

Deconstructing the Chilean Miracle

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Why Nations Fail

The Divergence of the Americas

- In our book *Why Nations Fail* Daron Acemoglu and I propose a simple framework which we believe can explain comparative economic development.
- Let me motivate our theory by discussing the economic and political history of the Americas.
- In 1492 it would have been very difficult to anticipate the current distribution of prosperity in the Americas since in was Mexico, Central America and Andean Perú and Bolivia which were more technologically advanced....

The Divergence of the Americas—Latin America

- Juan Díaz de Solís explores Río de la Plata ('River of Silver') in 1516, and Pedro de Mendoza founds Buenos Aires in 1534.
- But Solís and de Mendoza unable to enslave and put to work the hunter gatherer Indians of the area, Charrúas and the Querandí. Starving Spaniards soon left the area.
- In 1537, Juan de Ayolas found the sedentary and more densely settled Guaraní up the Paraná river, in Paraguay. The Spaniards could successfully take over the Guaraní hierarchy, enslave them and put them to work to produce food for them.
- A very similar pattern to the colonization of the Mexicas and the Incas (Tawantinsuyu).

The Beginning—United States

- Colonization attempts of Virginia Company in Jamestown in early 17th century, attempting to re-create an authoritarian, “extractive” regime:

“No man or woman shall run away from the colony to the Indians, upon pain of death.

Anyone who robs a garden, public or private, or a vineyard, or who steals ears of corn shall be punished with death.

No member of the colony will sell or give any commodity of this country to a captain, mariner, master or sailor to transport out of the colony, for his own private uses, upon pain of death.”
[from the laws passed by Sir Thomas Gates and Sir Thomas Dale].

- But the Company was unsuccessful—it could not force the English settlers into gang labor and low wages.

Persistent Development Paths

- The early initial institutions of the colonial period led to very different development paths.
- **In Latin America:** a vicious circle of extractive institutions.
- **In North America:** a virtuous circle of inclusive institutions (subject to challenges - Robber Barons).
- **Example #1:** US versus Cádiz Constitutions.
- **Example #2:** 19th Century frontier expansion.
- **Today:** Compare how Bill Gates and Carlos Slim made their fortunes.

Why Nations Fail

- Poor economic outcomes are the result of *extractive economic institutions* that fail to create incentives and opportunities for the vast mass of people.
- Extractive economic institutions are a consequence of *extractive political institutions* which have two dimensions
 - ① Narrow distribution of political power (lack of 'pluralism').
 - ② Weak and ineffective state (lack of 'political centralization').
- Institutions can be formal (laws, constitutions) but also informal ('obedezco pero no cumplo').

The Chilean Experience

- How does Chile fit into this pattern?
- Chile is both similar and different to the average Latin American country
 - **Similar:** no long-term pattern of convergence to living standards of rich countries, but slow modernization with high levels of inequality; undiversified economy based on natural resources; oligarchic frontier expansion in the 19th century; populism in the 1950s and 1970s; restricted democracy and military coups; civil wars.
 - **Different:** the most prosperous country in Latin America; economic transition since the mid 1980s seems to represent a new development path; low frequency constitutional change - 1833, 1925, 1980; lower frequency civil wars - and fought over institutional structure of society not over who was in power; European like political cleavages; populism yes - but relatively non-clientelistic; never had a rural insurgency.

An Approach to Chile

- I think the key to explaining Chile's development path is that it experienced precocious state formation in the 19th century, particularly the 1830s under Portales.
- Chile developed a much more effective central state which was better at raising resources, exerting its control over the country and providing key public goods like order, infrastructure, and education.

Chilean State Formation

- Why was Chile able to build a central state when most other Latin American countries were not?
- I propose three basic arguments
 - ① Population was centered in a small part of the country (Santiago-Valparaíso corridor plus Concepción - contrast with Colombia or Argentina)
 - ② Dense populations of indigenous peoples were south of the Bío-Bío and outside the state (like in the US).
 - ③ Chile's peripheral position in the Spanish colonial empire gave it some advantages.
- 1 is important because it led to a fused elite where economic and political elites were embedded into close social networks.
- These factors are important because they created much more consensus about building state institutions (unlike Colombia, or Argentina in 1853) and there was no incentive to rule the 'periphery' indirectly (like in Colombia).

The Advantages of Being Peripheral

- It is not a coincidence that the places which had fewer indigenous peoples and were marginal to the Spanish colonial system (Argentina, Chile, Uruguay) are the richest countries in South America.
- As the historian James Lang put it

“The absence of a strong control from the Spanish bureaucracy had two additional effects. First, the development of a strong merchant ethos among most elite members that were involved in international trade through Valparaiso. This group defended “free-market” policies and strongly demanded political and economic stability. It is not by chance that one of the most important political figures in the development of the state in Chile in the 19th century was a former merchant (Diego Portales) who enter into politics to defend the interests of this group.”

- The ‘cabildo abierto’ which was a much more participatory (read: inclusive) form of local government in Spanish America.

The Difficulty of Building a State

- State formation is not a technical problem - it is a political problem.
- Rival elites have to be sure that the power of a state will not be used against them (why the British parliament refused to allow the creation of a tax system or a standing military until it gained control of the monarchy after 1688). So building a state requires a political settlement.
- Much easier to forge such a settlement if the elite is homogeneous and has inter-related economic interests.
- But state formation in itself creates other forces which need to be managed in order for it to happen. To see what this means let me return to the structure of inclusive political institutions and ask how 'political centralization' and 'pluralism' are related.
- In the book we discuss these as being separate things but it is plausible that it is inter-related. Consider the English example.

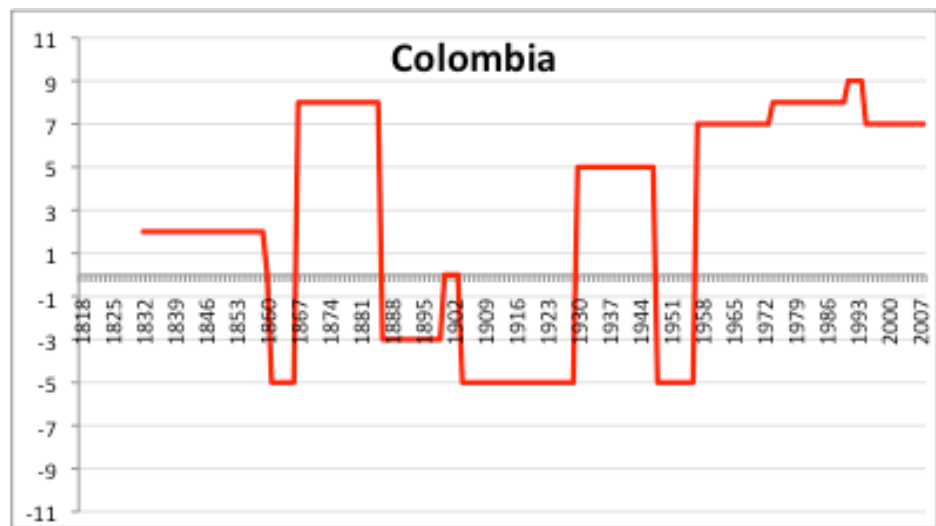
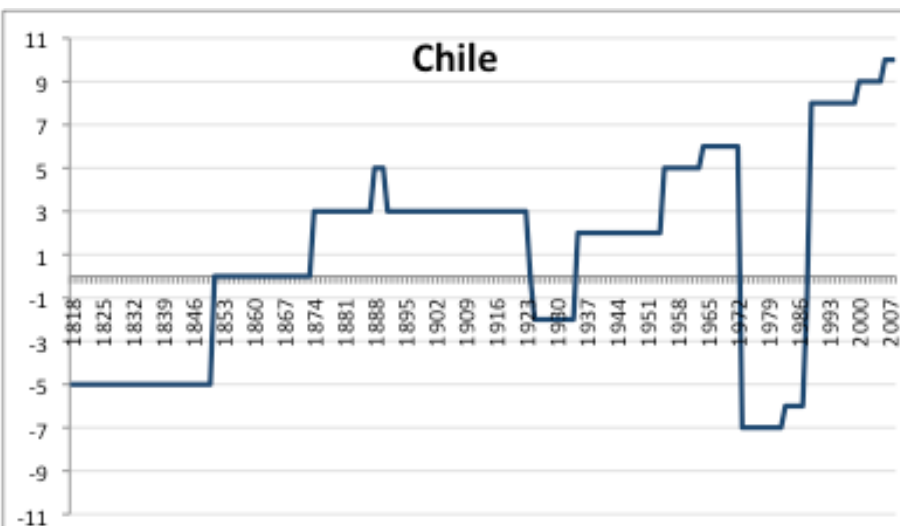
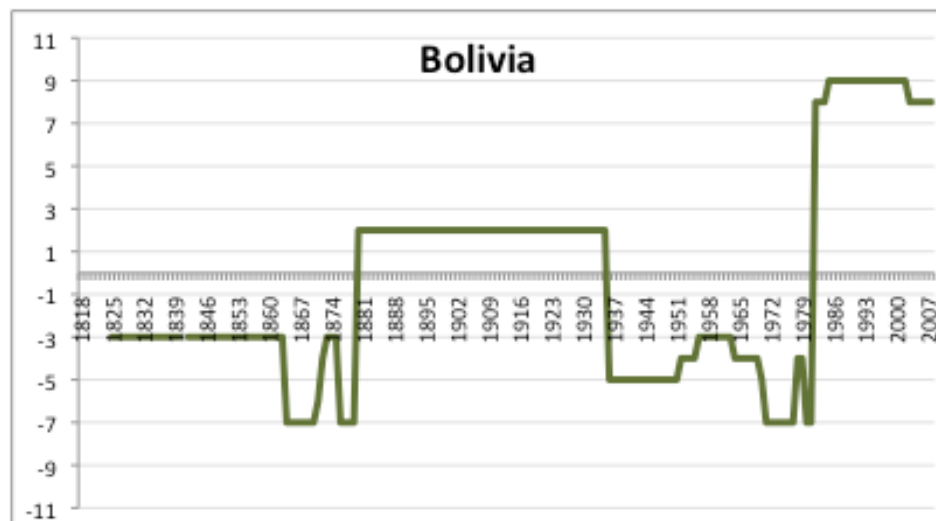
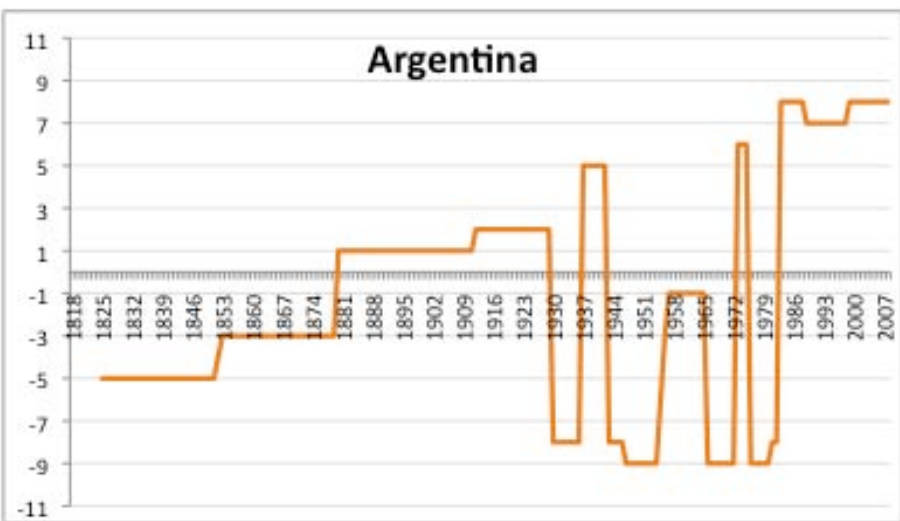
The Formation of the English State

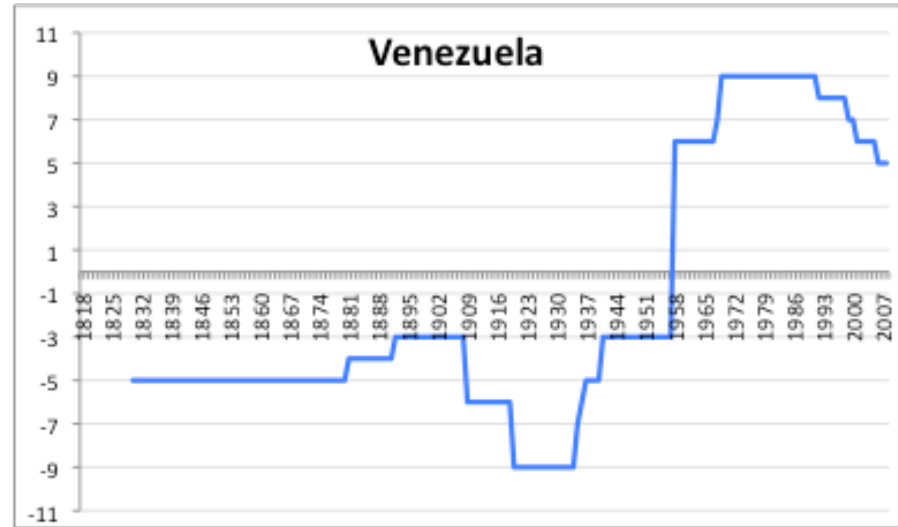
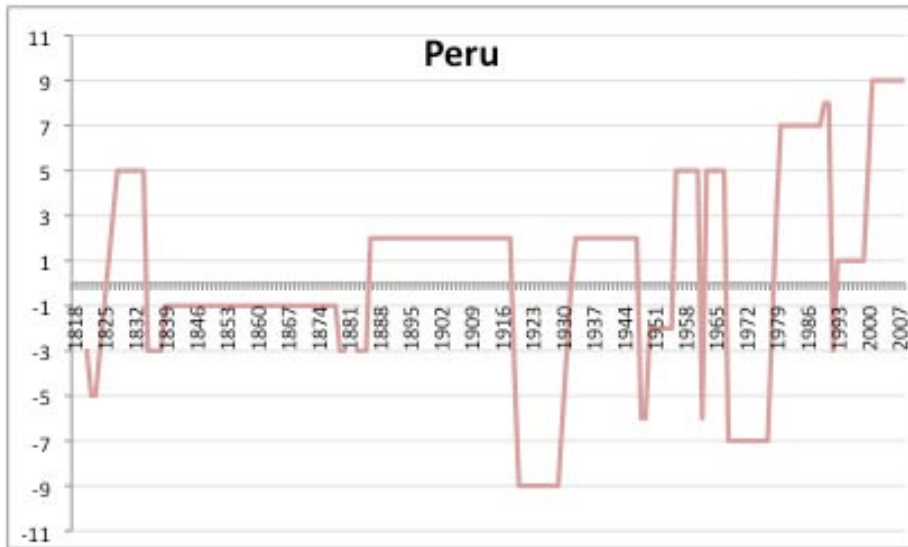
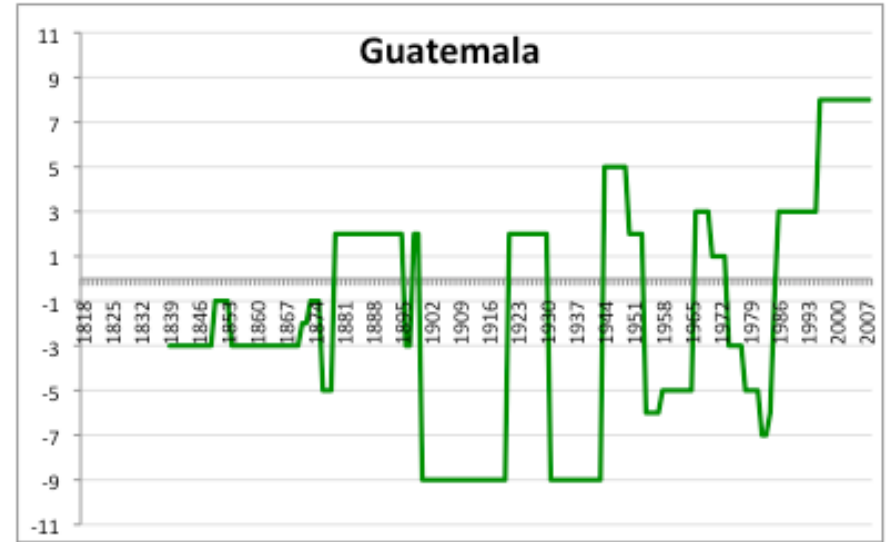
- The process of state formation which took place after 1485 under the Tudors had the impact of drawing far more people into national society. Traditional local social relations broke down (disarming the aristocracy, enclosures, Tawney's 'rise of the gentry'). This changed the nature of contentions demands (Tilly) and it meant that the Civil War of the 1640s and 1688 were completely different types of conflicts - not a dynastic power struggle like the War of the Roses which ended in 1485 but mass struggles over how the society should be organized.
- This property of state formation naturally propelled the distribution of political power in a pluralistic direction.
- In the 1670s two national competing political parties emerged, the Whigs and Tories.
- English elite not fused: aristocrats, London merchants, colonial merchants in Bristol, Liverpool, nascent manufacturing interests involved in 'putting out'.

How Chile Diverged from the English Path

- Just like in England, state formation in Chile had the same impulse of drawing people into the national political arena (post office, railways, schools...).
- But the fused elite stopped this dynamic converging to an inclusive society in Chile (oligarchic democracy, extensive electoral fraud until 1958, Communist Party banned, illiterates banned from voting until 1970).
- Fused elite also effective at managing attempts to change the balance of power (Balmaceda and the Civil War of 1891, Arturo Alessandri).
- Nevertheless, this impulse plus the fused elite - who's ability to cooperate and social connections meant that democracy was not very threatening to them (compare the inability of conservatives in Argentina to deal with the electoral dominance of the Radical Party after the passing of the Saenz Peña Law in 1912) can explain why Chile has been more democratic than most parts of Latin America.

Democracy since Independence in Latin America (From Polity IV Database)





Chile: The Catch-22 State

- Precisely the circumstances which allowed precocious state formation in Chile and moved it forwards in one dimension of inclusive political institutions created a Catch-22 - it could not move forwards in the other dimension - pluralism.
- Without the full set of inclusive political institutions in place, economic institutions were not going to be inclusive.

More Consequences of State Formation

Political Cleavages and Programmatic Populism

- Nevertheless, the precocious state formation in Chile can explain many things about why the country is different.
- European like political cleavages - consequences of the integration of the national community (compare with Colombia).
- Relative absence of clientelism, particularly noticeable in the populist experience under Salvador Allende, very different from Chavismo or Peronismo.

More Consequences of State Formation

Civil Wars and Constitutional Change

- Chilean Civil War of 1891 were much more like the English civil wars of the 17th century (you could even compare it to the Glorious Revolution - they didn't even re-write the constitution, very English) or US Civil War.
- Unlike Colombian civil wars which were power struggles between the Liberals and Conservatives more like the English War of the Roses (House of York and House of Lancaster).
- Though it is true that civil wars in Colombia and elsewhere led to constitutional change this was much more high frequency and much more about rigging the rules in the winner's favor.

Evidence for the Fused Elite

- Bauer (1975) in his book *Chilean Rural Society* showed that between 1854 and 1918 around 50% of all Chilean legislators were large landowners.
- Ratcliffe and Zeitlin (1988) *Landlords and Capitalists: The Dominant Class of Chile* showed the extent to which the landowning class was the same as the business elite in the mid 1960s.

Table 47 Number and percentage of Chilean congressmen who directly own a large rural estate: 1854, 1874, 1902, 1918

	1854		1874		1902		1918	
	Senator	Deputy	Senator	Deputy	Senator	Deputy	Senator	Deputy
Total members of Congress	29	54	30	96	33	94	37	118
Of these, the number who own large estates	14	20	21	42	24	49	25	47
Percentage of Congressmen who own large estates	48%	37%	70%	44%	73%	52%	67%	40%
Total number of Senators and Deputies in Congress	83		126		127		155	
Number of these who own large estates	34		63		73		72	
Percentage of all congressmen who own large estates	41%		50%		57%		46%	

Source: The names of congressmen are from Luis Valencia Avaria, *Anales de la República* (Santiago, 1950), 2 vols.; 'large estates' are defined as having \$6000 or more annual income in the 1854 *Renta agrícola* and 1874 *Rol de contribuyentes*; over \$200 000 *avalúo* in Espinoza, *Geografía* and the 1908 *Indice de propietarios*. For 1918, I used the Valenzuela O., *Album*.

Source: Arnold J. Bauer (1975) *Chilean Rural Society from the Spanish Conquest To 1930*, New York: Cambridge University Press.

Stars in the Chilean Firmament

The view in 1909 by the US political scientist Paul Reinsch

"This society constitutes at the present time the only aristocracy in the world which still has full and acknowledged control of the economic, political and social forces of the state in which they live. These men are the owners of the great haciendas; important industrial enterprises in mining and irrigation bear their names ... When you enter the halls of congress and look down upon the senators or the deputies, the names of Concha, Figueroa, Subercaseaux, Tocornal, Errázuriz, Vergara, Zañartu, Irarrázaval, Edwards, Balmaceda, Walker, etc., will again be repeated to you. They, too, are the stars in the firmament of Chilean social life. These families ... form a society which recalls in all its aspects the English society of the eighteenth century; a group of families small enough so that all the members are personally acquainted ... Though split up into numerous parties, which carry on a lively political warfare, its solidarity as a society nevertheless comes out again and again."

The Chilean Development Path

- The consequence of precocious state formation was that Chile had greater public good provision (education, postal service, railways).
- They had a far more effective military (like the English after 1688) hence the success of the War of the Pacific 1879 - 1883.
- But the oligarchic power which had created the state blocked more rapid economic development since it created large amounts of extraction in the economy.

The Transition of the 1980s

A Hypothesis

- If Chilean economic development has been disappointing since independence as a consequence of extractive institutions the primary candidate for an acceleration in the growth path must be a reduction in how extractive institutions were.
- My hypothesis stems from the fact that after the electoral reforms of 1958 the traditional elites temporarily lost control of politics - evidence from my research with Jean-Marie Baland.
- Frei and Allende launched an assault on extractive institutions in the rural sector and broke up large haciendas. Combined with the post-1973 coup abolition of cooperatives and price deregulation this set in motion a far more inclusive and dynamic rural economy.
- But note how state formation is important: the relatively non-patrimonial nature of the Chilean state made it far more likely that reforms like this would move institutions in an inclusive direction (contrast with 1952 Bolivian Revolution).

Chile: PIB Per Cápita

Porcentaje del PIB Per Cápita de EEUU

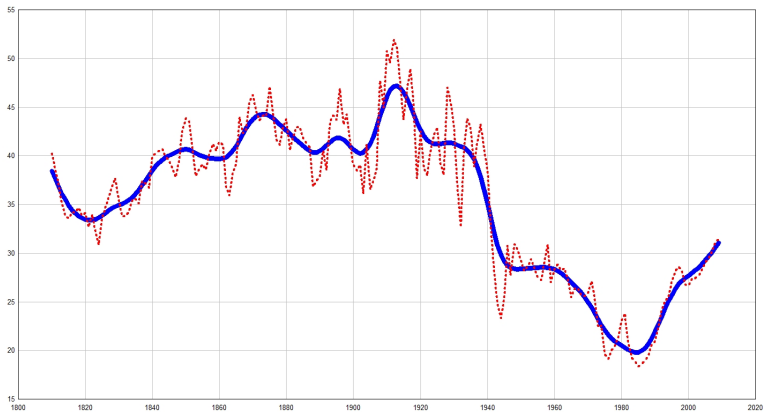
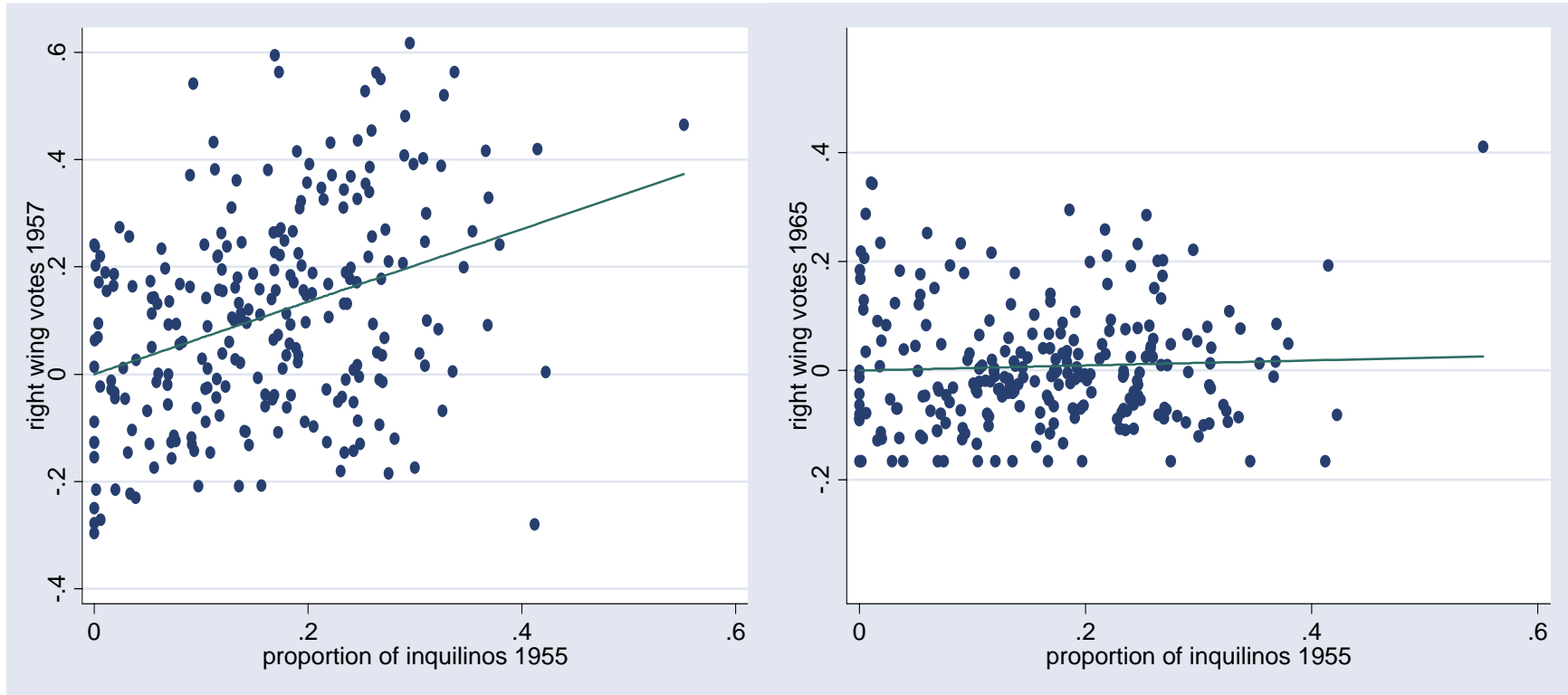


Figure 1: Right-wing votes in 1957 and 1965 and the ratio of inquilinos to registered voters in 1955 (scatter plot and simple regression line)



$$\text{Right57} = 0.319 + 0.523 \text{ Inq/voter55} \\ (0.017)(0.078)$$

$$\text{Right65} = 0.149 + 0.145 \text{ Inq/voter55} \\ (0.010)(0.047)$$

El Continuismo of the Concertación

- Chile's recent economic success is not just a consequence of the transition in the growth path in the 1980s. But also due to the continuity after 1990.
- This is not common feature of the 'bureaucratic-authoritarian' implementation of free market policies (compare with Argentina of Martínez de Hoz).
- But not surprising given my hypothesis: the combination of Frei-Allende-Pinochet resulted in more inclusive institutions in the rural sector. The creation of democracy after 1990 was hardly likely to reverse this inclusion even if it did not succeed in deepening it elsewhere in the economy.

The Continuity of the Catch-22 State?

- Though the conflicts of the 1960s and 1970s eliminated some important elements of extractive institutions in Chile they did not change the underlying oligarchic structure of society.
- Indeed, there is evidence that in some dimensions this has got worse, rather than better.
- To illustrate this in one simple way let me discuss some data on the educational backgrounds of Cabinet Ministers and leading Chilean business elites in 1958-1960 and in 2008-2010.

A Stable (or even narrowing) Elite?

- 2008-2010

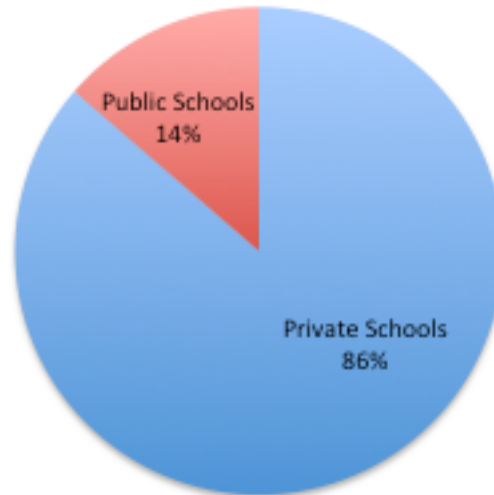
- In the first cabinet of President Sebastián Piñera 86% of the Ministers attended private schools, of these more than one half came from just 4 - Tabancura, Sagrados Corazones Manquehue, Verbo Divino, San Ignacio.
- Of the CEOs of the top 100 Chilean companies by market capitalization 86% attended private schools, of these one half came from just 4 - Tabancura, Sagrados Corazones Manquehue, Verbo Divino, San Ignacio.

- 1958-1960

- In the first cabinet of President Jorge Alessandri 81% of the Ministers attended private schools, of these one half came from just 3 - Sagrados Corazones Manquehue, Liceo Alemán de Santiago (Verbo Divino), San Ignacio (Tabancura did not exist).
- Only 54% of business elites attended private school and of these only 23% went to these same three schools.

2010: Cabinet Members

**Cabinet Members: President S. Piñera
(First Cabinet 2010)**



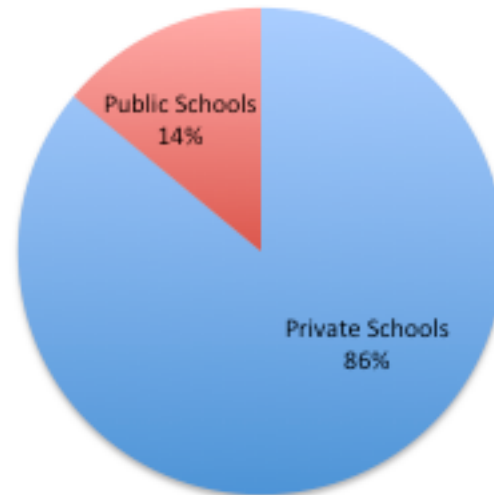
2010: Cabinet Members

**Cabinet Members: President S. Piñera
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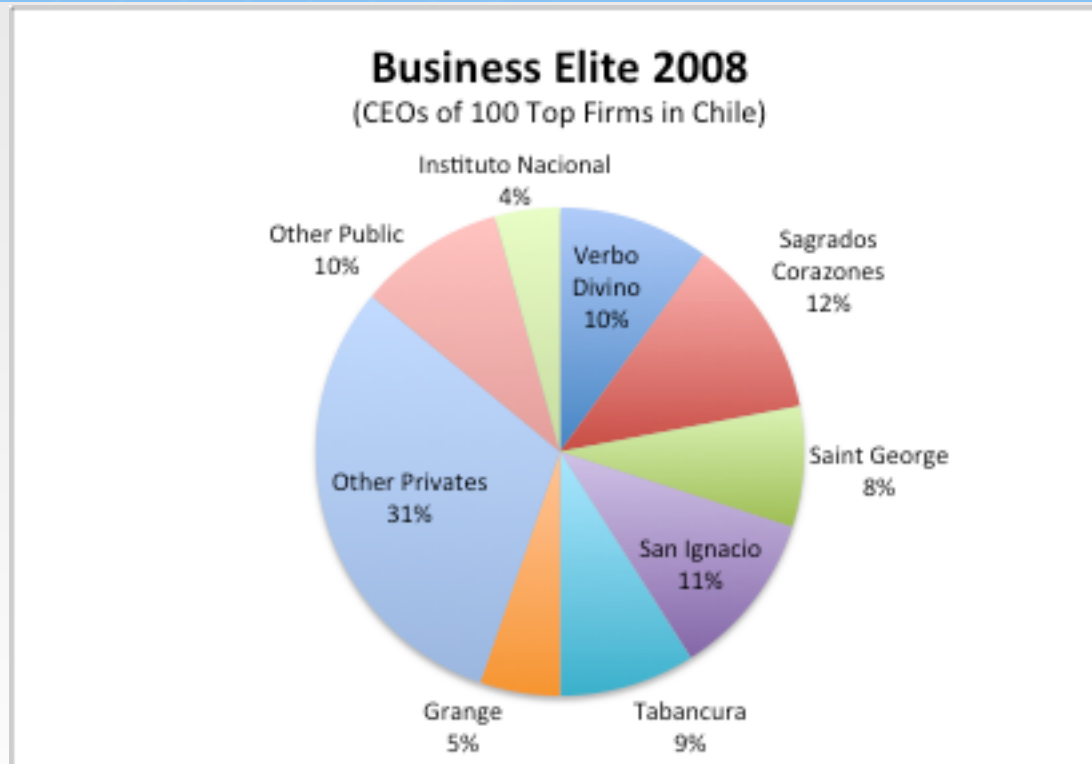


2008: Business CEOs

Business Elite 2008
(CEOs of 100 Top Firms in Chile)

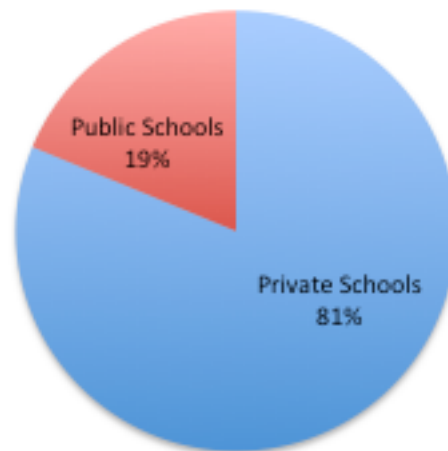


2008: Business CEOs

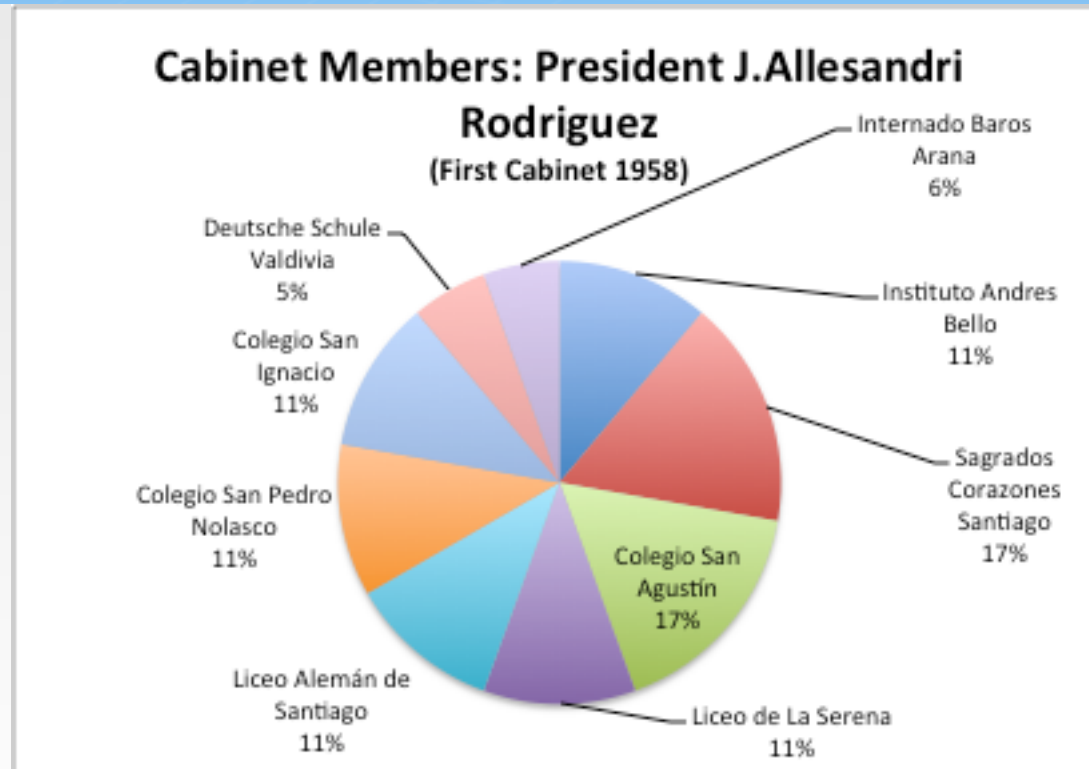


1960: Cabinet Members

Cabinet Members: President J. Alessandri Rodriguez (First Cabinet 1958)



1960: Cabinet Members



The Future of the Catch-22 State

- Even with the current structure of the economy based on natural resource exports Chile might aspire to be like Australia or New Zealand, both of which are considerably richer.
- But I doubt even this is possible without institutions moving in a more inclusive direction which means changing the influence of elite social networks and informal institutions on Chilean politics and society.
- The 19th century equivalent to the Chilean elite, the 'Squatters' who ran vast sheep farms in the interior, lost their political power in the 1840s and 1850s to several democratic impulses (gold mining boom) and the electoral reforms Chile adopted in the 1950s came in the 1850s in Australia.
- This made Australia one of the world's most democratic and egalitarian countries.
- So the path towards inclusive institutions in Australia was very different from the path Chile has followed in the last century.