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# Political Institutions, Policymaking Processes and Policy Outcomes in Chile

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## **Abstract**

This analysis characterizes the salient features of the policymaking process (PMP) in Chile. It emphasizes the influence of political institutions on the PMP and examines the linkage between policymaking and policy outcomes in Chile.

The salient features of the Chilean PMP are the electoral system and the associated party system, characterized by two long-lived coalitions, a powerful Executive, with de facto control over the agenda, a relatively independent judiciary, a bureaucracy that is relatively free from corruption even by the standards of the OECD, and a series of veto points in the policymaking process that permit adversely affected actors to block policy change.

Consistent with the theoretical framework of Spiller and Tommasi (2003), the small number of actors who interact repeatedly and the predictability of policy implementation and of law enforcement lead to a policymaking process in which transaction costs are low and inter-temporal political exchanges are credible. The veto players help to give inter-temporal exchanges their credibility, but they can also block reforms. Looking at policy areas in cross section, we find that policy areas in which policymakers' interests are more nearly aligned, and in which there is more rapid exogenous change, are associated with more successful efforts at reform, while in areas in which the interests of the Executive and the various veto players diverge, policy tends to stagnate.



## 1. Introduction

The framework for this paper is based on work by Spiller and Tommasi (2003) intended to identify features of the PMP that tend to produce cooperative outcomes. Cooperation means working together for a common purpose or benefit, and this can only happen when there is at least some alignment of interest among the participants, and when the degree of alignment between the parties places a ceiling on the amount of cooperation that one can expect to observe. The Spiller and Tommasi (2003) framework emphasizes five factors identified in the game theoretic industrial economics literature (Friedman, 1971; Green and Porter, 1984; Abreu, 1986) as facilitating cooperative outcomes: (i) small immediate benefits from renegeing on agreements, (ii) a small number of decision-makers, (iii) repeated interaction among decision-makers, (iv) deviations from agreed-upon behavior are easily observed, and (v) the existence of credible enforcement mechanisms. Left off of their list is the degree to which agents' interests align, though the alignment of interests is central in the industrial economics literature from which the list is derived (in that literature the set of viable equilibria is characterized in terms of the parameters of firms' profit functions, e.g., in terms of their interests—reducing the elasticity of demand and *ceteris paribus* expanding the set of sustainable equilibria). Accordingly, we take the advice of Spiller, Stein and Tommasi (2003) to combine the “lens with which authors ... can focus the analysis of the PMP” with “others that they believe relevant for understanding key features of their respective countries” and add a sixth factor to the list of those facilitating cooperative outcomes: (vi) the degree to which the parties' interests are shared.

An additional consideration bearing on the repeated games literature from which the unifying theoretical framework of this paper springs is that the factors it identifies as facilitating cooperation are factors that expand the set of possible equilibria to include cooperative outcomes along with “uncooperative” myopic equilibria—the oligopoly models that allow for possible cooperation also have other equilibria consisting of endless price wars. The game-theoretic models provide little guidance as to which of the possible equilibria will actually occur. Thus, one may think of the factors identified by the framework applied here as identifying an upper bound on the level of cooperation that can emerge in a given political system. It may be that some significant differences between, say, Uruguay and Chile—both of which have relatively small and stable party systems and independent courts—result from policymakers having

coordinated on different equilibria amongst the set that are supported by their institutional framework.

Thus one may think of the six elements identified by the preceding discussion as “risk factors” for the emergence of cooperation; while the presence of these factors does not guarantee that political actors will successfully coordinate on one of the cooperative equilibria, it does at least hold out the possibility that they will do so.

### ***1.1 Policymaking after 1990 in Chile***

This section focuses on the policymaking process in Chile since 1990, when the military dictator Augusto Pinochet turned over the presidency to his democratically elected successor, Patricio Aylwin. That moment represents a sharp change in the institutional framework, so that it makes sense to treat the ensuing period as a distinct policymaking regime. We identify four salient institutional features that together have shaped policymaking in Chile since 1990. First, there is the party system, which consists of two closely knit and stable coalitions, one on the left and the other on the right. This party system is strongly shaped by the electoral system, which creates pressures for moderate polarization in legislative elections, which use the D’Hondt rule with open-party lists, while a “dual ballot” system for electing the Executive discourages extremist presidential candidates.

The second salient feature of the PMP is an extremely powerful Executive, which faces a set of veto players. The President of the Republic has near-monopoly control over the legislative agenda, with proposal and veto powers that make him a *de facto* agenda setter. Thirdly, the PMP is studded with veto players, some of them written into the constitution by the outgoing military government in order to make policy changes by subsequent elected governments more difficult. These include a bicameral congress, a comptroller general, and independent loci of judicial power including the regular courts, a constitutional tribunal, and an electoral tribunal. Less traditional checks on policy formation (which enjoy less popular acceptance) include the presence of unelected Senators in the upper chamber of Congress and the relative autonomy of the Armed Forces themselves (the heads of the Armed Forces cannot be removed by the

President of the Republic, and they are a dominating presence on the COSENA (National Security Council).<sup>1</sup>

A fourth key feature of the Chilean PMP is the existence of a well-functioning mechanism for policy implementation, including an independent judiciary and an honest and reasonably efficient bureaucracy (although there is variation across policy areas on this last score).

To foreshadow the subsequent discussion of the workings of the process, we observe that because the party system shrinks the *de facto* set of decision-makers, and because the parties are long lived, the Chilean system is characterized by a relatively small set of decision-makers who repeatedly interact (two of the *criteria* identified by Spiller et al., 2003, as facilitating cooperation). The relatively clean and well-working bureaucracy and judiciary facilitate cooperation by enhancing transparency (through adherence to standardized procedures), and providing reliable enforcement of the policies that are put in place. The existence of a transparent enforcement technology also limits the benefits obtainable by defecting from agreed-upon policies. The degree to which policymakers' interests align differs across issues. However, two features of the Chilean polity are worthy of particular note: firstly, Chile's is a small open economy, so that the consequences of poor economic policy are particularly keenly felt, and secondly, there is the "hangover" from the civil strife of the early 1970s and from more than a decade and a half of military rule: certain sensitive issues create a shared interest in avoiding conflict. Beyond these two features, the alignment of interests among policymakers varies from issue to issue.

Section 2 describes Chile's policy outcomes and the policymaking capabilities of the Chilean state from a comparative perspective. It focuses on the outer features of policies following the criteria set by Scartascini and Olivera (2003). Section 3 describes and analyzes Chile's institutional setting and the incentives it sets for political actors. First, it analyzes the combined effects of the two different electoral systems, for presidential and legislative elections, and the congressional rules over the party system and the number of political actors. The following subsections describe the powers of the Executive and its role in the legislative process, review the

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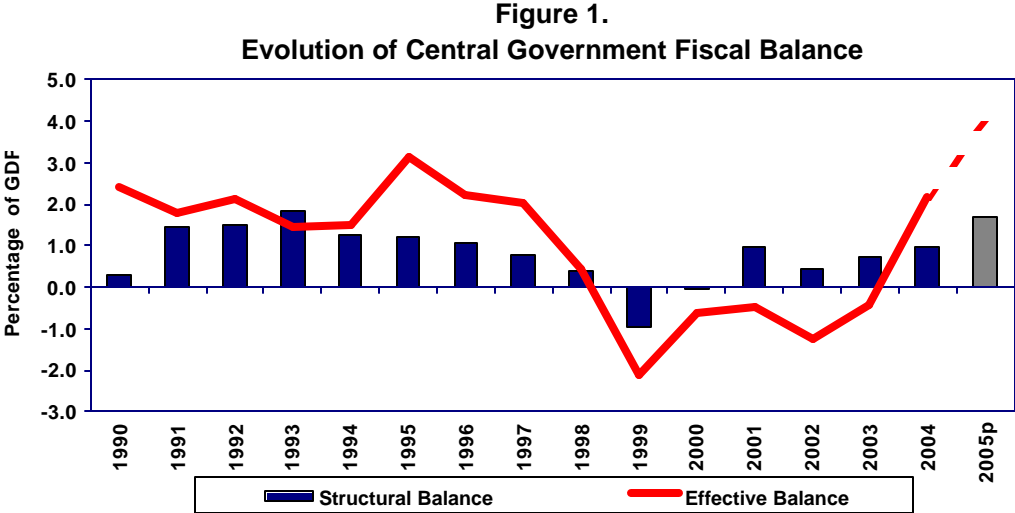
<sup>1</sup> These undemocratic institutions were introduced by Pinochet in the 1980 Constitution. After 15 years of negotiations between the center-left government coalition and the right-wing opposition coalition, they were eliminated by a constitutional reform in 2005.

role of enforcement technologies and the civil service on policy implementation and analyze the interactions of the different actors in the policymaking process. Section 4 concludes.

## 2. Policy Outputs and Policymaking Capabilities

### 2.1 Stability and Flexibility

Public policy in Chile has shown a remarkable level of stability in the face of political changes since the restoration of democracy in 1990. The three different administrations that have governed the country since the transition to democracy maintained fiscal discipline and avoided manipulation of fiscal policy for political purposes. A fiscal surplus was consistently maintained between 1990 and 1998. During the “Asian Crisis,” recession pushed the budget into a deficit of 1.4 percent of GDP in 1999, but the budget was again balanced the following year. The government quickly addressed the problem and proposed the adoption of a new fiscal rule in March 2000. The new rule seeks a “structural” surplus of 1 percent of GDP. It was designed to prevent inefficiencies produced by erratic and discretionary government spending, maintain stability in fiscal policy and increase transparency in government spending.<sup>2</sup> However, unlike other public policy features, the “1 percent fiscal surplus rule” is a discretionary policy self-imposed by the current administration and might not survive beyond the end of Lagos’s term in March 2006.



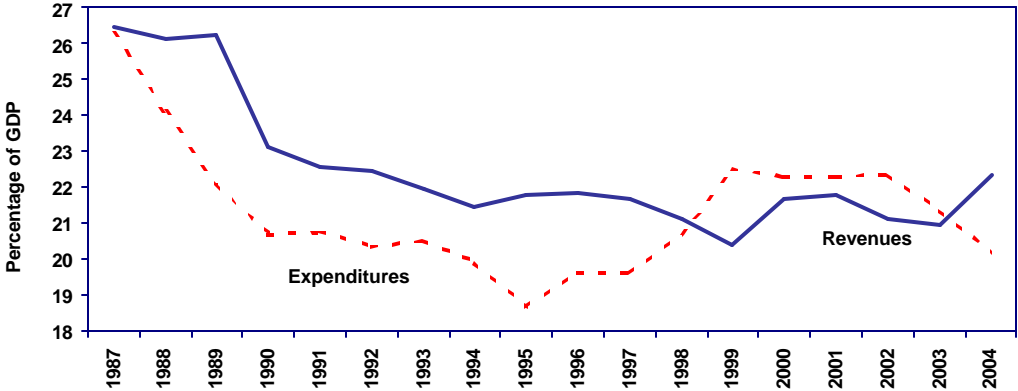
Source: Authors' calculations based on DIPRES, 2005.

<sup>2</sup> For more details regarding the structural balance rule, see Marcel et al. (2001).



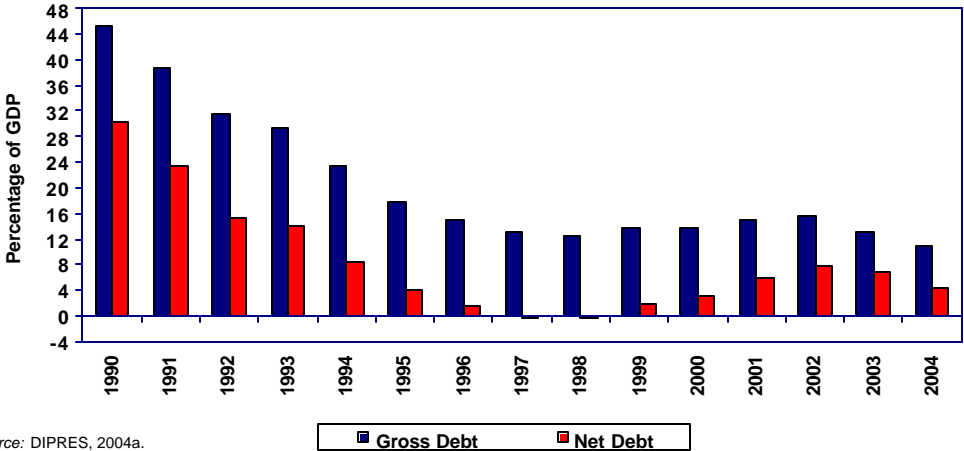
High rates of GDP growth during the 1990s allowed governments to increase public expenditure while repaying most foreign debt, thus assuring a solid macroeconomic position to foreign investors. Government debt decreased from 42.7 percent of GDP in 1990 to 13.3 percent in 2003 (DIPRES, 2004b). The relatively conservative fiscal response of the Chilean government to the “boom” years of the 1990s can be examined in the context of Latin American countries’ tendency towards pro-cyclical fiscal policy, and runs counter to the stereotype of developing country governments trapped in “boom and bust” cycles.

**Figure 2.**  
**Evolution of Central Government Revenues and Expenditures**



Source: DIPRES, 2005.

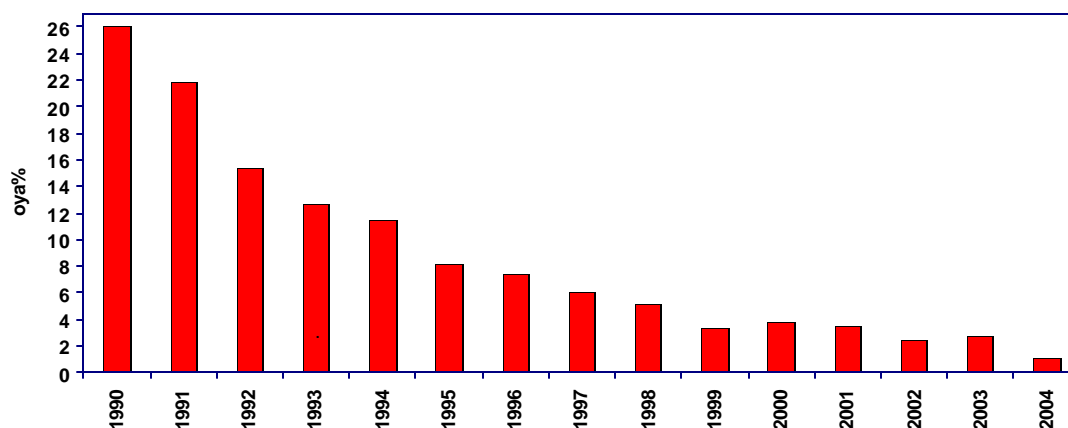
**Figure 3.**  
**Evolution of Central Government Debt**



Source: DIPRES, 2004a.

Monetary policy has also been very conservative since the restoration of democracy. The Central Bank applied restrictive monetary policies during most of the 1990s, achieving a gradual reduction in average inflation rates from 26 percent in 1990 to 1.1 percent in 2004.<sup>3</sup> Between 1989 and 2000, the Central Bank worked with one-year inflation forecasts to lower expectations of future inflation. In 1999, the Bank announced a policy shift, effective in 2001, to an inflation-targeting framework (IT). The IT reduces the Central Bank's discretion and puts automatic stabilization mechanisms in place to maintain inflation within the target band of 2 percent to 4 percent. This simple targeting rule tends to protect the Bank from political pressure. The IT framework for monetary policy has been successful, as inflation has remained within the band since the inception of the system in 2001. Chile today enjoys a stable and very low level of price inflation, and its fiscal and monetary institutions have earned praise from multilateral institutions, credit rating agencies and international investors.

**Figure 4.**  
**Consumer Price Index**



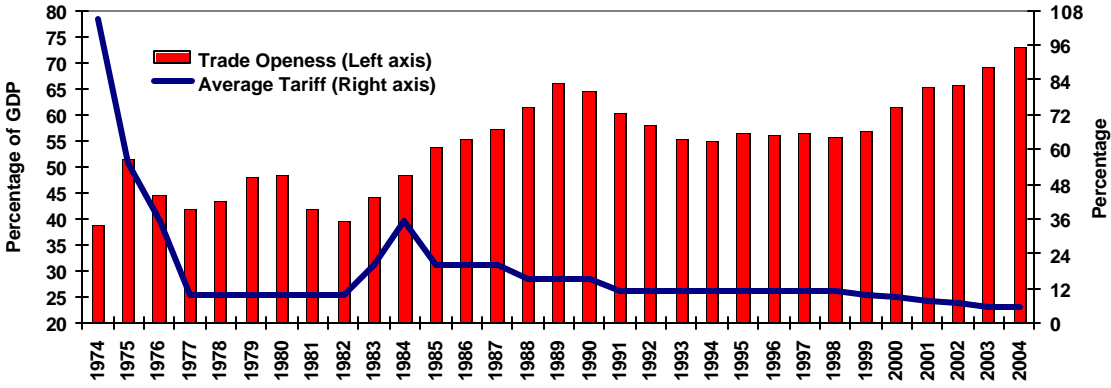
Source: "Base de Datos Estadísticos," Central Bank of Chile.

Trade policy is another example of stable policymaking with successful results. The military dictatorship initiated an aggressive unilateral liberalization strategy in the mid 1970s to eliminate the high trade barriers that had protected domestic economic production for most of the twentieth century. By 1989, Chile had lowered its average tariff to 15 percent with almost no dispersion. The *Concertación* governments continued with the unilateral liberalization policy. Tariff rates averaged 11 percent during the 1990s. Then a four-year-long series of tariff

<sup>3</sup> Source: Central Bank of Chile. [www.bcentral.cl](http://www.bcentral.cl)

reductions beginning in 1999 lowered across-the-board tariffs to 6 percent in 2003. The *Concertación* administrations complemented the unilateral liberalization policy with bilateral economic agreements during the first half of the 1990s with several Latin American countries, including the Mercosur trading block. In 1996, Chile signed a free trade agreement with Canada, and later signed other FTAs with the European Union, the United States and South Korea. Today Chile has one of the freest economies in the world, trade volumes closely follow the evolution of terms of trade, and the share of trade in GDP has risen steadily from 28 percent of GDP in the 1960s and early 1970s to more than 70 percent today.

**Figure 5.**  
**Trade Liberalization**



\* Trade Openness is calculated as the share of total trade (exports and imports) in GDP.  
Source: Authors' calculations based on "Base de Datos Estadísticos", Central Bank of Chile.

Cross-national indices of economic policy also reflect the stability of Chile’s policy outcomes. Since its transition to democracy, Chile has improved consistently in indices such as the Index of Economic Freedom of the Heritage Foundation, the Growth Competitiveness Index of the World Economic Forum, the Corruption Perceptions Index of Transparency International and the Governance Indicators of the World Bank.<sup>4</sup>

Fiscal, monetary and exchange-rate policies are also good examples of public policy flexibility. On monetary policy, until 2000 the Central Bank used estimates of future inflation (12 months in advance) as its main tool for reducing uncertainty, and while it did not state precise targets for inflation, this was done very much in the spirit of inflation targeting since the

<sup>4</sup> See Kaufmann, Kraay and Mastruzzi (2003); Miles, Feulner and O’Grady (2003); Transparency International (2003) and World Economic Forum (2003).

projections were usually lower than previous year inflation and everyone knew that the Central Bank was committed to using policy instruments to make the projection come true. However, starting in 2001 (two years after the announcement was initially made), the Central Bank began to use an inflation-targeting framework. This method restricts the discretionary power of the Central Bank without renouncing the use of stabilization policies. One of the basic conditions for a well-functioning Central Bank is its independence from the government in power. That has been the case in Chile since late 1989.

In September 1999, the Central Bank decided to abandon an exchange-rate policy based on a price band and adopted instead a free-floating exchange-rate policy. The floating exchange-rate policy gives the economy enough flexibility to face external shocks and reduces the discretionary power of the Central Bank. The Central Bank has twice intervened in the exchange market in recent years (in July 2001 because of the Argentine crisis and in October of 2002 because of a crisis in Brazil). However, on both occasions, the interventions have been transparent and well-founded, with the Central Bank providing a public rationale for its actions and providing full disclosure as to the amounts involved in the operations and the timeframe for the unusual action.

## ***2.2 Coordination and Coherence***

Government policy has been highly coherent across policy areas. In part this suggests a long-term strategy for economic policy, and in part it is the result of a shared commitment by both the government and the opposition coalitions (the *Concertación* and the *Alianza*, respectively) to promote efficient economic policy. During these past years, changes made in key policy areas—including structural balance rule, a monetary policy with inflation targets and a free floating exchange rate—have made the entire public policy process more transparent, coherent and internally consistent.

In a country with a flexible exchange rate like Chile, the inefficacies and inefficiencies of fiscal policy counsel against using them as instruments to bring about stabilization. Instead, their main role should be to secure a solid fiscal position. That better serves as a basis for a stable monetary policy and serves to consolidate long-term economic growth. In this way, the fiscal rule of government surplus adopted in 2001 under the tenure of Finance Minister Nicolás Eyzaguirre is a significant innovation, as it acts as an automatic stabilization tool.

Similarly, since the free-floating exchange rate was adopted in 1999, a potential source of incoherence in the formation of public policy was eliminated. Before that decision, the Central Bank had to worry about keeping the exchange rate within the target band at the same time that it sought to control inflation, which occasionally produced competing and contradicting objectives. The costs of these tensions between competing objectives became evident in 1999, when the Central Bank was forced to raise interest rates well beyond prudent limits when the exchange-rate band came under pressure after the Russian Debt default. The only Central Bank objective now is to meet inflation target goals.

While the military government left what Navia and Velasco (2003) refer to as a “first generation of reforms” in place, subsequent democratically elected governments continued the reform process with what have been called second-generation reforms, including privatization of the port sector and utilities, introduction of private concessions in public works, and educational, health, and labor reforms.

These reforms, however, have been achieved with varying degrees of success. The most advanced areas correspond to macroeconomic policy, where there is considerable consensus. Also, substantial success has been achieved in improving the regulatory framework, the transparency of government policies, and state capabilities. Areas where success has been more elusive are those related to human rights, social issues (such as divorce) and efforts at reforming the labor code and the import-competing agricultural sector (wheat, vegetable oils and sugar).

The introduction of public works concession programs has been a successful innovation. Historically, the state was in charge of building and operating public infrastructure works. In the 1990s, however, the state initiated an aggressive concessions plan through a system of Build, Operate and Transfer contracts (BOT). As known, this scheme works in the following manner: a private company finances and builds the project, and then charges for its use by the public. The use of such a system brings about huge improvements in efficiency and welfare. It allows the state to increase the provision of new infrastructure without a heavy burden on the fiscal budget. In addition, because the company that builds must also maintain the new infrastructure, the correct incentives are in place to build with high quality materials and technology. From a distributive approach, it is convenient that the users of the new infrastructure pay for it rather than placing the burden on all taxpayers. Finally, the design of the contract seeks to generate

competition and helps discard ideas where the expected demand does not justify the construction of the new infrastructure (MOPTT, 2003).

There are also a large number of public policies that work in a manner directly opposite to the above-mentioned Concessions Program: they carry very heavy political costs in the short term, but yield enormous long-term benefits. If those political property rights are not protected, it will be difficult for governments to undertake those kinds of reforms. Two sectors that clearly present these kinds of challenges are health and education. Not surprisingly, progress in these areas has been far slower than in concessions of public works.

On education, it must be noted that educational spending has increased by more than 220 percent between 1990 and 2003 (DIPRES, 2004b). That trend has allowed the government to reverse the decline in educational spending observed in the 1980s. As a result of a correct diagnosis of the bad state of Chilean education, an educational reform (elementary and secondary) was adopted in the 1990s. A number of initiatives to improve the system were undertaken: improvements in working conditions and salaries for teachers, improvements in structure and equipment for existing schools, improvements in access to education (reflected in an increase in enrollment figures) and the most comprehensive curriculum reform in 25 years. Together with improving the quality of education, enormous efforts have been made to reduce school drop-out rates. Yet, much remains to be done. Access to higher education remains highly discriminatory against low-income youth. Because the public funding scheme for university education only covers public institutions, many capable young students who attend private universities are left without access to public funding for their university education. In summary, although some important reforms have been undertaken in recent years with the objective of giving more autonomy to educational institutions, linking teachers' pay with their performance, providing more information to parents on schools' performance and improving access to higher education to all students, the successes in this field have been positive but largely insufficient.

In the health sector, there are some signs of progress, but some worrying signs of neglect as well. In the early 1990s, there were significant deficiencies in infrastructure and equipment in the public health system, a lack of qualified human resources and administrative inefficiencies. To correct those problems, the government invested more in the public health system than it had at any previous time in the country's history. Health spending went from 1.9 percent of GDP in 1990 to 3.0 percent in 2003. The increase is also evident when comparing health spending as a

share of total expenditures, as it went from 9 percent of total expenditures to 14 percent during the same period (DIPRES, 2004b).

Even though Chile has achieved health indicators (lifetime expectancy at the time of birth, infant mortality and mother's mortality) higher than what its economic development level would predict, public satisfaction with health coverage is low. One of the main criticisms against the system is that it does not constitute a system *per se*. Instead, there are two systems (one public, one private) that function in parallel, with little coordination and insufficient cooperation between them. A partial health reform guaranteeing speedy access to the public system in case of a limited number of illnesses was approved in 2004, but it falls far short of what is needed to improve the efficiency and coordination of the whole system. Opposition by the *Alianza* and by other interested parties—including doctors' and health workers' unions, with the tacit or explicit support of congressmen belonging to the government coalition—was able to derail important structural changes initially proposed by the government.<sup>5</sup>

Despite repeated efforts to improve labor markets, success has been moderate. The first labor reforms adopted after the restoration of democracy (1990 and 1991) sought to correct the imbalance between workers and employers. That imbalance was inherited from the labor reforms adopted by the Pinochet dictatorship during the 1970s and 1980s. The lack of legitimacy of the labor system inherited from the dictatorship weakened its long-term stability. Thus, while the new democratic government sought to maintain some of the improvements made in the 1970s and 1980s regarding flexibility and modernization, other rules on individual contracts, collective bargaining and labor unions operations were introduced to bring legitimacy to the system and to bring labor unions on board as allies, rather than enemies, of labor market reform efforts (Mizala and Romaguera, 2001).

Yet, during the last year of the Frei administration, a labor reform was launched in an effort to reverse the low levels of labor union participation and collective bargaining by seeking to bring some additional protection to workers and labor unions. Partially, it was intended to show that the pro-labor protection promises made by the center-right presidential candidate were inconsistent with the legislative record of conservative senators and deputies. The labor reform initiative was rejected by the legislature in the midst of the 1999 presidential campaign, to no

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<sup>5</sup> It is worth mentioning that the former chairman of the doctors' union is now a member of Congress in representation of PPD (the president's party) and was very active in the Health Commission of the Chamber of Deputies, which is almost completely monopolized by medical doctors.

one's surprise. Yet, President Lagos, after taking office, sent a new labor legislative initiative to Congress that was eventually passed. The new legislation had two objectives. First, it sought to increase the legal protection of workers (by formally recognizing a number of rights that were not clearly spelled out in the existing legislation) and, second, it sought to reduce the costs of hiring new labor. This dual—and somewhat contradictory—goal has made it difficult to appropriately evaluate the success of the reform.

In October 2003, the government sent Congress a legislative initiative designed to bring more flexibility and adaptability to the labor market. The initiative sought to strengthen productivity and increase employment by introducing some flexibility that would allow companies to adjust their labor requirements to meet the demands of their productive sectors and better respond to the economic cycle. The initiative also sought to increase and facilitate the incorporation of women into the market. This initiative is currently under consideration by the legislature, although initial opposition to it from within the *Concertación* ranks will likely delay it beyond the end of Lagos's six-year term in March 2006.

A significant improvement in labor market regulation was achieved in 2002. The approval of a mandatory unemployment insurance scheme for those who enter the labor market during or after 2002 was passed into law after some tough negotiation and bargaining with the opposition and left-wing *Concertación* legislators. Eventually, the newly created unemployment insurance scheme should replace the existing dismissal compensation scheme. A novel feature of this system is the introduction of individual savings accounts with contributions by both the workers themselves and companies to fund compensation during the unemployment period. However, the law did not include a revision of the high dismissal compensation scheme, which puts a very heavy burden on companies that seek to lay off workers and introduces severe distortions into the Chilean labor market.<sup>6</sup>

In Lora's structural reform index for the 1985-2001 period (Lora, 2001), reforms have increased the efficiency of the public policies and have strengthened free markets in Chile for the five economic sectors considered. The level of progress and liberalization of each of those five sectors is different, but there is no incoherence in the reforms implemented in each one of those sectors. The most important advances took place in the commercial and financial arenas. The labor index is the only indicator that could arguably show a decline towards the end of the 1990s.

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<sup>6</sup> For more information on this topic, see Cowan et al. (2003).

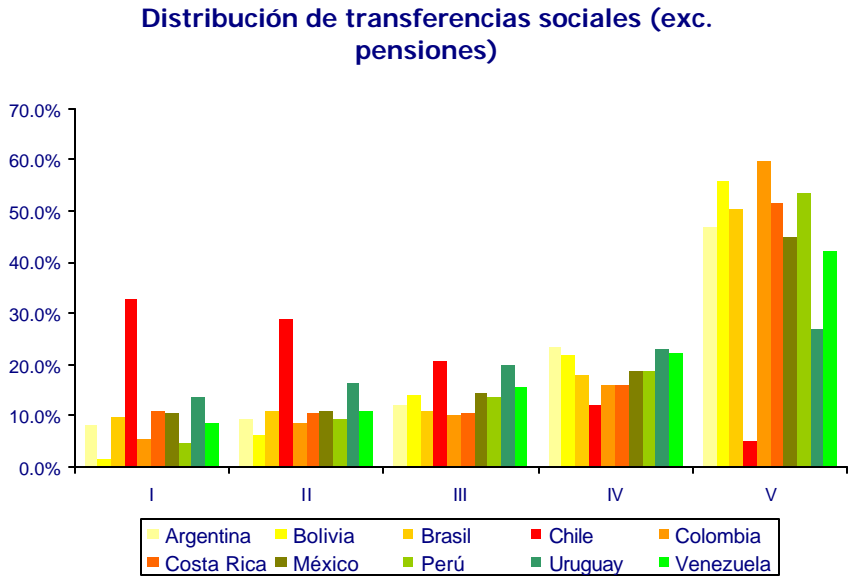


Yet, as discussed in the previous section, the labor reforms implemented during the 1990s sought to restore certain workers' rights that were lost in the previous decade.

**2.3 Public Regardness of Public Policy**

Government spending in Chile by and large reaches those in most need. The last poll on poverty and inequality, CASEN 2000,<sup>7</sup> shows that fiscal spending on health, education and direct subsidies for the poor was well-spent; 68.8 percent of all spending on these items went to the poorest 40 percent and an impressive 80.2 percent of public spending in health benefited the poorest 40 percent of the population. In terms of education, 62.8 percent of spending went to the poorest 40 percent of the population. In terms of direct subsidies, 73.1 percent of all that was spent went to the poorest 40 percent of the population. Altogether, the subsidies and benefits that the state offers to the poorest Chileans allowed the first decile (the poorest 20 percent) to increase its share of income from 3.7 percent before taxes and subsidies to 6.4 percent of total pre-tax income, while the wealthiest 20 percent saw its share of income reduced from 57.5 percent before subsidies to 53.4 percent after subsidies. The following chart shows the pattern of the distribution of social transfers in Latin America.

**Figure 6. Distribution of Social Transfers, Excluding Pensions**



<sup>7</sup> See MIDEPLAN (2000).

However, there are some areas where highly intense private interests have captured the policymaking process. A notable example of this is the price bands for some agricultural goods. Chile introduced price bands for some agricultural products with the aim of reducing tensions in politically sensitive southern regions of the country. The price bands are applied to wheat, sugar and vegetable oil. The argument behind the decision was that highly fluctuating international prices for these goods placed an overwhelming burden on producers. A protectionist neutral band was adopted so that the government could impose tariffs when international prices were too low and reduce tariffs when international prices were too high. The scheme was not deemed protectionist, but rather was defended on the grounds that it would reduce price volatility, thus improving the welfare of agriculture workers. Yet, this mechanism has not functioned correctly. Lobbying by agricultural producers has prevented the government from reducing tariffs when international prices increase and has even effectively altered the scheme by which the government calculates the appropriate price bands for these products. For example, Galetovic (2001) has shown that the private sugar-producing quasi-monopoly IANSA received US\$37 million just as a result of the price intervention on sugar, while the government only received US\$25 million on additional money as a result of the higher tariffs on imported sugar. US\$16 million were given to national sugar beet growers. In the case of price intervention on vegetable oil, 90 percent of oil consumption is from imported oil, thus the state benefits from additional tariffs more than national producers. Even worse, the benefits from price intervention go primarily to well-off agricultural producers, not to minimum-wage agricultural workers. Galetovic (2001) showed that 63 percent of small sugar beet producers produce only 4 percent of the national production and receive less than 1 percent of transfers from consumers who pay more for imported sugar. Those transfers accounted for US\$258 million in the 1998-2000 period. Taking into account its effect on consumers and producers, this price intervention policy is probably one of the most regressive policies that exist today in Chile.

#### ***2.4 Overall Quality of Public Policy and State Capabilities***

Useful proxies for overall quality of public policies are indices that measure corruption, governance, business environment and quality of institutions. Among those indices is the Corruption Perception Index, produced by Transparency International.<sup>8</sup> It ranks Chile among the

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<sup>8</sup> See Transparency International (2003).

least corrupt countries in the world; Chile is the least corrupt country in Latin America. Among some of the institutional changes of note adopted in Chile in 2003 are a new law on Government remuneration and spending that regulates salaries for high-level officials and caps their discretionary budgets; a new legislation that requires the government to maintain a registry of all individuals, institutions and companies who receive public funds; a new public administration bill to create a civil service in Chile's overly politically dependent bureaucracies; and finally, a new law on political party and campaign financing that has brought the issue of money and politics to the forefront of debate in Chile. Most recently, the legislature also began to debate a proposal to regulate lobbying.

According to the Global Competitiveness Report,<sup>9</sup> Chile is ranked 26th among 123 countries in the world. The score is obtained by averaging each one of the three fundamental pillars for growth as defined by the World Economic Forum: business environment, good institutions and technological development. Chile's highest ranking comes from its good institutions. The "Doing Business" Index prepared by the World Bank<sup>10</sup> ranks the business environment by identifying regulations and policies that foster (or hinder) investment, productivity and growth. Some of the regulations in Chile include the following: if someone wants to start a business in Chile, that person must complete 10 different steps (procedures). That is below the Latin American average, but is significantly higher than in OECD countries. In order to enforce a contract, 21 procedures are needed in Chile, requiring an average time of 200 days and costing an expected 14.7 percent of GDP per capita. Although those values are lower than the Latin America average, the costs of enforcing contracts is much higher than in OECD countries, where it stands at 7.1 percent of GDP per capita. Chilean courts normally take 5.8 years to rule on insolvencies, much longer than in OECD countries, where courts take on average 1.8 years.

## ***2.5 State Capabilities***

Policy schemes and regulation are relatively transparent. There is a simple tax code, tax evasion is low and rates of effective and total protection are very similar. The procedures and time required to open new businesses and to comply with government regulations are much lower than regional averages (but are still higher than in OECD countries). The regulatory burden is

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<sup>9</sup> See World Economic Forum (2003).

<sup>10</sup> See World Bank (2004).

moderate. While survey data reveals that the time and government fees needed to comply with regulations when a new business is opened are low by international standards, the total number of regulations that must be complied with exceeds the international average. The staff of the regulatory agencies, tax collection agencies, Central Bank and Finance Ministry tends to be more prepared, better trained and more professional than that of other government agencies.

It is well known that the liberalization of the economy and of the financial system, the privatization of companies that offer public services, and the consolidation of markets must be accompanied by the strengthening of the institutions in charge of regulating those activities. Otherwise, there will be high risks of capture where the regulator works in the interest of the regulated industries rather than to defend the interest of consumers and to secure more competitive markets. The option of choice for Chile's regulatory scheme has been based on reducing entry barriers and on selective, rather than structural, intervention executed by anti-monopoly commissions that bring more flexibility to the system. It would be far-fetched, however, to suggest that regulatory policies have changed since 1990. The so-called "rules of the game" have not undergone significant changes. Instead, there has been an effort to improve the regulatory framework in light of specific problems that have arisen over time.

The levels of tax evasion are a useful proxy for the capabilities of the state. They provide insight into the efficiency of the tax-collecting agency in Chile. In the early 1990s, tax evasion was close to 30 percent. During the 1990s, this figure decreased constantly until it reached levels closer to 19 or 20 percent (18.3 percent in 1999). At this time, Chile has the lowest tax evasion rate in Latin America. In terms of personal income taxes, evasion levels have also decreased. In 1990, personal income tax evasion was close to 50 percent. In 1997 (the most recent year for which data is available) the evasion level was 41.7 percent. In 1990, more than US\$1 billion was collected in taxes simply because of lower tax evasion.

Between 1990 and 1999, the number of tax collectors and tax collection office workers increased. While the effective number of tax collection bureau workers in 1990 was 2,170, the number increased to 2,953 in 1999, a 36.1 percent increase (SII, 2000).

With regard to the quality of the personnel who work for the central government, there is a high degree of centralization of relevant decisions. There is a very limited margin for decision-making at the local, regional and specific institutional level. There is a high level of inflexibility, with little room for discretion for those responsible for the management of the respective

institutions and offices. Moreover, there is a single and uniform regime of human resources for the entire public sector. That makes it more difficult to adjust to the specific needs and demands of particular institutions and public services. There is a very rigid employment stability framework, which in reality accounts to the practical inability to fire public workers. Salary and public compensation also respond to a rigid and nationally controlled scheme that often favors those who have been employed by the public sector the longest.

In 1994, an Inter-Ministerial Modernization Committee for the Public Sector was formed. Its mission was to coordinate the modernization efforts and initiatives hunched by different public sector bureaucracies and to propose new initiatives and efforts. The Committee produced a Strategic Plan that defined six action areas to deepen state modernization: strategic management and evaluation, human resources, public sector transparency and probity, quality of public sector services and citizen participation, state institutionality and public relations (Comité Interministerial de Modernización de la Gestión Pública, 2000). A new program for State Modernization and Reform (PRYME) was launched in 2000. This initiative complemented the effort initially undertaken in 1994 and sought to increase transparency, efficiency, equity and citizenship participation as the bases of a well-functioning state. One of the most remarkable items in this initiative was the creation of a Public Civil Service division (*Nuevo Trato y Dirección Pública*). This new office will fill between 1,900 and 3,500 positions that were previously considered presidential-appointed positions. Two autonomous institutions were created to appoint the new public sector employees for those positions: the *Consejo de Alta Dirección Pública* and the *Dirección Nacional del Servicio Civil*.

A new legislative initiative designed to regulate lobbying was also recently introduced to Congress. Among the noteworthy features of the new legislative package are the proposal to register and identify all official lobbying organizations and individuals as well as meetings between lobbyists and public authorities, the provision of equal access to authorities for all lobbyists, the restrictions on public sector employment and electoral eligibility for those who work as lobbyists and restrictions on political contributions by lobbyists.

### **3. Political Institutions and the PMP in Chile**

This section maintains that Chile has an institutional system of checks and balances—with some similarities to the United States, but some important differences as well—that has worked well in terms of promoting intertemporal political transactions since the restoration of democracy in 1990. Chile has a presidential system with a bicameral congress, a proportional electoral system with a district magnitude of two, and independent judiciary and other enforcement technologies. The system produces a PMP favorable to intertemporal political transactions in most policy areas, as it favors a small number of political actors, who interact repeatedly with long time horizons and there are good enforcement technologies overseeing the process. Some “undemocratic enclaves,” established in the 1980 Constitution left behind by the Pinochet regime, at least temporarily, reduced the “issue space” for policymaking, restricting cooperation in areas regarding human rights and some military related issues. Sections 3.1 to 3.3 describe the main components of Chile’s political system and analyze the incentives they establish for political actors. Section 3.4 explores their interactions and the combined effect on the policymaking process.

Chile has a presidential system similar to that of the United States, with a bicameral congress as part of a system of checks and balances. Such systems are designed to allow for slow but incremental change, preventing policy instability as a result of changes in the balance of political power. If these systems are well designed, however, they also allow for decisiveness when there are external shocks that change the relative prices of political issues (this can be framed in the valence model.)

The crucial issue here is not the existence of institutions designed to be checks and balances, but the precise design that determines the workings of those institutions. Several comparative studies note that policies are of very different quality in countries with similar institutional settings. The effectiveness of the institutional design is in its details, which will determine the possibility of finding loopholes or by-passing the checks and balances, which in the end will determine the real incentives for political actors.

Systems of checks and balances are designed to produce good policies in areas of relative consensus, or in cases where compensation could possibly be worked out, to have more status

quo bias in more conflictive policy issues, and to produce relative gridlock on issues where political actors have strong opposing views.

In that regard, the Chilean system seems to be well designed. It has allowed for a constant and incremental improvement of policies, institutions and rules and regulations since the restoration of democracy. It has allowed for stability with respect to political shocks and for decisiveness with respect to socio-economic shocks. As expected in a system of checks and balances, the quality of policies varies across policy areas. It tends to be higher with regard to macroeconomic issues, international integration, financial markets and regulations, as opposed to social issues like labor markets, social security, health and education. On moral issues, human rights and military-related issues, policies show higher rigidity and overall lower quality.

### ***3.1 Effects of the Electoral System, Electoral Cycle and Congressional Rules on the Party System***

Chile has two different electoral systems for legislative and presidential elections, which give different incentives to political actors and cross-pressure them in their electoral strategies. For parliamentary elections, Chile has the so-called binomial electoral system, which is a proportional representation system with a district magnitude of two in all districts. It uses open lists and the D'Hondt seat allocation formula, and allows for coalition formation, but coalitions are nationally binding. In practice, each of the lists (coalition/parties) receiving the two highest vote shares wins one of the two available seats per district unless the list receiving the most votes outpolls its second place rival by a ratio of more than two to one, in which case it receives both seats.

Chile's electoral system has a two-fold effect on the party system: it reduces the number of relevant actors by encouraging parties to coalesce and it strengthens the national leadership of parties. At a district level, a magnitude of two determines an upper bound of three parties (Cox, 1997). At the national level there can be many parties presenting candidates in just a few districts; hence the system allows for the existence of several parties. There is a strong incentive to coalesce at the district level, since if the list receiving the most votes obtains 100 percent of the seats available in the district if it doubles the second place rival. If a list secures second place and avoids being doubled, it gets 50 percent of the seats being contested. The provision that coalitions are binding at a national level leads parties to form broad-based national coalitions.

Since it is difficult to form coalitions that can secure more than two-thirds of the votes in each district, and it is relatively easy to secure one-third of the vote share, the most likely outcome is the formation of two national coalitions. Under this scenario, if coalitions are already formed, any given party would pay a high toll if it unilaterally leaves its coalition. On the other hand, this sets a high entry barrier for a third national coalition or independent party.

Since 1990 there have been six parties with congressional representation, organized into two national coalitions. The 1988 plebiscite to decide whether General Pinochet should remain in power for eight more years organized the existing political actors into two blocks supporting the “yes” and “no” votes. These blocks were maintained during the subsequent democratic elections, with the center and left-wing parties that opposed Pinochet in one coalition, and the right-wing parties that supported the General in the other: the *Concertación de Partidos por la Democracia* and the *Alianza por Chile*, respectively.<sup>11</sup> The *Concertación* and the *Alianza* are still the only two coalitions with congressional representation today, and have become the longest-standing coalitions in Chile’s long republican history.

The existence of these coalitions provides political parties with several incentives and restrictions. Since only one-third of the vote is needed to secure 50 percent of the seats in each district, it drives parties’ platforms away from the median voter, potentially polarizing the party system (as indicated below, this effect is mediated by the effects of the presidential electoral system, which reduces its centrifugal incentives). Also, the potentially high price a party would pay in terms of its share of the national vote if it unilaterally leaves its coalition enforces high intra-coalition discipline. This has been important for maintaining unity in both coalitions during the last 14 years, since they include parties with different platforms on several issues and political leaders with high personal rivalries. Despite publicized intra-coalition bickering between parties, both coalitions have remained united by the pressure of their Congress members on their respective party’s leaderships. Congress members know that their re-election chances would be jeopardized should their coalitions break up.

The binomial system also encourages continuous intra-coalition party negotiations to decide which candidates will be nominated to the coalition’s lists in every district. This

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<sup>11</sup> The *Concertación* originally consisted of 17 parties that opposed the Pinochet regime. During the 1990s, these parties merged or disappeared. The *Concertación* currently consists of the centrist Christian Democratic Party (PDC), the leftist Party for Democracy (PPD) and the Socialist Party (PS). Since 1989, the *Alianza* has had several names but it has always consisted of two parties: the moderate right wing National Renovation (RN) and the more rightist Independent Democratic Union (UDI).



strengthens the national leadership of parties, but only to a certain extent. In high-magnitude proportional representation systems, candidates have to respond to their party leadership to be included in the ballot. In single-member districts, politicians are political entrepreneurs since they have to respond to their local constituencies. Under the binomial system, politicians and parties have mixed incentives. The national party leadership has to negotiate with its partners as to the districts in which it should present candidates while responding to both national and local considerations: on the one hand, parties have to negotiate their share of the coalition's candidate list, and on the other, they have to try to get the districts where the party has candidates with strong local support.

The legislative electoral system does not have term-limit provisions, which, together with the need for candidates with strong local support, encourage politicians to seek long legislative careers. In Chile 75 percent of Congress members are renominated and about 60 percent are re-elected (Carey, 2002). This re-election rate is much higher than in other Latin American countries, but is lower than in the United States, where 99 percent of representatives seek re-election and about 80 percent succeed (this issue is examined further in the section on the role of seniority in Congress.)

Summing up, the main effects of the binomial system are that it reduces the number of relevant actors to a few parties organized into two broad-based, stable coalitions and strengthens the party leadership while at the same time encouraging politicians to respond to their constituencies and have long legislative careers. Finally, given the difficulty of one coalition to double the vote share of the other in any given district, congressional representation for each coalition oscillates around 50 percent of the members of each chamber under the binomial system.<sup>12</sup>

For presidential elections, there is a majoritarian electoral system with run-off provisions if no candidate obtains a majority of the votes in the first ballot. This system induces the nomination of moderate candidates who seek the median voter position. In the context of only two large coalitions having congressional representation, this system induces intra-coalition

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<sup>12</sup> It is worth mentioning that in addition to the effects the binomial system produces for the working of the PMP, it produces a direct negative effect on the representativeness of the party system. Given the difficulty of one coalition doubling the vote share of the other in any given district, the binomial system normally leads to a situation in which each one of the two main coalitions has a secure seat in most districts. This in turn allows coalitions to present candidates responding to strategic national interests instead of voters' preferences.

negotiations to nominate one candidate for each coalition, which in turn reinforces coalition cohesion and

Municipal elections in Chile are held nationwide on the same day. This makes them another arena for the electoral contest between the coalitions, and provides another opportunity for intra-coalition negotiation to agree upon a common list of candidates (which distributes seats for each party.)

The combined effect of the three electoral systems on politicians, parties and coalitions is a set of incentives which cross-pressure them and multiplies the opportunities for electoral competition and intra-coalition negotiation. There is a 12-year electoral cycle for concurrence of presidential and parliamentary elections; municipal elections are never concurrent. Hence, between 1989 and 2005 there have been 10 different electoral contests, no more than three years apart, and often held every other year or even in consecutive years as in 1992-1993, 1996-1997, 1999-2000-2001 and 2004-2005.<sup>13</sup>

Different electoral systems functioning under a continuous electoral cycle have a moderating effect over the coalitions. The binomial system is the core of the electoral system, and is the main force leading parties to coalesce. However, the existence of municipal and presidential elections mediates the polarizing effect of the binomial system on parties to design their electoral platforms aiming at one-third of the electorate, and encourages coalitions to aim closer to the median voter. On the other hand, the high sequence of elections forces parties to successfully reach intra-coalitions agreements, reinforcing coalition discipline and increasing the power of party leadership and hence, party discipline as well.

Finally, the informal rules that determine the actual workings of Congress reflect the power of both parties and coalitions. The two main institutions that shape the workings of Congress are the executive boards (*mesas*) of each chamber and the chambers' committees. Formal rules determine that committee assignments are nominated by the *mesas* and ratified by the respective chambers, and shall proportionally reflect the partisan composition of each chamber. In actuality, however, the *mesas* consider the parties' requests for committee assignments. Proportionality is not strictly maintained, but coalitions work out agreements. Also,

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<sup>13</sup> At the time of this writing a Constitutional Reform to reduce the length of the Presidency to four years and reintroduce simultaneity in Congressional and Presidential elections is well advanced and has a good chance to pass before the end of 2005. This will facilitate the operation of coalitions, allowing for "compensations" in Congressional elections to the parties that have to resign their presidential options within each coalition.

the chairmanship of committees is not proportionally assigned, but is agreed upon by the coalitions and normally rotates from one congress to the next. In this respect, it can be argued that the workings of Congress reinforce the importance of both parties and coalitions, and that both coalitions and parties as well are central to Chilean politics, contrary to Carey (2002), who states that the only relevant unit of analysis is coalitions.<sup>14</sup>

### ***3.2 An Agenda-Setting Executive with an Array of Negotiating Tools Confronted by Several Checks and Balances***

The Chilean political system is one of the strongest presidential systems in Latin America. The Executive has exclusive legislative initiative on several policy areas, has a highly hierarchical control of the budget process, and has an array of urgency and veto options, which makes it a *de facto* agenda-setter. Yet there are a number of institutional actors that are able to block executive policy initiatives (Londregan, 2000). These include an independent judiciary, a Constitutional Tribunal, a Comptroller General and the “National Security Council” (COSENA) that gives the semi-autonomous Armed Forces a direct institutional role in the government. The bicameral Congress, with has almost a dozen non-elected senators in the upper chamber, and requires supermajority thresholds to change many laws, enables various minorities to block policy changes.

Presidents are elected for six-year terms and are prevented from running for immediate reelection. The candidate-nomination process has varied across elections and parties during the last 14 years, but the two main coalitions have presented candidates for every presidential election. Despite the fact that in all elections several candidates have competed, in all three elections the candidates of the main two coalitions—which include all the parties with congressional representation—have dominated the elections. The three presidential elections have been won by *Concertación* candidates.

The constitutionally mandated agenda-setting powers enjoyed by the Chilean president are quite substantial. Issues are divided into “matters of law” and “matters of administration.” All legislation related to the daily running of the government is considered a “matter of administration.” Members of Congress can only propose legislation that is considered a “matter of law.” This greatly restricts the legislative initiative of Congress.

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<sup>14</sup> For evidence of the interplay between coalitions and political parties in Chile, see Aninat and Londregan (2004).

Within matters of law, the Executive has the sole legislative initiative over legislation concerning the political and administrative divisions of the state, its financial administration, the budget process and the selling of state assets. Also, the Executive has sole initiative in areas such as taxation, labor regulation, social security and legislation related to the Armed Forces. Therefore, the Executive has sole authority to initiate legislation that requires budget increases or allocation of new funds, which gives it exclusive legislative initiative over most economic policy areas.

Furthermore, the Executive can convene an Extraordinary Legislative Period—in addition to the constitutionally mandated legislative period from May 21 to September 18 of each year—during which the Executive determines the legislation Congress is allowed to consider.<sup>15</sup>

Perhaps the constitutional provisions that best reflect the strong powers vested in the presidency are those governing the budget process. The formal rules governing the budget process give strong powers to the Executive, making Chile one of the countries with the most hierarchical budget institutions in Latin America (Alesina et al., 1999; Vial, 2001). The constitutional responsibility for the financial administration of the state belongs to the president via the finance minister, assisted by the budget director. They are in charge of setting the spending limits and leading the negotiations with the spending agencies during the preparation stage of the annual budget process, and of overseeing the execution and control stages. Legislators are not allowed to introduce amendments that raise spending or create any financial commitments. Every legislative proposal by Congress that has financial implications has to be accompanied by a financial report prepared by the Budget Office (Ministry of Finance) with an estimate of the financial impact of the project and the sources of financing under the current budget law. The Public Finances Committee of each chamber has to review the specific articles carrying financial implications.

The Executive has the sole responsibility for the overall revenue estimates and the presentation of a medium-term macroeconomic program, which is presented to Congress' Special Budget Committee by the finance minister at the opening of the budget debate. Congress cannot vote on sources of revenue and cannot modify expenses linked to entitlements granted

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<sup>15</sup> In the absence of a presidential request for an extraordinary legislative period, the Congress can convene for an Extraordinary Legislative Period, in which case the legislation to be considered is determined by the legislature.

under permanent laws, in which the government has to spend as much money as needed in order to cover legal obligations. Congress cannot increase expenses in any item, it can only reduce or reject expenses proposed by the Executive, as long as it does not interfere with the ability of the government to run state policies or meet previous legal commitments. Additionally, Congress has 60 days to approve the Budget Law sent by the Executive, or the original proposal becomes law.

The tight control of the Executive over the budget process and all matters of legislation with fiscal impact gives it control over side payments to compensate congressmen negatively affected by new legislation. For example, in the case studies developed in this paper (see the Appendix), the Executive can successfully implement a major port reform and can sign a partial accession to Mercosur, given its ability to financially compensate the losers of those reforms.<sup>16</sup>

In addition to its agenda-setting powers, the Executive controls the flow of legislation through the use of “urgencies”—a constitutional mechanism designed to give the Executive the power to force the legislature to vote on an initiative within a fixed time limit. The *Ley Orgánica Constitucional del Congreso Nacional* (#18,918)<sup>17</sup> provides for three different types of urgencies that can be introduced solely by the Executive at any moment during the legislative process. A *Simple Urgency* requires the chamber to vote on the initiative within 30 days (or 10 days if the initiative is already in a mixed Senate-Chamber committee after different versions of the initiative have been passed in both chambers). Legislative initiatives granted *Summa Urgency* priority must be voted upon by the Chamber within 10 days (or four days if in a mixed committee). Legislative initiatives granted *Immediate Discussion* status must be voted on by the Chamber within three days (or one day if in a mixed committee).

The Executive can also exercise a wide range of veto options (see *Ley Orgánica Constitucional del Congreso Nacional*).<sup>18</sup> The use of the partial veto (*veto sustitutivo*) gives the president the power to amend legislation that has already been passed, thus allowing the Executive to exercise a last-minute bargaining tool with the legislature after the preferences of both chambers have already been made public in the floor vote of the legislation. The high costs associated with opposing a partial veto by the president often lead both chambers to acquiesce to

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<sup>16</sup> For more on this, see Aninat and Londregan (2004).

<sup>17</sup> <http://www.senado.cl/site/institucion/normativa/ley/>.

<sup>18</sup> <http://www.senado.cl/site/institucion/normativa/ley/>.

the president's preferred version of the legislation, even if the version approved by Parliament was closer to the legislature's ideal point (Aleman, 2003).<sup>19</sup>

In sum, the Chilean Executive does not only have strong agenda-setting powers, but also has good negotiating tools that allow it to implement most of its preferred legislation.

The president's non-legislative powers include broad authority to nominate, appoint and dismiss government officials. The president can nominate the Supreme Court justices, the Central Bank's governing board members, one of the seven members of the Constitutional Tribunal, and the Comptroller General with the Senate's approval. This procedure ensures non-partisan, or at least politically balanced, nominations to these key institutional posts.

The Executive also has the authority to nominate two of nine so-called "Institutional Senators" every eight years, and all former presidents who serve for at least six years are entitled to a lifetime voting seat in the Senate<sup>20</sup> (more on this below, in the section on the undemocratic enclaves of the 1980 Constitution.)

The president directly appoints all Cabinet ministers, regional and provincial governors, ambassadors and heads of government agencies and state companies. Given that the party system fosters coalition governments, cabinet formation might be negatively affected by reducing the Cabinet's cohesion. However, the highly hierarchical structure of the Cabinet, combined with the president's authority to appoint and dismiss any of the 18 ministers and the prominent role of the finance minister in determining the budget of each ministry, has produced highly efficient cabinets in the three administrations since the restoration of democracy. There has been a constant number of ministries and a low rotation of ministers and undersecretaries.

The president, however, cannot exercise discretionary power over the high command of the Armed Forces. The heads of the Army, Air Force, Navy and Carabineros are appointed by the president for four-year terms from a list consisting of the five highest-ranking officers of each branch. The president cannot remove the heads of the Armed Forces without the approval of the COSENA.<sup>21</sup>

The degree of support for the Chilean presidents in Congress is relatively high and constant under the current electoral system. As mentioned above, the binomial electoral system

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<sup>19</sup> However, this power has seldom been exercised in the last 15 years, except to amend technical errors in the legal text.

<sup>20</sup> Former president Aylwin does not have that capacity since he held office during a special transitional term of only four years.

<sup>21</sup> This is also being modified as part of the Constitutional Reforms currently being discussed in Congress.

encourages coalition formation, and leads to rather similar congressional representation for each coalition in both chambers of Congress. Therefore, support for the Executive in Congress oscillates around 50 percent in all legislatures.

Because presidents are the *de facto* leaders of the multiparty coalitions that have characterized Chilean politics since 1989, presidents exercise significant influence over the decisions made by the government coalition (Carey, 2002; Montes, Mainwaring and Ortega, 2000). In all legislative and municipal elections, sitting presidents have been called upon as the ultimate arbiter in disputes among party leaders over the composition of the *Concertación* electoral lists (Carey and Siavelis, 2003). Because they assume the role of coalition leaders, presidents have actively sought to distance themselves from the political parties they belong to, to avoid the impression that they are benefiting their own parties and hurting the other parties that comprise the government coalition.

Offsetting the Executive's substantial powers are several constitutionally mandated checks and balances. Of the number of veto players the Executive faces, some are "traditional" checks and balances present in most of today's successful democracies, but others are "undemocratic enclaves" entrenched by the Pinochet regime in the 1980 Constitution. Among the former are the bicameral congress, supermajority provisions for some legislative matters,<sup>22</sup> and several enforcement technologies such as the Judiciary, the Constitutional Tribunal and the Comptroller General. Among the latter are the semi-autonomous Armed Forces, the National Security council (COSENA) in which the Armed Forces are heavily represented, and the Institutional Senators (nine non-elected senators appointed by different state institutions, but again giving undue political power to the Armed Forces).<sup>23</sup>

Although it is weak by comparison to the U.S. Congress, the Chilean legislature is unusually professional and technically competent by Latin American standards. The bicameral legislature consists of a 120-seat Chamber of Deputies and a Senate with a variable membership. Thirty-eight senators are elected from 19 two-member districts. Also, there are nine so-called

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<sup>22</sup> Different quorums are required for legislating on different types of laws. There are four types of laws in Chile. A simple majority of the present members of each chamber of Congress are required for ordinary laws; laws of qualified quorum required a majority of the total number of members of each chamber; organic constitutional laws, require a supermajority of four-sevenths of the total number of Congress members; and laws that interpret the Constitution require a three-fifths supermajority.

<sup>23</sup> All three are now being removed as part of the above mentioned Constitutional Reform.

“institutional senators” appointed to eight-year terms. In addition to these 47 senators, all former presidents who served six-year terms are entitled to lifetime membership in the Senate.

The Chilean bicameral legislature makes extensive use of committees. Only the Finance Committee is required by law to exist; other committees are established by each chamber at its own discretion, though traditionally there are 19 permanent committees in each chamber. The legislative committee system in use in Chile gives committees less power to influence the final composition of a bill than the U.S. House of Representatives sometimes grants its committees under closed rules provisions. Moreover, Senate rules permit the floor to easily overturn committee decisions (the signatures of 10 senators suffice to force a floor vote on a provision rejected in committee).

The legislative process consists of three “constitutional” steps (*trámite constitucional*). The first constitutional step begins when a legislative initiative is submitted by the President to a chamber of his/her choice. Individual legislators and groups of legislators can also submit legislative initiatives under some very restrictive conditions. The respective chamber assigns the initiative to one of its established committees or to a specially assigned joint-committee depending on the nature of the initiative. The committee then discusses the bill “in general” and can modify the initiative at will. Regardless of the committee’s vote on the initiative, the chamber votes on the amended initiative presented to the floor by the committee. If amendments are offered during the general discussion, this triggers a second reading of the bill, called discussion in particular. At this stage, the bill is returned to the committee, and all amendments are discussed. Typically the chamber will agree to extend the deadline for presenting amendments. Once this has passed, the committee meets, discusses and votes on the new amendments. The bill, along with any adopted amendments, then returns to the floor. In the Senate there are easy procedures to “renew” amendments rejected by the committee (with the signatures of 10 senators, less than a quarter of the chamber). Any member of the legislature can introduce amendments in advance of the second reading, and in the Senate, committee members must put each proposed amendment to a publicly reported vote.

Once the first legislative step is completed, the initiative moves on to the other chamber for the second legislative step. A similar process ensues. But since an initiative that has cleared the first hurdle is closer to final passage, the second chamber often votes first on the intention to legislate (*idea de legislar*) the project as a package (*en general*) and in the end, the truly



important vote is on the specific articles of the proposed legislation after it has gone through the respective committees.

At this stage, if both chambers have approved exactly the same version of the bill it is sent to the president for his signature or veto. However, if the chambers have approved distinct versions of the bill (*e.g.* if the revising chamber has sustained any amendments) the bill is referred to a conference committee made up of equal numbers from both chambers and chaired by a member of the Senate. For bills referred to a single committee, the Senate conferees are typically the members of the relevant committee. Deputies committees tend to be larger (13 members *vs.* five for the Senate), so not all of the deputies from the relevant committee will be involved in the conference committee. The bill put forth by the conference committee is put to an up or down vote in each chamber, without the possibility of amendment.

If and when both chambers have approved the same version of the bill, it goes to the president. He can sign the bill, in which case it often goes to the Constitutional Tribunal for approval of its consistency with existing constitutional provisions, if a minimum number of Congress members or the President ask for it, and if provisions about the constitutionality of the objected part of the norm have been raised during the legislative process (objections at this stage tend to be genuinely related to constitutional issues, so that the Constitutional Tribunal does not act as a third legislative chamber, as it could if it were to abuse its authority). If the president does not wish to sign the bill, he can veto it in whole *or in part* and send it back to Congress. At this stage he can also offer “observations,” which are essentially amendments to the bill. Congress must first vote (up or down and without the possibility of amending them) on the “observations” offered by the president. Only if these are rejected does Congress proceed to a vote on veto override, which for most laws requires the approval of 3/5 of the members present in each chamber. If the veto is overridden, or if the “observations” are accepted, the bill is promulgated. If a successful presidential veto only applies to part of a bill, then the remainder of the bill is promulgated.

Constitutionally mandated supermajority thresholds for some special legislation contribute to offsetting the Executive’s substantial agenda-setting power. They range from an absolute majority of the total membership (as opposed to a majority of those present) up to two-thirds of the members. Those provisions permit a minority in one legislative chamber to block legislation. With the exception of the weakest threshold (a majority of total membership), the

*Concertación* has always faced the need to negotiate changes to legislation that require supermajority approval with the conservative opposition in at least one legislative chamber.

Other checks and balances the Executive must face are the three main enforcement institutions of the system: the Judiciary, the Constitutional Tribunal and the Comptroller General. These institutions are independent and politically insulated, and do not play any active role in legislation, but are strong independent checks on the Executive. The judiciary in Chile does not have judicial review powers, hence it plays no legislative role. As the main enforcement technology, however, it is an important check on the Executive for policy implementation.

The seven-member Constitutional Tribunal is appointed in staggered terms and it is politically balanced (as explained in the next section). The Constitutional Tribunal exerts ex-ante jurisdiction over legislation, so it can prevent legislation from being enacted if it violates the constitution, but cannot act “de officio;” it has to be asked by parties fulfilling special conditions in all matters but those having to do with changing the constitution or “organic laws.” In some cases, the Constitutional Tribunal is mandated to verify the constitutionality of legislation. In other cases it can do so if requested by the president or by at least one-fourth of the members of either chamber. Given its non-partisan composition, the Tribunal does not take an active role in shaping legislation by itself. It can be used by legislators to delay the discussion of a bill, however, as a small number of legislators can temporarily stop the discussion of the bill by sending it to the Tribunal to review its constitutionality.

The Comptroller General is appointed by the president with Senate approval (simple majority) and must retire at age 75. The *Contraloría’s* primary role is to oversee the administrative actions of the Executive, and it can exert control over executive orders and decrees issued by the president.

The 1980 Constitution gives the Armed Forces a political role as “guarantors of the Constitution,” whatever that may mean. Among the undemocratic enclaves through which the Armed Forces can interfere with the Executive’s policy agenda are their semi-autonomous status, their role in the COSENA and their power to nominate four of the nine institutional senators. The four branches of the Armed Forces are semi-autonomous and can dispose of their budgets without government oversight (they are entitled to receive 10 percent of the revenues of the state-owned copper company, CODELCO). As stated before, the president can only appoint the

head of each branch from among the five highest-ranking officers for four-year periods, but cannot dismiss them at will.

The COSENA is comprised of eight members: the President of the Republic, the Senate President, the Supreme Court President, the National Comptroller and the heads of the Army, Navy, Air Force and *Carabineros*. The COSENA appoints four of the nine institutional senators (who have to be former heads of each branch of the Armed Forces) every eight years, and two members of the Constitutional Tribunal. Because half of the COSENA members are Armed Forces officers, the Armed Forces can exercise veto power over who is elected to those posts. This has insulated the Armed Forces from direct civilian control, and has allowed the military to exercise some influence over the political process. Not only does the COSENA appoint four former heads of the Armed Forces to the highly contested and narrowly divided Senate, but it also appoints two of the seven members of the influential Constitutional Tribunal. While the COSENA has not taken an active role in the formulation of economic policy, it has been actively engaged in shaping the policies related to the human rights record of the former military regime, including the government's response to the arrest of General Pinochet in the United Kingdom in 1998.

The nine appointed senators are selected as follows: two are chosen by the outgoing president, three are selected by the Supreme Court (two must be former Supreme Court Justices and one must be a former Comptroller General), and four are selected by the COSENA. If a non-elected senator dies in office, a replacement is not named until the end of that senator's term. The outgoing dictatorship nominated all nine institutional senators in 1990, giving the right wing a majority in the upper chamber ever since. As time has passed, the *Concertación* administrations have been able to nominate some institutional senators. In 1997, President Frei nominated two senators, significantly altering the composition of the Senate for the remaining two years of his term. In 2005, when appointed Senate seats are to be filled again, President Lagos will be able to influence the composition of the Senate for the entire period of his successor's presidency, most likely giving the *Concertación* a majority for the first time.<sup>24</sup>

In sum, the combined effect of a de facto agenda-setting president, who has effective negotiating tools but is confronted with several checks and balances, produces a policymaking

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<sup>24</sup> Given the Constitutional reform been considered in Congress, this is a highly unlikely scenario. It is more probable that the appointed senators will be eliminated.

process in which legislation is not easily approved. But the very difficulty of approving legislation means that once a measure is approved, it is hard to overturn it. Passing a law in Chile represents a genuine policy commitment.

### ***3.3 Independent and Politically Insulated Enforcement Technologies and a Semi-Professionalized Civil Service***

As mentioned above, the main enforcement technologies overseeing Chile's political system are the Judiciary, the Constitutional Tribunal and the Comptroller General (*Contraloría General de la República*, or CGR). The 1980 Constitution establishes their absolute independence from other powers of the state and their institutional design successfully accomplishes that goal. All three institutions have nomination procedures that assure their independence from other branches of the state and avoid partisan biases in their composition.

The judiciary is composed of the Supreme Court, the courts of appeals and ordinary courts. The Supreme Court is the highest tribunal in the country and is composed of 21 judges. They are nominated by the president from a five-person list proposed by the Court, and have to be approved by two-thirds of the Senate. Judges cannot be removed until they are 75 years old, unless sanctioned for misdemeanors. There are 17 courts of appeals throughout the country, and their judges are designated by the president from a three-person list proposed by the Supreme Court.

The Constitutional Tribunal consists of seven members—three Supreme Court judges and four lawyers—who serve eight-year terms and cannot be removed unless impeached; a quorum of at least five members is needed to convene. The Supreme Court nominates the three judges through simple majority voting in successive and secret ballots; the president and the Senate nominate one lawyer each, and the COSENA nominates two lawyers. This nominating procedure ensures the Tribunal's technical capability and avoids partisanship in its rulings. The rulings of the Tribunal are not subject to appeals of any kind, though it can rectify previous rulings if it independently decides to do so.

The CGR is also autonomous and independent from political pressure. The Comptroller General is appointed by the president with Senate approval, and cannot be removed until he or she is 75 years old, unless impeached by the Senate based on a constitutional accusation by the Chamber of Deputies.

Even though all three enforcement technologies are nominated by other powers of the state, the correct combination of checks and balances assures their political independence. In all cases, the people who aspire to hold these offices cannot cater to the interests of one branch of the state alone and, once nominated, their non-removability insulates them politically so they may carry out their duties.

The CGR consists of the Comptroller General and the *Contralorías regionales*. The CGR controls the lawfulness of the state administration. It oversees both the centralized and decentralized organs and services of the state, and also any private entities that deal with the state and receive public funds of any kind. The CGR verifies the constitutionality and legality of the actions of administration, but it does not have punishing powers; it proposes measures to the appropriate authorities or presents a case to the courts. It regularly publishes bulletins setting the correct interpretation of norms and administrative procedures. The CGR is in charge of the general accounting of the nation and calculates the annual balance of the financial administration of the state. It also provides information and advice to the Executive and Congress.

The 1980 Constitution mandates that constitutional review in Chile be performed by two institutions: the Constitutional Tribunal (TC) for *preventive control*, and the Supreme Court for *repressive control* (ex-post review). In practice however, given that the Chilean legal system is based on civil law, Supreme Court rulings do not set a valid precedent for other similar cases, giving the Constitutional Tribunal de facto sole power to review for ex-ante constitutionality of laws. The TC has to review the constitutionality of all organic constitutional laws and laws interpreting the Constitution before they are promulgated, but as mentioned before when analyzing the legislative process, it can also review specific articles of any bill if requested by a certain number of members of congress during the discussion of a bill.

The Judiciary, headed by the Supreme Court, is the final and most important enforcement institution. It has to review all legal disputes in the country, enforce property rights, and hear all cases brought by the CGR regarding the legality of government actions.

### ***3.4 State Capabilities and Bureaucracy***

Chile is a unitary state; its main political divisions are 13 regions subdivided into provinces. The administration of the state is centralized in the central government in Santiago, with local branches of the central government located throughout the country. There is some degree of local decision-making at the municipal level, but there is no fiscal decentralization. Communities have

some opportunity to participate in local decision-making through consulting councils at the regional and provincial levels.

The head of the administration of the state is the President of the Republic. The bureaucracy is divided into ministries for sectorial administration and intendencies (*Intendentes*) and governorships for regional and provincial matters, respectively. The president can appoint and dismiss at will all 18 ministers, all *Intendentes* and all governors. Coordinating sectoral decision at the regional and local levels are the *Secretarías Regionales Ministeriales (SEREMIs)*, which administratively depend on the ministries but work with the *Intendentes* to implement the sectorial policies at the regional level. Finally, there are councils for local consulting at different levels, which incorporate local concerns, but have no decision-making power.

Chile's bureaucracy has undergone a profound reform process in the last 30 years. During the twentieth century it developed a reputation for low corruption levels by Latin American standards, but also was marked by strong centralization, an emphasis on procedures more than on outputs, and no participation of civil society or market mechanisms in the provision of public services, making it rigid and not very efficient. The major economic transformations carried out by the military dictatorship in the mid 1970s started a slow but incremental process of reform that led to major reforms in the late 1990s and early 2000s during the Frei and Lagos administrations. The military implemented structural economic reforms and reduced the size of the state by privatizing public companies and the social security system, deregulating several markets and improving the tax system. These reforms, however, were carried out in an ideological environment contrary to empowering the state, which led to under-investing in state capabilities and no effort to modernize the provision of public services.

After the end of the dictatorship, as both the nascent democracy and the new economic institutions gained popular support and consolidated, a gradual reform of the civil service has been taking place. The Frei Administration initiated a significant modernization of the state, which has been further developed by the Lagos administration after a scandal broke out in 2003 regarding the existence of a salary supplement system for ministers and deputy ministers. As of July 2004, the most important pieces of approved legislation addressed the following issues: simplifying administrative procedures (Law 19.880), updating the level of remuneration of high public officials to make it more in line with the private sector, and reducing the amount of undisclosed funds (Law 19.863), the professionalization of the public service in order to improve

and develop long-term careers in the civil service regardless of political changes (Law 19.882), and increasing the transparency of government procurement and the concessions system (Law 19.886).

Other bills still under discussion in Congress intend to decentralize the execution of social spending, modernize municipal financing, reorganize the state holding of public companies, improve the regulation of lobby activities and improve the capabilities of regional governments.

Changes to the administration of the state that do not require legislation and which are already in place include a wide range of e-government initiatives,<sup>25</sup> the modernization of the CGR and improvements in the performance indices for civil servants. The latter were introduced in the mid-1990s as experimental programs but have evolved to cover all central government institutions and are currently used to partially link salaries to measures of performance. They are regularly scrutinized by Congress during the annual discussion of appropriations as part of the budget allocation process.

Despite the ongoing effort to improve the capabilities of the state, Chile's bureaucracy is still too rigid and procedure oriented, and wages at the professional and high-responsibility levels in the public sector are lower than their counterparts in the private sector. These shortcomings lead to lower performance and at the end of the day contribute to a lower quality of public policy. It is important to emphasize that these criticisms of Chile's civil service are based on a comparison with OECD best practices and that the Chilean bureaucracy is highly competent by Latin American standards.<sup>26</sup>

### ***3.5 Interactions: The Policymaking Process in Chile***

While numerous features of the Chilean system have thus far been mentioned, the two most salient from the standpoint of implementing cooperative policies are (i) the existence of a small number of long-lived political parties that interact repeatedly with each other and with the voters and (ii) the existence of implementing institutions—the bureaucracy and the judiciary—that function honestly and with some degree of efficiency and transparency.

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<sup>25</sup> [www.gobiernodechile.cl](http://www.gobiernodechile.cl), [www.presidencia.cl](http://www.presidencia.cl), [www.elecciones.gov.cl](http://www.elecciones.gov.cl), [www.chilecompra.cl](http://www.chilecompra.cl), [www.dipres.cl](http://www.dipres.cl), [www.senado.cl](http://www.senado.cl), [www.camara.cl](http://www.camara.cl).

<sup>26</sup> For evidence on this, see the previous section on Policy Outputs and Policymaking Capabilities.

Repeated interaction between the parties not only makes it possible for them to make (and keep) policy deals, but it more importantly creates an incentive for the parties to maintain their ideological “brand names” with the voters—thus constraining the sorts of policy changes they align themselves with. Because the laws passed and executive decrees handed down are actually implemented, deals are credible, opening the door for policy agreements that involve inter-temporal trades.

While other noteworthy institutional features such as the agenda-setting powers of the Executive, the number and disposition of the veto players and the degree to which policymakers’ interests align on a given issue are important to the details of the policymaking process, Chile would achieve a much less cooperative policymaking process without its party structure and implementation technology, while neither changes in the Executive’s agenda-setting power, nor in the blocking capacity of the various veto players (insofar as it did not interfere with the equilibrium party structure or the integrity of the judiciary or the bureaucracy), nor a variation in the degree of interest-group alignment would rule out at least some degree of cooperation in policymaking.

To illustrate the relative impacts of the salient features of the Chilean PMP, it is useful to consider some examples of policy compromises. Two important reforms—the partial privatization of Chile’s major port facilities (*Ley 19.542*) and the approval of Chile’s special relationship with Mercosur—each led to improvements for the general public, and each came at the cost of a disadvantaged group. In neither case did the disadvantaged group enjoy a policy veto, yet in both cases the government committed itself to compensating the losers from the reform.

In the case of port modernization, the government faced the need for an expensive upgrading of Chile’s outdated port facilities. The massive capital outlay required would have placed enormous strain on the public budget, and so the government chose instead to grant long-term concessions to private investors in return for the investors undertaking specific construction projects. This route actually relieved the strain on the budget, since the private concession holders paid for the privilege of running the port facilities. The government calculated that the higher rates charged by the private service providers would be compensated by a more rapid processing of ships through the port, leaving overall shipping costs lower—something that in fact has happened, with transfers from port operators to the government far exceeding initial



estimations. However, this reform entailed replacing the existing state-owned enterprise EMPORCHI, which controlled most of Chile's ports, and it meant that existing EMPORCHI employees would lose their jobs. Given that the great majority of Chileans would be better off as a result of the proposed reform, the government could have simply scrapped EMPORCHI, lived with the ensuing strike and gone on with the reform.

However, the dominant *Concertación* coalition of left-of-center parties could only choose to abandon the EMPORCHI workers at the cost of violating some of its basic ideological premises regarding the treatment of workers, thus sending a signal to the rest of the labor movement that the government was not to be trusted. Because the *Concertación* parties were in a long-term relationship with organized labor, which they needed for electoral purposes, it was politically costly to simply abandon the port workers. Accordingly, the port reform included expensive "parachutes" for the dismissed dockworkers, such as educational benefits for their children, occupational retraining and funds for dismissed longshoremen to start small businesses.

The right-of-center opposition was much less ideologically constrained to compensate the dock workers, and the Executive could have formed a coalition of opposition legislators and some members of his own party coalition to push through the reform without expensive concessions to the dock workers. However, the constraining effects of ideology and of party reputation prevented the Executive from doing so.

A similar process played out in 1996 on an even larger scale with the passage of the government's trade agreement with Mercosur. This treaty would open attractive markets for Chilean pharmaceuticals manufacturers and reduce the price of food in Chile. The Mercosur countries were among the world's most efficient producers of vegetable oils, wheat and sugar. This threatened Chile's "traditional" agricultural sector, which was involved in the production of sugar beets and wheat. Both the *Concertación* and the opposition *Alianza* were electorally competitive in the adversely affected regions, so the government risked long-term alienation among adversely affected farm voters and eventual seat losses if it pushed the policy through with a majority coalition of legislators from outside the affected areas. Instead, the government persuaded almost all of its adversely affected legislators to vote in favor of the treaty, promising economic compensation to the affected farm areas.<sup>27</sup> This compensation actually arrived in the form of a budget reallocation equal to 3 percent of the 1999 budget, and in the form of

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<sup>27</sup> The fact that the districts are heavily biased in favor of rural areas was also a key factor.

redesigned price supports in 2003 that had the effect of extending temporary tariff protection to sugar beet growers. These latter shifts of resources were not trivial (the sugar tariff fell disproportionately on the poor) but the *Concertación* sustained them in order to preserve its reputation; long-term interaction with the voters made renegeing too costly.

In the case of the budget, the Executive enjoys even more draconian powers relative to Congress than in other “matters of law.” Nevertheless, congressional approval is required to pass a new budget (but if Congress does not address the government’s budget on time, the government’s initial proposal automatically becomes law). One possible outcome of Chile’s institutional structure would be for the opposition to follow a “scorched-earth” policy of voting against the government’s budget and forcing a constitutional impasse, given the practical ambiguities of the constitutional norm. However, this is not what happens; instead, budgets typically pass with majority support from both the government coalition and from the opposition. This is partly facilitated by rules limiting the government’s discretion in allocating funds, and by the independent supervision of expenditures by the *Contraloría General*—any efforts by the government to act in bad faith regarding budgetary allocations would be quickly detected.

But why would there be good faith to begin with? First of all, it exists because even the opposition wants to avoid a constitutional crisis caused by gridlock.<sup>28</sup> Moreover, the actual budgets reflect compromise solutions with the opposition, in which spending growth for favored government programs is slower than the Executive would prefer, giving the opposition something to point to as an achievement and restraining the growth of spending, even as the government can deliver a balanced budget and pass its programs. Without the ongoing reputations of the ruling coalitions, the temptation for individual legislators to play “blame games” by sabotaging new budgets and arguing over who was responsible might become overwhelming. Voters would then be stuck trying to sort out which maverick legislators were really to blame and which were in fact defending voters’ interests. The organization of the legislature and the Executive within the rubric of two electoral coalitions makes allocating blame much easier, and so increases the incentives for politicians to implement cooperative solutions.

Looking across policy areas, one can see that when the Executive has greater control over policy, as in the budget-making process, policies are closer to the Executive’s preferred outcome.

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<sup>28</sup> Something that is often on Congress’s mind when the final deadline approaches is the memory of the 1891 Civil War (the bloodiest conflict in Chilean history), which started after Congress rejected President Balmaceda’s budget.

Likewise, an alignment of interests facilitates the passage of legislation and reduces the probability of gridlock, which impedes resolution of the military government's human rights legacy, and which has hampered reform in areas such as education. However, even when the Executive is in a position to impose his will, he often makes concessions to adversely affected minorities. These concessions arise from the governing coalition's need to maintain its ideological "brand name" and its reputation for keeping its policy promises (as in the case of its favorable treatment of sugar beet farmers). The need to maintain a reputation, for the sake of ideological consistency and for the sake of being able to keep one's word, stems from the stability of Chile's political parties and their small number. This cooperative behavior is facilitated by the existence of good institutions for enforcement and implementation, and it responds, on margin, to variations in the institutional structure of the legislative process and to differences in the alignment of interest. However, it is the organization of policymaking around a small number of long-lived parties that is a decisive factor in the cooperative nature of policymaking in Chile. Without it, the remaining elements of the PMP could easily degenerate into non-cooperative behavior.

#### **4. Conclusion**

The policymaking process in Chile is characterized by an institutional structure in which a gauntlet of institutional veto players opposes an agenda-setting Executive. The institutions responsible for enacting policies into law are relatively transparent, honest and efficient, though there is significant variation on this last score. The electoral system (which is open-list d'Hondt with two member districts, and has selection within lists by plurality rule) has fostered the development of two ideologically distinct coalitions of political parties.

The small number of parties (there are five major parties) and their longevity make them vehicles for accountability, staking out credible ideological positions with the voters and cultivating reputations for fulfilling promises. Within this framework, the relative divergence or alignment of interests by the major actors influences the ease with which cooperative outcomes are reached.

The legislative institutions create pressures for selective gridlock, punctuated by policy changes that strain the tolerance of the veto players. However, the capacity of the system to actually implement the laws that are passed makes negotiations over policy outcomes

meaningful: policy debts are paid in the hard currency of policies that will actually be carried out, with verifiable contents. The party system, which is shaped by the electoral laws, creates an environment in which policymakers can break out of the structure of an agenda-setting president and a gauntlet of veto players to implement cooperative policy choices. Because there are relatively few parties and because they are longer lived than the individual politicians, they are willing to invest in their long-term reputations, which facilitates inter-temporal bargaining. While any change in the institutional details would influence the behavior of the system, we believe that it is the political party system that is the essential foundation for cooperation—change other features of the process (e.g., by weakening the Executive’s agenda-setting power, or by removing some of the veto players) and the parties (and voters) would adapt, but they would continue to cultivate their reputations, and this would lead them to continue to act as guarantors of inter-temporal bargains. Fracture the party system (e.g., by adopting a higher-magnitude electoral rule, or implementing a federal structure with powerful governors) and the *status quo* legislative institutions and bureaucratic capacity would fail to support cooperative policy outcomes.

## **Appendix: Case Studies to Provide Further Details on the Policymaking Process in Chile**

This appendix provides further details about the four cases alluded to in Section 3.2.

As noted, the small number of long-lived parties has the potential to facilitate cooperative policy outcomes, while the relatively efficient and honest bureaucracy and the independent and largely impartial judiciary facilitate transparency and credible enforcement, and also open the door to cooperation.

### ***1. Legislative Approval of Partial Accession to the Mercosur Treaty***

As noted above, an example of the ability of the export-promotion issue to overcome even well-entrenched interest groups can be found in the debates over ratifying Chile's special relationship with the Mercosur trading block. While the free-trade agreement with Mercosur was welcome news to some Chilean sectors, including pharmaceuticals and textiles, it implied the opening of a substantial breach in the dike of high tariffs that kept Brazilian sugar and Argentine wheat from flooding Chilean markets. This represented a boon for consumers, but it placed producers in Chile's "traditional" agricultural sector under considerable competitive pressure.<sup>29</sup>

Both of the major political coalitions were competitive in the affected regions, just as both enjoyed considerable support in the rest of the country. Thus, each coalition was cross-pressured, with some members representing the adversely impacted areas of traditional agriculture, but with a majority of their legislators from the rest of the country. At the same time, legislators were not ideologically neutral. Most of the *Alianza* legislators were ideologically inclined toward free trade.<sup>30</sup> Legislators in the left-of-center *Concertación* were more ambivalent about free trade, and were ready to use the power of the state to "defend" individuals from adverse market forces.

Thus, legislators on the ideological left elected from districts where traditional agriculture was important opposed the treaty on both ideological grounds and on behalf of their constituencies. Likewise, legislators on the right from districts where traditional agriculture was not important were pressured by both their ideologies and their districts to favor the treaty. The

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<sup>29</sup> Chile's traditional farmers are located mostly in the VII, IX, and X regions, and in parts of regions VI and VIII.

<sup>30</sup> The policy of the UDI party was unambiguously in favor of free trade. The RN party was divided, with a majority of its members in favor. At the moment of its foundation RN did include some economic nationalists who favored protection for domestic producers, however, during the middle 1990's the dominant position in RN was in favor of free trade (Allamand, 1999).

preferences of the remaining legislators were subject to cross pressures, with ideology and their districts tending to pull in different directions.

In addition to the pressures already mentioned, it was a *Concertación* president who brought the treaty to the Congress. Thus, members of President Frei's PDC, and more generally, members of the *Concertación*, were under party pressure to back the treaty. Likewise, the association of the treaty with the *Concertación* made it less attractive for *Alianza* members to vote for it. However, the president had substantially deeper pockets than the adversely affected members of the *Alianza*, and when it came to mobilizing their respective coalitions, President Frei was much more successful than were *Alianza* members from the region of traditional agriculture. Notice that both sides were pushing against the ideological predispositions of their members.

Carlos Carmona, a legislative adviser to President Frei, described the government's strategy for winning the approval of legislators from the affected area as "flying helicopters over the traditional agricultural regions, dropping money" (Carmona, 2003). In fact, given the indivisibility of the treaty, what the helicopters were dropping were IOUs, as is made clear in the speech of PPD deputy Felipe Letelier from the eighth region, where traditional agriculture was important:

...with this we are getting a visa that tomorrow will permit us to insist that our government's promises are kept in so far as backing the farm sectors affected by Mercosur and by other treaties. With luck we'll never have to use this visa that today has been given to us (Cámara de Diputados, 1996: 41).

What sort of promises were being made? Alvaro Garcia, the Minister for Economy, Development and Reconstruction, outlined some of the public commitments of the government (Cámara de Diputados, 1996: 24-27):

- To spend more money on government efforts to promote exports
- To emphasize lower tariffs on inputs for traditional agriculture when forming commercial treaties
- To spend more money on the technological development of agriculture
- To spend more money subsidizing grazing land, tree farms, and to include small farmers in the subsidies
- To expand subsidies for vocational education and for government centers designed to help businesses develop in rural areas
- To provide cheap loans (in dollars) to farmers

To support "environmentally sustainable" farming  
To spend more money on soil restoration.

These promises were not appended to the treaty. Instead, legislators had to trust that the government would keep them, something that was evidently easier for members of the *Concertación* than for *Alianza* members. When the vote came, the treaty won approval by a vote of 76 in favor, 26 against, with three abstentions (Cámara de Diputados, 1996: 63-64). Not a single member of the *Concertación* voted in opposition. In contrast, the opposition was divided, with many members voting on both sides of the bill in the Chamber of Deputies, while many party leaders were simply absent on the day the vote was taken.

By the time the Mercosur treaty reached the Senate, the government's promise of largess had made it clear that the bill was virtually a *fait accompli*. By then the *Alianza* senators had all but abandoned their efforts to mobilize their coalition against the treaty, which passed by a lopsided margin. Only a relative handful of *Alianza* senators voted against it.

In order to ratify the treaty, President Frei used his agenda-setting powers to make a "take it or leave it" offer to Congress; it had to be voted upon without the possibility of amendment. Moreover, the issue placed stress on both coalitions, with both opposition and government legislators pushed to vote against their ideological leanings. Yet, the passage of the treaty was more than just a simple exercise in agenda control. President Frei had more weapons in his arsenal, and he used them. By offering considerable compensation to the affected districts, he sought to remove the pressure to vote against the treaty that would otherwise have been brought to bear on *Concertación* legislators with constituents in traditional agriculture. He was able to make this work because the political parties of the *Alianza* could make credible commitments to their members. Thus, disciplined political parties expanded the set of possible intertemporal trades. In this case, the parties made it possible for members to vote in exchange for an IOU from President Frei.

However, IOUs or no, the days of the domestic wheat and sugar industries are numbered under the Mercosur agreement. Starting in 2007, tariffs on sugar and wheat will gradually fall, reaching zero by 2014. Competing with some of the world's most efficient producers, most wheat farmers and perhaps all sugar beet farmers will be forced to grow other crops, or to abandon their farms. Massive layoffs at IANSA (which processes domestically grown beet sugar) have already begun.

## ***2. Legislation on Price Bands for Traditional Agriculture***

Part of the bargain facilitated by the party system to enact Mercosur was the promise to compensate adversely affected regions. In the spring of 2003, these promises were called in by the sugar beet farmers. By then, the sugar beet industry of Southern Chile was in severe decline in the face of competitive pressures unleashed by Mercosur. Sugar prices were falling steadily, and between 2002 and 2003, domestic production of sugar fell dramatically.<sup>31</sup> Domestic sugar producers were incensed, staging protests that included public demonstrations and road closings. The policy bargain struck in 1996 by the Frei administration to ratify Mercosur was under threat.

At the same time, the WTO dispute resolution organization, acting on a complaint by Argentina about arbitrariness in the application of “stabilizing tariffs” against Argentine wheat, handed down a decision demanding that Chile reform its system of price stabilizing tariffs. The government used this reform as an opportunity to adjust tariff protection for sugar beet farmers upwards.

Throughout the 1980s and 1990s and into the current decade, Chile employed a system of conditional tariffs intended to “stabilize” prices for sugar, wheat and vegetable oils. This system was centered on a pair of prices meant to bracket the “normal” price range for a given commodity. If the price of an imported shipment of the commodity fell below the lower end of this range, the applied tariff was increased, whereas if the price of an import shipment rose above the high end of the range, the normal tariff was reduced. In 2000, Argentine farmers protested to the WTO that the method for determining the floor and ceiling prices on individual shipments of wheat was too arbitrary. However, their complaint did not involve the price bands for sugar, nor did the WTO resolution of October 2002, which was mostly in favor of Argentina.

The WTO sentence forced the Chilean government to legislate revisions to the system of price bands. To not do so would result in the application of WTO penalties against Chile. Yet, the reform backed by the government was not neutral with respect to other policies, and it included a change in the system of price bands applied to sugar. This change in price bands included a one-time increase in the floor of the price band (from a 2002 average of \$US 292 per metric ton to \$310 per ton), which was then set to decline gradually until the system would expire in 2014.

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<sup>31</sup> In 2002 Chile produced 3.5 million tons of sugar, whereas in 2003 domestic production plunged to around 2.1 million tons. Likewise, 47,413 hectares of Chilean farmland was devoted to sugar production in 2002, but by 2003 that area had shrunk to a mere 27,192 hectares.



Thus, the government of *Concertación* President Ricardo Lagos, a PPD member, used its agenda control to transfer rents from the remainder of the country (for whom the price of sugar would rise) to the sugar beet farmers. This was not an automatic feature of the legislation passed at the time of the treaty. Instead it required presidential initiative.

When the sugar beet growers were up against the promotion of Chile's exports, they lost. But this was not because they were a weak and inconsequential interest group. As an interest group rich in swing voters, they had more than enough political clout to face off against the consumers and candy manufacturers. Thus, the victory of the Mercosur treaty over the objections of the beet farmers attests to the vitality of Chile's export-oriented vocation, rather than to the weakness of the sugar growers.

### ***3. Privatization of the Water Works***

The privatization of state-owned enterprises is perhaps the epitome of the neoliberal reforms of the 1980s. One such reform contemplated by the military government when the transition toward democracy occurred, but never materialized, was the privatization of the sanitary services (sewers and water works). However, the subsequent *Concertación* governments strove to improve economic efficiency and moved forward with the process of privatization, albeit somewhat carefully.

Chile's system of sanitary services developed incrementally throughout the twentieth century under centralized state control. Under that system, the same entities running the state companies that provided the sanitary services had both regulation and oversight responsibilities, creating an apparent conflict of interest. In 1988, the Pinochet regime introduced the main elements of the system currently in place. The new system created a new independent regulatory agency, the *Superintendencia de Servicios Sanitarios*, and divided the state provider into 13 independent—but state-owned and operated—companies.

Since its inception, the system has been remarkably stable to changes in the political arena, and flexible to new social and economic challenges. During the three administrations after the transition to democracy, several reforms were been introduced to increase efficiency while maintaining the original structure and goals of the system. The main reform was the one intended to privatize the 13 state companies mentioned above and improve the regulatory agency. The sanitary system is part of a government-wide policy to decentralize the provision of social services, using the private sector to increase efficiency and encourage investment in

infrastructure while overseeing and regulating these industries through independent technically capable regulatory agencies. There is wide consensus in Chile that this system has increased the nation's welfare and that it is intended to provide for the public good.

The *Concertación's* goals of making safe drinking water available to all Chileans and undertaking expensive sewage treatment, combined with rapid growth in some areas such as metropolitan Santiago, required an investment of US\$1.3 billion over the period 1995 to 2000. To sustain an investment of this magnitude, the Frei administration sought to privatize Chile's water works and sewage systems, replacing the state-owned enterprises then in charge of the system with regulated investor-owned utilities.

While the *Concertación* supported the president's goal of universal access to clean drinking water, many of its members disliked the resort to privatization. The opposition parties on the right, however, were favorably disposed toward the legislation. In contrast with the agricultural policy initiatives discussed earlier, Frei's proposal to privatize the water system met with the general approval of the opposition, while members of his own coalition needed to be brought around through the use of party discipline. In May 1995, Frei introduced legislation in the Senate to privatize the water works. Legislators on the right strove to amend the bill in an even more free-market direction. While Sergio Bitar (PPD) opposed many of the right's amendments to the bill in committee, the *Concertación* delegation supported the amended bill, which it accurately predicted would not be approved in the same form by the Chamber of Deputies, forcing the use of a conference committee.

The repeated application of executive *urgencias* was vital in moving the proposed reforms through the Senate and subsequently through the Chamber of Deputies. Also vital was the Executive's appeal to party discipline. Because of *Concertación* opposition to the presidential initiative, it was necessary for Frei to sign an agreement protocol with *Concertación* deputies to secure their favorable vote for the project.<sup>32</sup> After the bill had spent two months in committee, the Minister of the Presidency, Juan Villarzú, and *Concertación* deputies signed a protocol on December 23, 1996 in which the Executive promised to sponsor amendments to essentially restore the bill to its original content, leaving the state in control of up to 35 percent of the large EMOS and ESVAL utilities (though allowing smaller utilities to be 100 percent

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<sup>32</sup> One of the leaders of the Alianza, Andres Allamand (RN), publicly referred to the existence of this protocol, which *Concertación* Deputy Juan Carlos Latorre (DC) defended.

privatized). By retaining such a large ownership share, the state effectively reserved itself veto power over company operations in EMOS and ESVAL.<sup>33</sup> After the protocol was signed, the committee swiftly produced its report. At that point, the president gave this legislation high priority *suma urgencia* and the Chamber favorably voted on it the next month. The Executive's need for an accord illustrates a key weakness behind his urgency powers: he can force Congress to give him an answer within a given time limit, but he cannot guarantee that the answer will be to his liking.

The approval by the two chambers of Congress of widely disparate versions of the same bill on a highly technical topic is an invitation for the involvement of special interests. This is because the two versions must be considered by a conference committee, which involves a small number of legislators, and whose bill is considered by the two chambers under a "closed rule," that is, without the possibility of amendment. Nevertheless, in this case the main points of disagreement were not very technical and had to do with the degree to which privatization implied the end of government control over the newly privatized utilities. The main provisions sought by the *Concertación* were endorsed by the conference committee, and subsequently enacted into law.<sup>34</sup>

Despite the adverse impact on government workers in the state-owned water works, and notwithstanding ideological misgivings on the left of the government's coalition, the Frei Administration was able to gain the approval of the key veto players needed to pass this efficiency-promoting initiative. Not to have done so would have meant either not expanding the water and sewer facilities in economically dynamic areas of the country, or having to raise the money publicly. Although the Administration did moderate somewhat the details of the privatization plan, economic growth largely trumped the policy preferences of some core members of the president's support coalition. Ironically, the law was amended in 2003 at the request of the same legislators who insisted on the protocol, to allow for the sale of the remainder of the shares under government ownership and to make room for more public expenditure.

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<sup>33</sup> This veto rests on a provision of the laws governing *sociedades anonimas*.

<sup>34</sup> At that stage, the opposition senators were forced to choose between what they regarded as a less than ideal level of privatization, or no privatization at all. They voted for the former.

#### ***4. The Budget Process***

The budget process is one of the most successful areas of policymaking in Chile. The wider institutional arrangements described in this paper are conducive to good policy outcomes in economic matters. The clearest evidence of this is the steady reduction in the size of the public debt from 42.7 percent of GDP in 1990 to about 12 percent today (DIPRES, 2004a). The budget process, however, enjoys an even more sophisticated institutional setting than most other economic policy areas, which is the result of an evolution over the last 30 years. In 1975, fiscal reforms unified the control of public finances under the Finance Ministry, and more specifically under the Central Budget Office (DIPRES). Since the transition to democracy, the three center-left administrations have improved the system in order to increase its efficiency and transparency, and to protect it from political pressures. Throughout the 1990s, Chile enjoyed fiscal surpluses while repaying most of its public debt and since 2001, the Lagos Administration has implemented the structural surplus rule of 1 percent of GDP as an explicit ex ante rule limiting spending according to medium-term macroeconomic forecasts.

Beginning in 1994, the Finance Ministry and DIPRES developed a series of institutional transformations geared toward changing the focus of government action from inputs to outcomes (DIPRES, 2003). These transformations in the execution and control stages were developed in close relation to the preparation and approval phases, obtaining important synergies and gradually changing the role of the DIPRES.<sup>35</sup>

The institutional arrangements governing Chile's public expenditure management (PEM) system are spelled out in the Chilean Constitution (1980) and the State Financial Management Law (*Ley Orgánica para la Administración Financiera del Estado, LOAFE, 1975*). The Budget Law attempts to be fully comprehensive of general government operations, central government operations (revenues, expenses and financing), and all transfers between the central government and other state entities like public enterprises and municipalities.<sup>36</sup>

These formal rules governing the budget process give strong powers to the Executive, making Chile one of the countries with the most hierarchical budget institutions in Latin America

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<sup>35</sup> This changing role of the Budget Office is part of a wider trend experienced in most developed countries (Schick, 2001).

<sup>36</sup> The only exceptions are some operations of the Copper and Oil Stabilization Funds and the transfers and expenses of the Armed Forces covered by the law that allocates them 10 percent of the revenues of CODELCO, the state copper company. However, all those operations have to be authorized by the Ministry of Finance under the LOAFE.

(Alesina et al., 1999; Vial, 2001). As stated above, the constitutional responsibility for the financial administration of the state belongs to the president via the finance minister, and more specifically the budget director. They are in charge of setting spending limits, leading the negotiations with the spending agencies during the preparation stage, and overseeing the execution and control stages.

The Executive has the sole legislative initiative in areas such as taxation, social security and labor regulations and legislators are not allowed to introduce amendments that raise spending or create any financial commitments. Until the 2001, the budget process did not have any ex ante spending limits. The Lagos Administration introduced a structural surplus rule of 1 percent of GDP based on long-term projections of GDP growth and average expected prices of copper.

Every legislative proposal by Congress that has financial implications has to be accompanied by a financial report prepared by the Budget Office (Ministry of Finance) with an estimate of the financial impact of the project and the sources of finance under the current budget law. The Public Finances Committee of each chamber has to review the specific articles that have financial implications.

The Executive has the sole responsibility for the overall revenue estimates and the presentation of a medium-term macroeconomic program, which is presented to Congress' Special Budget Committee by the finance minister at the opening of the budget debate. Congress cannot vote on sources of revenue and cannot modify expenses linked to entitlements granted under permanent laws, in which the government has to spend as much money as needed in order to cover legal obligations. Congress cannot increase expenses in any item; it can only reduce or reject expenses proposed by the Executive as long as it does not interfere with the ability of the government to run state policies or meet previous legal commitments. Additionally, Congress has 60 days to approve the Budget Law sent by the Executive; otherwise the Executive's original proposal becomes law.

Another aspect that increases the Executive's control of the budget process is the fact that there is no co-sharing of any kind of taxes with regional governments. The regional governments' operating expenses are determined in the National Budget and the resources for investment by the regional governments are allocated to the Regional Development Fund (FNDR), which is distributed among regional governments using a preset formula.

Local governments (municipalities) have their own sources of revenues (land taxes and commercial permits) as well as resources that come through the education and health budgets, which are allocated at the local level using voucher systems (education) or via a per-capita basis (primary health services). Municipalities are barred from borrowing by the Constitution.

The emission of public debt must be authorized by Congress, so the Budget Law usually carries an article setting an upper limit for public debt to be issued in the year. The government cannot extend its guarantee to public-sector companies unless authorized by law. The practice so far has been to pass a law every five to 10 years that sets a global limit that is used up gradually, with periodic information provided to Congress regarding drawings against that authorization.

In sum, the wider institutional arrangements that govern Chile's PEM are consistent with the indices developed by Alesina et al. (1999), and by the related frameworks developed by Von Hagen (1992) and Eichengreen, Hausmann and Von Hagen (1996). PEM institutions are hierarchical and relatively transparent, giving a high standing to the finance minister in determining spending limits, leading negotiations with spending agencies, promoting bilateral meetings with them at the preparation stage and setting high constraints for Congress to amend the government's budget proposal. Additionally, the minister limits the Executive's borrowing autonomy and bars municipalities' borrowing rights.

One potential weaknesses of the current institutional setting is the lack of institutionalization of the ex ante spending limits. As stated before, the structural surplus rule followed by the Lagos Administration is voluntary, and future governments might decide against it. Also, even though there has been important progress in improving transparency, there is still room for improvement at the medium and lower levels of government.

#### *4.1 Preparation Stage*

Given the strong presidential powers, including the Executive's ability to remove any Cabinet or top government official at will, the government's internal budget process depends very much on the president's style and preferences. The LOAFE gives the minister of finance, through the Budget Office, the responsibility for preparing the budget proposal. However, given the complexity of the tasks, the tradition has been to delegate most of the responsibility and the

initiative for the budget preparation to the Budget Office, one of the most professional, centralized and hierarchical institutions in the Chilean state.<sup>37</sup>

The normal budget process starts toward the end of the first quarter of the year, with an internal review of the budget assumptions and guidelines by the Budget Office, which is conducted simultaneously with the preparation of the medium-term financial program (three years).<sup>38</sup> After an initial framework has been set, spending limits and other criteria are communicated to the government agencies in June. Preliminary budget proposals by the agencies are received by the Budget Office by the end of that month, and July is devoted to bilateral technical meetings involving budget office officials and agencies' financial managers, up to the level of deputy ministers. A preliminary budget proposal is prepared by the Budget Office in August to be presented to the minister of finance and the president. After that, a last round of bilateral meetings occurs between the minister of finance, the budget director and the political and financial authorities of each of the public agencies to iron out pending issues before the official submission to Congress by the end of September.

Agreement between agencies and the Ministry of Finance are reached in that last round, but there are a few cases in which the president has to solve conflicting points. The tradition so far has been for the president to delegate this task to the minister of finance, after the general framework has been set and major priorities have been identified in the earlier stages of the process.

#### 4.1.1 Rigidities in Government Spending

One of the problems that has become evident in recent years is the great rigidity of government spending in the short-run, to the point that the resources available for “discretionary” allocation in the budget law represent a marginal proportion of the total amount each year. This severely limits the possibilities of fiscal policy, especially in the context of strong spending restrictions. While the LOAFE, and later the 1980 Constitution, did away with the possibility of enacting

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<sup>37</sup> The Budget Office (DIPRES) is a relatively small institution with about 180 employees, consisting mostly of career professionals (80 percent), with a majority of economists, public administrators and some lawyers. It is responsible for preparing and managing the budget of the central government, approving and supervising the budget of state companies and intervening in the preparation and reporting of all law projects that involve financial commitments by the government. It has a very strong tradition of non-partisan professional careers, which have carried through the military regime and the restoration of democracy after 1990.

<sup>38</sup> Since the inception of the structural rule, the process has changed slightly at this stage given that there are ex ante spending limits (DIPRES, 2002).

taxes to finance specific expenditures, this did not completely eliminate the budget rigidities, many of which grow out of the need to ensure certain essential payments.

Rigidities are not limited to expenditures fixed by law, however. Some grow out of contracts, the most important being those derived from investment projects, which often have an implementation horizon far greater than the budget year. Experience indicates that the “typical” spending profile of the Public Works and Social Housing Ministries investment budget is approximately 25-30 percent in the year in which the projects get underway, 40-50 percent in the second year and 25-30 percent again in the third year. These “holdover” expenses for investment projects initiated in previous years amounted to 10 percent of total approved spending. This leaves less than a quarter of the budget as a component that can be affected during the budgetary exercise.

#### *4.2 The Approval Stage*

The Constitution determines that the budget bill must be sent to the Chamber of Deputies before October 1. Congress then has 60 days to dispatch the law in its totality, otherwise the bill sent by the Executive goes into effect. So far, the budget law has always been approved on time.

Given its singular nature, the budget bill has been granted a special legislative procedure mentioned in the Constitution. It is submitted to the Chamber of Deputies, which sends it to the Special Budget Committee, which consists of 26 members—an equal number of deputies and senators—and is traditionally chaired by the president of the Senate Finance Committee. The finance minister formally opens the debate on the bill with a presentation to the Special Committee on the public treasury statement, which is an analysis of the medium-term macroeconomic situation of the country. Five subcommittees are then created, which distribute the analysis of the various budget lines among them. The budget director opens the debate of the first subcommittee with a presentation on the budget’s macroeconomic aspects.

The budget bill rules give the sub-committees special significance in the approval process, since subsequent revisions by the full Special Budget Committee concentrate only on modifications to the original project. So if the subcommittee does not make any amendment to a given ministry budget, then it cannot be modified in the following steps. The only exceptions to this rule are amendments presented when discussing the project before the floor of the full chambers.



After approximately two weeks of work in subcommittees, the Special Committee meets in plenary to issue its report, which then moves to the Chamber of Deputies for approval. The bill approved by the Chamber of Deputies is then sent to the Senate for approval. If the latter makes no modifications to the version approved in the Chamber, it is ready for dispatching. If there are changes, the Chamber must vote on them, and if approved, the process ends there. If there are discrepancies, the bill must be sent back to the Special Budget Committee, which acts as a mediating body to hammer out and approve an alternative that is then sent to both chambers of Congress to be voted up or down (without further changes). During the legislative process, the government can introduce amendments to the original proposal at any time, requiring only the signature of the president and the finance minister, with no further legal restrictions than those that apply to the Budget Law.

In the 1990s, the Executive's party coalition—the *Concertación*—consistently had a broad majority in the Chamber of Deputies (and its Finance Committee) but had a minority in the Senate due to the presence of designated senators. The Senate opposition majority narrowed significantly in 1998, when the *Concertación* government nominated several of the designated senators. Starting in 2000, when former President Frei became a lifetime senator and with the *de facto* withdrawal of former President Pinochet,<sup>39</sup> the majority changed in the Senate, allowing the *Concertación* to attain a majority on the Special Budget Committee.<sup>40</sup>

The situation described above has made the Senate the decisive political negotiating body for passing the budget bill, although there has always been participation by and consultation with the deputies who partake in the Finance Committee.

The relatively few actors involved in the legislative process, their long time horizons, and their repeated interaction in other legislative initiatives give Congress significantly more negotiating power than it appears to have in the formal rules. This power has been used, and agreements have been reached in virtually every year allowing the passage of the bill with broad majorities in both chambers and within the deadlines established in the Constitution. These agreements have resulted in setting overall current and investment spending limits, restricting the

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<sup>39</sup> After Pinochet's arrest in England and his return to Chile, the two main coalitions negotiated a retirement of Pinochet from public life.

<sup>40</sup> It is worth mentioning that in the 1990 drawing to define the composition of the Senate commissions, the only one that ended up with a *Concertación* majority was precisely the Finance Committee. This composition has remained unaltered since then, although the Special Budget Commission has had an equal number of opposition and government senators up to now.

margins of flexibility enjoyed by the executive branch in the LOAFE. In addition, conditions have been placed on the provision of information and evaluation of various government programs, and the amount for freely available use in the Public Treasury's Provision has been limited.<sup>41</sup> In the second half of the 1990s, these agreements were formalized into protocols that clearly identified a set of commitments of this sort that the Executive assumed as a condition for expeditious approval of the budget.

An important factor that has allowed for successful negotiations on these themes has been the absolute leadership exercised by the finance minister, as the Executive's representative, in guiding the legislative process. The sectorial ministers are normally limited to presenting and defending the budgetary proposals for the services under their control in the initial stages of work in the Special Budget Committee's subcommittees. After that, the entire process continues under the baton of the finance minister and the budget director—in direct consultation with the president—who must sign all observations presented by the Executive that diverge from the original project.

Many of the Executive's observations arise precisely out of the legislative discussions, but they have to be sent by the Executive as they are matters of its exclusive legislative initiative. Major adjustments have been made on a couple of occasions to budget items that have affected nearly all state institutions. They have generally been made at the finance minister's initiative, but without having to pass through a discussion with each minister.<sup>42</sup>

#### *4.3 Execution Stage*

The execution phase starts in December, before the approved budget for the following year comes into effect. DIPRES submits an execution program to the finance minister setting the rules and norms for the execution of the budget of the public sector and specifying contingency rules and priorities for transfers, increases, reductions and other budgetary modifications. DIPRES

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<sup>41</sup> This provision is the fund that allows lines to be supplemented over the course of the year to deal with contingencies, emergencies and spending deriving from the application of laws approved during the budgetary exercise. This is one of the lines that have received the greatest attention during the budget debate. For more background, see Vial (1997).

<sup>42</sup> In 1990, general cuts were made to variable expenditures to adjust to the new macroeconomic scenario generated by the oil crisis related to Iraq's invasion of Kuwait. In 1999, 3 percent of spending on consumer goods and services (which excluded the Ministry of Health) was reallocated to finance the spending commitments for agricultural support, agreed to as a consequence of the legislative approval of Chile's incorporation into Mercosur.

also has to support the execution of the budget by spending agencies by requiring and facilitating information.

During the execution year, DIPRES is required by law to present monthly and quarterly Budgetary Execution Reports for the central government to the finance minister and Congress. And also it has to present reports on law initiatives that have a financial impact on the state. The Executive is required to issue monthly Reports on the Budgetary Execution of the Public Sector, and to publish a *Balance de Gestión Integral* on April of the following year.

The budget offices within the spending agencies and ministries have to ensure that the execution of the budget is done in compliance with the norms and rules established by DIPRES.

During the execution phase, the Executive needs congressional approval to increase the use of resources in certain matters, reallocate resources between ministries and increase the funds to state-owned companies. Since the creation of the Special Budget Committee, Congress has developed a higher specialization on budget matters and has assumed a more active role in the execution and control stages of the budget.

In the last five years, the execution of the budget by the central government has fluctuated between 97 percent and 99.8 percent of the approved budget, and its disbursement is linear throughout the year (IMF, 2003).

#### *4.4 Control Stage*

The two main institutions in charge of budget compliance are the *Contraloría General de la República* (CGR) and DIPRES. The first is in charge of ensuring compliance to laws and rules related to the management of state agencies' resources, and to audit their financial reports. It also has the sole ability to investigate and examine the state's debts and loans, and control all revenues and investments of the central government, municipalities and other state agencies. Finally, the CGR is responsible for the general accounting of the country. All CGR documents are made public.

The CBO also shares responsibility for the control of the decentralized agencies' expenditures, and it has to require and provide any information to these agencies in order to facilitate their budget management. By law, all government agencies have to have internal budget and audit offices in order to help ensure budget compliance.

Since the restoration of democracy, there has been a constant effort to improve the budget process, with special emphasis on budget discipline, execution and control. Together with the ex

ante spending limits established by the structural fiscal surplus rule, the most significant reforms to the budget process have been at the control stage. Between 1994 and 1997, performance indices and a system of evaluation of government programs were developed. In an effort to improve individual institutions management, the Integrated Management Balances were created in 1997 and were improved in 2000. In 1998, the government developed a program to evaluate the impact of different government programs through the Management Improvement Programs (PMG). And along the same lines, in 2001 it developed a program of Competing Funds for the most efficient government programs in different areas. Most recently, in 2002, a new and more comprehensive performance measurement program was created called Comprehensive Expenditures Evaluation. All these reforms are in line with developments in budget control in most OECD countries.<sup>43</sup>

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<sup>43</sup> OECD (2002).

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