



# The Legacy of the Pinochet Regime in Chile

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## 1 INTRODUCTION

Many countries have a democracy functioning at the shadow of a recent dictatorship (O'Donnell and Schmitter 1986). The authoritarian legacies can be easy to ignore, perhaps difficult to observe, and sometimes require tremendous efforts to eradicate. Examples abound all over the globe,

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from the political shadow of Suharto in Indonesia (Martínez Bravo et al. 2018), the drastic military dictatorship in Brazil (Martínez-Bravo et al. 2020), the infamous Adolf Hitler in Nazi Germany (Voth and Voigtländer 2015), and the Francoist dictatorship in Spain (Valencia and Tur-Prats 2020), among many others. Chile is also one of these countries, with nowadays more than 30 years of democracy at the shadow of the Pinochet dictatorship (1973–1990).

This chapter reviews the Chilean experience from an economic history perspective. We divide our analysis into four parts. The first part provides an overview of the rise and fall of the Pinochet dictatorship from September 1973 to March 1990. We cover the installation of the military regime after the 1973 coup with an emphasis on the arrival of the main political and economic collaborators who guided the economic and institutional reforms. We then summarize the origins and rationale behind the implementation of market-oriented policies, the creation of a new constitution, and the use of state repression. We end with a description of the democratization by election after the 1988 referendum and with details about the fate of Augusto Pinochet during democratic years.

The second part describes the economic persistence after the transition to democracy. We start by describing macroeconomic patterns related to economic growth, inequality, and poverty rates. Although the remarkable growth of the Chilean economy from 1985 until the late 1990s is well documented, there is little consensus about the contribution of the dictatorship's reforms. The reasons are the multitude of simultaneous events—e.g. democratization, favorable external conditions—and our lack of knowledge about a counterfactual economy where some reforms could have also been introduced. Patterns of inequality are perhaps less popularly known, and we describe some of the discussions in light of the most recent literature studying top incomes in historical perspective. We describe the most prominent economic policies implemented by the Pinochet regime and the emergence of business elites after the economic crisis of the early 1980s. The common theme is an increasing role of the private sector at the expense of a deteriorating public sector, trends which have continued at a constant pace in the decades after democratization.

The third part discusses economic research related to the political persistence after the Pinochet years and reflects on related avenues for future research. We begin by a discussion of the role of firms, usually overlooked and recently emphasized as politically influential and as vehicles of political power across turbulent times. We also review recent

research documenting the functioning of local governments in the period 1973–1990, which provides important and more general lessons about the persistence of dictatorship elites. In particular, we emphasize that appointed politicians during dictatorial times obtained an incumbency advantage presumably related to the added political experience and the fact they became more recognizable among the public. This advantage can trigger political careers and create persistent political elites. Overall, the evidence points toward a drastic change in the distribution of political power during the Pinochet regime and a subsequent persistence that inevitably affected the functioning of the new democratic times.

The fourth and last part offers a description of several protest movements using a simple political economy framework (Acemoglu and Robinson 2006). Early waves of discontent were led by high school and college students in the form of massive demonstrations in 2006 and 2011. In both occasions, the incumbent government responded with partial reforms that failed to permanently change the prevailing institutions. As a consequence, new and stronger waves of discontent appeared in the mid- and late 2010s. Politicians attempted once again to respond with partial reforms, but the public kept demanding structural and permanent changes to political and economic institutions. The discontent exploded in October 2019 and a new political class offered for the first time the possibility of permanent reform. Chile is currently on a path to replace the constitution, interpreted by many as the end of Pinochet’s legacy. We end this chapter with a brief description of the country’s constitutional endeavor and emphasizing some of challenges of the near future.

## 2 THE RISE AND FALL OF THE PINOCHET REGIME

This section provides an overview of the installation of the Pinochet regime in 1973, the main policies implemented, and the transition to democracy. Our focus is in relation to the legacy of the regime and provide details with this goal in mind. We refer the reader to Huneus (2000) and Cavallo et al. (2011) for a more detailed description of the Pinochet regime.

### 2.1 *The Installation*

The Pinochet dictatorship began after a coup in September 11, 1973. That day, President Salvador Allende was overthrown by the Navy, the

Air Force, the National Police, and the Army. All political activities were suppressed, the Congress was closed, the constitution was suspended, and the leaders of the armed forces and the National Police became rulers in a junta.<sup>1</sup> The Commander-in-Chief of the Army, Augusto Pinochet, was designated head and, after consolidating his power, became head of the state in December 1974. In the beginning, “there were no plans, no names, just the agreement of assigning government departments to the armed forces and, hopefully, some civilians” (Cavallo et al. 2011, p. 25). The ministers of the first cabinets were appointed in the weeks after the coup with the objective of having a “functioning government as quickly as possible” (Spooner 1999, p. 85). The first wave of appointed ministers came mostly from the armed forces, but there was significant turnover in the months that followed.

During this installation period, the right-wing coalition persuaded Pinochet to implement market-based policies and to change the institutional framework. Collaborators in this early stage came from two groups (Huneus 2000). The first are popularly known as “Chicago Boys,” highly educated individuals trained mostly at the University of Chicago. Most of these economists studied business and economics at leading Chilean universities, had close connections to the business world, and were in charge of the design and implementation of economic policies (Silva 1996a). The second group were politically oriented individuals from the “Gremialism” group at the Catholic University in the late 1960s. The Gremialists were responsible for the design and implementation of the legal framework. The majority of these advisors were formally or informally associated with the right-wing coalition. The most well-known collaborator in this group was Jaime Guzmán, a leading intellectual behind the 1980 Constitution and the founder of the Independent Democratic Union in 1983, today one of the largest political parties.

## 2.2 *Repression and Market-Based Policies*

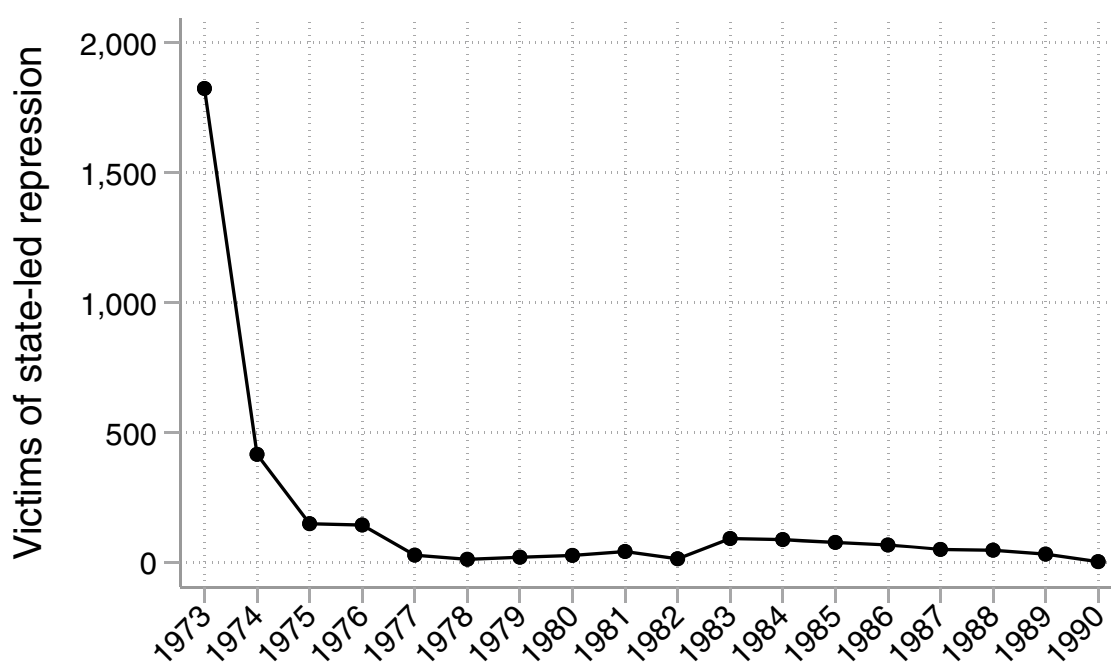
Market-oriented policies, the creation of a new constitution, and state-led repression are perhaps the most well-known policies of the Pinochet

<sup>1</sup> The causes behind the 1973 coup are a matter of debate among scholars. Previous research has emphasized the role of the extreme left to radicalize Salvador Allende’s economic agenda (González and Vial 2021). Other explanations include the role of the US invisible blockade (Sigmund 1974; Aldunate et al. 2021).

regime. The right-wing coalition saw in the turbulent times after the coup an opportunity to implement their policy platform, described in a lengthy document known as “The Brick” and first drafted as an economic plan for the right-wing candidate in the 1970 presidential election (Centro de Estudios Públicos 1992). The implementation of many of these policies started in 1975 and became more moderate after the 1982 economic crisis. In contrast, state-led repression began the same day of the coup.

The military junta rapidly declared to “struggle against Marxism and extirpate it to the last consequences” (Constable and Valenzuela 1991, p. 36). More than 3200 people were killed and more than 38,000 people were imprisoned, 94% of whom were tortured (Comisión Rettig 1996; Comisión Valech 2004). Repression was implemented in three periods. The first (1973) was characterized by mass raids and infamous military campaigns such as the “Caravan of Death” (Verdugo 2001). The National Intelligence Directorate (DINA) was the lead actor in the second period (1974–1976), “elite” military who selectively repressed members of the left-wing, including socialists and communists. Internal disputes and the killing of General Orlando Letelier in the US in 1976 increased foreign pressure on human rights abuses. The National Center of Information (CNI) and an elite unit known as Comando Conjunto became the repression leaders in 1977. The intensity of state-led repression decreased substantially in the late 1980s. Figure 1 presents the number of victims per year between 1973 and 1990 as documented by Comisión Rettig (1996).

The consequences of the human rights violations committed by the Pinochet regime are many and have been the focus of extensive research across many different disciplines. From the economics and political science literature, however, the attention has been remarkably limited. An exception is Bautista et al. (2021), who reconstruct the geographic history of military bases throughout the country to show that the regime relied on these facilities to implement the early repression. Using this information, the authors are able to empirically show that state-led repression strengthened (rather than weakened) opposition forces and thus contributed to the transition to democracy.



**Fig. 1** Victims of state-led repression during the Pinochet regime (1973–1990) (*Notes* The number of victims includes killings and forced disappearances. Data processed by Bautista et al. [2021] and originally constructed by Comisión Rettig [1996])

Together with repression, a large package of economic reforms was implemented, motivated primarily by a technocratic belief in the efficiency of markets and private ownership.<sup>2</sup> The most well-known policies are a massive privatization program and a trade liberalization which introduced uniform 10% tariffs (González et al. 2020; Cuesta et al. 2015).<sup>3</sup> As part of these reforms, the regime implemented a crawling peg exchange rate regime, eliminated import licenses and prohibitions, promoted exports, pushed back on the agrarian reform, and designed a plan to control a persistent inflation (Edwards and Lederman 1998; González and Vial 2021). These policies brought some prosperity during

<sup>2</sup> In contrast, television stations and newspapers were controlled by the dictatorship almost during the entire period. This media control incentivized citizens to produce and consume relatively more unbiased information from radio stations and magazines, particularly after the protest wave of 1983–1984 (Leon-Dermota 2003).

<sup>3</sup> Before the Pinochet years, tariffs and non-trade barriers were used to favor certain sectors of the economy, but this was eliminated to increase market competition and promote specialization (Lederman 2005).

the late 1970s, but in 1982 the country experienced an economic crisis derived from some of these market-oriented policies. The crisis triggered an increase in tariffs to 35%—later reduced to 11% in 1991—and the privatization process was interrupted to return with intensity in the late 1980s. After the crisis, the existing business elite was shattered, allowing a new business elite to emerge (Lefort 2010; Rojas 2015). By the end of the dictatorship, the economy had again experienced some years of sustained economic growth after the crisis, but 40% of the population was in poverty and inequality had reach an all-time high.

In addition to the market-oriented policies, the Pinochet regime was also able to consolidate their legal vision of political institutions by writing a new constitution in 1980 (Barros 2002). This text made the junta the legislative body and Pinochet president for the period 1981–1989 and then Commander-in-Chief of the Armed Forces from 1990 to 1998. Although the constitution was approved by little more than two-thirds of citizens, scholars of the period have casted doubt on the legitimacy of the process due to a number of electoral irregularities (Fuentes 2013). Some reforms to the constitution were introduced in 1989, and a more significant package of reforms with more inclusive political institutions was only implemented in 2005.

### 2.3 *The Transition to Democracy*

As mandated in the 1980 Constitution drafted by Pinochet's allies, a referendum in 1988 was to decide the future of the regime. The "YES or NO" election known as the "1988 plebiscite" was held on October 5, 1988, and a "YES" victory would validate Pinochet in power for eight more years (Barros 2002; Boas 2015). In contrast, a "NO" win would trigger a presidential election with candidates from all political parties. The 1982 crisis, the 1983–1984 protest wave, and the actions from social organizations all contributed to the strength of the opposition and thus played a crucial role in making the plebiscite possible and the election free and fair. Why did the regime allowed the election to take place? The regime aimed to get international validation, hoped to transform Pinochet into a democratic leader, and presumably miscalculated their chances of victory (Treisman 2020). Before the plebiscite political parties were made legal again and 7.5 million people registered to vote, an estimated 90% of the voting-age population (Bautista et al. 2021).

During the month before the 1988 plebiscite, the opposition—a coalition organized under the name of *Concertación de Partidos por la Democracia*—got the opportunity to use television for political advertising. The advertisements were presented by the regime as a signal of competitive elections and “had one of Chile’s largest TV audience [and] became the most discussed program on television and ‘the’ subject of conversation for the month it was broadcast” (Piñuel Raigada 1990; Hirmas 1993). The opposition’s side of the campaign consisted of a news show hosted by a popular anchorman that discussed important (and usually ignored) subjects such as human rights violations (Boas 2015). The regime emphasized the economic success of the second half of the 1980s and associated a potential opposition victory with the arrival of communism and the end of economic prosperity. These campaigns favored the opposition (González and Prem 2018).

More than 55% of people voted against Pinochet in the 1988 plebiscite and bolstered the democratic transition. After negotiations between the regime and the opposition, 91% of people voted for the “Approve” option in July 1989 to reform the constitution. Then, in December 1989, a presidential election with candidates from all parties took place and, as expected, the opposition candidate Patricio Aylwin won and took office in March 1990. The regime’s defeat at the 1988 plebiscite was unexpected because there was no legal institution in charge of regulating the election, which had allowed the regime to enjoy victories in the 1978 and 1980 plebiscites (Fuentes 2013). International scrutiny and internal organizations increased the legitimacy of the 1988 process (Engel and Venetoulis 1992; Tagle 1995; Santa-Cruz 2005). Moreover, previous surveys did not give a clear prediction (Cauce 1988), and most people thought Pinochet was not going to acknowledge a negative result (Huneus 2006). On election day, most preliminary results showed that Pinochet was winning, and the opposition’s victory was only recognized on the next day at around 2 a.m. (Méndez et al. 1988). In previous research, we confirm the unexpectedness of the result by looking at abnormal returns in the stock market (González and Prem 2020).

After the transition to democracy in March 1990, Augusto Pinochet remained as Commander-in-Chief of the Army for eight more years and, as mandated in the 1980 Constitution, held a lifetime seat in Congress. However, in one of the most well-known political events of the late 1990s, Pinochet went to London for medical treatment, was indicted by a Spanish magistrate, and was charged with several crimes including human



rights violations and corruption. After potentially being extradited to Spain, a judge authorized Pinochet to return to Chile after medical exams determined he was unable to face trial. Shortly after his return to Chile, Pinochet resigned to his seat in Congress to face judicial prosecution. He died under house arrest in December 2006.

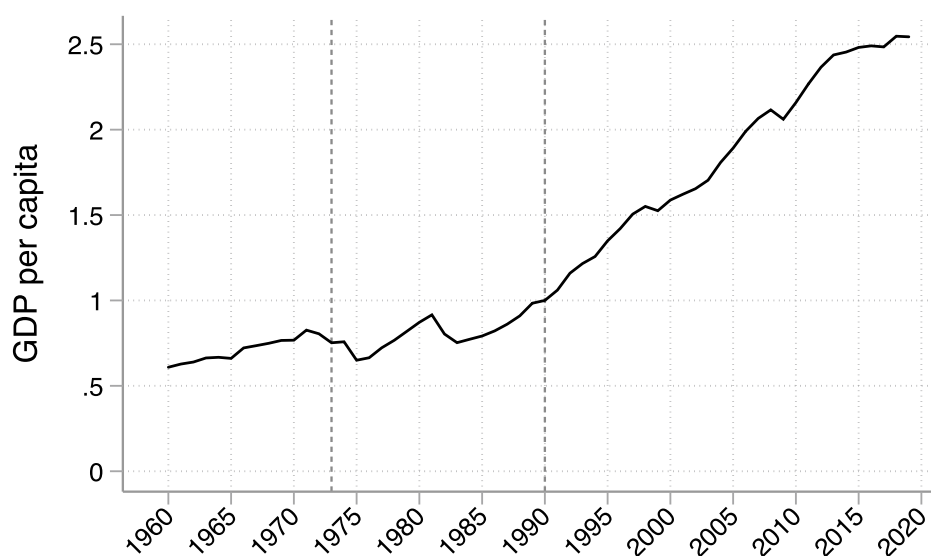
### 3 THE PERSISTENT ECONOMY

This section begins with a discussion of macroeconomic trends, then focuses on prominent economic policies, and ends discussing recent research on privatization and business groups.

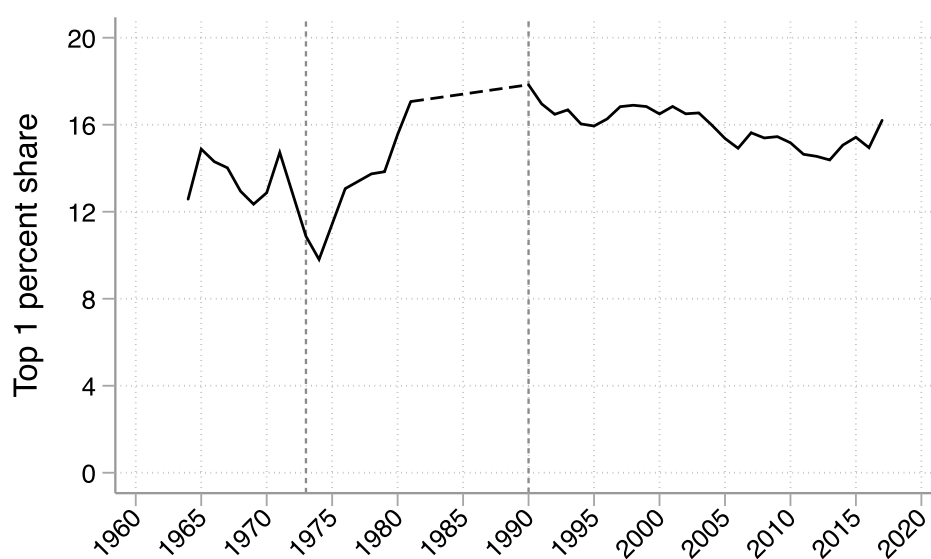
#### 3.1 *Growth and Inequality*

Panel (a) in Fig. 2 presents the GDP per capita in the period 1960–2019. Economic growth during the Pinochet regime was below average when compared to the 1990s and 2000s (Ffrench-Davis 2018). However, the country’s growth between 1985 and 1998—which included the recovery after the 1982 crisis—was one of the highest worldwide (Gallego and Loayza 2002), leading many to claim that it was the consequence of the market-oriented reforms implemented in the 1980s (e.g. Bosworth et al. 1994). The early literature in economics used time-series and cross-country regressions together with growth accounting and pointed to an important role of total factor productivity (TFP), favorable terms of trade, and increasing availability of foreign capital. Some scholars have claimed that the Pinochet reforms increased TFP and because of that made the financial sector stronger. The empirical evidence is far from conclusive and the period of sustained growth could have been the consequence of favorable external conditions, economic policies that would have been implemented in the absence of the Pinochet regime (e.g. uniform tariffs), or the combination of post-crisis recovery with policies implemented in democracy.

Patterns of inequality have also sparked significant debate. Nowadays, Chile exhibits high-income inequality—as measured by the Gini index and top incomes—within Latin America and among OECD countries (OECD 2015; Alvaredo et al. 2018). Survey data and tax records reveal that inequality reached an all-time high toward the end of the 1980s (Sanhueza and Mayer 2011; Flores et al. 2020). The most common



(a) GDP per capita



(b) Top 1 percent share

**Fig. 2** GDP per capita and inequality (*Notes* Panel (a) uses real GDP per capita data from the World Bank. We have normalized these numbers relative to GDP per capita in 1990 to facilitate comparisons over time. Panel (b) uses fiscal incomes data from Flores et al. [2020]. The vertical lines denote the beginning and the end of the Pinochet regime [1973–1990])

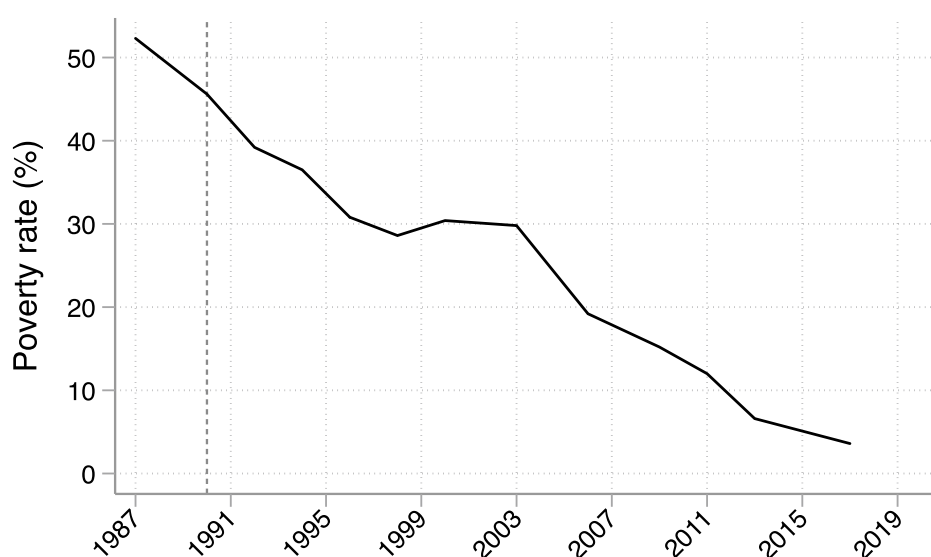
explanation is that policies implemented by Pinochet favored the elite, depressed the real wages of workers, and inequality increased as a consequence (Rodríguez 2014; PNUD 2017). Income inequality seems to have decreased slightly after the transition to democracy. The most recent literature uses tax data to measure income concentration because surveys underrepresent high incomes (Atkinson et al. 2011). These estimates show that the top 1% share increased rapidly and almost doubled during the Pinochet dictatorship, decreased slightly in the first two decades after the transition, and has begun to increase again in recent years (Flores et al. 2020).<sup>4</sup> Panel (b) in Fig. 2 presents the most recent estimates. A striking pattern is the persistently high-income concentration after the transition in 1990, which some scholars attribute to structural changes arising during the Pinochet years (Rodríguez 2017).

The decades after the Pinochet regime also exhibited a remarkable reduction in poverty rates from 50% toward the end of the 1980s to less than 10% in the late 2010s. Panel (a) in Fig. 3 plots this rate as the percentage of people living with less than \$5.50 a day. Scholars have found that economic growth was a key factor behind the decreasing poverty rates (Contreras 2003), and thus, there is again an inconclusive debate about the contribution of the Pinochet reforms. The persistent high-income inequality and the decreasing poverty suggest that a sizable share of the population is only slightly above poverty levels and that the size of middle class has been increasing markedly. Panel (b) in the same figure plots the distribution of monthly wages of full-time workers aged 18–65 in 2017—omitting the 10% with the highest wage—which reveals that half of the workers have a monthly wage lower than US\$580. These patterns suggest that an expanding middle class is facing new economic challenges in a market-oriented system that we now partially describe.

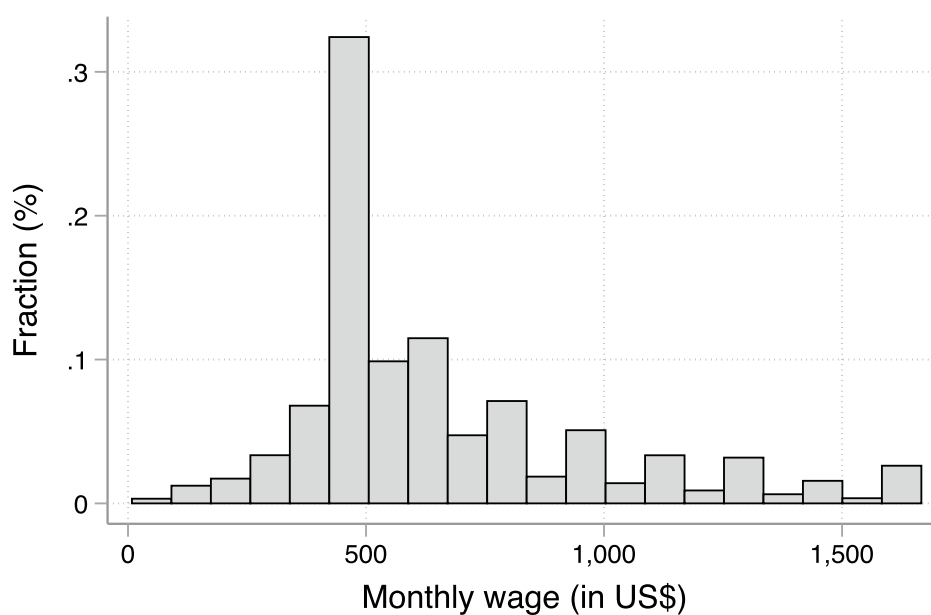
### 3.2 *Prominent Economic Policies*

*Education.* The 1981 reform introduced a market-oriented educational system with the goal of increasing the efficiency of spending in education (Bautista et al. 2021a). The introduction of a nation-wide voucher system to promote freedom to choose and competition to increase the

<sup>4</sup> The exact level of the top 1%  $t$  share depends on adjustments related to undistributed profits, capital gains, and tax evasion. See Fairfield and Jorratt De Luis (2016) and López et al. (2016) for details.



(a) Poverty rate



(b) Wage distribution in 2017

**Fig. 3** Poverty rates and wage distribution (*Notes* Panel (a) uses poverty rates defined as the percentage of the population living with less than \$5.50 a day [2011 PPP] from the World Bank. Panel (b) plots the wage distribution among full-time workers between 18 and 65 years old from the 2017 CASEN survey omitting the 10% workers with the highest wages [more than US\$1667])

quality of education was the most salient policy (Friedman 1955; Gallego 2006). The management of public schools was decentralized from the central to local governments.<sup>5</sup> Higher education was also liberalized, with private universities replacing mostly free public universities. This reform was implemented after a substantial reduction in public spending in 1974, which decreased enrollment significantly and affected cohorts for a lifetime (Bautista et al. 2021a). Overall, after the reform, the system became one of the most market oriented in the world (Figlio and Loeb 2011). The public sector has been shrinking steadily, from 80 to less than 40% after 30 years (Hsieh and Urquiola 2006). Left-wing governments kept the structure of the system after democratization with changes to the curriculum, the allocation and salaries of teachers, and the introduction of remedial programs (Schiefelbein and Schiefelbein 2000). One of the most controversial policies in higher education has been the introduction of a state-guaranteed loan in 2005 to be used for fees in private institutions and to be paid while earning a wage in the formal labor market.

Critics of the reform to primary and secondary education stress that the system has become increasingly segregated, with children from low-income households attending low-quality public schools and high-income ones attending private schools. The critique to the higher education system points to high fees, the low quality of institutions, and the financial burden associated with state-guaranteed loans. Supporters of the system emphasize that the market-oriented reforms have allowed many to access education and have therefore being the pillar behind the high enrollment rates in the last decades (Delannoy 2000; Patrinos and Sakellariou 2011; Solis 2017).

*Health.* The health insurance system was installed in 1979–1981 as a mixture of private and public providers. The public option is publicly financed by a 7% payroll tax, and private providers are insurance companies that compete by offering risk-priced products in a regulated market. Insurance companies charge payments and receive contributions from payroll taxes. The public option served 66% of the population in the 1990s and almost 80% today, a trend explained by the rising costs of

<sup>5</sup> Funding still came from the central government, but local governments now received per-student payments based on enrollment and school attendance. Local governments were also now in charge of human resources and investments. The system has remained the same with small changes such as increases in the size of the voucher.

private insurers (Galetovic and Sanhueza 2013; MDS 2018). Cream skimming in this market is well documented with the public sector serving lower-income and riskier people and the private sector serving richer and healthier people (Parente and Silva 2012). Public hospitals are more crowded and have 1.2 physicians per 1000 beneficiaries, while in the private sector this number is 5.3. Similarly, spending per capita is almost \$3000 in the private sector and less than \$1000 in the public option (Bautista et al. 2021b). Overall, access to health has increased, but there is a larger share of the population that is being served by a relatively low-quality public option.

*Pensions.* The 1980 pension reform replaced the pay-as-you-go system by a fully funded capitalization one run by private investment funds known as Pension Fund Administrators (PFA).<sup>6</sup> The system can be simply described as follows. When a citizen works in the formal labor market, she is mandated to give 10% of their earnings (up to a cap) to a pension fund of their choice, firm which then grows the money using investment strategies, and by the time the worker is 65 years old, she can retire her funds. The pension payment depends on the worker's total savings, life expectancy, and the chosen option of retirement (fixed or not). Informal workers contribute voluntarily and those who fail to reach a minimum pension are given a solidarity pension equal to half of a minimum wage. Although some reforms have been introduced, the system remains virtually unchanged.<sup>7</sup> We hypothesize that structural changes have not taken place because the system ranks above average internationally (ACFS 2017), the first fully-exposed cohort will retire in 2025, existing power relations between PFAs and the political world (Bril-Mascarenhas and Maillet 2019), and because PFAs have contributed to economic growth through higher savings rate and the development of capital markets (Corbo and Schmidt-Hebbel 2003).

There have been four critiques to the current pension system. First, the founder famously claimed that workers will have a pension equal

<sup>6</sup> The new system aimed to solve increasing fiscal problems derived from aging population and decreasing contribution rates (Vial and Castro 1998). Citizens in the old system were given the option to remain there, but they had economic incentives to switch. Therefore, in practice, almost all workers switched to the new system.

<sup>7</sup> For example, new policies guarantee a minimum pension for those without sufficient funds in their individual accounts, increase competition among PFAs, and decrease the fees paid by contributors.

to 70% of their wage (Piñera 1991). However, half of the people who will retire in 2025 will get a pension equal or lower than 15% of their wage (Presidential Commission 2015). A median monthly wage of 700 US dollars implies that pensions will be lower than \$100, and thus, the general discontent with the system has spread. Second, wages are low, the informal sector is large, and long periods of unemployment common, all which cause that most citizens are unable to finance meaningful pensions. Third, the amount of resources managed by PFAs is more than half of the country's gross domestic product, which has been used to fuel the supply side of the economy (Edwards 1996), create large profits for PFAs, and pay high wages to board members.<sup>8</sup> Fourth, the armed forces have their own pension system financed by taxpayers, and they get an average payment more than ten times larger (Arellano 2017).

*Housing and subsidies.* The use of targeted subsidies to fight poverty was yet another characteristic of the regime's economic policies during this period. Perhaps one of the most prominent examples is related to housing policies between 1979 and 1985 (Murphy 2015). In an effort to eradicate urban poverty, the regime relocated two-thirds of people living in slums in the capital city—5% of the total population—to new housing projects in the periphery (Morales and Rojas 1986). Recent research in economics shows that this policy decreased the educational attainment and earnings of children from relocated families not evicted (Carrera and Rojas-Ampuero 2021).

### 3.3 *Business Elites*

Firms can be instrumental to build economic power. Some of our research has studied the impact of policies implemented during the Pinochet dictatorship on the dynamics of economic power as measured by business groups before and after the country's democratization (Aldunate et al. 2020). The data we employ comes from annual firm-level data collected by a regulatory agency (SVS, now CMF) and historical administrative records of groups. The largest firms in the country were mandated to

<sup>8</sup> Their 25% return over equity in 2006–2015 is five times larger than the predicted return derived from market risk (López 2016). According to audited annual reports submitted to Chile's regulatory agency, in 2015 the average wage of board members in PFAs was \$7500 monthly, with some members earning more than \$15,000 monthly.

submit yearly reports of their financial activities, which provides an opportunity for researchers to study balance sheets, debt with banks, income statements, and the identities of owners and board members during the dictatorship, transition, and democracy periods.

One of the most important policies implemented by the Pinochet regime was the sale of state-owned firms. This privatization process was primarily chosen due to the belief in the efficiency of private property. To gain support from the public, Pinochet framed the process as “popular capitalism” and “diffusion of property to make Chile a country of owners” (Huneus 2006, p. 314). The first sales were organized by the Production Development Corporation in the 1970s and the second round began after the 1982 crisis. A research commission called by the Congress after the return to democracy succinctly summarizes three key aspects of the policy implementation (CEME 2004): (i) scarcity of information about firms being sold and their price, (ii) a variety of methods of sale with unclear rules for the ones chosen (e.g. public auctions, prequalifications, use of credit), and (iii) a flexible and unclear legal framework to regulate the process.

What were the economic consequences of the privatization reform for the following decades of the democracy? The sale of previously state-controlled firms contributed to the replacement of traditional business by new business groups and thus facilitated the renovation of elites. This evidence is important because groups are by far the key organizational structure in the country (Rojas 2015).<sup>9</sup> Before the Pinochet years, approximately 20% of listed firms were part of a business group (Salvaj and Couyoumdjian 2016), but after the transition to democracy in 1990 this number jumped to 70%. The empirical evidence is clear to show that *new* business groups were built around privatized firms, and particularly so when firms were sold after the 1982 economic crisis. Traditional business groups suffered from the crisis and new agents use the opportunity to acquire state-owned firms (Silva 1996b). More precisely, firms sold before the crisis ended up as part of traditional groups, while firms sold afterward became the pillars of new business groups, which can be explained

<sup>9</sup> The contribution of government policies to the formation of new business groups is a relatively old hypothesis proposed by academics in Chile and other parts of the world such as China, Japan, Malaysia, and Russia (e.g. Morck and Nakamura 2007; Khanna and Yafeh 2007; Lefort 2010; Kandel et al. 2019).



by the fact that prevailing business groups were mostly bank based and were severely affected by the 1982 devaluation (Silva 1996b).

## 4 THE POLITICAL PERSISTENCE

The distribution of political power also changed drastically during the Pinochet years. Many of the newly empowered individuals successfully maneuvered their interests during the transition to democracy. This section reviews some of the mechanics behind this political persistence. We do not attempt to be exhaustive, and we mostly focus on the empirical evidence from our work on firms, politicians, and the related economics literature.<sup>10</sup> We do not cover the consequences associated with state repression and the lack of persistence in terms of political preferences at the local level (Bautista et al. 2021) and the persistent political participation of people who registered to vote for the crucial 1988 plebiscite that bolstered the transition (Kaplan et al. 2020).

### 4.1 *Firms as Political Vehicles*

Modern economic research recognizes the influence of firms in the political sphere both in democracies and in dictatorships (Zingales 2017). Political corporations affect both the design and implementation of policies and contribute to resource misallocation and inefficiency (Faccio et al. 2006; Colonelli et al. 2021). Yet it is surprisingly less clear how firms become political and how they contribute to the persistence of political structures. The case of the Pinochet dictatorship is important because it provides critical lessons both about the origins of political firms and the role of firms as vehicles to preserve political power after a transition to democracy.<sup>11</sup>

Political transitions create enormous economic changes (Acemoglu et al. 2019), and thus, they have the potential to affect firms. It is thus

<sup>10</sup> We do not cover the persistence of political institutions such as the 1980 Constitution, among others. Albertus and Menaldo (2012, 2018) provide an excellent coverage of constitutional persistence from the political science literature.

<sup>11</sup> Previous research has shown that corrupt privatizations have a negative effect on firm performance (Fisman and Wang 2014), that political reasons are usually behind the origins of these reforms (Boycko et al. 1994; López-de-Silanes et al. 1997), and that privatizations might be used as a tool to gain political support (Bel 2010).

reasonable to expect firms to make decisions to survive and perhaps even thrive after transitions. The privatization reform enabled many individuals to acquire control of important firms. For example, one of the largest mining companies in the world was sold underpriced to Pinochet's son-in-law, and this type of link between firms and the state is at the heart of well-studied economic inefficiency (Fisman 2001; Khwaja and Mian 2005; Cingano and Pinotti 2013). The anticipation of losing these links after a transition could lead firms to prepare for the future. In previous research, we have shown that firms successfully prepared their business operations for the upcoming democratic years and, as a consequence, they transferred economic inefficiencies across political regimes and possibly limited the benefits of democratization (González and Prem 2020). Many firms were managed and controlled by Pinochet's allies, were relatively unproductive, and benefited from resource misallocation. The day after the 1988 plebiscite, firms learned that the dictatorship was going to be replaced by a left-wing democratic government, and they responded by increasing their productive capacity, experienced higher profits, obtained more loans from the state-owned bank, and then after 1990 removed board members related to the dictatorship (González and Prem 2018b). These firms were attempting to shield their market position and were able to successfully transit across the country's democratization.

Why is it important that firms from the dictatorship preserved their economic power? As mentioned, firms have the ability to influence the design and implementation of policies. In related research, we show that firms sold underpriced to Pinochet's allies formed connections with the new democratic governments, financed political campaigns, and were more likely to elude taxes and appeared in the Panama Papers (González et al. 2020).<sup>12</sup> These firms appointed politicians and *substituted* them from the *old* to the *new* government after democratization. These links again increased resource misallocation and produced rents for owners and board members (Blanes i Vidal et al. 2012). The results reveal one way in which authoritarian regimes can influence young democracies using firms as vehicles to transfer their political power across regimes. The privatization reform contributed to the politicization of firms and constitutes a

<sup>12</sup> A data collection effort enabled us to confirm the relative underpricing of the sales when the buyers were closely related to the Pinochet regime. Some of these controversial privatizations have been studied by Mönckeberg (2015).

clear example against the idea of private firms as apolitical entities (Boycko et al. 1996, 1997).

Privatized firms were also used by buyers with political links to the regime to build indirect ownership through pyramidal ownership structures in order to exploit them as providers of capital within their respective business groups.<sup>13</sup> The state firms which were sold to buyers connected to the Pinochet regime during the privatization process were much more likely to be part of a pyramidal ownership, to be placed at the bottom of these, and became providers of credit within the group. We detected these capital markets within business groups by studying the ownership of firms through many layers. In all, privatized firms were used as sources of capital by individuals who presumably lost privileged access to bank loans after the transition.

#### 4.2 *The Persistence of Dictatorship Politicians*

An important but understudied dimension of authoritarian regimes is the functioning of local governments. Some dictators appoint individuals as local leaders and some use elections. After transitioning to democracy, local leaders are unlikely to lose their power and to be forgotten by the public. Moreover, they can prepare for the democratic times and invest in de facto power before the transition unfolds. This was the case in Chile (González et al. 2021). We reconstructed the history of local governments from 1973 until the first local election in 1992 to study these issues. Although we know a lot about the Pinochet regime (Huneus 2006; Cavallo et al. 2011), we know relative little about appointed mayors. Weeks after the 1973 coup, the *junta* removed all mayors democratically elected in 1971 and appointed trusted individuals until Pinochet left power in March 1990. The appointments were discretionary and we show they were unresponsive to important events which revealed mayors' abilities (e.g. protests and natural disasters).

Pinochet-appointed mayors were far from retirement after the transition in 1990. The analysis of candidates and voting preferences in the 1992 local election reveals that many of them decided to run for office and obtained a vote premium of nine percentage points. The ones who

<sup>13</sup> Pyramids allow indirect control (Bertrand and Mullainathan 2003), they are relatively common (La Porta et al. 1999), and they are associated with tunneling and expropriation of minority shareholders (Johnson et al. 2000).

were mayors more recently, particularly sitting incumbents, were the most politically rewarded. Interestingly, an increase in local spending right before Pinochet left power can explain some of these additional votes they obtained, which is consistent with evidence from other parts of the world (Voigtländer and Voth 2021). Why should we care about the fate of appointed mayors? We followed them in all local elections in democracy and discovered that they were enjoying a well-known incumbency privilege (Lee 2008). All those years in office during the dictatorship gave them an advantage over their competitors, and this can explain their additional votes in democratic elections.

Was the persistence of dictatorship mayors important? To answer this question, we exploited some of the transitory electoral rules in the first local election, which allowed us to approximate a natural experiment in which dictatorship mayors persisted as local leaders in some but not all parts of the country. The findings reveal that dictatorship mayors brought significantly more votes for right-wing candidates in local and presidential elections and facilitated the election of right-wing councilors. However, their economic performance was similar to other mayors. Other researchers have also hypothesized important links between authoritarian regimes and subsequent democracies (O'Donnell and Schmitter 1986; Huntington 1991; Linz and Stepan 1996), but empirical studies are only recent. Before our study, the evidence came mostly from Indonesia's transition (Martínez Bravo 2014; Martínez Bravo et al. 2018), which differs from the Chilean case because it was more relatively more abrupt. In all, local politicians were also able to maintain their power and thus contributed to elite persistence (Acemoglu and Robinson 2008).

The persistence of politicians goes beyond appointed mayors. In some cases, the incumbency advantage was sufficiently large to be translated into decades-long political careers. The most prominent examples include appointed mayors who are current members (or even leaders) of right-wing parties, democratically earned seats in the Congress, or have been recently appointed as leaders of critical government departments (e.g. labor and social security). Remarkably, some of them continue to represent the same local areas they governed as appointed mayors. In addition to the persistence of appointed mayors, the Pinochet dictatorship was also able to include in the 1980 Constitution that nine out of 47 seats in the senate were to be appointed by the National Security Council, the Supreme Court, and the President. The constitution also installed a binominal system to elect members of the Congress, which supported

a persistent balance of power among the two largest coalitions and was almost impossible to break for outsiders. Overall, the appointments and the constitution contributed to the persistence of dictatorship politicians.

## 5 THE QUEST FOR INSTITUTIONAL CHANGE

A simple theory of social change is useful to understand the dynamics of discontent in Chile (Acemoglu and Robinson 2006). At the beginning of the 2000s, the left-wing coalition had been in power for a decade. Their capacity to change the status quo, however, was constrained by the opposition coalition. The opposition was politically aligned with the former Pinochet regime, at least in their preference for a market-oriented systems and existing political institutions. After years of successfully managing the existing institutional framework, organized groups of citizens decided to exert pressure on the incumbent with the goal of reforming the existing rules of the game. When these early waves of discontent arrived, the options for the incumbent were either to repress the movement, to offer temporary reforms, or to completely reform the status quo. We argue that the strategy of the incumbents has predominantly been to offer temporary reforms, which led to a major discontent and a potential path of permanent structural reforms.

### 5.1 *Early Waves of Discontent*

The first large wave protests after the return to democracy were led by high school students in 2006 and gathered hundreds of thousands of people to reform the persistent educational system implemented in dictatorship. In particular, the objective was to modify constitutional laws which framed the system as market oriented. After months of demonstrations, the conflict came to an end when the incumbent President Michelle Bachelet offered increasing benefits for low-income students and created a formal transitory institution to develop a reform plan. The lack of a permanent reform triggered another student movement in 2011 (Simonsen 2012; González 2020). Protests were now joined by environmental groups who opposed the construction of hydroelectric plants due to concerns about their impact on the local ecosystem. The environmental discontent began in 2006 after the announcement to build five plants but increased their visibility during this time. In terms of education, the goals of protesters were now related to higher education and included

more spending, more equal access, and reforms to state-guaranteed loans, used by most students to enroll in higher education. Students continuously rejected offers of partial reforms from the government. Months of conflict ended after the beginning of institutionalized negotiations, increasing protest violence, and concerns about grade retention. Overall, the 2011 protests made education and the environment top priorities and trigger important reforms to state-guaranteed loans.

Another wave of demonstrations took place in mid-2016 to protest against the pension fund system installed by the Pinochet dictatorship. Illegitimate origins, low pensions, and the high profitability of PFAs were key to explain the low satisfaction of the public (Presidential Commission 2015; Matus 2017). The organizers of the discontent aimed at establishing a new one based on principles of benefits and solidarity. The origins of the movement can be found as early as 2012, when citizens and labor unions gathered for the first time to discuss the pension system (Rozas and Maillet 2019). Protests began in 2013, but the ones in 2016 were the largest. A combination of grassroots organization and a trigger event related to the high pensions of gendarmerie workers seem to be the key explanation behind the massive rallies. These events had some short-run effects in the stock market, generated reductions in fees paid by contributors, and were successful in bringing this subject to the public debate, including the creation of a potential state-owned PFA (López and Nuñez 2017). However, large reforms to the system remain to be seen.

When citizens are able to organize demonstrations, what could be the response of an incumbent government? The government may decide to repress a movement or offer temporary reforms. The latter ranges from a transitory change in the speech of incumbent politicians, to the proposal of partial reforms that serve as “patches” to the system, or to the start of uncertain legislative paths. The incumbent government rarely offers radical or permanent reforms that completely satisfy the demands of the movement, especially at times in which partial reforms are enough to dismantle demonstrations. What can citizens do if the government is unwilling to reform? Leaders of the early waves of discontent have entered the political arena with the goal of implementing structural reforms. Some founded political parties with varying degrees of success, and some became mayors or earned a seat in the Congress. Although permanent reforms have certainly attempted to make their way in the political sphere, most of them could not be implemented. Perhaps the most prominent example is a failed attempt to create a new constitution in the mid-2010s.

## 5.2 *Explosion and Institutional Response*

Early waves of discontent were followed by massive protests in late 2019. The first events were organized by students after an increase in subway tickets and political scandals from early October. Students from the largest public schools organized collective fare evasions in subway stations starting on October 7. Day after day, fare evasions increased markedly and incorporated social organizations, pushing the government to make use of the police to control protests. On Friday 18th, the confrontation between protesters and the police reached a tipping point: dozens of subway stations stopped their operations and some were burned under currently unknown circumstances. That day, the Ministry of the Interior appealed to a state security law and filed complaints for criminal behavior against those engaged in violent events. As a consequence, protests and barricades spread throughout the country, leading the president to decree a state of emergency.

These rallies became the largest manifestation of discontent after the return to democracy. Protesters were complaining about increasing living expenses, illegitimate institutions, and incumbent politicians. Their demands could be summarized as more social rights, which most interpreted as reforms to the market-oriented system (e.g. education, pensions, health) and a new constitution to create a more egalitarian society where everyone was treated equally; “dignity” was the word most used by protesters. The initial response of the government was to offer partial reforms on October 22 (“Nueva Agenda Social”). Protesters rejected these and a massive demonstration took place on October 25 with more than 1 million people in the city capital. Protests in certain weekdays became the norm and a violent conflict emerged between the police and protesters. Accusations of human rights violations became common after hundreds of individuals were heavily repressed by the police. Dozens of people died, thousands were hospitalized, and hundreds received rubber bullets from the police directly in their eyes (see Human Rights Watch 2019).

After being unable to solve the escalating conflict, the incumbent president made a call to the leaders of political parties to propose a solution for the discontent. After days of negotiations, a political agreement was reached on November 15 which consisted of a potentially permanent reform: a plebiscite would take place on April 2020 to ask citizens (1) if they would like to replace the existing constitution and (2) if they

would like the new constitution to be written by a fully elected convention or by one composed half by congresspeople and half by elected citizens. Due to the global health crisis, the 2020 plebiscite was moved to October 25, 2020, day in which 78% of 7.5 million people voted in favor of a new constitution and 79% for a fully elected constitutional convention. Many scholars have interpreted this election as the end of Pinochet's legacy (e.g. Charney et al. 2021). In the following months, the Congress agreed that the convention would have 50% reserved seats for women and 10% for representatives of indigenous people. In the following months, protests declined and then came the outbreak of the pandemic in March 2020.

## 6 MOVING FORWARD

One hundred and fifty-five members of the constitutional convention were elected, half are women (77) and 17 represent indigenous populations. Many of the newly elected constituents became politically active during the waves of discontent, and many political or social organizations originated in protest movements from the past twenty years. In contrast, existing political parties obtained significantly fewer seats than expected, with independent candidates and their vote shares experiencing a turn to the left of the political spectrum: the left-wing coalitions obtained 34% of seats, while the incumbent right-wing coalition obtained 24%. Moreover, the arguably most important party in the last 60 years (Christian Democrats) obtained only one seat. Crucially, the right-wing coalition—which main parties provided support to the Pinochet regime—was unable to secure more than one-third of seats, which would have given them a veto power. The group with the most seats has fewer than two-thirds, which means agreements across coalitions will be key.

There are still many unknowns about the constitutional future. One of the most important is the functioning of the convention. The transit from a market-oriented constitution to one that guarantees social rights and environmental regulations appears to have the necessary quorum. Whether the composition of the Congress will be modified or the power of the executive will be diminished remains unclear, among many other critical matters of the political system. Perhaps the last big unknown in this path of institutional change is the “Exit Plebiscite.” The political agreement of November 2019 determined that after the convention drafts the constitution there will be a plebiscite to approve (or reject) the drafted



constitution. Participation will be mandatory, which means that millions of people who have never voted will have to do it for the first time. The legacy of the Pinochet regime could finally come to an end, but only time and democracy will tell.

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