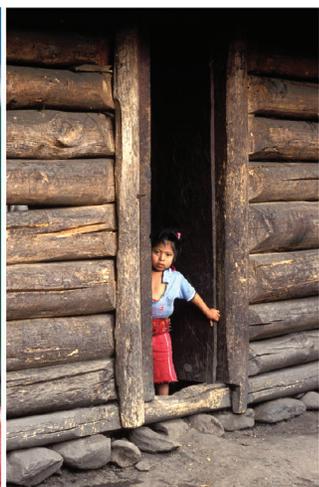
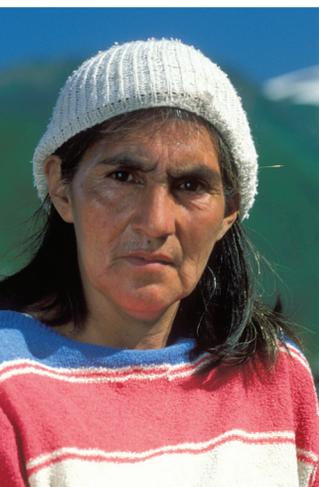


EQUITY AND SUSTAINABLE GROWTH

# Twenty Years of Social Policies, Chile 1990–2009



José Pablo Arellano M.

DECEMBER 2011



THE WORLD BANK

# **EQUITY AND SUSTAINABLE GROWTH: TWENTY YEARS OF SOCIAL POLICIES, CHILE 1990–2009**

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This book examines social policy in Chile between 1990 and 2009 through the eyes of one of its key actors. Special emphasis is placed on allocation of resources, the relationship between social, fiscal, and macroeconomic policy, and the relationship of these three types of policy with growth and equity.

The book covers each area of social policy: subsidies/monetary transfers, education, housing, pensions and social protection, health care, and income generation. The author analyzes the mechanisms used to prioritize social spending in the allocation of public resources. Within social policies, he examines the main criteria and priorities that guided allocation of resources.

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# INTRODUCTION

During the 1990s, I had the opportunity to take part in the Government's social policy design, first via the Ministry of Finance's National Budget Office (Dirección de Presupuestos—DIPRES) and then via the Ministry of Education. From the mid 1970s through the 1980s I studied the evolution of social policies in Chile, and have done the same in recent years, by responding to invitations, giving talks and teaching courses, and maintaining an ongoing interest in social policy. This book, in part, brings together the reflections brought on by these experiences.<sup>1</sup>

Early 2010 saw the end of a 20-year cycle of four administrations of the center-left political coalition, the Concertación (Concert of Parties for Democracy). These administrations placed equitable growth at the center of their agenda, and managed to give continuity to a major set of social policies aimed at achieving this goal.

This book summarizes the distinctive and noteworthy aspects of social policy between 1990 and 2009, emphasizing allocation of resources; how social, fiscal, and macroeconomic policies interact; and the relationship of these three policy types to growth and equity.

The text stresses the importance of fiscal policy and economic growth in the sustainability and continuity of social policies over these two decades. It analyzes the mechanisms used to prioritize social spending in public resource allocation. The main priorities and criteria within social policies that guided resource allocation are examined, with special attention placed on equity in distribution.

The book examines the main features of each social policy area: subsidies or monetary transfers, education, housing, pensions and social protection, healthcare, and income generation. More than a detailed analysis of each area, it gives the commonalities of the approaches.

As will be shown, there are common threads over this 20-year period that guide social policy strategy and its contribution to equitable development.

The main emphasis of the study is on the macro elements of social policy: its financing and resource allocation options. This emphasis is not only due to the author's greater knowledge of the subject, but also to the importance of these factors in the success of the micro aspects of social policy. The amount of resources and the choices made regarding their allocation define the conditions under which each program's specific aspects are implemented. This book will not address other policies that impact equity, like those aimed at the labor market (minimum wage policies, labor and union laws).

To get a comprehensive view of social spending in an economy where private financing plays an important role in complementing government contributions, this book introduces the concept of "national social expenditure" and describes its evolution during the period.

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<sup>1</sup> In a previous study, which served as background research for this book, we examined policy in the 1990s. CIEPLAN Socio/Economic Studies No. 26, April 2004.

It also examines key aspects of the policy design, institutional framework, and political realities that made the ensuing outcomes possible. Policy design, institutional frameworks, and actions of political leaders are ingredients that define “policy quality.” This is a critical aspect when it comes to achieving good results in a country’s development.

The text ends by mentioning some future social policy challenges for Chile. In many cases, these are the results of the policies’ own achievements.

These pages present a positive outlook on what has been achieved in these two decades. Far from constituting complacency toward what has been accomplished and Chile’s current social and economic

situation, this is intended to strengthen faith in what can be achieved with good policies, in order to address the many aspects that need to be improved.

The descriptions of the policy details and their implementation have been reduced to a minimum in order to focus on the analysis of policy choices and the reflections or lessons that emerge from them.<sup>2</sup>

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<sup>2</sup> The book does not address the internal differences and political negotiations that existed in relation to the different initiatives. This would require a much more detailed analysis than the one presented here. In some cases there will be reference to studies on this topic.

# EQUITABLE GROWTH AND THE DISTRIBUTION OF GROWTH BENEFITS

Social policies played an important role in the policy of equitable growth, which was inaugurated in 1990 with the return to democracy by the administration of President Patricio Aylwin. It included improved conditions for workers, as a result of reforms in the labor market and benefits channeled to the poorest segment of the population with government social spending.

Growth with equity meant *growth*, first of all. Therefore economic and social policies had to be designed to encourage growth, and in no case put it at risk, as social policy had often done in the past. Risk occurs when public spending initiatives go beyond the viable short-term financing, risking macroeconomic imbalances that can put the economy in a crisis situation, thus jeopardizing the implementation of the social policy. In the best-case scenario, when there is no crisis, the growth rate declines and with it goes the possibility of a solid resource base for the social effort. Social policy may also jeopardize growth if its design and implementation lead to inefficiencies and obstacles to growth. Concern with avoiding both of these risks was very much present in economic and social policy design. In fact, for most of the 20-year period there was a virtuous circle in which growth and equity mutually reinforced each other, as will be seen in the next section.

## Sustained Poverty Reduction Through Growth

During this period, poverty fell sharply, from 39 percent of the population in 1990 to 15 percent in 2009 (in 1987 this figure hit 45 percent).<sup>3</sup> There is no precedent for a poverty level reduction of this magnitude in Chile, and it is also exceptional on an international level.

This reduction is the result of the increase in income for these households, which in turn is a product of higher salaries and better job opportunities. To a lesser extent, monetary subsidies from the state also played a role.

The orders of magnitude are: for 25 percent of households who overcame poverty between 1990 and 2009, their monetary income rose by about 50 percent in real terms. The majority of this increase

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<sup>3</sup> Unless otherwise indicated, all information in this section comes from CASEN surveys (National Socioeconomic Characterization Survey); see [www.mideplan.cl](http://www.mideplan.cl). Poverty is measured in absolute terms, that is, the number of people or families who do not have the income per person needed to purchase goods and services deemed essential to meet basic needs. This income is defined as twice the cost of a basket of food sufficient to meet food needs.

came from improvements in family income due to higher salaries and more employed persons per household. As will be seen later, government monetary subsidies, despite their significant growth, only account for around a quarter of the increase in these households' income. That is, over 75 percent of the income increase that allowed families to overcome poverty came from increased work-related income.

Naturally, the total effect of government social spending on poverty is greater, since the above figures only include monetary transfers and one must factor in the benefits of housing and water and sanitation policies, as well as health and education benefits. Moreover, these benefits affect the ability to obtain employment and income in the medium term, which is also left out by these figures.

The determining factor in overcoming poverty was the better working conditions resulting from the country's economic growth during the period. This growth, in turn, was the result of policies that provided the necessary stability and favorable conditions.

The population that remained in poverty also experienced improvements in these years, but the increase in income was not enough given the group's very low initial income in 1990. However, the poverty gap decreased.

An additional factor in poverty reduction was demographic change, which meant a smaller household size and fewer dependents per worker. Household size in the two poorest quintiles decreased from 4.6 persons per household in 1990 to 3.8 in 2009.

The purpose here is not to examine the causes of poverty, but it is important to note two salient

characteristics of families that remain in poverty: first, they have low educational levels, and second, their households are comparatively more numerous.

Those between 25–34 years of age in the first quintile studied an average of 10 years; in other words, they dropped out of secondary education before graduating. The same age group from the highest-income quintile averaged more than 15 years of schooling. Having fewer years of schooling, even without considering the differences in the quality of the education, undoubtedly results in a reduced ability to obtain a good income in the future.

Along with the lower income per worker and the factors associated with this lower earning capacity, a very influential factor in the level of poverty in this group is the greater amount of dependents per economically active person. The number of economically active persons is slightly lower among the poor than among middle and high-income groups. What is much higher in these households is the number of dependents. In the lowest income quintile, for example, there are 2.9 dependents (mostly children) for every employed person. In contrast, for the next quintile, which is above the poverty line, this ratio is 2.1 per employed person, and in the highest-income quintile it is 0.8 for each employed person.

This shows that policies directed toward the child population are crucial in providing support for the poorest households. Also, increased access to education and a higher quality of education will contribute to reducing poverty and income inequality in the future.

## EMPHASIS ON EQUITY AND FISCAL DISCIPLINE

The focus on equity via social policy has resulted, since 1990, in a clear shift of focus and priorities in fiscal policy. Fiscal discipline was emphasized, and unlike during the second half of the 1980s, when the proceeds of economic growth were used to reduce taxes, beginning in 1990 the proceeds were directed to increasing social spending.<sup>4</sup> In this year a tax reform was passed that reversed the tax cuts of the previous years, and this financed a shift in social spending.

Social policy is built on the basis of fiscal discipline. This was an approach that triumphed and has been a guiding principle of economic and social policy since the beginning of President Aylwin's Government, emerging as early as the presidential campaign period. During the campaign it was stated that there would be no new government spending without first ensuring that adequate resources would be available. This was, on one hand, a reaction to the populist movements of the past, and on the other, a way of instituting the gradualism necessary to satisfy unmet social demands. So in 1990, despite unfulfilled social demands, there was no new social spending until the Congress could pass a tax increase with the support of the opposition.

This emphasis on fiscal discipline was a constant during this 20-year period, throughout different macroeconomic realities. This gave social spending policies long-term sustainability, as opposed to the untenability of policies in other countries and in other historical periods in Chile. Fiscal discipline in

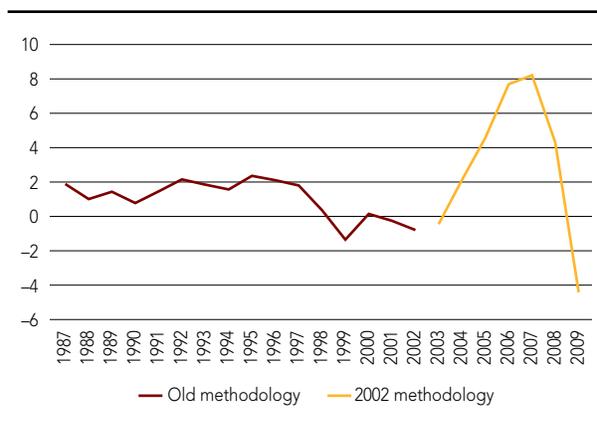
the early 1990s was mainly the economic team's priority, strongly supported by President Aylwin's political team,<sup>5</sup> but gained more and more support as a result of its outcomes.

Fiscal policy began embracing new mechanisms to achieve long-term sustainability and responsibility. Unlike in the past, government spending was made independent of variations in copper prices (revenues from copper sales are a major line item in the Chilean national budget). In periods of good prices, revenue was saved for periods of low prices and income.<sup>6</sup> It is not the purpose of this book to analyze the fiscal policy of these two decades, but Figure 1 provides the fiscal outcome. The government surplus between 1990 and 2009 was 1.7 percent of GDP on average. The years in which deficits were recorded correspond to those of the Asian crisis in the late 1990s and the great financial crisis of 2008–09.

<sup>4</sup> Fiscal social spending in 1989 was 11.5 percent lower in real terms than in 1985. The budget approved by the military government in 1990 included a further reduction to the social spending of 1989. This was reversed by the new democratic government.

<sup>5</sup> For more on this subject, see the accounts of the politics of the era written by Edgardo Boeninger, Minister Secretary General of the Presidency at the time and a great promoter of the political importance of macroeconomic stability. See also the numerous publications of Finance Minister Alejandro Foxley, the Ministry of Finance Annual Budget speeches in October 1990 and 1993, and Foxley (1993).

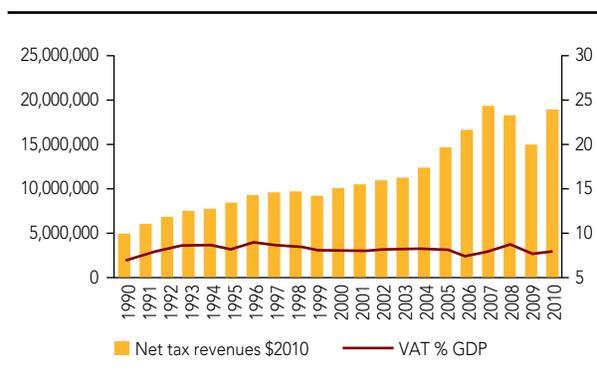
<sup>6</sup> See Arellano (2005), Marcel et al (2001), Velasco et al (2010).

**FIGURE 1:** Central Government Surplus (Deficit) as a Fraction of GDP, 1987–2009

Source: Calculations based on DIPRES, Government Finance Statistics.

Since in 2002 the methodology for calculating the budget balance was modified, the data presented here are calculated based on the official methodology at the time (since this was what guided the policy decisions of the time).

Social policy sustainability requires adequate funding. Figure 2 shows the behavior of the General Government's tax revenues (including municipality revenues, but excluding the taxes paid by CODELCO, the state-owned copper company).<sup>7</sup> Between 1987 and 1989 taxes reached an average of 17.2 percent of GDP, and by 1990 they had fallen to 14.9 percent. This was the result of successive tax cuts made in the last years of military rule. As part of the new

**FIGURE 2:** Tax Revenues and VAT, in 2010 Pesos, 1990–2010

Source: Calculations based on statistics DIPRES Government Finance Statistics and the Central Bank.

equitable growth policy, taxes were increased in the second half of 1990 to fund social policies.

These tax changes reversed the rate cuts of the late 1980s. As a result of this reform and of subsequent changes to ensure continuity of tax revenue, average yearly tax revenue amounted to 17.9 percent of GDP between 1992 and 2010.<sup>8</sup>

Although the increase in tax rates was important in providing more resources for increased social spending, economic growth was even more important, and this was heavily influenced by macroeconomic policy. In effect, tax revenue nearly quadrupled between 1990 and 2010. In simple terms, it can be estimated that 81 percent of the increase in tax revenue in this period was the product of growth, and the remaining 19 percent was due to changes in tax legislation and better tax administration and enforcement, which reduced evasion.<sup>9</sup>

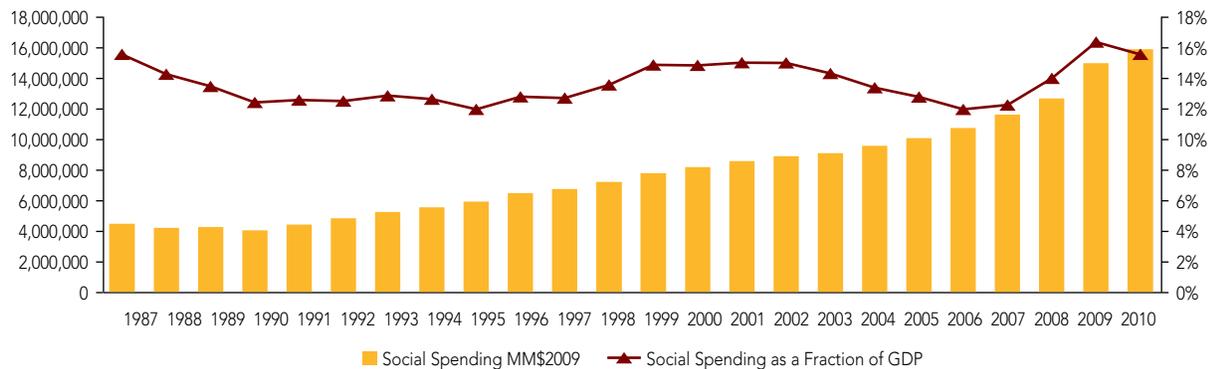
The final result, thanks to higher tax revenues, was a significant increase in the resources allocated to social programs. These resources nearly quadrupled between 1990 and 2009. Figure 3 shows the social spending behavior during these years.<sup>10</sup> In real terms, social spending grew annually, throughout the entire period and without interruption, at a rate

<sup>7</sup> Municipal taxes (real estate tax and municipal contributions) were 1.1 percent of GDP in the early 1990s and rose to 1.4 percent in 1996. The taxes do not include those paid by Codelco. For a proper understanding of the measurement of the tax burden see Arellano (2012).

<sup>8</sup> The drop in tax revenue as a fraction of GDP in 2009 and 2010 is a result of the international financial crisis that erupted in 2008. This is a partial definition of tax revenue.

<sup>9</sup> Along with changes in legislation, the fight against tax evasion also contributed to the higher tax revenue. This was the result of a steady improvement in administration. The increased revenue has been broken down into growth and legislative/administrative changes considering what the revenue would have been in 2010 with 1990 collection rates.

<sup>10</sup> In 2003, a new accounting methodology for public finances was established, introducing several changes. Social spending data with the old and new methodology for the entire period can be found in the annex. Methodological changes are documented in DIPRES (2003) Estadísticas de Finanzas Públicas. Data in this series use the measurements under the new methodology.

**FIGURE 3:** Public Social Spending in 2010 Pesos and as a Fraction of GDP, 1987–2010

Source: Calculations based on DIPRES Government Finance Statistics. MM = millions of 2009 pesos.

of over 7 percent. As a fraction of GDP, it rose from 12 percent in 1990 to 17 percent in 2009.

As evidenced by this data, a virtuous circle occurred during these two decades. Fiscal discipline contributed to good macroeconomic performance, which created favorable conditions for economic growth. This then translated into the main source of resources to fund social policy. This is the social dividend of fiscal discipline.

Fiscal discipline prevented the economic cycles—typical of populist policies—that generate macroeconomic imbalances, which in turn result in higher interest rates and/or inflation and/or external account deficits. Thus, greater stability was achieved and the country risk rating was improved, improving financing conditions and increasing investment. The resulting growth increased the resources available for social policies.

The sustainability of social policies is determined during periods of prosperity. This is accomplished, as it was in this case, by saving revenue during periods of rapid growth and favorable terms of trade for the negative periods of the economic cycle. With these savings it is possible to maintain and even expand social programs in times of difficulties, when they become more necessary.

Continuity in social efforts and in policies is, unfortunately, a rare phenomenon in Chile's history and in the Latin American context. Typically policies are interrupted shortly after they begin, due to a lack of economic sustainability and/or changes in

the principles that guide them. The result is great instability, frustration on the part of the people involved, and a very low effectiveness.

Going back to tax policy, this was viewed as an efficient mechanism to raise the resources required for fiscal policy. Thus, the structure was kept as simple as possible and flat tax rates were favored. In particular, the proposed idea of introducing different VAT rates for redistributive purposes was discarded. The prevailing approach was to use a simple and effective tax system to raise resources, where the VAT, which in Chile's case is the closest thing to a sales tax, acquired a growing importance (again, see Figure 2). For example, when faced with demand to lower or eliminate the VAT on books, it was decided to maintain the VAT and instead increase government spending on textbooks and libraries for students in government-subsidized schools and on public libraries.

There were changes in tax composition as a result of successive reductions of tariffs, which were at 20 percent in 1990 and were reduced both unilaterally and as a result of the free trade agreements that Chile signed with numerous countries. This was offset by the VAT and a higher corporate tax rate, which was 0 percent in 1990, re-established at 15 percent in 1992, and increased to 17 percent in 2006.

Significant changes were made to improve tax administration, reduce evasion, and reduce some tax exemptions, thereby achieving a more efficient and equitable tax system in horizontal terms.

It was decided to pursue income redistribution and social policy through the clearer, more effective path of government spending, instead of the less promising option of modifying the tax structure.<sup>11</sup>

### Changes in Budget Priorities Favoring Equity

In addition to increased resources from tax policy and greater growth, there was a redirection of resources from the public budget to social programs. Social spending rose from 61 percent of total government expenditure in 1989/90 to 67 percent in 2009.

Five factors contributed to this redirection of resources.

**First, investments in infrastructure** were made with private funds, which freed the state to invest in essential projects for the country's development. Investments in energy (electricity) infrastructure and telecommunications were privately held as a result of the privatizations of the 1980s. As a result of the new concession system created in the 1990s and/or new privatizations, private investors made investments in water and sanitation, roads, ports and airports. This factor's significant contribution to increased social spending is often overlooked. Thanks to the transfer of infrastructure investment to the private sector, the state was able to free up considerable resources that traditionally would have gone to financing investments necessary for the country's growth.

From 1992, the year the new system of public works concessions was implemented, until mid-2010, more than US\$11.6 billion was invested in the construction of more than 50 projects.<sup>12</sup> At the same time, the state financed infrastructure with high social content that could not be concessioned.

Meanwhile, privatization enabled the establishment of a user-pays system for these public services. This way, the state was not only freed from subsidizing investment in these services, but also from unnecessarily subsidizing their operation.

When public services are state-owned, it is common to see the introduction of universal subsidies that favor the groups with greater income

and consumption capacity. This has happened in the past in Chile and is a common practice in other countries. In this case, however, users were charged the cost of using these essential utilities, and targeted subsidies were put in place for needy households who could not afford the services. This was the case with drinking water, where along with introducing fees to cover costs (and as a precursor to privatization), a new drinking water consumption subsidy was created in 1991 for the most needy families. A targeted subsidy was also established in the case of electricity, as a result of a major fee adjustment made in 2005.

At the same time, in the areas of electricity, telecommunications, roads, water, and infrastructure for small fishermen, the state actively financed investments that directly benefitted low-income rural families.

The fees charged were part of a pricing system, based on marginal costs, that promoted a more efficient use of the infrastructure. Ultimately, these fee and investment policies promoted efficiency, which consequently advanced growth and equity.

To grow rapidly, it was clear that the country required massive investment in infrastructure. The mechanism that was used relied on private funding, freeing the public budget from these requirements and thereby eliminating the traditional competition of resources between productive infrastructure and social spending. Strictly speaking, government investment in infrastructure did not decline; on the contrary, it grew, but as has been mentioned, it constituted a small fraction of the investments that produced the growth the country experienced.

**A second factor** that opened up more space for social spending was the relative decrease in **defense spending**. The conditions of peace allowed this expense to be maintained without growth, causing general government defense spending to drop from

<sup>11</sup> See for example the argument presented in the Annual Budget speech for 2003. Studies that demonstrate the wisdom of this choice include Engel, Galetovic, Radatz (1998).

<sup>12</sup> Details of all of these projects can be found at the following link along with a Ministry of Public Works analysis, Sistema de concesiones en Chile 1990–2003.

2.2 percent of GDP in the late 1980s to 1.2 percent in the 2005–2009 period.<sup>13</sup>

**The third factor** that helped expand social spending was also a direct result of fiscal policy. The budget surpluses enabled, firstly, a reduction in **public debt** and secondly, an accumulation of financial assets during the 2006–2008 supercycle of high copper prices. First, loans were prepaid, reducing the central government debt from 44 percent of GDP in 1989 to 12.5 percent in 2000 and 6.3 percent in March 2010. Also in March 2010, investments in financial assets were equivalent to 15.7 percent of GDP. This brought government spending on interest down from 3.2 percent of GDP in 1990 to 0.5 percent in 2009, and led to net income in 2008–2009.<sup>14</sup> See figure 4.

The savings on annual interest payments, thanks to a reduction in public debt, are currently financing an amount equal to half of all government spending on healthcare. This is another clear example of the virtuous circle between fiscal policy, growth and social spending (see Figure 4).

**The fourth factor** that raised funds for social programs was the **mobilization of private resources**, which added to the public effort. This “leveraging” of private resources in different social programs took place primarily via the financial system. For example, a new microcredit system was introduced in which the state pays a subsidy and financial institutions bestow the loans. In housing, subsidies were used to a greater extent than direct contracts by the state. Higher education student

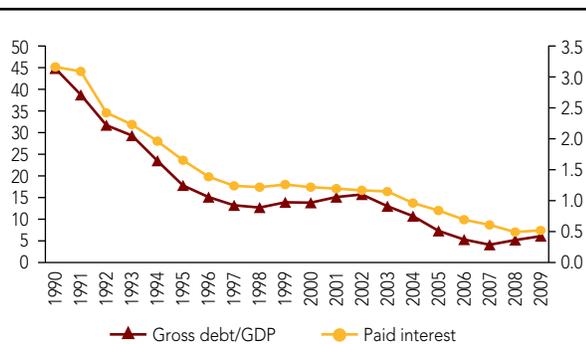
loan refinancing systems were created by CORFO (Development Corporation Agency). Also introduced was the so-called CAE (crédito con aval del estado), the state-guaranteed student loan program—discussed below—where the state is the final guarantor, reducing the fiscal resources to be disbursed directly.

These systems, apart from amassing additional resources to fund programs, may provide better management and are better able to raise funds than traditional government programs, to the extent that they transfer the loan process to specialized institutions.<sup>15</sup>

Another example of leveraging private resources occurred in rural telecommunications and electrification programs, where the state, via public tenders, only financed the portion of the investment costs required to make private investment profitable. In the case of rural telecommunications, for example, 6,000 public telephones were installed in rural areas for more than 2 million inhabitants between 1995 and 2001. Private companies funded a total of 86 percent of the US\$161 million invested.<sup>16</sup>

Finally, **the fifth factor** that increased social investment was **contribution by the beneficiaries**. Several programs promoted stakeholder contributions, enabling the state to concentrate its efforts on those most in need and/or broaden the population receiving benefits. Examples of these initiatives are participatory paving programs, where neighbors help finance the paving of their streets, and cost

**FIGURE 4:** Paid Interest and Total Debt of the Central Government as a Fraction of GDP



Source: Calculations based on DIPRES Government Finance Statistics.

<sup>13</sup> The figures refer to total defense spending, including those financed with CODELCO contributions under the reserved copper law. These are recorded as extra-budgetary expenditures.

<sup>14</sup> General government interest payments as a result of fiscal policy during this period have been much lower than the 3.8 percent OECD average in 2000 and the 4.2 percent EU average. They were even lower than the interest payments in the OECD countries with the lowest debt burdens, Korea and Norway, at 1.6 percent of GDP (Atkinson and van den Noord, 2001). Government interest spending in figures for Chile includes interest on recognition bonds in the pension system; without them, the figures are even lower.

<sup>15</sup> One example, in the case of microcredits, can be seen in Arellano and Ochoa (2007).

<sup>16</sup> World Bank 2004 Chile New Economy Study.

sharing systems for elementary and secondary education, which supplement state subsidies with contributions from families.

The five factors (use of private resources for infrastructure, lower defense spending, saving on interest payments on public debt, leveraging private resources, and increased contributions from users) provided social policy with more funds for greater coverage and clearer targeting of the most needy households.

The latter two factors are related to social policy design, unlike the first three, which are associated with budget allocation. Social policy design identified how to leverage private resources and how to incorporate contributions by beneficiaries without distorting the policies' ultimate goal.

The use of private resources in infrastructure, the leveraging of private resources to finance social policy, and the user contribution system all pose new challenges that will be addressed later.

### Criteria for Social Resources Allocation

Along with the increase in resources, certain criteria and priorities that were either introduced or brought to the foreground should be noted. The goal here is not to detail resource allocation to different programs, but to mention some policy options and focal points.

#### *Priority for those most in need and progressivity of public spending*

One clear objective of social policy was progressivity: allocating resources by giving priority to the poorest. Almost without exception, any increase in resources and/or any new program benefitted first and foremost the most needy households. Pension adjustments, for example, gave first priority to the lowest pensions and the oldest pensioners. Increases in educational subsidies and/or provision of educational materials have been higher for the poorest students and/or schools, and in the case of housing, resources were directed toward more modest housing programs that assist families with the greatest needs.

#### *Monetary subsidies were highly targeted*

A clear example of the increased progressivity of social policy is the case of monetary subsidies (non-contributory pensions, family allowances, special family allowances for non-contributing families [subsídio único familiar—SUF], and the drinking water subsidy). These subsidies were increased in both amount and coverage and were redirected towards those most in need. The first quintile went from receiving 34 percent of the total allotted resources in the late 1980s to more than 44 percent in 1998. Even the first decile saw a sharp increase in the percentage of resources received, from 19 percent to 28 percent of spending. In exchange, quintiles III–V received a lower proportion and an even lower amount of absolute resources.<sup>17</sup> See Table 1.

Table 2 shows the number of beneficiaries and the average amount of the respective subsidies. Non-contributory pensions and family allowances, precisely those that benefit the poorest population, increased the most in both quantity and value. Indeed, these benefits acquired greater significance as a source of income for the poorest segment of the population. In 2009 monetary subsidies represented 32 percent of monthly income for the first quintile and 7.6 percent for the second (see Figure 5).<sup>18</sup>

This marked increase in the progressivity of monetary subsidies is noteworthy. It is quite exceptional to see reallocations like the ones achieved in this period, considering that they require clear policy decisions and agreements that make them politically feasible. Also needed are benefit allocation

<sup>17</sup> The reduction of benefits seen between 1987 and 1990 is partly explained by the disappearance of emergency public employment programs (PEM and POJH), which were discontinued as unemployment went down.

<sup>18</sup> Since 2009 was a year of economic crisis, independent incomes remained relatively stagnant, whereas monetary subsidies rose. Moreover, the data do not capture the full extent of benefits paid that year: since the Casen survey is during November 2009, it does not include the impact of monetary transfers paid in March and September of that year as part of the countercyclical fiscal policy. When calculating the monthly equivalent of the additional transfers of this year, monetary subsidies rise to 51 percent and 14 percent of independent income in quintiles I and II.

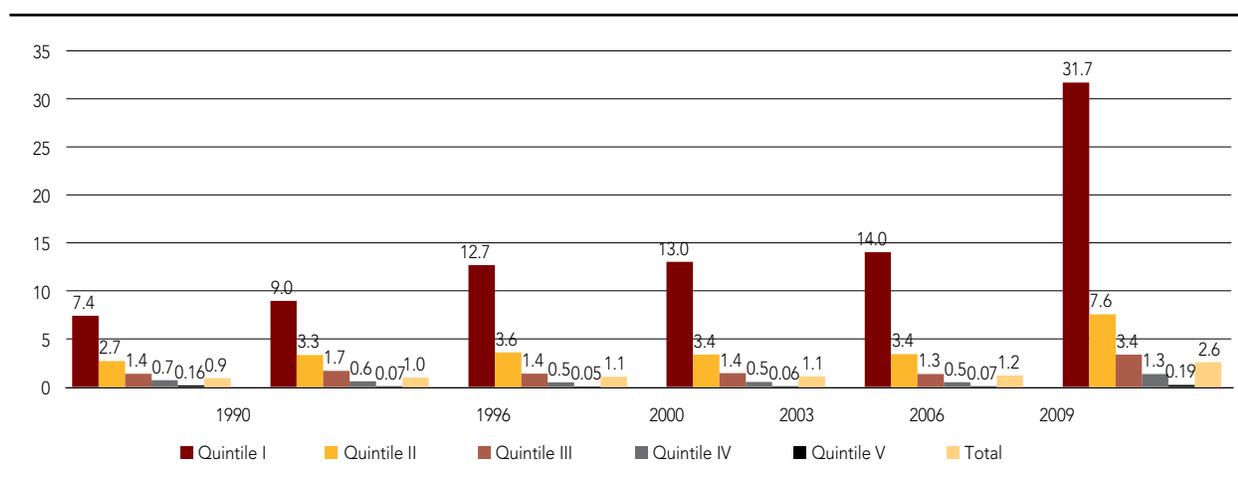
**TABLE 1:** Distribution of Monetary Subsidies by Income\* Quintile, 1987–2009

Income Quintile	1987	1990	1992	1994	1996	1998	2000	2003	2006	2009
I	33.6	33.7	36.6	38.8	36.2	46.2	45.7	46.7	49.4	44.2
II	22.3	23.8	26.3	26.1	27.7	26.5	27.4	25.7	25.1	24.7
III	17.9	18.5	17.7	17.3	20.5	15.9	15.9	15.7	14.3	16.6
IV	14.9	13.8	12.0	12.1	11.5	8.5	8.4	8.8	8.0	10.3
V	11.3	10.2	7.4	5.7	4.1	2.9	2.6	3.1	3.2	4.3
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: MIDEPLAN (Ministry of Planning and Cooperation), Department of Social Information, CASEN surveys from the respective years.

Note: Excludes live-in domestic workers and their families.

\* Per capita.

**FIGURE 5:** Monetary Subsidies as a Percentage of Independent Income by Quintile, 1990–2009

Source: Based on Mideplan Casen Surveys.

instruments that are objective and effective in identifying the most disadvantaged families.

It is interesting to note that over 75 percent of households in the poorest quintile receive some sort of monetary subsidy. This high coverage and concentration of beneficiaries in the poorest segment of the population demonstrates the extremely high effectiveness of these programs in addressing the needs of the most disadvantaged families. Over the years, coverage has been expanded and the selection and benefit-granting mechanisms have been revised. This was done on a basis of objective socioeconomic need criteria, without which these achievements would have been impossible.<sup>19</sup>

Having said that, it should be noted that just over 20 percent of families living in poverty (those that fall

within the lowest 15 percent in the country in terms of income) do not receive any monetary subsidy. This means that, either due to a lack of available capital or because of the benefit-allocation mechanisms, there is still a group of households that does not have access to these subsidies. However, it is important to emphasize how difficult it is for these programs to cover 100 percent of households, if one takes into account the high mobility and changes experienced by families in the lower income groups.

Although often thought otherwise, there is a high mobility of households across income quintiles. This is clear from data from panel surveys, based on the

<sup>19</sup> See the section below on professionalization of social policy.

**TABLE 2: Monetary Subsidies, Number and Value 1987–2009** (In December 2009 pesos)

Year	Non-Contributory Pension		Family Allowances		Special Family Allowances for Non-Contributing Families		Drinking Water Subsidy		Unemployment Subsidy	
	Number of beneficiaries (thousands)	Monthly average (\$)	Number of beneficiaries (thousands)	Monthly average (\$)	Number of beneficiaries (thousands)	Monthly average (\$)	Number of beneficiaries (thousands)	Monthly average (\$)	Number of beneficiaries (thousands)	Monthly average (\$)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1987	318.7	24,525	4,015	3,107	985	3,400	—	—	66.1	21,912
1988	291.0	26,595	3,817	2,581	926	2,952	—	—	51.8	19,140
1989	292.3	26,061	3,777	2,367	886	2,990	—	—	39.2	17,437
1990	311.4	26,476	3,976	2,379	881	3,185	—	—	33.8	14,212
1991	299.3	30,197	4,021	2,444	894	3,359	—	—	30.2	16,804
1992	290.6	30,538	3,732	2,615	840	3,527	315.9	967	23.4	17,385
1993	296.2	30,346	3,354	2,782	863	3,631	351.9	1,532	19.1	17,497
1994	312.3	31,445	3,239	2,844	819	3,685	389.7	1,686	20.6	18,074
1995	318.8	32,441	3,239	2,902	779	3,820	399.2	3,441	21.3	18,573
1996	326.5	34,908	3,244	3,028	766	3,939	442.5	3,740	21.3	19,191
1997	339.6	34,849	2,915	3,443	910	4,111	507.8	4,211	22.6	18,282
1998	345.4	38,036	3,053	3,304	984	4,154	507.8	4,487	27.3	16,641
1999	350.7	46,852	2,901	3,363	933	4,314	507.9	4,652	49.0	16,100
2000	358.8	46,242	2,827	3,543	872	4,983	521.6	4,552	46.2	16,496
2001	365.3	51,267	2,906	3,464	888	4,806	485.3	4,672	51.3	14,973
2002	371.9	50,256	2,773	3,606	934	4,711	547.9	4,406	48.5	13,679
2003	372.7	50,957	2,764	3,632	937	4,677	614.7	5,432	51.2	22,480 <sup>b</sup>
2004	372.8	51,653	2,735	3,681	938	4,826	619.1	6,289	71.6	51,809 <sup>b</sup>
2005	398.4	54,931	2,801	3,556	953	4,782	573.0	6,431	82.4	73,287 <sup>b</sup>
2006	424.3	55,805	2,685	3,660	987	5,237	666.3	4,875	99.4	88,635 <sup>b</sup>
2007	452.9	55,696	2,278	4,205	1,051	5,396	684.5	4,877	108.7	96,236 <sup>b</sup>
2008	502.7 <sup>a</sup>	60,637 <sup>a</sup>	2,123	3,960	1,312	6,470	691.5	5,008	119.1	104,473 <sup>b</sup>
2009	581.3 <sup>a</sup>	74,232 <sup>a</sup>	2,131	3,888	1,726	12,270	—	—	156.6	115,324 <sup>b</sup>

Source: **1987–2000:** (1) and (2), Pension Normalization Institute (INP) Annual Report 2000; (3) and (4), Social Security Supervisory Agency (SUSESOC); (5) and (6), Social Security Supervisory Agency; (7) and (8), Administrative, operational and legal background of the subsidy; (9) and (10), Social Security Supervisory Agency. **2000 onwards:** (1), (2), (3), (4), (5) and (6), Social Security Supervisory Agency Statistical Bulletins, years 2006, 2007, 2008 and 2009; (7) and (8), Drinking Water Subsidy Report 1996–2006 and 2006–2008, Mideplan; (8) and (9), Pensions Supervisory Agency. **2008 and 2009:** (1) and (2), Pensions Supervisory Agency.

<sup>a</sup> PASIS (Non-contributory pension system) includes winter bonuses, holiday bonuses and special bonuses. As of July 2008, the non-contributory pensions benefit was eliminated; Law 20,255 replaced this benefit with Basic Solidarity Pensions (PBS). Between January and June of 2008 the PASIS number is 485,375 and the monthly average in 2009 pesos is \$51,137. Between July and December of 2008, the monthly average PBS number is \$520,016 and the average monthly value in 2009 pesos is \$65,772.

<sup>b</sup> In May 2003 a new unemployment insurance administered by the Pensions Supervisory Agency came into force.

CASEN, held in the years 1996, 2001 and 2006, with a portion of the households surveyed again later. According to these records, only 4.4 percent of households were in a condition of poverty in all three measurements, while 34 percent of the population was poor at some point in the ten-year period under study. These data reveal that there is a much greater degree of social mobility among poor households than is sometimes assumed, while at the same time making it necessary to revise the assumption underlying some social policy proposals that families in poverty permanently remain in this condition.<sup>20</sup>

The introduction of these targeted cash transfers to the poorest families occurred more than 30 years ago. In 1975 non-contributory pensions were established. Although the amount was roughly equivalent to a third of the minimum pension, for the first time 200,000 people bereft of resources and previously outside the pension system received benefits. In 1981, the special family allowances for non-contributing families (SUF) were created. These extended the family allowance benefit to more than

550,000 children of poor families whose parents were outside the system due to a lack of formal employment. Family allowances had been introduced in the 1940s and 1950s for workers employed in the formal sector. After a steady increase in their purchasing power, they—along with pensions—suffered a severe fall starting in 1972 (see an account of these changes in Arellano, 1985).

These targeted transfers set the precedent for the current conditional cash transfers that have become popular in several countries in Latin America since the mid-1990s.<sup>21</sup>

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<sup>20</sup> For a very interesting study of the vulnerable situations faced by households, the ways of dealing with them and the role that subsidies play, see Raczynski, Serrano, and Valle (2002).

<sup>21</sup> A complete account of the evolution of conditional transfers can be seen in Ferreira Francisco and David Robalino 2010 *Social Protection in Latin America Achievements and Limitations*, World Bank.



## EDUCATIONAL POLICY AND A GROWING EMPHASIS ON INVESTMENT IN HUMAN CAPITAL

A second feature of the equitable growth policies was the increasing priority given to education in the allocation of public resources. This was consistent with the importance acquired by investment in human capital in the country's development. While the government funding channeled to education declined in real terms by 11 percent between 1985 and 1990, thanks to the change of priorities, in the next two decades it increased steadily.<sup>22</sup> During most of this period funding grew more than 10 percent in real terms per year, so that in 2009 it was more than five times greater the level of 1990.

During the 1990s the expansion rate was greater, first due to the need to replenish the seriously deteriorated sector and then thanks to the emphasis that President Eduardo Frei Ruiz-Tagle's administration placed on this goal from the very beginning of his term, increasing the priority on investment in human capital. Frei's presidency promoted an educational reform program, which included the extension of the school day among its most significant undertakings. This led to an increase of 25 percent in the average school day, which required more hours from teachers and staff in general, as well as the expansion of school infrastructure that in most cases was being used in two shifts during the shorter day (see Arellano 2000 and Cox 2003 for an account of education reform during this period).<sup>23</sup> In the first half of the 2000s the momentum of the expansion of resources declined. It

then gained strength again during President Bachelet's presidency, due to the expansion of preschool education, the creation of a preferential per student subsidy,<sup>24</sup> and increased funding for higher education.

It is interesting to examine the ways in which the principles that guided social policy materialize in educational policy. In the allocation of funds for education, one can see the priority given to equity. Within education, priority was mainly directed at preschool, primary school and secondary school, through resources aimed at increasing coverage as well as improving quality. In higher education, however, most resources were associated with increasing coverage.

<sup>22</sup> Education spending in real terms declined every year between 1985 and 1989, and the budget approved by the military government in 1990 envisaged a new reduction, which was reversed by Aylwin's government. Between the early and late 1980s, the subsidy per student fell by 30 percent in real terms, and the number of textbooks distributed in basic education decreased by over 30 percent in the same period. See information in Cox et al (1997).

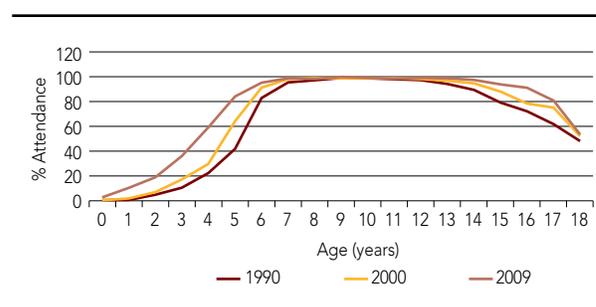
<sup>23</sup> It is interesting to note that the decision to implement the full school day was made with the explicit purpose of improving the quality of education. International studies demonstrating the importance of time in school for learning were taken into account in this decision.

<sup>24</sup> A general account of human capital policies in President Michelle Bachelet's administration can be seen in Velasco (2009), *State of the Public Budget* Speech.

Table 3 shows the increase in coverage in preschool and secondary school, according to the students' household income (evolution of primary education coverage is not shown in the chart because it was already universalized in the 1980s). It is noteworthy that preschool access for children from the poorest 40 percent of households rose by more than 20 percent, on par with the increase seen by the rest of the households.

Figure 6 presents attendance in daycare or school by age for the poorest quintile. There is a significant increase in coverage for children 3 to 5 years old. At 6 years of age attendance is almost universal, and at 4 years of age it exceeds 60 percent for children in the lowest income quintile. This is of great importance because it ends a long-standing problem in less developed countries: late entry to school resulting in dropouts and grade repetitions. Moreover, entry into the education system at an early age helps support the development of small children from vulnerable households at a key stage in their growth. This increase in coverage has been helped by the increased enrollment in programs run directly by the

**FIGURE 6:** First Income Quintile and Its Evolving School Attendance (Percent), by Age, 1990, 2000 and 2009



Source: Calculations based on CASEN.

Government, through the JUNJI (National Daycare Agency) and the Integra Foundation, and the expansion of the kindergarten and pre-kindergarten enrollment in government subsidized schools.<sup>25</sup> The

<sup>25</sup> The subsidy per student is the monthly payment made by the government to municipal or subsidized private schools for each student attending classes in the respective month.

**TABLE 3:** Preschool and Secondary School Coverage by Independent Income Quintile,\* 1990–2009 (Percentage)

Preschool Education Coverage									
Quintiles	1990	1992	1994	1996	1998	2000	2003	2006	2009
I	16.9	19.8	21.1	22.3	23.6	25.5	30.5	38.0	37.8
II	17.5	22.1	22.7	26.8	29.1	29.6	33.7	39.2	41.0
III	20.4	23.9	27.2	30.0	30.5	32.7	35.3	44.3	42.6
IV	27.2	27.9	33.4	36.8	34.8	37.6	35.9	46.4	44.1
V	32.4	44.6	46.0	48.4	44.8	50.2	49.0	52.0	57.0
Total	20.9	24.8	26.9	29.8	30.3	32.4	35.1	42.4	42.6
Secondary Education Coverage									
Quintiles	1990	1992	1994	1996	1998	2000	2003	2006	2009
I	73.3	73.6	73.9	75.3	77.4	82.3	87.7	87.7	89.9
II	76.3	77.9	79.8	81.0	84.1	88.0	92.0	90.9	92.6
III	80.5	83.0	86.6	89.3	88.4	92.4	94.2	93.4	94.2
IV	87.2	88.8	90.9	95.3	94.5	96.1	96.9	97.3	95.1
V	94.3	96.7	96.7	97.2	97.7	98.5	98.8	97.6	95.9
Total	80.5	82.4	84.2	85.9	86.9	90.0	92.8	92.4	93.0

Source: Prepared by MIDEPLAN, Social Division. Based on CASEN surveys, respective years.

\* Excludes live-in domestic workers and their families. Corresponds to household income from the factor market, i.e. the labor and capital markets.

per student subsidy was introduced to the pre-kindergarten level in 2001 with a limit on the students who could receive it, a limit that increased every year until it was universalized in 2008 for all subsidized education.

During President Bachelet's term, special priority was given to preschool programs, with resources more than doubling between 2005 and 2009.<sup>26</sup> This was part of a wider comprehensive early childhood protection program called *Chile Crece Contigo*. This is a management model that follows children's development from birth until they enter pre-kindergarten. It offers a number of support services to children from families in vulnerable contexts.

At the secondary school level, participation of students in first-quintile households grew by more than 15 percent. Coverage has exceeded 90 percent and has been approaching that of the higher-income youth. This notable expansion in coverage in secondary education was concentrated in technical-professional education. This is in response to demand from parents seeking an education that can best prepare their children for a job. Despite attempts to update technical-professional education, and despite trials with more effective methods, such as dual education (in which the student does part of his or her learning at work), there is still much to be done to improve the quality of this form of education, which largely serves low-income students.<sup>27</sup>

After decades of efforts to provide education to the entire population, increasing coverage has been disappearing as a concern in K-12 levels. In the coming years, the problem will be the decline in the school-age population. In effect, the population aged 6–13 peaked in 2000, the 14–17 year-old population has been declining since at least 2005, and even the population of young adults of the age to attend higher education peaked in 2009. This reduction in school-age population poses reorganization and consolidation challenges for primary and secondary schools to be addressed in the coming years.

Table 4 shows the significant growth in resources per student in state-subsidized K-12 education, which quadrupled in real terms.

The increase in resources per student in the school system went almost entirely to raising the subsidy per student.<sup>28</sup> This enabled an increase in teacher

salaries, which had been severely reduced. The deterioration of teacher salaries resulting from the reduction of resources allocated to education in the late 1980s was so serious that it resulted in a strong lack of interest in pursuing an education degree, risking the supply of skilled education professionals. The subsidy per student fell by 30 percent during the 1980s.<sup>29</sup> In contrast, since 1990 it has steadily increased every year. The average subsidy was \$13,500 pesos per student per month in 1990 in 2009 currency; in 2000, it had risen to \$33,200 pesos, and in 2009, to \$65,400 pesos. These are average values, with differences by educational level, school hours, rurality and whether or not they receive the preferential subsidy (subvención escolar preferencial—SEP).

With the per student subsidy increase, teachers' real salaries more than tripled for the municipal sector and grew even more for those in subsidized private schools (See Table 4).<sup>30</sup>

In addition to increasing salaries, the teacher compensation policy, via the Teacher Statute for the municipal sector, was aimed at creating earnings for seniority and training. In the following years, this was focused mainly on increasing the minimum salaries for those entering the teaching profession in order to encourage younger teachers. At the same time, major innovations were introduced, such the stimulus for teachers working in areas considered

<sup>26</sup> A complete detail of policies and initiatives for early childhood education can be seen in Arenas (2009) Informe de finanzas públicas proyecto de ley de presupuestos 2010, *Financiamiento e institucionalidad de la educación parvularia en Chile: avances 2006–2010 y desafíos*.

<sup>27</sup> An interesting study that favorably portrays the incorporation of students in technical-professional education into the labor market was conducted by the Department of Economics at the University of Chile (1999).

<sup>28</sup> The subsidy per student is the monthly payment made by the government to municipal or subsidized private schools for each student who attended classes in the period.

<sup>29</sup> The subsidy per student fell by 30 percent in real terms between the 1980/82 and 1989/90 averages. See Cox et al (1997).

<sup>30</sup> There is no information on income averages in this particular sector, but the minimum salary rose by over 500 percent in the period in question.

**TABLE 4:** Central Government Expenditure per Student in the School System (average, K-12) and Teacher Salaries, 1987–2009 (2009 pesos)

Year	Average Annual Expenditure per Student	Enrollment K-12 (thousands)	Annual Expenditure on Subsidies per Student	Monthly Salary for the Municipal Sector		Minimum Monthly Salary for the Subsidized Private Sector (Minimum)
				Average	Minimum	
	(1)	(2)	(3)	(4)	(5)	(6)
1987	183,849	2,767	176,505			
1988	187,043	2,779	171,119			
1989	184,256	2,758	178,219			
1990	180,425	2,738	178,693	343,922	189,136	97,276
1991	193,846	2,709	181,371	361,407	225,635	209,724
1992	214,195	2,742	195,770	422,131	249,761	240,399
1993	239,040	2,755	214,637	475,068	264,457	245,506
1994	267,042	2,786	240,175	541,257	306,937	274,523
1995	302,802	2,862	282,301	595,535	338,697	331,676
1996	338,291	2,962	306,875	639,501	372,338	370,729
1997	372,227	2,995	343,049	698,711	408,881	406,775
1998	409,559	3,029	363,109	734,758	445,603	445,278
1999	441,420	3,123	376,942	771,538	475,650	475,650
2000	475,298	3,196	408,066	805,419	503,590	503,590
2001	510,946	3,246	435,685	826,905	510,135	510,135
2002	544,082	3,295	457,689	865,248	511,443	511,443
2003	546,763	3,341	463,989	868,666	511,311	511,311
2004	603,261	3,357	501,428	884,773	512,238	512,238
2005	591,507	3,400	511,551	893,243	508,852	508,852
2006	624,793	3,398	530,863	907,728	510,892	510,892
2007	684,477	3,363	573,312	916,848	514,851	514,851
2008	806,067	3,322	673,931	1,008,819	510,512	510,512
2009	932,436	3,236	764,804	—	554,928	554,928

Sources: (1) Spending on Education: Expenditures in Government Finance Statistics Report 1987–2003, 1997–2006 and 2000–2009.

(2) Enrollment K-12 Education Statistics Annual Reports. Types of establishments: Municipal, Subsidized Private and Corporations. Levels: Preschool, Primary and Secondary (including special education). Does not include Paid Private.

(3) 1989–2002 Government Finance Statistics, Functional Classification of Expenditure, Expenditure on Subsidies. 2003–2009 Informes de Ejecución Trimestral, DIPRES.

(4), (5) and (6) Department of Research and Development, Planning and Budget Division, Ministry of Education. Published in Anuario Estadístico 2008. Teacher salaries are for a 44-hour workweek, monthly average.

difficult due to their rurality or marginality. Another innovation was the teacher performance incentive: every two years since 1996 teaching teams at the top 25 percent of schools in terms of educational progress are selected to receive a quarterly performance bonus (*SNED*). The amount of this bonus as a percentage of salaries has been rising steadily, even exceeding an annual salary. Similarly, in 2006 it expanded to the top 35 percent of schools.<sup>31</sup> With

<sup>31</sup> In 2008–9 more than 57,000 teachers received an average bonus of \$630,000 pesos under this program. An analysis of the topic can be found in Alejandra Mizala and Pilar Romaguera (2002) “Evaluación del desempeño e incentivos en la educación chilena,” Center for Applied Economics, Department of Industrial Engineering, University of Chile. Updated information regarding its application is found at [www.mineduc.cl](http://www.mineduc.cl).

the introduction of the teacher *evaluation system* in 2004, *performance bonuses* associated with outcomes were put in place.

Raising the subsidy per student was not only intended to increase teacher salaries; it was also raised to fund a longer school day. The full school day (*jornada escolar completa*—JEC) represents an increase of almost 25 percent in hours of study. It meant an increase of 35 percent in the average subsidy per student, plus the expansion and construction of educational facilities to accommodate students for the full day. This reform was primarily intended to raise the quality of education, improving student learning by way of increased study time. The available international evidence predicted a clear positive effect from this initiative.<sup>32</sup> The only empirical study that sought to measure its impact in Chile was done by Bellei (2009) and concluded that for high school students in schools with the JEC, math and language outcomes improved as compared to students in schools that had not yet implemented the JEC.

Table 5 shows the implementation process of the full school day starting in 1997. It was a slow process, due to the necessary expansion of facilities and reorganization of school activities. It turned out to be slower and more difficult than was originally expected, particularly in the oldest and most traditional establishments in consolidated urban areas where it was difficult to obtain land for expansion. However, by 2000, more than 560,000 full-time students had been incorporated into the JEC. In 2010, over 2 million students took part in the full school day, representing more than two thirds of eligible students. A significant percentage of those who had not been incorporated were special education students.

Since the JEC represents an ongoing, significant national expense, the Government proposed and passed the maintenance of the VAT rate, which would otherwise have gone down,<sup>33</sup> in keeping with the fiscal discipline that characterized social policy in the period.

In 2008, the preferential per student subsidy was introduced (SEP). This was an initiative that was studied and advocated for several years. It became a reality in the Government of President Bachelet

**TABLE 5:** Transition to the Full School Day

Year	Levels of Education Incorporated into the JEC	Cumulative Enrollment in the JEC (thousands)
1997	15,298	232
1998	3,950	345
1999	2,169	423
2000	3,594	561
2001	4,375	757
2002	4,602	949
2003	4,655	1,146
2004	3,742	1,304
2005	4,547	1,528
2006	2,993	1,640
2007	3,552	1,763
2008	3,276	1,866
2009	3,280	1,968
2010	2,753	2,042
Without JEC		967

Source: Calculated based on MINEDUC data records.

Note: Enrollment in 2010 for establishments that transitioned to the JEC in the corresponding years. The schools do not transition to the JEC in full each year, but rather do so by grade levels. Only schools that by law have the right to a JEC subsidy are included.

and provided special support to the most vulnerable students.<sup>34</sup> Educational establishments serving students in this situation receive an additional subsidy per priority student of more than 50 percent of the general subsidy in the first grades of primary school. This is supplemented with an additional

<sup>32</sup> A secondary benefit of the JEC was increased participation of women in the labor force. Dante Contreras, Paulina Sepúlveda C and Soledad Cabrera, Department of Economics and Micro Data Center, University of Chile 2010, in *The effects of lengthening the school day on female labor supply: Evidence from a quasi-experiment in Chile* estimate this effect by separating it from other variables that contributed the increased participation of women in this period. A broad evaluation of the JEC was commissioned by the Ministry of Education in 2005.

<sup>33</sup> In the 1990 tax reform, the government won support for tax increases for four years only, after which they would go down. This increase was renewed in 1993, but the VAT had to be lowered in 1997. Along with the JEC's approval, it was also approved to maintain the VAT.

<sup>34</sup> See a discussion of this topic in, for example, Arellano (2006) and Larrañaga and Peirano (2006).

contribution according to the degree of concentration of priority students in the school. The creation of this preferential subsidy constitutes a major step towards strengthening equity in the school system, directing more state resources towards schools attended by students from vulnerable families. This new subsidy is in the first years of implementation and will generate major changes in terms of both equity and educational quality.

In the years before the creation of the preferential subsidy, programs had been developed for the most vulnerable schools and/or schools with the lowest academic results. The P900 program, aimed at subsidized schools in the lowest tenth percentile in terms of SIMCE<sup>35</sup> test results, was the first in this vein. A special program to support rural schools was also developed. In the case of secondary education, the Montegrande school program sought to raise the quality of education of vulnerable students in secondary school. As a general rule, all new programs began by first attending to the most vulnerable students: the educational online network Enlaces, the full school day, school improvement programs, etc.

At the same time, during these two decades, resources were increasingly spent on support programs for low-income students, such as more school meals, textbooks, teaching materials and support for the most disadvantaged schools (see Arellano 2000 and the studies in Cox 2003 for a detailed account).

One aspect that is rarely emphasized and is very important in terms of equity is the sharp increase in public resources devoted to education of children with special needs. The Ministry of Education expenditure item with the most growth is special education. It has risen by more than 20 times in the last two decades, its relative importance increasing from less than 1 percent to over 4 percent of total expenditure. This is the result of an increase in coverage for children with disabilities and/or special educational needs and the sharp increase in the subsidy per student for the schools that serve them.

As a way to increase education funding with contributions from parents, in 1994 the **cost sharing** system was modified. This system dictates that schools can charge parents a monthly fee. As the

charge increases, the subsidy provided by the Government decreases. Up until 1994, the decrease in the subsidy resulting from charging parents was very costly for schools. After this date, all parent payments of less than \$9,000 pesos (2010 currency) went to benefit the school.<sup>36</sup> This change resulted in a significant increase in the number of schools covered by the cost sharing system. During the next five years, the number of students who were enrolled in private schools and whose parents shared costs doubled, accounting for 68 percent of these schools' enrollment in 1999. This increased to 72 percent in 2010 (equivalent to 41 percent of enrollment in all subsidized schools).

To prevent cost sharing from generating problems for families who could not pay the amount charged by the school, in 1997 a mandatory scholarship system was established in each school for the equivalent of at least 7 percent of total revenue from parental contributions. In 2006 it became mandatory for at least 15 percent of students in subsidized schools to be from vulnerable economic situations, and it was prohibited to charge these students for cost sharing. Furthermore, the preferential subsidy system (SEP), introduced in 2008, released the parents of children receiving the benefit from any payments.

This cost sharing system has helped provide resources to the school system. The average payment per student has been just over 20 percent of the contribution made by the Government.

In recent years there has been concern regarding the degree of segregation in the school system and the influence that this system of financing could have on the matter. Empirical information is insufficient. Apart from specific complaints, there are no studies that follow students when they change

<sup>35</sup> SIMCE is the national student learning assessment system.

<sup>36</sup> Charges of less than 0.5 educational subsidy units (USE) (the USE value in 2011 was \$18,190; in 2010 it was \$17,457) do not mean a decrease in the subsidy. Charges between 0.5–1 USE mean a subsidy reduction of 10 percent, charges between 1–2 USE mean a reduction of 20 percent and charges between 2–4 USE mean a reduction of 35 percent. If charges are more than 4 USE the school is not entitled to a subsidy.

schools, or information on why parents choose schools.<sup>37</sup> No doubt segregation is a major concern that deserves to be addressed and examined in detail, given the value of school integration both for education and for building social capital.

With respect to teachers and their key role in education, much of the effort of the period was aimed at improving earnings. In the early 1990s this was essential, because the deterioration was creating a growing disinterest in studying education. This situation was corrected little by little and in the second half of the 2000s there was an explosive increase in the number of education students. More remarkable still, entrance scores have improved, which was the goal of a 1998 scholarship encouraging students with good academic performance to obtain education degrees. This was part of an effort to improve the initial teacher training programs. Also worth noting are the in-service teacher training initiatives, and the introduction and ongoing improvement of assessment tools and individual and collective performance recognition tools. Training included an innovative overseas internship program that between 1996 and 2005 gave more than 6,000 classroom teachers (from preschool, primary, secondary, adult and special education) and administrators scholarships to study 6 to 8 weeks in foreign universities, becoming familiar with the teaching experiences of twenty countries from all the continents.<sup>38</sup>

As seen, policies to raise the quality of education were aimed at supporting schools, teaching staff, and students with an emphasis on equity. Also, incentives and recognitions were promoted for the best teachers, for establishments with marked improvements in learning, and so on. Rather than establishing new quality requirements, numerous supports and contributions were implemented (amount of time in school, teaching resources, teacher training and more) to gain a better quality of education.

Only in recent years have new requirements aimed at raising quality been introduced. The new quality assurance system, which underwent legislative debate in 2007 and was only recently signed into law in 2011, is the main initiative in this area. Until the enactment of these new laws, the Ministry of Education had no authority to demand educational outcomes and to question the continuation

of a school if it did not achieve certain results. All existing requirements are either purely administrative, or deal with the educational process (conditions of the facilities, amount and characteristics of staff, maximum class size, plans and programs, etc.), but not their educational results.<sup>39</sup>

As a result of the aforementioned efforts, access to and attendance in the educational system of children from the poorest households has decidedly improved. School conditions in terms of infrastructure, equipment, materials, and learning opportunities have also markedly improved.

There is undeniable progress in the coverage and equity of the system, but can the same be said about the quality of education? The available data deal with measurements of student learning in the school system, via both SIMCE tests and international tests. A thorough analysis of the issue far exceeds the scope of this text, but it is necessary to cover it briefly.

Chile started taking part in international learning assessment tests in 1996 with the TIMSS test, and since 2000 the OECD has been administering the PISA test to 15-year-old students in 65 countries. In 2009, the fourth time the test was given in Chile, the average scores of Chilean students rose systematically in language and mathematics. The same trend has been observed in all available measurements.<sup>40</sup> Not only have scores risen, but Chile was also one of the countries with the greatest improvement on the test.

The improvement seen in the average is due to the fact that students from low-income families and those who had the lowest outcomes improved the most. The test has a level 1 category in which performance is considered insufficient, and

<sup>37</sup> Those who have studied segregation compare indices aggregated according to whether or not the school participates in cost sharing, and they believe that this financing policy would indeed generate segregation. There are no results that can define the extent to which segregation originates in the financing or comes from factors such as the spatial segregation of the population.

<sup>38</sup> See an account of this in Mireya Arellano and Ana María Cerda (2006).

<sup>39</sup> A description of the concepts behind these reforms can be seen in Darville and Rodríguez (2007).

<sup>40</sup> Chile did not participate in the second measurement in 2003.

17 percent of Chilean students managed to rise out of this category. This is notable because it occurred at the same time as the aforementioned increase in secondary education coverage. In other words, many of these students come from families whose children, until very recently, were dropping out of school before the age of 15. Today they are going to school and most attain a sufficient level of learning. This sustained improvement in learning revealed by the PISA confirms what SIMCE tests have reflected in recent years, and is what has led the recent *Informe McKinsey* to highlight Chile as one of the countries with the greatest improvements to its educational system.

Despite this, and despite the fact that Chile has the best educational results in Latin America, these results are well below the OECD country average and are much lower than those achieved by students in places like Shanghai, Korea, Singapore and Finland. There is a long way to go to achieve the learning levels that will put Chilean students in a comparable situation. This is especially true for students from more precarious economic situations, but it is equally valid for the high-income elite attending private schools, who despite having as many or more resources obtain results below those of the students in the aforementioned cases.

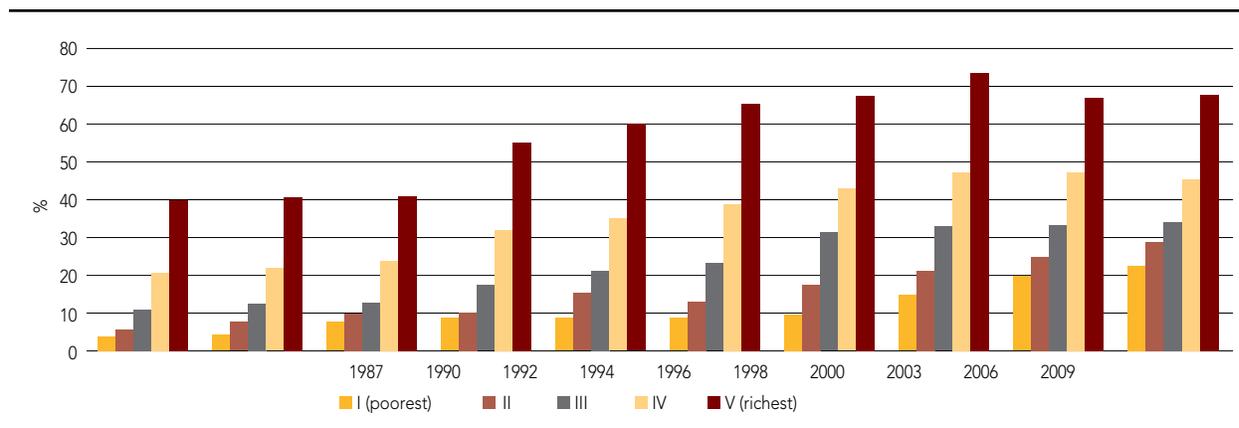
It is not the purpose of this study to thoroughly examine the priority actions required to address system deficiencies. It is enough to note that there are a number of recently approved and

soon-to-be-implemented measures that address them, such as improvements to the quality assurance system. However, one critical aspect is worth emphasizing: teacher recruitment and initial training. Here progress is still modest and there have even been some setbacks (see Panel de Expertos para una Educación de Calidad, [2010], Cox et al, 2010, OECD, 2010). These situations must be urgently corrected. Persevering with and intensifying the approach taken during these twenty years, and making the necessary adjustments, will enable the quality of education to continue improving, and ideally, to accelerate.

**Higher Education:** In higher education, there was a strong increase in coverage during the period under study, particularly in the 2000s. As shown in Figure 7, this was widespread. In 1990 there were 245,000 undergraduate students in higher education. In 2000 enrollment had almost doubled, reaching 436,000. It doubled again by 2009 to 835,000 students. The increase in enrollment was higher among women—who now outnumber men—and in institutions located outside the metropolitan region.

With this rapid expansion, higher education was made universally accessible and stopped being only for the elite. The analysis of the last cohort for which data are available reveals that 57 percent of students who graduated from secondary school in 2005 enrolled in higher education. In 2006, one year after graduation, 32 percent enrolled. Another

**FIGURE 7:** Higher Education Coverage According to Income Quintiles, 1987–2009



Source: Based on CASEN surveys for the respective years.

25 percent enrolled in one of the next three years. Factoring in dropouts between 2006 and 2009, ultimately 42 percent of students who graduated in 2005 stayed enrolled.<sup>41</sup> Dropouts are certainly a serious problem, as discussed below.

The vast majority of these young people are the first generation in their families to have access to higher education. This is apparent from a national survey of 2005 high school graduates showing that 64 percent of these students had parents who at most completed high school.<sup>42</sup>

Based on the 2009 CASEN survey, it was estimated that in the poorest quintile, heads of households with students in higher education had an average of eight years of schooling, and in the next quintile, they had nine years of schooling. This reveals the huge increase in access to education occurring between one generation and the next.

To fund this increased higher education coverage, families, young people, and the state have all made a growing effort. See Table 6.

The increase in public resources has mostly gone towards students, both through tuition scholarships and loans. Tuition scholarships did not exist before 1990: they were created in 1991 and multiplied by 10 between 1992 and 2010. As a result, 54 percent of students in the two lowest income quintiles are receiving this benefit (Rodríguez *et al* 2010). See the growth in student aid in Table 7.

The Government also increased institutional funding for higher education, and has been establishing competitive grants and performance agreements since 1999 with the program for improvement in the quality and equity of higher education (MECESUP). See Table 6.

An ongoing effort was made to expand and improve loan systems to finance tuition. The initiatives have been aimed at increasing state contributions and modifying the loan system both to make it more affordable and equitable and to add financial system resources to complement government financing. In 1995, the university loan solidarity funds replaced the previous university loan system.

To stimulate the development of a range of long-term financing options with financial

institutions, in 1995, a CORFO refinancing line was created for long-term loans aimed at graduate school programs. This system was extended to undergraduate studies in 1997. Student loans with and without CORFO refinancing have grown, reaching more than 360,000 undergraduates as of late 2010. In 2010, 48,000 loans were issued, equivalent to two-thirds of the increase in enrollment for that year.<sup>43</sup>

In 2006, a new state-guaranteed loan system for higher education was added to the government-funded loan system. It has experienced much growth, expanding to private universities, professional institutes, and technical training centers.<sup>44</sup> These entities, which before this system had virtually no access to government-backed funds, have been its heaviest users, and this has contributed to the sharp rise in their enrollment in recent years.<sup>45</sup> The system is administered by the Ingresita Committee.

Despite the increase in government contributions to higher education, the contribution per student was almost the same in 2009 as in 1990 due to robust growth in enrollment, considering only the universities that make up the Consejo de Rectores, which receive the greatest share of government contributions. If all students in higher education are included, the Government's contribution per student

<sup>41</sup> This reality is very different depending on student background. Graduates of paid private schools tend to enter higher education immediately after graduating from high school. Francisco Meneses, Rodrigo Rolando, Manuel Valenzuela and María Antonieta Vega (2010) *Ingreso a la Educación Superior: La Experiencia de la Cohorte de Egreso 2005*.

<sup>42</sup> Francisco Meneses, Rodrigo Rolando, Manuel Valenzuela and María Antonieta Vega (2010) *Ingreso a la Educación Superior: La Experiencia de la Cohorte de Egreso 2005*.

<sup>43</sup> For more information see the *Banks and Financial Institution Supervisor surveys from 2004 to 2010*.

<sup>44</sup> From its launch in 2006 through 2010, more than 170,000 students obtained a state-guaranteed loan for higher education.

<sup>45</sup> Strictly speaking, the financing for these loans is private, from the financial system; the state is the final guarantor. This is why it is a contingent liability for the state and does not appear in the fiscal budget.

**TABLE 6:** Central Government Expenditure on Higher Education 1987–2009, in Thousands of 2009 Pesos

Year	Average Annual Expenditure per Student in Universities of the Consejo de Rectores <sup>1</sup>	Enrollment in Universities of the Consejo de Rectores (thousands)	Average Annual Expenditure per Student in all Higher Education Institutions	Total Enrollment in All Higher Education Institutions (thousands)
	(1)	(2)	(3)	(4)
1987	1,686	119	897	225
1988	1,348	116	672	233
1989	1,683	106	772	230
1990	1,365	112	614	249
1991	1,614	118	761	250
1992	1,599	128	714	286
1993	1,491	144	681	316
1994	1,404	152	651	327
1995	1,400	162	657	345
1996	1,411	175	672	367
1997	1,305	184	631	381
1998	1,322	200	650	407
1999	1,356	207	660	425
2000	1,169	215	556	452
2001	1,142	227	537	483
2002	1,120	244	523	522
2003	1,083	247	471	567
2004	1,150	247	485	585
2005	1,146	253	449	646
2006	1,183	262	469	661
2007	1,132	286	424	763
2008	1,192	295	437	805
2009	1,345	303	465	876

Sources: Calculated based on Expenditures in the Government Finance Statistics Report 1987–2003, 1997–2006 and 2000–2009 and the Higher Education Information System (Sistema de Información de la Educación Superior—SIES).

<sup>1</sup> Universities in existence before 1981.

is lower than in the early 1990s. See Table 6, columns 1 and 3. These figures do not include provisions for student loan guarantees that the Government has assumed.

It follows from the above that an important part of the financing required for the expansion of higher education has come directly from families or from the future payment commitment of students who have gone into debt.

It is important to evaluate the limitations on the contributions to funding higher education that families and future professionals are able to make. As

coverage increases, access of low-income youth has been growing and will continue to grow. For them and their families the cost of financing higher education represents a very significant proportion of their income, effectively creating a limit on household financial contribution. An estimate by Rodríguez et al (2010) suggests that spending on higher education in the lower income quintiles is between 18 to 20 percent of the family budget. This shows that the limits to the financial effort that families are able to make to fund their children's higher education have been exceeded.

**TABLE 7:** Higher Education Student Aid, in Million of 2009 Pesos

	Loans		Tuition Scholarships	
	(1)		(2)	
	Beneficiaries (thousands)	Amount	Beneficiaries (thousands)	Amount
1989	74	62	0	—
1990	72	302	0	—
1991	71	257	9	43
1992	73	241	15	75
1993	70	243	21	104
1994	71	203	30	140
1995	73	226	32	184
1996	79	261	32	187
1997	82	293	33	199
1998	88	373	37	239
1999	95	423	42	275
2000	110	487	45	302
2001	110	511	54	333
2002	113	555	60	362
2003	117	582	61	366
2004	119	587	63	394
2005	123	634	67	433
2006	140	1.035	73	539
2007	187	1.457	88	664
2008	211	1.971	120	925
2009	260	2.848	150	1.224

Source: MINEDUC.

Note:

(1) Includes university loan and loan with state guarantee.

(2) Includes: Bicentennial Scholarship (Ex-Ministry of Education), Repair Programs, Juan Gómez Millas Scholarship, Education Scholarship, Scholarship for children of Professionals in Education, New Millennium Scholarship, Academic Excellence Scholarship, Indigenous Peoples Scholarships, First Lady Scholarship and President of the Republic Scholarship.

From a governmental point of view, prioritizing the allocation of resources to preschool, primary, and secondary education as compared to higher education had a clear progressive effect. Increased coverage in the preschool and secondary levels primarily affected the low-income deciles. (See Tables 4 and 6 and Figure 7.) Even so, the Government continues to invest a higher amount per student in higher education than per student in K-12, although

these differences have declined markedly.<sup>46</sup> If the Government had fully funded higher education through a traditional free-of-charge policy, this huge

<sup>46</sup> This difference is higher in many developing countries. In Brazil, for example, it is about 10 times greater. In OECD countries, in contrast, what the state spends per student in higher education is about 2.5 times greater than for K-12 students.

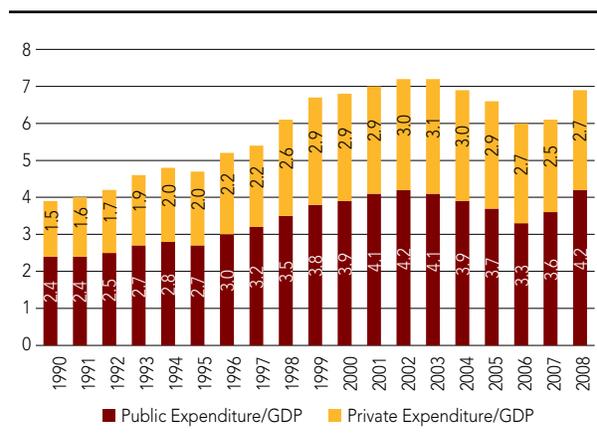
expansion of coverage would simply not have been possible, or would have occurred at the expense of the increased resources for students in preschool, primary, and secondary education.

With all the positive effects of increased coverage in higher education, there are also problems that must be urgently addressed. Shortfalls in the efficiency, quality, and governance of the Chilean higher education system are alarming. Dropout and repetition rates are high. For this reason, time spent to graduate is on average three semesters longer than the scheduled amount, 14 semesters versus 10.8 for the cohort that graduated in 2007. Accreditation, certification, and quality assurance are very weak and the system does not have even a minimum amount of governance.<sup>47</sup>

Students, their families, the state, and the educational institutions themselves are making a huge effort to meet the demand for higher education, and so it is essential to address these challenges to prevent future frustration and misuse of resources. This is particularly true for the vast majority of young people who are the first generation in higher education.

**Total investment in education:** If one looks at the educational system as a whole, there has been robust growth in investment. See Figure 8.

**FIGURE 8:** Total Expenditure on Education as a Percentage of GDP, 1990–2008



Source: Ministry of Education, Research Department, 2003–2008.

Increased resources from families for their children's education has been just as important as the increased resources from the state. Private funds grew even faster than public funds in the 1990s. This was a result of increased coverage in higher education and the K-12 cost-sharing system.

**Private Expenditure:** estimation from the Mineduc Research Department, based on information from the Central Bank of Chile, Department of National Accounts.

Higher education has been an educational investment area with major growth. It is the most expensive level of education per student and the increase in coverage has taken place very quickly. As discussed above, direct government contributions as well as loan systems were increased in order to finance this area.

The amount of educational investment in Chile has grown to exceed that recorded for OECD countries. It is higher than the average of the member countries, with only three having a higher amount of investment in education relative to GDP than Chile. The difference is in the contributions made by the state and families, the latter being significantly higher in Chile.<sup>48</sup>

In short, the data indicate that the allocation of resources to the education sector by the state and by families has not only been very significant, but has also been growing. Public resources were assigned with a clear progressive approach, favoring mainly children from low-income households. This resulted in increased coverage, lower repetition and dropout rates, and more classroom hours. At the same time, teacher income rose sharply, which reversed the dropouts from and disinterest in the teaching profession of the 1980s. Lastly, measurements of student learning consistently show improvement in terms of quality.

<sup>47</sup> See Brunner, 2009, and OECD, World Bank Higher Education in Chile (2009).

<sup>48</sup> See OECD Education at a glance.

## HOUSING AND WATER AND SANITATION INFRASTRUCTURE

In housing policy, policy choices similar to those of other social policies have been made. There have been more state resources, better targeting towards the poor, and a mobilization of private resources to complement public efforts, thus multiplying their impact. This enabled a greater rate of housing construction, concentrating government action where it is most needed.

The Government increased its investment in housing and urban planning from an annual average of \$280 billion pesos between 1987 and 1990, to \$580 billion pesos between 1996 and 2001, and to \$1.3 trillion pesos in 2009, in 2009 currency. Lump sum subsidies for home purchases were allocated through a continual review and better targeting of the housing subsidy programs.

In this case, private resources to supplement the public effort were leveraged through three mechanisms: the financial system, which provides complementary mortgage loans; the progressive replacement of the Government's direct contracting of housing (the SERVIU) with lump sum subsidies for home purchases, which are used to purchase privately financed and constructed homes; and the transfer to the water and sanitation companies of investment in drinking water and sewage networks required for new housing.

Table 8 shows that the number of completed houses and annually paid lump sum subsidies rose from 62,000 to 76,000 between the late 1980s and late 1990s, and to 162,000 in 2009. Lump sum subsidies for home purchase went from comprising 50

percent of the housing program at the beginning of the period to nearly 100 percent at the end. This subsidy mechanism not only enables greater progressivity and leveraging of private resources, but also is a more transparent and easier way of targeting the most needy households.

A study by the Banks Supervisory Agency<sup>49</sup> reveals that in 2007, two-thirds of housing subsidy beneficiaries had received bank financing. On average, bank debt at the time represented 36 percent of home values. Defaults did not exceed 3 percent of the portfolio (although one-fifth of debtors had been refinanced).

It should be added that, in addition to the aforementioned subsidies, a growing number of repair and improvement subsidies have been issued. These reached nearly 80,000 dwellings in 2009. The average value of these subsidies is one-fifth of the traditional subsidy for a newly constructed home.

It should also be noted that the lump sum value of the subsidy issued per household increased steadily during the period in question. In the early 1990s it amounted to 145 UF (unidad de fomento)<sup>50</sup> per household, in the late 1990s it was 170 UF, and

<sup>49</sup> Banks Supervisory Agency "Financiamiento Bancario De Viviendas Asociadas A Programas De Subsidio Habitacional" July 2008.

<sup>50</sup> UF is a local accounting unit that is nearly always used for long term contracts, because it is adjusted daily to reflect price inflation. One UF was equivalent to US\$45 dollars in 2010.

**TABLE 8: Paid Subsidies and Completed Homes 1987–2009**

Year	Paid Subsidies and Completed Homes		
	Total Completed Homes	Total Paid Subsidies	Total Housing Programs
	(1)	(2)	(3)
1987	25,711	22,166	47,877
1988	26,285	34,249	60,534
1989	32,139	32,799	64,938
1990	15,899	45,682	61,581
1991	31,142	41,741	72,883
1992	31,064	51,541	82,605
1993	28,018	49,494	77,512
1994	29,573	51,986	81,559
1995	31,053	56,580	87,633
1996	30,169	55,263	85,432
1997	22,581	50,166	72,747
1998	18,118	48,601	66,719
1999	24,515	52,835	77,350
2000	22,674	49,132	71,806
2001	20,301	51,369	71,670
2002	22,517	57,892	80,409
2003	12,347	61,975	74,322
2004	13,206	76,178	89,384
2005	3,030	74,909	77,939
2006	4,032	83,530	87,562
2007	144	103,385	103,529
2008	200	154,972	155,172
2009	96	161,816	161,912

Source: Ministry of Housing, DPH, DITEC.

Note: (3) = (1)+(2).

in the late 2000s it exceeded 300 UF. Behind this increase in the average value of the subsidy per beneficiary is the increase in housing prices, especially land prices, and an effort to improve the size and quality of financed homes. The minimum size of social housing increased from 36 m<sup>2</sup> to 50 m<sup>2</sup> during the second half of the 2000s. Prices of land in major cities haven risen considerably. According to data collected by Pablo Trivelli in the Market Bulletin, prices for land in Santiago rose 6.6 times on average in 34 districts between 1990 and 2006, while GDP per capita rose slightly more than 2 times. In

districts with strong expansion, the increase was higher: in Quilicura prices rose 18 times, and in Puente Alto, they rose 11 times, in the same period.<sup>51</sup>

Also noteworthy are the efforts to group subsidy recipients through different programs, such as homes for groups of workers. This can reduce costs and promote cooperation, improving community life for future neighbors.

The housing program was also aimed at achieving other objectives, such as densifying the city. To this end, the urban renewal subsidy was created and has enabled, through a special subsidy, the recovery of city neighborhoods with untapped housing potential.<sup>52</sup>

Efforts to target and innovate programs for the poor include the progressive housing program, the rural housing subsidy, and the “Chile Barrio” program, which aims to eliminate slums.<sup>53</sup> More recently, 2002 saw the launch of the dynamic social housing without debt program (Programa de Vivienda Social Dinámica sin Deuda), where the amount of the subsidy is equivalent to the total cost of the dwelling, and the housing solidarity fund (Fondo Solidario de Vivienda), both aimed at the poorest families.

The impact of the housing subsidy programs on the most needy families has been evaluated based on data from the CASEN survey. From this data it can be concluded, for example, that between 1990 and 2006, thanks to the housing policy, the percentage of families in the first income quintile that own homes rose from 57 percent to 68 percent. The distribution of housing subsidies in the three-year period between 2004 and 2006 benefitted 38 percent of the poorest quintile and 29 percent of the next quintile.<sup>54</sup> The available data

<sup>51</sup> Trivelli (2009) Suelo urbano y equidad, journal *Mensaje*.

<sup>52</sup> For a detailed account of the history and evaluation of the urban renewal program from its creation in 1991 to 2006, see Arriagada, Camilo, Juan Cristóbal Moreno, and Enrique Cartier (2007) *Evaluación de Impacto del Subsidio de Renovación Urbana*.

<sup>53</sup> A 2002 assessment of the Chile Barrios program—which was intended to eradicate slums—can be seen at the following link.

<sup>54</sup> Estimations done by Acuña, Hernán and Humberto Santos (2008).

indicate that subsidy distribution became more progressive over time.<sup>55</sup>

Tables 9 and 10 show the result of investments in drinking water and sewage. During the 1990s, 30 percent of households in the poorest quintile that lacked a potable water supply in the house obtained this amenity; in 2009, 96 percent of households in the poorest quintile had water in their homes.

The sewage system, for its part, extended its networks to serve 73 percent of households in the poorest quintile. Adding in the population segment with septic tanks, the proportion of households with proper sanitary conditions is 86 percent in the poorest quintile, nearly 40 percent more than in 1987.

For the next quintile, that is, those considered to be living in poverty in the late 1980s and whose income surpassed this critical level in the 1990s, drinking water in the home was a reality for 90

percent of households and sewerage for 80 percent. The expansion in coverage observed for these services between 1987 and 2009 was similar to that observed for the previous quintile.

The significance of these developments for families' everyday lives and for improvement of sanitary conditions and disease prevention is immense.

Progress has been significant not only in the area of *housing and sanitation infrastructure*; the area of household appliances has also seen much improvement. In 2009, 58 percent of households in the poorest quintile reported having an automatic washing machine in their homes,<sup>56</sup> 84 percent

<sup>55</sup> See Simian, José Miguel (2010).

<sup>56</sup> The percentage of households with a washing machine was 49 percent in 2006, which shows the rapid growth in access to these goods.

**TABLE 9: Drinking Water Coverage in Lower Income Quintiles, 1987–2009**  
(percentage by income quintile [\*] and potable water system)

Quintile I	1987	1990	1992	1994	1996	1998	2000	2003	2006	2009
<b>Public Network</b>										
Faucet inside the home	48.0	52.0	61.7	62.9	63.0	67.3	71.4	75.6	76.4	85.3
Faucet on-site but outside the home	24.1	23.4	15.3	15.0	12.1	10.6	7.2	6.7	6.7	1.9
Carried in	5.1	3.6	4.2	1.8	2.2	1.6	1.7	0.4	0.4	0.7
<b>No Public Network</b>										
Faucet inside the home	0.3	1.5	1.6	2.8	5.1	4.8	6.1	7.6	7.2	7.7
Faucet on-site but outside the home	...	1.7	1.4	2.7	3.0	3.2	3.1	2.8	2.6	1.3
Carried in	22.5	17.9	15.9	14.8	14.7	12.5	10.5	7.0	6.7	3.1
<b>Quintile II</b>										
<b>Public Network</b>										
Faucet inside the home	59.4	64.3	72.3	74.6	78.0	80.9	82.9	86.3	89.9	91.6
Faucet on-site but outside the home	19.2	17.2	11.1	9.8	7.4	6.7	4.2	3.5	2.0	1.4
Carried in	3.7	2.4	2.9	1.0	0.7	0.9	0.8	0.2	0.2	0.3
<b>No Public Network</b>										
Faucet inside the home	0.4	1.9	2.3	3.5	4.2	3.9	5.7	5.4	4.9	4.8
Faucet on-site but outside the home	—	1.1	1.3	1.6	2.1	1.5	1.6	1.5	0.7	0.6
Carried in	17.2	13.2	10.2	9.4	7.6	6.1	4.8	3.2	2.2	1.3

Source: MIDEPLAN, Department of Social Information, from respective CASEN surveys.

(\*) According to national independent income.

**TABLE 10: Sewerage Coverage in Lower Income Quintiles 1987–2009**  
(Percent of Households by Income Quintile (\*) and Type of Excreta Disposal System)

	Quintile I				Quintile II			
	Sewerage	Septic Tank	Latrine and Cesspool	Does not have	Sewerage	Septic Tank	Latrine and Cesspool	Does not have
1987	46.7	3.5	47.0	2.9	58.1	3.7	36.2	2.0
1990	51.5	4.1	40.9	3.6	62.9	5.0	29.5	2.6
1992	53.2	3.9	33.7	9.2	63.8	4.8	24.5	7.0
1994	53.2	5.3	32.1	9.4	64.7	6.1	22.0	7.2
1996	51.4	5.7	35.2	7.7	67.4	6.3	20.8	5.5
1998	56.5	5.6	30.8	7.1	70.4	6.5	17.9	5.2
2000	61.6	7.3	25.1	6.0	73.1	8.1	14.8	4.0
2003	61.8	9.5	22.7	5.9	75.8	9.1	7.0	1.7
2006	68.1	11.6	16.8	3.5	78.2	11.0	5.7	1.1
2009	72.7	13.0	11.8	2.5	80.8	11.0	6.3	1.9

Source: MIDEPLAN, Department of Social Information, from respective CASEN surveys.

(\*) According to national independent income.

reported a refrigerator, and 99.4 percent reported access to electricity. In 1990 only 23 percent of households in the first quintile reported having a refrigerator, and an even smaller percentage had a washing machine.

In the field of urban development, a new program worth mentioning is the Urban Parks program, launched in 1992. After ten years it had set up 58 parks with a total area of 310 hectares and an investment of over \$24 billion pesos. There have also been trials of programs such as Quiero Mi Barrio, aimed at improving public spaces in already established social housing areas. See for example [http://www.minvu.cl/opensite\\_20061113124729.aspx](http://www.minvu.cl/opensite_20061113124729.aspx).

Socially speaking, these common spaces and green areas are very important, especially for small-

sized social housing and in cities that continue to grow in size.

In sum, for the first time in many decades the country has reduced rather than increased its housing shortage. The state has increasingly concentrated its financial effort on the poorest families. At the same time, there has been significant progress in poor households' access to safe water and sewerage. Although still insufficient, some progress has been made in urban policy: densification of certain areas in major cities, construction of parks, and improvements of the urban road network.

The main challenges are associated with improving the quality, size, and characteristics of housing, and with urban public spaces, which are essential to growing cities and small homes.

## PENSIONS

When analyzing pension policy, it is necessary to distinguish between two periods: one that ended in June 2008, and the next that began on that date, when a major reform of the pension system took effect. This is examined separately below.

The contributory pension expenditure, that is, excluding non-contributory pensions (already analyzed as monetary subsidies), is the main outlay of government social spending. Therefore the pension adjustment policy was extremely cautious, due to the strong fiscal impact any increase in this benefit, however small, would have. The situation was even more difficult to address, because during the Military Government, there was a significant deterioration in the real value of pensions due to the lack of a 10.6 percent adjustment for inflation, which the Democratic Government was committed to restoring. This was fully implemented, but to make it consistent with the fiscal goals, it was done gradually.

In general the policy was to issue special adjustments (above the general adjustments to compensate for inflation), giving priority to the lowest pensions and those received by pensioners over 70 years old, as well as a new category of over 75 years old created in 2004. During the period, special adjustments were made to the minimum pensions on numerous occasions. This is reflected in Table 11. The minimum monthly pension amount rose at constant currency from \$55,000 pesos in 1989 to \$105,000 pesos for those under 70, and somewhat more for those over 70.

These general pension adjustments were given lesser priority than other social policy objectives,

due to their high cost and the lack of selectivity of this expenditure. On this basis, special benefits were created in the form of lump-sum allocations, such as the winter bonus for pensioners, which enabled the issuance of a more progressive benefit. However, when examining the minimum pension adjustments throughout the entire period, it is concluded that their real value increased almost as much as the growth of GDP per capita for the same period.

Public pension spending grew less than the GDP, rising from 6.6 percent of GDP in 1990 to 4.7 percent in 2009. Payment of “recognition bonds” (bonds that recognize pension contributions under the old system for those receiving pensions under the new funded system with individual accounts, *Administradoras de Fondos de Pensiones—AFP*) was the highest-growing outlay of the 1990s. It rose from 0.5 percent of GDP at the beginning of the decade to more than 1.1 percent in recent years, growing at the same rate as the GDP up through 2009. This amount is not included in the aforementioned pension expenditure.<sup>57</sup> This expenditure is projected to continue to grow for some years still. Spending on guarantees for minimum pensions for members of the AFP system rose by eight times between 1995 and 2003 in real terms, accounting for 0.1 percent of GDP. Since the guarantee is triggered when

<sup>57</sup> It was not accounted this way until 2003. Following the change in public finances accounting methodology in 2003, spending on recognition bond payments began being accounted as below the line items, as repayment of a liability.

the pensioner has exhausted his or her retirement fund, the fiscal outlay for this item has continued to grow steadily.<sup>58</sup>

Regarding protection for individuals over 65 years of age, in 2009, 84 percent received pension income. This percentage was close to 74 percent in the beginning of the 1990s, and this group's growth was due to the higher number of beneficiaries of welfare or non-contributory pensions. According to the CASEN survey, the percentage of people over 65 who received a non-contributory pension increased from 8 percent in 1992 to 27 percent in 2009. Improving the pension situation helped reduce the number of adults over 60 years of age and under the

poverty line from 20 percent in 1990 to 8 percent in 2009 (CASEN 2009).

In short, even before the 2008 reform, the number of people in the non-working population who received pensions saw a slight increase, and the value of these pensions grew in line with the growth of GDP per capita while pensions received by lower-income seniors grew more. Government spending on pension payments increased as a result of recognition bond payments, which are part of the cost of the transition from a pay as you go system to the fully funded system (AFP), introduced in 1981.

### The 2008 Pension System Reform

In this year, a comprehensive reform of the pension system was approved. This was the result of careful preparation, which included numerous technical studies and a look back at experience gained since 1981, when the new fully funded pension system with individual accounts was launched. There was also a valuable consensus building process, for which the Government set up a Presidential Advisory Council on Reform. An in-depth review of this reform is beyond the scope of this study,<sup>59</sup> but it will examine its general outlines and how it is linked to the social policy approach of these two decades.

The reform was based on a diagnosis of the main weaknesses of the pension system, viewed holistically (both contributory and non-contributory), and clearly established the goals it aimed to achieve.

Conceptually, three pillars of the pension system were differentiated. First is the contributory

**TABLE 11:** Minimum Pensions in December 2009 Pesos, 1987–2009

Year	Under 70 years old	Over 70 years old	Over 75 years old
1987	54,097	57,565	
1988	55,383	59,181	
1989	55,117	58,897	
1990	59,439	63,002	
1991	66,298	69,862	
1992	66,253	69,814	
1993	67,453	71,079	
1994	67,666	71,303	
1995	70,342	74,124	
1996	75,331	81,705	
1997	75,923	84,004	
1998	79,915	88,421	
1999	91,754	100,326	
2000	90,780	99,261	
2001	91,631	100,191	
2002	92,142	100,750	
2003	92,122	100,728	
2004	92,143	100,752	105,893
2005	91,718	100,286	105,146
2006	97,932	107,079	114,252
2007	99,211	108,479	115,744
2008	98,164	107,335	114,522
2009	104,960	114,765	122,451

Source: 1987–2002 INP Department of Statistics. 2003–2009 Social Security Supervisory Agency.

<sup>58</sup> See the estimates by Marcel (2001) and updated projections in DIPRES (2010) Informe de Pasivos Contingentes.

<sup>59</sup> An excellent account of the reform's preparation as well as its congressional debate and its implementation, and a summary of the major initiatives, can be seen in Arenas, 2010: *Historia de la Reforma Previsional Chilena*, ILO. See also Pensions Supervisory Agency Chile 2009: *Una Reforma Previsional de Segunda Generación de pensiones*. Some of the issues addressed by the reform had been diagnosed at the time the system was introduced in 1981; see Arellano (1985).

pillar, defined by pensions resulting from mandatory contributions to the old age, disability and survivor pension system; then the solidarity pillar, with benefits financed by general taxes for those who cannot self-finance a specified pension determined by the Government; and last is the voluntary pillar, with voluntary contributions to supplement compulsory savings. A combination of these three pillars (which were already present before the reform, but were then modified and integrated) is what defines the new system.

The main deficiencies that the reform addressed were insufficient coverage of pension benefits for current and future pensioners, gender inequalities, and competition and efficiency problems with the AFPs.

With the aforementioned increase in coverage in recent decades, at the time of the reform, 80 percent of those over 65 were receiving a pension, 50 percent contributory, and the rest, non-contributory. Contributory pension coverage projections for the coming decades indicated that over 45 percent of contributors would not be able to self-finance the minimum pension and few of them would be eligible for the minimum pension government guarantee.<sup>60</sup> It should also be noted that no more than 73 percent of the workforce was covered by the contributory system.

The problems mainly affect women, because of their lower participation in the labor force, intermittent contributions, early retirement, and lower average earnings. They also affect men with lower earnings and more intermittent contributions and/or who work independently.

The reform was designed to carefully integrate the three pillars, balancing greater protection, costs, and incentives. For those over 65 years of age in the three lowest quintiles, a basic solidarity pension was established as an improvement to the non-contributory pension. A social security solidarity supplement was introduced to complement the accumulated contributions in individual accounts, to ensure at least a minimal pension. Thus, the three pillars were successfully integrated and the solidarity pension supplement was designed so as to reduce the disincentives for contributing once requirements for the minimum pension guarantee were fulfilled.

A subsidy for young people's contributions was established in order to encourage contributions at early ages, which have a great bearing on the capital that accumulates throughout life. Subsidies of 50 percent of the first 24 contributions made by workers between 18–35 years of age were introduced, for both the worker and his or her employer. Independently from this reform, the youth employment subsidy was improved, with similar effects on future pensions. This subsidy encourages formal employment among young people and improves their future pensions.

The reform also took a very important step towards ensuring the incorporation of self-employed workers in the system, and in particular in the contributory pillar. This has been gradual, and will be absolutely mandatory in 2015. It is being integrated into the now compulsory contributions to the tax system. Along with providing old age, disability, and survivor protection, it incorporates self-employed workers into the protection system for occupational accidents.

Similarly, the employer payment of contributions became more stringent and tax incentives for voluntary pension savings, which had been introduced during tax modifications in 1990 and 2002, were expanded. Also, voluntary contributions by economically inactive persons were made easier.

Gender issues were addressed with the design of the solidarity pillar, as women had the least coverage. In addition, the reform established a per-child bonus for mothers equivalent to 18 months of the minimum salary, which is paid when the mother starts receiving pensions but accrues interest from birth. Also, a cross-subsidy in disability and survivors insurance that negatively affected women was corrected, and women's right to access the balance of the individual account of the spouse in cases of separation was established.

The first result of this reform, a year after its launch, was that the total beneficiaries of the basic solidarity pension exceeded 578,000, 20 percent more than those who received pensions in

<sup>60</sup> Berstein, Larrain, and Pino (2005) "*Cobertura, densidad y pensiones en Chile: Proyecciones a 20 años plazo, Documentos de Trabajo*" Pension Fund Administrators Supervisory Agency (SAFP).

early 2008.<sup>61</sup> Beneficiary projections for the solidarity pension system (basic plus complementary contribution) indicate that there will be an increase to about 1,200,000 beneficiaries in 2012 and approximately 2,000,000 in December 2025.<sup>62</sup> This reflects the significant growth in coverage of the solidarity pillar due to reform. Costs are discussed below.

Premature pensions are part of the shortcomings in the way the system operates and are not always given the attention they deserve. The vast majority of people begin receiving pensions (i.e., collect their accumulated funds) as soon as they are eligible to do so, which occurs before the legal retirement age, generating very low replacement rates. Each year that the pension is paid in advance implies a reduction of more than 6 percent in the final amount (the calculation uses a real annual return of 4 percent and a man retiring one year early, moving the retirement age from 65 to 64 years). Premature or early pensions are not a problem as long as people continue working, but it does become a problem when they lack other sources of income besides the pension. For this reason, efforts have been made to discourage premature pensions. Stricter requirements for retiring early were approved in 2004, and this reform established the age of 65 years as a requirement for obtaining the solidarity supplements to individual savings.

Given the increase in life expectancy, a review of the pension requirements for workers who do not obtain solidarity supplements is pending, in order to assess the timeliness and sufficiency of their pensions under the current standards that allow for early retirement with low replacement rates.

In this industry's operation, insufficient price competition in the system has historically led to charging relatively high fees to the affiliate. On average, the cost for a middle-income affiliate exceeded 4 percent of taxable income in the first seven years of the system's operation in the 1980s. After successive attempts to regulate the charging of fees and spending on advertising and sales, costs have fluctuated around 2.5 percent in the last ten years (the minimum was 2.42 percent). These costs include disability and survivors insurance, but even discounting this value, the system administration cost is high. In recent years the industry cost, minus the insurance fee, is estimated at 0.67 percent of the pension fund

balance.<sup>63</sup> Because costs are so incidental to future pensions, the reform sought to create more competition through a tender every 24 months of the new affiliates portfolio for the next two years. The first tender resulted in the addition of a new AFP to the market, with a significant decrease in costs.

The reform also included a reorganization and modernization of the public institutional structure for administering the pension system. This has certainly been a contributing factor in the success of its implementation.

It is important to examine how the state's fiscal stability is protected in this reform. This is because (a) fiscal discipline has been a hallmark of social policies during this 20-year period, giving them sustainability over time, and (b) in the case of pensions, the risks of generating long-term deficits are high if the proper safeguards are not taken. It is enough to note that pensions and health care together represent about 40 percent of the fiscal budget.

Projections made by the National Budget Office<sup>64</sup> indicate that additional costs for solidarity pensions amounted to 62 percent of spending on these pensions in 2009, and 96 percent in 2010, due to both an increase in the amount of the benefit as well as the number of beneficiaries.

The additional cost per year of the reform is estimated at 0.44 percent of GDP, projected to rise to over 1 percent of GDP by the year 2023. This calculation includes the other increased fiscal costs of the reform, which at that date are predicted to represent about 15 percent of total costs.

Since the resources involved are substantial, a pension reserve fund was created in preparation for the reform. Part of the fiscal surpluses goes towards

<sup>61</sup> A detailed description of the diagnosis and formulas adopted to increase coverage can be seen in Pensions Supervisory Agency Chile 2008: *Una Reforma Previsional de Segunda Generación*, capítulo 2.

<sup>62</sup> Arenas, Benavides, González, Castillo, Dipres, Public Finance Studies (2008) *La Reforma Previsional Chile Proyecciones Fiscales 2009–25*.

<sup>63</sup> This is a topic that has been heavily examined by numerous studies on the system in its almost thirty years of operation, see Pensions Supervisory Agency, *El Sistema Chileno de pensiones 2010* p. 181.

<sup>64</sup> Arenas *et al* (2008).

this fund. The reserve fund was established with an initial amount of US\$604 million and is increasing every year at a minimum amount of 0.2 percent of GDP of the previous year. It includes mechanisms for monitoring and screening to determine if it has a sufficient amount. Every three years a highly competent team must analyze the sustainability of the fund and issue a report. This is an essential practice for anticipating problems of sustainability. The *first report* has already been issued. Additionally, actuarial capabilities in the National Budget Office were strengthened. The first report concludes that, given the obligatory contributions to the reserve fund under the law, the prevailing benefit parameters, and demographic and economic projections, the fund is sufficient. It is very important that these projections, which did not exist before in Chile and are essential for assessing the sustainability of the state commitments, be incorporated into the political decision-making process.

Pension reform design sought to integrate the three pillars, with a combination of legally defined benefits (the basic solidarity pension, and the pension solidarity contribution for the bottom 60 percent of the population in terms of income) and legally defined contributions. The current pillar combination and its potential future changes are very important, both for the long-term sustainability

of the system and for its impact on the soundness of public finances.

A new Pension Advisory Council, designed to assess the evolution of the system and to support its sustainability, is another mechanism included in the reform. It is composed of five experts appointed by the president, four of whom must be ratified by the Senate, and whose function is to advise the ministers of labor, social security, and finance on matters related to the solidarity pension system. The council must produce an annual report for the ministers and the Congress, which will give its opinion on the operation of the system regulations.

Undoubtedly, this reform has addressed many previously identified system deficiencies, and also anticipated problems that would become more critical in the coming decades. The long-term success and sustainability of a pension system depends on the care taken to safeguard the critical aspects of the system.

In any case, this is a reform that will undoubtedly go down in history for its careful design, legislative-political discussion, and the success in its political and technical implementation. Due to the technical and political complexity of changes to pension systems, reforms that are successfully implemented, as in this case, are exceptional.



## HEALTH CARE

The health sector received top priority in government investment after the restoration of democracy in 1990. A plan was made to address the most urgent needs in the public health network. In parallel, the Government began a diagnosis and medium-term project development process for the public sector with the participation of the World Bank and the Inter-American Development Bank. These projects were aimed at improving the infrastructure of the public health sector, which had not received replacement investment for many years. For this reason, investment was what grew the most in the 1990s. It then fell in the first half of the 2000s, and re-grew at the end of the decade.

Initially, priority was given to allocation of resources to primary health care in clinics run by municipalities, making primary care the main destination for funds during the first decade.

Almost without exception, during the twenty years in question, public health spending grew more than total social spending, reflecting the priority consistently given to this sector (and the education sector).

The salaries of health personnel experienced significant increases. These increases largely arose in response to the increase in market wages of health personnel. The demand for personnel in the private health sector grew sharply during this period, raising market wages accordingly. This was compounded by pressures from unions in the sector, who on more than one occasion achieved special adjustments via pressure from activity stoppage, with the serious consequences that this entails. Additionally, staff increased in order to manage the new investments.

It is worth mentioning some of the major innovations in financing and management that accompanied the increased resource investment. Therapeutic diagnostic centers (Centros de Diagnostico Terapéutico—CDT) and reference centers (Centros de Referencia—CRS) were created in order to fill the gap between large hospitals and primary care clinics. Emergency primary care services (servicios de atención primaria de urgencia—SAPU) have helped address the ever-present and challenging issue of medical emergencies. Resources have started being allotted to public providers based not only on past budgets, but also on services, and in the case of primary care, based on the assigned population.<sup>65</sup>

It is important to look at the consequences of these increased resources in terms of coverage, health care, and the health status of the population. During the first half of the 1990s there was a slight decrease in the population covered by the public health system, due to the transfer of beneficiaries to ISAPRES (private health insurance companies that receive compulsory contributions). Strictly speaking, one can see a cycle of strong movement towards ISAPRES in the years of strong economic growth, and a subsequent return to public insurance (FONASA) during periods of lower growth. Since 1996, ISAPRES have not regained their former share; on the contrary, their covered population has been declining even in absolute terms. The opposite has happened in the public sector, which covers over 80 percent of the population (see Table 12). The private insurance industry

<sup>65</sup> See many innovative experiences in Montoya ed. *El Hospital Público vols. I y II*, 2003.

**TABLE 12:** Population Breakdown by Health Insurance System, 1987–2009

Year	Health Insurance System			
	Public and Armed Forces	ISAPRE	Private, Other	Total
1987	77.4	8.7	13.9	100
1990	69.8	15.1	15.1	100
1992	65.2	20.1	14.7	100
1994	66.1	23.7	10.2	100
1996	62.5	24.9	12.6	100
1998	64.6	23.2	12.2	100
2000	68.6	20.8	10.6	100
2003	74.8	16.7	8.5	100
2006	79.5	13.5	7.0	100
2009	81.2	13.1	5.8	100

Source: Based on the CASEN survey for the respective years.

is currently facing a critical situation because of the legal and constitutional rulings that prevent it from modifying the price of health plans as insurees age, which has been the practice since its inception. For a discussion of this and other aspects of the sector's current state of affairs, see the report by the *Comisión Presidencial de Salud, 2010*.

The population who reported having no coverage went down, with a consequent improvement in health protection.

As for health care, there was a general increase as a result of a marked increase in frequency of use. Consultations went from 2.8 to over 4 per person per year. Laboratory tests increased from 2.3 to more than 6 per person per year. In both cases, the increase was greater among the beneficiaries of the public system than among those affiliated with ISAPRES, partly because the initial level of care per person was lower among the first group. Even the number of tests per person in the public system exceeded that of the ISAPRES.

Hospitalizations per person stayed constant in the 1990s and decreased slightly in the 2000s. This is in contrast with the international trend, which showed a sharp reduction in hospitalizations.<sup>66</sup>

The amount of resources per beneficiary rose sharply, and this was matched by increasing numbers

and higher unit costs of consultations. The higher costs were due to an increase in health personnel salaries above the average national increase and the greater complexity of many of the services. The surge in spending per beneficiary in the public system was even higher than for those affiliated with private insurance, and therefore the gap with ISAPRES affiliates was reduced. Both the spending per beneficiary and service use frequency grew faster in FONASA's free-choice modality than in the ISAPRES.<sup>67</sup>

The FONASA expenditure with the most growth was the payment of disability benefits (subsídios de incapacidad laboral—SIL). In the 2000s, this sick pay benefit was used and abused, with both the number of sick leaves per contributor and their duration increasing. In ISAPRES, tighter control of this benefit limited its growth.<sup>68</sup>

As for preventive programs, the increase in coverage for certain preventive services is very significant. During this period, 20 percent more women received preventive examinations (see Table 13).

The slow progress among those who are not covered by any health system is noteworthy, underscoring the importance of good health coverage for

**TABLE 13:** Women 25–64 Years Old with a Pap Smear in the Last Three Years: Coverage by Health Insurance System, 1987, 2003, 2009 (Percentage)

Health Insurance System	1987	2003	2009
Public <sup>a</sup>	48.2	66.3	67.6
ISAPRE	62.5	72.1	74.2
Private	44.6	47.0	51.9
<b>Total</b>	<b>49.9</b>	<b>66.0</b>	<b>67.7</b>

\* Excludes live-in domestic workers and their families.

<sup>a</sup> Includes Armed Forces.

Source: Based on CASEN surveys from the respective years. Mideplan.

<sup>66</sup> In the OECD, in the last 20 years, the number of hospitalization days went down by 2.7 percent per year. However, the daily cost rose by 5 percent annually.

<sup>67</sup> A detailed analysis of the period of the 1990s can be seen in Tokman and Rodríguez (2001). For the 2000s, see Sánchez and Labbé (2011).

<sup>68</sup> Estimates can be seen in Tokman, Rodríguez and Larraín (2004).

the achievement of health objectives. The vulnerability of those not affiliated with any system is also reflected in the percentage of persons who, having had an illness or accident, turn to the health system. Among those not covered by any system in 2003, only 54 percent visited a healthcare service, while among those who were covered more than 76 percent did. Among those without coverage who did not use a healthcare service, 40 percent said this was due to a lack of money. The same reason was cited by around 12 percent of the rest of the population (CASEN 2003).

The number of women who did not receive preventative exams out of ignorance was sharply reduced, as a result of the educational campaigns carried out during these years.

The nutritional status of pregnant women also improved steadily, and the percentage of underweight pregnant women declined, from 15.5 percent to 8.3 percent between 1990 and 2000.

In 2000, the traditional nutritional program for supplying food to mothers and children, the National Supplemental Feeding Program (Programa Nacional de Alimentación Complementaria—PNAC), benefitted 1.08 million children under six years of age. Between 1990 and 2006 this program's coverage increased from 68 percent to 77 percent. The greatest increases benefitted the children belonging to the poorest households and children under two years old.

There was also significant growth in the supply of prescription drugs in the public health system. In 2009, over 80 percent of patients in the poorest quintile who were prescribed medication received it for free. Only 4 percent said they could not buy all the medications prescribed to them. By contrast, over 80 percent of those in the richest quintile who had used medications had to pay for them. In the effort to provide universal coverage, these indicators show steady improvement throughout the period.

In short, health protection has clearly improved, in terms of both access to consultations and testing as well as medical treatments. This is a result of increased resources invested in infrastructure, equipment, personnel, and supplies.

Furthermore, the health status of the population has continued to improve, according to various

indicators. The mortality of children under one year of age, for example, dropped from 17 per 1000 live births in the late 1980s to 10 in the late 1990s, and continued to decline until reaching 7.8 in 2008.

Not only was there a significant increase in resources, there was also a major reform in the sector's organization. In 2003 several years of technical and legislative debate culminated in the approval of four laws aimed at improving the regulation of ISAPRES, reorganizing the public sector (Health Authority Act), and establishing a new system of health guarantees.<sup>69</sup> This group of laws, better known as the "AUGE" laws, sought to ensure access to care for certain health problems. The guarantee is both in terms of cost (in the Fonasa free-choice system and the private insurance system), and in the timeliness of care (this is the most important guarantee in the public institutional care system). A limit is set for the copay and for the total costs, and a list is established annually with the diseases and/or health problems protected under this guarantee. When the system began, there were 25 health problems protected by guarantees (July 2005), and in 2010 the number rose to 69.

The analysis of the reform, its impact, and the extent to which it has achieved its objectives is beyond the scope of this text. It introduced major changes in the operational dynamics of the system: in how health action is prioritized, in how the usual waiting lists in the public sector can be reduced, and in how to confront the insufficient financial protection of health insurance.<sup>70</sup>

In keeping with the standard of long-term fiscal sustainability of reforms that involve significant costs for the state, the Government proposed and passed an increase in the VAT rate along with the health reform.

However, management of the health system has gone through a slow and uneven modernization process. The changes in management proposed by the reform have been partially implemented, and the upgrades that have occurred are primarily the result

<sup>69</sup> A detailed description of the legal texts can be seen in Ulises Nancuante and Almonacid Andrés Romero Celedón (2008) *La reforma de la salud*.

<sup>70</sup> See an evaluation of the first four years of reform implementation in Inostroza and Riesco (2011).

of initiatives by the professional teams of a specific hospital or service. The system's organization has not gone through the modifications necessary for the new realities of health care in terms of technology and diseases of the population. The significant investment in infrastructure and increased resources were not used to modernize the organization and

management of the sector, as would have been desirable. The flaws in private insurance and the regulatory inconsistencies of the system have been only partially fixed. Herein lie the remaining challenges, and they are of major importance and have complex solutions.

## FAMILY INCOME GENERATION

The most difficult social policies to successfully implement are those aimed at improving low-income families' ability to generate income. Moving from welfare towards the creation of opportunities and creating spaces for entrepreneurial activity and for access to quality jobs is the most complex task. Apart from the strong emphasis on education as an engine of opportunity, what has truly stood out in this period has been, firstly, and as highlighted in the first section of this study, the clear emphasis on economic growth and the job generation that it entails. However, there are several initiatives worth noting that sought to increase access to employment for the most disadvantaged and vulnerable sections of the population, which, due to their more precarious starting point, run the risk of not reaping the benefits of economic growth.

Among the innovative initiatives that have been successful is the microcredit program, in which financial institutions grant small loans to microentrepreneurs.

In 1992 the Government set up a subsidy for financial institutions for each loan given to microenterprises. This subsidy is justified in the high transaction costs of these operations compared to the amount of the loan and the banks' lack of prior information on these small businesses. The amount of the subsidy is determined by a bid among the interested financial institutions. The result has been quite remarkable. In 10 years 224,000 credit operations were subsidized; for every peso spent by the Government on subsidies, 11.2 pesos were mobilized in loans from financial institutions. The average amount of a subsidized loan was less than US\$1,000.

Perhaps even more important is the knowledge and ability to serve microentrepreneurs that evolved in the financial system. This initiative has helped promote unsubsidized loans, so much so that in 2002 the total loans given to microentrepreneurs was three times the number of loans that received subsidies. At the same time, and as projected, the per-unit subsidy amount decreased to less than half, due to learning on the part of the bank and subsequent cheaper costs.<sup>71</sup>

One aspect that is as interesting as the expansion of coverage in access to credit is the nature of the lending process, which the bank has carried out based on strictly commercial guidelines and on debtors' economic viability. This approach is quite different from what usually prevails in direct financing by public entities. Recovery is high. According to data from the microenterprise subsidiary of Banco del Estado, in operation since 1997 (without access to subsidies), and which has awarded more than 250,000 credits, 70 percent of debtors had never received a loan from a formal institution, and 99 percent of debtors meet the timely payment of installments (US\$800 average loan).

A survey by the Bank Supervisory Agency on lending to microbusinesses in the second quarter of 2007 reveals that in the 2000s, the annual growth rate of loans was around 17 percent. This figure far exceeds the rate of expansion of the loans to commercial clients (10 percent average in the last two

<sup>71</sup> Information based on "La situación de la micro y pequeña empresa en Chile," Ministry of Economy, 2003.

years) and consumption loans through banks (8 percent on average in the last five years). According to a study using this data, 28 percent of microentrepreneurs had access to bank financing. 85 percent of the microenterprises financed had monthly revenues below US\$1,800.<sup>72</sup>

Stimulating microcredits has been a major innovation in the traditional way in which the state supported funding for productive purposes. The discipline of the financial market is more demanding and therefore more likely to unlock the potential of microentrepreneurs. In contrast, the more traditional state programs are more likely to wind up protecting nonviable initiatives and hiding commercial flops. What has stood out is the high potential of microentrepreneurs when given opportunities and the responsiveness of financial institutions.

Progress in this microcredit program contrasts with the insufficient upgrading of the credits program for farmers, which through the agricultural development office (INDAP) maintains the traditional lending practices and their emphasis on welfare. See Arellano and Ochoa (2006) for a comparison of these two credit systems for small farmers.

Another innovative program with positive results has been job training for young people who drop out of school. The program began in 1991 with support from the IDB and continued with domestic financing. Between 1991 and 2000 the program trained around 200,000 young people who had dropped out of school. Program evaluations indicate a high success in targeting the programs and a high success in finding employment for participants, when compared to a control group. The satisfaction expressed by participants is also high.<sup>73</sup> Young people who have not had sufficient access to the school system and/or do not smoothly integrate into the labor market will suffer the problems of poverty unless they receive appropriate and timely support, hence the great importance of this program.

In recent years, one of the major training efforts has focused on the training of employees in small businesses and microbusinesses, an area that traditionally had been very limited.<sup>74</sup>

In June 2009 the youth employment subsidy came into force. This is undoubtedly the measure

with the greatest scope for promoting youth employment and comes from a proposal of the Presidential Advisory Council on Labor and Equity in 2008. The subsidy is a monetary contribution for the worker (two thirds of the subsidy) and another for the employer hiring the worker (one third of the subsidy), when it comes to young people between 18 and 24 years old belonging to households in the first four deciles of the population with gross monthly salaries at or below \$360,000 pesos. The subsidy grows in the first salary range, rising to 30 percent for salaries of \$160,000 pesos, staying constant, and then declining slowly in the upper range.<sup>75</sup> Although there has not yet been an evaluation of this program, during the first nine months of operation 189,950 workers had applied for this benefit.<sup>76</sup>

These are some successful innovations in the programs aimed at improving income generation opportunities for the poor. However, it is clear that an ongoing search for new mechanisms to provide greater equality of opportunity is required.

The timely induction of young people in the formal labor market is extremely important for future job performance. Furthermore, in a funded pension system with individual accounts, it is important for the future pensions of young workers. About 40 percent of a pension is determined by contributions from the first ten years of work. Therefore, the state's formal employment subsidy is not only helping to improve the employability of young people but is also avoiding subsidies in the annuity payout period.

<sup>72</sup> See Liliana Morales and Álvaro Yáñez *Micro finanzas en Chile Resultados de la Encuesta de Colocaciones en Segmentos Micro empresariales*.

<sup>73</sup> See data from Santiago Consultores asociados, Ex-post evaluation Chile Joven phase II.

<sup>74</sup> See an assessment of these innovations in the *study commissioned by DIPRES*.

<sup>75</sup> Chile has been one of the few countries to introduce this type of pro-employment program in the context of the international financial crisis. See an account of the programs that were implemented in different countries in Mackenzie, David and David Robalino (2010).

<sup>76</sup> See a detailed description of this and other youth employment and training programs in Cristóbal Huneus (2010) *Balance de los avances y desafíos de las políticas de empleo para jóvenes*.

## PROTECTION AGAINST LOSSES OR DECREASES IN FAMILY INCOME

One cause of poverty and/or significant decreases in standards of living is associated with job loss, illness, or accidents affecting the family. At the same time, a characteristic associated with poverty and/or low income is the high vulnerability and therefore the serious consequences associated with temporary or permanent loss of the ability to generate income.

During this period some initiatives were introduced to counter the effects of these situations on income.

In 1992 an individual savings system was established for domestic employees that serves as severance pay for loss of employment. Under this provision, an employer contribution of 4.11 percent of wages paid was established. These funds can be withdrawn when the employee terminates the contract for any reason.

In late 2010 there were over 680,000 of these accounts with a positive balance and an average savings of \$136,000 pesos. Every month there were more than 200,000 deposits and 7,500 withdrawals averaging \$330,000 pesos.

It is an innovative mechanism that offers some protection to workers who until this point were totally unprotected from job loss.

In 2002 a new unemployment insurance system came into force. The new system was launched after nearly ten years of discussion and analysis of the necessary features so that the system both provided

protection for dependent workers and did not become a disincentive to formal employment and/or a risk to the fiscal budget.

The new insurance is compulsory for all workers who signed an employment contract in and after October 2002. It is funded by contributions from the worker for 0.6 percent of their salary in the case of a permanent work contract, by the company for 2.4 percent if the contract is indefinite and by the company for 3 percent if the worker is hired for a fixed term, with treasury contributions in very limited cases. There is a combination of savings in individual accounts and solidarity funds. Withdrawals can be made from individual savings in cases of contract termination for any reason, including voluntary resignation, making as many withdrawals as the insured person's years of contributions, with a maximum of five and in decreasing amounts. If the employee is dismissed by decision of the company, the solidarity fund complements his or her individual savings and allows him or her to withdraw 50 percent of his or her income in the first year, and up to 30 percent in the fifth year, with caps on the amount of the withdrawals.

In late 2009, eight years into the system, the number of insured members exceeded 6 million, of which 3.2 million were contributing. At the same date, 4.7 million members had benefitted from the insurance through withdrawals from their individual accounts, but only a minority of 186,000 workers

with a permanent contract benefitted from the solidarity fund.<sup>77</sup>

Precisely this low use of the solidarity fund and the accumulation of resources in it led to its modification in 2009, allowing workers with fixed-term contracts access. The actuarial estimates and projections of the Pensions Supervisory Agency made by Fajnzylber and Poblete (2010) conclude that this change will improve the insurance's coverage and benefits without compromising its long-term sustainability. This improves the quality of the insurance without risking its sustainability or producing a fiscal liability, as has been the case with most unemployment insurance.

This insurance created significant protection against unemployment (which had been practically nonexistent before) and was designed in such a way as to avoid the negative effects that this insurance has had in many countries.<sup>78</sup>

It is not easy to design and implement an unemployment insurance that, while fulfilling its objective, does not become a fiscal liability and/or discourage the job search. In most countries where these systems exist, there is frustration and dissatisfaction with performance, hence the value of this experience. A very good study of policy analyses of the time and the considerations taken into account in their design can be seen in the paper by Ramos and Acero (2010). As in the case of pension reform, unemployment insurance design is the result of careful study and risk assessment, in order to avoid unintended effects in boosting employment and/or in the national budget.

In the past, in the absence of other mechanisms to support unemployed workers, the state resorted to public employment via funds transferred from the Central Government to municipalities. This is what happened during the declining growth and rising unemployment of 1999 and the following years. Gradually this method was replaced by a subsidy for private employers and/or unemployed worker training, such as the youth employment subsidy of 2009 (mentioned above).

The importance of these emergency programs is huge in situations where there are significant increases in unemployment. Even when their productivity is not desirable, their contribution to solving

a social problem makes them indispensable. Fiscal soundness allowed them to continue functioning without problems, despite falling tax revenues.

Finally, there was also significant growth of private voluntary insurance that offers protection in the event of death. Similarly, microenterprise and consumer loan insurance was established for protection in the case of loss of earning capacity of the debtor.

Life insurance premiums increased from 1.6 percent of GDP in 1990 to 2.7 percent in 2002, and stayed at this rate into 2010. The value of premiums per capita grew six times in the period. Traditional life insurance policies grew the fastest. Their total premium rose even faster than the insurance associated with the pension system (annuities and compulsory survivors insurance). This is a safeguard that will surely continue expanding and will increasingly provide forms of protection to middle and low-income households. The state can contribute with policies that help overcome the market failures typical of insurance, which often limit coverage. Self-employed workers are particularly vulnerable, and mechanisms must be devised for them that, once market failures are overcome, are as voluntary as possible.

In sum, many new ways of tackling the adverse effects associated with loss in earning capacity (unemployment, disability, death) have emerged. Protection against these risks must continue expanding in the future to avoid economic consequences, and to help prevent serious loss of income and greater poverty. The main gap is the high vulnerability that affects self-employed workers. As mentioned above, the 2008 pension reform set up a phased program to gradually overcome this gap in the area of pensions and occupational accidents. Better healthcare coverage is still pending.

<sup>77</sup> Information from Eduardo Fajnzylber and Isabel Poblete (May 2010), A projection model for unemployment insurance, Working Paper Series, Pensions Supervisory Agency.

<sup>78</sup> A complete description of the insurance can be found in Pensions Supervisory Agency (2010) *Seguro de Cesantía en Chile*.

## NATIONAL SOCIAL EXPENDITURE

As has been shown, in recent decades a social policy has been developed with universal objectives, but with selective or targeted public funding. Instead of funding all social benefits, the state gives preference to those targeting families who need subsidies because of their socioeconomic status. The goal is to achieve a greater progressivity in government social spending and to use taxes and the government budget to finance only those social expenditures for those who cannot afford the costs of health, housing, education, and other social services. The objective is also to leverage private resources and seek the contribution of beneficiaries to meet social policy objectives.

At the same time, the state imposes the obligation to participate in certain social services: health, retirement pensions, and life, disability, and unemployment insurance, in order to avoid the personal and social consequences of a lack of protection.

Therefore, to understand the evolution of social policy and its financing, it is not enough to analyze government social spending. One should also examine private spending (i.e., spending funded by families and/or leveraged with private resources). It is important to give the appropriate attention to private participation, as it is a distinctive feature of social policy in Chile.

Another relevant breakdown in social spending is whether the service provider is a public or private entity; the analysis so far has looked at the financing of the services and not the provider. Overall, private provision is greater than private financing, as there are services that are publicly funded and whose providers are private (e.g. subsidized private education,

social housing, school meals, free-choice health care with public insurance (FONASA), etc.).

For this reason it seemed appropriate to introduce the concept of national social expenditure. This combines privately financed social spending and public social spending. These private expenditures are, in the case of health and pensions, mostly mandatory spending because the state requires insurance to be taken out and/or mandatory savings for old age. Housing and education have a more voluntary nature; here private expenses consist of savings and loans for housing, supplementary payments in the school system and the cost of higher education paid by families.<sup>79</sup> Table 14 presents the first estimates of Chile's national social expenditure for each of the sectors for the years 1990, 2001 and 2008.

The data in table confirms the importance of privately funded social spending: it is approximately 10 percent of GDP, and national social expenditure approaches 27 percent of GDP. In housing<sup>80</sup> and health is where one can see the most significant private contributions.

In social security, private financing has been growing in importance and will continue to do so as the new funded pension system with individual accounts matures.

<sup>79</sup> In the case of education, this excludes textbooks and materials, which are purchased by families. In the case of health, drug purchases by families are excluded.

<sup>80</sup> Private spending on housing overestimates social spending, since due to a lack of information, housing investment, including in second homes, made by high-income sectors could not be excluded.

**TABLE 14:** National Social Expenditure as a Percentage of GDP, 1990, 2001 and 2008

Year		1990	2001	2008
Health <sup>a</sup>	Public (1)	1.9	2.8	3.3
	Private (2)	2.2	3.8	3.6
	Total (3)	4.1	6.6	6.9
Housing	Public (4)	0.9	0.9	1.3
	Private (5)	3.8	3.5	4.0
	Total (6)	4.7	4.4	5.3
Social Security	Public <sup>b</sup> (7)	6.6	6.1	4.3
	Private (8)	0.4	1.4	1.6
	Total (9)	7.0	7.5	5.9
Education <sup>d</sup>	Public <sup>c</sup> (10)	2.4	4.1	4.2
	Private (11)	1.6	3.2	2.7
	Total (12)	4.0	7.3	6.9
Other Social	Public (16)	0.9	1.1	1.2
	Private (17)	0.0	0.0	0.0
	Total (18)	0.9	1.1	1.2
Total	Public (19)	12.7	15.0	14.3
	Private (20)	7.9	11.8	11.9
	Total (21)	20.7	26.8	26.2

*Sources:*

(1), (4), (7), (10), (13), (14), (16) and (17): Government Finance Statistics 2003 and 2009, Dipres.

(2) and (5): National accounts of the Chilean Central Bank, Annual Reports 1999, 2002 and 2009.

(8): AFP Supervisor and Social Security Supervisory Agency.

<sup>a</sup> The 2008 health expenditure comes from OECD data.

<sup>b</sup> Public Expenditure on Social Security – Public Expenditure on Recognition Bonds.

<sup>c</sup> Excludes municipal education spending financed with own resources.

<sup>d</sup> Education spending from 1990 onwards comes from data prepared by MINEDUC. Data from previous years come from the national accounts of the Central Bank.

It has been shown that social spending has grown since 1990. Here one can see that private spending has increased even faster than public spending, especially in the areas of social security, health, and education, where there is significant growth in private financing.

In the coming years, private financing on social security will surely continue to rise, along with private expenditure on health care (according to economic growth).

This significant private sector participation frees the state from universal funding of certain benefits,

and enables it to concentrate tax revenues on benefits for families who cannot self-finance their social protection, thus making social policy more equitable. Although the state is freed from funding, this does not guarantee access for all who need the benefits or the proper functioning of the benefit systems. In fact, this way of organizing social programs gives rise to new regulatory needs where there are market failures. Efforts that have been made along these lines will be discussed below.

Moreover, this form of financing provides social service users with a wider offering of providers, creating better conditions for quality improvement and services that are more responsive to user needs and demands. If regulatory issues are well resolved, this scheme will be more equitable, since the Government can concentrate on the most needy segment and be more responsive to user requirements.

The method used here for measuring Chile's national social expenditure has been recently used in the OECD to compare social spending in countries with different policy approaches. These estimates, apart from the mandatory contributions to social security and health care that are not part of the public budget, also include voluntary contributions (by employers, in many cases). The OECD estimates differentiate between gross social spending, i.e. before taxes, and net social spending, after payment of taxes and tax exemptions. This is important because there are some social benefits that pay taxes (e.g. pensions) and some private contributions that are exempt and/or receive tax benefits. The higher the spending, the higher the tax burden and therefore the more important the difference between gross spending and spending net of taxes.<sup>81</sup> This distinction was not used in the figures for Chile given in this study. On the other hand, the

<sup>81</sup> Several OECD studies are available on this topic: Adema (1997) What do countries really spend on social policies? A comparative note, OECD Economic Studies No. 28; Adema, W. and M. Einerhand (1998), "The Growing Role of Private Social Benefits"; Adema, W. and M. Ladaique (2009), "How Expensive is The Welfare State?: Gross and Net Indicators in the OECD Social Expenditure Database (SOCX)."

measurements used here included public and private spending on education, which generally is not included in the studies cited.

The conclusion from comparing national social expenditures among OECD countries is that the differences between countries are much lower than when only government social spending is analyzed. Private spending is growing in some countries that

have introduced reforms to encourage it. As noted in these studies, "To get a picture of the amount of resources devoted to meeting social needs in a country, both net public and net private social benefits should be considered."<sup>82</sup>

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<sup>82</sup> Adema, W. and M. Ladaique (2009) p. 49.



# SOCIAL POLICY APPROACHES

It is interesting to examine the approaches that, more or less explicitly, characterized social policy during these years. There are several important dimensions to these approaches or paradigms. Below is an analysis of six relevant dimensions and how they have characterized the policies of these years.

## 1. Insurance versus transfers

When need arises from a situation that is not permanent (unemployment, sickness, disability, maternity, old age), it can be insured, making room for social insurance. However when the need is permanent due to lack of skills and/or opportunities for overcoming poverty, transfers or subsidies are used. In many cases both situations occur simultaneously and this makes it difficult to discern the best way to intervene. Social policy has taken both directions in these two decades. Transfers were increased both in coverage and benefit amounts, and insurance was improved. Examples of the latter are: compulsory savings for loss of employment for domestic workers (1992); unemployment insurance (2002); and the pension reform (2008), which improved the insurance system and, in particular, introduced old age and disability insurance for self-employed workers, a very significant and traditionally unprotected sector. The AUGE healthcare plan (2003) expanded public and private insurance coverage to the defined health programs made explicit in the plan.<sup>83</sup>

## 2. Assistance vs. increase in capacities and opportunities.

No one will dispute that the desirable thing to do is support an increase in capacities and opportunities. However, often the urgency of needs and/or the difficulties and time needed to develop capacities necessitate action through assistance or welfare programs. Both types of initiatives were seen in the twenty-year period under discussion, but priority and emphasis have been on initiatives to increase capacities. This can be seen in the priority in resource allocation given to children and young people as compared with older people. Resources for education grew much faster than those for pensions.

Apart from this strong priority on education, there were also initiatives facilitating the incorporation of women and young people into the labor market. Support in financing small enterprises and microenterprises has had the same aim, generation of opportunities.

Prevention and promotion of healthy and effective behaviors is similar in nature to the generation of skills and opportunities. In most social policies, people's behavior is crucial to the outcome. In health and education this relationship is particularly clear. In education, the result depends on the student, with his or her individual self-esteem,

<sup>83</sup> There were originally 15 conditions in 2005; currently there are 69.

motivation, interest, and effort. In health, it depends on the patient, with his or her individual illness prevention habits and motivation to recover when sick. To be effective, policies must consider and prioritize these personal behaviors. In the period in question, there are some initiatives along this line, but it would be desirable to put much more emphasis on this area. Notable examples are the preventive health care with the care of mothers and newborns, primary care, investment in sanitation infrastructure (water supply, sewerage, water treatment), and the strengthening of disease control policy. In the case of education, noteworthy initiatives include the updating of the curriculum and course programs, to make them not only more relevant but also more in line with the interests of young people; the upgrading of textbooks and teacher training programs; and MECE (Improvement in the Educational Quality and Equity) programs for young people in secondary education (a stage where motivation is very important). Alcohol and drug programs and sex education in the school system are some initiatives that were prioritized during these two decades.

All in all, this is an area where more initiatives should be innovated and tested.

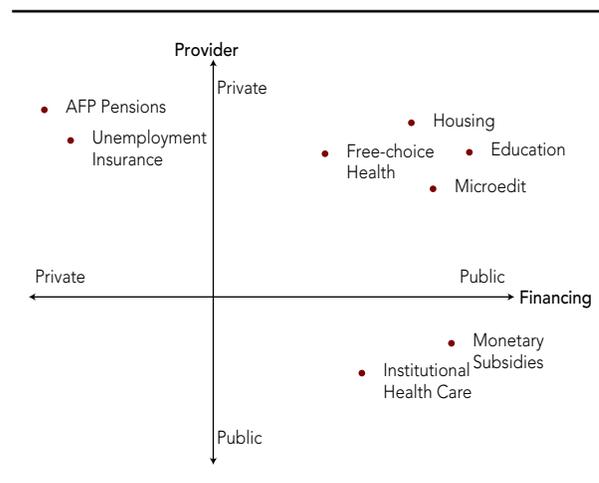
### 3. The complementary relationship of the public and private sector in financing and providing services.

In almost all areas of social policy, the state, families, and provider entities (companies, corporations, foundations) act together in financing and providing services. The extent and manner in which they do so will lead to different results from the point of view of equity and efficiency. A distinction should be made between mandatory private funding (e.g. contributions for pensions, health, and unemployment) and voluntary funding (e.g. medical copayments, voluntary savings for retirement, and cost sharing for education). Also, the public provider could be the Central Government or the municipality.

Figure 9 illustrates these combinations.

During the 20-year period, there was a diverse use of these combinations. In general, the state sought to leverage private providers (examples:

**FIGURE 9:** Financing and Providers in Public and Private Sectors



microcredit subsidy granted by financial institutions, unemployment insurance, housing, electricity and communications in rural areas). Also, in education, private providers (subsidized schools and higher education institutions) gained ground where they competed with public providers (municipal schools and state-owned universities). In contrast, private insurance providers (ISAPRES) lost health insurance participation to the public provider (Fonasa).

The increased involvement of private providers is reflected in the fact that public resources increased much more than the government personnel in the ministries in charge of the social policies, as shown in Table 15.

In terms of financing, the public sector increased its contribution (strengthened the solidarity pillar) with the pension reform, and also increased its contribution to higher education with the establishment of loans and scholarships for students enrolled in private institutions, and to the preschool level with the universalization of the pre-kindergarten subsidy.

While it is true that in virtually all cases there has been more public funding for social programs, as seen in the previous sections, the above examples are some references to changes in the financing structure of existing programs or the way the new programs were organized.

**TABLE 15: Government Spending Per Employee, Social Ministries**  
Millions of Pesos in 2009 Currency

Year	Education	Health	Social Security	Housing
1995	133.9	16.7	416.3	151.0
1996	150.8	18.1	445.1	170.3
1997	1617.0	19.1	453.2	164.0
1998	176.4	20.2	464.1	161.4
1999	196.6	21.0	497.6	186.2
2000	183.5	22.2	449.0	188.0
2001	190.6	23.1	528.3	183.4
2002	202.0	23.4	529.5	186.5
2003	205.4	24.1	538.1	186.2
2004	224.5	25.4	550.6	214.0
2005	222.5	27.1	571.8	249.9
2006	234.3	29.9	576.6	269.0
2007	242.5	32.8	568.3	298.6
2008	260.1	33.7	572.1	352.1
2009	275.1	39.5	594.2	409.1

Sources: Calculations based on: Public Sector Human Resources Statistics, DIPRES. Government Finance Statistics from the respective years, functional classification of expenditure, DIPRES.

#### 4. In almost all the social services analyzed here, the markets or quasi-markets operate with special features.

It is worth reviewing these features to see how they have been addressed.

There are many situations that can lead to market failures: externalities exist. There are significant information asymmetry problems between the user and the provider (doctor, teacher, clinic, school, university, insurance company, bank). In many cases these involve complex decisions that a person makes once or twice in a lifetime and which have high costs if he or she wants to turn back (pension decisions, school and career choices, home purchases). There are possible active selection behaviors the provider (school, insurer) may adopt to avoid the most costly cases, and the insurer for its part faces possible adverse selection and moral hazard. There is also uncertainty and underestimation of risks by individuals (illness, accident, death). The special conditions affecting the financial and capital markets are also relevant, in particular for pension savings and housing

financing. All the realities touched upon here require government action through proper market regulation and/or improved decision making.

These actions can be grouped into several categories and different forms of regulation: improvements in information; requirements and standards for providers; increased competition among providers; and user organization. Virtually all of these initiatives have been used over the years to improve market performance. Not including aspects related to the capital<sup>84</sup> and financial markets, here are some of the initiatives:

- Information: improvement and expansion of SIMCE tests and participation in international learning assessments; service quality and cost surveys for AFP and ISAPRES; national testing for graduates of medicine and education (Prueba Inicia); information on the employment success of higher education graduates. Information on quality of service continues to suffer large deficits and should be an important part of the future agenda. There is currently significant global progress being made on this highly complex issue.
- Requirements and standards: accreditation of university degree programs; quality assurance and the new Education Supervisory Agency; hospital accreditation; residential construction standards. In terms of university degree program accreditation, medicine and education have been prioritized.
- Competition: System with different pension offerings (annuities versus scheduled retirement).<sup>85</sup> Tenders for: new members in the AFP; unemployment, disability and survivors insurance; rural electrification and telecommunications subsidies; microcredit subsidies; and student loans. Competitive funds for social programs.
- Bundling of demand: Applicants for housing subsidies; committees for participatory paving programs; AFP affiliates for bids.

<sup>84</sup> For more on the development of the capital market in these years, see a list of the main legal changes in Mazzo, Rodrigo (2010).

<sup>85</sup> This system was introduced in 2004. See an assessment of its effects in Halcartegaray and Miranda (2011).

- Coordination of service offerings. Often state initiatives have poor coordination and those most in need have difficulties accessing benefits, due to a lack of knowledge and conditions needed to meet the requirements. To compensate for these difficulties and to support the effort of overcoming extreme poverty, the Chile Solidario program was created (2002).

The fact that the state is not a direct provider does not exempt it from responsibility. Rather it obligates the state to be vigilant and active in finding intelligent ways to address potential market failures from their roots. This is a major policy design challenge.

### 5. Legally defined contributions versus benefits

When the state imposes compulsory insurance, it can define contributions and let the resulting coverage be determined by the behavior of the relevant variables (in the case of pensions: earnings growth, life expectancy, retirement date, return on investment, etc.), or it can do the opposite, legally define the benefits and/or coverage afforded. In the first case (DC), the state defines the mandatory premium, so coverage and benefits are the result of the behavior of risks and other market variables. Alternatively, with legally defined benefits (DB), the state establishes the coverage and benefits, and the premium is the amount necessary to finance the coverage. Although the two systems are considered to have the same cost, risk distribution and the behavior of the different actors vary in the two cases.

The choice of scheme produces a very significant difference, the consequences of which are not always visible. It is therefore useful to analyze these consequences before examining the changes made in this respect during these decades.

It is useful to make a comparison between DB and DC in the case of old age pensions. Under DB, the law defines the pension amount (in UF<sup>86</sup> or as a percentage of pay in a given period) and the conditions and requirements for obtaining the benefit. In the case of DC, the law establishes compulsory contributions and the pension depends on the contributions accumulated at the time of retirement. The latter occurs not only in a system where individual

account funds accumulate; it may also occur if the formula for calculating the pension depends on the contributions made and life expectancy at the time of retirement.

In practice, there is not a pure DC or DB system; the systems are a combination of both schemes. In a DB system benefits are always linked to individual contributions, and in a DC system there are risk pooling regulations, and therefore the benefits are not linked solely to the contributions and risks of each contributor. The figure below illustrates possible combinations.

What should be emphasized here is that there are differences between the two systems in the way different actors react and behave in response to risks and uncertainties. Therefore, the adjustment to changes in critical variables is different and produces different results.

For example, if life expectancy is raised in the post-retirement stage, under a DB system this increased cost is assumed by the state and this will force the state to raise the contributions and/or taxes, and/or reduce other expenses to fund the increased pension costs. In contrast, in a DC system, the pensioner will receive a lower pension unless he or she postpones the age at which he or she retires and/or increases his or her savings in anticipation of this increase in life expectancy.

There are also differences in the adjustment to changes in asset returns and wage growth.

Moreover, the DC system requires beneficiaries to make more decisions than the DB system, where the main decisions are made by the authority. For example, in the case of retirement pensions, the beneficiary must decide how much additional savings to accumulate, where to invest the funds saved, when to retire, and how to distribute the pension flow over time. These are complex decisions and the beneficiary does not always have adequate preparation and advice. In the DC system more risks are transferred to individuals, while in the DB system, the political system must manage these risks.

<sup>86</sup> Since the UF (unidad de fomento) is indexed based on the CPI, the pension's purchasing power is protected from inflation.

It is important to note the differences in the political economy and behavior of the political system under both schemes. For example, when a change in the law increases benefits and coverage, the public perception of the costs is immediate in the case of DC and may be far off in the case of DB; in this case, the cost may even be passed on to the next generation.

For the population, in the DC system the costs of introducing changes to benefits and coverage are much more evident than in the DB system. Benefits under DB tend to be considered entitlements and downward adjustments are much more difficult for the political system.

The quality of the political system, the nature of constitutional procedures for changing the DB and DC, and good information and financial projections regarding these benefits make an important difference in how these systems function.

One can look at the major tensions in Europe's political system to comprehend the difficulty of making changes to DB systems. These countries have experienced serious demographic changes (aging population) and economic changes (unemployment) that have made it necessary to reduce the defined benefits.

The difference between these schemes not only involves differences in political economy and the behavior of the actors; also behind these schemes is the distinction between responsibilities (DC) and rights (DB). This is part of the argument that underlies the debate on social policy and the welfare state.

During the twenty years under study, there have been changes in the DB/DC combination in the pension system. Changes occurred under the pension reform of 2008 and under the 2003 healthcare reform, and choices between the two mechanisms were made when introducing unemployment insurance and severance savings for domestic workers.

An implicit assumption of the 2008 pension reform was that the system in place since 1980 rested too much on DC and gave very insufficient protection, especially for women. Therefore the DB component was expanded, thus strengthening the solidarity pillar.

Originally, unemployment insurance was almost exclusively DC, but after an assessment of its performance and results, the DB component was

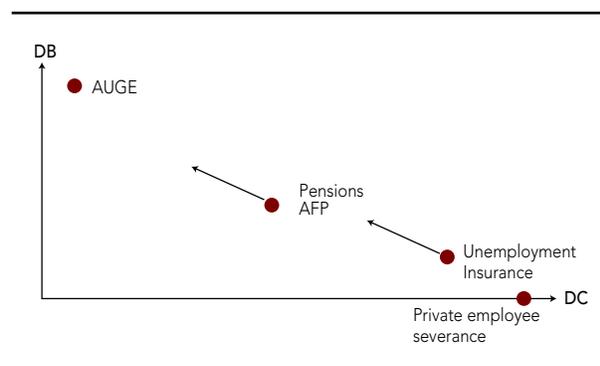
expanded. In the case of severance savings, there is only DC.

Finally, the healthcare reform, with the so-called AUGE Plan, explicitly introduced a DB scheme. This change was designed to give legal guarantees for a plan with benefits explicitly defined by the authority. This change significantly transformed the dynamics of the health sector and the way that authorities and doctors prioritize health problems. Prioritization is unavoidable in any health system, given the limits on resources and the increasing development of new technologies and medical responses. The health reform, by introducing a DB approach, changed the shape and dynamics of how this prioritization is determined.

Figure 10 illustrates the combinations of these two mechanisms in the policies and the direction of changes that occurred in the period.

In short, the distinction between DC and DB is quite important, though not always correctly perceived, and has significant consequences for the dynamics of social policy performance and the risks to which individuals are exposed.<sup>87</sup>

**FIGURE 10:** Legally Defined Benefits (DB) and Contributions (DC)



<sup>87</sup> At the international level there have been major changes in the use of both schemes. For example, in the United States, retirement pensions paid by the employer went from being mostly DB to mostly DC. In 1985, 35 percent were DC, a percentage that rose to 61 percent in 2009. In addition the funds invested in private pension funds increased by more than four times. See Ryan, Trumbull and Tufano (2010).

## 6. Public Goods

In the area of social policies one finds a significant presence of public goods, which are defined as non-excludable goods or services, that is, a person using or consuming them does not prevent others from doing so. These goods and services by their nature are necessarily state-funded and become more important with the growth of cities.

A case in point: in 1992, an urban park investment program was established, and to date thirteen

parks have been created with a total area of 97.5 hectares, located mainly in the peripheral areas of the Metropolitan Region.

Another increasingly important public good that has not been addressed in this study is public safety. The safety of people, particularly in cities, is a typical case of a public good that the state must provide and which receives growing resources. Public safety has also become a critical aspect of quality of life, particularly for the poorest people.

## INNOVATIONS IN SOCIAL POLICY

Since the return to democracy, there has been an effort to innovate with respect to social policy, in order to provide new solutions for social needs and also to address needs or groups that traditionally have been neglected and/or have emerging needs.<sup>88</sup>

The spirit of innovation is manifested in the new FOSIS solidarity fund, created in October 1990. One of its objectives was precisely to innovate and develop initiatives that until then the state had not addressed. FOSIS gave rise to the microcredit subsidy project and the microentrepreneur technical assistance project, which have seen significant subsequent growth.

In 1996 the program ChileBarrio came into being. This program is aimed at addressing the housing situation of families living in slums.

In 2002 the Chile Solidario program was born. This program is aimed at about 230,000 families in extreme poverty and offers personalized support to ensure their incorporation into the network of state social programs. As seen above, there are still a significant number of households that, despite being in poverty, are unable to access the social network, and suffer all the negative consequences this entails. The program's efforts to ensure that the social protection network effectively reaches families in extreme poverty are worthy of mention. This program systematically identifies all the families in this condition and helps them access all the social programs that apply to them. It also provides extra monetary support for two years, in a temporary and decreasing fashion. An aspect that is just as important as these additional financial resources is the personalized psychosocial support the family receives, in order to identify

what it needs and to plan how to use the social network to overcome its situation (through the FOSIS Programa Puente). The program aims to address the entirety of the situation of poverty and therefore also addresses the entirety of social policy, not just sectoral policies. The state organizes policies by sector, but the needs of families are comprehensive and not necessarily sectoral. Herein lies the unprecedented value and innovation of this program. At the same time, it serves as a learning opportunity for the state on the flaws and potential of the social network that serves the needs of the poorest segment.<sup>89</sup>

Another effort to integrate sectoral initiatives is the comprehensive early childhood protection program, Chile Crece Contigo, launched in 2006. This program united the proposals of the Presidential Advisory Council on the Reform of Child Policies.

Also, a number of initiatives have been created to address specific population segments based on their special needs or characteristics: the indigenous population through CONADI and the Orígenes program, and the disabled population through the FONADIS Disability Fund.

In every area of social policy there have been innovative initiatives in terms of meeting needs. Some are cited below by way of example. In education, there is the P900 program for the most needy schools, the MECE programs to improve educational quality,

<sup>88</sup> The analysis in this section may be complemented with the analysis done by Serrano and Raczynski (2005).

<sup>89</sup> See a description at the following link. A network for sharing learning experiences can be accessed at the following page.

the Enlaces IT network, the preferential per student subsidy for priority students, the capital contribution for the extended school day program, and the new scholarship and college credit systems. In housing, there is progressive housing, the urban densification subsidy, new housing subsidy initiatives, the participatory paving programs, and drinking water and electricity subsidies for the poorest families. In income generation, there are programs for female heads of household, severance pay for domestic employees, and the unemployment subsidy. In health care, there are the emergency systems of the 1990s (primary emergency care [SAPU] and SAMU 131), the AUGE plan of the 2000s, and self-run, concessioned hospitals.

Non-governmental organizations acting as service providers for the most needy people have been an additional source of innovation. Social policies

have made room for non-governmental providers in almost all areas of social programs. Competitions for public funds have been held for new initiatives and programs, and these have generated new and increased opportunities for innovation. The greater space resulting from tax exemptions for social donations had the same effect. This is how “social entrepreneurs,” who innovate and seek new solutions to social problems, have been encouraged.

However, there is room and need for greater innovation in order to respond to continuing social needs and to take advantage of changes in technology and the successful experiences of other countries. This requires a practice of innovation, where social programs and initiatives are piloted and then assessed. More room must be made in public policy for pilot programs and all that they entail, including evaluation, reform, and closure when needed.

## PROFESSIONALIZING SOCIAL POLICY: DESIGNS, EVALUATIONS, TARGETING METHODS

During this period, social policies went through a growing professionalization, in everything from design, implementation, and assessment to political debate and approval. There has been increasing participation of professionals specialized in these issues who studied best practices, and they have applied concepts of economics, sociology and public policy design to this area.

This has been important in generating new data and statistics. The CASEN survey is one important example. This national survey has been held every two or three years since 1987, with the specific goal of supporting the study and assessment of socio-economic reality, poverty, and policies. Also noteworthy are several new surveys of social safety nets and other social surveys done by the new *Microdata Center* at the Center of Economics at the Universidad de Chile.

The National Budget Office has been promoting efforts to improve *management of public programs* since 1993. In 1997, it incorporated a systematic assessment, conducted by independent experts, of programs and institutions. This program to date has enabled an assessment of almost every social program, which in turn has helped improve existing programs and better design new initiatives.

Meanwhile, the methods used to identify the intended beneficiaries of policies have improved, thus better directing resources to the target population. The CAS card (Ficha de Comités de Asistencia

Social), used to qualify for social assistance and introduced in 1987, underwent a refinement process. After some modifications this culminated in the introduction of the Social Protection Card (Ficha de Protección Social) in 2007. The CAS card was applied in a decentralized manner by municipalities, responding to direct requests made by families. In late 2005, there were about 2 million families with the CAS card.

In 2007, as mentioned, it was replaced by the *Social Protection Card*, which aims to go beyond basic needs and address the vulnerability and risk of being in poverty, which necessitates support and social protection. The concept of vulnerability allows for a dynamic notion of poverty as an actual or potential condition, and at the same time provides a better characterization of “hard” poverty as those households that consistently have income levels below the poverty line.

In 2010 there were 3,670,000 households, 65 percent of the national population, who had this card. The card is used to allocate resources in 60 public programs that accounted for 15 percent of public social spending in the 2010 budget. The need to further refine this instrument led to the establishment of an expert committee, which has issued a diagnostic report and given recommendations aimed at improvement. Similar advances have taken place in educational policy. The SIMCE tests measuring

student learning have continuously expanded and improved, Chile has begun participating in the international TIMSS and PISA tests, specialized professional training programs have been established, and numerous *studies and assessments* of Ministry of Education programs have been conducted. Similarly noteworthy is the creation of the *MIDEUC* center, specializing in the evaluation of student learning and teacher assessment.

The concept of professionalization of social policy design also includes the formation of diverse committees, made up of relevant actors and specialists, to make policy design recommendations to the authorities. The most significant include the Unemployment Insurance Users Committee (2002), the Presidential Advisory Council on Pension Reform (2006),<sup>90</sup> the Presidential Advisory Council on Labor and Equity (2007), and several others in the field of education such as the National Commission for the Modernization of Education (1994). Also, technical committees have been created to monitor the performance of certain policies and/or to advise on decision making. These include, for example, the Pension Fund Investment Technical Council created under the pension reform to produce reports, proposals, and pronouncements concerning these investments, and the Pension Advisory Council to advise the ministers of labor and social security and of finance on matters related to the pension system.

In these multistakeholder committees or councils, efforts focus on finding practical solutions that are effective at achieving the desired objectives, taking into account their second-order effects. This is a way of moving beyond debates that in other circumstances would be very ideological, and constructing more lasting solutions.

Another worthy contribution is that of the technical teams of the World Bank, IDB and more recently the OECD, which through technical missions and/or loans have provided an external perspective

and a comparison of the Chilean reality and policy proposals with international best practices.

A frequent criticism of the social policy of these years is that while at the macro or aggregate level they were adequate, this contrasted with what happened in practice, or at the micro-level. At the program-specific level, examples of this are numerous and are identified in several of the assessments commissioned by the National Budget Office. The problems have to do with the human, management, and organizational capacities. For example, in municipalities, which have important responsibilities in the implementation of social policies, these deficiencies are common. The same is true in many cases in the different ministries.

State modernization—the state's increased capacity to manage and respond to new tasks—has been slower than the increase in financial resources. This has caused the frequently observed difficulties in implementation.

Once the lack of economic resources is overcome, these capacities are the critical variable. This is one more reason that realism and gradualism in social policy objectives are so essential, along with explicit capacity building and development proposals.

In any case, this professionalization is a new reality through which the country has developed the capacity to expand and improve their social policies. This new reality is very different from that of thirty years ago, when the first modern studies on the distributional impact and efficiency of social programs were published (Foxley Aninat and Arellano [1980] *Las desigualdades económicas y la acción del Estado*, Arellano [1985] *Políticas Sociales y Desarrollo 1924–1984*, Rodríguez Grossi [1985] “La distribución del ingreso y el gasto social en Chile 1983,” ILADES).

<sup>90</sup> Arenas 2010 details how this contributed to the success of pension reform.

## SOCIAL POLICY'S POLITICAL-LEGISLATIVE PROCESS AND DEBATES

Naturally, in the creation of the policies described here, there have been many debates and differences among the various actors involved, which ultimately led to the outcomes that have already been discussed. Without attempting a detailed analysis of this process, some general points should be noted.<sup>91</sup>

Below is a review, first, of the main debates and differences between political alliances (the governing center-left coalition vis-à-vis its center right opposition), the role of unions, and the new debate on the middle class and social benefit coverage, that explores how and why differences were overcome. Last is an analysis of the role that institutional framework, i.e. the legal and constitutional rules of the game, has played throughout this debate.

**The main political differences** centered around financing the benefits of social programs.

The opposition has consistently opposed tax increases. In 1990 the Government deemed that any improvement in benefits was conditional on approval of the tax reform, which in the end was obtained temporarily. This approval of tax increases for short periods—a few years—was repeated. This forced the Government to re-discuss funding every few years. (It is contradictory that in the case of tax exemptions, where there are very good reasons to approve temporary changes, numerous exemptions have been permanently approved).

The other major conflict between the Government and the opposition has revolved around the

role of the state and the market, or more precisely, of private providers in social programs. This has been an ongoing topic of dispute and debate in all social program reforms. Here, ideological differences have dominated, even though, as in the case of financing, agreements were reached to introduce regulations promoting behavior that would produce the desired results while maintaining the role of private providers.

Apart from the Government and the opposition, trade unions and business associations have also played a role in the debate. Since the Teacher Statute in 1990, the teachers union, the medical doctor association, and public service employee associations have, in most cases, opposed reforms in the interest of obtaining greater benefits for their members. This has limited their professional input, given that their proposals have been almost exclusively dominated by union and profession-specific interests, weakening not only their potential contribution but also their support from public opinion.

For their part, private provider organizations have also been resistant to change and to regulation of the markets in which they operate. The extreme example is that of the ISAPRES, which have been very averse to the change that has, albeit slowly, been imposed.

<sup>91</sup> An interesting and documented analysis of this issue can be found in Boeninger Edgardo 2007, *Políticas públicas en democracia*, Uqbar Editores.

In recent years there has been increasing debate and tension between targeting of benefits and the needs of the middle class. In the early years, there were virtually no voices questioning the targeting of benefits to the poor. Over the years the protest against the so-called “abandonment of the middle class” has been growing in importance in the discussion of social policy, and in fact has slowed the increase in progressivity achieved in the 1990s (although some new programs, targeted by definition, were introduced in the 2000s). Behind this argument is the successful reduction of poverty from over 40 percent to less than 15 percent, reducing the population benefitting from programs for the poor and increasing the number of people who do not receive these benefits. Significant challenges in managing targeted benefits arise when families must leave programs because they no longer meet the requirements to qualify as beneficiaries. Moreover, the middle class has to help finance many services that were either highly subsidized or free when they were created. This is the case in education and health care, where fees have been raised in real terms or relative to wages, increasing the burden for the middle class.

Undoubtedly, this tension will continue in the future, putting limits on progressivity. Limits on the degree of progressivity do not mean that replacing the current progressivity with state-financed universal benefit systems must be considered as an option. Rather, the goal is to continue the work started during this 20-year period, funding fiscal transfers to the poorest segment but ensuring that for the rest of the population there are properly regulated public goods, services, and insurance, in a way that allows equitable access, effective coverage, and equal opportunity.

Despite the differences described above, **consensus building** prevailed. This was helped along by a strong emphasis on good governance, starting with Aylwin’s administration, as a key to the successful transition to democracy. This objective remained strong in subsequent governments and resonated with the opposition, which also sought a successful transition. This search for consensus has been indispensable to achieving results, as no governments have had parliamentary majorities

and therefore have been forced to reach agreements with at least part of the opposition. Thus priority was placed on the search for state policies, i.e. policies with broad support. Pluralistic political and technical committees with a high level of prestige played an important role in reaching agreements with solid foundations based on good institutional and policy design.

This has all contributed to the stability of policies and reforms introduced in this period, and this stability has been the root of their effectiveness. Typically, in other historical contexts and in other countries, there are permanent changes in policy from one administration to the next, generating strong conflicts and weak impact due to high instability.

To achieve these agreements and results, constitutional and fiscal **institutions** have been very important. This institutional framework has several important aspects worth mentioning. Agenda control is in the hands of the president, who has the exclusive right to propose tax and pension changes and can take the lead in the legislative process via urgency bills. Only the executive branch has the initiative in spending, taxes and changes in state organization. These powers, enshrined in the present constitution, are the result of a long learning process regarding the enormous dangers involved in an institutional structure where Congress has the spending initiative and can compete for granting social benefits regardless of the fiscal consequences. It was after the insistence of all the presidents since Juan Antonio Ríos in 1943 that President Frei Montalva managed to pass a constitutional change in 1970 ending the congressional initiative on pension benefits and the like. This had generated competition for providing social benefits and ultimately bankrupted the old pension system, leading to ongoing national budget deficits. The current institutional structure places administrative responsibilities with the president of the republic and grants him or her power in negotiations with the legislature. (A more detailed analysis of this issue can be seen in Arellano 2005, *Del déficit al superávit estructural: Razones para una transformación estructural en Chile*, CIEPLAN).

The executive branch also has extensive powers in the approval and implementation of the

annual budget. This, along with the other aforementioned constitutional provisions, has facilitated the solid fiscal results that characterized the period. In addition, the budget has been a valuable tool for experimenting with and introducing new social programs without having to wait for a full legal framework. In education, for example, the MECE programs and almost all new programs began as part of the annual budget, and then, based on how they evolved, became permanent legislation or were subject to revisions and adjustments. The same happened with housing subsidies, employment and training programs, new health programs, municipal and regional administration programs, and so forth. There is high flexibility for introducing new programs, innovating and experimenting. Strictly speaking the new programs have a one-year life span, like the budget law, but if they work, they can continue and where applicable be converted to permanent law.

Finally, managing people's **expectations** is an important issue. It is not enough to have institutional rules to control the political competition that could trigger public spending or take it to unsustainable levels: the expectations and demands being encouraged are highly important. The needs far exceed the short-term solutions, hence the necessary gradualism. This concept implies a high degree of responsibility, unlike populism, which is characterized by raising expectations via the state instead of adapting expectations to reality. The rejection of populism and the promotion of gradualism in satisfying social needs and fulfilling goals has been a crucial, constant factor in the achievements described herein.

In short, this road, which emphasizes good governance, aims for consensus, and rejects populism, has been possible thanks to a political class that has managed to generate quality policies. Without political actors willing to seek a state policy, it would have been difficult to arrive at the outcomes described here.



## CHALLENGES

With all that has been achieved, the challenges are still numerous. Two types of challenges deserve to be analyzed in greater depth: quality of services and new problems.

As new demands and challenges arise due to the progress made during this 20-year period, it is valuable to examine how these actions project into the future.

### Quality of Service Challenges

First of all, there are challenges associated with the still low quality and lack of equity in social services paid for with public financing. This is particularly true in health care and education. In both cases, almost universal coverage has been achieved (professional prenatal and postnatal care, child health monitoring, basic and secondary education), but the quality of the services is still unsatisfactory. Significant efforts have been made to improve quality, particularly in the case of education, where much of the effort has been directed at improving equity and quality. However, the quality challenge remains unsolved, in a social and economic context that increasingly demands both more education and more *from* education. Health care is in a similar situation, where thanks to technological advances, there are more and more options for addressing health problems.

In the case of housing, quality issues are also present, but take a different shape. They have to do with construction quality, the size of homes, and, in particular, urban problems, such as congestion and public transport deficiencies that increase commutes, lack of public spaces, and so forth.

Service quality challenges depend as much on management as on the amount of resources invested. It could be said that while the coverage challenge is mainly a question of resources, the quality challenge is mainly a question of management, regulation, proper incentives, capacity building, and system organization. Capacity building incorporates top-level professionals: teachers, healthcare personnel, and the corporate governance of services providers (schools, universities, hospitals) in order to create institutions that are more competent in providing quality solutions to increasingly complex demands.

In addition to capacities and management, the information, control, and quality assurance systems must also be improved, thus the increasing importance of instruments such as the educational quality measurements (SIMCE), international learning tests, and institutional accreditation of educational and health programs. The CASEN survey is an instrument that helps assess the effectiveness of the state's social policy. These are examples of the trend towards enhanced quality measurements.

Of course, issues of quality are not the only challenges; there are still problems of coverage and access. Among the most important are preschool care and elderly care.

All recent evidence underscores the crucial role of preschool in an individual's future development in the school system, in the working world, and in society in general. Good early childhood development is a key factor in combating poverty and social exclusion. The country still has a long

way to go in supporting parents in the development of children under three years old.<sup>92</sup>

### Challenges Associated with New Problems

The second type of social policy challenge arises from the new realities and new problems facing Chilean society. Some of the most important challenges are listed below.

First is the aging population. In 1950 there were 18 people over 60 years old for every 100 children under 15 years old. In 2000 there were 36, and by 2020 there will be 70 people over 60 for every 100 children under 15. In other words, the change of the last 50 years is being repeated in a period of only 20 years. This rapid aging is occurring in a context where society is not sufficiently prepared to deal with the new kinds of problems it entails, either from the familial point of view or the public policy point of view.

Just looking at the health sector, one can see that the new requirements will be enormous. The healthcare cost per beneficiary over 65 years old in FONASA is 2.6 times that of the rest of the population. In the OECD countries it is 3 to 5 times higher. A World Bank on Chile study estimated that healthcare costs over the next 15 years, with the current FONASA technology and level of use, will rise by 2 percent per year just for the aging population.

Other issues are the lack of care for adults who cannot care for themselves, poor housing conditions for families to care for their elders, a lack of professionals trained in the care of the elderly, and more.

Another challenge has to do with changing epidemiological patterns related to aging and the appearance of new conditions. Among children, for example, malnutrition has virtually disappeared, coming in at 0.7 percent in the last measurement, while extra weight and obesity have more than doubled.<sup>93</sup> Among adults the change is seen in chronic and infectious diseases: diabetes, hypertension, cancer, and others that are common to the epidemiological patterns of most developed countries. This means that health policy must be adapted, but also has much broader implications that must be addressed through education, housing and urban planning.

The infiltration of drug traffic and consumption and the ensuing damage is another challenge.

This was a phenomenon of only minor importance in the late 1980s that social policies have had to begin addressing.

Issues of public safety have become of increasing concern to the population, as they affect the quality of life. The public agenda and social policies must include these issues among their objectives.

The family is undergoing significant changes and new demands. Between 1987 and 1990 there were 100,000 marriages annually, whereas between 2005 and 2009 there were only 56,500 per year. The proportion of married women in the 25–34 year-old age group has fallen by more than 20 percent in the last 20 years. The marriage rate dropped from 8.0 in 1989 to 3.3 in 2008. Pregnancy has increased among teenagers, the only age group for which the fertility rate has not been reduced. Two-thirds of children born in 2009 were born to unmarried mothers.<sup>94</sup>

Women will undoubtedly see a growing participation in the labor market, following the trends in other countries. Social policy must consider how to incorporate these changes and what support the families will need in addressing these new challenges.<sup>95</sup>

New challenges like these can be addressed with a thorough analysis of the best public policy options and a clear priority in implementation. The significant progress made by the country in this period is proof that a country can move forward when there is clarity of purpose and determination. We hope that the information given here contributes to this analysis and the search for new solutions.

<sup>92</sup> See the work of Heckman (2006) and (2007) on the impact of preschool care and Esping-Andersen (2010) on different policies in OECD countries to address preschool care.

<sup>93</sup> Casen survey, see also *Estudio de la JUNAEB*. The problem of obesity is a growing problem in OECD countries, as seen for example in OECD, “Health at a glance 2001.”

<sup>94</sup> Only after 30 years of age were the majority of births to married mothers. See statistics: [http://www.ine.cl/canales/chile\\_estadistico/demografia\\_y\\_vitales/estadisticas\\_vitales/2011/Vitales\\_2009\\_21102011.pdf](http://www.ine.cl/canales/chile_estadistico/demografia_y_vitales/estadisticas_vitales/2011/Vitales_2009_21102011.pdf).

<sup>95</sup> See an interesting analysis of this issue in Gosta Esping-Andersen (2010), who analyzes the impact of changes in women and family roles and implications for social policy.

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# ANNEX

## Social Spending with Different Methodologies

Since 2003, government finance statistics information has been recorded with a new methodology.

For purposes of comparison, the two sets of data available for the period are shown.

## Social Expenditure 1987–2009 in billions of 2009 pesos

Methodology	Health Care		Housing		Education		Social Security		Other		Total	
	Old	New	Old	New <sup>a</sup>	Old	New	Old	New <sup>b</sup>	Old	New <sup>c</sup>	Old	New
1987	540	521	240	244	818	767	1804	2086	512	411	3914	4470
1988	629	629	240	290	813	755	1851	2154	456	381	4046	4209
1989	632	629	298	286	805	760	1904	2302	380	287	4007	4265
1990	603	600	286	300	778	735	1939	2130	353	273	3968	4038
1991	710	705	295	339	874	810	2015	2273	382	301	4334	4428
1992	830	827	352	400	1004	907	2137	2368	421	326	4786	4828
1993	931	924	392	458	1090	1016	2318	2497	478	357	5248	5252
1994	1026	1064	431	486	1189	1101	2397	2533	509	372	5571	5557
1995	1069	1117	471	512	1328	1240	2541	2642	566	409	5975	5921
1996	1162	1217	526	573	1500	1433	2736	2809	627	460	6551	6492
1997	1231	1289	498	551	1652	1563	2863	2861	674	495	6918	6760
1998	1332	1385	513	557	1841	1764	3035	2988	724	534	7445	7227
1999	1373	1453	504	618	1969	1966	3352	3197	828	563	8026	7798
2000	1488	1561	481	603	2139	2049	3519	3351	891	629	8517	8193
2001	1611	1690	512	588	2319	2210	3699	3407	912	694	9053	8589
2002	1691	1773	522	605	2497	2358	3719	3463	917	717	9347	8917
2003	—	1879	—	593	—	2392	—	3526	—	713	—	9103
2004	—	2019	—	684	—	2576	—	3609	—	713	—	9601
2005	—	2197	—	771	—	2575	—	3780	—	771	—	10096
2006	—	2488	—	825	—	2734	—	3884	—	827	—	10757
2007	—	2813	—	965	—	3042	—	3880	—	934	—	11635
2008	—	3012	—	1198	—	3513	—	3920	—	1066	—	12709
2009	—	3672	—	1441	—	4061	—	4312	—	1535	—	15021

Source: DIPRES, Functional classification of expenditure, Government Finance Statistics for the respective years

<sup>a</sup> This is composed of the classification of expenditure on housing and community services given by DIPRES plus the "Housing" item from the social protection expenditure.

<sup>b</sup> This is composed of the expenditure on social protection for the elderly.

<sup>c</sup> This is composed of the expenditure on social protection (minus expenditure on the elderly and expenditure on housing in social protection) and recreational activities, culture and religion





This book examines social policy in Chile between 1990 and 2009 through the eyes of one of its key actors. Special emphasis is placed on allocation of resources, the relationship between social, fiscal, and macroeconomic policy, and the relationship of these three types of policy with growth and equity.

The book covers each area of social policy: subsidies/monetary transfers, education, housing, pensions and social protection, health care, and income generation. The author analyzes the mechanisms used to prioritize social spending in the allocation of public resources. Within social policies, he examines the main criteria and priorities that guided allocation of resources.

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