Changes in Labour Laws under the Authoritarian Government in Chile: Revisiting Douglass North’s New Institutional Economics

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Ulises Garcia
Statement of Authentication

The work presented in this thesis is, to the best of my knowledge and belief, original except as acknowledged in the text. I hereby declare that I have not submitted this material, either in full or in part, for a degree at this or any other institution.

Ulises Garcia
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Abbreviations

AAR  *Alianza Anti-Revolucionaria;* Anti-Revolutionary Alliance

ABIF  *Asociación de Bancos e Instituciones Financieras de Chile;* Association of Banks and Financial Institutions of Chile

AD  *Alianza Democrática;* Democratic Alliance

AFL-CIO  American Federation of Labor and Congress of Industrial Organizations

APL  *Alianza Popular Libertadora;* Popular Freedom Alliance

BHC  *Banco Hipotecario de Fomento;* Bank of Mortgage Development

BOP  Balance of Payments

CCC  *Cámara Central de Comercio;* Central Chamber of Commerce

CChC  *Cámara Chilena de la Construcción;* Chilean Chamber of Construction

CESEC  *Centro de Estudios Socio-Económicos;* Centre for Social and Economic Studies

CICYP  *Consejo interamericano de comercio y producción;* Inter-American Council for Trade and Production

CNC  *Cámara Nacional de Comercio;* National Chamber of Commerce
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<th>Acronym</th>
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<td>CNI</td>
<td><em>Central Nacional de Informaciones</em>; National Information Centre</td>
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<tr>
<td>CNS</td>
<td><em>Coordinadora Nacional Sindical</em>; National Co-ordinating Committee of Workers</td>
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<tr>
<td>CNT</td>
<td><em>Comando Nacional de Trabajadores Chilenos</em>; Nacional Workers’ Command</td>
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<tr>
<td>COAJ</td>
<td><em>Comité Asesor de la Junta</em>; Advisory Committee to the Junta</td>
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<tr>
<td>COPACHI</td>
<td><em>Cooperación para la Paz en Chile</em>; Committee of Cooperation for peace</td>
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<tr>
<td>CORFO</td>
<td><em>Corporación de Fomento de la Producción</em>; Development Corporation of Chile</td>
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<tr>
<td>CPC</td>
<td><em>Confederación de la Producción y Comercio</em>; Confederation of Production and Commerce</td>
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<tr>
<td>CPI</td>
<td>Consumer Price Index</td>
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<tr>
<td>CRAV</td>
<td><em>Compañía Refinadora de Azúcar de Viña del Mar</em>; Sugar Refining Viña del Mar</td>
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<tr>
<td>CTC</td>
<td><em>Confederación de Trabajadores de Cobre</em>; Confederation of Copper Workers</td>
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<tr>
<td>CUT</td>
<td><em>Central Única de Trabajadores</em>; Central Union of Workers</td>
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<tr>
<td>DINA</td>
<td><em>Dirección Nacional de Inteligencia</em>; Directorate of National Intelligence</td>
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<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>FPMR</td>
<td>Frente Patriótico Manuel Rodríguez; Manuel Rodriguez Patriotic Front</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<td>ISI</td>
<td>Import Substitution Industrialisation</td>
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<td>LIBOR</td>
<td>London Interbank Offered Rate</td>
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<td>MAPU</td>
<td>Movimiento de Acción Popular Unitaria; Movement for Unitary Popular Action</td>
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<tr>
<td>MDP</td>
<td>Movimiento Democrático Popular; Democratic Popular Movement</td>
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<tr>
<td>MIR</td>
<td>Movimiento de la Izquierda Revolucionaria; Movement of the Revolutionary Left</td>
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<td>MNC</td>
<td>Multinational Corporation</td>
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<td>MNS</td>
<td>Movimiento Nacional Socialista de Chile; National Socialist Movement of Chile</td>
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<td>NIE</td>
<td>New Institutional Economics</td>
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<tr>
<td>ODEPLAN</td>
<td>Oficina Nacional de Planificación; National Office of Planning</td>
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<tr>
<td>PAL</td>
<td>Partido Agrario Laborista; Agrarian Labour Party</td>
</tr>
<tr>
<td>Code</td>
<td>Full Name</td>
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<tr>
<td>PCCh</td>
<td><em>Partido Comunista de Chile</em>; Communist Party of Chile</td>
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<td>PD</td>
<td><em>Partido Demócrata</em>; Democratic Party</td>
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<tr>
<td>PDC</td>
<td><em>Partido Democrática Cristiana</em>; Christian Democratic Party</td>
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<tr>
<td>PEM</td>
<td><em>Programa de Empleo Mínimo</em>; Minimum Employment Program</td>
</tr>
<tr>
<td>PN</td>
<td><em>Partido Nacional</em>; National Party</td>
</tr>
<tr>
<td>POJH</td>
<td><em>Programa Ocupacional para Jefes de Hogar</em>; Occupational Program for Heads of Household</td>
</tr>
<tr>
<td>POS</td>
<td><em>Partido Obrero Socialista</em>; Socialist Workers’ Party</td>
</tr>
<tr>
<td>PS</td>
<td><em>Partido Socialista</em>; Socialist Party</td>
</tr>
<tr>
<td>PyL</td>
<td><em>Patria y Libertad</em>; Fatherland and Liberty Nationalist Front</td>
</tr>
<tr>
<td>SENCE</td>
<td><em>Servicio Nacional de Capacitación y Empleo</em>; National Training and Employment Service</td>
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<tr>
<td>SFF</td>
<td><em>Sociedad Fomento Fabril</em>; Society for Industrial Development</td>
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<tr>
<td>SNA</td>
<td><em>Sociedad Nacional de Agricultura</em>; National Agrarian Society</td>
</tr>
<tr>
<td>SONAMI</td>
<td><em>Sociedad Nacional de Minería</em>; National Mining Society</td>
</tr>
<tr>
<td>UDT</td>
<td><em>Union Democrática de Trabajadores</em>; Democratic Workers Union, formerly known as the Group of Ten</td>
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<tr>
<td>UP</td>
<td><em>Unidad Popular</em>; Popular Unity</td>
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Abstract

This thesis explores the reasons why particular neo-liberal labour laws took a long time to be implemented in Chile. It also considers the manner in which particular neo-liberal labour laws were implemented. The period under analysis is 1973 until 1982, the duration of the authoritarian government of Army General Augusto Pinochet. The thesis examines the three main actors with an interest in labour legislation. These include labour, business and the polity. The thesis also explores the contribution of Douglass North’s New Institutional Economics (NIE) in addressing the above problems.

This thesis uses a case study method in order to understand why the implementation of particular neo-liberal labour laws was delayed and how particular neo-liberal labour laws were implemented. The case study is based on documentary sources and data archives and uses sources from a variety of disciplines in answering the thesis questions. The results of the case study form the foundation of the assessment of North’s NIE. The thesis asks whether the established critique of North’s NIE and this thesis’s extension of that critique can be supported by the results from the case study.

The thesis discovers that the reason for the delay in neo-liberal labour laws may be attributed to the multi-polarity of the Chilean government and the different intellectual traditions within the Chilean armed forces. The different intellectual traditions of the branches of the armed forces meant that it would take time for the neo-liberal intellectual tradition to achieve a hegemonic position over the other contradictory intellectual traditions.

The study also reveals that the implementation of particular neo-liberal labour laws was achieved through the strength of particular business organisations, the general weakness of labour and the strength of the Army. Supporters of
the neo-liberal labour laws included the Army and business organisations, which were mainly dependent on international markets. The initial implementation of institutional reform in the polity and economy directly supported the backers of the neo-liberal labour laws. These same institutional reforms made labour weak, forcing labour to fight for its survival. Thus, the Army and particular business organisations could implement the neo-liberal labour laws with minimal opposition.

Finally this study reveals the limitations of North’s NIE in trying to answer why particular neo-liberal labour laws were delayed and how particular neo-liberal labour laws were implemented. Some of the limitations of North’s NIE include the use of methodological individualism, North’s conception of the state, informal institutions, and ideology or mental models. These limitations constrain the effectiveness of North’s NIE in answering the questions in relation to the implementation of neo-liberal labour laws in Chile.
Prologue

The driving force behind this thesis has been my personal background and the topic chosen for my Honours thesis. I am Australian born from parents who originated from Spain and Chile. My Honour’s thesis was titled ‘The impact of Social Movements for Change on Chilean Economic Policies, 1983 to 1986’.

A number of issues sparked my interest in researching the Chilean political economy. My Chilean background ignited my curiosity in the political economy of Chile. The Chilean economic experience has also been widely reported as a neo-liberal economic success story that should be replicated in other developed and developing nations. This success story has been presented in the mainstream media, in newspapers, documentaries, and television programs. Furthermore, as I studied as an undergraduate in economics, economic textbooks also referenced the Chilean experience.

For my Honour’s thesis I analysed the change in direction of economic policy driven by the Latin American financial crisis of 1982 and the Chilean social movement of 1983. I discovered a moderation of economic policy prescriptions away from a radical neo-liberalism. This moderation included, but was not limited to, a devaluation of the currency, increases in tariff barriers and further controls on financial intermediation. Yet I also discovered that during this time there was intensification of neo-liberal policy reforms in the sphere of labour policy, in contrast to this moderation. The abolishment of the indexation of wages and the active reductions in the real minimum wage, for example, represented a deepening of radical neo-liberalism.

Hence my interest in the labour market resulted from the findings in my Honours thesis. I was interested in understanding why there was a particular
level of implementation of radical neo-liberal labour market laws and policies at a particular time. I wanted to discover the forces that created the labour market laws and policies. I became aware, with the assistance of my supervisors, that this would require an understanding of the historical development of the Chilean political economy. I discovered that the current research of the Chilean labour market focused on what was implemented, and not why or how it was implemented.

To explain how and why the labour market laws and policies changed, or did not change, at a particular point in time, required a theoretical framework. As an economist, I was driven toward institutional economics, as institutional economics concerns itself with the economic drivers of change in laws and policies. Initially I was drawn toward what has become known as ‘old’ institutional economics. This opened up a vast literature on the subject of institutional change. I also discovered the work of New Institutional Economist Douglass North. His framework was enticing to me, as it was relatively contemporary, it had garnered its author a Nobel Prize in Economics, and, it seemed to provide a plausible explanation of the situations and processes in Chile in which I was interested.
1 Introduction: the problem and the structure of the thesis

The Chilean political economy provides a compelling case study of the reasons why neo-liberal labour laws were implemented and the manner in which this was undertaken. A coup on 11 September 1973 installed an authoritarian government, which has been considered by the scholarly literature and the mainstream press as a successful example of the implementation of neo-liberal policies. This interpretation is due to some of the high rates of economic growth achieved during the authoritarian government (1973-1990). Thus, the implementation of neo-liberal labour laws represents one aspect of this widely heralded success story. However, the neo-liberal labour laws were implemented years later than other neo-liberal policies, including prices, trade, and privatisations.

1.1. Problem context

The neo-liberal labour laws were implemented over a two year period, in 1978 and 1979. From the year of the coup, 1973, the eventual implementation of neo-liberal labour laws therefore took six to seven years.

Other neo-liberal laws were implemented much faster, such as the original change in the exchange rate or price reform. In comparison to the implementation of other neo-liberal laws and policies in Chile, the neo-liberal labour laws took a long time to be implemented. This is an anomaly given that there was an authoritarian government, which would be expected to be able to implement changes in laws more easily than would be the case in a democracy or a more pluralist political structure. Furthermore, the military had taken power partly to stem what the military and a large section of the
Chilean elite perceived as too much power and influence of labour during the Allende years.

The answer to the questions raised by these contradictions can be used to assess a theoretical framework that concerns itself with institutional change in an economy. In the economic literature changes in laws are referred to as institutional change. Non-change or the maintenance of a law over time is also a form of institutional change. A theoretical framework that addresses institutional change is Douglass North’s New Institutional Economics (NIE). The answer to the phenomenon of the slow implementation of neo-liberal labour laws may be used to develop a critique of North’s NIE.

Therefore, this thesis has two goals:

- To explain the phenomenon of the slow implementation of neo-liberal labour laws in Chile;
- To assess the ability of Douglass North’s NIE to explain this case of institutional change.

1.2. Thesis questions

This problem context leads to three thesis questions. The first two thesis questions focus on the phenomenon of a relatively slow implementation of neo-liberal labour laws.

1. Why did it take so long to implement neo-liberal labour laws under an authoritarian government in Chile?
2. How were the neo-liberal labour laws promulgated under the authoritarian government in Chile?
These two questions focus on the ‘why’ and ‘how’ of labour market institutional change in Chile and of the delay in the implementation of neo-liberal labour laws.

The third question refers to the ability of North’s NIE to explain this particular case of institutional change, the Chilean case study.

3. What are the strengths and weaknesses of Douglass North’s New Institutional Economics in explaining the Chilean case study?

Thus, the presentation of the case study provides an answer to questions one and two, while the case study as a whole serves as the reference point for the assessment of North’s NIE.

1.3. The case study method

While there is extensive literature on case study method and its use in different disciplines, case study methodology is still novel in economic research and therefore requires a brief introduction. Using a case study method for this economic research proceeded in two steps, each of which will be briefly outlined in the context of some key authors, in particular the work of R. K. Yin.

1.3.1. The Chilean case study: implementing neo-liberal labour laws in Chile

If the answer to the first two questions is conceptualised as a case study, two important aspects need to be defined, namely the case and the units of analysis.
There are many different types of cases. ‘A case may be simple or complex… An event or happening may represent a case’ (Stake 2005: 444). Yin (1994: 12; 2009: 17) lists a wide range of case topics, including individuals, organisations, processes, programs, neighbourhoods, institutions, and even events. In a case study anthology, Yin (2004: 47-53) provides an introduction to papers which discuss how abstract topics such as processes may represent a valid case. He discusses the implementation of a specific economic development program as the case, rather than the economic development program itself or the location of its implementation. Similarly, the case under investigation in this thesis is the ‘how’ and ‘why’ of Chile’s implementation of neo-liberal labour laws. This case represents an event process, where the description of ‘how’ and ‘why’ this event took place becomes the answer to the first two thesis questions.

The units of analysis may be some entity or entities that are less well defined than a single individual (Yin 1994: 21-23; Yin 2009: 33). The units of analysis for this case include labour, business and the polity. The units of analysis were chosen as the three main actors with an interest in labour legislation (Ehrenberg and Smith 2006: 2-3).

Case study research and historically based research answer ‘how’ and ‘why questions’, generally with a focus on processes and structure. Yin (1994: 6) reports that historical research tends to dwell upon ‘how and why questions’. ‘How and why questions’ deal with operational links or processes that need to be traced through time. Sarantakos (1998: 192) reports that when the researcher is interested in structure and/or process, then a case study method may be employed.

This thesis is an open-ended investigation of the units of analysis in order to discover the reasons for the delay in the implementation of the neo-liberal labour laws. This open-ended investigation analysed the institutional constraints and incentives, both formal and informal, in relation to the units of
analysis. The thesis questions were refined through this open ended investigation.

The case study is based on documentary sources and data archives, which have been explicitly discussed as specific resources for a valid form of case study by Robson (2002: 360; 2007: 27). The advantages of this form of evidence are that the evidence is stable, unobtrusive, exact, and has broad coverage (Yin 1994: 80; Robson 2002: 358). The limitations of documents include problems with retrievability, biased selection, reporting bias and difficulties with access, including language barriers (Yin 1994: 80; Robson 2002: 358).

The problems of biased selection and reporting bias were addressed through the use of a wide variety of documents, which also provided a deeper understanding of the phenomenon under investigation. This thesis used original documents located in Australia and on the Internet, in both Spanish and English. While the language barrier could be overcome by the author’s fluency in Spanish, possible retrievability and access limitations that result from not being physically present in Chile are explicitly acknowledged.

Documents used included books, policy documents, legal statutes, newspapers, magazines, and scholarly journal articles. The thesis has taken a cross disciplinary approach in developing the case study. It incorporates explanations and data from Economics, Industrial Relations, History, Sociology, Anthropology, and Political Science. This wide variety of data sources not only ameliorated potential biased selection and reporting bias, but also provided for a deeper understanding of the case.

There are two key limitations of this thesis, which at the same time are key strengths. First, this thesis does not cover the totality of literature in relation to the authoritarian government experience in Chile. Rather, the selection of the documents was determined by the purpose of this thesis, the elaboration
of a Chilean case study as a tool to assess North’s NIE. Second, this thesis is not a historian’s account of a historical event. This thesis is an economist’s work, which is using the result of the Chilean case study to assess the validity of another economist’s theory, in this instance key tenets of North’s NIE. This allows the thesis to lay the groundwork for a richer analysis of North’s NIE, while at the same time providing a new perspective on the Chilean political economy of the first half of the authoritarian government.

1.3.2. Using the Chilean case study to assess North’s New Institutional Economics

This section explains how the explanatory potential of Douglass North’s New Institutional Economics (NIE) was assessed in regards to the Chilean case study. It addresses the third thesis question: What are the strengths and weaknesses of Douglass North’s New Institutional Economics in explaining the Chilean case study?

This step specifically tests the applicability of a theory, in this case North’s NIE. Yin (2009: 38-39) sets out how a rival theory may be tested against a case study and this thesis puts forward Chile as the case study. North’s NIE is presented as a rival form of explanation to the one presented in the Chilean case study of this thesis.

The results of the Chilean case study form the foundation of the assessment of North’s NIE. The case and the units of analysis remain the same, however the spotlight is now on the theory employed and an assessment of the theory’s ability to answer the questions that the Chilean case study addressed.
The assessment of North’s NIE is therefore guided by the Chilean case study. Importantly, revisiting North’s NIE addresses whether North’s NIE would indicate other areas or explanations not explored in the Chilean case study. This requires an elaboration of North’s NIE with reference to the Chilean case study. The thesis also asks whether the established critique of North’s NIE and the extension of that critique can be supported by the results from the Chilean case study.

North’s NIE will be analysed in relation to the Chilean case study, focusing on the following three questions:

- Does Douglass North’s New Institutional Economics cast further light on the reasons or manner in which the neo-liberal labour laws took a long time to be implemented as compared to those identified in the case study?
- Do the critiques of North’s NIE apply if North’s NIE were used to answer the Chilean case study questions?
- Does the Chilean case study deepen or extend any or all of the aspects of the critiques of North’s NIE established in the scholarly literature?

One form of case study used by other New Institutional Economists is called analytic narrative. The analytic part of the method refers to the use of a theory, normally rational choice or game theory, while the narrative part of the method focuses on the story, account or phenomenon (Bates, Greif et al. 1998: 10). Edited volumes by Rodrik (2003) and by Bates, Greif et al. (1998) provide examples of analytic narratives. In this context the analytic provided in this thesis can be seen as the use of the critique of North’s NIE and as this thesis’s extension of that critique. The narrative provided in this thesis is the result of answering the thesis questions one and two, presented as the Chilean case study. The narrative then becomes a tool to validate the analytic.
Therefore this thesis develops its Chilean case study in Parts one and two, which are used in part Three as the narrative to analyse the case study developed by other New Institutional Economists. This answers the third thesis question: What are the strengths and weaknesses of Douglass North’s New Institutional Economics in explaining the Chilean case study?

1.4. Thesis contribution

1.4.1. Insights into the process of implementation of neo-liberal labour laws

Why the labour laws took so long to be implemented

The multi-polarity of the Chilean government was an important cause in the delay in the implementation of labour laws. The different groups that comprised the authoritarian government were initially given equal power to legislate under their areas of control. Therefore the different branches of the armed forces that made up the groups of the authoritarian government could legislate differently for a certain time. Neo-liberally inclined groups were initially not in control of the labour ministry. Therefore there was delay in the implementation of neo-liberal labour laws as the neo-liberal group needed time to assert control over the whole of the authoritarian government, including over the labour ministry.

The different intellectual traditions of the armed forces were an important cause in the delay in the implementation of labour laws. These different intellectual traditions of the armed forces contradicted each other. For example, the Air Force had a corporatist intellectual tradition and controlled the social area, which included the labour ministry. Corporatism was in
contradiction to the neo-liberal intellectual tradition. Thus, corporatist elements within the authoritarian government needed to be neutralised or removed before the neo-liberal labour laws could be implemented.

How the neo-liberal labour laws were implemented

The strength of particular business organisations that preferred and profited from neo-liberal institutions meant that those business organisations could facilitate the implementation of neo-liberal labour laws. A particular set of business organisations in Chile were highly profitable and benefited greatly from the implementation of neo-liberal institutions in trade, prices and other economic areas. These business organisations’ high level of profitability allowed them to pursue the implementation of neo-liberal institutions also in other areas, including the area of labour legislation.

The general weakness of the labour movement in the wake of the violent coup meant that the different sections of the labour movement could not effectively oppose the implementation of neo-liberal labour laws that were against their interests. The inception of the authoritarian government marked the beginning of extreme physical and legal forms of repression against labour and its representatives. This weakened labour’s organisational ability, which is represented by lower unionisation rates, lower real wages, lower minimum wages and so on. Thus, labour was unable to stop the implementation of neo-liberal labour laws.

The strength of Augusto Pinochet (Army) in relation to Gustavo Leigh (Air Force) allowed the Army to support the implementation of neo-liberal labour laws with minimal opposition from the Air Force and its corporatist intellectual tradition. The ascendency of General Pinochet within the governing authoritarian government may be paralleled by the decline of Air Force General Gustavo Leigh. This parallel fall and rise in political power may be
mirrored in the legal statutes that biased the authoritarian structure towards Pinochet.

1.4.2. A deeper critique of North’s NIE

The focus of this thesis is the contribution of North’s theory in relation to sources for institutional change. The evaluation of North’s theory of institutional change uses the existing critiques of North’s NIE and the extension of these critiques provided by this thesis.

North’s NIE is presented in Chapter 7 with examples illustrating how it would relate to the Chilean case study. Existing critiques of North’s NIE are presented in this context. This thesis’s critique is therefore derived from both the existing critiques and the Chilean case study.

A key question this thesis asks is, ‘What would happen if the established critiques were applied to different situations discussed in the Chilean case study?’ This question implies that there may be certain situations in the Chilean case study which may extend those validated by the established critiques.

For example, the critique of North’s NIE, focussing on his use of methodological individualism, argues that he conflates the organisation by treating it as an individual (Milonakis and Fine (2007). This thesis finds that by applying the critique of methodological individualism to the structure of an organisation, it also becomes evident that hierarchy cannot be explained with North’s methodological individualism. Ultimately, the Chilean case study provides support for critiques that emphasise multiple units of analysis.

The Chilean case study thus becomes the reference point for illustrating the validity of key aspects of existing critiques of North’s NIE. It is shown how
these critiques can be documented, supported and extended through the Chilean case study.

This thesis focuses its critique on three sources of institutional change identified in North’s NIE, namely relative prices, ideology or mental models, and North’s particular conception of the state. Other aspects of North’s NIE are explored in their relevance to the Chilean case study and include his concept of informal institutions, methodological individualism, and North’s assumption about the market’s origin.

1.5. Thesis outline

1.5.1. Parts One and Two: Chilean Case Study

Parts One and Two of this thesis answer the ‘how and why question’ in relation to the delay in the implementation of the neo-liberal labour laws in Chile under General Pinochet.

Part One (Chapters 1 – 4) introduces the problem and structure of the thesis. Chapter One presents an Introduction to these issues. Chapter Two provides a background to the polity that was established on 11 September 1973. Chapter Three discusses the reasons and manner in which the neo-liberal labour laws were delayed in relation to the business context. Chapter Four discusses labour’s inability to shape labour legislative outcomes.

Part Two (Chapters 5 – 6) focuses more specifically on the polity. Chapter Five traces the historical origins of the Chicago Boys, who were so influential in the evolution of the Chilean political economy. The chapter identifies the quick implementation of the Chicago Boys’ neo-liberal policies in areas such as trade and prices, as opposed to the slow implementation of the neo-liberal
labour laws. Chapter Six discusses the differences and ensuing contradictions between the proposed corporatist labour laws and the neo-liberal labour laws. The chapter describes and analyses how the Chilean neo-liberal labour laws were implemented from the perspective of the polity.

1.5.2. Part Three: Assessment of North’s NIE based on Chilean Case Study

Part Three comprises Chapters Seven and Eight. The first part of Chapter Seven produces a comprehensive overview of North’s NIE. The second part of Chapter Seven analyses the question whether North’s NIE indicates alternate or additional avenues of research not explored in the Chilean case study and confirms the established critique of North with evidence from the Chilean case study. An extension of that critique is provided by this thesis based on the established critique and reference to the Chilean case study. Chapter Eight is a discussion which identifies the contributions to the literature of this thesis from the Chilean case study and the assessment of North’s NIE. Part Three assesses the rival theoretical explanation to identify both the strengths and weaknesses of North’s NIE in explaining the Chilean case study.
Part One
2 The structure of the polity: Hegemony of Neo-Liberalism?

2.1. Introduction

This chapter explores the history of corporatism in Chilean labour, political, business and military life. The main goal is to identify a school of thought, other than neo-liberalism, that was present during the authoritarian government of 1973-1989. The mainstream press and the scholarly literature on Chile was and still is predominantly focused on the hegemony achieved by the ‘Chicago Boys’ in economic and social policy making. In reality, however, there were also other schools of thought during the authoritarian government period, which were not alien to the Chilean political landscape, and amongst them first and foremost corporatism.

The chapter addresses two key questions:

- Was corporatism present in the labour, business, political and military organisations of Chile?
- What do these historical antecedents of corporatism in labour, business, political, and military organisations indicate about the support for corporatism in the authoritarian government?

These questions provide information that relates to the first two key thesis questions:

1. Why did it take so long to implement neo-liberal labour laws under an authoritarian government in Chile?
2. How were the neo-liberal labour laws promulgated under the authoritarian government in Chile?
In relation to the first specific question of this chapter, it can be shown that corporatism has been a continuous undercurrent of Chilean political life since Chile obtained independence from Spain in 1818. It has helped shape government policy and manifested itself in a number of areas, including business, politics and the military. In relation to the second specific question of this chapter, these organisations may form sources of support for corporatist or neo-liberal labour legislative change. It is thus important to understand the depth of support for corporatism within the different organisational spheres of labour, business, politics, and the military. This will assist in identifying the reasons behind the delay in the implementation of neo-liberal labour laws.

This chapter provides an introduction to the authoritarian government that took power on 11 September 1973. The aim is not to provide an account of what went wrong with democratic government prior to the coup. There is already substantial literature on the subject focussing on Socialist President Salvador Allende (Steenland 1974; Wallis 1974; Stallings and Zimbalist 1975; Winn 1976; Zapata 1976; Oppenheim 1993; Loveman 2001). The aim of analysing this period is to provide knowledge about the corporatist organisations that were formed and about the structure of the coup plotting.

This thesis will therefore need to define corporatism.

### 2.2. Definition of corporatism

A standard definition of corporatism is provided by a dictionary of economic terms:

The system of reaching economic decisions through negotiation between centralised corporate bodies representing economic groupings, notably employers and workers. This is contrasted with a reliance on decentralised
bargaining between individuals or limited groups…
(Black 2002: 91)

This definition highlights the fact that economic decisions are reached through corporate bodies, such as through business associations and unions. Rather than the individual as the centre of analysis, it is the organisation. This focus of corporatism already indicates a possible limitation in North’s New Institutional Economics (NIE), which has a strong conceptual focus on the individual and individualism.

A limitation of this definition of corporatism, however, is the omission of the role of the state. Is the state seen as an arbitrator, is there a state at all in this concept of corporatism? These questions are unanswered in this definition, leaving this concept of corporatism too open for analytical use in our context.

Another definition of corporatism is supplied by Robert Kaufman, drawing upon Linz:

…a term roughly synonymous with Linz’ (1964) concept of limited pluralism – refers to a pattern of state-group relationships in which formally organised, noncompetitive, officially-sanctioned functional associations monopolise interest representation and in turn are supervised by agents of the state bureaucracy (see Schmitter, 1974: 93-94). In ideal typical terms, corporatist systems are vertically segmented societies, encapsulating individuals within a network or legally-defined guilds and corporations which derive their legitimacy from and in turn are integrated by a dominant bureaucratic centre (Kaufman 1976: 7)

This definition of corporatism allows for the state to exist and gives it a key function in a corporatist society. The state’s key function is to legitimise and facilitate organisational representation. A kind of symbiotic relationship develops between state and representative organisation. This definition calls
attention to organisations’ connection to the state. Yet it does not clarify whether there are competing organisations or whether the state grants a particular organisation a monopoly for representation.

A corporatist characteristic identified by Jeremy Williams includes representative organisations that

- are controlled in emergence
- have quantitative limitations (can be expressed legally)
- are vertically stratified (hierarchy to society)
- have complementary interdependence

(Williams 2002: 32)

This is not an exhaustive list of corporatist indicators but it does provide a point of departure for this chapter. An example of ‘controlled emergence’ would be the state supporting, with conditions, the emergence of a representative organisation for the business sector. An example of ‘quantitative limitations’ would be legislation by the state that allows only one representative organisation for an industrial sector. An example of ‘vertical stratification’ would be a firm or local level organisation that answers to a regional level organisation and there is clear hierarchy. ‘Complementary interdependence’ refers to a situation where the functioning of representative organisations is dependent on the state and the state is dependent on the representative organisations. These indicators need to be found in the Chilean case in order to be able to identify corporatist influences.

In this thesis the term state corporatism is used in relation to authoritarianism and repression, while societal corporatism is linked with democracy, pluralism and oriented towards social welfare. An important aspect of state corporatism is its importance for maintaining social harmony through repression, which contributes to the smooth operation of the economy.
2.3. Historical origins of corporatism in Chile

This historical analysis of corporatism's origins in Chile surveys three different but related aspects, which include the Medieval Catholic Tradition, institutions inherited from Spanish colonisation and the prerogative of Diego Portales, who is considered the founding father of Chile.

The Medieval Catholic Tradition is one of the historical origins of corporatism in Chile. Kaufman (1976: 11-12) argues the main feature of the Medieval Catholic Tradition is an ongoing synthesis between two apparently contradictory legal-political principles: the organisation of society into hierarchical, semi-autonomous ‘corporate’ units; and the juridical concept that these units exist and are legitimised through the grace of a single, ‘patrimonial’ centre, which acts as an integrating and balancing force for the society as whole (Kaufman 1976: 11-12). This is close to the definition by Kaufman where corporatism may be represented by ‘vertical stratification’.

Colonial Spanish America conferred special jurisdictions, prerogatives, and obligations on the Church, the military, Indian communities, and merchant, mining and other guild groups. When Chile won political independence from Spain on 12 February 1818, this brought little change to the social order. Drake outlines how familial politics and the Roman Catholic Church still retained their control of a weak state (Drake 1978: 88). This once more emphasises vertical stratification.

A corporatist intellectual tradition originated at the Chilean Catholic University. The Catholic University was founded in 1888 by the traditional and conservative sectors of the Chilean populace (Kaufman 1976). The University would provide a melting pot for the Medieval Catholic tradition and the colonial Spanish origins of Chile.
In Chile, corporatist and patrimonial principles have been stressed in universities, law faculties and in assorted legal codes and practices. Individuals who develop and learn within this framework might well be expected to be predisposed to react in a ‘corporate’ or ‘authoritarian’ manner. For example, this has manifested itself in Chile with the growth of the state bureaucracy as a source of protection and privilege for the upper and middle classes; and the creation of official unions which co-opt or coerce the emergent labour movement (Kaufman 1976: 12).

Finally, at least since the time of Diego Portales (the ‘founding father’ of Chile’s early nineteenth century republic) Chile has had corporatist leanings. He was a Catholic, corporative, and a conservative intellectual, and this has appeared in the legal tradition of Chilean political life (Kaufman 1976: 25). The Conservative Party and the Christian Democratic Party have some connections to corporatism. According to Kaufman, a number of writers have found significant Catholic legal influences in the Chilean constitutions of 1833 and 1925 and in the property and labour codes written in the 1920s (Kaufman 1976: 25).

While the origins of corporatism are relatively limited, appearing most significantly in some formal institutions, it has still had some influence on the political and intellectual life of Chile.

2.3.1. Historical lack of corporatism in the labour movement?

The labour movement in Chile has been most closely related to the Socialist and Communist parties (Angell 1972). These parties’ core ideals have come from class conflict and Marxist thought, or are seen as interpreted through them. Thus, it is rare to find corporatist tendencies in the labour movement.
Nevertheless, the Christian Democratic Party of Chile’s connection to the labour movement displays corporatist tendencies.

Marxist parties have played an active role in Chilean politics since the second decade of the twentieth century. Communists, Socialists, and Trotskyists could trace their ancestry to the labour movement of the late nineteenth century. The Democratic Party\(^1\) (founded 1887), and the Socialist Workers’ Party\(^2\) (POS), led by Recabarren and his comrades, after 1912, were the first workers’ parties in Chile connected to Marxist thought (Loveman 2001: 230). Although the Communist party’s origins date only from 1922 and the Socialist party from the early 1930s, by that time an indigenous Marxist movement linked to international Marxism had struggled for at least half a century to reform, if not destroy, formal Chilean democracy. This long history of Marxist parties involved in the labour movement means that other schools of thought would have difficulty entering the labour movement.

Table 2.1 derived from Alan Angell’s text *Politics and the Labour Movement in Chile* represents the percentage of votes for delegates for the Central Union of Workers obtained by the Christian Democratic Party of Chile\(^3\) (PDC). This party has been the largest in recent political history with a corporatist tradition. The higher the percentage of delegates affiliated to the PDC, the greater is the influence of corporatism in the labour movement. Following this logic, corporatism’s influence peaked in 1962. This peak in influence could be said to coincide with the election of Christian Democratic President Eduardo Frei who took office in 1964. Overall, while the PDC remained an important faction in the labour movement, its views were never dominant.

\(^1\) PD – *Partido Demócrata*; Democratic Party.
\(^2\) POS – *Partido Obrero Socialista*; Socialist Workers’ Party.
\(^3\) PDC - *Partido Demócrata Cristiano*; Christian Democratic Party.
Table 2.1  Political affiliation of delegates to CUT\(^4\) congresses (per cent)

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<td>17.9</td>
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(Source: Angell 1972: 218)

In the labour movement, the Marxists had created a firm base of popular support. Families transmitted loyalty to the Communist or the Socialist party from generation to generation. Party oriented youth movements, retail shops, sports clubs, doctors, and even barber shops allowed most of such people’s daily lives to continue within a network of party loyalists (Loveman 2001: 230). This tradition of a tight network among the labour movement would mean corporatism would be shut out of the labour movement in Chile.

A tradition of loyalty was not present in the PDC union movement. For the PDC, trade unions were not the most important issue. Agrarian reform, marginalised people, education, and copper were considered more pressing concerns for the PDC (Angell 1972: 177). At the national level, public-sector and rural unions were the most important for the PDC (Angell 1972: 186). However, the rural unions were fragile, due to the seasonal nature of work. Thus, while the PDC had a presence in the union movement, it was not as central as the Communists or Socialists.

In summary, the corporatist elements in the labour movement were very weak. The origins of the union movement were associated most closely with the Communist and Socialist parties. The PDC had obtained a limited level of support from the union movement. Tight networks between the party and labour were not developed by the PDC due to low representation of former union officials as PDC deputies or senators. Union financing of the party was minimal compared to the Communists or Socialists. Additionally, the Christian Democratic Frei administration introduced negative labour policies.

\(^4\) CUT - *Central Única de Trabajadores*; Central Union of Workers.
(Angell 1972: 189 and 199-200). All this made the PDC a relatively weak force in the labour movement compared to the Socialist and Communist parties.

This meant that there would be modest to no support from the labour movement for corporatist labour laws or neo-liberal labour laws (see Chapter 6).

2.3.2. Business associations

The state was the first to initiate organisation in the Chilean business community. Through a decree from President Joaquin Prieto Vial (1831-41), the aristocratic government encouraged the functional organisation of the dominant class – the latifundistas – into the private National Agrarian Society⁵ (SNA) in 1838 (Drake 1978: 89). The SNA would later become the model for future business associations such as the SFF⁶ (manufacturing) and the SNM⁷ (mining). The business associations were granted juridical status and representational monopoly from the state, which are two indicators of corporatism (Drake 1978: 89).

When the CPC⁸, the umbrella organisation for all business associations in Chile, was created in 1933, the first president came from the SNA. He advocated corporatist views, such as an active role for the business associations in government, and espoused corporatism as a way of bringing about social harmony between capital and labour (Drake 1978: 102). The

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⁵ SNA - Sociedad Nacional de Agricultura; National Agrarian Society.
⁶ SFF - Sociedad Fomento Fabril; Society for Industrial Development.
⁷ SNM - Sociedad Nacional de Minería; National Mining Society.
⁸ CPC - Confederación de la Producción y Comercio; Confederation of Production and Commerce.
corporatist leanings come as no surprise as the SNA was the first business association in Chile comprising the traditional, Catholic landowners.

During the inter war years, the SFF established relatively permanent representation in relevant Senate and House legislative committees, state banks and credit and trade agencies, the semi-autonomous National Development Corporation\(^9\) (CORFO), the social security administration, and a host of other public organisations (Drake 1978: 103; Williams 2002: 41). In 1964, the SFF had 43 representatives in public and private organisations: ‘26 were voting members of government policy-making boards and 8 were voting members on government advisory councils’ (Menges 1966: 349). Furthermore, the CORFO had input from a wide variety of business associations and professional associations including the SNA, SFF, SNM, CPC, and the Institute of Engineers (Drake 1978: 105). This integration of representative business organisations into the state indicates corporatism.

The strength of the rightist parties in Congress was backed up by the direct representation of the major business associations within state decision-making bodies. Until at least the mid-1960s, these corporatist arrangements afforded upper class interests highly significant non-party and non-legislative means of influencing political decision-making. Major business associations, for example, could often name cabinet-level appointees in ministries relevant to their economic sector. They could also veto government initiatives deemed especially harmful to their interests, and were even able to regulate new investment in the economic sectors under their control (Kaufman 1976: 33). These corporatist tendencies were central for business organisations in Chile.

\(^9\) CORFO - Corporación de Fomento de la Producción; Development Corporation of Chile.
2.3.3. Political parties: Conservative and Christian Democratic Parties

At its 1932 convention, the aristocratic Conservative Party, one of the first parties in Chile, called for an organic society organised along decentralised, functional lines. Papal encyclicals, Christian reform doctrines, and fears of communism and anarchy prompted the Conservative Party to urge a revamping of individualist liberal capitalism. Consequently, they praised corporative organisation, the family, the Church, and private property as the best guarantees of social harmony. In addition, paternalistic social reforms and Catholic trade unions were advocated to dampen worker discontent. On balance, these were programs for relatively autonomous economic organisations, closer to societal than state corporatism (Drake 1978: 95).

The term conservative here relates to the traditionally large agricultural land owners. This group was strongly influenced by the Catholic Church and advocated social harmony through a strong state that controlled or at least directed competing organisations’ formation and action. This was meant to preserve the existing social and economic order.

The Conservative Party may be thought of as part of the corporatist undercurrent in Chile.

Arturo Alessandri Palma’s presidency has been described as partially corporatist in nature. Alessandri was President twice; 1920-1924 and 1932-38. For example, “[Alessandri’s]…administration set in motion a systematic campaign to pressure empleados\textsuperscript{10} and employers into a corporatist “consensus” that culminated in Law 6020’ (Silva 2006: 90). This Law provided a legal minimum wage to white collar workers. The significance of

\textsuperscript{10} White Collar workers. In Chile prior to 1973 there was a legal distinction between white collar workers and blue workers, which affected minimum wage and benefits.
this law was that it was pushed through by President Alessandri in a broader plan for social stabilisation (Silva 2006: 93). There were a number of other political parties that supported corporatist thought.

Movimiento Nacional Socialista de Chile\textsuperscript{11} (MNS) was one of the few political parties to have a strong corporatist bent. The party was founded on the 5th April 1932 during the depression (Bicheno 1972: 373; Klein 2004: 590). This party gained 3.5 per cent of the vote in 1937 and achieved three deputies in the legislative elections. Most of their electoral support was garnered in the conservative agrarian south of Chile (Klein 2004: 596). This represented a very minor proportion of the vote. The party soon merged with Unión Socialista (Socialist Union) in 1938 and became known as the Alianza Popular Libertadora\textsuperscript{12} (APL). The APL supported the presidential candidature of Carlos Ibañez in the 1938 presidential elections.

\textit{Estanquero}, a magazine related to the MNS, developed the clearest corporatist thought in the economic sphere:

(1) Chilean control over national resources, especially copper
(2) An anti-inflationary programme comprising reduced public expenditure and a reduced bureaucracy, and stabilisation of wages and salaries. The programme advocated neither agrarian reform nor major tax reforms.
(3) Simultaneously the introduction of a period of ‘social peace’, which would include limitations on the right to dissent, press restrictions etc. The introduction of a form of corporatism would be crucial here, to fix wages independent of both management and unions, and to coerce the trade union movement into accepting the suppression of the right to strike.

(Grugel 1985: 115-116)

\textsuperscript{11} MNS - \textit{Movimiento Nacional Socialista de Chile}; National Socialist Movement of Chile.
\textsuperscript{12} APL - \textit{Alianza Popular Libertadora}; Popular Freedom Alliance.
The above represents one of the few explicitly corporatist written accounts in Chile. It also emphasises the MNS and the later APL as bastions of corporatist thought in political parties in Chile.

The MNS did not limit itself to the democratic system to achieve its aims. An attempted coup with connections to the former MNS was violently put down in September 1938, which has later been termed the *Seguro Obrero Massacre*\(^{13}\). The coup attempt was meant to place Carlos Ibáñez back into power. This occurred supposedly without Ibáñez’s knowledge. The APL would become a minor political force after this incident and later disappear with the merger to the Agrarian Labour Party\(^{14}\) (PAL) in 1945.

At their peak, these professedly corporatist parties garnered together less than 10 per cent of the votes in the national congressional election of 1937: MNS 3.5 per cent, Agrarians 2.4 per cent, and Republican Action 2.4 per cent. In the 1940s all these movements fell apart (Drake 1978: 98). Therefore, while representing a part of Chilean political history, strictly corporatist parties never attained a large following.

The Christian Democrats also had corporatist leanings. This corporatist theme in the Christian Democrats is identified by Zeitlin and Petras (1970: 17): ‘The ideology of Christian Democracy in Chile is an amalgam of vaguely defined nationalist, corporatist and populist ideas’. This corporatist ideology is also identified by Johnson (1968: 82). The Christian Democrats Catholic and business community connections made the undercurrent of corporatism possible.

These corporatist leanings manifested themselves through the organisation of peasants, rural communities and labour organisations. For example,

\(^{13}\)Labour Insurance Massacre.

\(^{14}\)PAL - *Partido Agrario Laborista*; Agrarian Labour Party.
Williams (2002: 42) identified that the corporatist faction of the Christian Democrats favoured ‘state-sponsored, -financed, and –promoted trade union activity as a means to integrating the lower classes’. While the labour organisations were never fully under the direction or support of the state, peasant unions flourished (Johnson 1968: 82; Fleet 1985), demonstrating that corporatist thought had a real impact on government policies.

### 2.3.4. Military connection

The dictatorship of Carlos Ibáñez del Campo (1927-31) fed on an antiparliamentary undercurrent. However, Ibáñez only ever flirted with the idea of corporatism as an alternative to the parliamentary system (Drake 1978: 90-91). Although Ibáñez toyed with the idea of corporatism and the replacement of political parties with trade unions, he never attempted to implement those ideas (Bicheno 1972: 369). However, his flirtation involved a greater role for the central government in the economy of Chile.

The areas of state expansion under Ibáñez can be seen as an indication of corporatism. State agencies began to deal with industrial credit to agricultural colonisation. Public works for fishing development and provinces were reorganised to more closely resemble their economic specialities (Drake 1978: 92). The concern with state integration with the economy indicates a move toward corporatism. However, these were only marginal moves to corporatism. Ibáñez still respected the traditional parties and their role in the state.

The fall of Ibáñez’s ‘mild’ dictatorship in 1931 represented the turning point where the military would retreat from the political realm. From that point onwards military/civilian disputes took on a trade union character, that is, the military argued for better pay and supply of equipment. These trade union-like disputes occurred periodically during 1924, 1939, 1947-55 and 1969
This retreat to the barracks before and after Ibáñez’s rule represented the weak political motivations of the military.

The ‘retreat of the military to the barracks’ was also reflected in the military’s own sense of purpose. ‘…86 percent of Hansen’s sample of officers (as opposed to 71 percent of civilian middle and upper class respondents) accepted the “constitutional guardianship” function as a proper one for the military establishment’ (Kaufman 1976: 35-36). In other words, this meant the military did not take an active role in politics, the military ‘returned to their barracks’. This view was shared by civil society.

The civilian view of the military prior to the 1973 coup showed that civilians respected and trusted the military:

Hansens’s (1967) survey of Santiago residents indicate that large majorities of all social classes viewed military officers as less ‘ambitious' and ‘corruptible’ than politicians, and more ‘honourable’ and ‘trustworthy’ – traits which presumptively qualified officers as potential referees in the political game.
(Kaufman 1976: 35)

On the one hand, the military’s lack of participation in politics reduced their ability to rule. This would arguably diminish their ability to implement labour laws, if they were to return to political office. On the other hand, the military’s self-removal from politics helped them gain credibility as guardians of the system. They were seen as less corruptible than politicians. Thus, in the advent of a crisis they would be more likely to be called upon to ‘save' the system and return it to order. The ‘order’ the military chose would be up to them.
2.3.5. Foreshadowing: Allende administration

When the Allende administration (1970-73) gained office, extreme political organisations of the right formed in reaction. One of the more prominent political organisations that formed in the wake of Allende’s election was the Fatherland and Liberty Nationalist Front\(^{15}\) (PyL). Its main goal was to topple or block the administration of Allende. However, their founding principles were ‘an integrating state, authoritarian government, workers integrated into their enterprises, and functional democracy’ (Drake 1978: 112). The headline for the group’s newspaper was ‘Nationalism, Gremialismo, and the Armed Forces’ (Roxborough, O'Brien et al. 1977: 207). The first leader, Pablo Rodríguez Grez of the PyL, was a former leader of the SNA. This evidence indicates a strong current of corporatism in the organisation.

The Fatherland and Liberty Nationalist Front (PyL) dissolved with the coup, officially on 12 September 1973. The members of the PyL moved into areas such as National Directorate of Social Communication (DINACOS), trade union desk, Secretary of the Business Associations and the secret police (O'Brien 1983: 21). These areas were closely related to the repressive character of the regime; this was part of their desire to create a strong authoritarian government.

\(^{15}\) PyL - *Patria y Libertad*; Fatherland and Liberty Nationalist Front.
2.4. Indications of corporatist leanings of the military junta 1973-1979

2.4.1. Exclusionary corporatism and bureaucratic authoritarianism

The concept of corporatism has been expanded by a number of authors. Two such extensions have been the exclusionary corporatism of Alfred Stepan (1978) and Guillermo O’Donnell’s influential concept of Bureaucratic-Authoritarianism (1973; 1978).

This section outlines a different way of conceptualising corporatism. Previously, it was implicitly assumed that all groups of people in society could have their representative organisation integrated into the state. The corporatism here purposefully excludes some representative organisations. That is, labour organisations do not have to be represented in the state or may even be repressed and there is still conceptual room to label a government corporatist.

A definition of exclusionary corporatism is provided below:

...those governments which combine repression and Right-wing policies with direct control of labour through centrally-directed agencies and it is frequently argued that this combination is particularly effective. (Philip 1980: 432)

An exclusionary corporatist state represses the lower strata. The organisations that become repressed in this context are usually peasant unions, labour unions, and their related political organisations. This leads them to have little or no input in the state’s functions. In terms of North’s
New Institutional Economics (NIE), one would say that this reduces their ability to access the polity.

However, this reduced access to the polity begs the question. ‘Why are these lower class organisations repressed?’

A period of inclusionary democracy in Chile increased the participation of lower class organisations in government. Their increased participation placed increased pressure for benefits from the state. This was seen as threatening the upper classes’ privileged position. In Chile this took a dramatic turn with the Presidency of the Socialist Salvador Allende (1970-73); Allende’s redistributive and transformative policies directly threatened upper class positions. This led the upper class to put pressure on the armed forces for a coup to ‘save the nation’ from communism.

It can therefore be said that severe inequality produces strong pressures and incentives for political exclusion. The more stratified the society, the more the privileged few have an interest in depriving the many of a voice in public affairs (Remmer 1985: 73).

Some authors have described the Chilean government as exclusionary corporatist after the coup of 11 September 1973, which ousted the democratically elected President Salvador Allende (Epstein 1984; Remmer 1985). The extensive repression of the working class (see Chapter 5), coupled with neo-liberal economic policies, is thought to be part of exclusionary corporatism.

The rule of the exclusionary corporatist regime is based on a minority. This minority is generally represented by powerful business, oligarchic agriculturists and financial sectors of the economy. Thus, it is the alienation of these groups that would threaten the stability of the exclusionary
corporatist regime. Protest or pressure from labour unions should have a small impact on an exclusionary corporatist regime.

Bureaucratic authoritarianism (BA) has been likened to exclusionary corporatism. For example, Epstein (1984: 37) describes Chile and the junta (1973-1980) as exclusionary bureaucratic authoritarian. The discussion of BA here is limited because the purpose of this section is to illustrate that the concept of BA and exclusionary corporatism have common elements.

The core meaning of BA is:

The BA is a system of exclusion of the popular sector, based on the reaction of dominant sectors and classes to the political and economic crisis to which populism and its developmentalist successors led. In turn, such exclusion is the requisite for attaining and guaranteeing “social order” and economic stability; these constitute necessary conditions to attract domestic investments and international capital and, thus, to provide continuity for a new impulse toward the deepening of the productive structure. (O'Donnell 1978: 13, 15)

There are a number of similarities between exclusionary corporatism and BA. They both repress the popular sector or the lower strata because of the developmental demands they put on the state prior to the BA. The lower strata’s demands put pressure on the state, sometimes leading to populist economic policies, which may create macroeconomic instability. O'Donnell argues this instability generally manifests itself with increasing inflation, declining GDP and investment rates.

In Chile, prior to the 1973 coup, there were indicators of macroeconomic instability. In 1973 inflation reached 361.5%, real GDP declined by 4.9% and
investment fell to 10.4% of GDP\textsuperscript{16} (World Bank World Tables 2008). Such a situation is antagonistic to the objective needs of stability and social predictability of any complex economy (O'Donnell 1978: 6-7). This compels the elite or privileged in society to ask for military intervention to protect their position or ‘save the nation’ as constitutional defenders.

Successful military intervention occurred in Chile on 11 September 1973. This led to the widespread repression of groups and organisations with left leaning ideologies. A first consequence already has been hinted at: eliminating the political threat by deactivating the popular sector, beheading its leadership and curbing its autonomy vis-à-vis the state and the dominant classes (O'Donnell 1978: 13). This then generated a situation where domestic and international capital felt more comfortable to re-enter the nation.

If the junta established in 1973 is exclusionary corporatist or BA then the historical record should reveal repression of unions. The repression of unions and the lower socio-economic strata does not exclude corporatism as a possible avenue of organisation for the state under military rule. The concepts of Exclusionary Corporatism and BA provide scope for corporatism under these arrangements.

However, the official discourse of the junta may not parallel the actual repressive character of the military or secret police. That is, they will tacitly support unionism, but wish to eliminate the Marxist influence on the union movement. In essence, the junta want to make the labour movement apolitical. Apolitical unionism can still be part of corporatism. Unions can still be integrated into the state, but ideologically neutral or unaffiliated to a political party.

\textsuperscript{16} Investment was calculated as Gross Capital Formation: Total divided by GDP.
2.4.2. Corporatism in the junta

Corporatism as a solution to social conflict was arguably its main attraction to the junta. As Drake (1978: 87) argues, corporatist systems are designed to minimise social conflict and maximise economic productivity.

The level of violence and repression applied by the Chilean junta was unprecedented in the nation’s recent history. Only six months after the coup, arrests had reached a total of 80 000 persons and 160 000 persons had been dismissed from their jobs for political reasons (Remmer 1980: 282). 200 000 more had fled voluntarily and involuntarily into exile (Wright and Zúñiga 2007: 31). These figures illustrate the exclusionary corporatism or BA that the junta practised.

Given the briefly outlined historical record it is not surprising that within the military junta there were corporatist influences. The main organisation that can be identified as strongly corporatist is the Air Force under the Commander-in-Chief Gustavo Leigh Guzmán. Two quotes provided by Kaufman (1976) illuminate the position of Leigh:

We do not consider parties decisive for the progress of the country. Our line is one of total political transcendence. Our policy will be nationalistic, with participation of técnicos, of youth organisations, of women, and naturally we will ignore partisan allegiances when their specialties require it. We are not going to govern with parties

[Air Force General Gustavo Leigh] (Kaufman 1976: 5)

We want a modern, flexible Constitution, which gives participation to women, which gives participation to gremios, which gives participation to youth; in which parliamentary offices are of a national character

[Gustavo Leigh] (Kaufman 1976: 5)
Firstly, Leigh’s rejection of political parties is important as he does not view them as necessary for the functioning of the state. Secondly, Leigh views the participation of _gremios_ 17 (business associations and organisations), and youth and women, as integral to the functioning of the state, believing they should be given a place within a new Constitution. Thirdly, he highlights the ‘technical’ character that these organisations may bring to the functioning and decision making of the state. These three points correlate with the corporatist intellectual tradition.

Other generals who supported Gustavo Leigh’s point of view included Bonilla, Arellano, Nuño, Palacios, Díaz Estrada (Zárate 1999/2000: 11). These other generals were part of the coup planning and were considered highly influential within the military. This meant they would be considered for high-ranking ministerial positions within the authoritarian government.

It is interesting to note that General Augusto Pinochet Ugarte was not always strongly supportive of the ‘Chicago Boy’ or neo-liberal intellectual tradition. As head of the military junta and shortly after the coup, Pinochet made it known that the new constitution would also give a prominent place to industrial, commercial, agribusiness, mining, and professional associations, which he termed ‘the authentic representatives of the people’ (Newton 1974: 6; Kaufman 1976: 25). Again, this represents a rejection of political parties and an elevation of the _gremios_ and other professional organisations as the true representatives of the people. This would indicate that the business associations would become an important part of the state’s decision making process.

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17 A strict translation of _gremios_ is guilds. However, in the context of the discussion here _gremios_ generally refers to business associations or the representatives of business at the sectorial and national level.
Corporatism and ability to govern

The change in Pinochet’s position away from corporatism towards supporting the orthodox Chicago tradition may be related to the character of the different branches of the military establishment. For example, Kaufman (1976: 45) states that the Chilean Navy and Air Force were more conservative than the Army - an impression that is consistent with the alleged ‘moderation’ of General Pinochet, relative to his other colleagues on the junta. This would indicate that the Air Force would be more likely to remain within the tradition of corporatism and the Navy within the tradition of neo-liberalism.

Throughout his military career Pinochet was known for his pragmatism, such that he changed his loyalties with the changing winds. Muñoz (2008) outlines how Pinochet managed to avoid a number of conflicting situations to advance his career in the Army. Pinochet is described as being more likely than others to try something new like the neo-liberal economic policies emanating from Chicago. He was said to be picking the winning horse as it emerged.

One problem with the corporatist tradition in the military was a lack of technical or political training of officers. In contrast to the Peruvian and the Brazilian dictatorships, technocratic-political orientations had not been widely built into the professional role structure of the Chilean military. Traditionally, Chilean officers had not run for elected public office, served on boards of directors in semi-public corporations, sat on planning boards, or served in ministries (Kaufman 1976: 46) – as was common for their Peruvian or Brazilian counterparts. This indicated that the technical or political ability of the military in Chile was low compared to that of its neighbours, and that the military would need to rely on civilian support in these areas.

The military’s only real experience in office came when Allende appointed military personnel to various offices, but prior to that there were no real military positions in government for 30 years. From the end of the ‘mild’
dictatorship of Ibáñez in the early 1930s until the end of the 1960s, conflicts in Chilean society had become more and more funnelled through the party structure (Kaufman 1976: 42-43). The military’s political experience was more than thirty years ago or lasted less than three years under a transformative Socialist government.

The symbolism behind messages from the previous military dictatorship of Carlos Ibáñez and from Augusto Pinochet are very similar. Both dictators invoked the name and spirit of Diego Portales, considered the founding father of Chile (O’Brien 1983: 20). The seat of government is named ‘Diego Portales’ and the self made President Pinochet was often shown posing for photographs in front of portraits of Diego Portales. This symbolism shows some of the nationalist tendencies of Pinochet that can be seen as part of his corporatist background.

**Gremio thought and business associations**

The economics departments of the two most important universities in Chile, the University of Chile and the Catholic University, were not specialists in corporatist thought. Thus, many of the civilian technocrats who were employed would not strongly support the corporatist tradition of the Air Force. While there was political support for gremios in the department of political science in the Catholic University, the economics department did not hold to the same views.

The gremialist movement found its theoretician in Jaime Guzmán, a professor of constitutional law at the Catholic University. Guzmán was a member of the junta’s Constitutional Commission (Newton 1974: 35). He initially favoured a more corporatist style, where representation was channelled through organised groups defined by the workplace (Valenzuela 1995: 44). This saw some participation by the civilian gremio movement, but it was limited to the political institutions (in this case the constitution).
Guzmán’s allegiance to a particular branch of the military would indicate a corporatist inclination for that branch. Guzmán began his career in the Junta’s government by advising Air Force General Gustavo Leigh (Valenzuela 1995: 44-45). However, as Leigh’s political power began to diminish he moved to align himself with Army junta member Pinochet. Guzmán’s early alignment with the Air Force would indicate that the Air Force was initially the branch with the strongest corporatist influence. The fall of Leigh is discussed further in Chapter 6.

Finally, a way for the military to legitimise its rule in the early stages of the authoritarian government was to allow the participation of civilian organisations. This meant business associations like the SNA were allowed to appoint and negotiate. to a limited extent, the official positions in the new authoritarian government (Drake 1978: 83), indicating an under-current of corporatist thought, this time used in a way to legitimise the junta’s rule.

The Chilean Junta’s consultative apparatus remained quite crude by Brazilian or Peruvian dictatorship standards. The Chilean junta, led by Pinochet, remained the principal decision-making body. It was not underpinned by an elaborate network of military coordinating committees, civil-military advisory bodies, or political supervisory and control structures (Kaufman 1976: 47). Leaders of the gremios or business associations who supported the coup consulted on an ad hoc basis with junta members or with other key officials.

### 2.4.3. Review of Corporatism and the Junta

Corporatist action is apparent in the historical record. There are examples and rhetoric that echo the exclusionary corporatist model, indicating that corporatism was a valid alternative. Contrary to the common portrayal of the
dominance of neo-liberal policies in Chile, corporatism was seriously considered, in particular during the early period of the authoritarian regime. However, if our alternative analysis is correct, it needs to be reflected in the political institutions in place. Was there scope for the elaboration of different models or modes of thought?

2.5. Structure of the military junta and government after 11 September 1973

The previous section has described some of the corporatist tendencies within the authoritarian government. It has been demonstrated that corporatist policies can be seen as a constant undercurrent within the Chilean political and business scene. Yet prior to the coup of 1973, the military only flirted with the idea of corporatism when it was in power under the relatively mild dictatorship of Carlos Ibáñez in the early 1930s.

Overall, the military had little experience in politics. This inexperience had two consequences. The military’s non-interference in politics made them a ‘respectable’ alternative to the politicians to ‘save’ the nation during a crisis. However, the military’s lack of experience in politics also meant that their ability to govern was limited. Thus, while the military was legitimate in the eyes of some sections of the populace as a saviour, the military programs would need the cooperation of civilian experts.

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18 While President Allende was elected with 36.3% of the vote in 1970, the party coalition behind Allende, the Popular Unity, achieved 44% of the vote in Congressional elections in March 1973 (Sigmund 1977: 199). This represented an increase in their share of the vote. Thus, the coup of 11 September 1973 had only limited support. The ‘whole’ of the populace was not behind a coup.
The driving question for this section is: Was the structure of the political institutions at the beginning of the coup conducive to the elaboration of different types of policies or of only one type of policy?

2.5.1. Background

The presidential election of 1970 was split three ways. Socialist Salvador Allende was the candidate for the coalition of parties called Unidad Popular19 (UP). The broad coalition comprised left leaning parties and included the Chilean Socialist Party, the Chilean Communist Party, the Radical Party, the Social Democratic Party (PSD), the Popular Independent Action (API) and the Movement for Unitary Popular Action20 (MAPU). The other two parties who presented a candidate for the 1970 Presidential Election were the National Party, whose candidate was Arturo Alessandri, and the Christian Democratic Party, whose candidate was Rodmiro Tomic.

The result of the presidential election was that none of the three candidates obtained an absolute majority of the votes. Salvador Allende and the UP obtained the most votes with a 36.2% share (Sigmund 1977: 107). Second was Alessandri with 34.9% and Tomic was last with 27.8% (Sigmund 1977: 107). If no candidate wins a majority of the vote in Chile, the Congress elects the President from the candidates. Traditionally, the candidate that had won the most votes was the candidate selected for President. In this way a vote by Congress established Salvador Allende as the democratically elected President of Chile.

The ascension of Allende to the Presidency created great tensions in the country. There was great pressure from the upper class and the middle

19 UP - Unidad Popular; Popular Unity.
20 MAPU - Movimiento de Acción Popular Unitaria; Movement for Unitary Popular Action.
class and their representatives within the National Party and the Christian Democrats to destabilise the President’s cabinet and programme for reform. This led to an increased role for the armed forces in the polity as an arbitrator and to a perception of the armed forces as protector of the constitution.

According to Roxborough and colleagues, reforms for the armed forces by the early Allende administration made them seem capable of political roles in the eyes of the general public. These reforms envisioned the armed forces playing a part in the development of the nation. This involved participation and organisation in literacy programs and the building of infrastructure such as roads. This represented a continuation of the policy pioneered by the Christian Democratic Party (Roxborough, O’Brien et al. 1977: 192). A side effect of the armed forces’ participation in development programs was the experience in the organisation and the running of the polity.

The armed forces were also called upon by the Allende administration to suppress protests against the government. Two important incidents were the December 1971 ‘March of Women with Empty Pots’ and the ‘March for Freedom’ of March 1972. The police (Carabineros) and the military dispersed the first protest (Roxborough, O’Brien et al. 1977: 194). States of emergency were called for the capital city of Santiago\(^{21}\) for each of the two protests. Under such a state of emergency the control of the city fell under the jurisdiction of the military commander of the Santiago garrison. These states of emergencies meant the armed forces gained experience in running a city during a crisis.

Roxborough and colleagues outline how strikes by gremios and other business owners brought the armed forces into a position of arbitration. A new cabinet was sworn in on 3 November 1972, with three generals as

\(^{21}\) Santiago is the centre of Chile’s largest conurbation. Approximately 2.82 million people lived in Santiago in 1970.
ministers. The Chief of Staff of the Armed Forces, traditionally from the Army, General Carlos Prats, was appointed interior minister (Roxborough, O'Brien et al. 1977: 199). This again provided experience for the military in the running of the polity.

The generals remained in the cabinet from 2 November 1972 until 4 March 1973. In March the mid-term congressional elections took place. The National Party and the Christian Democratic Party had called for the military to ensure the mid-term congressional elections were fair. This meant that the military needed to leave UP cabinet positions to remain neutral. The fact that the military was expected to act as a neutral overseer of the election illustrates the regard in which the military was held by the populace.

2.5.2. Coup plotting

This section deals strictly with the coup plotting prior for the coup of 11 September 1973, which unseated the democratically elected President Salvador Allende. While it is acknowledged that previous coup attempts against Allende would have contributed to the structure and timing of the successful coup of 11 September, they distract from the main issue. The main issue is to show how the successful coup plotters were able to transfer their success into the structure of decision making of the polity post coup. This implies that those who were unsuccessful previously would not determine the structure of the polity after a successful coup by others.

Roxborough and colleagues (1977) identify three different groups within the armed forces during the presidency of Allende. The first group were the anti-communist coup supporters. The supporters of the constitutional guardianship role for the armed forces led by the Chief of Staff of the Armed Forces General Carlos Prats were the second group. The third group were a
clear minority, the pro-UP officers in the armed forces headed by General Bachelet.

The plotting for the 11 September coup began in earnest after the failed coup of July 1973. A few days later, a group of Army, Navy, and Air Force officials formed the ‘Committee of Fifteen’ to discuss the growing political crisis (Constable and Valenzuela 1991: 50). From this Committee of Fifteen the coup plotters emerged. The coup plotting began most forcefully in the Navy compared to the other two branches of the military.

Spooner (1994) discusses how the Navy’s personnel and actions made it the key instigator of the coup. She highlights that more affluent individuals joined the Navy as compared to the other services. The Navy was seen as the most conservative, a fact that has been traced to the socio-economic background of the personnel (Roxborough, O'Brien et al. 1977: 187). Spooner dates the purge of Allende supporters from the Navy as beginning on 6 August 1973, when they were accused of being leftist infiltrators (Spooner 1994: 32). The composition and the actions of the Navy would thus indicate that the Navy was likely to be the leader in the plans for a coup and an authoritarian government.

The Navy was also the instigator of an economic plan in the event of a coup through the support it provided to the policy document *El Ladrillo*. To have this document prepared prior to the coup and distributed to high ranking Navy officials just prior to the coup indicates the level of preparation carried

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22 Air Force General Bachelet was the father of the former President of Chile, Michelle Bachelet.

23 The political crisis was the continued lock-outs, strikes, violent activity of ultra-left and right political organisations on the Chilean political economy. It is beyond the scope of the thesis to go into the details of these activities.
out by the Navy. The content of this policy document and the connections to the Navy will be discussed in detail in Chapter 6.

The Air Force was the next to instigate planning. When Gustavo Leigh became head of the Air Force on 17 August 1973, he replaced the constitutionalist Raul Montero. Leigh was an ardent anti-communist. Constable and Valenzuela (Constable and Valenzuela 1991: 51) outline the role of Air Force General Nicanor Díaz Estrada, who was also instrumental in the coup plotting. This high level involvement by the Air Force early in August places the Air Force above the Army in the conspiracy.

The junta member from the police (Carabineros) was its weakest member. According to O’Brien, General Mendoza was seventh in line to command the Carabineros until the coup (O’Brien 1983: 46). On the day of the coup he took command of the Carabineros, who were mainly a police force and geographically dispersed rather than concentrated within barracks or bases. They had little access to more advanced weapons found in the armed forces. Little is said in the literature about their involvement in the coup.

Army Commander-in-Chief Augusto Pinochet appeared to be the least informed of the coup. According to Spooner it was only on 8 September 1973 that General Arellano Stark informed Pinochet of the Army’s plans for the coup (Spooner 1994: 37). Thus, the Army’s coup plotters were officers in rank below Pinochet. These officers included Sergio Arellano, Oscar Bonilla, Herman Brady, Augusto Lutz, Sergio Nuño and Javier Palacios (Constable and Valenzuela 1991: 51). This indicates a weak position for Pinochet among the coup plotters.

Spooner discusses how on 9 September two Navy admirals and a captain brought a letter to Pinochet by the Navy Commander-in-Chief. The letter needed to be signed by Pinochet for the go ahead of the coup on 11 September. Leigh had already asserted his participation in the coup.
Pinochet was the last of the commanders to take his place on the day of the coup, which began with a pre-dawn uprising in Valparaíso led by the Navy. Major combat lasted no longer than 24 hours and only two weeks of minor skirmishes were mainly located in Santiago (Spooner 1994: 38).

This discussion of the organisation of the armed forces in general and the Army in particular demonstrates that there was not one homogenous entity with one entrepreneur at the top directing the actions. The Army was directed to the coup by officers below the Commander-in-Chief of the Army.

In other words, there was not one individual entrepreneur at the head of the organisations, who was the cause of the coup plotting, but rather a group of individuals below the top of the hierarchy. Later, this thesis will outline how these facts pose a problem when using the theoretical framework of Douglass C. North.

2.5.3. Structure of decision making

This section focuses on the initial structure of decision making within the authoritarian government. The time frame is limited to the period from 11 September 1973 until the end of September 1973 in order to leave out Pinochet’s consolidation of power. Pinochet’s consolidation of power will form part of the political institutional change that explains the reason for the delay in implementing neo-liberal labour laws. This will be explored in Chapter 6.

Generally, one would expect the distribution of power among the armed forces to follow the relative military strength. Roxborough and colleagues provide the following data. The Army was the largest in size, with personnel of 26 000. The Navy came second with personnel of 15 000 and the Air Force last with 8500 (Roxborough, O'Brien et al. 1977: 187). This statistical
comparison would place the Army at the head of a governing junta. However, such a statistical comparison would not consider the consequences of the coup planning.

The previous discussion showed the Army as the weakest of the three branches. This was due to the break in discipline and hierarchy within the Army as the officers below Pinochet began to plan the coup without his knowledge or consent. The Navy and the Air Force were in a relatively strong position as planning had begun from the top of the organisation, which maintained the hierarchy of the organisation.

The Army Commander-in-Chief would need to reassert his position vis-à-vis the coup plotters. This is illustrated by the fact that the Ministry of Interior was given to Oscar Bonilla, one of the known coup plotters within the Army. This is a highly visible position with the ability to call for states of emergency. Pinochet would need to reassert his authority within the Army before he could consolidate his power.

The Carabineros (Police) were also in a weak position. Their newly appointed head had only taken his post at the beginning of the coup. There was also little in the way of force that the Carabineros could mount against the military. They were geographically spread out and their armaments were inferior to those of the military.

Barros (2002) discusses the decision making structure in those first few weeks in detail. A four-man junta del gobierno (junta of the government) took office officially on 12 September 1973. This was established with Decree Law 1, where the junta took on the Supreme Command of the Nation. The four members of the junta were the three Commanders-in-Chief of the armed forces and the head of the federal police force (Carabineros). The Decree Law also appointed Pinochet President of the Junta. However, the President did not have any special powers in that position. Furthermore, the junta
members envisioned a revolving president of the Junta, between the four Commanders-in-Chief.

Junta members had unlimited tenure. When they first took over, the timetable for a return to democracy indicated that they would only stay in office as long as circumstances so required them (Arriagada 1988: 5). This vague definition would be open to interpretation and could allow them an indefinite stay in power.

Barros (2002) outlines how the process of review of laws was also severely curtailed within the authoritarian government. Decree Law temporarily suspended the Comptroller General of the Republic on 13 September 1973. The Comptroller’s role had been to review laws for inconsistency with current laws and to judge if they complied with the constitution. Additionally, Decree Law 128 of November 1973 stated that ‘the Governing Junta has assumed constituent, legislative, and executive authority’ (Arriagada 1988: 9).

All ministers were fulfilling ministerial responsibility within the executive. Thus, ministers appointed by the Junta were part of a kind of cabinet of the Junta. According to Barros, the third session of the junta meeting on 16 September 1973 distributed ministerial positions (Barros 2002: 50). These are outlined below:

Commission 1: Finance, Economics, Development & Reconstruction, Mining, and Foreign Affairs - in the hands of the Navy (Admiral Merino)


Commission 3: Agriculture, Colonisation, Public Works, Housing and Urbanisation, and Transport - under Carabineros (General Mendoza) (Henderson 1977: 131)
Thus, according to the preceding structure, the Junta members had a relatively autonomous ability to direct institutional change under their jurisdiction. The Army with the largest personnel was given an overview task. However, the Army was not in a commanding position coming into the coup to direct formal institutional change.

This discussion of the initial structure of the state under the Junta shows that it does not match the conception of the state used by the theoretical framework of Douglass C. North’s New Institutional Economics (NIE). North’s conception of the state is that of an individual ruler at the top, like a benevolent dictator decreeing the rules of the game.

However, in this case each of the Junta members had legally equal decision-making power. This generates a cooperation problem. To pass a law they needed the unanimous agreement of all Junta members.

There is also an obeying rules problem. North’s model conceives that the ruler may act as they wish, as the ruler creates the rules of the game. However, the ruler is limited here. Each of them, including the ruler, must obtain the agreement of the other Junta members.

2.5.4. Chapter Conclusion

This Chapter addressed two questions that relate to the thesis questions, namely the question whether corporatism was present in the labour, business, political and military organisations of Chile, and if so, what these historical antecedents of corporatism indicate about the sources of support for corporatism in the authoritarian government.
The answer to the first question is that corporatism has been an important part of Chilean organisations throughout the 20th century. This has been evident in Chilean organisational history as well as in the previous authoritarian government of the early 1930s. This is important as it represents possible sources of opposition to neo-liberal labour laws and support for possible alternatives.

Part of the answer to the second question can be found in the historical accounts of the different organisations. Business would seem to be more conducive to corporatist institutions compared to labour organisations. However, corporatist thought was only one of the dimensions of business ideology. Labour organisations’ largest faction was oriented toward an ideology related to Marxist thought. The military and polity have been identified as important sources of support for corporatism.

In relation to the governance structure and the political institutions that determined decision-making in the polity, the polity under the military junta was divided rather evenly among the three branches of the armed forces and the police (Carabineros). The eventual even split of ministerial responsibility among the junta members’ organisations meant that institutional change could follow divergent paths. Each junta member had the ability to name ministers of his choosing and could shape formal institutions through their position in the junta.

Having established the presence of corporatism in Chile prior to, and at the beginning of the authoritarian government, important information is provided to address the first two thesis questions:

1. Why did it take so long to implement neo-liberal labour laws under an authoritarian government in Chile?
2. How were the neo-liberal labour laws promulgated under the authoritarian government in Chile?
While this Chapter does not directly answer the second thesis question, it does indicate that the neo-liberal school of thought within the armed forces must first achieve hegemony over corporatism before the implementation of neo-liberal labour laws could take place. This is explored in Chapter 6.
3 The intersection of business and the polity: labour legislation

This chapter is concerned with an analysis of the rise in influence of business organisations in the decision making process of the authoritarian government. Business organisations are an important part of the labour market and if they can influence the polity they would be a key cause of labour market institutional change. Thus it is important to establish how businesses influenced institutional change, and in what way the institutional framework impacted on business. Also under consideration are the consequences for labour market institutions.

This chapter addresses the following three questions:

- How did Chilean business organisations influence the direction of formal institutional change through ministerial channels?

- How did the perceived success or failure of institutional change impact on future institutional change?

- How did formal institutional changes impact on the power of business organisations and influence future institutional change?

The answers to these three questions will provide information needed to answer the first two questions of this thesis.

Two periods, as identified in the literature, are studied in this chapter – the periods of gradual adjustment (1973-1975) and of radical neo-liberalism (1975-1982) (Foxley 1986; Oppenheim 1993; Silva 1993; Silva 1995; Silva 1996a). Gradual adjustment refers to policies, laws, initiatives, which move
the economy toward a more liberalised position. e.g. reduced government
deficit, freed capital markets. However, there is no overarching model to
direct this adjustment. Radical neo-liberalism refers to policies, laws,
initiatives that conform to a particular model of the economy, which would
lead to a self-regulated economy. This model includes a monetary view of
the balance of payments and involves financial deregulation.
This chapter uses the work of Eduardo Silva (1992; 1993; 1995; 1996a;
1996b; 1998) extensively, as he is a pioneering author in the relations of
business to the authoritarian government in Chile.


The period of gradual adjustment was characterised by reforms of a neo-
liberal origin which were introduced slowly as the Minister of Economy,
Fernando Léniz24, feared that the Chilean population would not cope with a
shock program25 (Lama 1979: 102-105; Vergara 1984: 27). This period lasts
from the inception of the authoritarian government on 11 September 1973
until the implementation of the shock program on 24 April 1975.

In relation to the first question in this chapter, it is positioned that Chilean
business organisational structures determined the policies businesses would
pursue through their ministerial connections. In reference to the second
question, the perceived failure of gradual adjustment resulted in a shift in
economic policy to radical neo-liberalism. In relation to the third question, the
institutional framework of gradual adjustment weakened domestically
oriented conglomerates, while strengthening internationally oriented

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24 Fernando Léniz was Minister of Economy from September 1973 until April 1974.
25 In economics, shock program refers to the sudden release of price and currency controls,
withdrawal of state subsidies, and immediate trade liberalisation within a country, usually
also including large scale privatisation of previously publicly owned assets.
conglomerates. In relation to the thesis questions, gradual adjustment itself would not support neo-liberal labour laws. However, its perceived failure and the strengthening of the radical coalition contributed to the neo-liberal labour laws' implementation.

3.1.1. Environment of the implementation of gradual adjustment

The heterogeneous business coalition that assisted in toppling the democratic government, in addition to the fear of a return to the previous democratic government, meant gradual adjustment would be dominant. Business did not have a unified economic and social project at the beginning of the authoritarian government (Campero 1995: 131). This may be due to the heterogeneous coalition that toppled the previous government, which made gradual adjustment popular, as it could satisfy all business groups (Moulian and Vergara 1980: 79). Fear of the previous democratic government, the Presidency of Socialist Salvador Allende, was a factor that united the business organisations and prevented them from even mild criticism of the institutional reforms of the authoritarian government. ‘Class fear eclipsed sectoral concerns; class fear drove business to support a ruthless military regime’ (Frieden 1991: 151). The broad nature of the coalition in support of the authoritarian government and class fear meant gradual adjustment became the dominant framework.

3.1.2. Support base of gradual adjustment policies

How did Chilean business organisations influence the direction of formal institutional change through ministerial channels? This section identifies those business organisations that supported gradual adjustment and
discusses how those organisations’ connection to the state influenced institutional change.

*Conglomerates – identifying support for gradual adjustment*

According to Silva (1996a: 72), the domestic market orientation of various conglomerates led them to support gradual adjustment and non neo-liberal labour laws. Conglomerates in support of gradual adjustment included the Edwards, Matte, Luksic, Yarur-Bana, Briones and Lepe groups. These conglomerates had a large percentage of their assets oriented towards the domestic market. This means they owned companies that produced for the domestic market and would be dependent on favourable domestic market conditions to maintain profitability. For the three largest conglomerates, Edwards, Matte, and Luksic, the percentages of their assets devoted to the domestic market were 43.2%, 53.7% and 68.7%, respectively. This structure would lead them to support domestic market friendly formal institutional change or gradual adjustment. Neo-liberal labour laws would damage the domestic market by reducing labour’s purchasing power, which implies domestically oriented conglomerates would not support neo-liberal labour laws.

Domestically oriented conglomerates’ reliance on strong internal demand to maintain profitability resulted in their support of gradual adjustment and non neo-liberal labour laws. An econometric study by Jaime Gatica Barros (1989: 79-83) showed that domestic demand was the main source of output changes for manufacturing in Chile. Internal demand and wages must be held at reasonable levels for their domestic operations to be sustainable. Neo-liberal labour laws of the kind espoused by the neo-classically trained Chicago Boys would have decreased internal demand and would have hurt...

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26 The Chicago Boys were a group of Chilean economists who obtained their undergraduate degrees from the Chilean Catholic University and postgraduate degrees from the University
the domestically oriented conglomerates’ profitability. Thus, a gradual adjustment that did not drastically change labour laws and the domestic market would be beneficial for domestically oriented conglomerates.

**Business associations - identifying support for gradual adjustment**

Silva (1993: 536, 538) reports that all major business associations were in support of gradual adjustment and against drastic change to labour laws. These included National Mining Society\(^{27}\) (SONAMI), Central Chamber of Commerce\(^ {28} \) (CCC), Chilean Chamber of Construction\(^ {29} \) (CChC), National Agrarian Society\(^ {30} \) (SNA) and the Society for Industrial Development\(^ {31} \) (SFF). With the major business associations in support of the gradual reform process, the umbrella organisation for all business associations, the Confederation of Production and Commerce\(^ {32} \) (CPC), threw its support behind the gradual reform process. There were differing reasons why the business associations supported the gradual reform process, which Silva (1996a) discusses in detail.

For SONAMI, the mine owners’ association, gradual adjustment would be beneficial because it would return previously expropriated mines to their original owners. Additionally, trade reform would expand the demand for their raw materials. Prior to the coup, miners provided for domestic

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\(^{27}\) SONAMI – *Sociedad Nacional de Minería*; National Mining Society.

\(^{28}\) CCC - *Cámara Central de Comercio*; Central Chamber of Commerce.

\(^{29}\) CChC – *Cámara Chilena de la Construcción*; Chilean Chamber of Construction.

\(^{30}\) SNA - *Sociedad Nacional de Agricultura*; National Agrarian Society.

\(^{31}\) SFF – *Sociedad Fomento Fabril*; Society for Industrial Development.

\(^{32}\) CPC – *Confederación de la Producción y Comercio*; Confederation of Production and Commerce.
production first and then exported overseas, however mine owners no longer wanted to be dependent on small and inefficient domestic industries.

SNA, the landowners’ peak association, had considered protectionism the root cause of decapitalization in the sector. They felt they had suffered because they were forced to have artificially low prices to satisfy the growing industrial labour force. The SNA, along with other large agricultural associations, supported the authoritarian government’s return of expropriated land and compensation (Remmer 1979: 447). Therefore, SNA supported trade reform and the general freeing of prices, but with a price floor instead of a price ceiling.

According to Silva (1993: 538; 1996a: 81), there was tension in the SFF between those who supported the old state-led development model and those who supported gradual adjustment. The main concern of the SFF’s members was the return of expropriated and nationalised businesses. The supporters of the state-led development model were weakened as they had suffered from nationalisations and expropriations under Allende. The supporters of the gradualist adjustment held the majority of the SFF board, with 24 members in support of gradual adjustment compared to a minority of seven for a state-led development model. Thus, while nominally split, the official line of the SFF was to support the gradualist policy of the authoritarian government.

*Business’ connections to ministerial positions*

Domestically oriented conglomerates were able to influence the direction of institutional change, and the lack of change to labour laws, through connections with ministers in economic areas. For example, Orlando Saenz, who was on the board of directors of the Edwards group, was also the president of the SFF and part of a team that went to New York to open channels of foreign credit (Remmer 1979: 456; Silva 1996a: 85; Cavallo,
Salazar et al. 2001: 101-103). Fernando Léniz had ties with the Edwards and Matte groups and became the Minister of Economy in October 1973 (Silva 1996a: 85). Raúl Sáez was one of the first directors of CORFO and had close ties to ISI (Silva 1996a: 85). Additionally, Sáez became the leader of the economic advisory team in October 1973 and was strongly against the radical neo-liberalism of Chicago (Cavallo, Salazar et al. 2001: 110). The first Minister of Finance, Lorenzo Gotuzzo Borlando, was also sympathetic to gradual adjustment (Zárate 1999/2000: 7). This meant that business organisations in support of gradual adjustment had ministerial connections to push the implementation of their preferred institutions, which made the implementation of neo-liberal labour laws unlikely.

On the level of the governmental junta, there was initially opposition to radical neo-liberalism, which would support the implementation of gradual adjustment and the non-change of labour laws. For example, General Augusto Pinochet stated that a neo-liberal approach to stabilisation would produce ‘a strong [increase in] unemployment and the suspension of numerous basic public works that the country cannot cancel without affecting its future development’ (Kurtz 1999: 408). General Gustavo Leigh reported that neo-liberal policies would imply ‘an enormous cost in lives, low wages, and a cruel and discriminatory economic policy’ (Varas 1980: 65). Thus, given the preferences of the governing junta, gradual adjustment and the non-change of the labour code were dominant.

Three different indicators have been used that allow inferences about the relative price of accessing the polity for certain organisations or individuals. The first of these indicators is the destination of the conglomerates production. The next is the business associations’ support for gradual

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33 CORFO – Corporación de Fomento de la Producción Development Corporation of Chile.
34 ISI – Import Substitution Industrialisation.
adjustment. Lastly, the personal relationship between ministers and the business community indicates support for gradual adjustment.

However, these indicators are a very indirect means to identify a price to access and influence a minister or policy maker. Yet North’s NIE relies heavily on relative prices when discussing accessing the polity. The fact that there is no open market for an individual or organisation to access the polity and that therefore the indicators described here are the most accurate description possible, raises a number of issues.

3.1.3. Economic policies

The gradual adjustment economic policies or institutions were promulgated from the beginning of the coup on 11 September 1973 until the end of 1974. Kurtz (1999: 406-407) argues that these institutions were part of the need to stabilise the economy after the Presidency of Socialist Salvador Allende from 1970 until 1973. Several of these economic policies are presented below.

The exchange rate system was rationalised from fifteen different exchange rates to three\(^{35}\) (Borlando 1979: 49; Fanis 2004: 371). Decree Law 522 promulgated on 15 October 1973 decontrolled the prices of 3000 products (Wisecarver 1986: 11). This process meant freeing a number of agricultural prices as well, which was favoured by the SNA. In 1974 Decree Law 534 stated that 50 000 government employees had to be fired within eighteen months (Edwards and Edwards 1991: 27-29). From September 1973 until July 1975 average tariff rates were reduced from 94% to 52% (Ffrench-Davis 2002: 58). In 1974 there were 325 state-owned enterprises that were

\(^{35}\) The first was the general exchange rate. The second exchange rate was for small and medium copper miners only. The third exchange rate was for tourists both entering and leaving Chile (Borlando 1979: 49).
returned to their original owners free of charge (Lüders 1991: 12). This included the return of some mines as desired by the SONAMI and farming land as desired by the SNA. The close match between what the business associations wanted, and the decree laws promulgated, indicates a close connection between the supporters of gradual adjustment and the polity.

3.1.4. Failure of gradual adjustment

This section addresses the second and third questions raised for this chapter, namely how the perceived success or failure of institutional change impacted on future institutional change and how formal institutional changes impacted on the power of business organisations and how they influenced future institutional change.

There were three main reasons why gradual adjustment lost support in the authoritarian government. First, the information feedback from the economic environment was negative, especially for inflation. Marcus Kurtz (1999: 410) argued that the perceived failure of the gradualist adjustment was the key reason for change in economic policy. Second, an economic recovery did not materialise, which led to economic stagnation, impacting on the domestically oriented conglomerates ability to support gradual adjustment.

36 While the large copper mines were not returned to their former owners, a number of considerations meant SONAMI was not terribly angry with this. First, the law that passed ownership to the state during the Presidency of Allende was passed with a unanimous vote of Congress on 11 July 1971 (The World Bank 1980: 23). Second, international interests that did not join the mining association owned the copper mines; thus, SONAMI was not obliged to defend them (Menges 1966: 346). Third, the authoritarian government provided compensation to the original mine owners (Latin American Political Report 1974a: 67; Latin American Political Report 1974b: 83). Decree Law 710 on 24 October 1974 facilitated the compensation (Barros 2002: 100). These three reasons explain why SONAMI did not defend the copper mines’ return during the authoritarian government.
Lastly, the sequencing of policies benefited some businesses more than others.

The information feedback from the economic environment was not positive despite gradual adjustment, especially in regards to inflation. Historically, high inflation was a core problem of the Chilean economy. Inflation was extremely high during the administration of Allende, increasing from 78% in 1971 to 353% in 1972 and 505% in 1973 (The World Bank 1980: 283). To control inflation, the authoritarian government instituted some repressive policies, including the banning of collective bargaining, a reduction in public employment, and an increase in the value added tax (Edwards and Edwards 1991: 27-29). In a 1973 Ministry of Finance Report, the Minister of Finance, Navy Vice-Admiral Lorenzo Gotuzzo Borlando, expected a decline in the ‘inflationary spiral’ in 1974 (Borlando 1979: 72), but inflation was above 300% by the end of 1974 (The World Bank 1980: 144). Actual inflation did not meet expectations, which meant that those economists who were tied to the gradualist policy lost credibility due to their perceived inability to control inflationary pressures.

The gradual adjustments’ inability to meet the predictions of their own proponents for GNP and investment growth meant that they lost credibility within the authoritarian government. In the 1974 Report on the State of Public Finance, Minister of Finance Jorge Cauas had predicted positive GNP growth of 6% and investment at 18% of GNP for 1975 (Lama 1979: 107). Actual GNP was negative in 1975 and the investment rate was 10.7% (Foxley 1983: 43-46). These results were clearly negative information feedback for gradual adjustment, reducing its credibility as a viable policy.

North claims that accumulation of negative information will lead an individual or organisation to change their model of reality. Negative information led to change in the economic model applied to the Chilean economy. That is,
gradual adjustment’s inability to control inflation or encourage economic
growth represented negative information feedback.

However, a key question is: ‘How to measure the importance of these
negative information feedbacks for disproving gradual adjustment?’ This is
left unexplained by North. It is contended here that an inability to control
inflation was important because gradual adjustment aimed at reducing
inflation. The same argument can be made for the lack of economic growth.

The weakness of the domestic economy would have weakened the
conglomerates in support of gradual adjustment. The economy had entered
into recession\(^{37}\) in 1973, GDP declined by 5.5% (Banco Central de Chile
2001: based on own calculations). It was expected that with the removal of
Socialist President Salvador Allende, the economy would recover. However,
the level of Industrial Production (IP) fell by 4% in 1974 and unemployment
increased by about 4% (Edwards and Edwards 1991: 29-30; Ffrench-Davis
2002: 83). The share of manufacturing out of total GDP fell from 26% in
1973 to 21.5% in 1975 (Banco Central de Chile 2001: based on own
calculations). Continued weak domestic demand, highlighted by decreasing
IP, increasing unemployment, reduced share of manufacturing output, all
meant that domestically oriented conglomerates, like Edwards, Matte and
Luksic, were in a weak position to support gradual adjustment.

Finally, the sequencing of policies was important for the failure of the gradual
adjustment coalition, benefiting conglomerates in support of a more radical
neo-liberalism. During the recessionary years (late 1974 until 1975) state
enterprises were privatised through a bidding process, in which the highest
bidder would be able to acquire the company (Hachette and Lüders 1993:
48; Meller 1993: 99). In the recession, obtaining credit domestically was

\(^{37}\) A recession is defined as two consecutive quarters of negative GDP growth (Kuttern and
difficult and expensive, meaning that those conglomerates with access to cheaper international credit could successfully purchase privatised firms. Credit could be guaranteed in large part by the shares that were purchased through the privatization process (Lüders 1991: 11). Privatised firms were sold at discounts of about 30% of the firms’ net worth (Foxley 1982: 13). Thus, internationally oriented conglomerates, such as Cruzat-Larrain and Vial (BHC)\textsuperscript{38}, whose main source of profitability and growth was financial intermediation, were well positioned to take advantage of the privatisation process. These two firms were supporters of a more radical form of liberalization for the economy. This further eroded the position of the gradual adjustment advocates.

3.2. Radical neo-liberalism: 1975-1982

Radical neo-liberalism was an intensification and spread of the policies applied under gradual adjustment. The economic ministers intensified the application of neo-liberal policies and followed the prescriptions from \textit{El Ladrillo}\textsuperscript{39}. Radical neo-liberalism was now also implemented in social areas like the labour market.

Two core conglomerates supported radical neo-liberalism, Vial (BHC) and Cruzat-Larrain. Silva (1996a: 47, 101) shows how the Edwards conglomerate was restructured to support radical neo-liberalism, which can be traced from November 1974 in editorials in Edwards’ flagship publication, \textit{El Mercurio}.

\textsuperscript{38} Other conglomerates would follow these two leaders. Notable among the followers was the Edwards group.

\textsuperscript{39} \textit{El Ladrillo} (The Brick) is examined in detail in Chapter 5 ‘Neo-liberal economic reform agenda: from proposal to implementation’.
3.2.1. Intensification: the shock program

Background

There was a formal relationship between the University of Chicago and the Catholic University of Chile, which allowed Chilean undergraduate students to complete a postgraduate degree in economics at the University of Chicago. This relationship between the two Universities lasted from 1956 until 1964. The Chilean postgraduates from this relationship obtained prominent ministerial and non-ministerial positions in the authoritarian government. Many of those students who studied at Chicago and those who shared their economic point of view would later be labelled Chicago Boys. Visiting University of Chicago Economics Professors influenced the direction of formal institutional change toward radical neo-liberalism and neo-liberal labour laws. Leading up to the shock program, Professor Arnold Harberger visited Chile three times for conferences. Arnold Harberger was a teacher of many of the Chilean graduate students who studied at Chicago and had a strong influence on them (Valdés 1995: 155). Arnold Harberger and Milton Friedman visited Chile in March 1975, sponsored by the BHC, a leading bank with ties to the Chicago Boys. Harberger and Friedman received substantial press attention (El Mercurio 1975a: 18; El Mercurio 1975b: 23; El Mercurio 1975c: 29, 35). They were referred to as world-class economists and Friedman was mentioned as short-listed for the Nobel Prize in Economics. Articles on their presentation concluded that inflation was the main cause of

40 For further detail on the origin of the Chicago Boys refer to Chapter 5 ‘Neo-liberal economic reform agenda: from proposal to implementation’.

41 Milton Friedman was awarded the Nobel Prize in Economics in 1976. What is commonly referred to as the Nobel Prize in economics is actually The Sveriges Riksbank Nobel Memorial Prize in Economic Sciences in Memory of Alfred Nobel. This prize was not one of the five prizes originally conceived by Alfred Nobel in 1895.
the Chilean economic stagnation and the solution was a reduction in the budget deficit. Furthermore, Friedman presented at the Diego Portales building, the seat of government in authoritarian Chile, and Friedman had a face-to-face meeting with Pinochet (Cárcamo-Huechante 2006: 414-415). These well-publicised visits would have had some impact on their audiences and influenced the direction of economic policy including labour laws.

Ministers sympathetic to gradual adjustment lost their positions within the authoritarian government, strengthening the radical neo-liberalism position and increasing the likelihood of neo-liberal labour laws implementation. Fernando Léniz lost his position as the Minister of Economy in early April 1975. His position was granted to University of Chicago Department of Economics postgraduate Sergio de Castro (Latin America Political Report 1975a: 113). The gradualist Raúl Sáez was given a reduced role in 1975 and was forced to leave the country for a diplomatic mission to Spain when the governing junta was debating whether to apply the shock program (Cavallo, Salazar et al. 2001: 116). On 6 November 1975 Raúl Sáez resigned as Minister of Economic Coordination (Campero 1984: 127). These gradualists were removed because their policies were perceived to have failed and because of the perceived ‘correctness’ of the radical neo-liberal model supported by the visiting Chicago economists. The gradualist adjustment coalition lost access to the polity and a more radical brand of neo-liberalism was supported, increasing the likelihood neo-liberal labour law implementation.

The shock program

The economic shock program signalled the change to radical neo-liberalism.\textsuperscript{42} Finance Minister Jorge Cauas, a Chicago Boy, announced on

\textsuperscript{42} Previously socialist countries of Central and Eastern Europe and the former Soviet Union have transitioned to market economies through economic shock programs. The similarities
national television at 10 pm on the 24 April 1975, the economic shock program, *Programa de Recuperación Económica*\(^{43}\) (Lama 1979: 155; O'Brien 1983: 54). Coincidentally, the shock program was announced exactly a month after Milton Friedman first landed in Chile. The shock program’s objectives were to lower inflation and increase economic growth through reduced government spending and employment.

According to González-Rossetti and colleagues (2000: 19), Cauas was given extensive control over the economic direction of the country through Decree Law 966, which instituted the shock program. Reportedly written by Cauas himself, the law granted the Minister of Finance power over every agency related to the Ministry of Finance, plus ten other ministries: Economics, Mining, Agriculture, Public Works, Transportation, Housing, Public Health, Labour, ODEPLAN\(^{44}\) and CORFO\(^{45}\). Decree Law 966 gave the Minister of Finance the power to appoint and remove all high-level civil servants, with the exception of the ministers themselves, who were to be exclusively designated by the President. This was also a change in policy as previously the Junta could veto the naming of a minister\(^{46}\).

Among the characteristics of the shock program were two strategies to reduce the state’s contribution to inflation. One was a reduction in total government expenditure (between 15% and 25%). Second was an acceleration of the program reducing the size of the public sector, which had begun in 1974 (Foxley 1983: 55-56). The private sector was targeted with

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\(^{43}\) Economic Recovery Program.

\(^{44}\) ODEPLAN - *Oficina Nacional de Planificación*; National Office of Planning.

\(^{45}\) CORFO - *Corporación de Fomento de la Producción*; Development Corporation of Chile.

\(^{46}\) This will be discussed in more detail in Chapter 6 as that Chapter focuses on the qualitative changes in the polity structure which impacted on the implementation of neo-liberal labour laws.
two strategies as well. First was a 10% temporary hike in income taxes. Second a tight monetary policy (Edwards and Edwards 1991: 31). This aligns with the radical neo-liberal project, which would increase the likelihood of neo-liberal labour law implementation.

The shock program was a decisive shift away from gradual adjustment and was a movement toward neo-liberal labour law implementation. The shock program included a credit crunch, which is defined as a large increase in domestic interest rates. For example, in the third quarter of 1975, the real interest rate reached 178.4% (Foxley 1983: 50-51). The shock program eroded the profitability of domestically oriented firms, for example, real GDP fell 13.3% in 1975 (Corbo and Tessada 2002: 467). Thus, the erosion of domestically oriented firms’ source of profitability and the general direction of economic institutional change contributed to the implementation of neo-liberal labour laws.

Ministerial support base for radical neo-liberalism

The internationally oriented conglomerates had connections with economic ministries, which allowed the conglomerates to pursue the institutional reforms they preferred. Relations between the core conglomerates and the Chicago Boys were particularly close in the Ministries of Finance and Economy. Jorge Cauas resigned as Minister of Finance on 26 December 1976. The following day the position was passed on to Sergio de Castro, a close associate of Cauas (Cavallo, Salazar et al. 2001: 211). Sergio de Castro, the Minister of Finance for this entire period of radical neo-liberalism, was an intimate friend of Manuel Cruzat, one of the directors of the conglomerate Cruzat-Larrain (Silva 1996a: 140). De Castro was also on the board of directors of the Edwards conglomerate prior to his appointment to government office and again immediately after leaving government service (Silva 1996a: 140). Jorge Cauas himself had been an executive in the internationally oriented conglomerate Cruzat-Larrain (Dahse 1983: 12).
Three of the four ministers of economy between 1978 and 1982 were also former executives, or directors, of Cruzat-Larrain or Vial (BHC) groups. This indicates a fall in the relative price of accessing the polity for the internationally oriented conglomerates compared to the domestically oriented conglomerates, which contributed to the implementation of neo-liberal labour laws.

Table 3.1 illustrates the strong connections between the Minsters of Finance, other ministerial positions and the Chicago Boys. The rise in importance of the Chicago Boys began in 1975 and represented a shutting out of alternatives. In Table 3.1 blank fields for ministers mean that the minister has no known affiliation to a conglomerate, the financial sector or the Chicago Boys. Rather what this table shows is the strong connection between internationally oriented conglomerates, such as Cruzat-Larrrain, and ministers.
### Table 3.1  Relations between ministers and conglomerates in Chile, 1976-1983

<table>
<thead>
<tr>
<th>Organisation/Ministerial Position</th>
<th>Name</th>
<th>Tenure</th>
<th>Conglomerate Affiliation of Official</th>
<th>Conglomerate Type</th>
<th>Official Linked to Finance Sector&lt;sup&gt;a&lt;/sup&gt;</th>
<th>Official is Chicago Boy</th>
</tr>
</thead>
<tbody>
<tr>
<td>CORFO Vice Presidents</td>
<td>Danús&lt;sup&gt;c&lt;/sup&gt; Ramos&lt;sup&gt;c&lt;/sup&gt; Varela&lt;sup&gt;c&lt;/sup&gt; Ramirez&lt;sup&gt;c&lt;/sup&gt;</td>
<td>1975-1979 1979-1980 1980-1981 1981-1983</td>
<td>Edwards Cruzat-Larrain</td>
<td>Radical International Radical International</td>
<td>Yes Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Neutral: Food distribution (supermarkets) gives it an interest in open trading (imports) but also in healthy domestic food processing manufactures. The Ibáñez group had no holdings in the financial sector

MNC: Multinational Corporation
<sup>a</sup> Official is on the board of directors of, an executive with, or a consultant to a private financial institution
<sup>b</sup> On the elected council of the SNA and SFF
<sup>c</sup> Army officer

(Source: Silva 1996a: 142-143)
In answer to the second and third questions in this chapter, the economic prosperity of conglomerates provided a demonstration effect and allowed them to finance support for further radical neo-liberalist changes.

According to Foxley (1986: 46), Cruzat-Larrain and Vial (BHC) were able to grow quickly and make profits based on their control of financial intermediation. Cruzat-Larrain and Vial (BHC) controlled a large proportion of the credit that entered Chile from abroad, approximately 48.5% in December 1982. There was a large difference between the nominal Chilean interest rate and the external interest rate, which fluctuated between 100% and 20% from 1976 until 1981. Thus, it would be possible for these conglomerates to acquire large profits through their control of financial intermediation.

To sustain this level of profitability a number of policies would need to be maintained. Cruzat-Larrain and Vial (BHC) adamantly opposed demands for devaluation of the Chilean currency, government intervention to lower interest rates, or ‘discriminatory’ sectoral policies of the gradual adjustment alliance (Silva 1996a: 151). The firms generated their profitability from external credits denominated in foreign currency. If the Chilean currency were allowed to devalue their dollar, liabilities would have increased many times over. Government intervention to lower interest rates would have reduced the profitability derived from the differential between external and internal interest rates. Finally, sectoral policies may have increased competition in financial intermediation, which may have reduced internal interest rates and hurt the conglomerates’ profitability (Silva 1996a: 151). Therefore, the conglomerates would support a radical neo-liberalism that maintained this status quo.
Part of the Chicago Boys’ prescription for the economy was the implementation of the theory of the monetary view of the balance of payments\(^47\). Blejer and Frenkel (1987: 497-498) provide a list of policies that correspond to this theory. The theory includes maintenance of a fixed exchange rate, no government intervention in the operation of interest rates, and non-intervention in product markets. The fixed exchange rate in the monetary view of the balance of payments was an economic model to produce an economy free from government intervention. In this economic model once the exchange rate was fixed it was to remain fixed for eternity. Thus a fixed exchange rate is consistent with minor government intervention in the economy and neo-liberalism in general. This represents part of the tight connection developed between the Chicago Boys and the internationally oriented conglomerates.

Increasing asset values and the growth of the conglomerates was a positive signal about the economic and financial institutions in place. Between December 1977 and December 1981, the Chilean stock market price index grew by seven times (Corbo 1985: 906). This is a massive increase in stock market value, representing a large increase in the value of listed company assets. Cruzat-Larrain and Vial (BHC), by the end of 1978, controlled enterprises representing 50% of the wealth of all corporations registered in the stock exchanges of Santiago and Valparaíso (Ffrench-Davis 2002: 50). Cruzat-Larrain and Vial (BHC) grew by 182% and 119.7% respectively, between December 1978 and December 1980 (Dahse 1983: 31). This spectacular growth was achieved through expansion and control of debt channels. These indicators provided a positive signal for the formal economic and financial institutions in place.

Table 3.2 illustrates the top two conglomerates’ percentage of loans issued to related companies. Rising asset values may be used as collateral to

\(^{47}\) The monetary view of the balance of payments is discussed in more detail in section 3.2.4.
secure loans, because if assets only rose in value, a borrower could always refinance a loan using the increased value of the asset (Brunnermeier 2008: 77-80). Thus continuous increases in asset values may lead to continuous increases in loans. The top two conglomerates controlled 48.5% of the external credits that entered the nation by December 1982 (Foxley 1986: 46). A significant percentage of these loans went to related companies within the conglomerate, backed by rising asset prices. This financial strength could be translated to support for the Chicago Boys in key ministerial positions.

Table 3.2: Economic conglomerates and the financial system

<table>
<thead>
<tr>
<th>Group and Banks they own</th>
<th>Capital and reserves</th>
<th>Loans</th>
<th>External credits</th>
<th>Loans to related companies as % of institution’s total lending</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>As % of the system in Dec 1982</td>
<td>Loans</td>
<td>External credits</td>
<td>Jun-82</td>
</tr>
<tr>
<td>Vial (BHC)</td>
<td>2.1</td>
<td>3.3</td>
<td>3.6</td>
<td>28.2</td>
</tr>
<tr>
<td>BHC</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>12.5</td>
<td>20</td>
<td>28.1</td>
<td>16.1</td>
</tr>
<tr>
<td>Morgan-Finansa</td>
<td>1.0</td>
<td>1.6</td>
<td>1.4</td>
<td>7.2</td>
</tr>
<tr>
<td>Cruzat-Larrain</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Santiago</td>
<td>11.8</td>
<td>11.8</td>
<td>12.1</td>
<td>44.1</td>
</tr>
<tr>
<td>BHIF</td>
<td>1.8</td>
<td>3.3</td>
<td>1.9</td>
<td>17.1</td>
</tr>
<tr>
<td>Colocadora</td>
<td>1.4</td>
<td>2</td>
<td>1.5</td>
<td>23.4</td>
</tr>
</tbody>
</table>

(Source: based on Foxley 1986: 46, based on Table 1.21)

The general direction of economic institutions was radical neo-liberal. This section showed that the dominant organisations were structured to benefit from the continuity of radical neo-liberalism. The success of the conglomerates that supported radical neo-liberalism in turn legitimised the program. This contributed to the implementation of neo-liberal labour laws.
Dogmatism and isolation of the Chicago Boys and their implicit support of internationally oriented conglomerates

The conglomerates were able to influence the direction of institutional change because the Chicago Boys were sympathetic to their cause and would not listen to alternatives. All possible criticism of the economic model was rejected by portraying it as the product of ignorance or the covert promotion of particular interests (Silva 1991: 394). The Chicago Boys denied any other solution to Chilean problems of inflation and stagnant economic growth other than the market system they wished to implement (Vergara 1984: 98). For further information on the dogmatism of the Chicago Boys refer to Chapter 5.

A classic quote from a Chicago Boy is provided to show the level of ‘independence’ they had achieved. Pablo Baraona, the president of the Central Bank, was quoted by the New York Times:

> The fact that more than 90 percent of the people are against our policies is proof that the model is working, that it has affected everybody and that it has privileged nobody. (New York Times 1976: A18)

The Chicago Boys and some in the junta deeply mistrusted organised entrepreneurs, believing that entrepreneurs placed their narrow sectoral interests above the general good of the nation (Silva 1995: 99). Pinochet in a speech on the fourth anniversary of the coup in 1977 declared:

> I want to make it clear this morning that those who believe that this government hardens or softens in response to the reactions it produces are wrong. Nothing of the kind, gentlemen. This is not a

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48 For a discussion of the Chicago Boys’ origin in this Chapter refer to background in Section 3.2.1 ‘Intensification: the shock program’.
demagogic government which is carried along by transitory and selfish currents. This government neither hardens nor softens, follows a trajectory which is clearly defined and not subject to compromise (Remmer 1979: 461)

Thus the Chicago Boys’ isolation and so-called independence was supported by Pinochet and access to them was denied except for those who agreed with their ideology or mental model (Silva 1995: 100). This represents the relative drop in price to accessing the polity for those conglomerates that agreed with the Chicago Boys (Vial [BHC], Cruzat-Larrain), while all other business organisations, including those who were part of the gradual adjustment, had an increased cost. This would increase the likelihood of the implementation of neo-liberal labour laws.

### 3.2.2. Apparent success of the shock program

*Media response – story of a success*

In the popular press within Chile, and internationally, the Chilean economy was praised as undergoing a miracle phase of economic growth. These press stories legitimised radical neo-liberalism as a success. Publications such as *The Economist* and *The Times* hailed the success of the Chilean economy (Strafford 1977: 13; Anonymous 1980: 17; Bleiberg 1980: 7; Bleiberg 1985: 11). The international press lauded the economic successes of the Chilean government:

‘Chile is a casebook study in sound economic management’ *Time*, January 14, 1980, quotation imputed to an officer of the Department of State

‘When Washington ends with its political sermons to Pinochet’s Government, perhaps, as a retribution of the friendly relations, Chile
should lend us their economic team. Economists who can simultaneously reduce inflation, tariffs, and unemployment are welcome in Washington’ Wall Street Journal, January 18, 1980, editorial
(Quoted in Foxley 1982: 3)

This represented positive information feedback for the economic work of the Chicago Boys and the authoritarian government. In Chile, the newspaper El Mercurio and the news magazine Que Pasa were also reporting the apparent success of the economy. Government institutions such as Development Corporation of Chile\textsuperscript{49} (CORFO) and ProChile\textsuperscript{50} advertised in international publications about the nation’s economic successes (Anonymous 1980: 17). This positive information feedback by the local and international press reinforced perceptions of radical neo-liberalism’s correctness, contributing to neo-liberal labour law implementation.

\textit{Economic indicators – positive results}

The correspondence between predictions and reality meant that the radical neo-liberal policies were perceived to be successful, which would increase the likelihood of neo-liberal labour law implementation. In an address to the nation on 29 June 1976 President of the Republic Augusto Pinochet Ugarte related the successes of the authoritarian government’s economic shock program of 1975. The three main economic problems listed by Pinochet included ‘an increasing fiscal deficit, deficit in the balance of payments and rampant inflation…’ (Pinochet Ugarte 1979: 193). The fiscal deficit was reduced to 2% of GDP in 1976 from a high of 8% in 1974 (Foxley 1983: 43). The balance of payments became positive in 1976 (US$490.8 million) and the amount of international reserves increased from US$463 million to

\textsuperscript{49} Corporación de Fomento de la Producción; Development Corporation of Chile.
\textsuperscript{50} Export promotion organisation of the national government.
US$880 million (Foxley 1983: 43). Inflation was reduced sharply from 343.3% in 1975 to 197.9% in 1976 (Corbo and Tessada 2002: 467). The indicators listed by Pinochet represented a short-term positive information feedback for the economic shock program.

Over a longer period of time key economic indicators also showed positive results from the economic shock program, increasing the likelihood of neo-liberal law implementation. Between 1976 and 1981 the average real GDP growth rate was 6.8% (Corbo and Tessada 2002: 467). Part of this expansion may be explained by the exponential growth of the financial sector. Between 1978 and 1981, in real terms, the financial sector expanded 75% on top of a 50% increase between 1975 (when financial deregulation began) and 1978 (Silva 1996a: 148). The reduction of inflation was also a key goal of the military government. Inflation was reduced drastically from 343.3% in 1975 to 9.5% in 1981 (Corbo and Tessada 2002: 467). The actual outcomes were positive for radical neo-liberalism, which increased the likelihood of neo-liberal labour law implementation.

Positive information feedback led to the expansion of the Chicago Boys’ mandate for change, including placing Chicago Boys in the Ministries of Mining, Education and Labour. The Minister of Labour and later Minister of Mining, Jose Piñera, was considered a Chicago Boy (Piñera 1990: 1, 6; Silva 2008: 154). He studied at the Catholic University and obtained a postgraduate degree at Harvard University (Piñera 1990: 1, 6). With this mandate they could ‘modernize’ the rest of the social area, increasing the likelihood of neo-liberal law implementation.

Presented here is positive short term and medium term information feedback of the radical neo-liberal model. North argues that an accumulation of positive information feedback will lead to a crystallisation of a mental model until it becomes a ‘belief’. This then makes the mental model difficult for the individual to refute or disprove.
The problem is to identify when a model becomes crystallised into a belief. This is not made clear by North’s NIE. However, this thesis has clearly identified that the radical neo-liberal model crystallised into a ‘belief’ for two reasons.

First, the radical neo-liberal institutions spread to other areas such as the social area of labour. Second, when the financial crisis began in 1981, the ministers in charge did not deviate from their model. These Chicago ministers actually needed to be removed from office to change the institutional makeup.

3.2.3. Spread: the new constitution and the seven modernisations

The shock program’s apparent success allowed the supporters of radical neo-liberalism to institute their preferred institutions also in other areas. First, the new constitution had the dual purpose of legitimising the authoritarian government and of protecting the neo-liberal model when the country transitioned to democracy. Second, the seven modernisations\textsuperscript{51} represented the spread of neo-liberalism to other social areas of the country, including, labour laws, education and health.

_Constitution of liberty_

The 1980 Constitution helped legitimise the Pinochet led authoritarian government and the economic model. It guaranteed Pinochet the Presidency until a plebiscite on his rule in 1988. The plebiscite was

structured so that Pinochet would be the only candidate, with only a yes or no decision. If Pinochet won the 1988 Plebiscite, then he could have remained President until 1996, at which point he would become a senator for life. If he lost, he would still remain Army Commander-in-Chief until 1996, at which point he would become a senator for life.

In this way, Pinochet would be able to oversee a return to democracy. Scholars such as Julia Paley (2001), James Petras and Fernando Ignacio Leiva (1994) have labelled these two situations as a ‘protected democracy’. Pinochet, as head of the Army, would sit on the National Security Council (NSC) where the armed forces had a majority vote. The NSC was tasked to uphold the constitution and maintain the institutional order. The NSC could, in principle, overrule the President and the Congress. Additionally, as Army Commander-in-Chief, Pinochet could easily direct another coup. Quite clearly the institutions put in place by the constitution were designed to maintain the institutional matrix that was established under the authoritarian government.

**Seven modernisations – labour law change**

The seven modernisations were the *Plan Laboral* of 1979: neo-classical labour law, educational, health services, agricultural sector, social security, justice system and administrative/regionalisation reform (Edwards and Edwards 1991: 103). The goal of the Chicago Boy’s modernisations was to introduce the tenets of neo-liberalism to all parts of Chilean society. These modernisations were also in line with the interests of those conglomerates that profited from the radical neo-liberal model.

The Labour Plan (*Plan Laboral*) of 1979 was based on the tenets of neo-classical economics. Multiple unions at the one firm were allowed and unions were only allowed to bargain at the enterprise level. These two aspects of the law were part of the neoclassical doctrine of breaking union
monopolies across industries. Formal labour market institutions are discussed and analysed in Chapter 4.

Another example of the seven modernisations upholding the tenets of neo-classical economics was educational reform. A voucher system was introduced, allowing parents the choice between privately run subsidised schools, fully private schools and publicly run subsidised schools. This education reform was supposed to foster competition among schools for students and give parents an increased choice (Mizala and Romaguera 2000; Contreras 2001; Castiglioni 2001: 43-44). Competition and choice are both major pillars of the neo-classical economic paradigm.

This section is limited in its discussion of the seven modernisations, as they do not form the main focus of this thesis. The goal was to highlight the formal institutional reforms as part of a larger authoritarian government objective to institute neo-liberal policy in all these social areas. Thus, the internationally oriented conglomerates were more successful than the domestically oriented conglomerates in generating formal institutional change. This is shown by the constitutional change designed to protect the seven modernisations. This represents the clear dominance of the neo-liberal school of thought on the direction of formal economic and social institutional change.

52 The number of students or vouchers received by the privately run and publicly run schools determines the amount of funding they receive. Alternatively, a parent may send their child to a full fee paying school where there is no government subsidy.
3.2.4. Collapse of the radical neo-liberal model: the role of the monetary view of the balance of payments in Chile

The monetary view of the balance of payments, as followed in Chile, led to the financial crisis of 1982.

Assumptions involved in the theory

There are a number of assumptions that support the monetary view of the balance of payments. These include:

- Fixed exchange rate
- Free capital markets
- Open trade system
- Neutral central bank
- Small economy relative to the global economy

First, the Chilean exchange rate was fixed in 1979 at 39 pesos to the US dollar. Capital markets were free in the late 1970s, illustrated by the 327% increase in capital inflows from 1976 until 1981 (Ffrench-Davis 2002: 110). There was an open trade system by 1979 with a uniform tariff of 10%. The Chilean economy was small, relative to the global economy, representing less than 0.3% of total world trade from 1973 to 1990 (Databanks International 2008). The Central Bank played a neutral role in the economy as epitomised by the following quote:

'We are so monetarist, we have reached a position where the Central Bank is hardly in control of the money supply anymore. It controls itself', The Economist, February 2, 1980, declarations by the Vice President of the Central Bank of Chile
With these assumptions met, according to the monetary view of the balance of payments, the economy should automatically adjust to financial and economic shocks.

*The mechanism for automatic adjustment within the monetary view of the BOP in relation to Chile*

What follows is an explanation of how an economy should automatically adjust according to the monetary view of the BOP.

Part of the money supply in Chile is foreign exchange held at the Central Bank. During the late 1970s large amounts of foreign exchange entered the country as loans, increasing the money supply in Chile. Figure 3.1 illustrates that the external debt of the Chilean economy increased substantially, adding to the money supply.
If the money supply increases and demand for money remains constant, then the interest rate will fall to create a new equilibrium interest rate. If interest rates fall this creates an increase in the demand for all goods and services by Chilean nationals.

Figure 3.2 demonstrates that real interest rates had fallen. The trend line shows that the thirty-day nominal interest rate was declining over time, consistent with the theory.

(Source: Bardón, Carrasco et al. 1985: 106)
If the economy is at full employment, the increase in demand for goods and services will push the current account into deficit because the local economy is unable expand to meet the increase in demand. Exports will decrease and imports should increase to meet the increase in local demand. This will result in a current account deficit.

If the economy is not at full employment, then the economy will grow, creating employment and further output. However, the flaw here is that demand responds much quicker than supply. This means the country has internal demand greater than internal supply, until supply can adjust, even when the economy is not at full employment. Chilean nationals will demand foreign produced goods to meet the higher level of demand. Imports will increase and the current account will go into deficit. A current account deficit

(Source: Foxley 1983: 50-51)
is usually correlated with imports greater than exports, which means that foreign currency has to be purchased to pay for the imports.

Thus, for the period where foreign exchange is entering Chile, we should also observe a falling unemployment rate and a high rate of growth in GDP. Unemployment fell from a high of 14.9% in 1975 to a low of 10.4% in 1980. GDP fell by 13.3% in 1975 and grew by 7.7% in 1980. This correlation with the model indicates a positive outcome for the Chilean economy. Such a positive outcome provides a positive information feedback.

A deterioration in the current account can be seen in Chile for the period in question. The straight line in the graph below represents the trend line, which does show a decreasing trend over time in the current account.

Figure 3.3: Chilean current account, 1975-1983

(Source: Ramos 1986: 14-15)

A maintenance of a current account deficit over a period of time is dependent upon continued capital inflows (or increases in foreign debt). For the Chilean
economy to continue expanding under the monetary view of the balance of payments, the capital account must remain positive and greater than the current account deficit. This would result in a positive balance of payments.

With a positive balance of payments, there is a continued increase to the money supply, which keeps interest rates low and the demand for goods and services increases. Why did the capital account remain in surplus for Chile? Chile during the late 1970s and early 1980s had become a darling of international capital markets (Bleiberg 1980; Bleiberg 1985). The reforms put into place by the Pinochet government generated positive press in the mainstream local and international financial media.

Figure 3.4 illustrates the positive balance of payments until the 1982 financial crisis. The sustained positive balance of payments for Chile must be viewed in the context of the recurring balance of payment crises other Latin American countries suffered at the time. The positive balance of payments generated a very positive information feedback for the radical neo-liberal economic policy.
It was therefore in the interest of the internationally oriented conglomerates to support radical neo-liberal institutions and to promote the confidence of international capital markets, as this allowed them to continue to access cheap foreign credit. Part of the radical neo-liberal institutional matrix allowed only large banks to access the cheap foreign money (Corbo 1985: 915). Yet in general, it is only financial organisations or large enterprises that have the capacity to borrow from international financial markets.

Table 3.3 Difference between foreign rates and domestic rates in dollars

<table>
<thead>
<tr>
<th>Year</th>
<th>LIBOR</th>
<th>Domestic</th>
<th>Differencea</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>6.12</td>
<td>118.53</td>
<td>106.3</td>
</tr>
<tr>
<td>1977</td>
<td>6.42</td>
<td>58.38</td>
<td>45.5</td>
</tr>
<tr>
<td>1978</td>
<td>9.35</td>
<td>51.10</td>
<td>32.4</td>
</tr>
<tr>
<td>1979 (1st Sem.)</td>
<td>11.21</td>
<td>42.10</td>
<td>19.7</td>
</tr>
</tbody>
</table>

a Difference between the interest rate in Chile and twice the LIBOR rate

(Source: Foxley 1982: 15)
The very large difference between the London Interbank Offered Rate (LIBOR) and the domestic interest rates allowed for substantial profits for financial institutions. Thus, the institutional setting of the financial market meant that financial institutions generated high profits. However, credit obtained had to be used for productive activities that generated enough income to ensure repayment, which had to be in foreign currency.

Unproductive activities that were supported by the Chilean foreign credit expansion at the time included consumer imports, a bubble in the stock market, and a real estate construction boom. The stock market grew by an annual rate of 86% per year between 1975 and 1980 in Chile (Palma 2000: 16-17). The average real GDP growth rate for the same years was 3.46% (Corbo and Tessada 2002: 467 own calculation). The stock market growth rate was larger than the capacity for productive growth of the Chilean economy.

Figure 3.5: Consumer goods imports as a percentage of total imports in Chile

(Source: Banco Central de Chile 2001: 873-874)
From Figure 3.5 it is evident that over the period of increasing foreign credits for the Chilean economy, the share of consumer imports increased from just over 5% in 1975 to over 25% by 1981. Ricardo Ffrench-Davis (1986: 60-61) found that the majority of these imports were in non-food consumer goods and categorised as dispensable or luxury goods. Consumer products do not generate a return and thus would over time make it more difficult for Chilean nationals to repay foreign debt.

The construction industry also experienced a boom during the growth in foreign credit as illustrated by the graph below. This boom in construction was described as speculative even by Arnold Harberger (1985: 455), a University of Chicago Professor, who was instrumental in the development of the Chicago Boys. That the use of foreign funds for a boom in construction can be speculative is a view also expressed by Sebastian Edwards (1986: 539). Construction does not always produce a return in the long run, especially if it is directed solely at housing. Housing does not normally produce goods or services that can be exported to repay the foreign debt incurred.

Figure 3.6: Total construction in Chile measured in metres squared

(Source: Banco Central de Chile 2001: 314)
There was productive investment in the Chilean economy during the boom in foreign credit, which could have helped repay the debt incurred. The industries that these internationally oriented conglomerates invested in were resource-based exports, which may be viewed as productive. However, there were two problems here, the change in the real exchange rate during the late 1970s and the early 1980s and the fall in resource based prices\textsuperscript{53}.

As can be seen in Figure 3.7 below, the trend for the Chilean real exchange rate was to appreciate relative to a basket of foreign currencies\textsuperscript{54}. The Chilean peso relative to a basket of currencies appreciated from 1978 until 1981. It would take fewer Chilean pesos to purchase one unit of a foreign currency, which represents an appreciation of the currency. In real terms, a higher inflation rate in Chile, compared to the rest of the world, would lead to an appreciation of the Chilean exchange rate relative to foreign exchange rates. Given the exchange rate in Chile was fixed, higher inflation in Chile relative to the rest of the world would make products in Chile relatively more expensive than similar products overseas. This also represents an appreciation of the Chilean peso relative to foreign currencies, because it is cheaper to purchase foreign products versus domestic products. Both of these effects are captured by Figure 3.7.

The appreciation of the Chilean peso made borrowing in foreign currency and imports into Chile cheaper. This appreciating Chilean peso was actually combined with a lowering of tariff barriers, which greatly exacerbated the problem of consumer imports (Ffrench-Davis 1986: 54-55). However, an

\textsuperscript{53} I will not enter into the discussion of the falling terms of trade in the long run for resource exporting nations as pioneered by Raúl Prebisch (1950) and Hans Singer (1949). However, this represents an important area of research for the modern Chilean economy. This represents a long term development issue.

\textsuperscript{54} Note that a decrease in the graph represents a real appreciation of the Chilean peso.
appreciating Chilean peso would have made Chilean exports relatively more expensive compared to other foreign exporters of similar goods or services.

Figure 3.7: Evolution of the real exchange rate, 1975-1983

![Real Exchange Rate Graph, 1975-1983](source)

(Source: Ramos 1986: 14-15)

Basic commodity exports still represented a large part of Chile’s earnings of foreign currency. Chilean exports of agricultural products, fruit, livestock, forestry and fisheries products increased as a percentage of the total value of exports from a low of 5.55% in 1975 to a high of 10.11% in 1982 (Banco Central de Chile 2001: 856-858). Mining exports remained very important, but at a declining rate. In 1975 mining exports as a percentage of total exports was 69.29% and by 1982 had reached a low of 58.12% (Banco Central de Chile 2001: 856-858). Thus, basic resource exports still represented almost 70% of the total value of exports in 1982 and were the major source of earnings of foreign currency for Chile.
The world price for resources was decreasing in the run up to and during the economic slump in Chile. Low prices for exports combined with an appreciation of the Chilean peso made exporting much less profitable, putting more pressure on the current account deficit and making paying off foreign debt more difficult. Table 3.4 shows the percentage changes in prices for a number of the commodities Chile exported, based on the currency in which they trade, namely US dollars.

Table 3.4 Percentage change in commodities prices Jan 1979-Jan 1983

<table>
<thead>
<tr>
<th></th>
<th>Metals</th>
<th>Agricultural Raw Materials</th>
<th>Beverages</th>
<th>Copper</th>
<th>Timber</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan 1979-Jan 1983</td>
<td>-2.4%</td>
<td>-23.2%</td>
<td>-22.7%</td>
<td>-5.1%</td>
<td>-13.7%</td>
</tr>
</tbody>
</table>

Source: International Financial Statistics Online

The catalyst for the Chilean financial crisis of 1982 began to materialise in May 1981 with the failure of Sugar Refiners Viña del Mar\(^{55}\) (CRAV). CRAV defaulted on a loan of US$3.8 million because of speculation on sugar that went bad. The importance of this particular bankruptcy is that CRAV was affiliated with the major Edwards conglomerate, the third largest company in Chile at the time, and its bankruptcy represented a major failure of a major entity (Campero 1984: 232-233). This was a strong negative information feedback about the future direction of the economy.

The next signs of crisis were government interventions to rescue a series of financial institutions in late 1981, which overall represented 9.3% of the total capital and reserves of the financial system (Foxley 1986: 26). There were clear signals that the economy was in line for at least a severe recession. International capital began to flee Chile at the end of 1981. This is reflected in the negative balance of payments, which in 1982 was greater than US$800 million.

\(^{55}\) CRAV - *Compañía Refinadora de Azúcar de Viña del Mar*; Sugar Refiners Viña del Mar.
The number of business failures highlights the contraction of the Chilean economy. For the year 1977 the number of bankruptcies totalled 224, and rose to 810 for the year of 1982 (Frankel, Froot et al. 1986). This was almost a four-fold increase in bankruptcies and represented a major negative information feedback on the radical neo-liberal model.

The authoritarian government depended on the automatic adjustment built into the model, which stated that if the balance of payments goes into deficit, then foreign currency is leaving the country. When foreign currency leaves the country in a system with a neutral central bank, the money supply shrinks.

According to the monetary view of the balance of payments, this contraction of the money supply would lead to increased interest rates and decreased domestic demand (Kemp 1975; Blejer and Frenkel 1987). This occurred to a shocking degree. The real interest rate in Chile hit nearly 50% in 1982 and in the same year GDP fell by 14%. According to theory, there would be a spontaneous switch of resources to export oriented projects, combined with a decrease in imports, which would allow the economy to generate foreign exchange to repay its loans. However, due to the fixed high exchange rate and the low world price for resources, this increase in exports did not occur. Additionally, these adjustments proved not to be spontaneous, nor instantaneous.

*Impact on organisations behind the radical neo-liberal model*

The impact on the organisations that were in support of the radical neo-liberal model was severe. The two major conglomerates in support of the model went bankrupt in 1983 and the authoritarian government intervened (Edwards and Edwards 1991: 80). Javier Vial of the conglomerate Vial (BHC), took a more aggressive stance towards the government intervention
and fought it unsuccessfully in court (El Mercurio 1983a: A1, A10). In early 1983, Javier Vial was jailed and charged with fraud, along with two others connected to the conglomerate (Paulson 1984: 34). Vial (BHC)’s bankruptcy represents the end of the organisation’s legal existence, thus the organisation’s ability to access the polity or to support an institution, fell to zero.

When the financial crisis deepened in 1982, the Chicago Boys lost their credibility with the authoritarian government, lost their positions in the ministries, and were replaced with more ‘pragmatic’ individuals. This can be illustrated by the movements in the Ministry of Finance. Sergio de Castro, Minister of Finance from December 1976 until May 1982, was a key Chicago Boy within the authoritarian government. De Castro was an intimate friend of Manuel Cruzat, one of the directors of the core internationalist Cruzat-Larrain conglomerate. De Castro was also on the board of directors of the Edwards group just prior to his appointment to government office and immediately after leaving government service. His departure in May 1982 was a blow for the Chicago Boys (González-Rossetti, Chuaqui et al. 2000: 26). His replacement was another Chicago Boy, Sergio de la Cuadra, who only lasted 5 months and was quickly replaced by Rolf Lüders.

Rolf Lüders was connected to the Vial (BHC) conglomerate. However, his policies were much more heterodox and business friendly in general. One of his successes was to negotiate new loans from the IMF. Lüders remained in office until February 1983 when the worst of the crisis was over (El Mercurio 1983b: A1 and A10).

Other notable ministerial resignations also occurred. Miguel Kast, a Chicago Boy, was forced to resign as President of the Central Bank in 1982 (Lavin 1986). Jose Piñera left the government on 3 December 1981, as the Minister of Mining (Huneeus 2007: 210-211). During 1982, the proportion of civilians vis-à-vis military personnel in the cabinet was at its lowest since 1978.
(González-Rossetti, Chuaqui et al. 2000: 29). For example, Army General Luis Danus became the Minister of Economy in 1982 (Silva 1996a: 163). This all demonstrates the fall from favour of the Chicago Boys during the financial crisis.

The authoritarian government saved many banks and firms from the financial crisis. The conglomerate Cruzzat-Larrain was saved. While this group of companies was effectively insolvent, government support for the major financial institution at its centre allowed management to maintain independent control of the company, rather than having to cede control over a company that was de facto insolvent to the rescuing government (Délano and Traslaviña 1989: 114). However, the fate of Vial (BHC) was a complete break up of the conglomerate and ownership by the government.

Workers on the other hand received little support, as there was little unemployment insurance in Chile, except for menial work programs provided by the authoritarian government. In June 1982 full wage indexation was abolished and between June 1982 and June 1983 the nominal exchange rate was devalued 99%. As inflation was only 32% during the same period, this led to a real depreciation of the currency (Edwards 1985: 248), which in turn meant a serious drop in the average wage, laying the burden of economic adjustment to the 1980s financial crisis on the workers. Petras and Vieux summarise this:

> As the U.N.’s World Economic Survey 1990 put it, “Wage earners sacrificed the most in making available the surplus needed to make payments on external debt.” (Petras and Vieux 1992: 3).

The plight of workers is discussed further in Chapter 4.
3.2.5. Summary of the period of radical neo-liberalism

In relation to the first question in this chapter, namely how Chilean business organisations influenced the direction of formal institutional change through ministerial channels, it can be said that the ministers had connections almost exclusively with the radical internationally oriented conglomerates. The ministers’ behavioural mode made them only listen to the conglomerates in support of radical neo-liberalism. This influenced the direction of institutional change toward radical neo-liberalism.

In reference to the second question, how the perceived success or failure of institutional change impacted on future institutional change, perceived success of radical neo-liberalism can be identified on three fronts. The conglomerates that supported radical neo-liberalism were highly successful, the local and international press lauded the Chilean miracle, and previous predictions for economic success were met. This legitimised radical neo-liberalism, increasing the likelihood of the implementation of neo-liberal labour laws.

In relation to the third question, how formal institutional changes impacted on the power of business organisations and influenced future institutional change, the institutional framework strengthened the radical conglomerates. This increased the likelihood of neo-liberal labour law implementation.

The Chicago Boys and the internationally oriented conglomerates were in a weak position after the crisis. The crisis opened up the polity for input from a variety of business organisations and individuals.
3.3 Conclusion

This Chapter illustrates the ability of business associations and business people to influence the path of economic and labour market institutional change. Three questions have been addressed for different periods:

- How did Chilean business organisations influence the direction of formal institutional change through ministerial channels?

The connections between business organisations and ministers were important in determining the direction of institutional change. Under the period of gradual adjustment, the ministerial connections allowed the implementation of a slow liberalisation. These ministers were also against a radical neo-liberalism. This liberalisation was meant to benefit a broad coalition of business organisations.

Under radical neo-liberalism there were strong connections between a limited number of conglomerates and ministers. This much more limited coalition of forces could more forcefully push for their desired institutional change. The ministers under radical neo-liberalism were dogmatic in their behaviour and would only listen to those businesses with a similar viewpoint, which shut out any voices of alternative business organisations.

- How did the perceived success or failure of institutional change impact future institutional change?

In broad terms, the failure of gradual adjustment allowed for the implementation of a more radical neo-liberalism. Radical neo-liberalism was a perceived success and allowed for its continuation and spread to other areas of the political economy.
Radical neo-liberalism eventually failed with the inception of the 1982 financial crisis in Chile. This would arguably put in jeopardy the reforms instituted by radical neo-liberalism that are viewed to have caused the crisis.

- How did formal institutional changes impact on the power of business organisations and affect future institutional change?

The gradual adjustment policies, to some extent unintentionally, weakened those businesses that were domestically oriented and strengthened those businesses that were inclined to support a more radical model, the internationally oriented conglomerates. When radical neo-liberalism became instituted, it further benefited the internationally oriented conglomerates. This led the radical neo-liberal model to spread to other social areas.

The eventual failure of radical neo-liberalism destroyed the main business organisations in support of radical neo-liberalism. These internationally oriented conglomerates were bankrupted and taken over by the state. This would put in jeopardy the reforms that the internationally oriented conglomerates supported.

Under gradual adjustment, there was some concern for the situation of the domestic economy. Thus, there was little support for fundamental changes in the labour laws, which may help explain why the neo-liberal labour laws took so long to become implemented. This meant there was a low likelihood for the implementation of neo-liberal labour laws.

In the end the neo-liberal labour laws became implemented because of the failure of gradual adjustment and the success of radical neo-liberalism. The failure of gradual adjustment weakened those that would have blocked neo-liberal changes to the labour laws and gradual adjustment’s inability to meet
expectations delegitimized it in the polity. This opened up space for radical neo-liberalism to take over.

Radical neo-liberalism supported a neo-liberal labour law. The internationally oriented conglomerates that supported radical neo-liberalism had connections with the ministers to implement their preferred institutions. The perceived success of radical neo-liberalism legitimised it in the eyes of the polity, which was a mechanism that allowed the implementation of the neo-liberal labour laws.

The 1982 financial crisis delegitimized radical neo-liberalism, as radical neo-liberalism caused the crisis. The financial crisis led to the bankruptcy of the main business organisations in support of radical neo-liberalism. These two processes complemented each other and thus put in jeopardy the neo-liberal labour law, as a part of the radical neo-liberal framework.
4 The intersection of labour and the polity: labour’s inability to shape the possible outcomes of labour legislation

4.1. Introduction

Chapter 3 examined the ability of business organisations to access the polity and influence formal labour market institutional change. The previous chapter illustrated how initial formal institutional change benefited some business organisations over others, with the dominant organisations able to pursue further reform. Furthermore, the dominant business organisations’ preferred institutions were validated in the polity by a growing macroeconomy. This process of emerging dominant business organisations and validation of institutions took time and partly explains the delay in neo-liberal labour law implementation.

This chapter analyses how the institutional constraints placed on unions impacted on their ability to survive. Labour’s access to the polity was not possible given their fight for survival. These institutional constraints impacted on all of labour, including individual workers, labour organisations, and political parties related to workers.

In comparison to labour, all business was not fighting for its survival. Some sectors of business thrived under the institutional framework established under the authoritarian government. Thus, the following questions are addressed for each of the three time periods analysed:
• How did formal and informal labour institutional changes impact on unions’ survival during the authoritarian government?
• How did these changes to union power impact on the likelihood of the neo-liberal labour law implementation?

Furthermore, the analysis within this chapter takes into account the flow on effects of institutional change on reforms in subsequent periods, such as the impact of the emergency period on the ‘de facto’ liberalisation, and the period of ‘de facto’ liberalisation’s impact on the Plan Laboral period.

The questions in this chapter assist in answering the first two thesis questions; namely why it took so long to implement neo-liberal labour laws and how the neo-liberal labour laws became promulgated under the authoritarian government in Chile.

The main analytical tool for North’s NIE is the relative ability to access the polity. Formal and informal institutions constrain or facilitate access, and in so doing, increase or reduce an organisation’s cost of accessing the polity and ability to influence institutional change. As this is a key tenet of North’s NIE, limitations of this view are pointed out as they arise. North’s NIE and its critiques will be discussed in their own right in Part 3.

The three periods under analysis include the emergency response, ‘de facto’ liberalisation and the Plan Laboral. The emergency response relates to the beginning of the military government, when the military was asserting its authority over the nation. The period termed ‘de facto’ liberalisation refers to a time when no formal labour market institutional reforms were implemented. The Plan Laboral refers to the period when formal neo-liberal labour market institutions were implemented.
4.2. The emergency response against labour: 1973 – 1974

This section aims at analysing the impact of both the informal institution of repression and formal labour market institutions on labour organisations’ ability to access the polity to influence labour market institutional change. This analysis identifies whether institutions constrained or facilitated labour organisations’ ability to access the polity and the significance of the constraint or facilitation.

In response to the questions in this chapter, this analysis finds that the informal institution of repression and formal labour market institutions limited labour organisations’ ability to influence institutional change. An implication was that labour’s organisational weakness created space for labour law change in subsequent periods.

This first section is limited to the emergency response of the authoritarian government, which is associated with the tenure of the Minister of Labour and Social Security Mario Mackay (Zárate 1999/2000: 15). Federal Police (Carabinero) General Mario Mackay pursued institutional change that reformed the existing legislation. As outlined in Chapter 2 the Carabineros took on a repressive role, which would indicate the implementation of similarly repressive labour laws.

4.2.1. Informal institutions: fear as a constraint

Government sponsored physical repression may be categorised into three periods, where the first two of these are pertinent to this thesis. The first, from 1973 until 1974, is prior to the formation of the National Directorate of
Intelligence, known by its Spanish acronym DINA\textsuperscript{56} (Fruhling and Woodbridge 1983; Comisión Nacional de Verdad y Reconciliación 1991). DINA was an autonomous, self-sufficient intelligence and counter intelligence agency beholden to General Augusto Pinochet. The second phase incorporates the entire period of the DINA, from 1974 until 1977, and finally the third phase encompasses the period until the end of the authoritarian government (Fruhling and Woodbridge 1983; Comisión Nacional de Verdad y Reconciliación 1991). Following Fruhling and Woodbridge (1983) and the Comisión Nacional de Verdad y Reconciliación (1991), repression is viewed as intense but uncoordinated in the first period, but intense and coordinated in the second period.

\textit{Background: organisations of repression}

This section concentrates on the DINA and the CNI to analyse repression in Chile. The DINA and post 1977 the National Information Centre\textsuperscript{57} (CNI), unlike the Army, Navy, Air Force and Carabineros, used their position for systematic repression of labour and political organisations (Comisión Nacional de Verdad y Reconciliación 1991).

The DINA and CNI created a sense of fear in the populace, which would have limited the ability of labour organisations to influence institutional change. According to Fruhling and Woodbridge, prior to the formation of the DINA in 1974, (identified as the first period of repression), there was limited organised repression in Chile. ‘All members and followers of the former Popular Unity\textsuperscript{58} (UP) government were targets; regardless of importance or connection to the overthrown government’ (Fruhling and Woodbridge 1983: 512). For example, there were mass arrests in daylight hours and

\textsuperscript{56} DINA - Dirección de Inteligencia Nacional; National Directorate of Intelligence.

\textsuperscript{57} CNI – Central Nacional de Informaciones; National Information Centre.

\textsuperscript{58} UP – Unidad Popular; Popular Unity.
sometimes the arrest of the same individual by different branches of the armed forces. Repressive methods for individuals were different for similar cases, some prisoners were judged by court marshals, others were executed without trial, some remained in detention indefinitely. In response to this fear, unions held meetings, at night in a member’s house, which was only determined at the last minute (Katz 1975: 23). This increased fear in the populace, which extended toward labour organisations, limited their organisational ability.

The decree that created the DINA gave it scope to repress labour organisations, thus limiting labour organisations’ ability to influence institutional change. Decree law 521 officially created the DINA on 18 June 1974 and assigned it to ‘produce the intelligence necessary to formulate policies and planning, and to adopt measures to procure the safeguarding of National Security and development of the country’ (Constable and Valenzuela 1991: 91). In three secret articles the decree also gave DINA the authority to raid premises, arrest suspects, and demand collaboration from all public agencies (Constable and Valenzuela 1991: 91; Snyder 1995: 261 fn 53). These secret articles echo the DINAs clandestine operations and ability to generate fear.

DINA’s primary goal was to destroy leftist political parties closest to the labour movement, thus, damaging labour organisations’ ability to access the polity and influence institutional change. As discussed by Barros (2002: 128-129), the Movement of the Revolutionary Left (MIR), arguably the most radical of the left parties, was severely targeted in 1974. The Socialist party was targeted in 1975 and finally the least revolutionary, the Communist Party of Chile, was targeted in 1976. There was also a centralisation of repression and the removal of the armed forces as active agents of repression. Thus, the political parties that could have assisted the labour movement were weakened, which severely limited labour organisations’ ability to influence institutional change.
The end of the DINA began with the assassination of Orlando Letelier, a former foreign minister under the Allende administration, in Washington D.C. on 21 September 1976, which also marked the beginning of a decrease in repression. The assassination generated strong international condemnation of DINA and its chief Manuel Contreras (Hawkins 1997: 419-420). In response to this condemnation, President Pinochet removed Contreras from his post as head of the DINA in late 1977, although promoting him to Army general at the same time (Constable and Valenzuela 1991: 105). He also dissolved the DINA and replaced it with a new, more inhibited agency, the CNI (Constable and Valenzuela 1991: 105). The change from the DINA to the CNI, while cosmetic at first appearance, signalled a qualitative shift in the repressive organisation.

The CNI was a more circumscribed organisation than the DINA, which post-1977 increased labour organisations’ ability to access the polity. The CNI’s philosophy behind repression was to increase repression when opposition grew rather than to pre-empt opposition (Fruhling and Woodbridge 1983: 529). This philosophy arguably led to the reduction in the number of those killed or disappeared by the CNI as depicted in Table 4.1, which would have increased labour organisations’ ability to influence institutional change. However, fear generated prior to the creation of the CNI would still be present. Thus, it would take time for Chileans to psychologically overcome this fear. This would delay the resulting increase in labour organisations’ ability to access the polity and to influence institutional change.

Table 4.1: Victims by organisation: those who lost their lives

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<tr>
<td></td>
<td>592</td>
<td>148</td>
<td>426</td>
<td>33</td>
</tr>
<tr>
<td>a)</td>
<td>From 1978 to 1990</td>
<td>Rounded to nearest whole number</td>
<td></td>
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</tr>
<tr>
<td>b)</td>
<td></td>
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(Source: Comisión Nacional de Verdad y Reconciliación 1991: Appendix 2)
Domestic repression: actual and possible impacts on the labour movement

The main finding is that domestic repression constrained the labour movement’s ability to access the polity and to influence institutional change. Topics covered in this section include: behavioural changes, political parties, labour organisations, and a labour leader’s murder.

According to Timerman (1987: 12-13), two behavioural responses by the Chilean populace to repression were the informal institutions of ‘submarining’ and ‘sniffing’. ‘Submarining’ is a Chilean term for a situation in which someone lives their life attempting to go unnoticed, by conforming to perceived norms of behaviour. ‘Sniffing’ refers to the practice of asking certain questions to determine a stranger’s political affiliation. It was, for example, common to ask where someone shopped, as there were subsidised supermarkets for military families. These behavioural responses to repression indicate a lack of trust between individuals. One union movement response was that whenever a new and unfamiliar person solicited membership to the union the original members would not admit them for fear they were a government informant (Katz 1975: 23). This would limit labour’s organisational capacities.

North’s NIE does identify informal institutions. However, North’s theoretical framework does not concern itself with the significance of informal institutions.

The repressive character of the authoritarian government as an informal institution that constrained labour organization has been identified. The magnitude of the impact of this institution on labour organisations is the next important question in the investigation of a real life example.

North’s NIE does not provide any instruments to measure the magnitude of an informal institution’s impact on an organisation or individual. North’s NIE
may point towards the increase or decrease of an informal institution’s impact. This correlates with our discussion that, when the DINA turned into the CNI, the impact on labour organisation was weakened. This means that for this period we cannot identify the informal institution of repression of the authoritarian government as the main reason for labour organisation decline.

Informal institutions like ‘submarining’ and ‘sniffing’ raise questions about the concept of informal institutions in North’s NIE. In particular, North’s NIE does not offer a guide to interpreting the significance of these institutions, like addressing the question whether ‘submarining’ or ‘sniffing’ were important aspects of an individual’s attempt at self-preservation or whether they were easily observable but insignificant forms of self-preservation. North’s NIE only points to the positive or negative impact of informal institutions. In the case of ‘submarining’ and ‘sniffing’, North’s NIE would characterise the impact on labour organisations as negative.

Repression of the citizenship left a psychological impact, which clearly had a negative influence on labour organisations and their ability to influence institutional change. A conference of psychologists reported that citizens felt the following emotions: sensation of vulnerability, state of alert, sense of guilt, individual impotence and alteration of the sense of reality (Timerman 1987: 30-32). For example, encountering any uniformed military or police figure would engender fear (Gonsalves 1990: 148). Another example discussed in the literature is the fact that illegal strikes were broken up by police officers, which would later deter further industrial action (Katz 1975: 61). These psychological responses would have restricted labour organisations’ ability to organise and thus limit labour organisations’ ability to influence institutional change.

The repression of left-wing parties reduced labour organisations’ ability to access the polity, which created space for change of labour laws without labour’s participation. Table 4.2 shows the vast majority of fatalities are
affiliated with left-wing parties, traditionally the major supporters of labour organisations during democratic government. This would represent the elimination of experienced political figures and act to engender fear in the survivors. Furthermore, given that repression targeted left-wing parties, arguably the psychological impact was larger for them compared to others. Thus, repression of left-wing parties would restrict labour organisations’ ability to influence institutional change.

Table 4.2: Fatalities attributed by the Rettig Commission to acts of state repression by party affiliation (11 September 1973 – 31 December 1973)

<table>
<thead>
<tr>
<th>MIR</th>
<th>PC</th>
<th>PS</th>
<th>Other</th>
</tr>
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<tbody>
<tr>
<td>93</td>
<td>167</td>
<td>288</td>
<td>48</td>
</tr>
</tbody>
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Abbreviations: MIR = Movement of the Revolutionary Left, PC = Communist Party, PS = Socialist Party
(Source: Barros 2002: 124)

A large proportion of state sponsored repression was directed toward labour organisations because they would need to divert energy and resources to self preservation rather than labour rights advocacy. A survey in 1975 of 16 Chilean organisations in Switzerland indicated that at least 2200 union leaders were fired, 110 killed, and 230 jailed (Délano and Traslaviña, 1989: 76). The Rettig Commission, set up by the civilian government of President Patricio Aylwin to investigate human rights violations under the authoritarian government, found that the primary target for human rights violations were workers (Comisión Nacional de Verdad y Reconciliación 1991). Out of 130 Federations and Confederations affiliated with the main representative organisation for labour, the Central Union of Workers (CUT) in 1973, only a quarter were active in February 1974 (Campero 1985: 176). An International Labour Organisation (ILO) report established that union leaders elected during the previous administration of Allende occupied one third of union bodies, half had a mixed representation and just less than one fifth were newly appointed (International Labour Office 1975: 80). Furthermore, the ILO report mentions that a significant proportion of those trade unionists who
were killed were experienced union officials (International Labour Office 1975: 64). The targeting of labour organisations by the repressive apparatus would indicate a decline in the pool of resources and of experienced union officials. Thus, labour would be less able to access the polity and influence institutional change.

An important union leader’s murder signalled that, as of 1982, labour organisations were still repressed, which would engender fear and make organising labour harder. On 25 February 1982, Tucapel Jiménez, a centrist labour leader who was also friendly with the former junta member Air Force General Gustavo Leigh, was found dead (Correa, Sierra et al. 1983: 45-66). The crime was linked to the CNI by a munitions clerk (Constable and Valenzuela 1991: 111). Testimony at a trial revealed the outlines of a CNI plan to destroy opposition labour groups with help from right-wing unions (Constable and Valenzuela 1991: 111). Qualitative information about the depth and quality of the crime, where Jiménez was shot and slashed, making front-page news, illuminates its potential negative psychological impact on the labour movement (Diario La Tercera 1982). This would have been a contributing factor in the decline in union membership in Chile by 7.6% from 1982 to 1983 (Cortázar 1997: 240).

North’s NIE reduces different causes of institutional change to a question of relative prices. It is problematic reducing these repressive outcomes to a relative price signal because such a reduction omits important information. For example, the murder of Tucapel Jiménez as a price signal would miss his relationship with a former junta member and his leadership position in the union movement. A price signal alone is not able to encompass this additional qualitative information, and as such provides incomplete information – in extreme cases involving ‘prices’ as ‘high’ as being murdered, ‘incomplete’ information signals quickly turn into plain wrong ones.
International repression of opposition figures: neutralise international support

This section argues that the repression of opposition figures overseas also reduced the ability of labour organisations to access the polity and influence institutional change. Chilean international repression was channelled through Operation Condor, which was a campaign of political repression involving assassination and intelligence operations between nations officially implemented in 1975. Key members included the governments of Argentina, Chile, Uruguay, Paraguay, Bolivia and Brazil, with Ecuador and Peru joining later in more peripheral roles (Stanley 2006: 270). In Chile the DINA created and coordinated the international apparatus of repression, while the CNI would later dismantle it. Three high profile cases are highlighted here, which are discussed in detail by Constable and Valenzuela (1991).

In September 1974, former Army Commander-in-Chief General Carlos Prats, who some regime officials suspected of plotting to overthrow them, was assassinated outside his apartment in Buenos Aires. Thirteen months later, Bernardo Leighton, a distinguished Christian Democrat, who had condemned the coup, was shot and seriously wounded in Rome. These examples illustrate the reach of the authoritarian government to neutralise opposition figures and contain the labour organisations’ international political support.

The assassination of Orlando Letelier in Washington D.C. on 21 September 1976 significantly reduced labour organisations’ international support, due to the contacts he had developed as a former foreign minister and ambassador to the United States for Socialist President Salvador Allende. The loss of Letelier had an immediate negative impact. However, a consequence of Letelier’s death was an increase in international condemnation of the authoritarian government that led to the dissolution of the DINA in 1977 and to the creation of the more circumspect CNI. Thus, Orlando Letelier’s murder initially reduced labour organisations’ power but in the long run increased it due to the dissolution of DINA.
Enforcement: significance of institutional constraints

This section investigates how the law was enforced and finds that this process itself weakened labour organisations’ ability to shape institutional change. How formal and informal institutions are enforced is important for the effectiveness of institutions. The court system is an organisation that enforces formal institutions, while the stringency of enforcement may indicate institutional effectiveness. A deeper theoretical discussion of enforcement is provided in Chapter 7.

In this context another limitation of North’s NIE is considered, namely that organisations and institutions are considered separate entities. Organisations, whose primary role is enforcement, are tightly bound to institutions. Institutions have no meaning apart from the actual functioning of the organisation that enforces the institutions (Chaudhry 1997: 10, fn. 9; Schneider and Doner 2000: 41-42). This means that institutions do not exist in practice without organisations to enforce them.

Constable and Valenzuela (1991: 120-5) discuss how the application of the law in favour of the authoritarian government by the courts weakened labour’s ability to influence institutional change. Lawyers’ ineffectiveness at defending people from human rights abuses by the authoritarian government meant that repression against labour organisations went largely unchecked by the judiciary. About fifty lawyers, working principally through the Committee of Cooperation for Peace in Chile59, represented those who suffered repression from the authoritarian government. In two years, the committee staff handled more than 7000 cases and filed 2342 habeas corpus

59 COPACHI - Cooperación para la Paz en Chile; Committee of Cooperation for Peace in Chile.
petitions\textsuperscript{60}. Between 1973 and 1983, the Supreme Court rejected all but 10 of 5400 habeas corpus petitions filed by the Vicariate of Solidarity\textsuperscript{61} (\textit{Vicaría de Solidaridad}), formerly the Committee of Cooperation for Peace. The judiciaries’ neglect of the habeas corpus law made that institution virtually irrelevant in Chile.

Judges’ models of the operation of justice in Chile negatively impacted on labour organisations. By 1978, when the \textit{Vicaría} documented 613 unsolved disappearances, the high court still refused to pursue the problem, asserting that each case was handled by local courts. Workers represented the largest occupational group of those disappeared (Comisión Nacional de Verdad y Reconciliación 1991). Had judges acted with more alacrity, as the Inter-American Human Rights Commission asserted in 1985, ‘the disappearance of persons…would not have reached the dimensions it did’ (Constable and Valenzuela 1991: 125). By their ‘grave negligence’, rote application of law and deliberate ‘self-limitation’, the commission concluded, the courts helped ensure that ‘the state of law does not currently exist in Chile’ (Constable and Valenzuela 1991: 125). Thus, the judges played a part in weakening union organisations, limiting labour’s ability to shape institutional change. This further reinforces the connection between institutions and organisations.

The operation of labour courts in Chile also reduced labour’s ability to access the polity and influence institutional change. The labour courts in Chile were under the jurisdiction of the Supreme Court (Anonymous 1976: 162; Ietswaart 1981-1982: 657). The labour courts judges would need to follow

\textsuperscript{60} Habeas Corpus, also known as ‘The Great Writ’, is a court order addressed to a prison official (or other custodian) ordering that a prisoner be brought before the court so that the court can determine whether that person is serving a lawful sentence or should be released from custody.

\textsuperscript{61} On 11 November 1975, The Committee of Cooperation for Peace was closed down from pressure from Pinochet. It would then be reformed a month later with a new name under closer association with the Catholic Church.
the conservative Supreme Court in support of junta policy and law to gain promotion (Anonymous 1976: 162). Labour courts were encouraged to consider the claims of dismissed workers as demands for money wages only (Ietswaart 1981-1982: 657). This would work against union interests as members could be targeted with little chance for reinstatement. Labour courts have never identified with workers, identifying more closely with employers (Ietswaart 1981-1982: 658). For a worker to take a case to court was also expensive, as there was a tax on each sheet of paper used, furthermore, the slowness of court procedures added to these costs (Ietswaart 1981-1982: 659). Thus, the design and operation of labour courts diminished labour’s ability to access the polity and influence institutional change.

4.2.2. Formal institutions: legal limitations to labour action

Formal labour market institutional changes affecting cause for dismissal, working hours, collective bargaining, and union organisation shifted bargaining power from labour to business. Formal labour market institutions of the emergency period were temporary reforms of existing legislation, which had its origins in the 1931 labour code. These laws constrained labour organisations’ ability to shape the future direction of institutional change.

Public sector employment

Legislative Decrees No. 6, 22, and 98 allowed the government to dismiss public sector employees in large numbers without cause (La Junta de Gobierno de la República de Chile 1973b; La Junta de Gobierno de la República de Chile 1973e; La Junta de Gobierno de la República de Chile 1973f; International Labour Office 1975: 115).
Public sector employment levels are related to current government expenditure, which shows a reduction from 1973 until 1975. In 1973 current expenditures, at December 1969 constant prices, were 18.6 million pesos compared to 16.9 in 1974 and 14.4 in 1975 (The World Bank 1980: 118). This represents a 22.6% reduction in current government expenditures between 1973 to 1975 (The World Bank 1980: 118). Without investigating the details, this represents a significant reduction in public sector employment.

Decree Law 32: additional causes for dismissal

Decree Law 32 added additional causes for the lawful dismissal of a worker. This law was implemented on 21 September 1973, which was shortly after the coup of 11 September 1973. A list of the additional causes is provided below:

- Intent to damage the production process of the firm
- Illegal acts that impede or impeded the worker perform their tasks
- Destruction of materials, instruments, merchandise or anything that reduces the value of the company
- Command the interruption or paralysation of a firm, violent acts against a company, people affiliated with a company or workers of a company
- Incite violence against the firm
- Participate or be involved in fabrication or procurement of illegal arms/weapons

(La Junta de Gobierno de la República de Chile 1973c; Campero and Valenzuela 1984: 119-120).

These additional causes would have provided business organisations with a greater ability to dismiss workers, thus reducing the ability of workers and their unions to defend themselves against arbitrary dismissal. Additionally,
these additional causes applied retrospectively (International Labour Office 1975: 74). If a labour union leader broke any of the provisions in decree law 32, they would lose the protection granted to them as a union leader (International Labour Office 1975: 115).

The creation of special tribunals reduced the labour movement’s power relative to business. Decree Law 32 stated that for an employee to challenge a dismissal he or she would need to lodge an appeal with a special tribunal for both the public and private sector. These tribunals included military personnel (La Junta de Gobierno de la República de Chile 1973c; Campero and Valenzuela 1984: 119-120). Prior to the coup, claims of unfair dismissal by employees were heard by arbitration conducted through the judiciary. A contemporary ILO report observed that the result of cases that went to the tribunal were that few workers were reinstated into their positions (International Labour Office 1975: 116). This indicates a bias against labour by the tribunal.

Military personnel formed a part of the special tribunals. As outlined in Chapter 3, the military and business organisations had links, through personal and professional relationships. As such, the military may not be considered an unbiased arbiter of disputes between labour and business. Furthermore, individuals, as members of the military, received counter insurgency training with the context of persecuting workers, their unions, and their parties. The particular structure of Decree Law 32 was biased in favour of business over labour, in addition to the particular content, which itself was against labour.

There is no direct statistical evidence to substantiate the use business made of provisions provided by Decree Law 32, however, there is indirect evidence. An ILO (1975: 115) report indicated that most dismissals of workers occurred shortly after the coup, between September and December 1973, and a smaller number in the early months of 1974. A member of the
junta, Air Force General Gustavo Leigh, held a meeting of prominent business people in March 1974 at the seat of government, the Diego Portales building. At this meeting the Air Force General gave a speech that lambasted business people for their treatment of workers (Varas 1980: 67). Furthermore, an ILO report concluded that this law was used to dismiss Marxist and other ‘difficult’ union officials (International Labour Office 1975: 73, 116).

Decree Law 35: working hours

Decree Law 35 promulgated on 24 September 1973 extended the work week by four hours for public and private workers (Remmer 1980: 287). The extra hours were argued necessary for national reconstruction and workers could not claim these extra hours as overtime (La Junta de Gobierno de la República de Chile 1973a). An infraction of the law would incur a fine equivalent to one to ten sueldos vitales\(^{62}\) (vital or living wage) per month, with proceeds of the fine going to the national reconstruction fund (La Junta de Gobierno de la República de Chile 1973a).

Decree Law 43: collective bargaining

Decree Law 43 suspended collective bargaining indefinitely and replaced it with the indexation of remuneration by the national government (La Junta de Gobierno de la República de Chile 1973h; Anonymous 1976: 161; Campero and Valenzuela 1984: 120; Stallings and Brock: 81). In addition, this law suspended the right to strike indefinitely (La Junta de Gobierno de la República de Chile 1973h; Anonymous 1976: 161; Campero and Valenzuela 1984: 120). This law was promulgated and published on 29 September 1973, very shortly after the coup of 11 September 1973. This reduction in

\(^{62}\) Sueldo Vitale or Vital Wage is set by a government appointed commission during the first quarter of each year, to establish the legal minimum salary level of white collar workers.
union power was supposedly balanced by the removal of remuneration
determination from the market. The state would implement remuneration in
the form of periodic indexation supposedly inline with cost of living increases.

The lack of open protest against the authoritarian government, signals a
severe weakening of labour organisations. From 1974 until 1982 zero
general strikes and eight anti-government demonstrations were recorded
(Databanks International 2008). Over a similar time period, from 1965 until
1973, there were six general strikes and 13 anti-government demonstrations
(Databanks International 2008).

Table 4.3 below illustrates the nominal increase in wages granted by the
authoritarian government, which was in most instances below the level of
inflation. This led to decreasing real wages, which was the case in Chile for
most of the period under discussion. It was not until 1978 that real wages
began a sustained recovery with the economic boom, financed by foreign
capital inflows. Furthermore, only by 1990 had real wages recovered their
Table 4.3: Wage indexation: 1974-1981

<table>
<thead>
<tr>
<th>Period</th>
<th>Accumulated Inflation (%)</th>
<th>End of Period Mandated Nominal Wage Increase (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/10/1973</td>
<td>1/1/1974</td>
<td>107.7</td>
</tr>
<tr>
<td>1/1/1974</td>
<td>1/5/1974</td>
<td>87.1</td>
</tr>
<tr>
<td>1/5/1974</td>
<td>1/7/1974</td>
<td>31.3</td>
</tr>
<tr>
<td>1/7/1974</td>
<td>1/10/1974</td>
<td>39.5</td>
</tr>
<tr>
<td>1/10/1974</td>
<td>1/12/1974</td>
<td>30.4</td>
</tr>
<tr>
<td>1/12/1974</td>
<td>1/3/1975</td>
<td>41.4</td>
</tr>
<tr>
<td>1/3/1975</td>
<td>1/7/1975</td>
<td>103.2</td>
</tr>
<tr>
<td>1/7/1975</td>
<td>1/9/1975</td>
<td>19.0</td>
</tr>
<tr>
<td>1/9/1975</td>
<td>1/12/1975</td>
<td>28.1</td>
</tr>
<tr>
<td>1/12/1975</td>
<td>1/3/1976</td>
<td>30.2</td>
</tr>
<tr>
<td>1/3/1976</td>
<td>1/7/1976</td>
<td>56.8</td>
</tr>
<tr>
<td>1/7/1976</td>
<td>1/9/1976</td>
<td>14.8</td>
</tr>
<tr>
<td>1/9/1976</td>
<td>1/12/1976</td>
<td>19.2</td>
</tr>
<tr>
<td>1/12/1976</td>
<td>1/3/1977</td>
<td>17.8</td>
</tr>
<tr>
<td>1/3/1977</td>
<td>1/7/1977</td>
<td>19.2</td>
</tr>
<tr>
<td>1/7/1977</td>
<td>1/12/1977</td>
<td>18.7</td>
</tr>
<tr>
<td>1/12/1977</td>
<td>1/3/1978</td>
<td>7.5</td>
</tr>
<tr>
<td>1/3/1978</td>
<td>1/7/1978</td>
<td>10.0</td>
</tr>
<tr>
<td>1/7/1978</td>
<td>1/12/1978</td>
<td>11.9</td>
</tr>
<tr>
<td>1/12/1978</td>
<td>1/3/1978</td>
<td>7.5</td>
</tr>
<tr>
<td>1/3/1978</td>
<td>1/7/1978</td>
<td>10.0</td>
</tr>
<tr>
<td>1/7/1978</td>
<td>1/12/1978</td>
<td>11.9</td>
</tr>
<tr>
<td>1/12/1978</td>
<td>1/3/1979</td>
<td>5.5</td>
</tr>
<tr>
<td>1/3/1979</td>
<td>1/7/1979</td>
<td>10.8</td>
</tr>
<tr>
<td>1/7/1979</td>
<td>1/12/1979</td>
<td>18.0</td>
</tr>
<tr>
<td>1/12/1979</td>
<td>1/4/1980</td>
<td>9.4</td>
</tr>
</tbody>
</table>

a) These periods relate to when wages were legislated to change, which led to irregular periods.

A discussion of price policies and their impact on inflation is important to show its unequal impact on the poor and low-income earners. Decree Law 522, enacted in October 1973, limited the authoritarian government’s ability to set prices to only 51 commodities, which meant that all other prices were free (Corbo 1985: 913). Prior to the coup the government controlled hundreds of prices.

Typically, high inflation rates impact negatively on the poor and low-income workers, reducing their real wages. During the first three months of the
authoritarian government, the last three months of 1973, prices had risen by an estimated 400% to 500% (Frank 1976: 19). Official inflation figures for 1973 show that inflation reached 605.9% and freed prices may be partially responsible. Thus, most of the inflation for 1973 was concentrated when the authoritarian government was in power. Arguably, inflation was underestimated by the authoritarian government, which means that indexation based on official figures led to drops in the real wages of labour.

High levels of inflation eroded the standard of living of the poorest in the Chilean economy, as it was basic necessities that increased the most in price. For example, Frank (1976: 15) found that the price of bread had risen 22 times its September 1973 level by March of 1974. Bus fares by February 1974 had risen to ten times their September 1973 price. These examples are borne out in the difference between the general Consumer Price Index and a Consumer Price Index based on poor peoples' purchasing basket. The averages related here conceal the full impact on the poorest. The rate of inflation on the consumption goods of the poorest was higher than average, and levels of unemployment during the period of the crisis were significantly higher than average in the poorest sectors, geographically located in the shantytowns. Oxhorn provides an illustration for inflation in Table 4.4.
Table 4.4: Consumer price index weighted for the consumption patterns of the poor, 1975-1986

<table>
<thead>
<tr>
<th>Year</th>
<th>General CPI</th>
<th>CPI Based on Poor’s Purchasing Basket</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>387.4</td>
<td>567.8</td>
</tr>
<tr>
<td>1976</td>
<td>195.5</td>
<td>175.6</td>
</tr>
<tr>
<td>1977</td>
<td>73.4</td>
<td>112.6</td>
</tr>
<tr>
<td>1978</td>
<td>36.6</td>
<td>42.1</td>
</tr>
<tr>
<td>1979</td>
<td>36.1</td>
<td>47.7</td>
</tr>
<tr>
<td>1980</td>
<td>30.4</td>
<td>27.1</td>
</tr>
<tr>
<td>1981</td>
<td>16.8</td>
<td>8.6</td>
</tr>
<tr>
<td>1982</td>
<td>11.4</td>
<td>19.6</td>
</tr>
<tr>
<td>1983</td>
<td>29.5</td>
<td>36.5</td>
</tr>
<tr>
<td>1984</td>
<td>15.9</td>
<td>25.7</td>
</tr>
</tbody>
</table>

(Source: Oxhorn 1995: 71)

The above analysis confirms that the law’s impact was detrimental to the poor and low-income workers. This meant that workers had lost materially compared to employers who faced decreasing costs of labour. This was never compensated for in the wage indexations.

**Decree Law 133: Central Única de Trabajadores**

Decree Law 133, promulgated on 13 November 1973, dissolved the main representative organisation for labour, the Central Union of Workers\(^63\) (CUT) and liquidated their assets (La Junta de Gobierno de la República de Chile 1973d; Campero and Valenzuela 1984: 120). Business organisations such as the business associations were allowed to continue functioning as normal.

In the wake of the CUT dissolution, multiple national level unions were formed, which was splitting the effective voice of the labour movement. These new unions included the National Workers’ Central (CNT), the National Co-ordinating Committee of Workers\(^64\) (CNS), the United Workers Front

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\(^{63}\) CUT - *Central Única de Trabajadores*; Central Union of Workers.

\(^{64}\) CNS - *Coordinadora Nacional Sindical*; National Co-ordinating Committee of Workers.
(FUT), the Democratic Workers Union\textsuperscript{65} (UDT), the CUT external directorate in Paris and the National Union of Chilean Workers (UNTRACH) (O’Brien 1982: 11-12; Campero 1985: 162; Loveman 1987: 141-144; Loveman 2001: 283-284). Representative of the ideological divide between these organisations, the CNS was a left-wing union movement while the UDT represented the more right wing bias (O’Brien 1983: 11-12). Thus, from the perspective of ideological constructs, the two bodies had different views and may be considered separate entities on that basis as well (O’Brien 1983: 11-12). This split of the union movement at the national level would reduce the union movement’s strength.

\textit{Decree Law 198: union organisation}

Decree Law 198 was concerned with the organisation of unions and promulgated on 10 December 1973. This law suspended the election of union leaders and directors indefinitely. Moreover, DL 198 limited the functions that could be performed by union leaders. For example, union meetings could only be informative (La Junta de Gobierno de la República de Chile 1973g; Campero and Valenzuela 1984: 119). These changes represented a severe reduction in the organisational ability of unions.

Organisational intermediaries for government-labour relations were put into permanent recess. These organisations included:

- \textit{Juntas de Conciliación} (Boards of Conciliation)
- \textit{Comisiones Tripartitas de Remuneración} (Tripartite Commissions of Compensation)
- \textit{Comisión Central Mixta de Sueldos} (Central Joint Commission on Salaries)

\textsuperscript{65} UDT - \textit{Unión Democrática de Trabajadores}; Democratic Workers Union, formerly known as the Group of Ten.
Organisations such as the *Juntas de Conciliación*, which had provided a ‘voice’ to the unions in the government, disappeared. Voice as defined by Williamson (1985: 257-258) involves ‘dialog, persuasion and sustained organizational effort.’ The overall impact was to reduce the relative power of labour organisations compared to employers.

This law would have reduced the power of labour relative to business. Under this law there was no scope for renewal of the leadership of unions, due to retirement, old age, or death. The law only allowed for informative meetings, which stopped unions raising motions regarding work safety, management relations or unfair dismissals.

Table 4.5 illustrates the reduction in labour’s power. Overall, the number of unions increased with a consummate reduction of membership. This would result in the size of each union becoming smaller than in the past. The labour force in Greater Santiago\(^66\) averaged a 4.8% growth rate from 1973 until 1975, and combined with the reduction in union membership, unions would represent a smaller proportion of the economically active population (The World Bank 1980: 328, own calculation).

\(^{66}\) There was no labour force surveys conducted at the national level for 1973 and 1974.
Table 4.5: Trade unions and dependent members

<table>
<thead>
<tr>
<th>Year</th>
<th>Industrial</th>
<th></th>
<th></th>
<th></th>
<th>Professional</th>
<th></th>
<th></th>
<th></th>
<th>Total</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unions</td>
<td>Index</td>
<td>Members</td>
<td>Index</td>
<td>Unions</td>
<td>Index</td>
<td>Members</td>
<td>Index</td>
<td>Total Unions</td>
<td>Index</td>
<td>Total Members</td>
<td>Index</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>1,448</td>
<td>78</td>
<td>496,425</td>
<td>86</td>
<td>1,970</td>
<td>66</td>
<td>223,859</td>
<td>60</td>
<td>3,418</td>
<td>71</td>
<td>420,284</td>
<td>70</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>1,606</td>
<td>87</td>
<td>210,473</td>
<td>92</td>
<td>2,216</td>
<td>75</td>
<td>270,220</td>
<td>72</td>
<td>3,822</td>
<td>80</td>
<td>480,693</td>
<td>80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1972</td>
<td>1,782</td>
<td>96</td>
<td>233,781</td>
<td>98</td>
<td>2,734</td>
<td>93</td>
<td>339,146</td>
<td>90</td>
<td>4,516</td>
<td>94</td>
<td>562,927</td>
<td>93</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>1,841</td>
<td>100</td>
<td>227,786</td>
<td>100</td>
<td>2,946</td>
<td>100</td>
<td>372,408</td>
<td>100</td>
<td>4,787</td>
<td>100</td>
<td>600,194</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td>1,900</td>
<td>103</td>
<td>219,602</td>
<td>96</td>
<td>3,173</td>
<td>108</td>
<td>372,455</td>
<td>100</td>
<td>5,073</td>
<td>106</td>
<td>592,057</td>
<td>98</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>1,879</td>
<td>102</td>
<td>207,238</td>
<td>91</td>
<td>3,261</td>
<td>109</td>
<td>365,622</td>
<td>98</td>
<td>5,140</td>
<td>107</td>
<td>572,860</td>
<td>95</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1976</td>
<td>1,836</td>
<td>99</td>
<td>199,164</td>
<td>87</td>
<td>3,255</td>
<td>110</td>
<td>351,822</td>
<td>94</td>
<td>5,091</td>
<td>106</td>
<td>550,986</td>
<td>92</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1977</td>
<td>1,808</td>
<td>98</td>
<td>196,529</td>
<td>86</td>
<td>3,193</td>
<td>108</td>
<td>343,180</td>
<td>92</td>
<td>5,001</td>
<td>104</td>
<td>539,709</td>
<td>90</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a - Breakdown by legal definition into industrial and professional, excluding agricultural unions and their members (1970-77)
index 100 in 1973
(Source: Campero 2001: 8)


4.2.3. Review of the emergency period

In relation to the first question in this chapter, the informal institution of repression and the formal labour market institutions reduced labour organisations’ ability to survive. Access to the polity and ability to influence institutional change was arguably a secondary concern for a labour movement that was struggling for survival. In comparison, business did not have to fight for its physical survival and in some instances was able to thrive under the institutional framework put in place by the authoritarian government.

This section showed how the informal institution of repression could limit labours’ ability to survive through changes in behaviour driven by fear, the targeting of political parties who could support labour and the targeting of labour organisations. Formal labour market institutions constrained labour organisations relative to what had been available prior to the coup. There was the elimination of representative and intermediary organisations for labour, a ban on collective bargaining and strike action and the addition of causes for dismissal. The data on Chile illustrated that after the coup union membership declined, the number of unions increased (reducing the size of each union), and real wages fell, which showed a correlation between the institutions implemented and the negative impact on labour.

In relation to the second question, the period of emergency response created space to change the old Labour Code from 1931. The labour movement was greatly weakened, with strikes (basically non-existent) and visible forms of protest reduced.
4.3. Period of ‘de facto’ liberalisation: 1974-1976

This section is limited to the period some labour economists call the period of 'de facto' liberalisation (González 1996: 52; Romaguera, González et al. 1997: 82; Mizala and Romaguera 2001: 2-4). However, these authors do not discuss the period of ‘de facto’ liberalisation further. Authors that discuss the period of ‘de facto’ liberalisation include Verónica Valdivia Ortiz de Zárate (1999/2000; 2001; 2003) and Guillermo Campero and Arturo Valenzuela (1984). This period begins at the end of the emergency period in July 1974 and ends in March 1976, which relates to the time in office of Minister of Labour and Social Security Air Force General Nicanor Díaz Estrada. The period is typified by the absence of institutional change in the formal labour market.

However, the informal institution of repression was very strong during this period, when the Directorate of National Intelligence (DINA) was active. The three years of ‘de facto’ liberalisation, 1974, 1975 and 1976, represented the second, fourth, and third highest rates of disappearance in Chile, respectively (Comisión Nacional de Verdad y Reconciliación 1991). This represents a very high amount of repression. While the term ‘de facto’ refers to the formal institutions of the labour market, the dominant institution that influenced changes in the labour market at the time was the informal institution of repression.

The previous section argued that given the physical persecution and extermination of workers and their organisations, there would be an increased likelihood of neo-liberal labour law implementation. However, the Minister of Labour and Social Security, Nicanor Díaz Estrada, proposed corporatist labour laws, which never were implemented (Campero and

67 DINA - Dirección Nacional de Inteligencia; Directorate of National Intelligence.)
Valenzuela 1984: 121-125). This contradicts the prediction that neo-liberal labour law change would be more likely, given labour’s weakness. This would suggest that a weakness of labour would not by itself lead to the implementation of neo-liberal labour laws.

On a broader scale this section partially answers one of the thesis questions. Why did it take so long to implement neo-liberal labour laws under an authoritarian government in Chile? The short answer is that at the time corporatist labour laws were proposed rather than neo-liberal labour laws. Thus, the corporatist legislation was a roadblock to the implementation of neo-liberal labour laws.

In the literature that does discuss this period, namely Verónica Valdivia Ortiz de Zárate (1999/2000; 2001; 2003) and Guillermo Campero and Arturo Valenzuela (1984), there is little discussion of the processes involved. These three authors do not explicitly discuss how the neo-liberal labour laws were implemented and why it took so long.

The proposed corporatist labour laws were a roadblock in so far as they delayed the implementation of neo-liberal labour laws. Verónica Valdivia Ortiz de Zárate (1999/2000; 2001; 2003) reports on proposed corporatist labour laws as a part of a broader statist project from within the authoritarian government. In relation to the thesis question, the proposed corporatist labour laws were a part of a different program for institutional change, than the neo-liberal one. Verónica Valdivia Ortiz de Zárate provides a comprehensive history of the origins of statism in the authoritarian government as well as some of the statist ideas proposed. A limitation of her work, in relation to the thesis question, is that there is very little discussion of how the statist labour market project was overcome by the neo-liberal labour project. Another limitation of her work is that she does not connect her discussions to an examination of business activity at the time.
Campero and Valenzuela (1984) provide a detailed history of the formal labour market institutions that were promulgated or proposed, including the proposed corporatist labour laws. However, the authors do not discuss institutional change, or why the neo-liberal labour laws took so long to be implemented. Nor do the authors provide a comprehensive discussion of how the neo-liberal labour laws eventually were promulgated.

How this corporatist roadblock was removed would contribute to answering the second thesis question, namely how the neo-liberal labour laws were promulgated under the authoritarian government in Chile. For the neo-liberal labour laws to be implemented, the proposed corporatist labour laws first needed to be removed as a viable alternative.


This discussion is limited to the period of the Plan Laboral (Labour Plan), that is associated with the three Ministers for Labour and Social Security, Sergio Fernández, Vasco Costa, and Jose Piñera. Sergio Fernández and Vasco Costa were supporters of neo-liberalism. Jose Piñera was a civilian who had studied at the Catholic University of Chile, obtained a post graduate degree at Harvard University and has been labelled a Chicago Boy (Anonymous 1980: 17; Piñera 1990: 1, 6; Silva 2008: 154). Jose Piñera implemented the neo-liberal labour laws. These laws formed a part of the so-called seven modernisations. In relation to Chapter 3, the Plan Laboral most closely relates to the period called radical neo-liberalism.

The aim of this section is to analyse the formal labour market institutions’ impact on the survival of labour organisations. In relation to the first question in this chapter, the implementation of the Plan Laboral, formal institutional change, further weakened labour’s ability to survive as an effective organisation. In some instances the implementation of the Plan Laboral
represented an improvement for labour in comparison to legislation since 1973. However, in comparison to legislation in effect prior to 1973, the Plan Laboral weakened labour’s ability to bargain for wages collectively or individually, organise a union, and communicate with management.

In relation to the second question, the Plan Laboral was the implementation of neo-liberal labour laws.

4.4.1. Formal labour market institutional change prior to the Plan Laboral

The period prior to Jose Piñera, March 1976 to December 1978, is characterised by the Ministers of Labour and Social Security Sergio Fernández and Vasco Costa, who implemented temporary laws that would be superseded by the Plan Laboral.

Decree law 2345, promulgated on 17 October 1978, gave the Minister of Interior the power to remove any public sector employee without cause (Campero and Valenzuela 1984: 244). Decree law 2346 promulgated on the same day dissolved seven combative unions (Hurtado-Beca 1982: 245). These unions were in mining, metal, textile, construction and two peasant confederations (Falabella 1982: 21-22).

Decree Law 2347, promulgated on the same day, stated that only legally sanctioned unions or workers may represent labour (Hurtado-Beca 1982: 245). If this law was breached the person or persons responsible could be arrested and sent to prison. This law was said to affect between 400 and 529 unions and between 112 795 and 300 000 union members (Campero and Valenzuela 1984: 244).
Decree law 2376, promulgated on 26 October 1978, called for the election of new leaders for all labour organisations on 30 October 1978. There was a restriction on the election which meant that current union leaders and those who were identified as militants over the last 10 years were not allowed to present themselves as candidates (Hurtado-Beca 1982: 245; Campero 1985: 180). The results of the election meant that many of the new union leaders were young and inexperienced (Hurtado-Beca 1982: 245).

Decree laws 2544 and 2545, promulgated in February 1979, allowed for union meetings to take place freely on union premises, without the police’s prior authorisation (Falabella 1982: 22). This was an improvement from decree law 198, which required police permission for union meetings and limited the content of union meetings only to information. Additionally, these decrees gave the right to join and disaffiliate from unions, federations and confederations ‘freely’ and to voluntarily pay union fees (Falabella 1982: 22). Limitations for unions included that those without premises would have no place to meet, while prior to February 1979 union fees had been mandatory.

4.4.2. Formal institutions of the Plan Laboral

International pressure directed at assisting the Chilean union movement improved the situation of labour relative to the emergency period. Pressure from AFL-CIO68, the main national union organisation in the United States of America, forced the Chilean authoritarian government to implement labour laws that reinstated the right to collective bargaining and the right to strike (Council on Hemispheric Affairs 1979; Piñera 1990: 57-58). The AFL-CIO threatened to impose a U.S. embargo on trade with Chile, which would threaten U.S. exports of military equipment to Chile. Furthermore, by 1978, exports accounted for 21% of Chilean GDP, up from 10% in 1973 (Banco

68 AFL-CIO - American Federation of Labor and Congress of Industrial Organizations.
Central de Chile 2001: own calculations). In this context, the implementation of the formal labour market institutions of the **Plan Laboral** can be seen as the response by Chile to prevent this embargo.

The **Plan Laboral** was a replacement of previous labour laws rather than a collection of reforms of existing legislation. There were three basic reforms that formed the core of the **Plan Laboral**, which included the contract for work, organisation of unions and collective bargaining. This section compares aspects of the new Labour Code with the old Labour Code prior to 1973. It can be said that the implementation of these labour laws was possible due to the space created by the emergency period.

**Decree Law 2.200: contract for work**

Decree Law 2.200 addresses the contract for work and was promulgated on 1 May 1978. Even though this law was implemented prior to Minister Jose Piñera, it was maintained as a core aspect of the **Plan Laboral**. Roberto Kelly, the Planning Minister, supposedly masterminded this decree law. It was based on a scheme aimed at reducing labour costs as a means of attracting primarily foreign investment, in order to increase employment levels (Falabella 1982: 8).

Immovability (Protection from being fired/reasons why workers can be fired) included the following:

- Causes for the end of a contract
  - Mutual consent between worker and employer to end contract
  - 30 day advanced notice of end of contract by either employee or employer
  - If fired immediately, the worker is entitled to some severance (equal to one month multiplied by the number of years worked)

(Campero and Valenzuela 1984: 139-147)
According to Berg (2006: 37), dismissal without expression of cause was reinstated for all new hires. This would allow a business to dismiss the most politically minded workers without cause. Prior to 1973, there needed to be a ‘just cause’ for any dismissal to take place. Decree Law 2.200 would allow business to target militant workers.

Additional causes that an employer may use to dismiss a worker were incorporated from Decree Law 32, which was originally enacted on 21 September 1973:

- Intent to damage the production process of the firm
- Illegal acts that impede or impeded the worker perform their tasks
- Destruction of materials, instruments, merchandise or anything that reduces the value of the company
- Directed or direct the interruption or paralysation through illegal against the firm, violent acts against the company, people affiliated with company or workers
- Incite violence against the firm
- Participate or be involved in fabrication or procurement of illegal arms/weapons

(Campero and Valenzuela 1984: 139-147)

This law added additional causes for dismissal. Prior to 1973 these causes of dismissal were not present. These additional causes would prevent unions from pursuing relatively risky actions that could fall under this article of the law. For example, prior to 1973, unions would use wildcat strikes and factory takeovers in negotiations with management. Factory takeovers could also involve the temporary sabotage of machinery. These kinds of actions would fall under the new law, which would prevent unions using more aggressive methods during wage and other negotiations with management.
Restrictions on individual contracts were suppressed in the new labour law. Prior to 1973, those who wanted to work in certain occupations like hairdressing, radio announcing, graphic artists, and bakers, needed licensing (Alamos 1987: 7; Cortázar 1997: 244). The new labour law removed these licensing requirements. The removal of licensing requirements would increase the supply of those workers who previously needed licensing. This increased supply of workers would lead to increased competition and lower wages.

*Decree Law 2.756: organisation of unions*

Decree Law 2.756 addresses the organisation of unions and was promulgated on 3 July 1979. This law reinstated the ability of unions to gather for reasons other than information, as stated by Decree Law 19869. This law increased labour’s power relative to the emergency period. However, there were a number of conditions attached to the organisation of unions.

Decree Law 2.756 established a number of requirements to form a union. This law made it easier for unions to be formed, as fewer individuals were needed to form a union compared to the situation prior to 1973. However, the law was detrimental for unions as it allowed the formation of multiple unions in the one firm, which prior to 1973 was not allowed.

According to Mizala and Romaguera (2001: 5), to constitute a union in a firm of less than 25 workers, the union needs at least 8 workers to join. For a firm that has 25 to 50 workers there is a requirement that 50% of workers join in the formation of a union. If a firm has more than 50 workers there are two requirements to form a union. First, 25 workers are needed to form a

69 Please refer to Section 4.2 ‘The emergency response against labour: 1973-1974’ for more details.
quorum, and second, the union must represent at least 10% of the firm's workforce. Finally, regardless of the size of the firm, 250 workers may form a union. For any firm with more than 50 workers this allowed one firm to have multiple unions and union membership was completely voluntary (Edwards and Edwards 2000: 197; Berg 2006: 38). Prior to 1973, 55 per cent of workers were needed for the formation of a union in a firm (International Labour Office 1975: 40). The law prior to 1973 effectively gave one union per firm and union membership was compulsory for workers employed in a firm that had a union (Edwards and Edwards 2000: 197). The new law made the formation of unions easier. However, the new law was detrimental to labour as multiple unions could form per firm, potentially splitting the voice and resources of the union movement.

Under decree law 2.756, unions were independent of their employer, or employers, and could not receive from them, direct or indirect financing, of any sort (Alamos 1987: 16). The activities unions carried out were directly related to the membership dues their members agreed to pay. Prior to 1973, industrial unions were financed largely by a legally established participation in the profits of the enterprise (International Labour Office 1975: 39; Barrera and Valenzuela 1986: 233).

The new law on union organisation resulted in a reduced average number of workers per union. From 1970 until 1973 the average number of workers per union had been consistently above 100. Table 4.6 shows that after the first full year of the Plan Laboral, 1980, there was a downward trend in the average number of workers per union until 1985. The unionisation rate of those employed trended downwards from 1980 until 1985. From 1975 until 1978, prior to the implementation of the Plan Laboral, an average of 33.8% of those employed were unionised (Campero 2004: 27). From 1980 until 1985, after the implementation of the Plan Laboral, an average of 11.1% of those employed were unionised. This meant that unions were organisationally weaker after the Plan Laboral compared to prior its implementation.
Table 4.6: Unionisation in Chile, 1980-1985

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of unions</th>
<th>Number of workers affiliated</th>
<th>Average number of workers per union</th>
<th>Number of unionised workers as a percentage of the employed population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>4597</td>
<td>386910</td>
<td>84</td>
<td>12.3</td>
</tr>
<tr>
<td>1981</td>
<td>3977</td>
<td>395951</td>
<td>100</td>
<td>12.0</td>
</tr>
<tr>
<td>1982</td>
<td>4048</td>
<td>347470</td>
<td>86</td>
<td>11.8</td>
</tr>
<tr>
<td>1983</td>
<td>4401</td>
<td>320903</td>
<td>73</td>
<td>10.0</td>
</tr>
<tr>
<td>1984</td>
<td>4714</td>
<td>343329</td>
<td>72</td>
<td>10.5</td>
</tr>
<tr>
<td>1985</td>
<td>4994</td>
<td>360963</td>
<td>72</td>
<td>10.2</td>
</tr>
</tbody>
</table>

(Cortázar 1997: 240; Campero 2004: 27)

**Decree Law 2.758: collective negotiations**

Decree Law 2.758 promulgated on 6 July 1979 addresses collective bargaining. This law increased labour’s power by reinstating collective bargaining, which was suspended indefinitely with Decree Law 4370. However, compared to the situation prior to 1973, labour unions were in a weaker position with fewer rights when it came to collective bargaining.

There were restrictions to collective negotiation. Collective negotiation was denied in the Government Administration, the Judiciary, the National Congress, and Public or State Enterprises, where more than 50% funding originated from the state (Campero and Valenzuela 1984: 139-147). Their wages would be determined by periodic indexation. Some individuals were also denied collective negotiation, which included apprentices, those on limited term individual contracts, and house workers like maids or butlers (Campero and Valenzuela 1984: 139-147). Consequently, a firm could only offer individual contracts, so as to deny individuals the right of collective bargaining. Prior to 1973, individual contracts guaranteed the same rights as

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70 Please refer to Section 4.2 ‘The emergency response against labour: 1973-1974’ for more details.
permanent workers, which allowed individually contracted workers to enter the collective bargaining process (Berg 2006: 37-38). Another limitation of the collective bargaining process was to deny federations and confederations the right to enter the collective bargaining process, as bargaining was limited to the firm level (Piñera 1980: 1-10; Campero and Valenzuela 1984: 134-139). The pre-1973 labour law allowed for supra firm collective bargaining (Berg 2006: 37-38). Those sectors and individuals denied collective bargaining by this law would lack power relative to business.

Unions could only negotiate on behalf of their members. All new employees recruited after the collective negotiations were finished and those employees who chose not to participate in collective bargaining were required to sign an individual contract with their employer (Haworth and Roddick 1981: 59). Prior to 1973, the collective agreement had been valid for both members and non-members of the union and had included those who joined the firm after the end of negotiations (Etchemendy 2004: 279). The requirements of the Plan Laboral relative to the situation prior to 1973, meant collective negotiation would limit the incentive to join a union.

Decree Law 2.758 limited those workers who may strike. The law prevented those workers from striking who provided a public good, a service whose provision would damage the ‘health’ of the nation, restrict the necessities of life, damage the country’s economy or act in the interest of national security (Cortázar 1997: 243; Berg 2006: 39). This definition was purposefully vague to limit labour organisations’ ability to strike.

Strikes were limited to 59 days as on the 60th day the striker would have voluntarily quit their position without severance entitlements (Berg 2006: 37). Furthermore, from the first day of a strike, the firm may lock-out and replace workers (Edwards and Edwards 2000: 198; Berg 2006: 37) A worker could return to work after 30 days of strike and accept an individual contract with
the employer (Haworth and Roddick 1981: 59; Edwards and Edwards 2000: 198). This situation for labour was worse than that present prior to 1973.

The labour law relating to strike prior to 1973 benefitted labour more than that instituted with the *Plan Laboral*. Prior to 1973, strikes could last indefinitely and workers were not allowed to abandon the strike (Berg 2006: 37). Prior to 1973, the strike would suspend individual contracts, but employers were not allowed to hire replacement workers during the strike or lock-out workers (Edwards 1999: 287; Buchanan and Nicholls 2003: 76; Berg 2006: 37). However, employers were given the right to lockout in the event that workers had rejected arbitration (Edwards 1999: 287). The *Plan Laboral* relative to the law in effect prior to 1973, constrained labour’s ability to bargain effectively.

It was illegal for management to agree to make up lost pay or to pay social security dues covering the period of the strike in the final contract with the work force (Haworth and Roddick 1981: 59; Hurtado-Beca 1982: 249). Prior to 1973, the employer was still obliged to pay social security dues and workers could negotiate pay for days not worked due to the strike action (Silva 1988: 274).

There was a limit imposed on allowable matters in a collective negotiation. Those matters that were banned from collective negotiation included anything that limited the functioning of the firm, the faculties of the employer to organise, direct and administer the firm, and anything that implied an obligation from the employer to pay those days not worked due to a strike (Hurtado-Beca 1982: 249). In practice, collective negotiation was limited to remuneration. Prior to 1973, collective bargaining was not limited to remuneration (Berg 2006: 37).

Table 4.7 below shows that collective negotiations were only allowed to begin at certain times dictated by the first letter in a firm’s name. The
outcome of this strategy was to prevent firms in related industries from bargaining simultaneously, which could emulate supra-firm collective bargaining.

Table 4.7: Schedule for allowable collective negotiations based on firm names

<table>
<thead>
<tr>
<th>Negotiation for 1 Year</th>
<th>Negotiation for 2 Years</th>
<th>Collective Bargaining with &gt;25</th>
<th>Collective Bargaining with &lt;25</th>
<th>Start date of Collective agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>E</td>
<td>L-U</td>
<td>17-22 Nov. 1979</td>
<td>1-6 Dec. 1979</td>
<td>1 Jan 1980</td>
</tr>
</tbody>
</table>

(Source: Campero and Valenzuela 1984: 139-147)

Table 4.8 below shows that compared to the historical record, with the introduction of the Plan Laboral, the percentage of workers that participated in collective wage negotiation and strikes decreased.

Table 4.8: Worker participation in collective wage negotiation and strikes as a percentage of the total workforce

<table>
<thead>
<tr>
<th>Year</th>
<th>Workers that participate in collective wage negotiation</th>
<th>Workers that participated in strikes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-64</td>
<td>8.3%</td>
<td>4.4%</td>
</tr>
<tr>
<td>1965-70</td>
<td>13.4%</td>
<td>12.5%</td>
</tr>
<tr>
<td>1971-73</td>
<td>11.3%</td>
<td>16.3%</td>
</tr>
<tr>
<td>1980-85</td>
<td>3.0%</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

(Source: Campero and Cortázar 1988: 122)

Modification to Decree Law 2.200: Law 18.018

Law 18.018 was promulgated on 12 August 1981 and further liberalised the labour market.
Instead of having to dismiss a worker in person, the employer may write a letter to the worker to fire him or her (Campero and Valenzuela 1984: 132-133). There was a limit on the severance to a month’s pay for every year worked up to 5 years (Berg 2006: 37). An additional reason for being fired was added, which related to the necessity of the firm. The necessity of the firm was a purposefully vague definition, which encompassed, but was not limited to, such attributes as the profitability or viability of the firm, and the organisation of the firm (Taylor 2006). If a worker is fired because of the necessity of the firm, then there is no need to pay severance to the dismissed worker. Employers may change the work hours at will without the need to consult their workers. Minimum wage only applies to those older than 18 and less than 65. Unions’ funds were not to be used for health, housing or social services. Workers may trade in vacation for extra pay and severance above the legal 5 months.

4.4.3. Section review of the Plan Laboral period

In relation to the first question in the chapter, the formal institutional change of the Plan Laboral further weakened labour’s ability to survive. The Plan Laboral weakened labour’s ability to bargain for wages collectively or individually, organise a union and communicate with management.

The Plan Laboral (Labour Plan) was the implementation of neo-liberal labour laws and replaced the old Labour Code of 1931. In comparison to legislation in effect prior to 1973, the Plan Laboral negatively impacted labour organisations. However, in comparison to what was in effect from 1973 until the Plan Laboral’s implementation, the Plan Laboral provided some minor improvements for labour organisations. These improvements included, but are not limited to the reinstatement of collective bargaining and the right to strike.
4.5. Conclusion

The two questions in the chapter were answered, namely how formal and informal labour institutional changes impacted on unions’ survival during the authoritarian government and how these changes to union power impacted on the likelihood of the neo-liberal labour law implementation.

The informal institution of repression reduced labour’s ability to survive the authoritarian government. Labour, its organisations and the political parties that supported labour, were repressed by the authoritarian government. Repression included, but was not limited to, disappearances, murder, torture, unlawful arrest and harassment. Up until the dissolution of the DINA, the level of repression of the Chilean people was high. After the dissolution of the DINA and the creation of the CNI, there was a qualitative shift in repression, reducing the negative impact on the Chilean people.

The first section of this chapter analysed the emergency response against labour. The formal institutional change of that period led to decreased real wages, an inability to bargain for wages and a reduced ability to seek arbitration for disputes through the judiciary. The formal institutional change of the emergency period reduced the ability of labour organisations and political parties in support of labour to survive. Labour’s fight for survival increased the likelihood of the implementation of neo-liberal labour laws, because labour would be unable to mount an opposition to institutional change.

The second section of this chapter analysed the period of ‘de facto’ liberalisation. There was no formal institutional change, however the period still had an effect on the formal institutions of the emergency period, which would have maintained the weakness of labour from the emergency period.
This maintained the likelihood of the implementation of neo-liberal labour laws from the emergency period as labour was still fighting for survival.

The third section of this chapter analysed the period of the Plan Laboral. The Plan Laboral was the implementation of neo-liberal labour laws. The Plan Laboral weakened labour relative to legislation in effect prior to 1973.

These answers to the questions in the chapter relate to the first two thesis questions, namely why it took so long to implement neo-liberal labour laws and how the neo-liberal labour laws became promulgated under the authoritarian government in Chile.

The period of de-facto liberalisation represents an interesting puzzle. When labour was weakened and fighting for survival in the emergency period, it supposedly increased the likelihood of neo-liberal labour laws’ implementation. In contradiction to this, during the period of ‘de-facto’ liberalisation, there was the proposed implementation of corporatist labour laws. Thus, part of the answer to the first thesis question is illuminated. It took so long to implement neo-liberal labour laws in Chile because there was an attempt to instate corporatist labour laws. Therefore, answering how the corporatist labour law proposals were swept away would indicate how the neo-liberal labour laws were implemented.

This discussion raises the point that the weakness of labour was not enough to have neo-liberal labour laws quickly implemented in Chile. This would indicate the answer would need to come from multiple sources.

The limitations of North’s NIE that were highlighted, related to the cost of accessing the polity and the use of informal institutions. The cost of accessing the polity was not easily visible to actors in Chile. North’s conception of informal institutions gave no way to identify the significance of informal institutions to actors in Chile.
Part Two
5 Neo-liberal economic reform agenda: from proposal to implementation

5.1. Introduction

In the previous chapter, it was shown that workers, labour organisations and political parties in support of labour were fighting for survival. Formal and informal institutions led to reduced wages, smaller and fewer unions, less communication between management and workers, and a judiciary biased against labour. Access to the polity and influencing institutional change was not possible for labour.

In this chapter the following questions are addressed:

- What generated the relatively homogenous neo-classical organisation of economists commonly known as the Chicago Boys?
- How did the key economic policy document of the Chicago Boys translate into actual formal institutional reforms?

The questions in this chapter assist in answering the first two thesis questions, namely why it took so long to implement neo-liberal labour laws and how the neo-liberal labour laws became promulgated under the authoritarian government in Chile.

This chapter makes extensive reference to the economic policy document named *El Ladrillo*, the brick in English translation, a name due to the shape of the very limited number of printed copies that were in circulation at the time amongst an exclusive group of people.
5.2. Brief history of the development of neo-classical economics in Chicago

The objective of this section is to illustrate how the formation and early history of Chile’s connection with the University of Chicago contributed to Chile becoming a proponent of this kind of neo-liberalism.

It shows the origins of the Chicago School of thought that would later be transferred to Chile. The history of the origin and continuation of the Chicago intellectual tradition highlights generational continuity. The Chicago intellectual tradition was eventually transferred to the Chicago Boys and the economic policy document *El Ladrillo*.

5.2.1. The University of Chicago and Conservatism

The University of Chicago since its foundation has been known for its conservative roots and support from American industrialists. The American Baptist Education Society and the oil magnate John D. Rockefeller founded the University of Chicago in 1891 (Goodspeed 1916). Due to the financial support of John D. Rockefeller in the founding, the University of Chicago obtained the moniker The Standard Oil University (Valdés 1995: 53-54). The University’s conservative roots would indicate that the individual departments would share the same conservative mental model.

The conservative and pro-business reputation was well founded in the Chicago Department of Economics. The first director of the Chicago Department of Economics was J. Lawrence Laughlin. Laughlin was known as a ‘dogmatic theorist and a vigorous controversialist’ (Valdés 1995: 53-54). At the time, Laughlin was known as one of the most conservative economists of America. His influence would shape the future economics department of Chicago.
The 1930s was when the Chicago Economics Department began to acquire its academic prominence. The Chicago Economics Department name developed with such luminaries as Frank Knight, Jacob Viner, Henry Schultz, Oscar Lange, Paul Douglas, Henry Simons, and Lloyd Mints. Frank Knight made great advances in the theory of the firm, with the classic *Risk, Uncertainty and Profit*. It is in this book he made the distinction between risk and uncertainty. Jacob Viner is respected as one of the great historians of economic thought (Spiegel 1991: 642). Paul Douglas gained prominence for his contribution to the now famous Cobb-Douglas production function (Samuelson 1979: 923). However, these theoretical advances were not the only defining aspect of the School or key to the mental models that developed among those that studied at the Chicago economics department.

The defining characteristic of Chicago was not the theoretical advances but rather their identity of the economist as a crusader or the personality of the economist. This is a transfer of a particular mental model to students including those Chileans that studied in Chicago. They performed this task not only with their strength of personality and intellect but also with the bonds they formed with their students (Valdés 1995). Protégés of Frank Knight and Jacob Viner would later be leaders of the Chicago School. The new leaders included Milton Friedman, Rose Director Friedman, George Stigler, Allen Wallis, and Aaron Director.

Transition to the new Chicago Economics Department was haphazard. Henry Schultz died suddenly in 1938 at the age of 45. Jacob Viner left for Princeton in 1946. Oskar Lange left for political life in Poland in 1945. Paul Douglas became a US senator in 1948. Initially, Douglas left academia in 1942 to enlist as a private in the United States Marine Corps. During the 1940s Frank Knight went into semi-retirement handing the reigns of the department to Simons, Mints and Director.
From the 1950s onward, the Chicago School became well established. The theoretical aspect of the Chicago Boys’ mental model helped drive formal institutional change in the Chilean economy, therefore it is beneficial to analyse the source of this change. Some of the theoretical underpinnings of the neo-liberal mental model also influence the personality aspect of the model as well.

According to Hunt (2002: 465) the Chicago school of thought is based primarily on the concept that economics is akin to the natural sciences, such as physics or chemistry. The University of Chicago’s department of economics developed a type of economics that was supposedly value free. In their own way they painted other schools of thought in economics as value laden and therefore not true science. The Department of Economics’ belief that the Chicago school of thought was the only true economics gave the students of Chicago, including the Chicago Boys, a highly static or crystallised mental model.

Friedman advocated a particular brand of ‘positive’ economics that stressed the predictive ability of economics (Silk 1974: 72-73). One of Milton Friedman’s arguments in his influential 1953 work, The Methodology of Positive Economics, stressed the predictive ability of economics. Under his postulation, the assumptions that underlie a model do not matter, only the predictive ability of the model is relevant. In the eyes of those that support this positivist methodological conception, critiques of neo-classical economics based on assumptions is incorrect, as the assumptions do not fully determine the predictive ability of the model. This links with the intransigence of the Chicago Boys personality. Their attitude was epitomised by the question Why consider a critique from an opponent if it has no validity to begin with? (Valdés 1995).
One of the key implications derived from the Chicago model was the primacy of the market. Economic organisation through free markets would yield the optimum outcome for an economy. Free markets for Chicago economists meant that individuals were free to choose. That is, choice should not be constricted by government, as all actors are perceived equal in their models. Freedom to choose was related to the freedom of individuals; in an interview for the PBS program *Commanding Heights*, Friedman stated that ‘Freedom requires individuals to be free to use their own resources in their own way…’ (PBS Commanding Heights 2002a). That is, individuals are freer when they have no restrictions on their choices. For this reason, the Chicago economists can abide a politically unfree dictatorship that guarantees a ‘free’ economy, because ultimately free markets will undermine the very dictatorship that supported those free markets. Friedman reiterates this in his recollection of a speech he gave in Chile during the military government, titled ‘The Fragility of Freedom’. ‘The emphasis of that talk was that free markets would undermine political centralisation and political control’ (PBS Commanding Heights 2002a). An integral part of the freedom of the individual was linked to the freedom of the economy, which justified the Chicago Boys’ participation in the authoritarian government.

Two important leaders of the University of Chicago economics department were George Stigler and Milton Friedman. Both were winners of the Sveriges Riksbank Nobel Memorial Prize in Economic Sciences in Memory of Alfred Nobel71. This shows the significance with which they were regarded in the profession. Furthermore, they were both known for their strong personalities.

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71 The prize is commonly identified with the Nobel Prizes, although it is not one of the five Nobel Prizes in Physics, Chemistry, Physiology or Medicine, Literature, and Peace, which were established by the will of Alfred Nobel in 1895.
Some of the economic developments that were pioneered at the University of Chicago included search theory, human capital theory, and property rights or transaction cost theory. Generally, these theories relied upon a strict adherence to neoclassical price theory.

The theory that has arguably become the most associated with Chicago is monetarism as advocated by Milton Friedman. Monetarism is based on the quantity theory of money:

\[ M \cdot V = P \cdot Q \]

- \( M \) is the total amount of money in circulation on average in an economy during the period, say in a year
- \( V \) is the velocity of money in final expenditures
- \( P \) is the inflation rate
- \( Q \) is an index of the real value of final expenditures

According to Roll (1992: 516), Milton Friedman argued that the velocity of money was a constant and that \( Q \) sometimes interpreted as GDP was unaffected by any of the other variables in the equation. This interpretation meant that any change in the money supply would lead directly to a change in the inflation rate. Therefore, inflation was solely a monetary phenomenon. An increase in the money supply would lead to a proportional increase in inflation.

The reason why monetarism has been highlighted here is that it gained prominence in Chile after the coup of 1973 (see Chapter 3 for a discussion of the monetary view of the balance of payments and how it was applied in Chile). This policy depends on the quantity theory of money. This indicates one of the connections between Chicago and the economic institutions actually applied in Chile.
The endurance of the monetary theory promoted by Milton Friedman may be viewed by the actions of contemporary central banks. Today, central banks take on the primary role in controlling inflation. For example, in the Australian economy, when inflation exceeds, or is predicted to exceed, the central bank’s target band, the central bank raises interest rates. Higher interest rates are supposed to reduce inflationary pressures, by reducing investment and consumption levels.

Co-operation between the Chilean Catholic University and the University of Chicago

One aim of the University of Chicago was to transfer the intellectual tradition of Chicago to Chile. US AID provided majority funding for this program (PBS Commanding Heights 2002b). The transfer of the Chicago intellectual tradition was achieved by reforming the Catholic University’s undergraduate program in economics to mirror Chicago’s. Furthermore, Chilean students were allowed to study in Chicago for post-graduate qualifications, which reinforced the transfer of the Chicago intellectual tradition. Thus the Chilean students would learn only one type of economics through their undergraduate and postgraduate studies. This would mean the Chilean students would share a Chicagoan economics mental model, which would tend to generate a more homogenous group of economists.

5.2.2. Background to the connections between the two universities

According to Juan Gabriel Valdés (1995), the initiator of the contracts and connection between the Universities may be traced to Albion Patterson. Patterson was part of the Institute of Inter-American Affairs and was on a mission in Paraguay to assist the advancement of agriculture in the country.
He frequently encountered problems obtaining economic data on the issues regarding agriculture and he assumed that the discipline was poorly advanced in Paraguay and in Latin America, in general. As a result of these problems, he would pursue what he saw as the improvement of economics in Latin America.

Later, officials from the Institute of Inter-American Affairs moved Patterson to Chile. They wanted him to create a plan for agriculture in Chile, which would later be called *Plan Chillan*. A chance meeting in Chile with the head of the University of Chicago’s Department of Economics, T. W. Schultz, further convinced Patterson to create linkages between U.S. and Latin American universities to train Latin American students (PBS Commanding Heights 2002b). Schultz was a leading theoretician in human capital theory and thus had the theoretical ammunition to support such a program.

The University of Chicago’s Economics Department’s interest in a programme was derived from two facts. The Economics Department of the University of Chicago during the 1950s had difficulty in competing with the eastern establishment universities. Graduate students preferred institutions such as Harvard, Yale, MIT or Princeton (Barber 1995: 1943). Thus, the agreement with a Chilean University promised competent graduate students. In reality, graduate students from Chile obtained excellent academic results (Valdés 1995: 99). The second factor was that US philanthropic foundations’ money generally followed established universities and their students. The partnership program with a Chilean University would provide funding for the Chicago graduate program (Barber 1995: 1943; Valdés 1995: 99). Thus, it may be argued that the initial need for graduate students and funding was the incentive for Chicago to pursue the deal rather than to facilitate a transfer of a mental model.

Patterson, after numerous meetings with Schultz, decided to pursue his connections with Chilean universities while Schultz would return to Chicago
to prepare the Department for a program (Silva 1991: 390). Patterson initially approached the National University of Chile, which was the biggest and most prominent University in Chile. The rector of the university, Gomez Millas, had already created connections with European and American universities. Patterson proposed a connection with the University of Chicago where Chicago Professors would modernise the National University’s economics department.

According to Juan Gabriel Valdés (1995: 114-115), recollections then differ on why the connection was never developed between the University of Chicago and the University of Chile. On the one hand, Patterson recalled the rector was fearful of leftist economists inside the University opposing the idea. On the other hand, Millas was against the idea of only having a connection with the University of Chicago. Millas recalls that Patterson wanted the connection to be only with Chicago. This already indicates a non-pluralist agenda, or the transfer of only one type of mental model to Chile, which would strengthen the homogenous character of any students trained in the program.

In 1954 the rector of the Catholic University of Chile, Monsignor Alfredo Silva Santiago, then approached Patterson. He wanted assistance for the agricultural department of the University. The agricultural department, Patterson learnt from Paraguay, was usually run by the landed class and would resist change (Valdés 1995: 115-116). Patterson, however, convinced the rector to discuss the economics department.

The economics department of the Catholic University was underdeveloped, which would make it easier to change to the Chicago model. In fact, before 1955, the university had only a School of Commerce, imparting the principles of accounting, administration, and mathematics, but not economics (Barber 1995: 1942-1943). ‘Professors were old, most of them were lawyers with very little knowledge of economics, and full-time professors did not exist.
The library was poor. Most students left the school after the first year and the others used their free time, which was abundant, to study mathematics, the only well-taught course in the school’ (Valdés 1995: 117-118). The bad state of the Catholic University’s School of Commerce would make it easier for the Chicago Professors to change the school to resemble the University of Chicago.

According to Valdés (1995: 123), Patterson wanted assurances that the program would succeed in such an underdeveloped economics department and receive support from the Catholic University. On 6 January 1955, Patterson and some of his aides were received at the Catholic University by the rector, the dean of the Faculty of Economics, the dean of the Faculty of Law, and a group of ten professors. This showed the support of the University for the Project but the dealmaker seemed to be the support from the business community.

Valdés (1995: 125) outlines how some days later, the rector introduced Patterson to a host of business personalities, among them Jorge Alessandri, president of the Confederation of Production and Commerce\textsuperscript{72} (CPC), and later to become President of the Republic in 1958, Walter Muller, president of the Banking Association\textsuperscript{73} (ABIF), Domingo Arteaga, president of the National Agrarian Society\textsuperscript{74} (SNA) and Javier Echeverría Alessandri, a lawyer also linked to important business circles. Patterson gave a presentation where he argued that the transfer of free market ideas to Chile was a great opportunity for the business community and Chile. He argued that the Chicago trained students would need the support of the business community.

\textsuperscript{72} CPC – Confederación de la Producción y Comercio; Confederation of Production and Commerce.

\textsuperscript{73} ABIF - Asociación de Bancos e Instituciones Financieras de Chile; Association of Banks and Financial Institutions of Chile.

\textsuperscript{74} SNA - Sociedad Nacional de Agricultura; National Agrarian Society.
community for the program to be a success. This illustrates the beginning of the formation of a close relationship between business organisations and the Chicago Boys.

A mission led by T.W. Schultz on 27 June 1955 illustrated the commitment of the Chicago Department of Economics to the Catholic University. On 27 June 1955, a mission headed by T. W. Schultz, chairman of the Department of Economics of the University of Chicago, arrived in Santiago. The professors of the mission remained in Chile for a week, during which time they carried out detailed discussions about the agreement with the rector of the Catholic University, other individuals from university administration, and members of the Faculty of Economics (Valdés 1995: 126). This illustrates the large amount of effort extended by the Chicago and Catholic University to make this program a success.

5.2.3. The formal collaboration between the University of Chicago and the Catholic University

Contracts between the two universities were signed on 29 and 30 March 1956 (O'Brien 1982: 2; Valdés 1995: 126). The initial contract between the University of Chicago, the Catholic University and the International Cooperation Administration⁷⁵ (ICA) was originally planned to have a duration of three years, expiring in the spring of 1959 (Barber 1995: 1943). By that date, however, an extension until 1961 was accorded, followed by another with an expiry date of June 1964 (Valdés 1995: 127). As a result, the contracts lasted for a period of approximately eight years, although not all of their component parts had a similar life span.

⁷⁵ The International Cooperation Administration (ICA) would later become the Agency for International Development, AID or USAID.
There was substantial funding for the program, which would have contributed to its success. Initial financing came from the International Cooperation Administration (ICA) and amounted to US$375,000. By 1964, the ICA, by then called US AID, gave funding totalling US$812,000. From 1956 onwards, the project received funding from the other sources such as the Rockefeller Foundation, which contributed US$19,000. This diversification of funding sources would have helped ensure the program’s on-going success.

The execution of the program

The program was executed both in Chile and in Chicago, which created a more homogenous mental model for the students who studied at both universities. In Chile, the Catholic University’s Department of Economics was restructured. This involved the sacking, or transferring of old staff and the integration of new Chicago trained staff. The new staff were Chileans who obtained their post-graduate degrees from Chicago. For example, by January 1963, eight out of nine full time professors had obtained a post-graduate degree from the University of Chicago (Valdés 1995: 165). This created an integrated program so that the curriculum was the same in the undergraduate program in Chile and the postgraduate program in Chicago. For students who studied at both universities this would have created similar mental models and a more homogenous group of students.

The curriculum in Chile was changed with a focus on neo-classical economics. This meant a focus on two subjects, which were monetary theory and price theory. The curriculum was changed by the visiting Chicago Professors and then kept by the Chicago trained faculty in Chile. To be considered ‘rigorous’ and ‘true’ economists, it was asserted that instruction was needed in these two fields. Furthermore, this indicates that the mental models taught were homogenous between Chile and Chicago.
5.3. Organisation behind El Ladrillo

5.3.1. Business organisation support

Prior to the Chicago Boys ensconcing themselves within the economics group in the Society for Industrial Development76 (SFF), they received support and employment from a number of sources. There were four primary sources of support for the Chicago Boys, which included the Inter-American Council for Trade and Production77 (CICYP), Centre for Social and Economic Studies78 (CESEC), and the Edwards and Vial (BHC) conglomerates.

CICYP was a business association with members that may be categorised as large, internationally oriented conglomerates. The CICYP was established in Montevideo, Uruguay in 1941 (Valdés 1995: 224). The purpose of CICYP was to provide Latin American entrepreneurs and businesses with a way of making international contacts, especially with the United States. CICYP advocated the principles of private enterprise and individual initiative. An office in Chile was provided for the largest businesses in Chile, with the purpose of providing international contacts and advice from influential intellectuals and politicians interested in promoting free enterprise. In 1968, the CICYP branch in Chile included approximately forty members who directed the nation’s most important corporations (Valdés 1995: 224). This already indicates that some internationally oriented businesses were familiar with the free market institutions or mental model of the Chicago Boys.

76 SFF – Sociedad Fomento Fabril; Society for Industrial Development.
77 CICYP - Consejo interamericano de comercio y producción; Inter-American Council for Trade and Production.
78 CESEC - Centro de Estudios Socio-Económicos; Centre for Social and Economic Studies.
According to Valdés (1995: 225), CICYP assisted the Chicago Boys in a number of ways. CICYP members provided funds for the new campus of the Catholic University’s Economics Department. The new campus was located away from the main campus and therefore economics students would interact less with other disciplines, which helped maintain their homogenous mental models. CICYP also provided employment opportunities specifically for the Chicago trained economists from the Catholic University.

One of the most important initiative was the creation of the CESEC, which played an important role in the period prior to Allende's election in 1970 and the military coup in 1973. The Centre was created by Agustin Edwards and founded in 1968 (O'Brien 1982: 3; Silva 1991: 390). The initiative responded to a concern shared by Edwards and the Chicago Boys regarding what they called ‘the lack of economic ideas in the rightwing sectors’ (Valdés 1995: 227). This centre would only employ Chicago trained economists, which would have protected their mental models from change.

Valdés (1995: 225-229) outlines how the Edwards and the Vial (BHC) conglomerates supported the Chicago trained economists. The Edwards group gradually began to employ some professors and students as research directors at the Bank of Augusto Edwards (Banco de Augusto Edwards) and as executives in their firms. Cruzat Larrain, who studied at the Catholic University, took over the Bank of Mortgage Development79 (BHC), which would form the foundation of the conglomerate Vial (BHC). Cruzat fired most of the old workers and employed a new cohort that would match with his Chicago trained mental model.

The support from the private sector allowed the Chicago Boys to remain together and not compromise their mental models. From this basis, the

\[79\text{BHC - Banco Hipotecario de Fomento; Bank of Mortgage Development.}\]
Chicago Boys were able to write their main economic policy document, *El Ladrillo*.

The level of success achieved by the Edwards and the Vial (BHC) conglomerates during the period of radical neo-liberalism should come as no surprise. The types of institutions that the Chicago Boys implemented were foreseen and sponsored by at least these two conglomerates. These conglomerates actively supported and employed the Chicago Boys.

### 5.3.2. Monday Club and El Ladrillo

There were two main organisations that were behind *El Ladrillo*. The two organisations were the Monday Club and the economics group in the SFF. These two organisations shared common objectives and had mental models closely related to each other.

Members of the Monday club belonged to Edwards or Vial (BHC) conglomerates. Both conglomerates had mental models based on the Chicago free market system. This would allow them to cooperate without much conflict.

Table 5.1: The Monday Club and conglomerates

<table>
<thead>
<tr>
<th>Name</th>
<th>Conglomerate affiliation</th>
<th>Media executive</th>
<th>Economics degree from University of Chicago</th>
</tr>
</thead>
<tbody>
<tr>
<td>H. Cubillos</td>
<td>Edwards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jorge Ross</td>
<td>Edwards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R. Silva E.</td>
<td>Edwards</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>O. Saenz</td>
<td>Edwards</td>
<td></td>
<td></td>
</tr>
<tr>
<td>E. Sanfuentes</td>
<td>Edwards</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Javier Vial</td>
<td>Vial (BHC)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>M. Cruzat</td>
<td>Vial (BHC)</td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

(Source: Silva 1996a: 71)

‘The group that later came to be called “the Monday Club”, met each week at the office of the chairman of Editorial Lord Cochrane - the publishing house
for *El Mercurio* - and, according to Orlando Saenz, gradually became a “place for discussion and decision-making of even greater importance than SFF's governing body” *(Valdés 1995: 248).* In other words, the Monday Club was able to manipulate the policies and direction of one of the biggest business associations in Chile. This demonstrates the significance of the Monday Club.

The first objective of the Monday Club was to generate strategic, as well as financial support, specifically for the SFF and generally for the business community. The Edwards group was the largest conglomerate in Chile and its leaders were Agustin Edwards and Jorge Ross. Agustin Edwards and Jorge Ross had developed many contacts with the private sector and government organisations in the United States *(Valdés 1995: 224-225).* They could then channel money and support the business community in Chile through the Monday Club.

According to Kornbluh *(2003: 14-18)*, the second objective of the Monday Club was to overthrow the government of Socialist President Salvador Allende. One of the main tools used to overthrow Allende was the use of the popular media. Edwards was considered to be the richest man in Chile at the time and thus had a lot to lose with an Allende administration. The use of popular media was to change the public’s subjective models of reality (or ideology) so that they would reject the Allende administrations institutions. In addition, US$2 million worth of assistance was provided from the US Government to the Edwards group to keep *El Mercurio* running articles critical of President Salvador Allende. The Edwards and Vial (BHC) conglomerates had control over popular Chilean news publications including *El Mercurio, Que Pasa,* and *El Portado.*

The Monday Club also had connections with the Navy. Roberto Kelly had links with the Edwards group and was a former official in the Navy *(Cavallo,*
Salazar et al. 2001: 28). Roberto Kelly initially approached the Monday Club in March 1973 to commission an economic program in the event of a coup.

Prior to the commissioning of *El Ladrillo* by the Navy, the Monday Club reorganised the economics group of the SFF. The first person to be summoned was Sergio Undurraga, professor of the Institute of Economics at the Catholic University. Undurraga was not trained in economics under the agreements with the University of Chicago. He was, however, considered by colleagues to be an ‘honorary Chicago Boy’. Undurraga was charged to hire staff and had no problems recruiting the Chicago trained economists he desired.

Table 5.2: Authors of the economic policy document *El Ladrillo* (the Brick)

<table>
<thead>
<tr>
<th>Name</th>
<th>Conglomerate affiliation</th>
<th>Political party affiliation</th>
<th>Prior government service</th>
<th>Economics degree from University of Chicago</th>
</tr>
</thead>
<tbody>
<tr>
<td>E. Undurraga</td>
<td>Edwards</td>
<td>PN</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>E. Sanfuentes</td>
<td>Edwards</td>
<td>PN</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>S. de Castro</td>
<td>Edwards</td>
<td>PN</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>M. Cruzat</td>
<td>Vial (BHC)</td>
<td>PN</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>J. Braun</td>
<td>Vial (BHC)</td>
<td>PN</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>P. Baraona</td>
<td>Vial (BHC)</td>
<td>PN</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>A. Bardón</td>
<td>PDC</td>
<td>Central Bank</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>A. Sanfuentes</td>
<td>PDC</td>
<td>Central Bank</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>J.L. Zabala</td>
<td>PDC</td>
<td>Central Bank</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>J. Villarzu</td>
<td>PDC</td>
<td>Central Bank</td>
<td>X</td>
<td></td>
</tr>
</tbody>
</table>

PN – Partido Nacional; National Party  
PDC – Partido Demócrata Cristiano de Chile; Christian Democratic Party of Chile  
Central Bank – Banco Central de Chile; Central Bank of Chile  
(Source: Silva 1996a: 74-75)

Previously, I argued that the Chicago Boys shared the same mental model, which meant that they could act as a cohesive organisation. This is also the case with their main economic policy document. Table 5.2 shows that eight out of the ten authors of the policy document had Economics Masters Degrees from the University of Chicago (Silva 1996a: 74-75). As such, the document would be relatively homogenous and consistent with their neoclassical economics model. The purpose of the economics group was to
provide a critique of the Allende model and to propose an alternative for a future authoritarian government.

According to Valdés (1995), the predictions of the economic group of the SFF would help legitimise their mental model in the eyes of the political opposition and the military. The economic team was already able to detect, and report, a series of disequilibria derived from the expansionist policies of Allende: a rise in the fiscal deficit, a fall in international reserves, a drop in investment, and a trade deficit. All these indicators pointed to serious problems in the following year. By the end of 1971, there were signs of an impending, rapid acceleration in inflation.

The economic group’s ability to foresee the events of 1972 and 1973 in regards to inflation and economic growth raised their credibility. In other words, accurate predictions of the evolution of the economy under Allende led the economic group’s mental model to become respected by the opposition parties and the military.

The inclusion of some Christian Democrats in the elaboration of *El Ladrillo* is illustrative of the consensus among authors. It is important to note that the Christian Democrats who did contribute to the policy document were in fact all trained at the University of Chicago. This would indicate that the authors shared the same mental model when it came to economic institutional change.

**5.3.3. Connections between El Ladrillo and the Navy**

It has been shown how business support and the Chicago Boys’ economic policy document positioned the Chicago Boys to be ready to enter a future authoritarian government. They had support from coup backers, the Edwards group, Vial (BHC) and the Monday Club. The Chicago Boys would
be considered positive in the eyes of the military. Finally, the Chicago Boys had expertise that the military did not have, an issue explored in Chapter 2. The Chicago Boys supposedly had knowledge on how to administer and manage an economy.

Thus, the missing piece was the connection between the business organisations that supported the Chicago Boys and the military. This connection would mean that the Chicago Boys could then enter the polity to affect institutional change. This section analyses the connection based upon individual relationships between organisations.

Hernan Cubillos was an ex-Navy officer and the owner of a firm that specialised in arms deals for the Chilean armed forces (O'Brien 1982: 6). He was a part of the Monday Club and was formerly part of the Edwards conglomerate. Prior to Allende’s election, he was in control of *El Mercurio*. This was the first connection between a business organisation in support of the Chicago Boys and the military.

In late 1972, former naval officers Roberto Kelly and José Radic requested the Monday Club to produce an economic policy document that would ease the way for a military government (Huneeus 2000: 464-465). These two former naval officers had a connection with the Edwards group (Valdés 1995: 252). Roberto Kelly was also a personal friend of future Naval Junta member Admiral José Toribio Merino (González-Rossetti, Chuaqui et al. 2000: 65). This is another link between business in support of the Chicago Boys and the military.

In March 1973, the Chicago Boys were approached by Roberto Kelly to prepare the economic policy document. By May 1973, the economists who were preparing the document met in the city of Viña del Mar. Viña del Mar was the location of a major naval base. Roberto Kelly attended this meeting where they compared the studies that contributed to the volume. Consensus
was achieved quickly on what changes would be made. This consensus was achieved through the perception of the seriousness of the problem in Chile (Valdés 1995: 252). Furthermore, this consensus was arguably reached through the shared mental models of the authors.

*El Ladrillo* was completed and photocopied on the day of the coup, 11 September 1973, in the same building that normally printed the conservative daily newspaper *El Mercurio*. Roberto Kelly received the copies and transferred them to Navy Admiral Troncoso. Troncoso then distributed the policy document to high ranking military officials, including future member of the governing Junta Admiral Merino (González-Rossetti, Chuaqui et al. 2000: 77). Before midday on Wednesday 12 September 1973, the General Offices of the Armed Forces, who performed governmental duties, had *El Ladrillo* on their desks.

The connection between the Navy and the Chicago Boys was not transitory and extended well into the authoritarian government. Funding for the Catholic University and control of the economic decision making within the authoritarian government are linked by the relationship between the Chicago Boys and the Navy. This illustrates the continued relevance of the Chicago Boys under the authoritarian government.

According to Huneeus (2000: 464-465), it is interesting to note that the first military rector of the Catholic University after the coup was a Navy official. The Navy official, Jorge Sweet, was retired, but worked closely with the National Planning Office80 (ODEPLAN) through the Economics Institute (a Chicago oriented think tank set up by the Chicago Boys). For example, ODEPLAN signed 14 institutional agreements with the Catholic University from 1973 to 1989. ODEPLAN did not sign a single agreement with the National University’s Economic Institute. Another aspect of the connection

80 ODEPLAN - Oficina Nacional de Planificación; National Office of Planning.
between the Navy and the Chicago Boys is the support the head of the Navy and junta member Admiral Merino gave to the shock program. He publicly stated that the main economic enemy was large public expenditure and not unemployment (O’Brien 1982: 9). This indicates the continued support the Navy gave the neo-classical model even after the coup.

The main economic posts in the authoritarian government were assigned to the Navy, who then brought in Chicago trained staff, cementing their relationship. As was reported in Chapter 2, the Navy obtained commission one and were given the ministries of Finance, Economics, Development & Reconstruction, Mining and Foreign Affairs (Barros 2002: 50). The most important of these ministerial positions was ODEPLAN, which was supposed to coordinate activity throughout all the ministries. The directorship of ODEPLAN was given to Roberto Kelly, while the Chicago Boy Miguel Kast was hired by Kelly as deputy director (González-Rossetti, Chuaqui et al. 2000: 43; Huneeus 2007: 290-291). Miguel Kast has been labelled the great recruiter for enlisting Chicago Boys into the service of the military government (Huneeus 2007: 290-291). This is illustrative of the close relationship maintained between the Navy and the Chicago Boys.

5.4. Changes in formal institutions based on El Ladrillo: all of the economy versus the labour market

5.4.1. El Ladrillo diagnosis

The first chapter of El Ladrillo details in Part A the fundamental problems of the Chilean economy, as identified by the authors under the following headings:

(1) Low growth rate,
(2) Exaggerated focus on the state,
(3) Scarcity of productive employment,
(4) Inflation,
(5) Agricultural backwardness and
(6) Existence of conditions of extreme poverty in important sectors of the population.

Part B then outlines what the authors observe as the most important consequences of these problems, while Part C summarises the objectives of the proposed program.

It is worthwhile to have a closer look at what the authors of *El Ladrillo* see as the eight most important consequences of the six main problems of the Chilean economy of the previous 30 to 40 years.

*(1) Poor allocation of productive resources*

According to *El Ladrillo*, the Chilean economy has its productive resources concentrated in the production of luxury goods, because of an undervaluation of foreign currency, high tariff barriers on luxury goods and price controls on basic necessities. Luxury items have, per definition, a small market and thus economies of scale and technological progress cannot be exploited. These goods are produced inefficiently in comparison with markets that use modern technologies for mass production of basic necessities.

Wages policy, pensions and welfare payments are all described as a tax on labour power and as leading to price distortions (Centro de Estudios Públicos 1992: 41), yet any tax on the use of labour power reduces employment of labour. The undervaluation of foreign exchange rates is said to similarly promote the substitution of imported capital goods for labour.

The authors of *El Ladrillo* argue that controlled interest rates have led to negative real interest rates. Negative real interest rates allow nearly any
investor to make a positive return, no matter whether these had a positive economic or social return. The interest rate thus loses its role of efficiently allocating scarce investment resources.

Tax policy thus has been driven toward maximising fiscal income rather than better allocation of resources or investment incentives. Taxes should not distort the allocation of resources and should not be so high as to prevent private savings (Centro de Estudios Públicos 1992: 42).

Some of the formal institutional changes that would come from this policy prescription include lower tariffs, decontrolled interest rates, freed prices and a realistic exchange rate. This deregulation aims to create a price in good and capital markets that reflects a free market price to efficiently allocate scarce resources.

(2) Limited development of the export sector

Manipulations of the exchange rate and tariff barriers are said to have prevented the development of a successful export industry.

Chile has a comparative advantage in copper production, which has allowed the country to generate a sufficient level of foreign exchange to maintain an overvalued exchange rate (Centro de Estudios Públicos 1992: 43-44). It is argued that this overvalued exchange rate has been to the detriment of other exports sectors and has prevented their growth.

El Ladrillo outlines how this dependency on copper has left the country exposed to fluctuations in the copper price. Variations in the copper price may lead to low reserves, and thus to corrective measures such as higher tariff barriers. This then produces pressure for a fixed exchange rate, which leads to balance of payments difficulties. The related increase in foreign
debt increases dependency. An increase in the debt service level then becomes a restriction on growth.

The authors emphasise that foreign loans need to be used more efficiently to promote export growth and to generate resources for a more diversified economy. They call the potential to generate growth in agricultural exports, and thus foreign exchange, obvious.

From the problem of the limited development of the export sector, formal institutional change that is expected includes lower tariffs and a realistic exchange rate. In this context, a realistic exchange rate is one that is not overvalued.

(3) Low growth rate of productive resources

According to El Ladrillo, controls on interest rates and capital markets prevented national saving in Chile and led to a low level of investment (Centro de Estudios Públicos 1992: 45). The absence of a properly functioning capital market is shown to support state intervention, which involved forced savings that were then directed to specific industries. These interventions are said to have led to reducing levels of investment and saving.

In the same context the authors argue that general education should be focused on technical expertise and geared towards improved productivity. This would best be achieved by raising the cost of education, supplemented with a scholarship system. Technological development is said to have been low because of the absence of a cohesive policy, which led to low levels of expenditure on research and development.

The policy prescriptions that emerge from this would include freed prices, freed interest rates, open capital markets and a realistic exchange rate. An
open capital market refers to a situation where private individuals are not hampered by regulation in the issuing and attaining of credit.

(4) Inappropriate action of powerful groups

While this section of El Ladrillo recognises a need for increased competition and decisive anti-monopoly legislation in the business sector, it presents the main problems as being caused by unions: those in important and strategic sectors gain high real wages at the expense of consumers, capitalists and workers in less unionised sectors. They argue that the high levels of real wages in some sectors limit the employment in other sectors, calling this structural idleness and blaming the resulting pressure on government to reduce unemployment for fiscal deficits, printing money and the inflationary process in Chile since the 1930s.

This section of the document concentrates on the institutional framework that governs labour organisations such as unions. We should observe formal institutional change that constrains the ability of unions to organise and bargain for wages.

(5) Fiscal deficit

In this section the authors similarly trace the fiscal deficit back to pressure on the state to create full employment and to maintain investment levels, two pressures they see as direct consequences of the slow economic growth due to the erroneous economic policies outlined earlier. They lament the identification of support for full employment with direct employment by the state. Citing the 70,000 employees of the housing and public works departments as an example of the growing bureaucracy, they also deplore the increasing fiscal deficits caused by substantial increases over the last decade in expenses for personnel, welfare and transfer payments, rather than increases in investment.
This refers to formal institutional change that would lead to a reduced budget deficit. This may include, but is not limited to, reduced expenditure or increased taxation. Reduced expenditure may be achieved through cuts in public sector employment and cuts in expenditure programs.

(6) Frequent change of economic policy

According to this section of *El Ladrillo*, when a new economic policy is implemented, there is usually a lag before it affects the economy. However, quick judgements on how effective a policy is, may lead to premature changes to the policy. A lack of consistent policies means that people will no longer believe in the permanency of any policy (*Centro de Estudios Públicos* 1992: 49). This in turn will lengthen the lag of all policies, which generates instability.

This refers to the general direction of formal institutional change. As such, it may not be attributed to a single form of formal institutional change, rather the formal institutional change that does occur should be consistent. Given this context, the expectation is that the policy implemented or institutional change stays consistently within neo-liberalism.

(7) Bad use of political power

Once the state involvement in an economy has become the decisive factor in whether an activity or investment succeeds, entrepreneurs have an incentive to collude with the state. While this collusion fosters a larger state on the one hand, (*Centro de Estudios Públicos* 1992: 50) this larger state stifles entrepreneurial initiative on the other hand. Thus, entrepreneurs both win and lose. Yet investment decisions are taken based on political pressures and personal intents, rather than based on their expected returns. This will lead to disappointing economic growth.
The concept of bad use of political power concentrates on the role of state. This relates to a small government, usually represented by a balanced budget.

(8) Lack of any agrarian policy

According to *El Ladrillo* Chilean industrialisation has developed at the expense of agriculture. Industrialisation was supported with cheap raw materials for industry and cheap foodstuffs for workers, which allowed wages to remain at a reasonable level (Centro de Estudios Públicos 1992: 51).

The negative tariff barriers on basic foodstuff discussed earlier provided a disincentive to invest in agriculture, leading to low agricultural growth. The authors of *El Ladrillo* assert that once the policies holding back agriculture are lifted, Chile’s agriculture will industrialise and compete successfully with copper as the nation’s source of foreign exchange.

While the agrarian policy of the junta is an important element to analyse, it will not be covered here.

5.4.2. Economic reforms based on El Ladrillo

From 1973 to 1982, there was a more or less continuous move towards the implementation of neo-liberal formal institutions, based on the analysis presented in *El Ladrillo*. The formal economic institutions implemented included price reform, privatisation of state enterprises, financial market liberalisation, labour market reform, fiscal reform, exchange rate reform, and trade reform. The close relationship of the changes instituted based on *El Ladrillo* will be demonstrated showing the strong influence of the Chicago Boys in the polity.
Price reform

Decree Law 522, enacted in October 1973, was the centrepiece of freeing prices. With a big bang this decree limited the regime’s ability to set prices to only 51 commodities, which meant that all other prices were free (Corbo 1985: 913). Previously, hundreds of prices had been controlled by the government.

In December 1980 the final step in price reform was taken, when Decree Law 3529 made it necessary for a law to be passed for a price to be fixed. Hence it was no longer possible for a minister to declare a price fixed.

Free prices were in line with the Chicago tradition and the policy document. Free prices are a corner stone of neo-classical, Chicago economics. Prices are the main source of information to agents and if they are distorted, agents would receive distorted information. Supposedly free prices allow for the allocation of resources to become more efficient. It is important to note that the reforms began shortly after the coup, beginning in 1974.

Privatisation of State Owned Enterprises

The return to their original owners of formally expropriated firms and of firms where the state had significantly interfered with their management was an important part of the new military government’s economic policies. Over 325 enterprises were given back free of charge to their original owners in 1974 (Lüders 1991: 12). There was continued privatisation of state owned enterprise including major financial institutions. From 1975 to 1978, 228 enterprises were privatised (Lüders 1991: 12), through a bidding process in which the highest bidder would be able to acquire the company. Most buyers financed their bids through borrowing from the major financial institutions.
This was in line with the Chicago tradition and the policy document. This was part of the economic team's view that private enterprise should take the lead in economic development.

Financial markets reform

In May 1974, financiers (finance companies) were allowed to set interest rates freely, and in October 1975, commercial banks were given the same treatment (Corbo 1985: 915). Freed interest rates led to a spike in interest rates up to 178.4% per annum during the second quarter of 1975, which led to a monetary crunch that also would lessen demand significantly. In December 1974, foreign banks had been allowed to start operating in Chile (Ffrench-Davis 2002: 39-40).

However, in contradiction to these policies, the capital account was virtually closed from 1973 until September 1977. Prior to 1977, there were severe restrictions on the foreign borrowings banks could undervalue. It was only in 1977 that commercial banks were allowed access to the international capital markets under Article 14 of the exchange law. However, there was a quantitative restriction that applied to each commercial bank, which restricted them to a maximum monthly inflow of 5% of their capital and reserves (Corbo 1985: 915). The monthly restriction was removed in April 1980. There were only two restrictions left then: one, that overall loans be restricted to twenty times capital and reserves, and two, that there be a compulsory deposit with the central bank of a percentage of the foreign credit. The size of these deposits depended on the term, usually between 10% and 15% (Corbo 1985: 915; Ffrench-Davis 2002: 108-109). Table 5.3 shows the large increase in capital inflow due to the liberalisation after 1977.
Table 5.3: Capital flows from 1975 until 1982

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Inflow of Loans (1977 US$ millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>1,109</td>
</tr>
<tr>
<td>1976</td>
<td>1,086</td>
</tr>
<tr>
<td>1977</td>
<td>1,390</td>
</tr>
<tr>
<td>1978</td>
<td>2,559</td>
</tr>
<tr>
<td>1979</td>
<td>2,691</td>
</tr>
<tr>
<td>1980</td>
<td>3,270</td>
</tr>
<tr>
<td>1981</td>
<td>4,640</td>
</tr>
<tr>
<td>1982</td>
<td>2,238</td>
</tr>
</tbody>
</table>

Source: (Ffrench-Davis 2002: Own production based on Table5.1 110)

This movement to decentralisation and use of markets is a key theme in the Chicago tradition as well as in the policy document. Markets are supposedly able to allocate resources efficiently and the state does not allocate resources efficiently. Another important aspect is that the reforms began early in 1974.

_Fiscal reform_

During 1975 there was a sharp drop in GDP due to austerity policies implemented by the junta in order to slow inflation. The military attempted to balance the government budget, which led to a 28% real decline in the level of government expenditures in mid-1975 (Ramos 1986: 18).

The austerity measures contributed to a 17% decline in GDP for 1975 (Ffrench-Davis 1993: 6-7), a decline in GDP that may be seen as a very draconian way of cutting excess demand in order to alleviate inflation. Inflation from 1975 onwards dropped to an average of about 30% a year, compared with an extremely high rate prior to 1975.

While the level of government expenditure was reduced, revenue was increased. A value added tax was implemented at 20%, while the corporate
profit tax was reduced and capital gains and net wealth taxes were eliminated.

Once the shock policy was implemented in 1975, the fiscal deficit fell from 10.5% of GDP to 2.6% and continued to fall thereafter. During 1979, 1980, and 1981 the Chilean government ran fiscal surpluses, as a direct consequence of cutting expenditure and increasing revenue.

Table 5.4: Fiscal expenditures and deficits (percentage of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total expenditures excluding the public debt</th>
<th>Fiscal Deficit</th>
<th>Year</th>
<th>Total expenditures excluding the public debt</th>
<th>Fiscal Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>22.9</td>
<td>2.7</td>
<td>1976</td>
<td>20.1</td>
<td>2.3</td>
</tr>
<tr>
<td>1971</td>
<td>28.0</td>
<td>10.7</td>
<td>1977</td>
<td>20.9</td>
<td>1.8</td>
</tr>
<tr>
<td>1972</td>
<td>30.1</td>
<td>13.0</td>
<td>1978</td>
<td>20.2</td>
<td>0.8</td>
</tr>
<tr>
<td>1973</td>
<td>43.6</td>
<td>24.7</td>
<td>1979</td>
<td>19.3</td>
<td>-1.7</td>
</tr>
<tr>
<td>1974</td>
<td>28.0</td>
<td>10.5</td>
<td>1980</td>
<td>20.5</td>
<td>-3.1</td>
</tr>
<tr>
<td>1975</td>
<td>22.7</td>
<td>2.6</td>
<td>1981</td>
<td>23.5</td>
<td>-1.6</td>
</tr>
</tbody>
</table>

Source: (Foxley 1986: Own production based on Table1.6 30)

A small government sector is part of the vision laid out in *El Ladrillo* and a strong part of the Chicago tradition. The large deficits that the government was running prior to 1973 were viewed as adding to the monetary pressures adding to inflation. Therefore, a cut back in government expenditures was needed to create a smaller government and to bring the fiscal budget back into balance. It is important to note that the reductions in fiscal expenditures began in 1974.

*Exchange rate*

Between October 1973 and August 1975, three separate exchange rates were in operation, one for trade except copper, one for the copper industry and one for financial flows and tourism (Corbo 1985: 914). By August 1975
revaluations\textsuperscript{81} and devaluations of all three exchange rates collapsed them into one. The exchange rate in August 1975 was a crawling peg.

In June 1976 the peso was revalued 10\%, and a thirty-day preannounced value for future exchange rates was established as a way of reducing costs and influencing inflationary expectations. (Foxley 1986: 25)

The main reason for this revaluation was the government’s increasing interest in reducing the inflation rate.

Contradicting the above revaluations in response to inflation were devaluations of the exchange rate to compensate for the reduction in tariffs. These reductions were spread throughout the whole period in question. Nevertheless, a devaluation of the currency that is equivalent to a tariff reduction should have a zero net effect on the inflation rate, as one compensates on the other.

There was a 5\% devaluation in July 1976, in response to further tariff reductions and as compensation for the import substitution industry. Each month after July the devaluation was to be equal to CPI in the previous month, this policy was to be neutral to inflation. Inflation persisted, averaging 197.9\% in 1976, and further action was needed. In March 1977, a revaluation of the peso equivalent to 10\% was aimed at reducing inflation.

Another series of devaluations was needed in 1977 as the tariff rates were collapsed in line with announcements (see below for tariff policy). March 1977 saw 4\% devaluation and 3\% for April, to compensate import competing industry for a tariff reduction (Ffrench-Davis 2002: 94). Devaluations from April onwards were equivalent to the previous month’s inflation (Ffrench-Davis 2002: 94).

\textsuperscript{81} Following some of the revaluation refers to an appreciation in the level of the nominal exchange rate.
Davis 2002: 94). There was 6% devaluation in August and 4.3% devaluation in December to compensate for tariff reductions.

After 1977, a new exchange rate policy was announced that consisted of announcing a devaluation schedule (tablita) of the peso with respect to the dollar. The tablita foresaw devaluations at a decreasing rate, starting with a monthly rate of 2.5% and ending with 0.75% in December of 1978 (Corbo 1985: 914). In December 1978, the government extended this devaluation scheme with daily devaluations at a decreasing rate. However, with the total level of devaluations below the rate of inflation, the economy was actually experiencing a real increase in the exchange rate. This put downward pressure on the inflation rate. Inflation fell to 84.2% and then 37.2% in 1977 and 1978, respectively.

The compound rate of devaluation was going to be 14.7% for 1979. In June 1979, the junta jumped to the value of the exchange rate programmed in the tablita for December 1979 and announced that this rate would be fixed until the end of February 1980 (Corbo 1985: 914). In June 1979 the economy had a fixed exchange rate of 39 pesos to the dollar, which remained fixed until June 1982 (Corbo 1985: 914). Inflation began to approximate the rate of inflation in the global economy, because the exchange rate was tied to the US dollar. The US dollar appreciated greatly in the late 1970s and early 1980s, as did the Chilean peso.

The change in the exchange rate had taken some time longer than some of the other reforms. It did begin in 1975 with the collapsing of the exchange rate into one exchange rate and then converting it into a crawling peg. The exchange rate was used as a tool to counter the effects of the trade barriers reduction and later as a tool to help control inflation. This later incarnation as a tool to control inflation was part of the use of the monetary view of the balance of payments to regulate the economy.
Foreign trade

There were three stages to the liberalisation of external trade in Chile.

The first stage lasted from September 1973 until July 1975. The purpose of the policies in this first stage was to remove all non tariff barriers and to achieve a maximum tariff rate of 60% (Foxley 1986: 54; Buchi Buc 1993: 45-46). Accordingly, the average unweighted tariff rate was lowered from 105% to 65% at the beginning of 1975.

The second stage of tariff liberalisation began in August 1975 and continued until December 1977. There were to be six nominal tariffs at: 10%, 15%, 20%, 25%, 30% and 35%. These targets were to be achieved by early 1978, yet they were achieved ahead of schedule in August 1977.

The third and final stage of the liberalisation extended from December 1977 until June 1979, when trade liberalisation achieved a uniform tariff rate of 10% (Maloney 1997: 148; Harberger: 346). The only exception to the uniform tariff was the automobile sector.
Figure 5.1 depicts the falling protection from 1973 to 1979 when the uniform tariff of 10% was reached. A simple average tariff is calculated by the addition of all the various tariff rates divided by the total number of import categories. While the graph shows a smooth reduction in the simple average tariff rate there were three stages to the reduction.

The reduction in trade barriers is in line with the doctrines set out in *El Ladrillo*. Furthermore, the reduction in trade barriers began in early 1973 and was continually reduced from that point.

*Overview of economic reforms based on El Ladrillo*

The key issues that *El Ladrillo* wanted addressed were the creation of a small state with a balanced budget, free prices, a free financial sector, realistic exchange rate and markets and private enterprise as the motor for growth.
The shrinking state was achieved with the reduction in expenditure and the reduced fiscal deficit. The freeing of prices was achieved via decree and in future ministers could not impose price controls by law. The financial sector was freed of most controls. Foreign banks were granted free entry, interest rates were freed, and capital could freely enter and leave the country. The privatisation of state assets put the responsibility of production and growth firmly in the hands of private enterprise. More competition was introduced with the simplification and predictability of the exchange rate and the lowering of tariff barriers.

All these ‘achievements’ of the authoritarian government may be traced back to the economic policy document *El Ladrillo* and its fundamental theoretical building blocks. The other point to observe is that in every single one of those examples previously noted the institutional change occurred or was begun shortly after the establishment of the military junta. Most of the neo-classical institutional change began in 1974 and deepened from that point.

If we turn to the formal labour market institutions we should see the same phenomenon: the implementation of neoclassical institutions in line with *El Ladrillo* and a quick implementation of these institutions after the coup.

### 5.4.3. Formal labour market institutional change

Labour market institutional change was discussed in *El Ladrillo* under the diagnosis of the poor allocation of resources.

While a large part of the economy was under substantial transformation in accordance with the policy document, *El Ladrillo*, the labour market formal institutions surprisingly remained based on the old labour code of 1931. As was discussed in Chapter 4, there was an initial promulgation of formal
institutions very quickly after the coup, in 1973. These laws did as El Ladrillo proposed, which was to reduce union power. There was a ban on collective bargaining, a ban on strikes, further causes for dismissal were added and the main national union was banned. However, these formal institutions were of an ‘emergency’ character. As such they were considered temporary and did not fundamentally change or replace the old labour code of 1931.

As was stated in Chapter 4, the ‘emergency’ laws actually provided a space for institutional change. This space was created by two factors: first the emergency laws and second the repressive character of the regime. These two factors reduced union power and thus reduced a key opponent to labour law change. However, even though both these factors occurred shortly after the coup in 1973 and 1974, the labour laws were not fundamentally changed until 1979.

What is termed here as ‘space’, manifested itself in the Chilean economy as reductions in real wages, reduction in the unionisation rate and a substantial increase in unemployment. Real wages in 1974 were about 40% of those in 1973, and increased slowly thereafter (Source: Campero 2001: 8). For example, unionisation fell by 10% between 1973 and 1977. The unemployment rate in 1973 was 4.8%, by 1975 the unemployment rate was 15% (The World Bank 1980: 335). This ‘space’ did not translate into a quick reform of the labour laws to conform to the neo-classical vision set out in El Ladrillo.

5.5. Conclusions

There are a number of conclusions that can be drawn from this chapter. By illuminating the history behind the transfer of the Chicago tradition to Chile, a particular mental model instilled in the Chilean students becomes prominent. This mental model was the economist as a crusader. Believing that the Chicago brand of economics was the only value, or interest free economics,
they thought it was their purpose to cement the Chicago brand as the orthodoxy in Chile.

The mental model that was transferred helped create a homogenous group. This homogenous group of economists was able to work together and challenge others. Briefly analysing the history of the Chicago tradition raised a number of fundamental conclusions of their theory. These included that freedom is determined by economic as well as political choices, free prices provide the information necessary to make choices, the state should only concentrate on upholding the rules of the game or enforcement, and private enterprise leads to an efficient allocation of resources. These tenetss and beliefs were transferred to the Chilean students who studied at Chicago and the policy document *El Ladrillo*.

Business organisations that supported the Chicago school of thought and *El Ladrillo* benefited from this relationship. This relates back to Chapter 3 and the era which is called radical neo-liberalism. This means that those organisations that grew during the period of radical neo-liberalism were in the best position to take advantage of the emerging Chicago institutional framework. They knew in advance the direction of institutional reform and thus it comes as no surprise that they would also become the dominant business organisations during that era.
6 Overcoming corporatism: the proposed corporatist labour laws and the postponement of neo-liberal labour law reform

6.1. Introduction

This chapter has four goals. The first goal is to identify the organisations in the polity that supported the proposed corporatist labour laws. The second goal is to outline the proposed corporatist labour laws. The third goal is to demonstrate the contradictions between the proposed corporatist labour laws and the policy document *El Ladrillo* (the brick) and the *Plan Laboral* (Labour Plan). The last goal of this chapter is to identify the causes in the polity of the failure of the proposed corporatist labour laws. These goals are outlined as questions below:

- What were the mental models of the military organisations within the polity?
- What were the proposals for labour laws by non-dominant organisations and what were the main contradictions with the economic theory documents and the resulting policy of the dominant organisations?

These questions assist in answering the first two thesis questions, namely, why it took so long to implement neo-liberal labour laws and how the neo-liberal labour laws became promulgated under the authoritarian government in Chile.
6.2. Supporters of the corporatist labour law proposals


The rapid reform of the labour laws, shortly after the coup, indicates the early intention of the authoritarian government. These reforms to the formal labour market institutions were part of a set of emergency reforms, yet these emergency reforms did not replace the industrial relations system which was first established in 1924 through military intervention (Morris 1966: 230-240). The Minister for Labour and Social Security for this period of ‘emergency’ was Carabinero General Mario Mackay. The Carabineros are a uniformed national police force that has had military training.

Table 6.1: Emergency labour laws of 1973

<table>
<thead>
<tr>
<th>Short description</th>
<th>Promulgated</th>
<th>Decree Law number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dismissal of public servants without cause</td>
<td>12 September 1973 to 22 September 1973</td>
<td>Decree Law 6, 22 and 98</td>
</tr>
<tr>
<td>Additional reasons to be fired</td>
<td>21 September 1973</td>
<td>Decree Law 32</td>
</tr>
<tr>
<td>Longer working week</td>
<td>12 October 1973</td>
<td>Decree Law 35</td>
</tr>
<tr>
<td>Collective bargaining</td>
<td>29 September 1973</td>
<td>Decree Law 43</td>
</tr>
<tr>
<td>CUT dissolved</td>
<td>13 November 1973</td>
<td>Decree Law 133</td>
</tr>
<tr>
<td>Union leaders and organisations</td>
<td>10 December 1973</td>
<td>Decree Law 198</td>
</tr>
</tbody>
</table>

(Source: Campero and Valenzuela 1984: 119-120)

The labour laws listed in Table 6.1 were discussed extensively in Chapter 4.

A conclusion from Chapter 4 was the implementation of these emergency labour laws resulted in a reduction in the power of labour organisations. In other words, the power of labour relative to the military and business was reduced. Labour was preoccupied struggling for survival. This would facilitate further institutional change detrimental to labour but desired by the military and business.
The quick institutional change of the labour laws after the coup indicates that there was a consensus among the junta members. However a permanent change of the labour laws did not begin until late 1978. The emergency labour laws of the early authoritarian government were approved by the junta after fifteen hours straight of work (Correa, Sierra et al. 1983). For a law to be passed there needed to be a unanimous decision among junta members, which illustrates the consensus among junta members to implement labour laws under such a tight time frame (Barros 2002) p. 74-75. The supposed temporary nature of these laws would have aided consensus.

The initial consensus among the junta members deteriorated over time. This deterioration would indicate that there were divergent mental models or preferred institutions for economy and specifically the labour market. This would mean that competing organisations surfaced with different objectives to the neo-classical ideal of the Chicago Boys and the *Plan Laboral* (Labour Plan).

### 6.2.2. Corporatist agenda: 1974-1978

As discussed in Chapter 2, there was not always complete cooperation within the military. For example, Pinochet was contacted at the earliest four days prior to the coup on the 8 September 1973 (Arriagada 1988: 100-101). This may represent a lack of trust between the main conspirators (Air Force and Navy) and the Army. It is arguable that the need for consensus after the coup would have been paramount to maintaining the stability of the early authoritarian government.

A revolving head of the junta rather than a personal dictatorship indicates an even distribution of power. An even distribution of power would have allowed the different junta members to express their preferred institutions. Shortly after the coup, junta members initially envisioned there would be a revolving
President of the Junta (Arriagada 1988: 9). The first President of the Junta was Army Commander-in-Chief Augusto Pinochet.

The relatively equal distribution of ministerial positions between the branches of the military illustrates that each of the junta members could pursue the implementation of their preferred institutions. The ministries were to be equally divided between the three branches of the military and the police (see chapter 2).

The Army headed the legislative committee dedicated to Internal Affairs (Ministry of Interior), Foreign Relations, National Defence, and Transportation and Telecommunications (González-Rossetti, Chuaqui et al. 2000: 15). The Army Commander-in-Chief Augusto Pinochet was the President of the Junta. General Leigh, the Air Force Commander-in-Chief, was commissioned with what was considered the social area (Arriagada 1988: 16). The Navy Commander-in-Chief Admiral Merino, was designated with what was considered the economic area (Arriagada 1988: 16). It is arguable that some of the most overtly controversial areas were given to the Carabineros. The Carabineros geographical spread and numbers would have made them ideal to prevent and repress peasant uprisings, relocate shantytown dwellers, and redistribute land from the agrarian reform. This may explain why the Carabineros were assigned the ministries of Agriculture, Colonisation, Public Works and Housing, and Urbanisation.

The Navy’s mental model was neo-liberal. The Navy was the principal sponsor of El Ladrillo, the neo-liberal policy document that had been developed already developed during the democratic presidency of Salvador

\[\text{\footnote{For example, the agrarian reforms of Frei and Allende were reversed by the authoritarian regime. The tomas (land invasions) by shantytown people for housing and land were common practise before the coup of 11 September 1973, became virtually non-existent with the advent of the authoritarian government.}}\]
Allende. The policy document presented neo-liberal solutions and alternatives to the socialist policies of the Allende government. The authoritarian government provided the space and opportunity for the authors of this policy document to implement their policies. By extension, the authors of *El Ladrillo*, the Chicago Boys, were connected to the Navy. For a more thorough analysis of the Navy’s connection to neo-liberalism please refer to Chapter 5.

Within the armed forces the Air Force was the strongest supporter of corporatism. The Air Force historically has been a supporter of a corporatist role for the state. For example, the Air Force was in control of the meteorological service from 1952 and they wished to use this service as a tool for the economic development of the nation (Zárate 2003: 51). They were the organisation that proposed the corporatist labour laws. For a more detailed history of corporatism in Chile please refer to Chapter 2.

The Army and the *Carabineros* had no strong intellectual background to draw upon and thus remained nominally neutral in this regard. Historically, the Prussianization of the armed forces between 1885 and 1920, under Emil Körner, laid the foundations of anti-communism (Nunn 1970). In a more contemporary context, the anti-communist tendency of the officer corps is no surprise, as under Frei’s Presidential administration (1964-1970), many officers were sent to special anti-subversion courses run by the US military (O'Brien 1983: 32). The Army and the *Carabineros* supported a National Security Doctrine (NSD), which represented a hemisphere wide defence against communism (O'Brien 1983: 44-45; Valdés 1995: 13 and 16). The NSD meant that Chile was in a type of total war where Marxism and Communism were the enemy.

This NSD tendency appeared in the ‘Declaration of Principles’ of the junta. ‘Consequently Marxist movements and parties will not be admitted again to civic life’ (Junta Militar 1974; Sigmund 1977: 267). The NSD provided a
national security policy for the Chilean authoritarian government, which arguably influenced the formation of Operation Condor. However, the NSD would not provide a comprehensive economic or social program for the ruling junta.

With the corporatists in control of the labour ministry the neo-liberal project could not advance in that area. Quite to the contrary of an advance of neo-liberal formal labour market institutions, a series of corporatist labour law proposals were put forward by Air Force General Minister Nicanor Díaz Estrada. Air Force General Nicanor Díaz Estrada replaced Carabinero General Mario Mackay as the Minister of Labour and Social Security on 11 July 1974 (El Mercurio 1974: 1, 10). These proposals spanned the entire period from 1974 until 1976. These corporatist proposals are summarised in Table 6.2.

Table 6.2: Corporatist proposed labour laws

<table>
<thead>
<tr>
<th>Proposed law</th>
<th>Date of proposal</th>
<th>Law number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anteproyecto de Código del Trabajo</td>
<td>May 1975</td>
<td>2.200, 2.756 and 2.758</td>
</tr>
<tr>
<td>Estatuto Social de la Empresa</td>
<td>May 1975</td>
<td>1.006</td>
</tr>
<tr>
<td>Estatuto de Capacitación y Empleo</td>
<td>May 1976</td>
<td>1.446</td>
</tr>
</tbody>
</table>

(Source: Campero and Valenzuela 1984: 115-125)

The proposed corporatist labour laws explain the period of de-facto liberalisation explored in Chapter 4. In the period of de-facto liberalisation, there were no laws implemented, which highlights the importance of the proposed corporatist labour laws. This also explains why the neo-liberal labour laws were not implemented sooner. This problem was outlined in Chapter 5. The Chicago Boys were not in control of the ministry of labour until much later, thus they could not implement their preferred institutions.

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83 Operation Condor (Operación Cóndor) was a campaign of political repression involving assassination and intelligence operations officially implemented in 1975 by the right-wing dictatorships of the Southern Cone of South America. These nations included: Argentina, Chile, Uruguay, Paraguay, Bolivia and Brazil.
The importance of the proposed corporatist labour laws is illustrated by the substantial media attention given to them. For example, Minister of Labour and Social Security, General Nicanor Díaz Estrada, visited a copper mine union in Rancagua to explain why they were not able to obtain a salary increase because of lower copper prices (Latin America Political Report 1975b: 39). He also toured parts of the nation to discuss the proposed labour laws with prominent unions, such as the copper workers union (El Mercurio 1975d; El Mercurio 1975e). This showed the commitment the Minister had for the proposed corporatist labour laws and the importance of the proposals.

Furthermore, an unstructured survey of the leading daily newspaper in Chile, *El Mercurio*, produced a number of articles on the subject, in the year 1975. The proposed corporatist laws were discussed in the newspaper by prominent businessmen, business associations and union officials (*El Mercurio* 1975f; *El Mercurio* 1975g; *El Mercurio* 1975h; *El Mercurio* 1975i; *El Mercurio* 1975j). This again illustrates the importance of the proposed corporatist labour laws.

The problem of the Chilean society and economy, as perceived by corporatists, was its penetration by the left. To replace this system of competing social actors they proposed a state-centric vision of strong, depoliticising organisation (Kurtz 1999: 406). Thus, part of their goal was the de-politicisation of society, but the other was the integration of social actors including unions into the state.
6.3. **The proposed corporatist labour laws**

6.3.1. **Anteproyecto de Código del Trabajo**

The draft labour code was proposed in May 1975.

To create a new labour code (*Código del Trabajo*), three separate laws needed be to changed:

- 2.200 – Individual Workers Contracts
- 2.756 – Organisation of Unions
- 2.758 – Collective Negotiations

It was declared that workers should organise via industry (except those firms with more than 300 employees). Compared to the law prior to 1973, unions were confined to the firm level. To be legal, a union needs to provide evidence to the Ministry of Labour and Social Security that those workers firms are in a similar industry. A worker may only be a member of one union and organisation of unions should occur primarily via industry (Campero and Valenzuela 1984: 122-123). Territorially the union should be limited by province.

The workers within the same industry must have a union size of at least 100, and. at the minimum, represent 25% of the industry or service (Campero and Valenzuela 1984: 122-123). Federations are allowed to be regional or national in orientation. Confederations may only be national. Furthermore, a person may not be elected a union leader if they have committed any illegal acts.

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84 Draft Labour Code.
Furthermore, the state was allowed to intervene in collective bargaining negotiations.

6.3.2. Estatuto de Capacitación y Empleo\textsuperscript{85}

Decree Law 1.446 was promulgated on 1 May 1976. This relates to a period when Air Force General Nicanor Díaz Estrada was removed as the Minister of Labour and Social Security in March of 1976. However, I argue that its integration with the Social Statute of the Firm and the relatively short time period after his resignation suggests that the law is still part of the corporatist labour law project.

The statute for training and employment only applied to the private sector in Chile. This law would only come into effect when the draft labour code became law (Campero and Valenzuela 1984: 125). The law states that training policy was the sole responsibility of the firm or the National Training and Employment Service\textsuperscript{86} (SENCE). The SENCE was a department under the Ministry of Labour and Social Security.

The law stated that programs for training must be apolitical in nature. Workers who undertake training still get paid their normal wage. Any extra time spent in training does not garner extra pay. The costs of providing training were supposed to be borne by the firm and not the employee.

State training undertaken by the SENCE included:

- Priority areas for the state
- Scenarios where firms do not train workers
- Unemployed persons

\textsuperscript{85} Statute of Training and Employment.

\textsuperscript{86} SENCE – \textit{Servicio Nacional de Capacitación y Empleo}; National Training and Employment Service.
First time job seekers
(La Junta de Gobierno de la República de Chile 1976; Campero and Valenzuela 1984: 125)

This law is also connected to the Estatuto Social de la Empresa with the use of the Committee of the Firm. The Committee has to be continually informed of the training programs provided, and the Committee opinions should be taken into consideration (La Junta de Gobierno de la República de Chile 1976). The Committee’s report on training programs provided by a firm was also to be sent to the government agency SENCE (La Junta de Gobierno de la República de Chile 1976). This shows a level of integration between the proposed corporatist labour laws.

6.3.3. Estatuto Social de la Empresa

The bylaw of the Company was Decree Law 1.006 and was published on 3 May 1975. This law would only come into effect when the draft labour code became law (La Junta de Gobierno de la República de Chile 1975; Campero and Valenzuela 1984: 123-124). The objective of this law was to inform workers and give them the ability to contribute to decision-making.

In Article 8, the participation and integration of workers with management in a firm should at minimum follow the strictures laid out in Decree Law 1.006 (La Junta de Gobierno de la República de Chile 1975: Article 8). The Minister of Labour planned, through this law, that management and workers would create new sources of participation and integration voluntarily beyond that prescribed in Decree Law 1.006.

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87 Social Statute of the Firm.
The main tool for the integration of workers into the firm of the decree law was the establishment of the *Comité de Empresa* (Committee of the Firm). The main function of the Committee of the Firm was informative. The committee was obliged to meet at least once a month, and could hold another extraordinary meeting in the same month (La Junta de Gobierno de la República de Chile 1975: Article 20). The main functions of the Committee were set out in Article 15.

The legal obligation to form a Committee of the Firm indicates that it would impact on the whole Chilean economy. All firms with 100 or more workers were obliged to have a committee of the firm and those agricultural firms with 25 workers or more were similarly obliged to have a committee of the firm (La Junta de Gobierno de la República de Chile 1975: Article 14). If a firm did not have a Committee owing to the firm’s small size, the head of the firm was still obliged to meet and inform workers about the state of the firm. These meetings were to occur quarterly and attended by all workers (La Junta de Gobierno de la República de Chile 1975: Article 14).

There were a wide variety of informational demands that the workers could make on the firm, which would improve their knowledge of the functioning of the firm. Workers should be informed about the economic and financial situation of the firm, which includes the processes of productions, investments the company made, future plans, or any restructuring the company plans (La Junta de Gobierno de la República de Chile 1975: Article 15; Campero and Valenzuela 1984: 123-124). Management is legally obliged to give this information and failure to do so would result in a fine levelled at the firm.

The head of the firm should give information, listen to opinion and know of the observations made by the Committee of the Firm on the following matters:
• Modification of the organisation of the firm that would lead to changes in the methods of work or the lines of production
• Merger with another firm, transfer or sale of the installations of the firm
• The increase or reduction of activities of the enterprise
• The closure of the enterprise or part of the enterprise

(La Junta de Gobierno de la República de Chile 1975: Article 15)

The company must have mechanisms and systems in place to distribute information and consult with workers. There was a formal procedure for this also outlined in the Decree Law. Information was passed on to workers through a process of publication of minutes from the Committee of the Firm meetings. They stated that meetings held with both the entire workforce and the Committee of the Firm should happen at least twice a year (La Junta de Gobierno de la República de Chile 1975). This would mean that the entire workforce would be fully informed, compared to only a select group of workers.

To consult with the workforce there was a formal process that was developed. This envisioned a form of worker integration into the firm decision making. Thus, workers were allowed to make suggestions or consult with their immediate supervisor in the section or department where they worked. The supervisor was legally obliged to analyse the suggestion or consult, and then pass it on with their observations to a responsible and corresponding party at the administrative level (La Junta de Gobierno de la República de Chile 1975: Article 10). This would have blurred the line of decision making in a firm.

The Decree Law also gave the head of the firm and the worker representatives of the firm great latitude in raising issues in the Committee of the Firm and demanding information from management. Issues allowed to be raised included those thought to better the functioning of the firm or those
thought to improve harmony between the components that make up the firm. This use of the word harmony is common in the language of the corporatist writings. It boils down to the way this harmony is achieved between the neo-liberal model and the corporatist model, as will be seen in the next section.

The Decree Law envisioned giving workers a share of the decision making process. In the Bylaw of the Company there was a provision for the elected representative of the workers to be on the board of directors (Sigmund 1977: 265). The terminology used by the authoritarian government was careful. Instead of using the term, the ‘workers’ enterprise’, they used the term ‘integrated enterprise’. This was undertaken to distinguish themselves and the ‘law’ from the Christian Democrat and Popular Unity terminology and any ‘Marxist’ connotations.

The role of the worker in the decision making process was limited. There would only be one worker allowed as a director, with another worker as an alternate. The alternate has only the right of voice and may attend sessions (La Junta de Gobierno de la República de Chile 1975: Article 24). The worker designated a director would have the same rights, obligations and responsibilities of normal company directors (La Junta de Gobierno de la República de Chile 1975: Article 24 and 26). As there was only one worker with one vote, their ability to influence the board of directors was minimal at best. Their position would be informative rather than functional.

Workers must be involved in the creation and establishment of programs for training of workers and the evaluation of these programs. These programs and plans for training have to be agreed upon by both the workers and the management, before they can be implemented in the company. Training programs were to fulfil two criteria, which were to facilitate the functioning of the firm and improve harmony between management and workers (La Junta de Gobierno de la República de Chile 1975; Campero and Valenzuela 1984: 123-124).
The importance of this particular law for the corporatist project cannot be over stated. The Social Statute of the Firm was first referenced in ‘The Declaration of Principles’ of the authoritarian government, which was first published in March 1974 (Junta Militar 1979: 41). This foundational document was widely circulated in Chile and illustrates the importance attached to the law.

6.3.4. Further initiatives of Minister Nicanor Díaz Estrada

An additional initiative of the Minister of Labour and Social Security was the implementation of tripartite commissions. The commissions involved labour unions, business representatives, and government officials and were established with Decree Law 670 on 2 October 1975 (La Junta de Gobierno de la República de Chile 1974). However, a condition of this was that the minister of labour chose all the members who sat on the commissions (El Mercurio 1975k: 17). There were eight commissions created in total. However, the scope of these commissions was very narrow. For example, one of the eight commissions created, addressed elevator or lift operators. The purpose of the commissions was two fold, to inform the government about additional legal or other requirements for the occupation and to provide feedback on the proposed corporatist labour law Estatuto Social de la Empresa. The commissions ultimately only had a short life span, with many never holding a meeting in their entire existence.

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88 Social Statute of the Firm.

6.4.1. El Ladrillo and labour market institutions

There was no specific section or chapter in the neo-liberal policy document El Ladrillo (the brick) devoted to the Chilean labour market. However, the Chilean labour market is discussed repeatedly within sections of the policy document.

*El Ladrillo* outlines one of the key problems of the Chilean economy as a lack of productive employment. The document identified some of the causes of unemployment in Chile. The authors of *El Ladrillo* argued that labour organisations were able to bargain for increases in wages higher than productivity (Centro de Estudios Públicos 1992: 93-94). Higher wages occurred at the expense of profits for firms and return to capital. To maintain profitability, firms substituted expensive workers with relatively cheaper machines (Centro de Estudios Públicos 1992: 93-94). This switch from workers to machines would lead to a higher unemployment rate.

In this situation of high unemployment rates, the solution provided by the policy document was threefold.

- Change in the education system
- Increase the rate of economic growth
- Decrease the high cost of Chilean labour

(Centro de Estudios Públicos 1992: 34)

Most space in *El Ladrillo* was devoted to the last point, which was to decrease the high cost of labour. It was argued the main tool to reduce the high cost of labour in Chile was liberalisation of the labour market’s formal
institutions (Centro de Estudios Públicos 1992: 139). For example, the policy document suggests that the Legislation of Immovability should be abolished. With the Legislation of Immovability the employer must pay a severance if they terminate a contract with an employee prior to the contracts natural completion. The abolishment of this law was supposed to reduce the cost of labour and increase employment.

*El Ladrillo* suggested liberalisation of the labour market to help solve the unemployment problem. This liberalisation had two components. The first component was that the market should determine the allocation of resources (Centro de Estudios Públicos 1992: 160). For the labour market this means that the two parties, the employer and the employee, should be the only individuals in the bargaining of wages. The second component of liberalisation is that the state should only concentrate on setting legislation and enforcement of the law (Centro de Estudios Públicos 1992: 160). This means that the state should not employ persons permanently to alleviate the unemployment problem. The state should implement laws that exclude it from the wage bargaining process and allow the function of bargaining between only employer and employee.

### 6.4.2. Contradictions between El Ladrillo or Plan Laboral and the proposed corporatist labour laws

There are three areas where the proposed corporatist labour laws have contradicted the policy prescriptions of the neo-liberal policy document *El Ladrillo* or the legal strictures from the *Plan Laboral*. These include the differences on collective bargaining, labour input into the firm’s operation, and the state’s role in the labour market. These three issues show the contradictions between the neo-liberal model and the corporatist model for the labour market.
The proposed corporatist labour laws would have allowed collective bargaining at the industry level. This is against the prescriptions of the *Plan Laboral*. The *Plan Laboral* imagined a competitive labour market, thus they wished to restrict collective bargaining to the enterprise level.

Under the proposed corporatist labour laws, the worker would have input into the training provided by the firm. Under the *Plan Laboral*, the only item that workers could negotiate with management was the wage level. Related to the decision about training is the policy of who should provide the training. The proposed corporatist labour laws envisioned that the state would have a role in training those who were unemployed or first time job seekers. The authors of *El Ladrillo* state that the education system should be decentralised and training financed by individual firms (Centro de Estudios Públicos 1992: 148-150).

Under the proposed corporatist labour laws the state would be able to intervene in the collective bargaining process. Collective agreements could take on a tripartite character, between state, business, and workers. The policy document *El Ladrillo* envisioned that employer and employee would be the only parties allowed in wage bargaining process. *El Ladrillo* saw the state as an actor that would distort the bargaining process.

The corporatist proposal had the worker as a director on the firm even though the worker did not have to be a shareholder. This contradicted the *Plan Laboral*, which only envisioned the worker as an input into the production process. The *Plan Laboral* also envisioned that decision making would remain solely with management.

These contradictions were the reason behind the opposition of the authors of *El Ladrillo*, the Chicago Boys, to the proposed corporatist labour law proposals.
6.5. Decline of corporatist proposals in the polity

The proposed corporatist labour laws were supposed to be fully implemented on 11 September 1975. The laws were passed to the Council of State in October 1975 and were never seen again (Latin America Political Report 1976a: 308). The process that led to the failure of the proposed corporatist labour laws from within the polity involves organisational and institutional factors.

The decline of the proposed corporatist labour laws is viewed from the political perspective. Political institutions were used by the Army to strengthen their own position and weaken the two other branches of the military and the police. The Air Force’s decline, with their concomitant support of corporatism, is mirrored by the neo-liberals’ ascendency in the authoritarian government. Thus, the ascendency of Pinochet and the Chicago Boys in the polity is part of the explanation of the proposed corporatist labour laws failure.

There were a number of political institutions that over time contributed to the loss of power of the Air Force and simultaneously an increase in the power of the Army. These include Provincial Governorship Roles, the control of the secret police, the source of the legal aide provided to the junta, retirements and promotions in the armed forces, Santiago Garrison, Revolving Head of the Junta, the Political Role of the Shock Program, the Ousting of a Junta Member, and finally the Christian Democrat Party and Patria and Libertad.

6.5.1. Regional and provincial governorships

The accumulation of regional and provincial governorships by the Army indicates the Army’s power compared to the other military branches. Shortly
after the coup, the country was reorganised administratively by a split into 13 regions. Within these 13 regions were 50 provinces, and within the provinces 324 municipalities (Angell, Lowden et al. 2001: 83). The constitution of 1925, which was nominally in effect at the beginning of the authoritarian government, gave the President, in this case the President of the Junta, the authority to name regional and provincial governors in times of emergency. Additionally, according to Article 100 of the 1980 constitution: ‘

[Control of] the government and the upper level administration of each region lie with the regional administrator [intendente] who will be appointed by personal authority of the president of the Republic. The regional administrator will exercise these functions according to the law, and orders and instructions from the president, of whom he is the natural and immediate agent in the territory under his jurisdiction (Junta Militar 1980).

This meant that control of the regions’ functions would be under the regional administrator, which would be an important support base for the President of the Junta. The top ranking military officer would become the governor in each regional capital, and the same thing occurred at the provincial level (Comisión Nacional de Verdad y Reconciliación 1991). The result was that the top military officer in each region was likewise its top political, governmental, and administrative head. The governor who administered the region was also head of the zone in a state of emergency and the military judge.

The majority of regional administrator positions were held by Army personnel indicating the Army’s relative importance at the regional level. Eleven of the thirteen regions, including most importantly the Metropolitan Region, were under the control of the Army (Huneeus 2007: 120). Similarly the top officials and advisors to the regional administrators were primarily in the Army - except in the regions of Valparaíso, Region V, (Navy) and Llanquihue, Region X, (Air Force) (Comisión Nacional de Verdad y Reconciliación 1991).
This illustrates the level of control achieved by the Army over the other military branches at the regional level.

Likewise, the heads of the provincial offices primarily belonged to the Army, followed by the police and the far less represented Navy and Air Force. Of the fifty provincial governors in their posts in 1986, forty-two were military officers. Of these, twenty-eight were from the Army (two were retired), twelve from the Carabineros (three retired), and two were from the Navy (one retired), with the Air Force holding no positions at this level (Huneeus 2007: 122). This shows the lack of local power held by the Air Force at the provincial level. The large number of provincial governorships held by Army officers provided a support base for Pinochet.

When Pinochet eventually secured the Presidency in late 1974, it was at his sole discretion who maintained their positions as regional, provincial or municipal governors. As previously stated, this facility was provided to the President within Article 100 of the 1980 constitution and within the old constitution of 1925. This meant that those who were given an administrative position at the regional level or lower were supposedly direct supporters of Pinochet’s presidency. Those administrators would have supported Pinochet’s position over Air Force junta member General Leigh. The regional governors would answer directly to the President rather than the Junta, strengthening the Army’s position over the Air Force and Navy.

6.5.2. Secret police and Pinochet

The control of the Directorate of National Intelligence89 (DINA) would provide one member of the junta with important resources to create a superior position. The DINA was under the control of the President of the Junta,

89 DINA – Dirección Nacional de Inteligencia; Directorate of National Intelligence.
Augusto Pinochet. The DINA was formerly established by Decree Law 521 on 18 June 1974 (Remmer 1980: 300). The DINA was mainly filled with Army personnel and the other Junta members had trivial influence on how the organisation was run (Barros 2002: 31-32). The head of the DINA Army General Manuel Contreras was a former student of Pinochet’s at the war academy (Spooner 1994: 114). This indicates Pinochet’s close connection with the DINA. Pinochet’s control of the DINA would provide important resources for him over the other junta members.

The DINA’s independence from the junta would have given Pinochet a greater ability to act against junta members. The DINA, concerned about its own budgetary independence from the junta, also set up businesses for profit. While there is no literature that details the extent of business operations of the DINA, it can be argued that on balance the effect of the DINA was to lead to smaller government and weaker labour. In consequence, the DINA was a force for forwarding neo-liberalism in Chile. There was a real fear within the junta at the level of power the DINA had accumulated, as the DINA kept tabs on military and civilian officials in the authoritarian government (Valenzuela 1995: 49). The DINA was given extensive powers to arrest and detain without warrants, which was provided by three secret articles of Decree Law 521 (Constable and Valenzuela 1991: 91). For example, the DINA spied on Army officers to help maintain Pinochet’s complete control of the Army and armed forces (Constable and Valenzuela 1991: 102). DINA reported directly to Pinochet, which would have provided superior intelligence for Pinochet compared to the other junta members.

6.5.3. Legal aid to the junta

The legal advice to the junta favoured one junta member, which would provide that member with improved power over the polity. Advisory
Committee to the Junta\(^{90}\) (COAJ), was an organisation set up during the first few days after the coup in September. This organisation’s function was to provide advice to the junta on legal and coordinating matters. The organisation was controlled by Pinochet and was mainly staffed by Army personnel (Barros 2002: 50). For example, in January 1975, the number of officers assigned to the COAJ of rank major or higher by each service stood at eight from the Army, four each from the Navy and Carabineros and only one from the Air Force (Barros 2002: 53 fn 37). This indicates that advice to the junta would be blurred in favour of the Army and would provide advice to advance Pinochet’s position in the junta.

Carlos Huneeus (2007: 188) argued that the COAJ played a role in obtaining the Presidency for Pinochet. COAJ persuaded the Navy and Air Force that a separation of legislative and executive powers was needed for a more efficient and effective government. This involved the COAJ supporting Pinochet to take on the Presidency and the junta taking on a more collaborative role.

A later organisation that was created to give advice to the junta was the Council of State. The Council of State was formed and announced on 11 September 1975 by General Pinochet. Originally, the Council of State was conceived to advise both the junta and the President. However, in the final text, as passed by the junta, the Council of State would advise only the President (Huneeus 2007: 189). This again represented a source of superior knowledge and information for General Pinochet, compared to the other members of the junta.

\(^{90}\) COAJ - Comité Asesor de la Junta; Advisory Committee to the Junta.
6.5.4. **Retirements, Promotions and Competitors in the Armed Forces**

The Commander-in-Chiefs’ ability to dismiss officers within their branch of the military would cement their authority over the branch. On 21 September 1973, the junta adopted Decree Law 33, a measure designed to stave off insubordination by military officers who might be loyal to the Allende government. The law gave the Commander-in-Chief of each branch of the military exclusive powers for one year over the promotion and retirement of officers, powers that had historically been vested in the Council of Generals and the President of the Republic (Valenzuela 1995: 32). This would assist Pinochet in consolidating his position as Army Commander-in-Chief.

The retirement of those Army generals who were opposed to the neo-liberal vision of Pinochet was a tactic to reduce dissent in the military organisation. General Sergio Nuño declared, ‘the condition of the worker ought to be considered of equal importance within the enterprise’ (Remmer 1989: 9-10). General Javier Palacios was quoted as saying, ‘All my life I have been a socialist’ (Remmer 1989: 9-10). General Oscar Bonilla considered that decision making could be decentralised to the regional level and that professional organisations could contribute (Campero 1984: 97-98). These generals were labelled as having more statist or interventionist mental models. Other Generals who were considered supportive of the statist or interventionist model included Torres de la Cruz, Arellano Stark, and Augusto Lutz (Remmer 1979: 444; Remmer 1989: 9-10, 26; Zárate 2001: 35). These Generals were sources of opposition to the neo-liberal model.

Army generals who were important actors in the 11 September coup were a potential threat to Pinochet’s leadership. Consequently, many of these same generals were of a statist or interventionist mental model. Pinochet was the
last of the military Commanders-in-Chief to enter the conspiracy and thus was not viewed as a leader of the coup within the Army.

For example, Javier Palacios led the assault on the Presidential Palace on 11 September (Spooner 1994: 42-45). General Oscar Bonilla was the second in command of the Army behind Pinochet (Latin America Political Report 1975c: 80). Army General Arellano Stark was a key coup plotter and led the so-called ‘Caravan of Death’, which murdered 75 political prisoners in five Chilean cities shortly after the coup (Verdugo 2001: 1). Army General Augusto Lutz was also a coup plotter prior to Pinochet’s involvement (Verdugo 2001: 2). Finally, Torres de la Cruz was responsible for a raid of a state-owned factory prior to the coup in Punta Arenas and was also known for his extreme right-wing reputation (Latin America Political Report 1974c: 69).

These generals had some influence over their respective regiments (Remmer 1989: 9-10). These examples highlight the prominence of these Generals and the threat they potentially posed to Pinochet’s leadership. This is especially true in the context of Pinochet’s reluctance to join the coup plotters and his promotion to Army Commander-in-Chief by Salvador Allende, which was seen as tainting his reputation.

A spree of forced retirements followed soon after the coup. Torres de la Cruz retired early on 19 February 1974 (Latin America Political Report 1974c: 69). Others quickly followed. Their retirement would cement Pinochet’s control of the Army.

The consolidation of Pinochet’s rule was also achieved through the removal of generals who had a statist mental model or who were important during the coup. Generals Augusto Lutz, Oscar Bonilla and Sergio Arellano were critical of Pinochet. Generals Augusto Lutz died on 28 November 1974 after being misdiagnosed by doctors (Spooner 1994: 123). An Army helicopter
crashed on 3 March 1975, with Oscar Bonilla, the defence minister, dying in the crash (Latin America Political Report 1975d: 84). The results of an investigation by the Army on the cause of the crash were never released (Spooner 1994: 124). General Sergio Arellano Stark was pressured to resign by Pinochet in November 1975 (Latin America Political Report 1975e: 388; Spooner 1994: 125). The removal of these generals helped consolidate Pinochet’s position as Army Commander-in-Chief.

The retirements and deaths of generals who could possibly challenge Pinochet cemented his position as Army Commander-in-Chief. Another consequence was the ‘retirements’ of generals in favour of a more statist model, which would have improved the position of the Chicago Boys, while diminishing the position of those who supported the proposed corporatist labour laws.

Future developments in the process of promotions and resignations ensured Pinochet’s position as Army Commander-in-Chief. On achieving the rank of colonel, officers were expected to submit a letter of resignation to the Army Commander-in-Chief, which was kept on file and could be used at any moment to retire the individual in question (Valenzuela 1995: 33). Pinochet had the final say in promotions above the rank of colonel.

Pinochet’s practice of placing officers from different branches of the military in the same ministries – naming a cabinet secretary from one branch and an undersecretary from another – isolated officers from their peers and served as an effective deterrent against politicization of particular services (Valenzuela 1995: 34). This tactic created loci of support for Pinochet in ministries such as Labour where he did not have control of the minister.
6.5.5. The Santiago garrison

The split in control of the Santiago garrison would make it more difficult for anyone to forcibly remove Pinochet as Army Commander-in-Chief. General Bonilla’s death coincided with an important reorganisation of the Santiago based second division. This position is one of the most powerful in the country, giving one person complete control of the capital and its communications.

After Bonilla’s death, there was a separation of powers. The former head of the second division, General Arellano Stark, was to remain in charge of all troops in the city itself, and was promoted from brigadier-general to division general (Latin America Political Report 1975d: 85). The old post of commander of the second division went to General Julio Polloni Pérez, however much of his power was taken away (Latin America Political Report 1975d: 85). Pérez only controlled troops in the province of Santiago outside the capital. The logistics of coup-making would now be considerably more difficult. Thus, Pinochet as head of the Junta and President of the Republic, would be harder to displace.

6.5.6. Revolving head of the junta

A revolving head of the junta would mean that there was a relatively even distribution of power between the junta members. The concept of a revolving head of the junta was discussed openly for approximately three weeks after the coup. For example, General Pinochet stated in the swearing in ceremony of the junta:

...there was, in reality, a gentleman’s agreement. I have no pretension to direct the Junta while it lasts. What we will do is rotate. Now it is me, tomorrow it will be Admiral Merino, then General Leigh and after General
Mendoza. I don’t want to appear to be an irreplaceable person. I have no aspiration but to serve my country. As soon as the country recovers, the junta will turn over the government to whom the people desire (Ercilla 1974: 9)

From that point onwards, Pinochet worked to consolidate power under his authority. This consolidation came about on 26 June 1974, when Decree Law 527 made Pinochet Supreme Head of the Nation (Constable and Valenzuela 1991: 66). This was not merely a title, it gave Pinochet full executive powers, while still maintaining a vote on the junta. Any measures taken by the junta needed a unanimous decision, thus Pinochet could issue decrees that his peers could no longer veto.

Shortly after the law was adopted, Pinochet held a ‘swearing-in ceremony’ where the President of the Supreme Court presented Pinochet with the traditional ceremonial sash of the presidency (Valenzuela 1995: 37). This ceremony represented a strong symbolic status of Pinochet claiming the executive branch, which represented a supremacy over the other junta members. In a mere formality, on 17 December 1974, Decree Law 806 finally gave Pinochet the title of President of the Republic.

When Pinochet became President he obtained control of the General Secretariat, which would only advise him. The General Secretariat had control of the media through the national communications office, DINACOS (Huneeus 2007: 189). The General Secretariat was raised to ministerial rank in 1976, and as such gained independence from the Ministry of Interior. Pinochet was also given the power to hire or fire anyone within the General Secretariat without justification or review to the junta.
Visits by Arnold Harberger and Milton Friedman in March 1975 supported the Chicago Boys. The former teachers of the ‘Chicago Boys’ provided master classes in the capital Santiago and presentations, which were attended by regime officials, generating substantial press (El Mercurio 1975a; El Mercurio 1975b; El Mercurio 1975c; El Mercurio 1975l; El Mercurio 1975m). Friedman also gave a master class on neo-classical economics on state television on his visit (Taylor 2006: 3). Friedman was quoted:

…the immediate cause of inflation is always a consequence of a larger increase in the amount of money than production and this is clearly so in the Chilean case. The first necessity therefore is to end inflation and the only way Chile can do this is by drastically cutting the fiscal deficit, preferably by reducing public expenditure…in Chile…gradualism seems to me impossible (O’Brien 1982: 10).

The decline of the corporatists can be mirrored with the rise of the Chicago Boys and the concentration of power in Pinochet. The rise in importance of the Chicago Boys began in 1975. In April 1975 the minister of Finance Jorge Cauas (one of the Chicago Boys) was granted, through a decree, the power to direct from his office the economic policies of the country. Cauas implemented the drastic, shock program, Program of Economic Recuperation (Programa de Recuperación Económica), whose objective was to lower inflation, reduce government spending and employment and pursue increased economic growth.

Cauas was given a great deal of control over the economic direction of the country through Decree Law 966 - reportedly written by Cauas himself - which granted the Minister of Finance power over every agency related to the Ministry of Finance, plus ten other ministries including Economics, Mining, Agriculture, Public Works, Transportation, Housing, Public Health, Labour,
ODEPLAN\textsuperscript{91} and CORFO\textsuperscript{92} (González-Rossetti, Chuaqui et al. 2000: 19). Decree Law 966 gave the Minister of Finance the power to name and remove all high-level civil servants, with the exception of the ministers themselves, which were to be exclusively designated by the President. This was also a change in policy as until then, the Junta could veto the naming of a minister.

The majority of the ministerial positions held by military personnel came from the Army, which indicates Pinochet’s relative power over the other junta members. It is interesting to note that of the 133 ministers in office during the authoritarian government, the majority came from the Army. Of the 133 ministers in office, 67 came from the armed forces. Of these, 37 came from the Army (55 percent of military ministers), 11 from the Navy (16 percent), 11 from the Air Force (16 percent), and 8 from the Carabineros (12 percent) (Huneeus 2007: 116). This indicates that the Army was the dominant branch in the military with the greatest ability to direct institutional change. Furthermore, the relatively small number of ministerial positions obtained by the Air Force illustrates their weakness to direct institutional change compared to the Army.

The under-secretaries to the ministers were controlled by the President. Thus, the under-secretaries owed their positions to the President rather than the minister in charge. Pinochet would generally appoint from ODEPLAN, which was constantly a pro-market reform organisation within the authoritarian government (González-Rossetti, Chuaqui et al. 2000: 16). Also, the technical aspects of reform were usually not performed by the minister in charge, but rather the under-secretary (González-Rossetti, Chuaqui et al. 2000: 16). This generated a source of power in the ministries to pursue a neo-liberal vision compared to a corporatist one.

\textsuperscript{91} ODEPLAN - Oficina Nacional de Planificación; National Office of Planning.

\textsuperscript{92} CORFO - Corporación de Fomento de la Producción; Development Corporation of Chile.
With Pinochet firmly in place as President and with the power of Decree Law 966, Air Force General Nicanor Díaz Estrada lasted only another few months in the position of Minister of Labour and Social Security. On 5 March 1976, the full cabinet resigned. This was the end of General Nicanor Díaz Estrada’s term in the authoritarian government (Latin America Political Report 1976b: 81). This was a clear blow to the proposed corporatist labour laws, as General Nicanor Díaz Estrada was its main architect.

Sergio Fernández’s appointment by Pinochet as the new Minister of Labour and Social Security ensured the Chicago Boys had control of future institutional change in the labour market. Fernández was a civilian and close aide to Pinochet (Constable and Valenzuela 1991: 67; Teichman 2001: 75). He was initially recruited into the authoritarian government by Miguel Kast, a well known Chicago Boy (Teichman 2001: 75; Huneeus 2007: 196). Fernández was a person who distanced himself from the unions and supported the free market policies of the Chicago Boys (Latin America Political Report 1976a: 308; Valenzuela 1995: 46). He was also reported to be against the right to strike, stating that there is no ‘right’ to strike for unions and that the right to petition the government should be removed from unions (Anonymous 1976: 159-163). This marked a clear break with the corporatist proposals that General Nicanor Díaz Estrada supported.

There were some other ministerial losses for the Air Force. In April 1975, the Air Force lost the ministry of Public Works, which went to an engineer associated with the National Builders’ Association (Cámara Chilena de la Construcción), Hugo León Puelma (Huneeus 2007: 202). To compensate for this important loss, the Air Force received the Ministry of Transportation and Telecommunications, held for some months by Air Force Brigadier General Raul Vargas, who was later replaced by a Chicago Boy, José Luis Federici (Huneeus 2007: 202). The deputy positions of the Minister of Transportation and Telecommunications were held by Army officers (Huneeus 2007: 118).
This represents the erosion of the Air Force’s responsibilities in the authoritarian government.

6.5.8. The ousting of a junta member

The final blow to the corporatist organisation was the sacking of Air Force Commander-in-Chief Gustavo Leigh Guzmán. General Leigh was voted out of the governing junta on 24 July 1978 and replaced by a Pinochet and Chicago Boy sympathiser, Fernando Matthei (Herrera 1986: 133). When Leigh was ousted, Pinochet retired eight generals and another eleven other generals resigned in solidarity with Leigh (Valenzuela 1995: 39). One of those generals that resigned with Leigh was former Minister of Labour and Social Security, Nicanor Díaz Estrada, who was a close friend of Leigh’s (Varas 1980: 26; Correa, Sierra et al. 1983: 102). The virtual disintegration of the Air Force high command meant that those best experienced to push forward a corporatist agenda were removed.

Leigh was surprised by his removal from the junta, which illustrates his lack of knowledge of junta politics and his weak position. The cause of the ousting, according to reports from Chile, was a newspaper article that appeared in Italy and was reprinted in Chile. The material from that article came from an interview from the Italian daily newspaper *Corriere della Sera*.

General Leigh felt he had already lost authority within the junta prior to his ousting. In an interview given to Florencia Varas (1980: 33), Leigh felt he lost power in 1975. This matches with the year when Decree Law 966 was promulgated, which gave Pinochet and the Minister of Finance extra authority. Leigh also felt that Pinochet did not strictly adhere to Decree Law 527 in consulting with the junta on ministerial appointments (Varas 1980: 54). This shows that Leigh’s decline in power occurred over a period of time and his removal may be thought to be the end of a long process.
Once General Leigh was removed as Air Force Commander-in-Chief, neo-liberal reforms of the so-called social areas of labour, education and health could take place. These reforms occurred without the opposition of the new Air Force Commander-in-Chief, General Fernando Matthei. Matthei, who was a strong supporter of the neo-liberal project, thought that neo-liberalism was the only option for Chilean development (Correa, Sierra et al. 1983: 77-87). These neo-liberal reforms occurred rapidly after the ascension of Fernando Matthei to Air Force Commander-in-Chief, with new labour laws implemented within the year.

6.5.9. Christian Democrats: from supporter to dissenter to oppressed

The Christian Democratic Party$^{93}$ (PDC), which, with some exceptions, had tacitly or explicitly approved the coup, eventually became critical of the authoritarian government. Essentially, the Christian Democrats were determined to protect some level of social expenditure and their 'new' forms of property ownership. The Christian Democratic Party’s ‘new’ forms of property ownership included cooperatives and share participation schemes (O’Brien 1983: 51). The cooperatives and share participation schemes were a form of corporatism. It is arguable that individuals within those organisations may have formed a basis of support for the proposed corporatist labour laws. The corporatist foundations of the PDC are outlined in Chapter 2.

Finance Minister Cauas’ resignation from the PDC signalled the decreased influence of the PDC in the polity. Minister of Finance Cauas, when taking up the position in 1974, was a Christian Democrat. However, soon

$^{93}$ PDC – Partido Demócrata Cristiano; Christian Democratic Party.
afterwards, he resigned from the party. Furthermore, Christian Democrat advisers in Cauas’s Ministry and the Central Bank left the PDC soon afterwards (O’Brien 1983: 52). This left little space for the corporatists within the PDC to form or influence economic policy or institutions in the authoritarian government.

Over time many of the PDC’s ‘friends’ within the authoritarian government died, fell from favour or retired. For example, Manuel Torres de la Cruz, a right wing Army general with reportedly close ties to the Christian Democratic Party was forced into retirement (Fleet 1985: 192). Furthermore, General Oscar Bonilla, who died in a helicopter crash, was the former aide-de-camp of Ex-President Frei. This left the PDC as a weak defender of the proposed corporatist labour laws.

In response to the PDC’s dissent, the repressive character of the authoritarian government was extended beyond the Marxists to include them. For example, ‘Over time government definitions of the threat requiring exceptional security measures have referred not only to Marxist, but to those who “paved the way for Marxism” or who unwittingly aided and abetted the international Marxist conspiracy’ (Remmer 1979). In March 1976 a right wing terrorist organisation called the Anti-Revolutionary Alliance (AAR) threatened prominent Christian Democrats, including Patricio Aylwin, Jaime Castillo and Andrés Zaldívar (Latin America Political Report 1976b: 82). Furthermore, in August 1976 the previously immune Christian Democratic ex-president Eduardo Frei was sent a hoax bomb filled with white powder to his house (Latin America Political Report 1976c: 268). This represented a spread of the repression and an informal attempt at neutralising the opposition to the authoritarian government.

94 Eduardo Frei was a democratically elected Christian Democratic President from 1964-1970.
95 AAR - Alianza Anti-Revolucionaria; Anti-Revolutionary Alliance.
Legal or formal institutional measures were taken against the Christian Democratic Party structure from 1977. The Christian Democrats media outlets (e.g. Mensaje) were closed down in 1977 and on 12 March 1977, Decree Law 1697 dissolved all political parties (Loveman 2001: 272). Decree Law 1697 included the confiscation of political party assets by the state. Unlike the Communist Party, which had experience organising in a clandestine manner under the Ley Maldita\textsuperscript{96} (Evil Law) of 3 September 1948, which banned the Communist Party until its repeal on 6 August 1958 (Loveman 2001: 217, 225), the Christian Democrats were unprepared and inexperienced to operate in a clandestine manner.

The pressure the PDC could exert on the authoritarian government was minimal. The political links were effectively repressed by the authoritarian government. This would mean that support for the proposed corporatist labour laws would be weak.

**6.5.10. Patria y Libertad**

Fatherland and Liberty Nationalist Front\textsuperscript{97} (PyL) was a potential source of support for the proposed corporatist labour laws. PyL supported the corporatist model of an integrated enterprise (Zárate 2003: 215). However, they also preached the sanctity of private property and the maintenance of hierarchy in the enterprise.

There were three main reasons for its lack of assistance for the proposed corporatist labour laws. They never produced a detailed economic or

\textsuperscript{96} Officially called: Ley de Defensa Permanente de la Democracia (Law 8987).

\textsuperscript{97} PyL - Patria y Libertad; Fatherland and Liberty Nationalist Front.
political program. They disbanded shortly after the coup. They were never allowed entry into important ministry positions.

The organisation never provided or made a comprehensive program for a future military takeover. This is the opposite to the position of the Chicago Boys, as they produced *El Ladrillo* (the brick), which was ready by the time of the coup and distributed to the military on the day of the coup. This was discussed at length in Chapter 5. All the PyL’s efforts were actually concentrated on making the military act and overthrow the democratically elected government of Salvador Allende (Zárate 2003: 212). This opened the door for the Chicago Boys to gain further influence over the ruling junta.

PyL disbanded soon after the coup. On 12 September of 1973, the group was disbanded by its leader Pablo Rodríguez Grez. This happened for two reasons. First, the group achieved its goal of bringing the military to power and, as such, were ‘no longer needed’ (Zárate 2003: 215). Second, the junta had asked for all political parties and organisations to go into recess, which PyL obeyed (Zárate 2003: 215). The dismantling of the organisational structure of the PyL meant that they would be much less effective in supporting a corporatist legislative agenda.

Former members of PyL who entered the authoritarian government were never in positions of particular importance. Many went to participate in the DINA (Huneeus 2007: 51). Others with nationalist or corporatist tendencies did achieve positions within the authoritarian government, like Álvaro Puga as a direct adviser to Pinochet, Gaston Acuña as director of information for the Junta, and Federico Willoughby as press secretary for the junta (Huneeus 2007: 51). These positions, while important, were never ministerial positions. Ministerial positions were in the hands of the Chicago Boys and the military. Thus, the level of support they could provide from within the authoritarian government was minimal at best.
6.6. Conclusions

The first question of this chapter, ‘What were the mental models of the military organisations within the polity? ’ was answered by identifying the mental models of the different branches. The Army and Carabeniros held a National Security Doctrine, the Navy a neo-liberal model and the Air Force a corporatist model. This meant that there was potential for conflict between these mental models in the polity.

The second question in this chapter was answered with the comparison of the corporatist labour laws and the economic policy document El Ladrillo. These contradictions provided the impetus for the Chicago Boys to desire the ousting of the corporatists from ministerial positions.

The chapter questions assist in answering the first two thesis questions, namely, why it took so long to implement neo-liberal labour laws and how the neo-liberal labour laws became promulgated under the authoritarian government in Chile.

The Chicago Boys aligned themselves most closely with Pinochet. Thus, institutional change that supported Pinochet’s position as leader of the authoritarian government also directly and indirectly supported the Chicago Boys’ dominance over the corporatists and the Air Force. The ascendency of the Chicago Boys may be paralleled with the decline in influence of the Air Force.

In this way the Air Force was continually sidelined. The Chicago Boys’ success at pushing out competing organisations in the polity allowed them to introduce the neo-liberal labour laws. This culminated in the Plan Laboral (Labour Plan), which was discussed in the Chapter 4.
Part Three
7 The contribution of North’s New Institutional Economics framework

7.1. Introduction

New Institutional Economics (NIE) assumes there are positive transaction costs. A transaction cost is a cost incurred in making an economic exchange. Neo-classical economics, on the other hand, assumes zero transaction costs. This assumes a frictionless world for economic exchange. When it is costless to transact, the efficient competitive solution of neo-classical economics is obtained. This is so because the competitive structure of efficient markets leads parties to arrive without cost at the solution that maximises aggregate income regardless of the initial institutional arrangements (North 1990: 15). As Furubotn and Richter (2005) point out, in neo-classical economics institutional arrangements may be evaded or changed at no cost, because parties may acquire and possess any information instantly and without cost. Parties also possess perfect foresight, which allows them to create complete contracts (Furubotn and Richter 2005: 12). The results that are extracted from a zero transaction cost world are clearly unrealistic.

One conclusion from a zero transaction cost world is that the institutional matrix (the laws, rules, policies, morals, habits, and conventions) of society do not actually influence or constrain the individuals of the world. Technically, this means that institutions are allocatively neutral (Furubotn and Richter 2005: 12). For example, it means that it does not matter whether production is organised by the price mechanism or within an hierarchically organised firm (Coase 1937). In reality this is far from true. As Williamson (1985: 15) argues, it would leave the firm as a black box where the internal
workings of the firm are hidden. For this reason NIE has introduced the concept of positive transaction costs.

**7.2. Assumptions of North’s New Institutional Economics**

**7.2.1. Neo-classical assumptions**

The assumptions below are those identified by North (1995: 19) that most closely relate to neo-classical theory. They are quite common in the field of neo-classical economics.

1. ‘Scarcity hence competition postulate’

This is derived from the assumption that there is a finite quantity of resources, but an unlimited number of wants. This means that our resources are scarce and there will be competition for them to satisfy our wants.

The consequences of the competition postulate have evolved through North’s academic career and requires some clarification. Prior to 1981, North took the strict neo-classical position that competition leads to efficient institutions (North and Thomas 1973; Vandenberg 2002: 227). In North’s 1981 account of institutional change, however, competition between organisations is no longer a sufficient condition to achieve efficient institutions. Indeed, competition between organisations does generate more efficient organisations. That is, organisations over time ‘learn’ how to better use the given institutions and thus become more efficient.

2. ‘Economics as a theory of choice subject to constraints’
This is one of the main assumptions in North’s theory. The typical neo-classical constraint is the budget constraint. Budget constraints limit the number of choices for the individual.

Institutions, given this assumption, form another type of constraint, comparable to the budget constraint. Thus, by constraining some activities, incentives for others are created.

3. ‘Price theory as an essential part of the analysis’

Prices of goods and services provide us with the necessary information to make decisions. Prices also provide incentives for the allocation of resources. Thus, prices are a relevant form of analysis if organisations or individuals base their decisions on them.

4. ‘Change in relative prices as a major force in inducing change in institutions’

Relative price is the price of a good or service in terms of another, or the ratio of two prices. A relative price may be expressed in terms of a ratio between any two prices or the ratio between the price of one particular good and a weighted average of all other goods available in the market. Microeconomics may be defined as the study of how economic individuals react to changes in relative prices.

Thus, relative prices may also be seen as inducing institutional change. Relative prices determine real value. If the real value changes, then there is a reason to change the institutional setting to take advantage of that situation.

The four assumptions presented are those that North identifies as close to neo-classical economics. Competition remains a driver of organisational and
institutional change. North’s NIE remains firmly within the confines of neo-
classical economics by stating that economics in general should be seen as
a theory of choice subject to constraints. Prices remain the main tool of
analysis. These traditional assumptions of neo-classical economics are not
substantively altered by North.

7.2.2. North’s extension of the neo-classical
assumptions

Four assumptions are developed by North and are shared by economic
information theory. They are North’s main extension of the neo-classical
assumptions. However, it should be remembered that the basis of North’s
NIE remains firmly in neo-classical economics.

5. The individual is the basic unit of analysis

This assumption works on the basis that from the individual we can
understand such macro concepts as culture and the state. Thus, institutions
as macro concepts, do not influence individuals’ micro concepts.
Explanation flows from the micro to the macro, not in the opposite direction.

In this framework the individual forms the basis of the explanation. In North’s
NIE, the entrepreneur, as an individual, takes on the role of agent for an
organisation.

6. The individual is rational

A fully rational individual has the cognitive ability and time to weigh every
choice against every other choice. Rational individuals are able to maximise
their utility in all situations at all times. There are two keys assumptions
behind the ‘rational individual’ as used in neo-classical economics:
Completeness – all actions can be ranked in an order of preference (indifference between two or more is possible) (Jehle and Reny 2001: 6)

Transitivity – if action $a_1$ is preferred to $a_2$, and action $a_2$ is preferred to $a_3$, then $a_1$ is preferred to $a_3$ (Jehle and Reny 2001: 6)

Often, to simplify calculation and facilitate testing, some rather unrealistic assumptions are made about the world, which include that an individual has full or perfect information about exactly what will occur under any choice made. More complex models rely on probability to describe outcomes.

North augments the neo-classical definition of rationality by relaxing the axiom of completeness. This brings him closer to bounded rationality. North does accept that humans intend to act rationally, but are limited in their ability to do so. For example, the individual limits the number of choices they need to make. A law can limit what an individual may choose to do. An individual may also develop institutions such as habit and routine which provide predictability for the individual and again limit the number of conscious choices they need to make.

7. Information is costly and asymmetrically held

This is the key assumption provided by information theory, which is an extension of neo-classical economics. In North’s NIE, information is not free. Rather, there is a cost or price to information. Information asymmetries persist.

This costly and asymmetrically held information thus breaks with the neo-classical ideal.
8. Limited mental capacity of individuals, which implies bounded rationality

Humans are unable to make the mental calculation of an ideal rational individual. Individuals have limitations imposed on the choices they need to make, so they make approximately rational decisions.

7.2.3. Individuals’ ability to decipher their environment: ideology and mental models

For North, deciphering the environment involves three important and interrelated aspects. These include: possessing theories of the environment (ideology or mental model), possessing information about the environment, and the computational ability of the human mind. Institutions play a key role in overcoming difficulties of deciphering the environment.

First, the theories that we possess of reality (ideology or mental models), are rarely accurate (North 1990: 23, 25). ‘Mental models are the internal representations that individual cognitive systems create to interpret the environment…’ (North 1994: 363). If an ideology or mental model were accurate then we would be able to accurately predict the outcomes of our actions. This is rarely the case.

Fine and Milonakis (2003: 561 fn 14) suggest that for North, the ideology or mental model of the individual is derived by the individual and is not a part of the structure. Ideology or mental models are not an institution. Institutions are part of the structure. North still holds that ideology is conditioned by the individual, which implies holding on to the tenet of methodological individualism. These issues are addressed further below.
Ideology or mental models are explored further below, in order to focus on how learning or new knowledge can change the ideology or mental model of organisations and individuals.

Second, the information feedback received from our environment is incomplete (North 1990: 23, 25). This incomplete information feedback from our environment does not allow accurate correction of our ideology or mental model. For example, if the fragmentary information feedback is positive for an institution, this would generally support the continuation of the institution. However, in hindsight and with complete information, it may turn out that the institution should have been abandoned or changed. This means that fragmentary information feedback may cause an inefficient or ‘bad’ institution never to be corrected.

In North’s analysis, the exact way information feedback works remains unclear. For example, the manner in which the ideology or mental model of the individual filters the information feedback is not stated. These issues are taken up further in Section 7.6.

Third, the computational ability of individuals and organisations is limited (North 1990: 23). Thus, in an unbounded world (a world of limitless choices), individuals and organisations would not be able to maximize their utility functions.

It is no surprise that North looks on Herbert Simon’s work favourably:

[Homo Economicus] does not stand on a mountaintop and, viewing the whole world at his feet, make a global, omniscient, rational choice. He is rational within bounds set by his social role of economic man. (Simon 1958)
That is, North views Simon’s identification of the inability of an individual to compute a maximum utility as the source of ideology or mental models. Mental models are simplifications used by the limited individual to help interpret the environment and information they live in (North 1990: 23). Thus, there is a strong connection between an individual’s mental limitations and the mental models they possess.

As a consequence of these limitations to deciphering the environment, institutions are developed to constrain the choice sets of individuals and organisations. Institutions create a regular and predictable pattern of behaviour, which may reduce uncertainty for individuals and organisations.

Institutions have a dual purpose. One is to help simplify the environment for the choices the individual makes. The second is to provide a form of predictable behaviour of other agents. Otherwise, transactions would become unmanageable.

In relation to the Chilean case study, North’s NIE is able to distinguish between the different mental models of the armed forces. For example, North’s NIE is able to distinguish and explain why people adhere to a neo-liberalism or corporatism mental model. However, explaining the origins and choices of mental models is beyond the scope of North’s NIE and thus is more limited than the Chilean case study. For a further discussion of the limitations of ideology please refer to Section 7.6.

7.2.4. Limitations of neo-classical theory overcome by North’s NIE

North claims that there are three problems encountered by neo-classical economics, which are solved under his NIE. These three problems are:
1. Individual cooperation
2. Obeying rules of the game
3. Non-rational behaviour, e.g. altruistic behaviour.

(North 1981: 45-58)

The three problems are related to the rational individual. Why would an individual cooperate in an organisation when the individual may benefit by free riding? Why would an individual obey the rules of the game if their individual calculus says it is in their best interest to break the rules? Why would an individual act non-rationally if this implies not maximising their utility? For example, altruistic behaviour such as the free donation of blood becomes difficult to explain within the assumption of fully rational individuals.

Prior to North’s 1981 book, *Structure and Change in Economic History*, ideology was not part of his theoretical framework. This addition of ideology became problematic for North as it has a number of contested definitions. The term ideology was later slowly phased out of North’s work and replaced by the term ‘mental models’. However, the meaning that North gives this term is the same. Fine and Milonakis say in this regard:

> In commenting on an earlier draft, North accepts he was wrong in his 1981 book to “imply that ideology is part of the structure.” He also claims that he has since “conspicuously stayed away from the term because it is so loaded; and I have really been more concerned with the way in which beliefs evolve and the way in which learning takes place.” (Fine and Milonakis 2003: 561 fn 14)

In North’s NIE, what makes individuals cooperate, obey the rules, and sometimes act non-rationally is the ideology or mental model of the individual. That is, the way an individual perceives the world strongly dictates how the individual acts. For example, an individual may highly value the altruistic act of giving blood. This means that the individual derives some
utility from this act, but also, that his or her mental model says that this is the ‘right’ thing to do. The mental model is learnt or indoctrinated in the individual. It has a strong normative aspect of how an individual perceives the world should be.

The assumptions of North’s version of NIE show there are many similarities to neo-classical economics. Furthermore, the ‘extensions’ that North has made to the neo-classical assumptions are still within the mainstream framework of economics. For example, the information economics literature shares many of the same assumptions.

The one major extension that North has made has been the addition of ideology or mental models. However, the concept of ideology becomes constrained by the assumptions already taken on board from neo-classical economics. For example, ideology is not conditioned by the structure (institutions), it is determined by the individual (strict adherence to methodological individualism). Furthermore, ideology takes on the task of solving a number of problems inherited from neo-classical economics. These problems of explaining cooperation, non-rational behaviour and rule following are all solved by the same concept: ideology. However, the concept of ideology as developed by North remains largely unexplained.

7.3. North’s NIE: institutions and organisations

An elaboration on North’s NIE assists in the investigation of whether North’s NIE allows us to identify additional areas or explanations we have not yet explored in the Chilean case study.
7.3.1. Institutions

‘Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction’ (North 1990: 3; see also North 1991: 97). Institutions can be both formal and informal. Formal institutions include a constitution, statute law, common law or by-laws. Informal institutions include conventions, habits, or routines. Formal and informal institutions are not strictly defined categories and are better represented as a spectrum from formal to informal, as in Diagram 7.1.

Figure 7.1: Formal and Informal Institutional Continuum

<table>
<thead>
<tr>
<th>Constitution</th>
<th>Routine</th>
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<tbody>
<tr>
<td>Formal</td>
<td>Informal</td>
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</table>

Formal institutions can be generally imagined as a hierarchy. The constitution of a country is at the apex, with regulations at the base. The further up the hierarchy we go, the more difficult it is to change formal institutions. As Robert Goodin puts it, stability and predictability are achieved through ‘…a system of ‘nested rules’, with rules at each successive level in the hierarchy being increasingly costly to change’ (Goodin 1996: 23). Therefore, more resources would be needed to change more important formal institutions.

The discussion of informal institutions and their evolution is still in its infancy in the New Institutional Economics literature. For example, ‘North (1990: 37) links informal constraints to ‘our heritage’, ‘socially transmitted information’, or ‘culture transmitted between generations’ (Lowndes 1996: 188). Each of these terms for informal constraint evolution has different meanings. The concept itself is evolving and not clearly defined. The main tool used by
North to describe the continuation and evolution of informal institutions is culture. Culture is described as the ‘intergenerational transfer of norms, values, and ideas’ (North 2005: 50). However, how culture operates to generate this ‘intergenerational transfer’ remains largely, indeed almost wholly, unexplained.

The main focus of this thesis is to explain the ‘how and why’ of neo-liberal labour law implementation in Chile. It is beyond the scope of this thesis to determine in detail the sources of change in informal institutions of the Chilean labour market. Nevertheless, as identified in the thesis, informal institutions are acknowledged as playing an important part in the Chilean case study.

North’s NIE allows for the identification of informal institutions. Those informal institutions impact on the main organisations of the Chilean labour market. Those informal institutions may impact positively or negatively on the ability of Chilean labour market organisations to influence future institutional change. In this way, informal institutions may inform us about the ‘how and why’ of neo-liberal labour law implementation.

This thesis proposes that one of the main informal institutions was the repressive character of the military dictatorship. There was no written law on how to deal with what was labelled by the authoritarian government as the ‘Marxist Threat’. ‘Disappearances’ of prominent union leaders or of leaders of the political parties of the Left were to some extent random. This randomness created an even greater sense of fear in the populace, especially the working class. Such a justified fear in the working class drastically reduced the prospect of legal or illegal (wildcat) strikes by unions.

98 ‘Organisations are groups of individuals bound by some common purpose to achieve objectives’ (North 1990: 5). Organisations are discussed more fully below under Section 7.3.3.
Using the language of North’s NIE, the reduced possibility of strikes by the workers’ unions lowered their ability to influence any future changes in the formal institutions of the labour market, or to improve their remuneration under the existing institutional framework. Informal institutions such as the repressive character of the regime are used to illuminate how the formal institutions changed.

7.3.2. Why do institutions exist?

In North’s NIE, institutions exist for two main reasons: measurement and the computational ability of the human mind.

Measurement

Any form of trade involves measurement, and trade involves at least two parties. For example, a buyer wishes to purchase a chocolate bar to eat. The buyer wants to maximise her utility from this purchase. Therefore, the buyer would pick the chocolate bar she thinks would give her the highest utility.

Assuming that the chocolate bar is a normal good and the bars available are of similar quality, the buyer will want more rather than less. How does the buyer determine this? Measurement! The buyer finds printed on the packet of the chocolate bar a label with its weight.

For this label of ‘weight’ to have meaning to the buyer, both the buyer and the seller have to hold the same institution in common (North 1981: 35-36). That is, both buyer and seller must both hold the same way of measuring weight, for example they both may have learnt the metric system, which would mean that the label would be in grams.
If buyer and seller do not hold the same formal institution of weight in common then the buyer must use another form of measurement to determine the weight of the product (North 1981: 35-36). This may take the form of an informal institution. The buyer may hold each of the chocolate bars in her hand to gauge the weight of each product. In this case she is using an informal institution.

The more accurately the buyer can measure the weight of each chocolate bar, the greater the chance of maximising her utility. The formal institution of weights (in this case the metric system) provides a more accurate result than using the informal institution of measuring by hand. Thus, the institution used plays a critical role in determining how accurately we can measure the desirable attributes of a good or service.

*Computational ability of the human mind*

This issue was already discussed in Section 7.1.3 in some detail.

Summarised, in a world without institutions or constraints, there are limitless choices or decisions for an individual to make. Individuals must try to maximise their utility within this world. However, the human mind has a limited computational ability. Given too many choices or decisions, the human mind cannot reach a solution that maximises the utility of the individual. Institutions are developed to constrain the choice set of an individual. Within this constrained environment it is easier for the individual to maximise their utility. This is also true for organisations.

It must be mentioned that institutions do not have to be efficient in North’s NIE, which would mean that the institutions lead individuals to maximise their utility as if in a world of limitless choices. In the real world institutions are never truly efficient.
7.3.3. Organisations

‘Organisations are groups of individuals bound by some common purpose to achieve objectives’ (North 1990: 5). Organisations may be divided into different categories: political (political parties); religious (for example, the Catholic Church) and economic organisations (firms, unions, business associations) (North 1990: 5). In North’s NIE, the organisation is a homogenous entity, which does not give scope for organisations within organisations. This issue of organisational homogeneity is discussed further below in Section 7.6.

Organisations are created to take advantage of those opportunities generated by the institutional matrix (North 1990: 5). The institutional matrix is the totality of formal and informal institutions of a geographic and political area. Institutions may complement activities of organisations and thus create opportunities for expansion of those organisations.

The example discussed here is that of the for-profit firm. The profit maximising behaviour of the firm can take the form of making choices within the existing set of institutional constraints or the form of altering the institutional constraints. The choice of the firm is dictated by the costs and benefits attached to each of these two basic options (North 1990: 79). In the real world, firms generally invest in both options, they are not mutually exclusive.

When a firm attempts to maximise within the institutional constraints, they are trying to be more productive (North 1990: 79) by reorganising the internal organisation of the firm, using updated technology, reducing labour costs and so forth. Thus, a firm has two considerations when attempting to maximise profits within the institutional constraints. One is the firm’s production function and the other is transaction costs.
When a firm attempts to maximise profitability by changing the institutional constraints, they are changing the ‘rules of the game’ to benefit themselves over other(s). For a firm that wishes to change formal institutions this may involve lobbying those parliamentary representatives who have access to the decision making processes of the government.

In North’s NIE, it is the entrepreneur as the agent of the organisation who ultimately makes these crucial decisions. Thus, at the firm level, when an entrepreneur chooses to increase profitability there are two options. On the one hand, the entrepreneur may try to improve production within the existing institutional constraints. On the other hand, the employer may try to reduce transaction costs or production costs through changing the institutional framework. If the entrepreneur now becomes the centre of analysis, this raises a number of problems, which are discussed in further detail in Section 7.6 below.

In Chile, the main lobby groups for employers are the business associations, such as the Confederation of Production and Commerce\(^99\) (CPC) or the Society for Industrial Development\(^100\) (SFF). Historically, the strongest business associations have been the umbrella organisation for all business associations, the CPC and the manufacturing business association, the SFF (Silva 1996a). Large conglomerates such as Cruzat-Larrain and Vial (BHC) also lobby government on their own.

Workers may improve themselves within the existing institutional constraints or they may try to change the institutional framework to appropriate more of the gains from production. In Chile, the main lobbying group for workers are

\(^{99}\) CPC Confederación de la Producción y el Comercio; Confederation of Production and Commerce.

\(^{100}\) SFF Sociedad de Fomento Fabril; Society for Industrial Development.
the unions, such as the Central Union of Workers\textsuperscript{101} (CUT). North’s NIE is able to identify the organisations relevant to explain how and why neo-liberal labour laws were implemented, much like the Chilean case study presented earlier.

If both the worker and the firm have access to the polity, where formal institutions are changed, there are conflicts over whom the institutions of the labour market would benefit, the employer or the worker. This already highlights another key point. Institutions impact on the power or, in this case, the bargaining strength of the two parties.

Institutions can reduce the cost of institutional change for certain organisations over others. When organisations become more powerful, it may become easier for them to pursue further institutional reform. However, one must take into consideration the imperfect nature of the environment in which the organisations are acting. As mentioned in Section 7.2, organisations cannot fully predict the consequences of their actions, therefore the institutional change they seek may later become their damnation.

7.3.4. Organisational and individual learning

Organisations learn about the limits and opportunities of institutional constraints through action. This means that organisations, just like individuals, learn-by-doing and may develop tacit knowledge (North 1990: 74). Incremental changes allow them to retain the tacit knowledge of historical institutions. Thus, when organisations wish to change institutions, they generally do so incrementally. Thus a revolution or a non-incremental

\textsuperscript{101} CUT Central Única de Trabajadores; Central Union of Workers.
change in the institutional framework is not always in the best interest of organisations.

Learning has two broad results: one, the increased efficiency of the organisation and two, the mental model or ideology of the individual shaped by learning.

The opposite of tacit knowledge is communicable knowledge. According to North (1990: 74), communicable knowledge can be articulated, codified, and stored in certain media. It can be readily transmitted to others. The most common forms of explicit knowledge are manuals, documents and procedures.

Learning (tacit and communicable) is shaped by the mental model or ideology and the institutional matrix. It is the mental model of the individual that interprets the costs and benefits of different activities in relation to the institutional matrix. In other words, the institutional matrix provides incentives for knowledge acquisition or learning. These incentives are attributed a cost/benefit by the mental model or ideology of the individual.

The following example is in relation to a firm, which is a profit maximising entity. The institutional matrix provides incentives for certain types of activities over others. The incentives of the institutional matrix may lead to two results, a redistribution of income or an increase in productive activity (permanent increase in income) (North 1990: 79). For example, the institutional matrix may promote piracy. Piracy is a form of redistribution of income. The pirate will learn tacitly how to be a better pirate (North 1990: 77). Additionally, the organisation of the pirate will invest in new knowledge about piracy, to enhance the pirate’s profitability. Thus, the institutional matrix may shape the direction of the acquisition of knowledge and skills.
This does not mean that the pirate is locked into a path of continued and more efficient piracy. It simply means that there are strong incentives by the institutional matrix and the tacit knowledge gained from piracy to continue being a pirate (North 1990: 77-78). A strong caveat must be noted: the new knowledge that the pirate learns tacitly or otherwise may lead the pirate into productive activity (North 1990: 78). This would occur through a change in the mental model or ideology that the pirate holds. That is, productive activity would be perceived as more profitable than redistributive activity.

Increased knowledge may change the mental model or ideology that the organisation holds. This change in the mental model or ideology may change the perceived cost of institutional change versus investment in productive activity. Thus, if it is more cost effective to press for institutional change rather than invest in productive activity, then the organisation will more likely devote resources to changing institutions.

A change in the mental model or ideology of the individual has already been explored. Ideological change is conditioned by the information the individual receives (North 1981: 49; Denzau and North 1994: 13; Mantzavinos, North et al. 2004: 76). Because information is incomplete and mental models are not perfect, a mental model may never be completely disproved or proven. ‘Individuals do learn, and changes in mental models stem from outcomes inconsistent with expectations’ (North 1992: 4). Thus, if an individual reaches a point of receiving enough information that contradicts or weakens their model they will revise or completely replace that mental model.

There are a number of elements that have not been explored here. How do individuals rank the information they receive? How does the mental model relate to the types of information which are filtered in or out? How do mental models crystallise into beliefs? How do ‘sticky’ mental models change in the face of substantial contradictory information? These questions are generally
regarded as a black box in the literature (Fine and Milonakis 2003: 562) and are discussed further in Section 7.6 below.

The example in the Chilean case study is the perceived failure of gradual adjustment policies and the perceived success of the radical economic policies. The gradual adjustment policies were first introduced after the coup. The first priority of the gradual adjustment policies was to control inflation. After a couple of months of the gradual adjustment policies, inflation continued to exceed expectations, contradicting the predictions of a mental model. Thus, this mental model was discredited because of its failure to control inflation. The organisation of the junta learnt by this failure and discarded the gradual adjustment policy in favour of the shock program of the radical neo-liberal model to help control inflation. A problem is that North’s NIE is unable to determine why certain variables such as inflation were considered important. This issue is explored further in Section 7.6 below.

The above is a simplified explanation and example of organisational learning, but, the main points can be outlined in North’s words: ‘(1) the institutional framework will shape the direction of the acquisition of knowledge and skills, and (2) that direction will be the decisive factor for the long-run development of that society’ (North 1990: 78). North concludes that

Maximising behaviour of economic organisations therefore shapes institutional change by: (1) the resultant derived demand for investment in knowledge of all kinds… (2) the ongoing interaction between organized economic activity, the stock of knowledge, and the institutional framework… (3) incremental alteration of the informal constraints as a by product of maximising activities of organisation (North 1990: 78)

New knowledge may lead to redistributive or productive behaviour. It is organisations guided by the type of activity in which they engage
(redistributive or productive), the stock of knowledge and the incentives provided by the institutional framework, that are the catalyst for the acquisition of new knowledge. A by-product of this search for new knowledge is the incremental alteration of informal constraints.

7.3.5. Enforcement

‘Parties to an exchange must be able to enforce compliance at a (transaction) cost such that the exchange is worthwhile to them’ (North 1990: 54). Enforcement is a part of every form of trade. In every form of trade there is an explicit or implicit contract, which needs to be enforced so trade may exist.

Without enforcement of contracts the only form of trade is one from which both parties benefit and if a party reneges, or cheats, they would both lose. This type of trade is self-enforcing. Typical characteristics of a self-enforcing contract include situations in which both parties have substantial knowledge of each other and there are repeat dealings between the parties (North 1990: 55).

However, the majority of trade in the modern world has become impersonal. This usually means that both parties do not know a lot about each other and trade may be a one off (North 1990: 55). This means that there is a substantial opportunity for a party to renege or cheat in the trade and benefit from it.

In our modern world there are third parties to trade, whose sole purpose is enforcement. These parties or organisations include the courts, branches of the military or the police. For enforcement to work the enforcer needs to measure contract performance (North 1990: 59). This ‘measurement’, as
described earlier in Section 7.2.2, involves a host of formal and informal institutions. However, measurement is never perfect.

The second difficulty with enforcement involves the utility function of the organisations that do the enforcing (North 1990: 54, 58). Organisations such as the police have their own utility function, which they wish to maximise. This means that the decisions they reach may not represent an 'honest' enforcement of a contract.

For example, during the authoritarian government, the court system favoured business over labour in cases of unfair dismissal (González 1996; Mizala and Romaguera 2001: 3). It was in the interests of the court to avoid the repressive character of the authoritarian government and remain consistent with the support base of the authoritarian government, which included business associations. This further enforced labour market institutions’ support of business over labour. While this example can illustrate North’s point, using his discussion of enforcement issues has not yet revealed anything new in relation to the Chilean case study.

Enforcement may play the role of weakening or strengthening current institutions through both measurement and the enforcer’s utility function.

If the enforcer cannot measure the performance of a contract then the institution behind that contract (be it formal or informal) will be weakened. The weakening derives from the fact that the parties in trade are not likely to use that institution because enforcement of that particular institution is not certain. This provides scope for shirking, cheating or opportunism.

In addition, the enforcer’s utility function comes into play, further altering the institution. For example, it may be in the best interest of the military to enforce a particular institution very strictly so as to maintain their own dominant position in a government. This would then create a strong
institution. While a number of examples can be found in the Chilean case study to illustrate North’s point, his explanations do not add significant insights to the case study.

7.4. North’s NIE: stability and institutional change

It is necessary to combine the main elements of the previous sections to show how institutions may change over time. The important elements needed to further develop North’s theory include institutions, organisations and organisational learning.

In North’s view, organisations are the agents of change in institutions. Organisations are influenced by the incentives that institutions provide, while organisational learning may determine what types of institutions organisations are likely to change. Organisational learning may modify the ‘perceived’ cost of institutional change.

These elements are now used to discuss stability and institutional change.

The two crucial causes of institutional change are relative prices and preferences. A relative price is the price of a commodity such as a good or service expressed in terms of another, i.e. the ratio between two prices. Preferences assume a real or imagined ‘choice’ between alternatives and the possibility of rank ordering of these alternatives, based on the utility they provide. New Institutional Economists (NIE) still knows very little about the sources that influence change in preferences, despite North stating that institutions change, and fundamental changes in relative prices are the most important source of that change. (North 1990: 84)
One of the limitations of the framework proposed by North is his assumption that institutions do not impact on the preferences of individuals. Preferences are assumed to be fixed. In North’s NIE, an institution’s lone function is to constrain the menu of choices available to the individual. This issue is taken up further in Section 7.6 below.

In this NIE framework, one would argue that the how and why of neo-liberal labour law implementation is attributed to relative prices, specifically, the relative price of pursuing more productive economic activity versus pursuing institutional change through the polity. One would have to argue that the relative price of pursuing institutional change through the polity for business organisations was reduced dramatically during the era of the authoritarian government. At the same time as business organisations benefited from the authoritarian government, the main organisations for labour, (unions), were heavily repressed, meaning labour’s ability to access the polity was reduced. Thus, labour’s opposition to business organisation initiatives for institutional change would be ineffective.

As Eggertsson (1996: 14-15) argues, the distribution of power in a society is related to the system of property rights in place. Put differently, the institutions that determine property rights, or the institutions which govern labour relations in our case, determine the bargaining position of labour vis-à-vis business. The Chilean case study moved beyond simply stating the static position of bargaining power of each organisation. The Chilean case study also explored how organisations’ different bargaining positions then translated into the ability to effect formal institutional change and to what degree, including maintenance of the status quo.

In the previous examples preferences did not need to change for business organisations to access the polity. In this context, it is assumed that organisations will always pursue the most cost effective strategy, an assumption that is related to the bounded rationality assumption.
North describes how he sees relative prices work:

A change in relative prices leads one or both parties to an exchange, whether it is political or economic, to perceive that either or both could do better with an altered agreement or contract. An attempt will be made to renegotiate the contract. However, because contracts are nested in a hierarchy of rules, the renegotiation may not be possible without restructuring a higher set of rules (or violating some norm of behaviour). In that case, the party that stands to improve his or her bargaining position may very well attempt to devote resources to restructuring the rules at a higher level. In the case of a norm of behaviour, a change in relative prices or a change in tastes will lead to a gradual erosion and to its replacement by a different norm. Over time, the rule may be changed or simply ignored and unenforced… (North 1990: 86)

North illustrates how a change in relative prices may lead to a change in institutions. This passage relates to the thesis question by guiding the description of how a change in relative prices makes it easier for some organisations over others to access the polity to steer institutional change.

At the macro level, after the coup, the institutional reforms of freeing prices and reducing tariffs were a critical part of inducing changes in relative prices in Chile. Those dramatic changes helped shape the future direction of the Chilean economy. For example, large scale deindustrialization occurred after the coup (Barros 1989). North’s NIE is able to illustrate how changes in the structure of the polity after the coup were able to shape the future direction of the Chilean economy.

Within North’s NIE, level relative prices changed at the firm so that it became cheaper for businesses to press for change in the institutional matrix compared to investing in productive activity. But how exactly did it become
cheaper for the firm to access the polity? First, the authoritarian government was receptive to business demands, for example, there were connections between business, the ministers and the military. Second, the competing organisations of labour were repressed by the military and police, which, to put it mildly, reduced their ability to access the polity and influence institutional change relative to business.

Businesses as organisations wished to renegotiate contracts with workers to enhance their firm’s profitability. This renegotiation could not take place without the hierarchy of rules within the contract being changed. This hierarchy of rules or institutions included the right to strike, the right to request a cause for dismissal, and so forth. Under the authoritarian government the relative cost of changing institutions for business had declined, while the relative cost to workers had risen greatly. However, one of the issues here is how different organisations actually measure the relative costs of changing institutions. If the transaction costs of accessing the polity are not visible in the market, then how does one make a decision? These issues are taken up further in Section 7.6 below. North’s NIE is unable to establish how individuals find transaction costs, as they must use something beyond relative prices. Thus, rather than North’s NIE illuminating more about the Chilean case study, the explanations that can be provided based on North’s NIE are more limited than the Chilean case study itself.

7.5. North’s claim: ability to explain institutional change

North claims that he can explain formal institutional change. For North, the source of institutional change lies in relative prices, a change to which induces the individual or entrepreneur to re-contract. If the re-contract within the current bounds of the institutional framework cannot capture the gains from the change in relative prices, then the individual seeks to change the
institutional framework. This is contingent on the cost of changing the institutions being less than the gains made from the re-contracting.

A major part of North’s explanation relies on the premise that formal institutional change is driven by the relative price for accessing the polity. He assumes that there is competition among organisations to change the formal institutional framework. This means that an organisation’s relative cost to access the polity is comparable to an individual’s relative cost to access the polity.

Institutional change in this thesis focuses on the formal institutions of the Chilean labour market at a particular time. It could be reasonably expected that North would be able to explain why neo-liberal labour laws took so long to be implemented and how they were implemented.

North claims to have overcome three limitations of neo-classical economics, namely the obeying rules problem, the free rider problem, and the explanation of non-rational behaviour. These problems are all overcome by the use of mental model or ideology, which have been discussed in more detail in Section 7.2.3.

### 7.6. Critique of North’s NIE

There has only been a surprisingly limited critique of North’s NIE (Milonakis and Fine 2007: 28). It is necessary to review and critically engage with the major critiques published in the scholarly literature and to present some new critiques of North’s NIE derived from the Chilean case study.
7.6.1. The theoretical critique of NIE versus an empirically derived critique

One of the key reasons for the mainly theoretical critiques is the fact that NIE in general is difficult to apply consistently. For example, Keith Acheson (2000) and Ole Winckler Anderson and Kirsten Bregn (1992) point to the difficulties of using NIE for analysis of organisations and institutions.\(^\text{102}\)

The study of the relevance of NIE theory to case study or empirical investigation has been little undertaken. Andersen and Bregn (1992: 485) state in relation to Schotter’s and Williamson’s NIE that ‘…fundamental discussions about empirical relevance and potentials in relation to concrete institutional analysis have attracted less interest’. Additionally, there is difficulty in defining even the scope of NIE. This is clearly illustrated by Williamson’s attempts to define NIE:

The new institutional economics is preoccupied with the origins, incidence, and ramifications of transaction cost (Williamson 1979: 233)

Transaction cost economics is part of the New Institutional Economics research tradition (Williamson 1985: 486)

As these quotes demonstrate, at first transaction costs form the basis of NIE, but by 1985 they are only a part of that research programme. The research programme includes game theoretic explanations such as those put forward by Andrew Schotter.

\(^{102}\) Their critique is associated with the industrial organisation literature. These authors analyse issues related to the nature of the firm.
On a more specific note, Andersen and Bregn (1992) review the usefulness of the application of Schotter’s and Williamson’s version of NIE. Schotter’s main problem was that his game theoretic approach is limited to institutions which are produced organically (Andersen and Bregn 1992: 488). This means that in Schotter’s model, intention is not necessary. Arguably, the removal of intentionality removes the large majority of institutions developed over time.

Williamson’s major difficulty, as identified by Andersen and Bregn (1992: 485), is related to the vaguely defined and hard to operationalise concept of transaction costs. Transaction costs may be thought of as the cost of using the price mechanism, a definition coined by Kenneth Arrow (1969: 48). It is difficult to clearly identify what is, or is not, part of ‘using’ the price mechanism. Thus, to operationalise Williamson’s work is difficult.

A similar problem was encountered by Wallis and North (1986) when they estimated the size of market transaction costs in the economy of the United States of America. They first identified transaction industries versus non-transaction industries. Their main issue was to determine what part of a non-transaction firm is devoted to transaction costs versus pure production costs. The secretary to a car factory may be thought of as a transaction related occupation, while the manager of the same factory may be thought of as transaction related. The production line worker is regarded as non-transaction related. The national accounts are not defined between transactions versus non-transaction industries. An estimate was therefore needed. Ultimately, the authors made an estimate of the total size of transaction costs based on the wage bills by occupation. This estimate would involve a large error factor, as real job occupations do not match the neat categories established by the U.S Census Bureau, let alone taking into account the distinction between costs that are transaction related and non transaction related.
The lack of application of NIE is discussed by Acheson, almost a decade later, in relation to NIE in general (2000: 341): ‘This paper addresses one area of relative neglect – the interaction between study of particular organizations or institutions and the development of theory’. Both studies generally conclude with the argument that in relation to traditional testing techniques for economics, econometric or statistical analyses are not enough. Other forms of examining experience or empirical data are needed for such an endeavour.

Alston (1996: 29) concurs that conventional statistical analysis is currently not amenable to the literature on institutional change. He presents the case study approach as the most likely candidate for use in analysing institutional change. A qualitative analysis of the historical record may provide a clearer answer than a simple econometric study could provide. For these reasons a case study approach was chosen for analysing the how and why of neo-liberal labour law implementation in Chile.

In using a case study approach, this thesis bridges some of the gaps left open by the lack of application of North’s theoretical framework. Thus, the critique of North’s NIE developed by this thesis is derived from the Chilean case study. This provides an extension of the established critique, which is based mainly on the theoretical and logical inconsistencies of the model.

7.6.2. The problem of a market that has prior existence

A number of New Institutional Economists have made the assumption that the ‘market’ has existed throughout all time. An example is given by Oliver Williamson (1975: 20; 1985: 143) when he famously states that ‘in the beginning there were markets’. 
However, there is a problem with the conception of the market existing since the beginning of time. The ‘market’, like all forms of organisation, is an institution and has rules that govern it.

In any original, hypothetical, “state of nature” from which institutions are seen to have emerged, a number of rules, and cultural and social norms are already presumed. No “thought experiment” involving an institution-free “state of nature” has yet been postulated without them (Hodgson 1998: 182).

The ‘market’ has its own social norms, customs, instituted exchange relations and information networks that need explaining (Hodgson 1998: 182). Markets are not institution free, and thus are both diverse and historically evolving.

Alexander Field (1979; 1981; 1984) has launched the same fundamental criticism. To explain social institutions, NIE has to presume that given individuals are acting within a certain context. NIE must operate with a set of given individuals, but it is also necessary to explain the way they interact. This means that ‘in the beginning’ a number of institutions would need to be given (cultural, linguistic, etc), otherwise interaction between the given individuals is not possible.

There is also a problem for game theoretic explanations of the origin of institutions. For there to be a game, there needs to be some starting set of rules. Thus, a game cannot begin without some institutions (Field 1984: 703). Games nested within games run into the same problem. The meta-game or the first game in the hierarchy would also need to assume a set of institutions before it may begin.

Geoffrey Hodgson continues this train of thought of games within games and institutions within institutions as a problem of infinite regress. As a result of
the use of strict methodological individualism, each layer of institutions is dependent on the previous layer (Hodgson 2004: 21). This means that every institution is dependent on individuals. These individuals are dependent on previous institutions for creating the new institutions. This process would continue until an institution-free state of nature is found.

Daniel Ankarloo (2002: 20) makes the point that the above assumption of the eternal existence of markets is ideologically loaded. If the assertion is that markets were always present, all other forms of organisation are to be explained as a deviation from the natural state of ‘market’ (Ankarloo and Palermo 2004: 414). For example, when the market ‘fails’, there is space for another form of organisation. Assuming the ‘market’ is the natural state, or always a possible form of organisation throughout all time, is not appropriate without justification.

In conclusion, as it stands, North’s NIE has difficulty in explaining historical development of markets and institutions. Markets as an institution become omnipresent in North’s NIE. This means that the caveman, the medieval Lord, and the modern day entrepreneur had the choice of ‘market’ organisation when deciding on how to structure their ‘organisation’. According to North’s NIE, the caveman and the medieval Lord did not choose the market system for reasons of inefficiency. Milonakis and Fine (2007: 33) illustrate the point of choices allowed by North’s NIE with the evolution to settled agriculture:

…in typical neoclassical fashion, the emergence of settled agriculture and of stock raising is perceived as the result of a choice made by the “band” for settled agriculture over preexisting hunting and gathering. This choice is based on respective marginal products of labour across the two systems that, in the absence of a market to determine relative prices, are determined by the band’s own introspective calculations.
It is thus impossible for North’s NIE to conclude that the caveman and medieval Lord did not know of market institutions. This is clearly difficult to sustain in reality. There is a cost to knowing a system or discovering a new system of organisation. A system of organisation just does not exist without explanation.

In relation to the thesis questions of the how and why of neo-liberal labour law implementation, this strand of critique is not particularly relevant. This is due to the fact that when the neo-liberal labour laws were debated and implemented, they were in fact in a time period when markets were known as a possible alternative.

### 7.6.3. The problem of transaction costs in the context of institutional change

North claims that the world is full of positive transaction costs. The definition of transaction costs is ‘the cost to using the price mechanism’ (Coase 1937: 390). A cost has its own associated price. If there is a cost to knowing the price (transaction cost), then the initial transaction cost has its own price and cost associated with it (Ankarloo 2002: 16-17). This can lead into a problem of infinite regress.

North’s NIE has attempted to overcome this problem of infinite regress by arguing that the ‘cost of knowing the price’ is not reflected on the market. Or, as North puts it, a transaction cost is the ‘underlying cost of exchange’ (North 1989: 661). However, this poses its own problem. If the transaction cost is not a price visible on the market, then prices (in general) do not convey all the information necessary for the individual to make rational economic calculations (Ankarloo 2002: 17-18).
In North’s NIE, changing relative prices or preferences are the source of change to the institutional framework:

Institutions change, and fundamental changes in relative prices are the most important source of that change (North 1990: 84)

Explaining institutional change with relative prices then becomes a problem. If Ankarloo’s critique cannot be overcome, the individual does not have the necessary information to perform the calculations needed. Thus, relative prices are not enough to explain institutional change.

In the political world prices are not posted or clearly visible. There is no open market in accessing the polity (Pierson 2000: 260). For example, there is generally no ‘price’ or ‘cost’ visible for a lobby group or organisation to talk directly to a relevant minister. A minister does not openly set a ‘price’ that must be met to talk to him or her. This means that there are different ways of accessing the polity and at different costs. However, the costs are never truly visible.

Access to the polity is seen as a key source of formal institutional change in North’s NIE. Accessing the polity is viewed in this thesis as any attempt to influence the direction of formal institutional change. Organisations interested in formal institutional change need to influence the polity. However, different organisations are interested in different forms of institutional change. Thus, it is useful to distinguish between competing organisations and their relative cost to accessing the polity.

In Chapters 3 and 4, the cost for the two organisations to access the polity is analysed, with the understanding there is no direct price to access the polity
for either labour or business organisations. For the organisations and the researcher, transaction costs and relative prices are not enough to inform the individuals on their choices.

Both actors, the organisations concerned, as well as the researcher, use ‘non-economic’ devices of identifying ability to access the polity. This means that such characteristics as personal relationships with the ministers, public announcements, media releases, non-economic actions directed at the actors, economic actions directed at the actors, are all forms of indicators of access to the polity that do not rely on prices as a conveyer of information.

### 7.6.4. The problem of methodological individualism

Douglass North maintains the individual as the basic unit of analysis (Rutherford 1989: 301-302; Milonakis and Fine 2007: 36). In other words, ‘…the basic reliance upon methodological individualism remains’ (Fine and Milonakis 2003: 551).

Individual action creates and changes institutions. This is neatly summarised by North (1981: 116-17): ‘The active agents of change were overwhelmingly individuals with a direct interest in altering the system. The great bulk of the population was typically passive and inert’. Additionally, the entrepreneur is an individual that acts for an organisation to create and change institutions. As North (1995: 23) again states: ‘Economic change is a ubiquitous, ongoing, incremental process that is a consequence of the choices of individuals and

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103 From the particular historical reality of the military dictatorship in Chile, it also needs to be acknowledged that for union members it was often a question of survival rather than of “influencing the polity”. Using North’s language can easily distract from the particular historical circumstances.
entrepreneurs of organisations are making every day.’ In North’s NIE, the individual clearly remains the unit of analysis.

Based on his methodological individualism, North argues that institutions only constrain choices. He states: ‘In the jargon of the economist, institutions define and limit the set of choices of individuals’ (North 1990: 4). This leads to the conclusion that institutions do not impact or influence individuals’ choices about institutional creation or change. This is explored further below, in relation to the difficulty with ideology or mental models.

Individuals are assumed to be rational, or in North’s case, bounded rational. Fine and Milonakis (2003: 548, 551 and 553) refer repeatedly to the ‘optimizing individuals’ in North’s work. North, while critical of the concept of the rational individual, suggests an addition of ideology and informational constraints to remedy the problem. He states: ‘There is nothing the matter with the rational actor paradigm that could not be cured by a healthy awareness of the complexity of human motivation and the problems that arise from information processing’ (1990: 111). In this way, North uses his own version of the bounded rational individual.

A particularly relevant problem with methodological individualism is that organisations or collective action are simply thought of as aggregations of their individual parts. North (1990: 5) states that organisations ‘are groups of individuals bound by some common purpose to achieve objectives’. Milonakis and Fine argue that: ‘Aggregating over thousands of individual acts, however, does not change their character as individual action. Simple aggregation cannot transform individual action into collective action’ (2007: 39). The organisation or collective is more than the sum of its parts. North does not define or identify the collective agent beyond the mere aggregation

\[104\] Ideology will be addressed in a later section.
of individual parts. The individual is the key to explaining institutions and institutional change in North’s NIE.

This conception of the organisation as a single actor is taken further to apply to the state by North. According to Fine and Milonakis, ‘a collectivity (the state) is here treated as if it were a rational maximising individual subject to constraints, albeit with a dichotomy of motives’ (2003: 557). This issue will be examined more fully in Section 7.6.5 below.

A problem with North’s application of methodological individualism raised by Rutherford (1989) relates to individual decision making. When applying a rational individual to a particular context, it assumes one line of causation from the individual to the institution. The reverse line of causation is not acceptable (Rutherford 1989: 302). This means that an individual may make decisions without reference to the institutions in place. Rutherford outlines that this has two implications. First, the gamut of choices opens to be infinite, which makes for computational problems for the individual. Second, this implies that when an individual’s cost benefit analysis dictates it is favourable to break the rules, the individual should ignore the institutions and break the rules (Rutherford 1994: 302-303). This makes the institutions useless. This critique is explored further under the critique of mental models or ideology.

The entrepreneur, as a particular kind of individual, is also not explained. There is no definition or clarification of an entrepreneur. As the entrepreneur is the key to organisational action, this leaves a major gap in the framework. This is a problem inherited from the neo-classical framework that North’s NIE uses. As has been analysed in depth by feminist economists,

Economic man springs up fully formed, with preferences fully developed, and is fully active and self contained…As in our Robinson Crusoe stories, he has no childhood or old age, no dependence on
anyone, and no responsibility for anyone but himself…(Nelson 1995: 135)

The entrepreneur or agent of the organisation needs to be different from the ‘passive’ rest, although in what way is not explained. And the identifying features of the entrepreneur are not explained.

In a multi level organisation or organisations nested in each other, there would be a need for multiple entrepreneurs or agents. For example, the armed forces of a nation may be divided into a number of organisations. In Chile the military is a form of organisation. Within the military are three different branches, which include the Air Force, the Army and the Navy. Once more, each of these branches of the military may be considered an organisation. Now, if we specifically consider the Army, it is further divided into Corps, Division, Brigade, Regiment, Battalion and the like. Each of these may be viewed as separate, but linked organisations, as illustrated by Diagram 7.2.
North’s NIE assumes a homogeneity of the organisation. This means that organisations are not nested within others. Hodgson (2004: 427) identifies the same issue: ‘…a problem arises if we define organisations as actors. This would amount to an unwarranted conflation of individual agency and organisation’. However, Hodgson does not take the critique further. The conflation of individual agency and organisation leads the organisation to be represented by one entrepreneur at the head or top of the organisation. A number of important examples of the lack of homogeneity in the Chilean case study have been discussed in Chapter 2.

Another important issue with the concept of organisations within organisations is the fact that they are often not fully integrated. If the organisation within a larger organisation is not fully integrated there is space for a difference in the objective. For there to be organisations within organisations, each organisation would need to have its own unique objective, according to North’s NIE. If an organisation within the organisation...
has different objectives, then there is scope for the organisation to develop different ideologies or mental models. However, as North states, it is highly unlikely that ideologies or mental models converge. ‘...the information feedback from their choices is not sufficient to lead to convergence of competing interpretations of reality’ (Denzau and North 1994: 4). This means that if organisations develop different ideologies or mental models, there is scope for conflict within an organisation. This internal conflict may be the driver for change in the organisation and change in institutions.

A related problem results from the entrepreneur as the agent of the organisation. North claims that the entrepreneur is the active agent of the organisation, while the rest of the individuals are seen as being passive. But for each organisation within an organisation, there needs to be an entrepreneur. Thus, each organisation with its separate objective may generate conflict between entrepreneurs within the organisation.

This critique has demonstrated three key problems with methodological individualism and organisations. First, there is no explanation as to why or how an entrepreneur is different from the passive rest. Second, organisations within organisations may conflict due to different objectives. Third, entrepreneurs of different organisations within organisations may conflict with each other.

7.6.5. The problem of the conception of the state

This conception of the organisation as a single actor, an absolute ruler, is taken further by North in relation to the state. According to Fine and Milonakis (2003: 557): ‘a collectivity (the state) is here treated as if it were a rational maximising individual subject to constraints, albeit with a dichotomy of motives’. This is reinforced by North (1984: 260) when he states, ‘For the ruler there is no free-rider problem; but there is such a problem for
constituents’. The organisation of the state must be represented by an individual for there to be no free-rider issue. There is no scope for cooperation between individuals at the level of the state.

There are two motives of the state: First, the state or ruler wishes to maximise their own wealth, which also involves minimising transaction costs. Transaction cost minimisation in relation to wealth maximisation refers to the costs of monitoring, metering, and collecting taxes (North 1981: 28). A state will want to minimise the transaction costs related to ‘acquiring revenue’ so that the state remains profitable. This leads to the second motive of the state.

The state, within the constraints of wealth maximisation, will minimise overall transaction costs, that is, the state will minimise the economy’s transaction costs in an effort to produce economic growth without damaging the state’s revenue (Fine and Milonakis 2003: 557). What prevents the ruler focusing solely on the first motive is the fact that there are rival states who may perform the same function. At the rival states level, individuals may move between states, moving from poor performing to better performing states. This reduces the ruler’s potential revenue and induces action to mitigate falling potential revenue. At an extreme level, a poor performing state may cease to exist, taken over by a neighbouring state or another power.

However, the two motives of the state are not elaborated on substantially. According to Fine and Milonakis, North simply declares that when an economy grows, the second motive dominates the first, and when an economy is stagnant, the first motive dominates the second (Fine and Milonakis 2003: 557; Milonakis and Fine 2007: 31-32). There is no explanation apart from the presence and strength of rivals that ‘moves’ the motive of the ruler.
The three traditional problems identified by North of neo-classical economics, which include the free rider problem, the obeying rules problem and non-rational behaviour, may be problems for the state. These problems need to be explored theoretically: Can North overcome these problems given his framework?, Then they need to be explored in relation to the Chilean case study: What problems do we encounter when we apply North’s conception of the state to the Chilean case study?

As mentioned earlier, the conception of the state as an individual eliminates the free rider problem. Here, the ruler of the state does not need to cooperate with anyone and the ruler accrues the benefits (and costs) of his or her own actions (North 1984: 260). Theoretically and strictly within North’s NIE, this problem is eliminated.

This conception of the state is problematic for the Chilean case study. Pinochet needed the cooperation of others for the operation of the state, as has been outlined in Chapter 2. The benefits and costs of his rule were not contained within himself. Rather, groups of individuals linked to the operation of the state benefitted and bore the costs of his rule.

The obeying rules problem is not an issue for the ruler when the ruler is the sole maker of rules, laws or formal institutions. In North’s NIE there is no scope for another individual or organisation to review or modify the rules. In the Chilean case study this is clearly not the situation. Pinochet was never an absolute ruler of the nation. The governing junta, including other branches of the armed forces, and the 1980 constitution, did limit his ability to rule. This has been examined in more detail in Chapter 5.

Finally, the problem of non-rational behaviour is the most complicated in North’s conception of the state. While North allows other individuals to possess imperfect mental models or ideology, the state is assumed to be a rational maximising individual (Fine and Milonakis 2003: 557). This is
inconsistent because the ‘ruler’ in so far as he or she is an individual, must also possess an imperfect mental model. Otherwise, we would need to assume that the ‘ruler’ is unbounded by the constraints of the human mind.

If ideology is applied to the state, the ruler’s wealth maximisation, the first motive of the state, may not be valid. That is, the ideology or mental model that the dictator holds may be altruistic or despotic rather than wealth maximising. This may also question the second motive, that the state will pursue transaction cost-lowering institutions, which in turn will lead to economic growth. If we introduce North’s concept of ideology for the state/ruler, then lowering transaction costs may no longer be the sole motive for the ruler.

Another extension of this critique of the state relates to the question whether one can assume the correctness of North’s model of the state in the first place. The state is seen as oscillating between two objectives: individual wealth maximisation and transaction cost minimisation. Each of these two objectives represents a stylised model of the state. The individual wealth maximiser may be interpreted as the personal dictator. The transaction cost minimiser may be interpreted as the benevolent dictator.

Each of these two conceptions of the state, the benevolent dictatorship and the personal dictatorship, has problems\textsuperscript{105}. Under a capitalist system there is a distribution conflict between profits and wages. An institutional framework that aims to reduce economy wide transaction costs cannot be beneficial to both sides.

\textsuperscript{105} This is not meant to be a complete review of North’s theories of the state and the problems of these theories, nor is it the purpose of this section to provide solutions to the problems identified with this theory. It has to suffice to identify some of the issues relevant to the Chilean case study.
Under a personal dictatorship, it is unrealistic that a ruler may continue in power all by himself. A whole host of technocrats and bureaucrats are needed for the state to function. Hence, there are competing groups within the polity that continuously share and compete for authority. These ideas are explored in the case study in Chapters 2 and 4.

7.6.6. The problem of ideology and mental models

Ideology is a central premise of North’s NIE. Ideology provides a solution to a number of neo-classical problems. North’s concept of ideology is supposed to solve the neo-classical problems of individual co-operation, rule following and altruistic behaviour, to provide part of the reason why institutions exist and to provide a source of institutional change. According to North, a change in ideology leads to institutional change. For all these important reasons, a critique of North’s concept of ideology is crucial. For a fuller account of his concept of ideology refer to Section 7.2..

In the real world there are many instances of individuals cooperating to form organisations. It has been argued that due to the free rider problem, cooperation in organisations would not be feasible (Field 1981: 186; Bardhan 1989: 1391). If we assume that these individuals are rational, we are faced with the free rider problem. The Oxford Dictionary of Economics states that a free rider is: ‘A person or organisation who benefits from a public good, but neither provides it nor contributes to the cost of collective provision. They thus free ride on the efforts of others’ (Black 2002: 187). This free rider problem occurs at practically all levels of organisation between rational individuals. Thus, North needs to explain how people are able to cooperate.

In the real world there are many instances of individuals obeying the rules or acting altruistically against their interest. For example, North (1981: 45-46) concedes the point when he writes ‘…everyday observations provide
abundant evidence that individuals obey rules when an individualistic calculus should have them act otherwise. In reality, individuals do freely perform altruistic acts such as giving blood and giving money to charity. Thus, if individuals are assumed to be rational, then it becomes difficult to explain what is termed non-rational behaviour of these individuals.

Whenever an individual’s calculus of the costs and benefits dictates that the individual benefits from breaking rules or institutions, the rational individual will do so. This applies under a strict version of the ‘rational’ individual. Those same rules that are broken may become unenforceable or useless (Field 1981: 186; Bardhan 1989: 1391). Thus, two of the basic functions of institutions may fall apart or become useless. First, institutions provide a predictable form of behaviour to forecast other individuals’ actions. If individuals break rules then this is not accurate. Second, institutions limit the choice set for the limited mental capacity of the individual. Once more, if rule breaking is an option, this increases choices substantially. However, in reality, there are many instances of individuals following the rules when it would be in their best interest to break them. This rule following is addressed by North using his concept of ideology.

As argued by Fine and Milonakis (2003), ideology becomes the catch all for North. Whenever the rational choice paradigm of neo-classical economics is broken, North uses his concept of ideology as the answer. However, ‘Ideally, there would be a theory of how ideologies arise and are reproduced. But North declares himself dissatisfied with what is available…’ (Fine and Milonakis 2003: 562). This way of solving these problems becomes problematic, as North does not examine ideology as a concept in its full complexity, even though it is an integral element in his explanations of historical change.

The neo-classical problem of rule breaking has been partly solved by Axelrod’s (1984) computer simulation of tit-for-tat strategy, which in an infinite
game induces cooperation among self-interested individuals. The conclusion from Axelrod’s work meant that in situations where the game (transaction or exchange) is repeated, there is scope for the rational actor paradigm to hold. However, finite games pose a problem. In a finite game there is scope for cheating and getting away with it.

The critique of North’s concept of ideology or mental models in the literature is limited. As has been discussed above, North’s ideology or mental models are based on methodological individualism (Fine and Milonakis 2003: 562), which in this context means that the individuals are the ones who choose the ideology they want. Ideology is presented to the individual like the menu is presented to a customer in a restaurant. It is assumed that the institutions and culture the individual operates within have no influence on the ideology the individual chooses. To derive the ideology chosen solely from the individual’s choices is clearly an unrealistic assumption.

The connection between methodological individualism and ideology opens North’s approach up to a well-established critique of feminist economics. For North, ideology or mental models are chosen by the individual. The choice of a particular ideology or mental models is not conditioned at all by the individual’s environment. In North’s model, similar to the neo-classical model of methodological individualism, the baby that is raised does not adopt its parents’ ideology or culture (Nelson 1995). The baby would view the parents and their ideology from a purely materialistic point of view, that does not influence how its own ideology develops. The feminist critique addresses this unrealistic abstraction, which North shares with neo-classical economics, and that as the child is raised by the parents, to some extent the child’s ideology is shaped by the parents. A child is a social being and develops in relation to its surroundings. A nurturing environment will generally produce ‘healthier’ children than an environment that is not nurturing. Thus, the conception of ideology that strictly adheres to methodological individualism is untenable.
Fine and Milonakis (2003) also contend that ideology has been raised to the point where it becomes the pricing of principle. If there is a low cost to bear for adhering to our ideological principles in our choices, then ideology will strongly determine choice. However, if there is a high cost to bear for adhering to our ideological principles in our choices, the individual is expected to choose the most rational choice (Fine and Milonakis 2003: 563), while the rational choice is limited only by the computational abilities of the human mind. This is patently untrue in the sense that, historically, individuals have pursued their ideology even when faced with high costs.

A second issue is that the ideology or mental model remains largely unexplained, yet is a strong explanatory tool used by North. As Schlüter (2007: 1091) puts it, ideology or mental models remain largely unexplained. As such, they are treated as an exogenous variable to the explanation. Crucially, what is left unexplained is how an individual changes ideology. Ankarloo (2002: 21) charges North with ‘disappearance of the economic’, with the adoption of ideology as a universal panacea to the free rider, obeying rules and cooperation problems.

Finally, the concept of information feedback is also not well developed in North’s theory. If a mental model or ideology is continually verified by the information received, then the model of reality or ideology may become a belief. Once it becomes a belief, it creates a general filter for new information, making it resilient to change (Mantzavinos, North et al. 2004: 76). What remains unclear is the way in which information is filtered by the mental model or ideology. For example, does a mental model, once it has turned into a belief, filter out all information that is contradictory or only some? North does not provide an answer to this or related questions.

In addition to the fact that information is costly and asymmetrically held, the information that is received by the individual is seldom completely accurate.
There are numerous ‘distortions’ to this information. What is missing in
North’s model is how an individual ranks the information received in relation
to the accuracy of that information. Part of this ranking would need to include
validating the source of the information and/or assessing the methodology
and method employed in gathering the information. This is not discussed in
North’s NIE.

7.6.7. The problem of evolution of informal
institutions

North’s framework has been criticised for not explaining how informal
institutions evolve. North has, to date, provided only a limited idea of how
they actually change.

Lowndes writes that ‘North (1990: 37) links informal constraints to “our
heritage”, “socially transmitted information”, or “culture transmitted between
generations”’ (1996: 188). The main tool used by North to describe the
continuation and evolution of informal institutions is culture. In a more recent
publication, North describes culture as the ‘intergenerational transfer of
norms, values, and ideas’ (2005: 50). However, how culture exactly operates
to generate this ‘intergenerational transfer’ remains unexplained.

Culture has been linked in North’s NIE to the upbringing of the individual.
How do parents raise an individual, or how does schooling or religion
‘indoctrinate’ an individual? These questions again raise the problem of
using methodological individualism as the basis of analysis. The individual’s
normative aspects, given methodological individualism, should not be
influenced by the education system or religious system in which they reside.
Rather, the individual should be influenced by the raw data or information the
individual’s mind receives. This is clearly not the case in reality.
These processes, education and religion, or learning in general, are then filtered through the mental model or ideology of the individual. As has already been mentioned, ideology remains a black box in North's model. Thus, how an individual learns is not explained, and how this model changes because of various stimuli (information feedback) remains unclear.

This thesis has examined how formal institutions changed in Chile. Thus, it would be beyond the scope of this research to analyse how informal institutions generally evolve through time. However, this thesis has identified informal institutions and how they impacted on the power of organisations. Specifically, the thesis has elaborated in detail on the processes by which the informal institutions impacted on the business associations’ ability to access the polity, and on the unions’ inability to do so. In this way the thesis has demonstrated what tasks a New Institutional Economics would have to master. While brief and limited, this chapter has highlighted some of the conceptual shortcomings that prevent North’s approach from reaching this goal.

### 7.7. Conclusions

The main purpose of this chapter has been to outline the relevance of North’s NIE to examine the Chilean case study. The second purpose was to review and develop the critique of North in light of the Chilean case study. The two purposes of this chapter relate to the third thesis question; namely, what the strengths and weaknesses of Douglass North’s New Institutional Economics are in explaining the Chilean case study.

The conclusions to this chapter are organised around the main insights gained from North’s NIE and key aspects of the critique of this framework that result from the Chilean case study.
7.7.1. The Chilean case study and North’s claims

North claims that he is able to explain formal institutional change. While not necessarily explicitly stated, he does provide a reasoning why an entrepreneur would pursue formal institutional change (North 1990: 86-87).

North’s theory of institutional change can therefore be expected to be highly relevant to the Chilean case study, which is concerned with the delay in the implementation of neo-liberal labour laws. This is a form of formal institutional change or, more precisely, the lack of change. As such, the Chilean case study can reasonably be expected to be explained well using the framework of North’s NIE.

Conclusions from a case study usually cannot be generalised. This is a relevant issue for this thesis, as it presents case study research. ‘[A] single or a few cases are poor representations of a population of cases and poor grounds for advancing grand generalisation…’ (Stake 1998: 104). This commonly held view does not, however, directly apply to the use made here the Chilean case study, which is to form the basis of an evaluation of some of the key tenets of a grand theory or generalisation.

There are points where a case study may contribute beyond its specific nature. ‘Case studies are of value in refining theory and suggesting complexities for further investigation, as well as helping establish the limits of generalizability’ (Stake 1998: 104). This thesis addresses three aspects of an evaluation of a grand theory in relation to limitations to the theory presented, that may contribute to the refining of North’s NIE. The complexity of formal institutional change is exposed by this case study and finally, the limits of NIE’s generalisability are made apparent. The historical, social and economic context for each type of formal institutional change is important in the Chilean case study.
7.7.2. Organisational learning and relative prices in their role for institutional change

Organisational learning as a driver for institutional change is an important aspect of this thesis. According to North, an organisation’s mental model changes when the organisation learns something new. Learning is thus strongly connected to the model of reality adopted by an individual or in this case an organisation. North has learning conditioned by the type of information received. Positive information confirms the model of reality, while negative information disproves the model of reality. This means that preferences for institutions may change dependent upon information the individual or organisation receives about an institution’s ‘performance’.

As an organisation’s mental model or ideology becomes superseded by another, the organisation’s preferences for institutions change. This may lead to institutional change or non-change, if the organisation has access to the polity that facilitates formal institutional change. This aspect of North’s framework can be illustrated by the investigations presented in Chapters 3 and 6. However, on reflection, it becomes evident that North’s theory of organisational learning did not add new avenues of research or new insights in addition to the insights gained from the Chilean case study.

The key to institutional change for North is changes in relative prices. Formal institutional change occurs in the polity or the state. This thesis shows that change in the relative price of access to the polity can indeed be seen as an important key to formal institutional change. Competing organisations have different abilities to act on their preference for formal institutional change.

This concept of relative price to access the polity was explored in different ways in Chapters 3, 6, and 4. As with organisational learning, relative prices
can be shown in their role for institutional change in the Chilean case study, but they do not generate new insights or new avenues of research.

From the discussion presented earlier in this chapter, it has become clear that despite its far reaching claims, North’s NIE is closely related to neo-classical economics. The one truly innovative addition made by North’s NIE is the addition of positive transaction costs, while other fundamental limitations of neo-classical theory are maintained. These include the model of the rational individual, methodological individualism, price theory, economics as a theory of choice and the ‘scarcity hence competition’ postulate. Given the adherence to these overly restrictive assumptions, North’s NIE cannot operate as a new paradigm. As such, North’s NIE was unable to contribute new avenues of research or generate novel insights beyond those achieved with the traditional case study method applied in this thesis.

### 7.7.3. Problems of North’s NIE

Five broad problems with North’s NIE have been highlighted. Some aspects of the established critique in the literature were validated by examples from the Chilean case study. Some extensions to these established critiques were developed based on insights from the Chilean case study.

Methodological individualism presented a problem when applied to organisations as well as to individuals. The use of methodological individualism treats organisations as individuals, which does not provide scope for intra-organisational conflict as a source of institutional change at the national level. The use of methodological individualism also generates adult individuals with preferences fully formed. There is no explanation of how the preferences of an individual were initially developed, hence individuals are devoid of childhood or culture.
The concept of transaction costs as an analytical tool is flawed. In the political market costs do not have a price tag. This means that actors in this market cannot use relative prices to make decisions. Relative prices may also not be used by the researcher, as they are not visible. Using relative prices as one of the key analytical tools to explain institutional change is difficult to maintain when it is of questionable value in situations where costs are not measurable and hence relative prices cannot be compared.

Informal institutional change is not a clearly developed concept in North’s framework. There is still much debate in the field over how informal institutions change. North concedes that his model is underdeveloped in relation to informal institutions.

In North’s NIE, ideology or mental models remain a black box, despite being used as a universal problem solver. North does not explain ideology or mental models. How an ideology works or changes and evolves is not fully examined. The value attributed to information feedback in ideological change in individuals is not made clear. North does not elaborate on issues such as the amount of contradictory information needed before an individual changes their mental model or ideology.

Yet three problems inherited from neo-classical economics, namely the free rider problem, the obeying rules problem and non-rational behaviour, are all solved by the concept of ideology. Thus, mental models or ideology have to explain cooperation, rule following and non-rational behaviour such as altruism, despite the absence of a clear explanation of ideology or mental models themselves.

The market is assumed to have a prior existence. For North, the market as an institution, is assumed to have existed throughout all time. Hence every individual throughout history has had the choice of organising the firm,
economy or household via market principles. This takes away the historical context of individuals and makes markets a-historical institutions. When investigating real life examples, the researcher needs an explanation of how markets as institutions developed.

In the literature, the critique of North’s NIE has focused on theoretical and logical inconsistencies. The critique established in the literature is generally centred on the foundations that remain from neo-classical economics because they are clearly defined. The assumptions developed by North are vague and thus more difficult to critique.

The main conclusion from the literature on empirically oriented NIE is that an application of NIE is difficult, which has led to little empirical work being conducted. Quantitative application of NIE is difficult, as the tools have not been developed. This means that the critique of NIE from an application/empirical perspective may provide a unique contribution to the literature. In this situation, a critique of North’s NIE from the perspective of an empirical application using a case study provides a novel approach. Such an approach can substantiate how much North is still limited by the restrictive assumptions of neo-classical economics, but also how much one can demonstrate what he can and cannot achieve by introducing positive transaction costs and organisational learning.
8 Conclusion: the multidimensional aspects of labour law change in Chile

8.1. Problem context revisited

The neo-liberal labour laws were implemented over a two year period, in 1978 and 1979. Counting from the year of the coup, 1973, the eventual implementation of neo-liberal labour laws therefore took six to seven years.

Other neo-liberal laws were implemented much faster, such as the change in the exchange rate or price reform. In comparison to the implementation of other neo-liberal laws and policies in Chile, the neo-liberal labour laws took a long time to be implemented. This is an anomaly given that there was a military dictatorship and highly authoritarian government, which would be expected to implement changes in laws more easily than would be the case in a democracy or a more pluralist political structure. Furthermore, the military had taken power in part to stem what they and a large section of the Chilean elite considered to be too much power and influence of labour during the Allende years.

The answer to the above problem can be used to assess a theoretical framework that concerns itself with institutional change in an economy. In the economic literature, changes in laws are referred to as institutional change. Non-change or the maintenance of a law over time is also a form of institutional change. A theoretical framework that addresses institutional change is Douglass North’s New Institutional Economics (NIE). The answer to the phenomenon of the implementation of neo-liberal labour laws in Chile may be used to develop a critique of North’s NIE.
Therefore, this thesis has two goals. First, to explain the phenomenon of the slow implementation of neo-liberal labour laws in Chile and second, to assess the ability of Douglass North's NIE to explain this case of institutional change.

**8.2. Review of thesis questions**

The problem context has led to three thesis questions. The first two thesis questions focus on the phenomenon of neo-liberal labour law implementation, namely why it took such a long time to implement neo-liberal labour laws and the manner in which the neo-liberal labour laws became promulgated under the authoritarian government in Chile.

The third question refers to the ability of North’s NIE to explain this particular case of institutional change, namely, what are the strengths and weaknesses of Douglass North’s New Institutional Economics in explaining the Chilean case study?

The presentation of the case study provided an answer to questions one and two. It also served as a reference point for the assessment of North’s NIE.

**8.3. The Chilean case study contribution and conclusion**

**8.3.1. Why the neo-liberal labour laws took such a long time to be implemented**

The multi-polarity of the authoritarian Chilean government was the main cause in the delay in the implementation of labour laws. The different groups
that made up the authoritarian government were initially given equal power to legislate under their areas of control. Thus, different branches of the armed forces that made up the groups of the authoritarian government could legislate differently for a time. Neo-liberal inclined groups were initially not in control of the labour ministry. Thus, there was delay in the implementation of the neo-liberal labour laws as the neo-liberal group took time to assert control over the whole of the authoritarian government. These issues were discussed in Chapters 2 and 6.

More specifically, it was the different intellectual traditions of the armed forces that caused the delay in the implementation of labour laws. The intellectual traditions of the armed forces were contradictory. The Air Force had a corporatist intellectual tradition and controlled the social area, which included the labour ministry. Corporatism was in contradiction to the neo-liberal intellectual tradition, which was dominant in the Navy and, to a lesser degree, initially in the Army. Thus, corporatist elements within the authoritarian government needed to be neutralised or removed before the neo-liberal labour laws could be implemented.

8.3.2. How the neo-liberal labour laws were implemented

The strength of internationally oriented conglomerates that preferred and drew profitability from neo-liberal institutions meant that those conglomerates could facilitate the implementation of neo-liberal labour laws. Internationally oriented conglomerates in Chile were highly profitable, due, to a large degree, to the implementation of neo-liberal institutions in trade, prices and other economic areas. These business organisations’ high level of profitability allowed them to pursue the implementation of neo-liberal institutions in other areas, including labour legislation. The profitability of domestically oriented conglomerates was reduced with the same policies that
strengthened the profitability of internationally oriented conglomerates. This meant that the domestically oriented conglomerates were in a weak position to oppose the implementation of neo-liberal labour laws or support the implementation of the corporatist labour laws. This was discussed in Chapter 3 with a focus on the intersection of business and the polity.

The weakness of the labour movement in general, in the wake of the coup, meant that they could not effectively oppose the implementation of neo-liberal labour laws that were against their interests. The inception of the authoritarian government marked the beginning of often extreme physical and legal forms of repression against labour. This weakened labour’s organisational ability, which was represented by lower unionisation rates, real wages, minimum wages and so on. Thus, labour was unable to stop the implementation of neo-liberal labour laws. This was discussed in Chapter 4.

The strength of Augusto Pinochet (Army), in relation to Gustavo Leigh (Air Force), allowed the Army to support the implementation of neo-liberal labour laws with minimal opposition from the Air Force, which had supported corporatist labour law reform. The ascendancy of Pinochet within the governing authoritarian government may be paralleled with the decline of Air Force General Gustavo Leigh. This parallel fall and rise in political power may be mirrored in the legal statutes in regards to authoritarian structure biased towards Pinochet. This was discussed in Chapter 6 with the focus on the process of overcoming corporatism.
8.4. The assessment of North’s NIE contribution and conclusion

8.4.1. The problem of North’s conception of ideology and mental models

The existing critique of North’s concept of ideology is that ideological selection comes from an individual’s self-contemplation. This critique of ideology originated from Fine and Milonakis (2003), who argued that ideological choice, as theorised by North, is the same as selecting a meal from a menu. A logical extension would imply that the individual has an unlimited capacity to choose between ideological constructs. This would then make the individual a super-human calculator, which would be unrealistic.

Furthermore, this reliance on individual self-contemplation to pick an ideology divorces the individual from the environment in which he or she lives. Based on the feminist critique of neo-classical economics, it was argued that under North’s NIE, the environment does not influence the choice of ideology, apart from the information it provides to an individual. Thus, it can be said that North’s NIE neglects the development of an individual.

Another problem with North’s conception of ideology, which has been based on the Chilean case study, is the fact that the magnitude of importance of information feedback is unclear. The direction of information is usually clear, such that information may either assist to prove or disprove an ideology. However, what is not clear in North’s NIE is the importance of one piece of information to prove or disprove an ideology. There is no clarification of how an individual evaluates the importance of a piece of information.
8.4.2. The problem of relative prices

Relative prices or transaction costs may not be the most important factor for decision-making. If relative prices are not easily visible or discovered, then the individual may not base their decisions solely on price information (Pierson 2000; Ankarloo 2002). Furthermore, because relative prices may not be easily computable or visible, an individual or organisation cannot be fully informed from prices alone (Pierson 2000; Ankarloo 2002). Individuals and organisations must therefore use tools and information other than relative prices to base their decisions on when they are accessing the polity. In the Chilean case study, transaction costs and relative prices were not easily visible on the market and other tools were used by individuals, organisations and the researcher to inform decision-making.

8.4.3. The problem of North’s conception of the state

North’s conception of the state as oscillating between a benevolent and personal dictatorship is highly problematic. Under a benevolent dictatorship, the institutional framework cannot simultaneously benefit all people and reduce economy wide transaction costs. Under a personal dictatorship, it is unrealistic that a ruler may run the polity by him or herself. Technocrats and bureaucrats, individuals other than the ruler, are needed for the state to function. Rather, there are competing groups within the polity that continuously share and compete for authority. This thesis critique was validated within the Chilean case study.

8.4.4. The problem of informal institutions

North’s NIE could not explain how or why informal institutions change. His assumption that the environment does not influence the decision-making of
an individual means that informal institutions like culture cannot change without intentional actions of individuals. This is clearly unrealistic.

8.4.5. The problem of methodological individualism

With North, the entrepreneur as the agent of the organisation turns the organisation into a type of super-individual. Milonakis and Fine (2007) and Hodgson (2004) identified the same problem of the conflation of the organisation as an individual. This thesis found that the implication of this conflation was for an organisation to only have one entrepreneur. If there is only space for one entrepreneur there is no scope for hierarchy within an organisation, therefore, there is no possibility for multiple entrepreneurs. In the real world, each level within the hierarchy of an organisation would need an entrepreneur. This would make a super-individual organisation unfeasible. The evidence from the Chilean case study confirmed that there was scope for multiple entrepreneurs within an organisation, in particular within the authoritarian government.

Under North’s NIE, organisational conflict is located between organisations rather than within organisations. North conceptualises all individuals other than the entrepreneur as unresponsive, which has consequences for intra-organisational conflict. Technically, this makes intra-organisational conflict absent as the only active agent is the entrepreneur of the organisation. There is no scope for institutional change above the organisational level driven by intra-organisational conflict, as it is implied that there is no intra-organisational conflict. To ensure there is no intra-organisational conflict, all the passive individuals would need to share the ideology of the entrepreneur. This is unrealistic as each individual has unique experiences and while individuals may share the main tenets of an ideology, the details may be significantly different. Intra-organisational conflict was an important aspect within the Chilean case study, which North’s NIE could not explain.
8.5. Implications and further research

8.5.1. Implications

North's NIE could not replace the explanations developed through the Chilean case study. North's NIE has a number of serious limitations, as explored in the thesis' contributions to the assessment of North's NIE. The strict adherence of North's NIE to methodological individualism has meant that his theory cannot adequately explain hierarchy in organisations, the origin of entrepreneurs and intra-organisational conflict. North's conception of ideology cannot explain such phenomena as the development of the Chicago Boys and the magnitude of importance of information feedback. Transaction costs as a part of relative prices are not visible on the market and, as such, actors may not base their decisions on transaction costs alone. North's conception of the state was certainly not validated by the Chilean case study, notwithstanding the fact that it was a military dictatorship. Finally, informal institutions remain an unexplained concept in North's NIE.

North's NIE does not open up new areas or explanations in addition to those explored in the Chilean case study. In North's NIE, the areas that are meant to explain institutional change are relative prices, ideology and the conception of the state. The Chilean case study already explores the state, as a unit of analysis, as an avenue for explanation of institutional change. Ideology is already explored in the Chilean case study, for example with the analysis of the Chicago Boys. Relative prices, for example, the cost of accessing the polity, have already been explored in the Chilean case study as a function of labour and business. Therefore, North's NIE was unable to open up avenues of explanations that were not already covered in the Chilean case study and, as indicated, the Chilean case study reveals the
limits of North’s NIE as a theoretical framework by which to analyse diverse empirical situations.

8.5.2. Further research: a deeper critique of North’s NIE and other theories of institutional change

Further research into the contributions of North's NIE would also need to take into account path dependence. North's NIE states path dependence as a way for understanding institutional persistence. That is, path dependence discusses reasons why a particular institution or institutional framework may become 'locked in'. However, a problem with North’s version of path dependence and a key reason it was not deployed in this thesis is its inability to explain why an institutional framework that has become locked in, changes. Furthermore, the foundation of North’s path dependence is built upon his earlier work of institutional change. Thus, the current critique of institutional change developed and validated by this thesis may be deployed against North’s version of path dependence.

Given the reputation and claims inherent in North’s NIE, other rival theories of institutional change were not used to explain the Chilean case study. Using other theories of institutional change may provide a deeper insight into the Chilean experience of institutional change. For example, old institutional economics derived from authors such as John Rogers Commons (1931; 1934) and Gunnar Myrdal (1978) may be presented as alternative forms of explanation.

Using a case study method to understand the delayed implementation of neo-liberal labour laws in Chile and then discussing the understanding gained to identify strengths and weaknesses of North’s NIE, allowed this thesis to identify key areas in which theories of institutional change have to provide deeper insights than NIE can develop. While providing a novel view on a particular aspect of Chilean economic history, this methodology also
added a more substantial critique of North’s NIE to the existing literature on the issue.
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