

THE FALL OF CHILE

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Now, at long last, Chile has all three things: political freedom, human freedom and economic freedom. Chile will continue to be an interesting experiment to watch to see whether it can keep all three or whether, now that it has political freedom, that political freedom will tend to be used to destroy or reduce economic freedom.

—Milton Friedman (1991)

The neoliberal experiment—in Chile—is completely dead. It is likely to be replaced by a welfare state that will attempt to follow the Nordic countries.

—Sebastian Edwards (2019)

The “Economic Miracle” of the Chicago Boys

Following the failed Marxist experiment of Chilean President Salvador Allende, a free-market revolution led by the so-called Chicago Boys in the 1970s and 1980s created the conditions necessary for the country to experience an “economic miracle”

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that captured worldwide attention.¹ As Nobel laureate economist Gary Becker (1997) put it, Chile became “an economic role model for the whole underdeveloped world.” This performance, said Becker, “became still more impressive when the government was transformed into a democracy.” Along the same lines, Nobel laureate economist Paul Krugman argued that the reforms introduced by the Chicago Boys “proved highly successful and were preserved intact when Chile finally returned to democracy in 1989” (Krugman 2008: 31). Indeed, from 1990 to 2010 a left-wing coalition called “Concertación” came to power. Despite having been comprised of opponents to the military dictatorship and by many former members of Salvador Allende’s government, Concertación kept in place the foundations of the free-market system. A pragmatic view prevailed, leading to the recognition and adoption of the economic legacy of the Pinochet years. As Alejandro Foxley, the first finance minister of the democratic period explained:

The mature countries are countries that don’t always start from scratch. We had to recognize that in the previous government, the foundations had been established for a more modern market economy, and we would start from there, restoring a balance between economic development and social development. And that’s what we did [Foxley 2001].

For conservatives in the west, Chile’s economic reforms were a symbolic victory in the fight against socialism and progressivism. As historian Niall Ferguson (2008: 216) has pointed out, the “backlash against welfare started in Chile.” Moreover, according to Ferguson, the Chilean economic reforms such as the privatization of its social security system were “far more radical than anything that has been attempted in the United States, the heartland of free market economics. . . . Thatcher and Reagan came later” (ibid.). Along the same

¹In the 1950s the Catholic University and the University of Chicago began an exchange program that enabled Chilean students to pursue postgraduate studies at the Department of Economics of the University of Chicago. These students came to be known as the “Chicago Boys,” a label that was also applied to other students who graduated from American universities other than Chicago and took part in the implementation of free-market reforms under the Pinochet regime.

lines William Ratliff and Robert Packenham (2007) have argued that Chile was the first country in the world to make “that momentous break with the past away from socialism and extreme state capitalism” preceding “Margaret Thatcher’s Britain and Ronald Reagan’s United States.” For Marxist intellectual David Harvey (2005: 7–8), “the first experiment of neoliberal state formation occurred in Chile after Pinochet’s coup” providing “helpful evidence to support the subsequent turn to neoliberalism in both Britain (under Thatcher) and the US (under Reagan).”

George H. W. Bush’s visit to Chile in 1990 affirmed the symbolism of the Chicago Boys’ success story. On his arrival in Santiago, Bush (1990) declared that “Chile’s peaceful return to the ranks of the world’s democracies” was cause for “pride and celebration.” He went on to emphasize the importance of the free-market revolution that had taken place under the military government of General Pinochet: “Chile’s record of economic accomplishment is a lesson for Latin America on the power of the free market. Nowhere among the nations of this continent has the pace of free-market reform gone farther, faster than right here in Chile.” Along the same lines, former British Prime Minister Margaret Thatcher (1999) declared that Pinochet’s regime had turned Chile “from chaotic collectivism into the model economy of Latin America.”

The available data overwhelmingly support these views. Chronic inflation, which had peaked at over 500 percent in 1973, fell below 10 percent by the 1990s and under 5 percent by the 2000s (World Bank 2019). Between 1975 and 2015 per capita income in Chile quadrupled to \$23,000, the highest rate in Latin America (CNP 2016). As a result, from the early 1980s to 2014 poverty fell from 45 percent to 8 percent (CNP 2016). Several indicators show that this “economic miracle” benefited the majority of the population. For example, in 1982 only 27 percent of Chileans had a TV set. By 2014, 97 percent did (CNP 2016). The same is true for refrigerators (from 49 percent to 96 percent), washing machines (from 35 percent to 93 percent), cars (from 18 percent to 48 percent), and other items. More importantly, life expectancy rose from 69 to 79 years in the same time period and housing overcrowding fell from 56 percent to 17 percent. The middle class as defined by the World Bank, grew from 23.7 percent of the population in 1990 to 64.3 percent in 2015 and extreme poverty fell from 34.5 percent to 2.5 percent (Libertad y

Desarrollo 2017: 3). On average, access to higher education grew by a factor of five in the same time period mostly benefiting the bottom quintile, which saw its access to higher education increase by eight times (PNUD 2017: 20). This is consistent with the growth of income in the different socioeconomic groups. While between 1990 and 2015 the income of the richest 10 percent grew a total of 30 percent, the income of the poorest 10 percent saw an increase of 145 percent (PNUD 2017: 21). In turn, the Gini index fell from 52.1 in 1990 to 47.6 in 2015 (PNUD 2017: 37). If income inequality is measured within the different generations the reduction is even greater (Sapelli 2014). Other measures of inequality also show a narrowing of the gap between the rich and the rest of the population. The Palma index, which measures the income inequality of the richest 10 percent relative to the bottom 40 percent, fell from 3.58 to 2.78 in the same time period while the ratio between the incomes of the bottom and the top quintiles decreased from 14.8 to 10.8 (PNUD 2017: 21) In addition to this decline in income inequality, a 2017 OECD report showed that Chile had more social mobility than all other OECD countries (2018).² Chile also held the highest position among Latin American nations in the 2019 UN Human Development Index (PNUD 2019).

In short, thanks to the free-market reforms introduced by the Chicago Boys and maintained by the democratic regimes that came later, Chile became the most prosperous country in Latin America, which mostly benefitted the poorest members of the population.

Explaining Chile's "Paradox"

To many, the enormous economic and social progress that Chile has achieved in the last four decades seems to be in full contradiction with the crisis that broke out in October 2019, characterized by mass demonstrations, coordinated violence by small groups, and demands by the political left and others to abandon Chile's free-market model. The crisis upended Chilean politics and society, leading to a planned

²According to the study, it was more likely for people with parents in the bottom 25 percent of the income scale to move to the top 25 percent of the income scale in Chile than in any other OECD country.

referendum on writing a new constitution.³ Some have described Chile's current situation as a "paradox" (Edwards 2019). Indeed, it seems paradoxical that a country that has achieved so much prosperity has bitterly turned against the very institutions that made that prosperity possible.

Part of the explanation for the rage showed by the Chilean population has to do with the collapse in public trust of traditional civic and state institutions, including democracy. Between 2009 and 2015 people who believed that Chile's democracy worked well or very well plummeted from 26 percent to 10 percent, and those who believed that it worked poorly rose from 16 percent to 32 percent (Aninat and González 2016: 3). From 2015 to 2019, the first group shrank further to 6 percent and the second group rose to 47 percent. (CEP 2019). Institutions such as the Catholic Church, radio broadcasters, the police and armed forces, political parties and businesses have experienced similar or in some cases even more dramatic declines in public trust (Aninat and González 2016: 4).

Chile has also experienced a systematic decline in Transparency International's Corruption Perception Index, which assigns countries with higher public perceptions of corruption a lower ranking. From 2012 to 2018, the South American country's corruption perception index fell every single year—that is, the public viewed it as progressively more corrupt—ultimately dropping a total of six positions to

³In October 2019, Sebastián Piñera's government announced a small increase in the price of public transportation fares in Santiago. Demands for a withdrawal of the increase became widespread after the new fare was implemented. Initially, the government showed no willingness to reconsider what it correctly called a "technical" measure. As a result, hundreds of students began to evade payment of the subway. On October 18, two weeks after the price increase had been announced, the country exploded. Coordinated groups burned and destroyed almost 80 subway stations bringing Santiago's public transportation system to a halt. Riots and massive attacks on public and private property followed unleashing chaos in the capital city. By the end of the day, the situation was so desperate that Mr. Piñera had no choice but to declare a state of emergency and put the military in control. Massive demonstrations followed and Piñera gave in to the demands of the left to substantially increase the size of government and to create a new constitution through a constitutional assembly or a convention. The referendum that would initiate the constitutional process was supposed to take place in April 2020 but it was postponed to October 2020 due to the outbreak of the coronavirus crisis.

become the 27th least corrupt country among 183 nations (Libertad y Desarrollo 2019). Even more troubling are the results of a 2017 OECD report on the level of trust Chile's population has in its judicial system. Chile scored last among all of the nations the OECD surveyed, with the exception of the Ukraine, lagging behind countries like Brazil, Mexico, Colombia and Russia, among others (OECD 2017). A more general survey in 2019 showed that 58 percent of Chileans believed that state institutions in Chile were corrupt (Datavoz 2019: 4). In a 2017 United Nations Development Programme (UNDP) study, 34 percent of Chileans surveyed declared to have been mistreated by a public employee (PNUD 2017: 211).

Not only corruption but also chronic inefficiency contributed to the loss of legitimacy of state institutions. According to the 2016 World Economic Forum Competitiveness Index, government inefficiency was the main obstacle to doing business in Chile (World Economic Forum 2016: 144–45). All these problems have led to major proposals for reforming Chile's inefficient state apparatus, which is a crucial step for strengthening its democracy.⁴

Without a doubt, the recent decline in public trust of Chile's private and state institutions contributed to the climate of discontent and frustration that manifested in the crisis that broke out in October 2019. But this alone cannot explain Chile's departure from the free market formula that made it so successful. If Chile's elites and general population truly understood that free market institutions are crucial for the country's continued path to prosperity, then large groups among the protesters and the intellectual and political elites would not be demanding drastic changes to what is derogatorily referred to as Chile's "neoliberal" system.

If, as Friedrich Hayek believed, ideas and ideologies are the main drivers of social evolution (Hayek 2006: 98), then Chile is a clear example of how ideas hostile to economic freedom and favorable to state interventionism can gain traction, which in Chile's case undermined the legacy of the Chicago Boys. Indeed, material equality, the old obsession of the left, became the creed of the majority of Chile's political and intellectual class. Material equality was also endorsed by the Catholic Church, a large part of Chile's business community and

⁴See Centro de Estudios Públicos (2017).

highly influential among its cultural elites. The results of this egalitarian narrative were gradual institutional changes that over the years, leading to declining rates of economic growth. As René Cortázar, former minister in Michelle Bachelet's first administration, put it:

Growth, which had enabled a sharp increase in wages, employment and consumption, and that had allowed the emergence of new middle sectors, began to be taken, by many, for granted. It was forgotten that accelerated growth was not an attribute of the national soul; that in general our development had been mediocre; and that only the implementation of good quality rules of the game, and the construction of consensus around them, had made it possible to jump to the first place in the region [Cortázar 2019: 11].

Cortázar, an MIT economist at the center-left think tank CIEPLAN, crucially noted that the “emphasis was placed only on distributive aspects” adding that “distributive results were criticized with bitterness” although wages were rising like never before (Cortázar 2019: 12). By far the most aggressive egalitarian government along the lines denounced by Cortázar was Bachelet's second term (2014–18), in which several statist reforms were passed with the aim of “terminating neoliberal vestiges,” as Bachelet herself put it.⁵ Bachelet's labor, tax, and educational reforms, combined with an extremely hostile narrative against businesses and market ideas, caused one of the most unprecedented economic downturns in decades. Indeed, between 2014 and 2017 Chile's average economic growth rate was 1.8 percent, the lowest since the early 1980s and almost a third of the rate of 5.2 percent achieved in the previous four years of Sebastián Piñera's 2010–14 administration (Bergoeing 2017: 7).⁶

Many on the left tried to blame Bachelet's poor economic performance on international factors, but during her “anti-neoliberal” administration the world enjoyed an average growth rate of 3 percent.

⁵See www.latercera.com/noticia/bachelet-habia-vestigios-del-modelo-neoliberal-los-ido-terminando-traves-las-reformas.

⁶Even though Chile experienced high economic growth under Piñera's first administration, the capacity of the Chilean economy to grow did not reverse its declining trend. From 1990 to 2016, potential GDP declined from close to 7.5 percent to around 4 percent (see Le Fort Varela 2016).

As economist Raphael Bergoeing pointed out, international conditions were favorable to Chile's economic growth under Bachelet. Moreover, a moderate estimate indicates that in absence of Bachelet's statist reforms Chile would have grown at rates of 4 percent a year (Bergoeing 2017: 7). The climate of uncertainty that Bachelet created was clearly reflected in the rates of investment. Since data collection began in the early 1960s, until Bachelet's administration, Chile had never shown four consecutive years of decreasing investment (*ibid.*: 12).⁷

A crucial document for understanding the Bachelet administration's anti-liberal philosophy was a book written by five members of her brain trust shortly before she was elected for a second time. The book was titled *The Other Model: From the Neoliberal Order to a Regime of the Public* (*El otro modelo. Del orden neoliberal al régimen de lo público*), and the cover showed five workers destroying a brick (Atria et al. 2013).⁸ "The brick" was the name given to the economic program written by the Chicago Boys in the early 1970s and implemented after the fall of Allende. The message of the cover—and the book itself—was clear: the Chicago Boys' economic model had to be terminated, and Bachelet, who was the star speaker at the book's launch in 2013, should lead that process. According to *The Other Model*, neoliberalism and individualism had created an unequal, selfish, and unjust society where a privileged few had access to things that should be considered rights for everyone. In the view of the authors, governments were responsible for making sure that no differences existed when it came to economic goods such as education, pensions, or anything else the authors defined as a "social right." The authors further argued that it was only when the market logic had been expelled from these spheres that an equal and fair society based on solidarity could emerge. Although it did so in different terms, *The Other Model* presented and defended a socialist ideology and political system. Bachelet's second government embodied this radical ideology, and the reforms followed.

Due to the persistence of the egalitarian narrative over the years, large parts of the public bought into the idea that neoliberalism had

⁷The prediction of Chile's central bank referred to in the article turned out to be accurate.

⁸For a rebate of the myths, fallacies and errors of *The Other Model*, see Kaiser (2015).

led to more inequality and injustices even though income inequality was actually decreasing. When, in February 2020, Bachelet, as the United Nations High Commissioner for Human Rights, declared that inequality was the cause of the demonstrations in Chile and Ecuador, she reinforced the perception of large parts of Chile's population.⁹ Indeed, according to opinion polls published in December 2019, Chileans believed that the main reason for the social crisis had been the high level of income inequality (CEP 2019). ECLAC's 2015 Index of Perceived Inequality showed that Chile was the country with the highest perceived income inequality in Latin America. In addition, the same index showed that the perception that income distribution was unfair had increased over the years.

If the consensus among elites was that inequality was Chile's main problem before the social crisis, it is no surprise that after the crisis broke out this consensus was reinforced. In reference to the popular explanation for the crisis, Carlos Peña, an influential center-left scholar, observed: "If we take at face value the immediate reactions of these days, the cause of the phenomena would be injustice and especially the unquestionable inequality that affects Chilean society" (Peña 2020: 11–12).¹⁰ Peña himself correctly noted, however, that the country had never been more prosperous and equal than in present times. This meant that the well-established idea that economic inequality had been the cause of the social crisis was "intellectually incorrect" (*ibid.*: 13). Instead, Peña rightly argued, it

⁹See www.latercera.com/mundo/noticia/bachelet-pide-que-se-fijen-responsabilidades-por-violaciones-de-ddhh-cometidas-durante-protestas-en-chile-y-ecuador/EFXRNNTG5RGUVAZC4WJ6AOLHVI.

¹⁰There is another cause of the social crisis that Peña correctly mentioned in his work—namely, the excessive emotionality of the younger generations. According to Peña, Chilean students nowadays lack normative frameworks capable of orienting their lives beyond their mere subjectivity. As a result, they have grown intolerant, showing a tendency to break the socially accepted rules of conduct (Peña 2020: 142). This argument closely resembles Jonathan Haidt and Gregg Lukianoff's analysis of the American youth in their work *The Coddling of the American Mind* (2018). It should also be mentioned that another cause for frustration among middle class young people and their families is what can be called the "paradox of progress." This refers to the fact that the economic returns on higher education—the main driver of social mobility in Chile over the last decades—have declined along with its massification. In other words, the same process that has allowed millions to move upward in the income scale has made the goal of a high income and the social status associated with it more elusive (Klapp and Candia 2016).

was the perception of inequality that had changed. Thus, even if inequality had decreased in Chile, people had become more sensitive to it because the feeling that the existing inequality was legitimate had eroded (*ibid.*: 128–29). It was precisely this feeling of unfairness, to a large extent created by egalitarian narratives, which paved the way to the disastrous reforms of Bachelet’s second administration. In turn those reforms created additional frustration with the system by bringing the train of economic progress to a halt. After Bachelet, Piñera came to power a second time by promising to bring back “better times,” in the words of his campaign slogan. After failing to deliver, the social crisis erupted.

Part of the reason why the crisis will be so hard to resolve in Chile is that opinion makers do not realize that its origins are mainly ideological. It is through this lens that the widespread attacks on the free market have to be understood. Center-left sociologist Eugenio Tironi was correct when he argued that the massive demonstrations of 2019 were ideologically opposed to the economic model of the Chicago Boys (Tironi 2020: 26–27). Like Peña and many others, however, Tironi did not seem to understand that perceptions of that model’s legitimacy had been eroded by the egalitarian ideologies that intellectuals like himself and others had popularized. This shifted the country’s political and economic institutions almost entirely towards redistributionism.

As Douglass North (1988: 15) observed, ideologies refer to the “subjective perceptions that people have about what the world is like and what it ought to be.” Insofar as ideologies entail a prescriptive component, they “affect people’s perception about the fairness or justice of the institutions of a political economic system” (*ibid.*). Moreover, because the ideologies and beliefs available in a given culture ultimately define the form of government that determines the formal rules of the game—namely, property rights and enforcement characteristics—it is not a surprise, said North (1993), that efficient economic markets are so exceptional.

North (1990: 110–11) also argued that ideology is key to understanding the poor economic performance of Third World countries, since their ideologies usually promote policies that provide institutional constraints and discourage productive activity. Indeed, in the case of Chile, the nation’s egalitarian ideology led to changes in its formerly free market institutional framework, transforming its system into one increasingly incapable of delivering beneficial economic

results. This fueled egalitarian narratives even further because, as is typical of ideological dogmatists, proponents of the egalitarian system refused to change their views. Against all evidence, frequent repetition of the idea that the country's troubles were the result of extreme inequality and social injustice ended up convincing many people that the system had to be socialized further. As psychologist Daniel Kahneman has argued, "a reliable way of making people believe in falsehoods is frequent repetition because familiarity is not easily distinguished from truth" (2012: 62).

The Death of *Concertación* and the Collapse of Market Consensus

In a sense, the Chicago Boys' economic model was doomed to be dismantled with the passing of time. The fact that the governments that came after the Chicago Boys accepted their reforms does not mean that these administrations had a profound understanding of the positive nature of market forces, let alone a genuine moral commitment to economic freedom. Patricio Aylwin, the first president after the Pinochet years, best reflected the center-left view on the market when in the early 1990s, he declared:

The market can stimulate wealth creation but it is not fair when it comes to wealth distribution. The market has no social or ethical considerations. The market is usually tremendously cruel and favors those who are more powerful and compete under better conditions while it worsens the misery of the poorest because it increases social inequalities [Otano 2006: 417].

The lack of real commitment to economic freedom on the political and intellectual left—as well as on growing segments of the right—allowed more radical socialist narratives to gain greater acceptance. The influence of socialist groups grew so powerful that the center-left political parties responsible for administrating the Chicago Boys' market reforms felt too ashamed to vindicate the enormous prosperity that market forces achieved under their own governments. With almost no exceptions, they never defended their legacy from the attacks by the radical left.

Legal scholar and former Concertación minister Jorge Correa explained that one of the causes of the demise of the moderate

Concertación, which in turn enabled the rise of the radicalized left wing coalition Nueva Mayoría,¹¹ was that its members were “ashamed” to say that they were “supporters of the market. . . . Never did we really dare to defend with clear theses what we were embracing in practice” (Correa 2018: 223). Recognizing the importance of the battle of ideas in political warfare, the former minister added: “The defeat was cultural rather than political. It’s impossible to be successful in politics if you feel ashamed, even less so if you don’t dare to show your set of ideas” (ibid.). Concertación, he concluded, “committed suicide . . . she stopped believing in herself, defending her work” (ibid.).

The center right did not really engage in a strong defense of market principles either. Piñera best expressed the compromising tone the center right took toward egalitarian ideologies during his first administration. In a famous speech given in 2010, he declared:

I think that, first of all, Chileans do not tolerate the excessive degrees of inequality that have crossed our society for so long. And they have rebelled against excessive inequality, because Chile is the country with the highest per capita income in Latin America, but it is also the country, along with another country, with the highest relative inequality in Latin America. And, therefore, they are asking for a fairer society, a more egalitarian society, with fewer inequalities, or with greater equality of opportunities, because the inequalities that we experience in Chile are excessive, and I feel that they are immoral, because they are attacking the essence of a society, which is its cohesion and internal harmony.¹²

Following this vision, in his second administration, Piñera launched a program to expand social benefits to the middle class called *Clase Media Protegida* (Protected Middle Class). The program reflected a social democratic philosophy that validated the idea that

¹¹Nueva Mayoría was the coalition of leftwing political parties that succeeded the Concertación and which came to power with Bachelet in her second administration. Although it incorporated all former members of Concertación, it also included far leftwing political parties such as the old Communist Party. It also made alliances with the new far left populist coalition Frente Amplio.

¹²Speech available at www.lasegunda.com/Noticias/Politica/2011/07/667325/Texto-completo-del-discurso-del-Presidente-Sebastian-Pinera-en-el-aniversario-del-diario-La-Segunda].

the government's role was to take care of the population's well-being. Thus, Piñera moved Chile one step further along the path toward becoming a welfare state.¹³

Along these lines, after the social crisis broke out in October 2019, Piñera made a speech apologizing to the Chilean people for the injustices of the country's economic system, and announcing a massive increase in government spending:

It is true that the problems have not occurred in the last days, they have been accumulating for decades. It is also true that the different governments were not able to recognize this situation in all its magnitude. This situation of inequity, of abuse, has already meant a genuine and authentic expression of millions and millions of Chileans. I recognize this lack of vision and I apologize to my compatriots.¹⁴

Piñera further declared that “there were many coincidences, both in the diagnosis and in the solutions” of the crisis with the leaders of the left—the same politicians who were blaming “neoliberalism” and inequality for the crisis.

The unwillingness of Concertación—and many center right politicians such as President Sebastián Piñera—to clearly defend the free market precipitated the collapse of the political and social consensus upon which Chile's economic institutions had been based. This climate opened the door for a complete transformation of Chile's economic model, the degree of which will only be clear with the passing of time and once the new constitutional experiment Chile set in motion in 2019 is complete. In any case, and regardless of the exact

¹³See <https://clasemediaprotegida.gob.cl>.

¹⁴See www.youtube.com/watch?v=JlPpH76A_BI. Former presidential candidate Joaquín Lavín, one of the most emblematic and popular centre-right politicians in the country went even further than Piñera. In a column published in *El Mercurio*, he argued that Chile needed to “change its development model” because it had created two separate countries just like the Berlin Wall had created two separate Germanys. Lavín called for a social “reunification” and attacked Chile's economic elite for hindering social mobility. He also denounced the “horizontal inequality” that in his opinion characterized Chilean society. By this concept, Lavín was referring to inequalities in health care, housing and education. In Lavín's view, these injustices had to be “terminated” through more efficient government spending, higher levels of taxation and different public policies than those implemented thus far (Lavín: 2019).

outcome of the constitutional question, if there is anything that the fall of Chile can teach the world, it is that, once again, the power of ideas and ideologies is far greater than the appeal of facts. In other words, Chile confirms the old classical liberal lesson that there is no hope for the survival of the free market absent the moral case for economic liberty. That case, which must be accepted by the minds of the public, must also be made, at least in part, by the intellectual, political, and economic elite.

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