, the intrasectoral shift within the country's productive apparatus was on the order of 5 percent of GNP (see fig. 4.3).

By the end of the 1980s, these exposed sectors of the economy were prospering within an exceedingly favorable macroeconomic environment. A realistic exchange rate had been maintained through successive devaluations to encourage the use of resources in producing tradable goods. With the onset of an ambitious debt conversion program in 1985, total debt service declined from 49 percent of exports in 1985 to 25 percent in 1988 (see table 4.3). Many of the enterprises bought back by the state were privatized again but this time without the concentration of ownership that had characterized the first wave of privatization (Luders 1991). Growth picked up steadily, averaging 6 percent between 1985 and 1989, and unemployment dropped to 5 percent in 1989. In short, after many fits and starts, it appeared that the neoliberal economic experiment had borne fruit, at least where the private sector was concerned.

Over time, the military regime's liberalizing experiment thus created a set of powerful economic interests that prospered in the Chilean economic environment and owed their success to the dictatorship. While during the first period of radical neoliberalism this coalition was comprised primarily of financial and international capital, in the second phase of pragmatic neoliberalism it was rooted in productive capital within the country's traditional areas of comparative advantage. In both cases, the existence of these powerful economic constituencies led to a societal demand for a set of market-oriented policy outcomes conducive to economic openness, private property, and macroeconomic stability. In other words, throughout the course of its seventeen years in power, the military government of General Augusto Pinochet acted as an advocate for the types of capital that would both lend their support to and benefit from a central bank reform.[7]

7. Frieden (1991a) maintains that the salient division among Chilean capitalists under military rule was not sector but class. But as this analysis and Frieden's own both reveal, one can clearly delineate winners and losers in both periods of authoritarian rule that break down along sectoral lines. The fact that this economic distinction does not readily translate into obvious political differences should not be taken as evidence that the more protected sectors of the economy did not lose out under authoritarian rule. In the first period (1975–82), their quiescence can be explained by the fact that they still saw neoliberalism as the price they had to pay to prevent a reversion to socialism. In the second period (1983–88), their lack of vocal protest over economic policy reflects the fact that the losers within the smaller, more sheltered firms were not politically active or savvy, as will be noted subsequently.

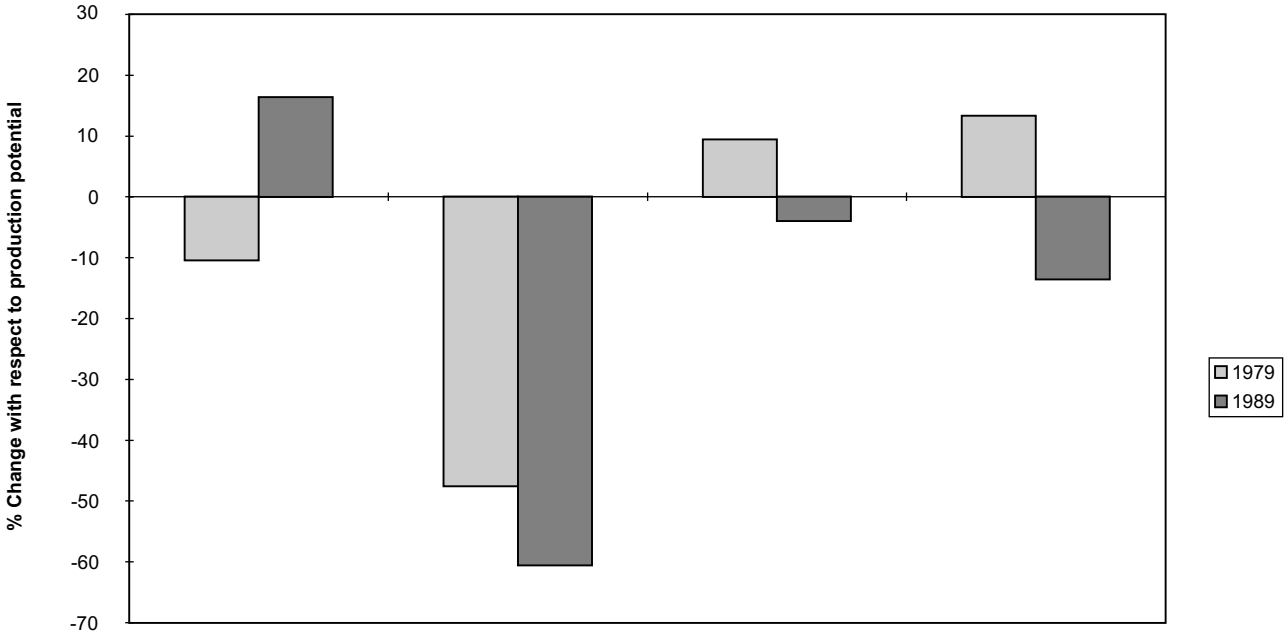

Fig. 4.2. Chile: Industrial restructuring (% change with respect to production potential). (From Valdes 1992, 64.)

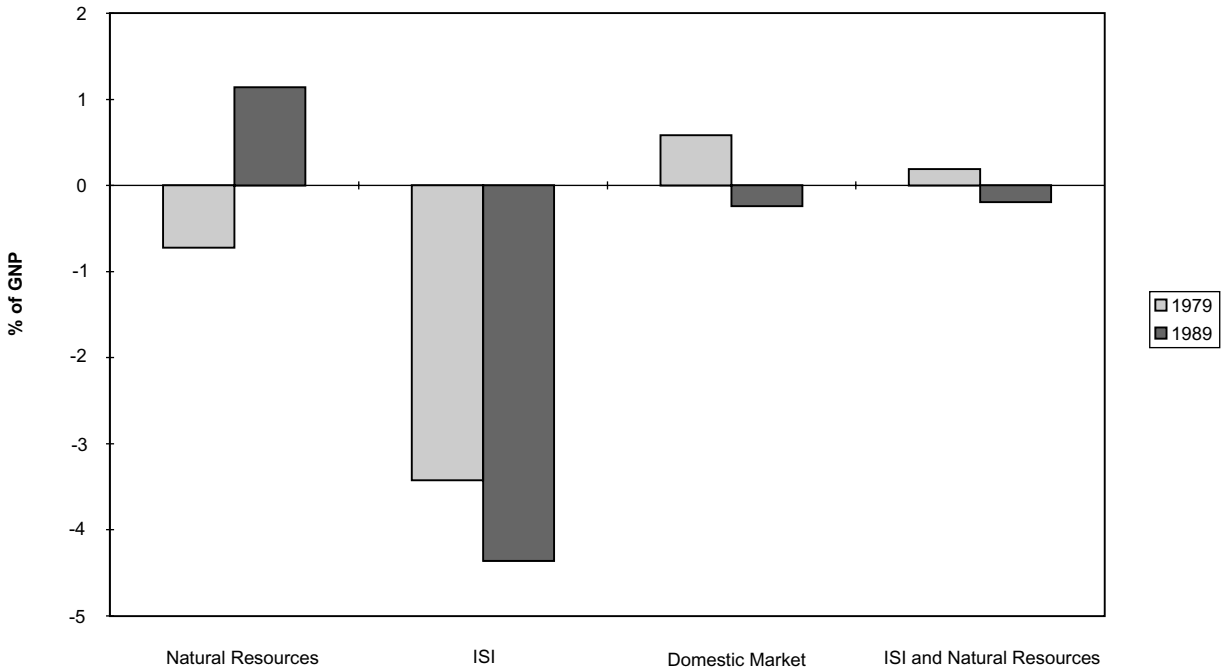

Fig. 4.3. Chile: Industrial restructuring (% of GNP). (From Valdes 1992, 64.)

TABLE 4.3. Chile: Selected International Economic Indicators, 1970–89

Year	Real Exchange Rate Index	Trade Deficit[a]	International Reserves (millions of U.S.$)	Balance of Payments[b]	Ratio of Debt Service to Exports	Import Cover[c]
1971	85.6	1.0	162.7	n/a	n/a	n/a
1972	64.7	3.5	75.8	n/a	9.9	1.5
1973	74.4	1.9	121.6	–21	n/a	n/a
1974	122.7	–0.7	41.1	–55	9.9	1.4
1975	147.1	2.0	55.9	–344	n/a	n/a
1976	124.1	–4.3	405.1	414	31.1	3.0
1977	100.0	1.8	426.5	113	33.8	2.4
1978	111.4	3.3	1,090.1	712	40.7	4.0
1979	112.2	2.8	1,938.3	1,047	26.5	5.4
1980	97.2	4.2	3,123.3	1,244	43.1	5.9
1981	84.5	10.3	3,213.3	70	65.0[d]	4.5
1982	94.2	1.9	1,815.0	–1,165	71.3	4.1
1983	113.1	–2.7	2,036.3	–541	54.5	5.2
1984	118.2	1.1	2,303.2	17	59.9	4.9
1985	145.2	–2.8	2,449.9	–99	48.6	5.8
1986	159.7	–3.8	2,351.3	–228	41.5	5.4
1987	166.6	–4.1	2,504.2	45	36.5	5.2
1988	177.6	–7.2	3,160.5	732	25.2	5.2
1989	173.5	–3.6	3,628.6	439.7	27.5	3.9

Source: For real exchange rate index and trade deficit data, the source is Corbo and Fischer 1994. For international reserves, the source is World Bank, *World Tables* (Washington, DC: World Bank, various years). For balance of payments data, the source is Edwards and Edwards 1991; and Central Bank of Chile, *Boletín Mensual* (Santiago, Chile: Central Bank of Chile, various years). For debt service to export ratios and import cover data, the source is International Monetary Fund, *World Debt Tables* (Washington, DC: International Monetary Fund, various years).

[a]Percentage of GDP, computed with national account information at current prices; a minus sign indicates a surplus.

[b]A minus sign indicates a deficit.

[c]Total reserves over imports of goods and services per month.

[d]Estimate.

Reform Timing: Questioning the Credibility Logic

In light of the decidedly market-oriented nature of Chile's authoritarian regime, it is perhaps not so surprising that the government would have chosen to enact a central bank reform. The relevant question to ask, however, is not why the regime chose to undertake a central bank reform at all but, rather, why it chose to do so when it did.

When the Pinochet government enacted legislation granting autonomy to its central bank in December 1989, the official rationale was twofold. First, central bank autonomy would aid in preserving a climate of macroeconomic stability. Many in the military government attributed Chile's inflationary history to the pervasive control that the executive branch had wielded over the central bank under democratic rule (De la Cuadra 1987). The authoritarians wanted Chile to avoid the macroeconomic imbalances that were said to result from the pursuit of short-term objectives such as output and employment in search of political dividends (Rosende 1993, 296). In order to do this, they argued, future governments could not rely on mere concertation among societal actors. Rather, they would need to "institutionalize mechanisms to ensure macroeconomic stability" (Fontaine 1989, 66). By making the effects of fiscal deficits transparent, an autonomous central bank would "sound the alarms . . . at this non-legal tax called inflation" (Fontaine 1989, 66). In short, the government invoked standard credibility arguments in its explanation for this reform initiative.

In addition to this more conventional credibility-based explanation, the reform was also justified on legal grounds. The 1980 Chilean political constitution had defined the Central Bank of Chile as "an autonomous entity of technical character that possesses its own assets" (Political Constitution of the Republic of Chile 1980, Article 97). Beyond defining these quite general parameters, however, the 1980 Constitution said very little about the technical basis for such autonomy.[8] Rather, the Constitution authorized the execution of a subsequent organic constitutional law, in which the composition, organization, and attributions of the central bank would be established in order to give more precise meaning to its putative autonomy. The existence of this clause effectively constituted a legal obligation to enact a more fully detailed central bank reform at some point in the future (Figari Oxley 1989, 1).

8. Article 98 of the Constitution did contain two clauses that would serve as important guidelines for the central bank law that would eventually be passed in 1989. First, it prohibited the central bank from financing any public expenditure or loan of the government either directly or indirectly. Second, it established a legal precedent of "no discrimination" with respect to the regulations or requirements pertaining to any individual, institution, or entity with which it conducted business. I will discuss these features of autonomy—and their relative significance under authoritarian rule—in more detail in chapter 5.

There is, however, good reason to question both of the government's avowed motives. A closer look at the central bank autonomy initiative as it evolved over the course of authoritarian rule suggests a much more political explanation for the timing of this reform.

Pre-1980: The Chicago Boys and Early Reform Efforts

The first thing to note in the Chilean case is that the original idea for central bank reform actually dates back to the mid-1970s, when the Chicago Boys first attempted to make the central bank autonomous. While the proposed setup was not identical to the reform that was eventually passed in 1989, what is striking is how many of the ideas that found their way into the 1989 organic law were also present in the original version.[9] If this is the case, then one must question why the government did not go ahead and enact a central bank reform when the idea first surfaced.

One explanation—consistent with a credibility-based account— is that the macroeconomic environment simply did not call for a central bank reform at this point in time. While the credibility literature does not specify an optimal time to undertake central bank reform, it seems most likely that commitment devices are most called for during times of economic crisis. Under conditions of fiscal imbalances and strong inflation, "the best antidote might be to adopt a permanent institutional change that eliminates legally the central bank's ability to finance the government" (Roubli-Kaiser 1996, 13). A severe crisis also opens up a political window of opportunity in which to introduce dramatic changes, break a policy stalemate, and put reform opponents on the defensive (Balcerowicz 1995). As Williamson and Haggard aptly note, "the worst of times give rise to the best of opportunities for those who understand the need for fundamental economic reform" (Williamson and Haggard 1994, 565).

The evidence from this period is somewhat difficult to interpret on this

9. Those closely involved with the first reform initiative swear that the two initiatives were almost identical, and portions of the proposed law discussed in meetings of the constitutional commissions during the late 1970s also lend support to this claim (Briones Espinosa 1989). The most striking difference between the two reform initiatives appears to have been in the area of exchange rate policy. While the earlier initiative subscribed to a fixed exchange rate regime (which largely reduced the central bank's role to one of carrying out exchange operations), the latter initiative was enacted under a crawling rate regime and thus, by definition, afforded the central bank a broader range of powers (interviews by the author, tape recordings, Santiago, Chile, with Pablo Baraona, former minister of the economy under Pinochet, April 21, 1995; Jorge Cauas, former minister of the economy and vice president of the Chilean Central Bank under Pinochet, May 3, 1989; Hernán Errázuriz, former legal adviser to the Pinochet government, April 26, 1995; Daniel Tapia, former central bank economist under Pinochet, April 20, 1995).

point. When discussions about central bank reform first began to incubate within the military regime in 1974–75, one could reasonably claim that the country was still in the midst of a macroeconomic crisis that warranted extreme anti-inflationary measures: inflation was still close to 400 percent, and the country was exhibiting a balance of payments deficit.[10] But by the time these discussions actually came to a head as part of a broader set of internal negotiations over constitutional reform in 1979, such need was less clearly visible: inflation had diminished considerably, and the regime was actually showing a fiscal and balance of payments surplus. In short, depending on when one chooses to date the timing of the central bank reform initiative, it was more or less necessary from a credibility standpoint.

If we reject the credibility hypothesis as a clear-cut explanation for the fate of the first initiative, perhaps its demise can be attributed to the lack of sufficient interest on the part of the private sector. It would be difficult to argue, however, that there was not a powerful capitalist constituency in place by the late 1970s that would have strongly favored a central bank reform. As noted earlier, the government's sectoral support base in the 1970s was quite conducive to central bank reform: financial conglomerates with considerable ties to international capital. There was also considerable momentum for central bank autonomy among the conglomerates' chief representative within the regime: the Chicago economic team. Its leading spokesman at the time, Sergio De Castro, contended that it was "fundamental to have a system that impedes the President of the Republic from imposing policies contrary to monetary stability on the central bank" (Briones Espinosa 1989, 40). The Chicago Boys even went so far as to consult with IMF officials as to how they might go about putting this idea into practice.[11] At their behest, discussion ensued within the regime over whether or not an autonomous central bank ought to be incorporated into the upcoming 1980 Constitution.

But despite these explicit pressures for central bank reform by powerful economic actors, the initiative encountered considerable resistance from Pinochet's political and legal advisers. The reluctance to endow a state body with so much independent power was evident in the legislative commissions that were established to evaluate proposed changes to the constitution. In the words of one member of these commissions, "a conflict between the presi-

10. Exactly when these informal discussions began with respect to central bank reform is unclear. Most of those interviewed, however, placed these discussions toward the middle of the decade. For example, Pablo Baraona, who was in many ways the intellectual father of the early initiative, claims that discussions began shortly after the military coup in early 1974 and that the crucial elements were in place by 1976 (Baraona, interview).

11. It was then that they discovered that their desires to limit central bank financing to the government and create a nonpoliticized central bank board were echoed in an emerging school of economic thought: the credibility literature (Errázuriz, interview).

dent of the republic . . . and a totally autonomous power that controls the monetary system would simply produce a catastrophe" (Briones Espinosa 1989, 39). This sentiment was echoed by another individual who commented, "such an organ would be absolutely incompatible with a presidential regime" (Briones Espinosa 1989, 39). Yet another member warned of the dangers that might ensue were a sitting president to be denied sufficient veto power over the central bank board. He described such an arrangement as "politically inconvenient," referring to autonomy as "an iron belt . . . that inevitably invites the possibility of breaking the very purpose it is meant to underlie" (Briones Espinosa 1989, 37). Ironically, the objections to central bank autonomy voiced by the government's political advisers were in many ways prophetic of the objections that would be raised ten years later by its democratic opposition when the initiative was finally unfurled.

As a result of this political resistance, the first attempt to grant autonomy to the Central Bank of Chile floundered. The "consolation prize" was the inclusion of three more general clauses in the Constitution rendering the central bank nominally autonomous, with the promise of a more detailed organic law to follow. But the vagueness of their terms was indicative of the profound disagreements that had taken place within the regime as to whether—and how much—autonomy was ultimately desired (Briones Espinosa 1989). For the time being, it was clear that autonomy was considered antithetical to the regime's political interests and that the Pinochet government did not have any intention of enacting an organic law at any point in the near future. Indeed, when some of the economists approached the new minister of finance about moving ahead with the organic law shortly after the 1980 Constitution had been ratified, they were told that it was "the last thing on the government's agenda."[12]

Chile's early battles over central bank reform are instructive. While it might be the case that the government balked because the idea was too novel or too untested, I would offer a different explanation that is consistent with the general thrust of this book: an authoritarian regime will choose to cede authority to an autonomous institution only when its hold on power begins to loosen. As one of the principal economic advisers involved in this early initiative noted when explaining its demise, "it is hard for governments to yield power. . . . the military government had lots of support then. It simply did not look like this government could end."[13]

The demonstrated opposition to early efforts at central bank reform thus casts doubt on the government's claim that the 1989 reform was driven

12. Former "Chicago Boy" economist closely identified with the first reform initiative, confidential interview by the author, tape recording, Santiago, Chile, April 28, 1995.

13. Ibid.

sheerly by economic motives. Absent a compelling political reason to do so, the government was simply unwilling to cede authority over monetary policy to an independent agency. In spite of explicit signs of support for an autonomous central bank among its economic advisers, it would seem that an additional political incentive was needed before the government would be prompted to act.

Post-1980: Big Business and the Economic Demand for Autonomy

Economic explanations for the reform's timing appear even more suspect in the period after 1980. If the constitution stipulated a legal mandate for central bank reform as early as 1980, why did the Pinochet government wait nine years to implement it?

The government claimed that the reform initiative had been stymied by Chile's 1982 economic crisis. According to the government, the crisis was such that it could not have prioritized a reform of this magnitude, and it waited instead for a more stable macroeconomic environment in which to move ahead.[14] What this really meant—as opposition economists would subsequently point out—was that the government needed a dependent central bank in order to bail out insolvent private commercial banks (Arrellano 1989, 93; Zahler 1989a, 100–101). As a result, it was simply not a propitious moment for the government to establish an autonomous institution purportedly rooted in the nondiscriminatory treatment of private lending institutions (Ossa 1993b).

One can question whether the 1982 financial crisis might, in fact, have provided the most favorable macroeconomic environment for central bank reform from the standpoint of gaining external credibility. This hypothesis will be considered in the next section of this chapter. But there is an additional, even more compelling reason to think that the government might have acted sooner. By the mid-1980s, extensive privatization and an atomized labor movement associated with pragmatic neoliberalism had combined to yield a powerful capitalist class with a vested interest in the policies guaranteed by an autonomous central bank (Silva 1996; Rehren 1995). We have already commented on the economic power of this exposed capital located within the country's areas of comparative advantage. Here, a word is in order on its political power.

As Campero (1991) notes, Chile's entrepreneurial class under military

14. See comments by various regime officials in "Autonomía del Banco Central es Mandato Constitucional," *El Mercurio,* November 25, 1988.

rule could essentially be broken down into two main groups: the "neoliberals"—large enterprises with a liberal capitalist vision of development—and the "corporatists"—small and medium-sized firms predominantly oriented toward the internal market. While the small and medium-sized firms dominated in numerical terms, they lacked economic and political might.[15] They thus had little influence on shaping the course of economic policy, and their pleas for greater protection and selective credit policies fell largely on deaf ears.[16] In contrast, the political dominance of the more internationally oriented, "neoliberal" faction was readily apparent.[17]

With the shift in domestic economic policy coalitions that took place following the 1982 crisis, there had been a corresponding shift in the role that capitalists played in the construction of economic policy. Business-government relations evolved from a behind the scenes, tacit alliance characteristic of the 1970s to one of active business participation in the policy agenda in the 1980s. The peak organization for large firms—the Confederation of Production and Commerce (Confederación de Producción y Comercio [CPC]) played a major role in redefining key parameters of the "pragmatic" neoliberal economic model that ensued (Silva 1991, 110–14; Campero 1991, 138–43). Important businesspeople were also named to ministerial posts in the economic agencies of the government (Silva 1991, 112–13). By 1984, large firms began to enjoy direct access to the policy-making process through their participation in various legislative and economic commissions, as well as a presidential consulting body—the Economic and Social Council (Dugan and Rehren 1990).

15. Of some 276,000 entrepreneurs in the late 1980s, about 240,000 owned small businesses (Campero 1991, 129). These firms tended to be concentrated in the less internationally competitive sectors, where 93 percent found their livelihood in transportation, traditional agriculture, or small-scale commerce and artisanry (Campero 1988, 48). Politically, they were weak and marginalized. Voluntary membership in business organizations deprived their peak organization—CONUPIA—of an important source of funding that might otherwise have been used to mobilize support for their preferred policies. And unlike the peak business association representing large firms, this organization was rarely consulted by the government on major policy initiatives (Juan Morales, president of Conupia, interview by author, tape recording, Santiago, Chile, June 5, 1995).

16. Note, for example, that the members of ASIMET—the business organization including small merchants and the transportation sector under military rule—felt that the economic reactivation did not favor national industry and that small and medium-sized firms continued to operate under depressed conditions. In June 1985, these sectors attempted to reconstitute a new confederation in order to advance their views. But they were unable to achieve substantial results and were thus overshadowed by the policy preferences of the large firms (Silva 1991, 142). For more on the economic policy preferences of small and medium-sized firms under military rule, see also Ortega Riquelme 1985; Pardo V. 1989.

17. This is not to suggest that there were no protectionist interests in the neoliberal coalition. But such large, protectionist firms were clearly dominated by the free-marketeers (Silva 1991, 117).

Above all, however, the political power of big business was reflected in the fact that it increasingly came to project itself as a sociopolitical actor independent of the government or political parties. By transferring so much control over economic activity to the hands of the private sector, Pinochet's economic program had endowed the Chilean business class with a tremendous amount of structural power and influence. Powerful capitalists gradually came to recognize that this privileged position gave them an automatic role in the decision-making process, such that they, together with the state, constituted the leadership of the system (Montero 1993, 53). As one Chilean businessman phrased it, "Governments can change, but none will produce a tenth of the well-being if capitalists do not produce it. It is important that politicians see this clearly—because it gives us more power than ever before" (Montero 1990, 112).

By the mid-1980s, entrepreneurs from large firms began putting such autonomy to use to defend their policy interests. Indeed, "there was a strong identification between the policies of the Pinochet government and the aspirations of a group of businesses that valued external opening, competition, and the role of cutting-edge technology" (Montero 1990, 110). A poll conducted of leading business elites in 1986 lends credence to this claim. The poll showed that they felt that the economic policies of the authoritarian regime mirrored their economic policy preferences almost perfectly (Campero 1988, 51). In 1986, they began employing mass gatherings as a vehicle for promoting this neoliberal ideology. Declaring themselves to be the "motors of development," the business class embarked upon a self-proclaimed "battle of ideas." This new discourse vaunted a market-oriented economic model as "the only one capable" of overcoming underdevelopment, advancing the idea of the "freedom to undertake economic activity as the foundation of modernization and progress" (Campero 1991, 144).

It is of particular note that business groups lent their enthusiastic support to the central bank autonomy initiative. They called publicly for a central bank with "maximum independence from the government and political power" (Garretón 1989, 101), which was seen as "an indispensable pillar for the development of any society that aspires to be truly free."[18] Business groups were also among those consulted by regime officials to express their views on early drafts of the legislation when the idea first resurfaced in the mid-1980s. Once a draft document was circulating in 1988, business leaders created a commission within the CPC to study the initiative and propose specific

18. Editorial statement by Fernando Agüero, president of the industrial sector's business association, SOFOFA (Sociedad de Fomento y Fábril [Organization of Industry and Manufacturing]) in *Industria,* June 1989, 6.

changes.[19] Perhaps most significantly, when the military government ultimately selected the individuals who would be on the first central bank board in late 1989, large firms were given the right to vet potential candidates.[20]

In brief, as early as 1986, the Chilean economy was dominated by a set of free-market economic actors who enjoyed considerable influence over economic policy-making and who demonstrated interest in an autonomous central bank. And yet, the government chose to overlook this obvious economic incentive to undertake central bank reform. It is true that the reform was actually reactivated as early as 1986.[21] But an adviser close to the team in charge of the initiative affirmed that this was more because the Constitution required it than because the regime felt that it needed a central bank reform at this point in time.[22] In support of this hypothesis, note that this legislation's evolution was exceedingly slow during this period and that key components—such as who would serve on the first central bank board—had been left incomplete. Rather than being a high priority for the regime, the law seemed destined to be indefinitely "in committee."

International Explanations: The Need for International Credibility

If domestic economic pressures do not seem to provide a satisfactory explanation for this reform's timing, perhaps a plausible motive can be found in

19. While the CPC enthusiastically endorsed the central bank legislation, it also had a number of specific differences with the government. For example, it favored greater accountability procedures especially over the central bank's management of its assets, fewer exchange rate controls, and the inclusion of a representative from the financial sector on the central bank board. Most of these changes were not ultimately included in the final legislation, although a few minor accountability procedures were included (interviews by the author, tape recordings, Santiago, Chile, with Manuel Feliú, former president of the CPC [in the late 1980s], May 30, 1995; Alfredo Gutierrez, professor of law at the University of Chile and head of the CPC study commission, May 31, 1995).

20. Former economic adviser to a leading business association, confidential interview by author, tape recording, Santiago, Chile, June 1995.

21. In 1986, a small commission of four or five individuals was formed to study previous central bank reform efforts in Chile as well as various models of autonomy from other countries. On the basis of these studies, it was to develop a draft of the new autonomy legislation. This committee worked on the legislation over the course of several years, refining and rewriting portions of the text and also circulating it to various members of the military regime and the Chilean business community for comment (interviews by the author, tape recordings, Santiago, Chile, with José Antonio Rodriguez, former legal adviser at the central bank under Pinochet, May 2, 1995; Jorge Cauas; Juan Andrés Fontaine, former director of studies at the Central Bank of Chile and principal author of the 1989 organic law, May 10, 1995).

22. Confidential interview by the author, tape recording, Santiago, Chile, April 28, 1995.

Chile's international economic environment. Here again, however, the evidence is dubious. By 1989, when the reform was finally undertaken, Chile failed to meet any of Maxfield's (1997) conditions for times when central bank autonomy is likely to be employed as a signaling device to the international community. First, despite a balance of payments deficit in 1985–86, Chile was running a balance of payments surplus by 1987. Nor did the predominant form of asset flow conform to the expectations about central bank reform held by Maxfield (1997, 45–54). In the latter half of the 1980s, Chile experienced an enormous influx of net foreign direct investment while indirect portfolio investment was negligible. According to Maxfield, such developments rendered central bank autonomy virtually "unnecessary" in the eyes of the government (Calderón and Griffith-Jones 1994, 5).

When we turn to Maxfield's third indicator—the extent of financial regulation—we see that Chile again defied the international credibility logic. According to Maxfield (1997, 44–46), greater financial regulation should make a country a less likely candidate for central bank autonomy, since it can arguably rely more on domestic sources for financing. But precisely because of the 1982 crisis, Chile's national capital account was heavily regulated, indeed, much more so than those of many other LDCs (International Monetary Fund 1992; Haggard and Maxfield 1996). Finally, other indicators of the need to compete for international capital simply fail to confirm the international credibility hypothesis: the ratio of debt service to exports had been virtually cut in half from close to 50 percent in 1985 to 25 percent in 1988; import cover had returned to its pre-1980 levels; and international reserves were steadily increasing (see table 4.3). To the contrary, what these indicators suggest is that Chile was in quite good shape vis-à-vis its external creditors when the central bank reform was enacted.

The same cannot be said for the period seven years earlier. Recall that the government attributed the delay in the central bank reform in the early 1980s to the enormity of the 1982 financial crisis. But if one accepts the proposition that central bank reforms are most necessary—in credibility terms—during periods of economic crisis, then there was arguably no better time for the Chilean government to have implemented the autonomy initiative than in 1983–84. Indeed, the external macroeconomic environment suggested that the country was ripe for a reform of this nature at that time.

Consider Maxfield's indicators. Unlike in the period when the reform was actually undertaken, in the early 1980s Chile was in the midst of an acute balance of payments crisis: the balance of payments deficit in 1982 was nearly equal in magnitude to what the surplus had been in 1980. Foreign capital inflows should also have militated in the direction of central bank reform. It is true that what little foreign capital did enter the country was almost entirely

in the form of medium- and long-term credits—providing only a moderate incentive for central bank reform (Maxfield 1997, 41–42). But given that the net resource flow during this period was actually negative, this was arguably even more of an incentive to entice renewed lending through the establishment of an autonomous central bank. Finally, it was precisely the liberalization of capital controls that contributed to the speculative behavior and subsequent collapse of the banking system in the early 1980s (Hastings 1993). According to Maxfield, this lax regulatory environment should have rendered Chile a prime candidate for central bank reform.

Other indicators also suggest that the early 1980s would have been a propitious time for the Pinochet government to enhance the credibility of its monetary policy. By the end of 1982, international reserves had dropped nearly U.S.$1.4 billion from the previous year. Concurrent with the sharp decline in international lending, foreign investment as a percent of gross capital formation also slumped, totaling in 1983 almost a third of what it had been before the 1982 crisis (Calderón and Griffith-Jones 1994, 6). The drying up of foreign capital inflows that took place in Chile in late 1981 was not entirely due to exogenous international forces. Rather, it was in many ways a reaction on the part of international bankers to the deteriorating domestic conditions and policy mistakes associated with the late stages of radical neoliberalism (Edwards and Edwards 1987, 196). As the real exchange rate appreciated, foreign funds had begun to head for more secure investments in dollar-denominated assets (Hastings 1993, 220). In the wake of plummeting foreign investor confidence, central bank reform would have been an obvious means through which the regime might have bolstered its flagging international image.

Briefly, if economic credibility had been the issue, there were any number of junctures in the seventeen-year span of the Pinochet regime when the government had sufficient economic incentives to make the central bank autonomous. It might have responded to domestic pressures when the idea first surfaced in the mid-1970s. Alternatively, it might have chosen to enact central bank reform following the 1982 financial crisis, as a signal of its commitment to macroeconomic stability before a skeptical international audience. Finally, it might easily have implemented the autonomy initiative in the mid-1980s, in light of its compatibility with the macroeconomic policy demands of powerful capitalist classes. The fact that the government chose to wait until 1989 suggests that its motive and timing were not strictly economic but also political.

Reform Motive: Transition, Fear, and the Drive to Insulate

Neither the concerns of powerful domestic economic actors nor the exigencies of international capital were sufficient to warrant central bank reform in

the 1970s and 1980s. Rather, the government needed to perceive that its hold on power was in jeopardy. Prior to 1988, there was no incentive for central bank reform precisely because Pinochet himself enjoyed a tremendous amount of power and security that enabled him to defend the neoliberal model and those interests behind it with impunity. In 1988, all of this would change, and the authoritarians would begin to have reason to rethink their strategy.

Pre-1988: Pinochet's Iron Hold on Power

Over the course of his seventeen-year rule, Pinochet had acquired numerous powers that placed him at the center of the Chilean political system. The military coup of 1973 eradicated all democratic political institutions and replaced these with a military junta that assumed all executive, legislative, and constituent duties, including the power to override the 1925 Constitution where it saw fit.[23] While government responsibilities were initially divided evenly among the four commanding officers of the junta, Pinochet moved quickly to centralize power in his own hands. Through a series of decrees, Pinochet catapulted himself from chief of the armed forces to "first among equals" in this governing body, ultimately proclaiming himself president of the republic. As the undisputed leader within Chile's strongly presidentialist political system, he was able to intervene directly in the design of laws and to exercise appointment powers across all spheres of the federal government. This concentration of power within the executive branch was matched by the progressive marginalization of the junta, which was increasingly relegated to a legislative rubber-stamp role, beholden to the whims of Pinochet (Arriagada 1985, 28–134; Valenzuela 1991, 36–40).

Pinochet's role as the commander in chief of the armed forces fortified his political power. His unilateral control over promotions and retirements within the army proved to be very effective both in eliminating rivals and in securing the loyalty of his subordinates (Arriagada 1985, 125–28). By infusing all levels of the government with military appointees—particularly from the army—Pinochet also ensured that his political authority was reinforced by his military seniority (Huneeus and Olave 1987; Huneeus 1988a). In this way, Pinochet was said to be imbued with a "dual legitimacy" deriving from his twin roles as president of the republic and its chief military commander (Huneeus 1988b). These two roles were synthesized in 1982 when his politi-

23. Prior to the coup, Chile had a separation of powers system. Following the coup, a state of siege was declared that suspended all individual rights. The legislature was closed down, political parties that had participated in the previous democratic government were banned, the free press was curtailed, and military appointees replaced all elected municipal authorities.

cal and military advisers were unified under one body—the secretary of the presidency, which cemented the centralization of power in one individual.

The final pillar of power within Pinochet's personalized dictatorship was its legal status in the 1980 Constitution. As the decade of the 1970s wore on, it became increasingly clear that if Pinochet were to justify his right to remain in power, he would need to institutionalize both a rationale and a modus operandi for protracted military rule (Garretón 1986, 160–63). The 1980 Constitution did this through two constitutional orders. The first served to extend Pinochet's extraordinary concentration of power through 1988.[24] The second corresponded to a second eight-year period, beginning in 1989, when Chile would shift from military rule to a protected democracy in which the armed forces would play a guardian role. In the short run, the 1980 Constitution thus enabled the governing block to "legitimately" continue military authoritarian rule for eight more years.[25] In the long run, it imbued the authoritarians' political project with a considerable degree of permanence.

Above all, the 1980 Constitution entailed a variety of features that were designed to afford the military a privileged position under the eventual democracy that would result. For example, the military was given a vaguely worded constitutional mandate to "guarantee the institutional order of the republic," without defining either how this function would be exercised or what was meant by "guarantee" (Valenzuela 1992, 64). The armed forces were also given predominant representation on a National Security Council with the ability to oversee national security and monitor the actions of elected officials, in addition to widespread appointment powers. Finally, the Constitution denied democratic presidents the power to remove or freely choose armed forces commanders. Regardless of what political events might transpire in the future, Pinochet would thus remain as commander in chief of the armed forces.

In contrast to its strengthening of the military's role, the Constitution sought to circumscribe the authority of the political sphere, particularly that of the president and the legislature. Some political features of this protected

24. The first period had its legal basis in a series of transitory constitutional articles. These articles abolished habeas corpus and gave Pinochet complete latitude to declare states of emergency and to impose drastic curbs on individual liberties and rights without appeal to courts. While Pinochet was removed as an official member of the junta, he obtained the right to a self-appointed representative who reported directly to him. Since the junta continued to operate under a unanimity rule, Pinochet thus continued to enjoy (indirect) veto power over the junta's proceedings.

25. The 1980 Constitution was ratified with a landslide victory in a constitutional plebiscite held the same year, which the regime officially won with 67 percent of the vote. But in light of opposition repression, government counting of ballots, and the lack of electoral registers, few observers considered this to have been a legitimate show of popular support (Valenzuela 1991, 54).

democracy included: an exceedingly difficult constitutional amendment procedure, a legislature in which a third of the Senate would be appointed by the military regime through the establishment of the so-called designated senators, and a supreme court whose power lay in a constitutional tribunal with a strong military presence. In effect, many powers commonly held by the president were disbursed to bureaucratic state entities that were granted both autonomy and tutelage over the system: the military, the designated senators, and the supreme court (Arriagada and Graham 1994, 252). Toward the end of the decade, all of this would be buttressed by a series of additional organic laws and electoral reforms that would strengthen even further the outgoing regime's stranglehold over an eventual transition to democracy (see chap. 5).

The Proximity of Threat: The 1988 Plebiscite

In sum, Pinochet had amassed a tremendous amount of power—political, military, and legal—during the course of his rule, with which he was able to promote and defend the interests of dominant economic actors as he saw fit. The only potential source of uncertainty in this iron hold on power was contained in the succession mechanism governing the transition between the two constitutional orders noted earlier. According to the 1980 Constitution, the political leadership during the second phase of "protected" democratic rule would be determined by a popular plebiscite to be held in 1988. In this plebiscite, the electorate would choose between allowing Pinochet to continue to rule Chile for another eight-year term or holding a popular election to select a new president. If all went according to plan, the plebiscite would merely provide a popular mandate for eight more years of authoritarian rule. In the event of a victory of the "no," presidential elections would be held on December 14, 1989.[26]

On the eve of the plebiscite, both subjective and objective indicators made it seem unlikely that the government would lose its bid to remain in

26. One can of course question why the regime created a constitution that contained the seeds of its own demise. A number of potential explanations have been offered. Most authors emphasize that at the time it created the Constitution, the regime was running out of legitimacy both with domestic audiences and abroad and needed to show that it was capable of political flexibility (Garretón 1986, 158–63; Valenzuela 1991, 50–54; Varas 1987). Others emphasize the fact that the regime was riding on an economic boom at the time of the 1980 Constitution and thus saw the plebiscite as no more than a "rubber stamp" (Arriagada and Graham 1994, 251). An alternative and potentially more compelling argument is that in addition to the reasons noted previously, the Constitution (and the plebiscite) was an effort by certain groups within the regime who feared a populist threat either by Pinochet himself or by another future government. In response to this fear, they wanted to establish clearly defined rules that would guarantee the preservation of certain political and economic assurances, regardless of who was in power (Moulian 1992).

power. To begin with, Pinochet saw himself as endowed with a historic mission to continue in office until his death. In the years leading up to the plebiscite he was quoted as saying, "the government of the armed forces has never been conceived of as a parenthesis in the civic history of the country. No one cannot recognize the legitimate right that we have to extend our project beyond 1989" (Varas 1987, 196). He additionally warned that "We will not turn over power just for fun; the first eight years served to dictate laws that complemented the 1980 Constitution, and the eight years that follow [are meant] to apply these in real form" (Huneeus 1986, 61). The quite prosperous state of the Chilean economy only made such an outcome seem all the more likely. Finally, the government's ability to use government ministries to target various social groups also gave it a considerable resource edge over its opponents. For all of these reasons, the vote was construed by the regime as no more than a legitimating device for maintaining power until the end of the century (Constable and Valenzuela 1991, 297).

This confidence exploded overnight, however, when the "no" vote won by a margin of 55 percent against Pinochet to 43 percent in favor. It is clear in retrospect that the regime overestimated its ability to win the plebiscite and, in so doing, unwittingly contributed to its own demise. On the one hand, the government went out of its way to ensure conditions for a "fair fight."[27] When the opposition actually won, the government thus had no choice but to accept the outcome, as a series of international and domestic pressures obliged it to do so.[28] On the other hand, the regime was also blinded by its own success in fostering growth and private investment. It dismissed opposition polls as biased and relied instead on reports from local government and army officials that were uniformly favorable (Constable and Valenzuela 1991, 304–5). In particular, it ignored its own poor record on social justice (see the following discussion). This played directly into the hands of the opposition, who ran an effective campaign indicting the regime for its neglect of the bottom 40 percent of the population (Arriagada and Graham 1994, 263–67).

The watershed defeat of Pinochet in the plebiscite had a number of

27. During the campaign itself, the government lifted states of exception, allowed for a fair and public registration process, and granted the opposition limited access to television. On the night of the actual vote, the opposition was allowed to set up an independent system to monitor elections and vote counting, with three poll watchers at each voting establishment as well as a sophisticated computerized vote counting system.

28. These included pressures from the U.S. government and the international financial institutions; the existence of moderate pro-democratic forces on the political right; and the nature of the armed forces itself, which—while loyal to their commander and chief—were also a highly professional institution strictly committed to constitutional rule (Constable and Valenzuela 1991, 302–5). With respect to this final point, note that it was a member of the ruling junta, General Fernando Matthei, who first declared the victory of the "No" campaign.

significant consequences. First, it was a visible signal that the Pinochet regime did not enjoy the widespread popular legitimacy that its leaders had imagined. It was particularly clear that the government's neoliberal economic program had worked against it in the electoral sphere. While the Chilean economic model had been widely praised for outstanding growth performance, the vast majority of the country's population had not reaped the rewards of such success (Ffrench-Davis 1991). In a post facto analysis of the plebiscite vote, 72 percent of those who voted "no" did so primarily for economic reasons, of which 38 percent saw the poverty question as the prime motivation behind the need for a change of government. Economic justice was prioritized even ahead of such concerns as human rights, general disapproval of the military government or Pinochet himself, or the need for a return to democracy (Méndez et al. 1989, 96).

In addition to revealing the regime's "redistributive illegitimacy" (Varas 1991, 75), the plebiscite also put an end to Pinochet's efforts to perpetuate his personal dictatorship through the end of the century. While he would remain as commander of the armed forces, his days of dual domination in both political and military spheres had come to an end. In this way, the plebiscite signaled the beginning of a shift in the internal balance of power within the regime, from a reactionary faction identified with maintaining Pinochet in power at all costs to a more moderate, negotiating faction open to the idea of a transition to democracy (Moulian 1993, 15–20).[29]The triumph of this more moderate faction would be definitively revealed when the government agreed to engage in negotiations over the Constitution in July 1989.[30]

Third, the plebiscite defeat also pointed to a well-organized opposition coalition under the leadership of the major parties of the center and left—the Concertation of Parties for Democracy (Concertación de los Partidos por la Democracia [Concertación]). Despite a decade of infighting and programmatic divides, these parties had been able to overcome their differences to successfully unite behind the singular goal of defeating Pinochet. Their success in this endeavor can be attributed to three separate learning processes

29. I refer here to the classic "hard-liner versus soft-liner" split (O'Donnell and Schmitter 1986). The "hard-liners" corresponded to the army and a conservative right-wing political party, the Independent Democratic Union (Unión Democrática Independiente [UDI]), while the "soft-liners" were represented by the other branches of the armed forces of the military and a moderate right-wing National Renovation Party (Renovación Nacional [RN]).

30. In the course of these negotiations, the government agreed to a number of changes to the Constitution: the quorum for a constitutional amendment was diminished from two-thirds of two consecutive Congresses to two-thirds of both legislative bodies; the veto power of the National Security Council was reduced in part; the presidential term following the transition was shortened from eight to four years; and the number of elected senators was increased from twenty-six to thirty-eight. For more on the events leading up to these negotiations, see Moulian 1993.

that took place in the years leading up to the plebiscite (Garretón 1991, 1992; Puryear 1994; Kinney-Giraldo 1996). First, they came to recognize their own role in bringing about the political gridlock that had culminated in a military coup twenty years earlier. They vowed to avoid a repetition of such polarization and sought instead to use the party system to restore consensus as both an ideal and a mechanism of democracy (Correa 1993).[31] Second, they also recognized that if they were going to end authoritarian rule, they would need to beat the regime at its own game. Despite their initial reticence to do so, the parties of the opposition ultimately decided to work within the confines of the framework of the 1980 Constitution—and the plebiscite in particular—as the forum for their fight. Finally, a third factor enhancing their success was their decision to unite in a strictly operational sense for the plebiscite, postponing the more potentially divisive issues of programmatic message and presidential candidate until they had first succeeded in ousting Pinochet.

By shifting the relative balance of power away from outgoing authoritarian elites and in favor of the incoming democrats, the plebiscite thus unleashed a process of transition to democracy. To be sure, this transition would unfold within the parameters set by the regime itself. But there was no question that it would take place as scheduled. The victory of the "no" was thus an unequivocal indication that democracy was not only an inevitability but also an event to which the country could attach a precise date and time.

The Intensity of Threat: The Specter of a Center-Left Future

The only remaining question was who would take Pinochet's place: a right-wing puppet government comprised of the parties that had supported him in the plebiscite and could be expected to continue his programmatic agenda; or the center-left coalition that had united to bring about his downfall in the plebiscite? While there was no way of knowing for sure, the results of the plebiscite suggested the latter. This scenario provided sufficient reason for the government and its powerful business allies to begin to worry about how such an outcome might affect their interests in the future.

It is certainly true that the opposition did make a concerted effort to repeatedly stress its intention of maintaining macroeconomic stability under democracy. Many authors have pointed to the moderate nature of the Concertación's economic message as a crucial factor in securing its victory in the 1988 plebiscite, particularly among undecided voters (Angell and Pollack 1990, 4–5; Arriagada and Graham 1994, 264–65). It is also true that Alejandro

31. On the notion of "consensus building" as a means to execute socioeconomic and political policies, see Foxley 1985; also *Revista Cieplan* 1988.

Foxley, who was widely expected to be finance minister in the event of a Concertación victory, repeatedly reassured the Chilean economic elite that he would respect private property, would exert fiscal responsibility, and would not dismantle Pinochet's economic reforms (Kinney-Giraldo 1996, 252–54).

But collective memories combined with poor communication links meant that, ex ante, such promises fell on deaf ears. As far as powerful economic actors were concerned, the political class of the left and center had not evolved since 1973 (Bartell 1992). As the president of the peak business organization declared at the time, "We do not perceive that the opposition political groups of the center or center-left have incorporated into their economic and social thought that the best economic system is that of the market" (Rehren 1995, 12). A prominent businessman similarly noted that "most of the guarantees of macroeconomic stability come from economists and not from political leaders or formal statements by opposition parties. . . . [This] strongly diminishes their credibility, since one could treat these as expressions of good will that, later on, will be overtaken by political events."[32] Such mistrust was reflected in the fact that when Alejandro Foxley went to address a business gathering four days after the opposition's victory in the plebiscite, he was booed publicly by members of the business community who stood up and shouted, "We don't believe a word that you say" (Cavallo 1992, 149)! It is perhaps not surprising that in the two days following the victory of the "no," the stock market dropped by 11 percent and 16 percent, respectively (Campero 1991, 149).

It would be a mistake, however, to emphasize exclusively the role of private sector skepticism in generating an atmosphere of fear. The truth is that there was also a series of objective indicators that stirred up uncertainty regarding the future economic situation of the country. To begin with, we must recall that the Concertación coalition was by no means composed solely of moderates. In addition to its leadership within the centrist Christian Democrats, this seventeen-party coalition also included several parties and political movements from the Chilean left, many of whose leaders had held prominent positions within the socialist Allende government of the early 1970s.

Much of the Chilean left had undergone a fundamental process of ideological renovation over the course of the 1980s, renouncing its previous commitment to armed struggle and embracing a path of moderation and compromise (Silva 1992; Loveman, 1993). But a variety of individuals from the more hard-line faction of the Socialist Party also formed part of the opposition coalition. Only years earlier, this movement had called for a "revolution

32. "El Futuro de la Política Económica," *Industria,* October 1988, 7.

of the proletariat," and its continuing ties to militant far-left groups led to allegations of secret pacts between the Concertación and the Marxists in the period following the plebiscite (Angell and Pollack 1990, 6).[33] It was no secret that the Christian Democrats needed an alliance with the left in order to obtain an electoral majority in the parliament (Moulian 1993, 34). If they wanted to keep this unwieldy coalition alive, they would have to heed some of the demands of the more extremist elements, particularly since all important decisions had to be made through negotiations between leaders of the various parties.

In addition to the presence of radical elements within the Concertación alliance, another objective threat to continued macroeconomic stability was the popular mandate for a more actively redistributive economic program. As noted earlier, the primary stimulus behind the victory of the "no" had been the perceived failure on the part of the Pinochet regime to respond to pent-up social demands. Polls conducted at the time suggest that there was a widely held view among the working-class and middle sectors that the economic situation under Aylwin would change considerably in their favor (Hojman 1990, 26). Such polls also revealed that the majority of the population preferred policies that did not correspond to those advocated by the neoliberal status quo. To the contrary, in a series of polls carried out between 1986 and 1991, 70 percent of the persons polled opted for health care and education managed by the state; 57 percent felt that the state should own the most important companies; and 80 percent believed that foreign investment should be subjected to greater controls, if not nationalized (Arriagada and Graham 1994, 265).

While Foxley was acutely sensitive to the dangers of generating populist policy cycles (Foxley 1990, 118), business groups had to worry about the government's ability to withstand popular pressures for a profoundly redistributive economic agenda. Few had forgotten the recent experience in Argentina, where a newly democratic government advancing a platform of economic restructuring ultimately caved in to interest group demands (Acuña 1994; Flisfisch 1994). Despite whatever moderate discourse Foxley and others might have put forth publicly, it was thus common knowledge that with nearly 5 million people below the poverty line in a country of 13 million, "Chile's return to democracy can only survive if it responds to popular demands for redistribution and greater social expenditure" (Angell and Pollack 1990, 21).

33. Indeed, while the Christian Democrats successfully opposed including any avowedly Marxist movements in their electoral coalition for the 1989 presidential elections, several individuals held joint membership in both the Concertación and the far left coalition—the Broad Party of the Socialist Left (Partido Amplio de la Izquierda Socialista [PAIS]).

A third factor exacerbating the overall atmosphere of uncertainty was the internal divisions within the Concertación leadership itself regarding what sort of economic policy to pursue under democratic rule. There were considerable differences among the various party elites over issues such as the optimal tariff regime and level of industrial protection, the size and nature of state intervention, the role permitted foreign investment, and even the desirability of enacting another agrarian reform (Hojman 1990, 41). Such discrepancies came to the fore in a much-publicized incident that took place in March 1989 surrounding a draft document for the Concertación's economic program. On this occasion, Foxley personally vetoed the initial document drawn up by the technical committees of the Christian Democratic and Socialist Parties. He argued for a less regulatory role for the state on no less than twenty different points concerning foreign investment, the system of tariffs, the tax structure, and the privatization of public enterprises.[34] While the program was ultimately revised to a milder, albeit still ambiguously interventionist version (see the discussion that follows), this version emerged only after Foxley threatened to quit the economic team entirely (Cavallo 1992, 150–52; Kinney-Giraldo 1996, 250–52).

The significance of such an incident cannot be understated. Note in particular that the draft was not the product of the extremists in the Concertación rank and file but rather reflected a consensus position taken after intense negotiations among the coalition's moderate vanguard.[35] Such an act suggests that there was considerable support within the opposition leadership for a much more decidedly statist economic policy orientation.[36] And because the draft document—and the dispute itself—was quickly circulated to the press, these internal programmatic tensions were widely known. Such an overt internal conflict made it clear that even if Foxley was personally committed to macroeconomic stability, there was no guarantee that he would be able to stem the tide of more populist currents within his own coalition.

Such doubts were not alleviated by the final version of the Concertación's proposed economic program. While the final draft was considerably muted compared with its predecessor, it did not remove these ambiguities entirely. As Loveman (1995) notes, "the Concertación program was

34. For the actual contents of this draft document, see *Hoy* 608 (March 13–19, 1989): 39–41.

35. I refer here to the Christian Democratic Party and the more market-friendly "Renovated" (PS-Nuñez) wing of the Socialist Party.

36. As a leading member of the opposition's political team noted when reflecting on this period, "in 1989 the climate of economic ideas that were being nurtured within the Concertación were—in the best case scenario—in transition" (Flisfisch 1994, 25). Indeed, it was not until 1991 that the Christian Democratic Party explicitly endorsed the role of the market and private property as part of its development strategy (Rehren 1995, 22).

ambitious—indeed, too ambitious" (Loveman 1995, 306). In the economic realm, it promised social and economic policies to mitigate income inequality, reduce unemployment, provide educational and economic opportunities, and reduce extreme poverty, while sustaining economic growth, technological innovation, and modernization of the public sector (Aylwin 1990). In particular, the opposition had made "growth with equity" the centerpiece of its economic platform, promising to redress the "social debt" left by the military government through tax increases on business, increased labor rights, and the creation of a solidarity fund in which public defense expenditures would be reassigned to social spending (Aylwin 1990). While the proposed economic agenda could hardly be termed radical, it was both sufficiently vague in specifics and progressive in spirit to excite the concern of its conservative opponents (Rehren 1995, 44–47).

For example, the president of the CPC referred to the Aylwin program as "quite ambiguous; it allows as much for a government that is interventionist, structuralist, and statist as it does for a government that is free, market-oriented, and open, like that of today."[37] A businessman in the right-wing RN party similarly queried, "it is not clear what will be the role of the market and what will be the role of central planning in the assignment of resources . . . which will be the role of the private sector and which the role of public sector in development. . . . will we have to relive the past? Return to . . . 1970?"[38] Business reacted particularly strongly to the proposed changes in labor legislation: "Can one believe that the fruit export sector will survive and continue its expansion with strikes during crop season, obligatory work stoppages . . . and ports controlled by union monopolies?"[39] A policy research organization favorable to the military government even went so far as to project the expected economic costs attendant on a Concertación victory in the presidential elections, predicting that a victory of the "no" would lead to an initial expansionary bonanza (Cheyre 1988).

While it is certainly true that, once elected, the Concertación did go on to pursue an economic program that continued the principal pillars of the military regime, this should not be confused with the mixed signals that were sent in the months prior to its taking power. Ex ante pledges to maintain macroeconomic stability notwithstanding, I would question how much this message ever registered upon the upper echelons of the entrepreneurial class in the twi-

37. Felia, Manuel. "Crecer en Democracia," interview by Andrés Adler, *Ercilla,* November 15, 1988, p. 18.

38. "Programa de Gobierno de la Concertación: Cree en el Estado y sus Burócratas y Desconfía de las Personas," *Renovación Etapa* 2, no.32 (July–August 1989): 9.

39. Commentary from the conservative magazine *Economía y Sociedad,* as quoted in "Se Dijo," *Industria,* December 1988, 11.

light of authoritarian rule. Rather, due to a combination of objective socioeconomic realities coupled with the actions and statements of the opposition itself, the authoritarian regime and the powerful capitalist actors behind it still feared a resurgence of the populist economic policies that had inspired the military coup of 1973. As one author summed it up, "democracy represented a dual threat for the business class: on the one hand, the possible destabilization associated with excessive participation, and on the other hand, the fiscal imbalance associated with populist fiscal measures" (Montero 1993, 54).

In this way, the 1988 plebiscite signaled to Chile's authoritarian government the onslaught of a democratic threat that was not only intense but also proximate. After seventeen years in which they had enjoyed free rein to impose their policy preferences at will, the authoritarians could not take a chance. If they wanted to take action to protect their interests, they would have to move quickly. The next chapter documents the nature of their response.