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Mechanisms of institutional continuity in neoliberal "success stories": Developmental regimes in Chile and Estonia

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MPIfG Discussion Paper 13/10

**Mechanisms of Institutional Continuity in
Neoliberal “Success Stories”
Developmental Regimes in Chile and Estonia**

Aldo Madariaga



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Abstract

How do neoliberal political economies threatened with declining competitiveness and social cohesion manage to remain neoliberal over time? This paper explores mechanisms of neoliberal continuity in Chile and Estonia by extending gradualist approaches to institutional change with the notion of institutional hierarchy. Neoliberal continuity, it is argued, depends on the ability of dominant groups to defend those institutions that are more favorable to their interests while altering those that are not in order to obtain political support from other social groups. The question is explored in relation to the parallel trajectory of two policy domains: monetary policy (exchange rates) and industrial policy. Dominant groups try to retain a conservative monetary policy and a neutral industrial policy by altering their parameters (marginal adjustment), narrowing their interpretation (solidification), or negotiating minor/larger concessions (accommodation/compromise). While these mechanisms have allowed dominant groups in Chile and Estonia to retain neoliberalism, the timing and combination of different mechanisms over time have generated different trajectories of continuity. Estonia remains closer to a neoliberal orthodoxy whereas Chile has a more pragmatic trajectory.

Zusammenfassung

Auf welche Weise gelingt es neoliberalen Ländern, deren Wettbewerbsfähigkeit und sozialer Zusammenhalt bedroht sind, neoliberal zu bleiben? Das Papier untersucht Mechanismen neoliberaler Kontinuität in Chile und Estland, indem es ein Modell institutioneller Hierarchien mit gradualistischen Ansätzen des institutionellen Wandels verbindet. Die neoliberale Kontinuität eines Landes, so das Argument, hängt davon ab, wie erfolgreich einflussreiche gesellschaftliche Gruppen Institutionen unterstützen, die ihren Interessen zuträglich sind, und jene umgestalten, bei denen das nicht so ist, damit sie politische Unterstützung von anderen gesellschaftlichen Gruppen erhalten. Die Frage wird im Verhältnis zu parallel verlaufenden Trajektorien zweier politischer Domänen untersucht: Geldpolitik (Wechselkurse) und Industriepolitik. Vier Mechanismen werden beschrieben, die von einflussreichen Gruppen genutzt werden, um konservative Geld- und neutrale Industriepolitik aufrechtzuerhalten: marginale Korrektur (Änderung der Parameter); Verfestigung (konkrete Deutung); Kulanz/Kompromiss (Einigung auf mehr oder weniger große Zugeständnisse). Anhand dieser Mechanismen konnte der Neoliberalismus in Chile und Estland gewahrt werden. Durch die zeitliche Abfolge der Ereignisse und die Kombination verschiedener Mechanismen sind unterschiedliche Kontinuitätstrajektorien entstanden. So bleibt Estland näher an einer neoliberalen Rechtgläubigkeit, während Chile sich auf einem pragmatischen Entwicklungspfad befindet.

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Mechanisms of Institutional Continuity in Neoliberal “Success Stories”: Developmental Regimes in Chile and Estonia

1 Introduction

In the 1980s and 1990s, radical liberalization processes took place at the capitalist periphery. Countries such as Chile and Estonia became poster children of market reform through radical liberalization processes under strong neoliberal ideologies.

After more than twenty years of neoliberal development, structural transformations and successive external shocks have undermined these “success stories” external competitiveness, have produced patterns of capital concentration and specialization in low value added activities, and have severely threatened social cohesion (see Bruszt/Greskovits 2009). Dominant groups in both countries have nevertheless been successful in retaining neoliberalism, although in different ways. While Estonia has remained closer to the orthodox regime it established after the fall of communism, Chile has shown a more nuanced trajectory within an overall neoliberal consensus. Research on liberalization processes shows two pitfalls when trying to understand these trajectories.¹ It either concentrates too heavily on the political economy of market reform, overlooking how neoliberalism is then reinforced, or it depends too much on path dependency arguments and is unable to capture divergence.

The present article fills these gaps by 1) studying the mechanisms that have reinforced Chile’s and Estonia’s neoliberal developmental regimes, and 2) explaining the differences between their particular trajectories of continuity. In order to do this, the article develops an analytical framework that extends existing theories of gradual institutional change in advanced political economies by incorporating more systematically the notion of institutional hierarchy (Amable 2003; Amable/Palombarini 2009). Institutional continuity and change, it is claimed, depends not only on the characteristics of the political context and the degree of interpretability of institutions (Streeck/Thelen 2005a; Mahoney/Thelen 2010), but also on the relationships between different institutions (Pierson/Skocpol 2002: 696) and most importantly, how these relationships are conceived by interested groups, i. e. the institutional hierarchy.

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1 For a critical survey of the literature based on Eastern Europe see Greskovits (2000). See also Stark/Bruszt (1998), Bohle/Greskovits (2012).

Institutional continuity is explained by the ability of dominant groups to defend high-hierarchy institutions – i. e. those institutions high up in the institutional hierarchy that reflect dominant bloc's interests more directly or constitute the basis of the dominant bloc's political compromise. Dominant groups are able to defend such institutions by altering certain parameters so that institutional performance is enhanced (*marginal adjustment*) as well as by narrowing parameter interpretation (*solidification*), or by negotiating minor/larger concessions in lower-hierarchy institutions (*accommodation/compromise*). These mechanisms of change in individual institutions are complemented by longer-term efforts at modifying the very conditions that affect institutional change so that the possibilities for future shifts are reduced. Divergent trajectories of continuity, on the other hand, are explained by resorting to the importance of turning points, the timing of different mechanisms of continuity, and the sequences of change they engender. This paper contributes to the existing literature in three main ways: first, it enlarges current research on endogenous institutional change by emphasizing the political dimension of change, and providing a set of mechanisms explaining continuity; second, it elaborates on broader processes of continuity in neoliberal political economies; third, it incorporates the capitalist periphery into the debates on institutional change.

The article is organized as follows. The following section elaborates the proposed analytical framework and applies it to each country from the moment of transition to neoliberalism – understood as a critical juncture – through to its heritage.² Two policy domains are analyzed in parallel: monetary policy (exchange rates) and industrial policy. Extensive within-case exploration shows how the paths of these two policies are set, how they persist or shift at relevant turning points, and what sources, agents, and mechanisms of change are involved. A short comparative section then analyzes the broader processes of continuity the two cases illustrate as well as the factors explaining their different trajectories. The paper concludes with a general reflection about the usefulness of the proposed analytical framework.

2 Continuity and change in contemporary capitalism

“Se vogliamo che tutto rimanga come è, bisogna che tutto cambi.”
(Il Gattopardo, Giuseppe Tomasi di Lampedusa: 32)³

Over the last two decades, issues of institutional continuity and change have been increasingly concerned with identifying causal mechanisms that reinforce or break institutional trajectories (Thelen 1999; Mahoney 2000). The discussion has moved gradually from path-dependent and punctuated equilibrium mechanisms explaining the persistence of

2 This conceptualization of historical sequences follows that of Collier/Collier (1991) although it is used here in a looser sense.

3 “If we want things to stay as they are, things will have to change” (Lampedusa 1961: 28).

Figure 1 Gradual institutional change, Mahoney and Thelen's version

		Characteristics of the targeted institution: Barriers to internal change	
		high	low
Characteristics of the political context: Status quo bias	high	Drift (Parasitic symbionts)	Conversion (Opportunists)
	low	Layering (Subversives)	Elimination/ displacement (Insurrectionaries)

Note: I have modified Mahoney/Thelen's (2010: 19) figure with elements borrowed from the original figure found in Hacker (2005: 48). The main change in Mahoney/Thelen's version were the labels of the conditions affecting institutional change, from Hacker's "Status Quo Bias" and "Barriers to Internal Change" to "Veto Possibilities" and "Discretion in Interpretation/Enforcement" respectively. In my view, restricting Hacker's "Status Quo Bias" of the political context to the existence of "Veto Possibilities" implies associating continuity with the absence of change, i.e., high veto possibilities block change. The main insight of this paper is, however, that more often than not continuity needs change. Thus, more important than blocking change is the ability of certain agents to reconfigure the institutional structure with few constraints in order to ensure its continuity (cf. Mahoney/Thelen 2010: 8–9). I contend that this idea can be better captured by Hacker's more general labels. Furthermore, these provide a better way to respond to recent concerns about the applicability of this framework to non-advanced political economies (see Levitsky/Murillo 2013). Source: Hacker (2005: 48) and Mahoney/Thelen (2010: 19).

institutional forms (Pierson 2000; Mahoney 2000; Hall/Soskice 2001) towards mechanisms of endogenous change explaining discontinuity (Greif/Laitin 2004; Thelen 2003; Streeck/Thelen 2005b). Recent work on the conditions under which these mechanisms operate (Hacker 2005; Mahoney/Thelen 2010) has helped establish a set of causally oriented hypotheses about *when* an institution is more likely to change (initial conditions related to the characteristics of the political context and of the targeted institutions), *how* the process of change is more likely to occur (mechanisms of drift, conversion, layering, elimination, and displacement) and *who* is more likely to steer it (agents: parasitic symbionts, opportunists, subversives, insurrectionaries) (see Figure 1).⁴

These efforts notwithstanding, a gap still remains between the two types of explanations: while theories of continuity remain too rigid to explain actual change (Thelen 1999: 387, 2003; Streeck/Thelen 2005a: 5; Mahoney/Thelen 2010: 5), theories of discontinuity are less useful for understanding resilience (Pierson 2004: Chapter 5 especially). As can be noted in Figure 1, while Mahoney/Thelen have provided a conjunction of conditions, mechanisms, and agents that do improve our understanding of transformative processes, there is no similar counterpart to explain regime continuity. More generally, by focusing on institutional change as part of global liberalization processes in advanced economies, analysts have lost sight of the specific mechanisms of change

4 For a critical discussion see Van der Heijden (2010), Steilín/Trampusch (2012).

presented in economies with already widespread liberal institutions (cf. Peck/Theodore 2007: 755–758; Crouch 2011) and have disregarded the study of change at the capitalist periphery (Peck/Theodore 2007: 750; Levitsky/Murillo 2013).

In this paper I try to tackle these deficiencies. I contend that a better integration of the research on institutional continuity and discontinuity can result from the incorporation of the notion of institutional hierarchy. The inspiration for this exercise comes from a reverse application of the contention made by gradualist approaches (Hacker 2005; Mahoney/Thelen 2010: 10–11; also Thelen 2003): institutions are not only able to change when not subjected to formal alteration, but can also persist despite formal institutional change – or precisely because of it. The proposed analytical framework is further infused with conceptualizations of processes, timing, and sequences prevalent in comparative historical analysis. While the first step allows a reconceptualization of the relationship between continuity and change in order to better understand institutional resilience, the second permits a better grasp of divergence within different trajectories of continuity.

The notion of institutional hierarchy

If institutions are understood as distributional compromises among groups with diverging interests, the set of social groups that manages to institutionalize its policy preferences and impose them on others forms a dominant bloc. An institutional hierarchy consists of those rules that are more important in maintaining the dominant bloc's hegemony and the underlying political compromise (Amable 2003: 66; Amable/Palombarini 2009: 135). The hierarchy that the bloc ascribes to these rules in fulfilling its policy goals reflects the relative power of different groups in the political economy in general, and within the dominant bloc in particular. Consequently, at the top of the hierarchy we find the rules that matter more for attaining the dominant bloc's policy goals, or around which the bloc's compromise is sustained. At its bottom, we find rules that are less determinant to their policy goals or that do not enter the compromise formula. The compromise formula on which this configuration rests can be formed resorting to a variety of factors whose impact needs to be studied in each historical case (cf. Gourevitch 1986; Amable/Guillaud/Palombarini 2011).⁵ When the dominant bloc and its hegemony are well set, high-hierarchy institutions impose their logic and give a “dominant tone” to the overall institutional architecture (Boyer in Crouch et al. 2005: 367).

5 In my analytical framework I do not touch on external influences affecting political leverage, policy preferences, and compromise formulae. For insightful analyses, see Stallings (1992), Jacoby (2006), Bruszt/McDermott (2009). I do consider, however, the effects of external forces on domestic actor configurations and politics in the analyses of cases (cf. Cardoso/Faletto 1979).

Three key insights emerge from this (see Amable 2003: 68–69). Change will be more difficult or implemented more cautiously 1) in domains where the most powerful groups have vested interests, or 2) where political compromises are difficult to obtain (i. e. high-hierarchy institutions). In the opposite way, it is expected that 3) those areas in which the dominant groups have little interest (i. e. low-hierarchy institutions) and/or where consensus is easier to achieve are easier to change (Amable 2003: 68; Amable in Crouch et al. 2005). In relation with the puzzle of institutional continuity, two general hypotheses ensue: 1) the stability of an institution depends on its position within the institutional hierarchy, and 2) the dynamic of regime continuity over time can be captured by the strategic actions dominant groups perform in order to defend higher-hierarchy institutions.

Institutional hierarchy and gradual institutional change

Expanding on Figure 1 to incorporate institutional hierarchy makes it possible to include mechanisms of continuity in gradual institutional change. I will assume that low-hierarchy institutions are more likely to show patterns of change of the sort studied by Streeck, Thelen, Mahoney and colleagues, where the agents of change are societal actors with *discontinuist* purposes (cf. Mahoney/Thelen 2010: 22–27). Conversely, high-hierarchy institutions are more likely to show patterns of change where the agents of change are societal actors with *continuist* purposes, i. e. actors trying to defend a regime and the institutional hierarchy behind it. The result is four new mechanisms of change that allow regime continuity (see Figure 2).

Figure 2 Gradual institutional change, enlarged version

		Dominant bloc's consideration of the targeted institution: Institutional hierarchy			
		low		high	
Characteristics of the political context: Status quo bias		Characteristics of the targeted institution: Barriers to internal change			
		high	low	high	low
high	Drift	Conversion	1 Marginal adjustment	2 (De-) Solidification	
low	Layering	Elimination/ displacement	4 Compromise	3 Accommodation	

Source: Author's own design based on Figure 1.

Mechanisms of institutional change in high-hierarchy institutions

Continuity, I have said, reflects the dominant bloc's ability to sustain its policy preferences, and is more likely to occur in a political context highly biased to the maintenance of the status quo. Where high status quo bias combines with high barriers to internal change (Figure 2, box 1), we can expect institutions to be *marginally adjusted*. Here the dominant bloc maintains its composition and correlation of forces while small changes to existing institutions are devised to improve their performance (Geels/Kemp in Dolata 2011: 22). Dominant groups alter the institution's parameters or introduce new institutions that are likely to attain similar policy goals. In this way, the resulting arrangements maintain the overall policy goals of the dominant bloc and reinforce its political support. With a high status quo bias but low barriers to internal change, a field for change is open to the dominant bloc's side. A change in power correlations can make a particular faction willing to reinforce or upgrade its privileged position by strengthening the institutions closer to its interests. Institutions may thus change through *solidification*, i. e. a deeper institutionalization of the norms favoring dominant-group interests and narrowing interpretation of the norms (Figure 2, box 2).⁶

When the political context allows a more severe challenge to the status quo, the ability of non-hegemonic groups (inside and outside the dominant bloc) to contest the existing hierarchy is higher. Where this combines with lower barriers to internal change, powerful groups still retain room for maneuver and discretion in the interpretation and enforcement of existing rules. In this context, they may want to bend the rules in order to *accommodate* them to the interests of other powerful groups pressing for change (Figure 2, box 3). Consequently, this type of adjustment is characterized by a re-composition of the dominant bloc with the aim of broadening the basis of support for a certain regime (cf. Tsai 2006: 140–141). In box 4 in Figure 2, where low status quo bias and high barriers to internal change combine, hegemonic groups have no room to change how existing rules are interpreted or enforced. In this case, the top of the hierarchy is severely threatened and factions from the dominant bloc attempt to recompose the political equilibrium in order to maintain their interests at the top of the hierarchy. This case opens the possibility for a *compromise*, i. e. a substantive change in the institutional hierarchy, the incorporation of new interests and groups into the dominant bloc and/or the dismissal of previous dominant groups and interests.

6 In weaker institutional settings, hegemonic groups can strategically use solidification to demonstrate to important domestic or external pressure groups (for example, international organizations, investors, etc.) that they are committed to change. The key issue here is how power relations shift with this change. When hegemony remains uncontested, change agents retain discretion in enforcing the new rules, which allows them to undertake formal changes without changing actual practices (Levitsky/Murillo 2013: 100–103).

Sequences of institutional continuity

While the first two mechanisms (*marginal adjustment* and *solidification*) make regime continuity likely because of the reinforcement of the institutional hierarchy and the dominant bloc, the second two (*accommodation* and *compromise*) suggest a more open contestation of future institutional hierarchy because of the introduction of new interests into the dominant bloc. It is here that two characteristics in the relations between institutions can constitute important mechanisms transmitting pressures to change to other related policy and institutional domains. The first is what Amable (in Crouch et al. 2005: 372) calls *compatibility*, i. e. the consistency of existing institutions in reflecting one policy goal so that their support coalition is more stable. The second is *complementarity*, in the sense that actors see one institution as necessary to equilibrate the performance of another institution (see Crouch in Crouch et al. 2005) thus making the viability of one institutional form dependent on the existence of another (Boyer in Crouch et al. 2005).⁷

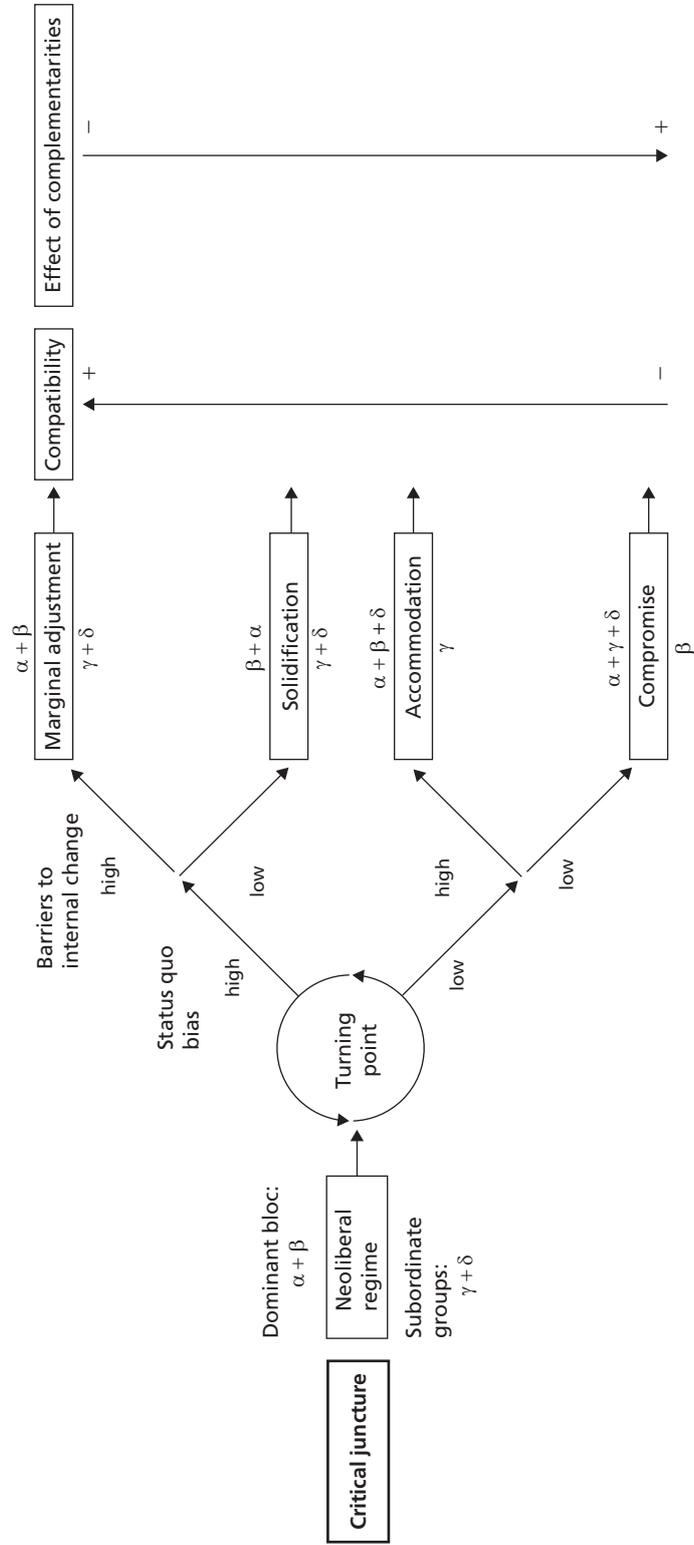
Regime continuity in historical perspective

Critical junctures are moments in which institutions *can be* (re-)organized in a way that new actors and coalitions emerge, new institutions are built, and new political compromises are forged (Capoccia/Kelemen 2007; Collier/Collier 1991). The result is that parameters affecting institutional change (the political context, the characteristics of institutions, and the institutional hierarchy) are modified. After such generative moments, economic performance and shifts in the balance of power are likely to set institutions on a process of change (Mahoney/Thelen 2010: 9–10). Subsequent economic and political events act as turning points where these factors can upset the existing political compromise with the effect of institutions – and their distributional outcomes – becoming reinforced, or overwhelmed and changed (Pierson 2004).

The continuity of a developmental regime draws on the ability of the dominant bloc to defend higher-hierarchy policies and institutions over successive turning points given the characteristics of the political context and those of the institutions under pressure of change (see Figure 3). These actions will alter the compatibility and complementarity between high- and low-hierarchy institutions thus pushing future change dynamics in particular ways. The combination of different mechanisms in concrete historical sequences and the specific patterns of change they produce can explain the existence of different trajectories of continuity (see Dolata 2011: 20; Hacker 2005).

7 For example, policymakers use the *trilemma of an open economy* to decide on macroeconomic policy (Obstfeld/Shambaugh/Taylor 2005). Accordingly, they are confronted with three desirable policy options, out of which only two can be consistently pursued: i) the stabilization of the exchange rate, ii) enjoying free international capital mobility, and iii) the utilization of monetary policy for domestic purposes. When taken into account, strong policy preferences towards two of these options condition the decision on the third.

Figure 3 Regime continuity in historical perspective



Institutional hierarchy and developmental regimes

I consider two ideal typical policy goals around which political economies at the capitalist periphery have organized in the last fifty years: price stability, leading to neoliberal regimes, and national competitiveness leading to embedded regimes. As indicators of these I have used two policy domains that are salient in reflecting not only economic interests but also broader political and societal projects (Canitrot 1980; Bradford Jr. 1990; also Frieden 1994; Gourevitch 1986): monetary policy (exchange rates)⁸ and industrial policy. Tables A.1 and A.2 in the Appendix show a qualitative operationalization that identifies the connection between policy alternatives, policy goals, and their shifts.

3 Chile: A neoliberal ecology with increasing incompatibility

The Chilean case illustrates the institutionalizing of a neoliberal compromise at the top of an institutional hierarchy while allowing degrees of freedom at the bottom. After an orthodox neoliberal experiment imposed by military force, Chilean neoliberalism was shaped by three turning points (see Figure 4). A deep financial crisis in 1982–1983 and the subsequent social turmoil obliged the military government to forge a *compromise* with business sectors in order to widen its basis of support. This opened the door to some policy pragmatism with the consequence of a *displacement* of a previously neutral industrial policy (IP). The return to democracy in 1990 brought a center-left coalition into power, heightening the incompatibility between orthodox and pragmatic neoliberal institutions and generating dissimilar patterns of change: an intense search for the *solidification* of the higher-hierarchy exchange rate (ER), and the *conversion* of promotion agencies towards greater embeddedness in the lower-hierarchy IP. The political and economic context surrounding the Asian crisis (1997–1998) prompted dominant groups to institutionalize a broad neoliberal consensus in the high-hierarchy ER (*solidification*). Increasing incompatibility of the regime, however, would push lower-hierarchy IP towards divergent goals, namely international integration and export promotion, producing further *conversion*.

Following the notion of “institutional ecology” by Peter Hall (2007: 80), I call this institutional trajectory a “neoliberal ecology,” which expresses the constant adjustment process in economic institutions and their political support required to stabilize both the performance and the acceptance of an institutional hierarchy committed to price stability. While ensuring support for neoliberalism, this adjustment process also entailed a widening of the interests inside the dominant bloc. Greater heterogeneity in the

8 According to Frieden (1994) both financial and trade liberalization have increased the political importance of the definition of the exchange rate over that of broader monetary policy.

Figure 4 Chile: Mechanisms of institutional change and turning points

		Institutional hierarchy			
		low (industrial policy)		high (exchange rate)	
		Barriers to internal change			
Status quo bias		high	low	high	low
		high	Drift --	Conversion Return to democracy (1990–2000) Post-Asian crisis (2000–)	Marginal adjustment --
low	Layering --	Displacement Post-financial crisis (1983–88)	Compromise Post-financial crisis (1983–88)	Accommodation --	

dominant bloc translated into greater incompatibility of the policy framework, which explains the increasing embeddedness of IP within the overall framework of price stability and the gradual yet notable contention over neoliberalism in the country.

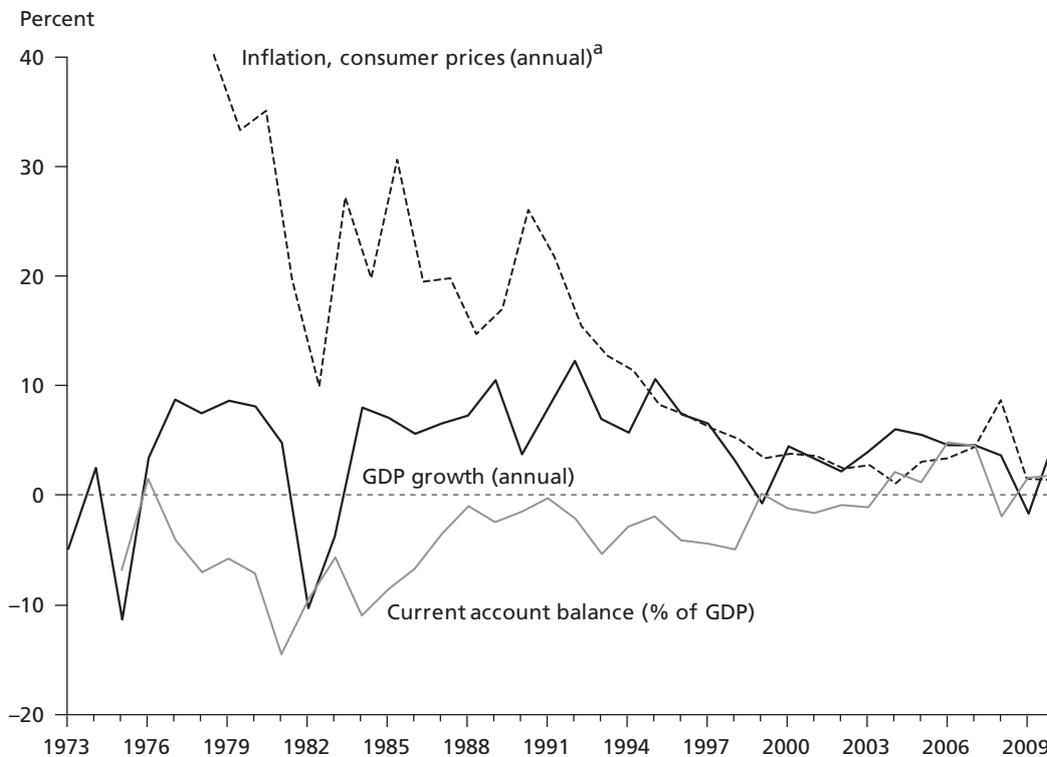
Critical juncture: Politics, business, and military (1973–1975)

On September 11, 1973, the Chilean armed forces overthrew the government of Salvador Allende. Allende had taken office in 1970 supported by a coalition of leftist forces led by the socialist and communist parties (the *Unidad Popular*, UP) and intended to move the existing statist developmental regime to its extreme.⁹ This led to a radicalization of a society already marked by political and ideological polarization, heightened the difficulties of the state-led developmental regime, and showed the contradictions of Allende's revolutionary project with a capitalist economy and a democratic polity.¹⁰ By 1973 a considerable opposition had assembled claiming the deposition of Allende.

9 After the Great Depression, Chile pursued an Import Substituting Industrialization (ISI) strategy. While economic growth and export diversification were not as spectacular as they were in other ISI followers in the region (Meller 1996: 50–55), Chile was characterized by a significant increase in the share of industrial production, a relatively well developed conservative-type welfare state, and an increasing yet discontinuous incorporation of new sectors into the modernization process (Illanes/Riesco 2007). The three critical points in the Allende program were the universalization of welfare policies to informal workers and peasants, deepening of agrarian reform and nationalization of national resources (launched by previous governments on a smaller scale), and the collectivization of large property (Illanes/Riesco 2007).

10 For an in-depth analysis, Valenzuela (1978).

Figure 5 Chile: Evolution of selected macroeconomic indicators, 1973–2010



a Central Bank of Chile.

Source: World Development Indicators (WDI), World Bank.

Supporters of the military intervention shared the goals of restoration of public order and respect of private property, together with the rapid solution of high inflation and chronic public deficits (Martínez/Díaz 1996: 80–81; Valdés 2003: 20; see Silva 1996: 68–95). However, hegemony was unclear in the initial years of dictatorship, reflecting the lack of a clear political project behind the military intervention not to mention internal dissent within the military Junta itself (Martínez/Díaz 1996; Valdés 2003: 16–17). Most business and civilian sectors supporting the coup – including the military – shared a nationalistic, conservative, and state-corporatist orientation. Only a small group of businessmen actively engaged in the overthrow of Allende and ideologically gathered around the “Chicago Boys,”¹¹ supported a neoconservative foundational program without precedent in the country’s political history (Valdés, 2003: 12–14; Silva 1996). This diversity was reflected in the heterogeneous policy measures undertaken between 1973 and 1975 (see Edwards 1983: 5–6; Agosín 2001: 109).

The years 1975–1976, which mark the resolution of this critical juncture, saw a first attempt at hegemony (Martínez/Díaz 1996: 81–87; Silva 1996: Chapter 5). The persistence of high levels of inflation and economic recession in 1974–1975 (see Figure 5) was a

11 For the story of the Chicago Boys, Valdés (2003).

determinant in reducing the influence of moderate nationalist technocrats. Army Chief General Pinochet secured control over the repressive apparatuses to fight his main adversaries, including those inside the Junta with nationalist and corporatist tendencies. Progressive concentration of power in his hands allowed him to tighten repression, dismiss opponents, and appoint Chicago-Boy technocrats in key decision-making positions (Valenzuela 1993). The latter won Pinochet's attention thanks to their ability to provide an alternative and coherent political project, as well as their group cohesiveness (Martínez/Díaz 1996).

The neoliberal experiment (1975–1982)

Within the context of a “total deprivation of public liberties and citizen's rights” (Valdés 2003: 10), a government ready to embrace a re-foundational project, and a cohesive reform team, the reform process moved decisively to shock therapy measures. The ER was placed on the top of the institutional hierarchy being actively used to fight inflation. Two steep revaluation shocks in 1976–1977, and a *tablita* scheme¹² between 1977–1978 were intended to signal the commitment of the government to fighting inflation (Ffrench-Davis 2003: 92–95 and especially chapter 4). The ER was finally pegged to the US dollar in 1979. Full liberalization of the capital account was accomplished at the same time, adding to the earlier liberalization of prices and trade and the restructuring of the state to complement an encompassing orthodox neoliberal program.

While monetary policies were arranged for stabilization purposes, industrial policy was completely dismantled. Together with the lowering of tariffs and ER protections and the opening of imports already under way, subsidies and tax exemptions were abolished as well as taxes on wealth and utilities in favor of a simplified tax system and flat VAT (Edwards 1983: 6). Consequently, the main state promotion agencies were kept only to help in the liberalization process (Román 2003: 36–38). For example, CORFO (Corporation for Development), the main agent of the Chilean ISI project was put in charge of re-selling expropriated companies and restructuring State Owned Enterprises (SOEs) to prepare their future privatization.

12 A type of fixed ER that consists of pre-announced depreciations at a decreasing rate to bring inflation down to international levels. See Frenkel/Rapetti (2010).

Dynamics of change: Turning points and the stabilization of a neoliberal ecology (1983–2005)

Financial crisis and the authoritarian/pragmatic consensus (1983–1989)

At the beginning of the 1980s the orthodox neoliberal regime had to face the performance problems of the high-hierarchy institutions and the shift in the balance of power this produced. Between 1976 and 1980, the ER-led adjustment process managed to produce economic growth and control inflation (see Figure 5), generated new supporting groups related to the growth of the financial sector, and provided reluctant business sectors with new business niches (Silva 1996: 137–149). This was achieved, however, at the expense of an important external imbalance (Ffrench-Davis 2003: 219–222; Meller 1996: 198–211). ER appreciation and trade openness swept previously protected industrial sectors, fed a consumption boom (imported goods), promoted the growth of short-term credit, and induced balance of payment deficits successively financed by external borrowing (see Figure 5). The opening of the capital account and the fixation of the ER in 1979 generated a massive influx of hot foreign capital that, after an increase in international interest rates, triggered a colossal banking crisis dragging in the highly indebted real sector and households.¹³

The military government faced the alternatives of withstanding deflation (the *orthodox* position) or devaluing the ER and providing widespread bailouts plus greater business involvement in policymaking (the *pragmatic* stance).¹⁴ The preference for orthodoxy was continuously stressed in 1981 and 1982 (Meller 1996: 218; Edwards 1983: 29), but the steep economic recession of 1982 made the government change its strategy. In June 1982 the Chilean peso (CLP) was devalued and the parity later withdrawn. In January 1983 the financial authorities declared the inconvertibility of the CLP, strict capital controls were implemented, and the state took over the banking sector, putting an end to the orthodox experiment.

Explanations of this turning point have focused on the continuity of the authoritarian regime (see Silva 1996: 9). In doing this, authors highlight the fear of popular mobilization as a factor inducing the loyalty of the business sector to the dictatorship. However, this does not explain the policy and institutional changes that occurred; moreover, it provides little insight into why the crisis contributed to the toppling of the neoliberal dictatorships in neighboring Argentina and Uruguay but not in Chile. We contend this change can be understood as a *compromise* underpinned by the shift in the correlation of forces within the dominant bloc that was produced by the crisis: from the military/technocratic alliance to the business sectors claiming bailouts once the supporting fi-

13 For a critical analysis at the time of the crisis see Ffrench-Davis (1983). A less pessimistic view can be found in Edwards (1983).

14 To illustrate the debate cf. Wisecarver (1983) and Fontaine (1983).

nancial sector had gone bankrupt.¹⁵ While this explains a political environment more favorable to a modification of the status quo, the rigidity of the institutions at the top of the hierarchy left little space for internal change.¹⁶

A reactivated political opposition sought to capitalize on the growing social unrest due to the biggest economic downturn in decades (around 14–15 percent of the GDP in 1982–1983), attracting business sectors into a new alliance in order to induce immediate re-democratization and the adoption of a more embedded regime (Silva 1996: 217–219). For the military/technocratic bloc this meant that increasing discontent among business associations with the economic situation could not be overlooked (Martínez/Díaz 1996: 95). Additionally, several conditions contingent to the crisis assured the bloc that any possible concession would be limited.¹⁷ For the internationally competitive business groups, an alliance with the orthodox coalition offered something more attractive: the possibility of excluding labor. The terms of the new alliance would in fact ensure the continuation of the dictatorship as a guarantor of the overall neoliberal character of the regime – which meant backing the political liberalization schedule of the regime – in exchange for a better responsiveness to business’ contingent interests and a continued repression of wages (Silva 1996: 223–226). From mid-1983, the military authorities removed the more radical Chicago Boys from the cabinet, incorporating milder technocrats into the finance and economy ministries and business representatives into the line ministries (Silva 1996: 224). In addition they granted peak employer associations an important role in influencing policy decisions through policy councils and consulting commissions in the following years (Silva 1996: 224).

As the composition of the dominant bloc changed, so did the relationship between high- and low-hierarchy institutions. The ER shifted towards a more embedded regime of crawling bands, with subsequent small devaluations to keep a depreciated real ER and help promote export competitiveness (Frenkel/Rapetti 2010: 34; Morandé/Tapia 2002: 68). At the same time, industrial policy received a new impulse, *displacing* neutral policies for a more pragmatic approach directed at protecting and promoting the export sector. Policies that were previously seen as “deviant, aberrant, anachronistic, or ‘foreign’ practices” (Streeck/Thelen 2005a: 20) gained prominence. Among them, a

15 Silva (1996) offers a similar interpretation.

16 As Edwards (1983: 30) notices, the decision to leave the fixed ER was preceded by several months of intense speculation and misalignment of the official ER with that of the informal market. In this context, the slightest change in the parity – like the one attempted from June–August 1982 – would produce a domino effect making the fixed ER impossible to withstand – as actually happened.

17 The depth of the fall in output left plenty of room for maneuver for satisfying business interests while not severely threatening price stability. Additionally, the strict commitment to repay the IMF loans to rescue the banking sector imposed an exogenous limit to pragmatic concessions. Finally, the need to ensure a commercial surplus in order to retain foreign currency and repay debt further supported the viability of the alliance. For a detailed analysis of the post-crisis, see Meller (1996: 233–265).

general increase in tariffs (up to 35 percent in 1984) plus over-tariffs in selected sectors, price bands for commodities, subsidies for the importation of intermediate goods, FDI attraction policies linked to the refinance of public debt, and protections to some sectors competing with imports (Agosin 2001: 120; Meller 1996: 246–249).

Restricted democracy and the expansion of the neoliberal consensus (1988–1997)

Following Pinochet's political liberalization schedule, a plebiscite was held in 1988 to decide on either another 8 years of dictatorship or a return to democracy. The victory of Pinochet's center-left opposition (the *Concertación*) in the plebiscite and the following elections was not expected by the dominant coalition and generated fears of policy and institutional reversals (Weyland 1999: 69).

Although the *Concertación* had moderated its critical discourse over the previous years in order to win the confidence of the business sector (Silva 1996: 225), its statist past continued to shed doubts on its capacity to maintain a "good business climate" as the coalition included factions of the socialist party that had been part of the Allende government (Silva 2002: 344). After taking office in 1990, however, the new government, largely dominated by the parties' *equipos técnicos* (see Silva 1991), rushed to ratify the fundamentals of the economic model inherited from the dictatorship (Fazio/Parada 2010: Chapter 1).

Two factors stand out to explain this: good economic performance, strengthening the position of neoliberal advocates and the resulting division within the *Concertación*; and the renewed forces of the more orthodox factions of the neoliberal coalition. After the deep recession of 1982–1983, the economy experienced an upsurge led by the expansion of the export sector and a strong recovery from the slump (see Figure 5). The prospects of democratization granted the model additional external recognition (Weyland 1999: 71). Conversely, after the 1982–1983 turning point, the weakened military/technocratic alliance reconstituted its basis of support through a strategic new wave of privatizations that included the financial institutions intervened with during the crisis and valuable state assets (Martínez/Díaz 1996: 98). These new groups would become the economic support of the right-of-center UDI party, the main defender of the dictatorship legacy (Monckeberg 2001). Also crucial for this development were the privatization of the social security system and the introduction of the new Labor Code just before the crisis (Martínez/Díaz 1996: 92–98).¹⁸ As a result, internationalist business groups with diversified interests openly supported the authoritarian option in the 1988 plebiscite, closing the door to any possibility of a more developmentalist pact (Silva 1996: 225).

18 While the new Labor Code broke down workers' organization and negotiating power, the privatization of the social security system transferred the bulk of social contributions to private social security administrators, guaranteeing easy access to finance to the new economic groups and the privatized SOEs.

This political environment produced a divide inside the *Concertación* between more moderate factions embracing pragmatic neoliberalism, and more progressive ones.¹⁹ In the eyes of the more powerful moderate faction led by the Christian Democratic party, the only way to safeguard the country's regained democracy and maintain a good climate for investors was to ensure the cooperation of the right and the business sectors, which implied maintaining the inherited political and economic institutions largely intact (Silva 1996: 225–226; Weyland 1999: 70–71). This also implied accepting the dictatorship's constitutional design and the last-minute institutional tethers it left, setting “the most constraining constitutional formula for a new democratic government” (Linz/Stepan 1996: 206).²⁰

With the economy growing and a governing coalition willing to cede, the business sector and their right-wing political allies managed to seal a broad neoliberal consensus by three key negotiations in the early 1990s: 1) the institutionalization of the Chilean Central Bank's (CBC) independence and exclusive mandate to ensure price stability in 1989 (see Bianchi 2008); 2) a tax reform highly biased towards indirect taxes (Fazio/Parada 2010: Chapter 2; Silva 1996: 232–233); and 3) the dismissal of a substantial reform of the Labor Code that would restore the unions' bargaining position (Frank 2002). The *Concertación's* liberal and progressive factions would remain in permanent dispute, their unity as a political project resting mainly on their criticism of the military regime for its violations of human rights, the maintenance of a social policy bias – limited by the maintenance of macroeconomic equilibria – and the incentives provided by the political system to maintain their alliance (Weyland 1999: 81–85; Silva 1996: 225–236).

With high status quo bias, and relatively low barriers to internal change, the inherited ER regime was preserved. In turn, a process of *solidification* of its complementary institutions was to be pursued in order to narrow the policy alternatives of the governing coalition. Apart from the role of the CBC, an innovative mechanism of *quasi*-inflation targeting was implemented consisting in annual announcements of the subsequent year's inflation target together with a tacit fiscal surplus rule (De Gregorio/Tokman/Valdés 2005: 11).

With regard to industrial policy, changes would be driven by two opposing forces. The first was the complementarity between trade liberalization and the neoliberal consensus. The *Concertación* governments followed the dictatorship's policy of unilateral trade open-

19 This would become clearer at the end of the decade when the thesis about the “two souls” of the *Concertación* emerged and a debate between the self-satisfied and the self-flagellants ensued (Luna/Mardones 2010: 110).

20 The “institutional tethers” included: 1) an electoral system that inflated representation of the right and severely reduced representation of the left, established incentives for parties to conflate to the center, and limited political competition; 2) a number of “authoritarian enclaves” (for example, unelected senators and a tutelary role for the armed forces) that made reformist legislation and constitutional amendments almost impossible to pass. See Linz/Stepan (1996: 205–217). For the effects on policymaking see Aninat et al. (2008).

ness (gradually diminishing tariffs throughout the 1990s) and inaugurated a new phase comprising the signing of Free Trade Agreements (FTA) with the country's major trade partners (see Fazio/Parada 2010: Chapter 3). Two further developments were crucial to bind industrial policy alternatives: the accession of Chile to the WTO, which required the elimination of the 1980s business support measures, and the signing of the free-trade agreements with the USA and the EU at the beginning of the 2000s, which would further decrease tariffs and constrain the utilization of protective measures (Agosin 2001: 120; Ffrench-Davis 2003: 280–284; see especially Fazio/Parada 2010: Chapter 3).

In parallel, the more progressive factions of the *Concertación* used the little space left for industrial policy to seek strategic support from SMEs and build a new bloc (Silva 2002: 352; see Román 2003: 40). They utilized existing institutions to advance a more coherent framework of industry promotion, although within the constraints posed by the higher-hierarchy policies. The scheme was constituted by a battery of demand-side subsidies based on a system of horizontal "matching grants" for financing new projects and/or training purposes (Román 2003: 40; see also Muñoz Gomá 2001: 49). With renewed financial and institutional resources for promotion, this new policy framework implied putting in movement a process of *conversion* of the moribund state promotion agencies, especially CORFO. Used during the dictatorship to sell state assets and reconfigure domestic business groups, these institutions were now "redirected to new goals, functions [and] purposes" (Streeck/Thelen 2005a: 26).

The Asian crisis and the consolidation of the neoliberal consensus (1997–2005)

The stability of the pragmatic neoliberal consensus under the regained democracy rested on two very fragile conditions for the maintenance of the high-hierarchy price stability goal: 1) that the economic expansion and the performance of the mix of orthodox and pragmatic policy measures did not threaten price stability, and 2) that the big business groups maintained confidence that the popular *Concertación* would be led by its moderate factions, which ensured its commitment to the inherited economic model. At the end of the decade both conditions would be altered, generating a further modification to the developmental regime.

During the export boom of 1985–1988 relatively low levels of capital inflows as well as important productive gaps did not raise the threat of inflationary outbursts and thus did not pressure the competitive ER.²¹ As argued above (see note 16), this was indeed an important condition for orthodox factions to accept a pragmatic compromise. Under the same policy framework, however, the acceleration of capital inflows, the reduction of the productive gaps, and the maintenance of high levels of economic activity

21 It is important to note, however, that contingent increases in public spending did so right after the financial crisis in 1983–1984 and on the eve of the transition to democracy (1988–1989). See Figure 5.

over several years activated a need to target both inflation and the ER bands, making monetary policy particularly stressful though successful in bringing inflation down (see Figure 5).²² The mix of competitive ER and inflation-targeting lasted for as long as both ER appreciation and the widening of ER bands strategically served to sustain anti-inflationary policies. In 1997 the scenario changed dramatically. When the Asian crisis broke out, the main fear from the CBC was that massive capital outflows, in a context of overheated domestic demand, would threaten the inflation target for the following year (Céspedes et al. 2005: 22; Morandé/Tapia 2002: 70; see also Ffrench-Davis 2003: 371). Successive waves of speculative currency attacks following the Russian crisis of 1998 convinced the CBC that the two simultaneous monetary targets were no longer possible (Céspedes et al. 2005: 24).

Conversely, the prospects of the 1999 elections in a context of economic recession and the constitution of a unified right-wing opposition (the *Alianza*) increased its chances to contest the *Concertación's* political dominance for the first time following the return to democracy (see Angell/Pollack 2000; Garretón 2000). With the victory of socialist Ricardo Lagos, the progressive forces of the *Concertación* hoped it would permit a reconstitution of the correlation of forces towards more progressive views (Garretón 2000: 84). However, Lagos took office in a political context hardly amenable to changes. Economic recession had strengthened the right-of-center UDI party within the *Alianza*, and facilitated a shift to hard line sectors within the business associations; with a narrow electoral victory, orthodox factions strategically exploited the political vulnerability of the new government to demand greater assurances and a further strengthening of monetary stability (see Silva 2002: 350).

Once again the *Concertación técnicos* rushed to *solidify* the policy framework before and after the election. In late 1999 capital controls were eliminated and the ER was set for free flotation allowing intervention only 'under special circumstances' (i.e. when depreciation threatened the inflation targets), while monetary policy was made extremely contractive. The Lagos administration took substantial measures to diminish discretion on both monetary and fiscal policy (Aninat et al. 2008: 161–162). Two stand out as crucial: 1) the introduction of a "full-fledged inflation targeting framework" based on an annual target inflation band (De Gregorio et al. 2005: 11–14),²³ and 2) the implementation in 2001 of a structural balance fiscal policy with a rule of a 1-percent fiscal surplus. This structural surplus policy was passed in 2003 as the "Fiscal Responsibility Law" (Fazio/Parada 2010: 123–133).

22 For a general outlook, see Ffrench-Davis (2003: 35–50 especially chap. 10). Also Frenkel/Rapetti (2010: 35).

23 While this measure depends exclusively on the CBC, the Lagos administration made sure that the CBC council was staffed with strong advocates of conservative monetary policy.

The events following the Asian crisis generated an opposite reaction at the lower end of the institutional hierarchy. The bad performance of the neutral industrial policy framework,²⁴ the disappointing growth levels following the Asian crisis, and the memory of how well the 1980s subsidies had performed helped to create a feeling that more selectiveness was needed (Muñoz Gomá 2001: 29–30, 2009: 45). In this context, the more progressive factions of the *Concertación* were able to gather consensus to renew the industrial policy framework under public–private cooperation programs and within the confines of the fiscal responsibility rule. They managed to push for a tax on copper sales (highly debated and diminished thanks to the opposition of the powerful mining companies, the right-wing parties, and the incumbent government) to fund R&D expenditures. In parallel, they managed to institute the National Council of Innovation for Competitiveness, a consultancy board mandated by the presidency that recommended that R&D expenditures should have a sectoral bias and support strategic productive clusters (Gobierno de Chile 2006).

Heritage: Increasing incompatibility and prospects of change (2006–present)

In the late 2000s the Chilean neoliberal path faced increasing contradictions. On the one hand, the high price of commodities and the appreciation of the ER under the free floating regime induced a Dutch disease (Fazio/Parada 2010: 99–109), heightening the divergence of interest between tradable and non-tradable sectors.²⁵ The pressures from tradable sectors grew strongly enough to force the CBC devaluation of the peso for the first time in 2008 and once again in 2011 (Fazio 2011).

On the other hand, discontented social groups, excluded from more than 20 years of neoliberal consensus and with limited political representation, started to rise up and push for greater inclusion and reforms. The loss by the *Concertación* in the 2010 elections and the biggest social demonstrations since the dictatorship in 2011 signaled escalating social discontent and the possibility of reconstituting alliances on both sides of the political spectrum (see Luna/Mardones 2010; Sehnbruch/Donoso 2011). Greater political will to change the electoral system and the strengthening of the left-wing opposition could be the seeds of a new balance that could erode the neoliberal consensus. Its strong institutionalization over the last decade, however, makes alternative paths hard to achieve without a significant amount of political and social change.

24 As Román shows (2003: 61), during the 1990s SMEs decreased their participation in sales, employment, and credits allocated by the banking system, hardly constituting a basis of power to any groups contending the dominant bloc.

25 Leaders of the export sector have been increasingly pushing for such measures as the management of the ER and the imposition of capital controls to tackle declining competitiveness (see for example *El Mercurio*, 18/01/2011; also *Diario Financiero*, 11/05/2011). In mid-2011 they mobilized producers, labor unions, and members of the production chains to demonstrate in favor of more active intervention. See *Diario Financiero*, 09/05/2011; 02/06/2011.

4 Estonia: Positive feedback for a tight neoliberal path

Estonia shows a trajectory in which neoliberal institutions managed to remain largely uncontested. Three turning points helped to sustain it (see Figure 6): an early banking crisis (1992–1994) when the main conditions of the critical juncture were still present, ensuring the endorsement of the neoliberal regime; the effects of the Asian/Russian crises (1997–1998), when external actors interested in the maintenance of the high-hierarchy price stability institutions took over a large part of the Estonian economy; and the recent global financial crisis in the face of EMU accession (2007–2010) when high-hierarchy institutions were subject to further endorsement.

Figure 6 Estonia: Mechanisms of institutional change and turning points

		Institutional hierarchy			
		low (industrial policy)		high (exchange rate)	
Status quo bias		Barriers to internal change			
		high	low	high	low
high	Drift --	Conversion --	Marginal adjustment Early banking crisis (1992–94) Asian-Russian crisis (1997–98) Financial crisis (2007–10)	Solidification --	
low	Layering International integration process (1997–)	Displacement --	Compromise --	Accommodation --	

This tight neoliberal path is related to the positive feedbacks yielded by a set of temporally chained causal connections.²⁶ A pattern of ethnic politics arising from the fall of communism empowered political groups proposing a radical break with the Soviet past, and insulated them so that they were able to implement their orthodox neoliberal program. The under-institutionalization of the political system made the maintenance of the initial reforms possible despite the upcoming economic turbulences and changing political incumbents. During this turbulence, the constitution of a powerful support group made of external economic agents and the domestic actors' preference for

26 Cf. the notion of “reactive sequences” in Mahoney (2000: 509).

European integration strengthened support for the institutions at the top (*marginal adjustments*) while producing – as part of the EU accession process – the slight embedding of industrial policy (*layering*).

Critical juncture: From Soviet rule to an ethnic democracy (1987–1992)

In the late 1980s Gorbachev's *glasnost* and *perestroika* reforms facilitated the emergence in Estonia of social movements with a strong nationalist flavor as a way to reaffirm national culture, condemn Soviet occupation, and demand increased economic autonomy and sovereignty (Lauristin/Vihalemm 1997: 74–90; Raun 1997: 345–348; Ruutsoo 1996). From 1987, a renewed political activity diminished the power and influence of the Communist Party of Estonia, rapidly turning the autonomy discourse into an independence one. Two key political referents emerged: the Popular Front of Estonia (PFE), formed in 1988 by reformist communist elites, and the Citizens' Committees (CCs) that appeared in 1989 with the support of former dissidents and *émigré* Estonians, and wide popularity among younger generations.

The key difference between the two was their stance towards independence (gradual vs. radical) and the character of the new nation-state (Lauristin/Vihalemm 1997: 90; Pettai/Hallik 2002: 508–513; Smith 2002: 54; also Linz/Stepan 1996: 408). The latter involved two major definitions: inclusion or exclusion of the Russian-speaking minority, and the type of state-society relations of the new polity.²⁷ These also had a decisive effect on each faction's economic policy orientations and the pace of reform they envisaged (Ruutsoo 1996: 109). Around 1990 the two movements took charge of the political arena by separate means (the PFE took control of the Supreme Soviet – later called the Supreme Council – and the CCs took control of the self-convoked and dissident Congress of Estonia), generating a period of competition between the two projects.

The PFE took the lead from the Supreme Council in early 1990, launching its advocated gradual and negotiated transition and gaining confidence from public opinion (Pettai/Hallik 2002: 511–512). This entailed the refoundation of the state on the basis of the existing multi-ethnic nationhood, ensuring open participation for both ethnic Esto-

27 Estonia had a short-lived independent life in the interwar period. National institutions such as the Parliament (*Riigikogu*) and the Bank of Estonia were created, and three constitutions passed with very different executive-parliamentary arrangements. The PFE and CC struggled either over the restoration of one of these constitutions or the establishment of a new political order. Moreover, after the Russian invasion during WWII, the proportion of non-Estonians living in Estonia rose from 5 percent to almost 40 percent in 1989 (Linz/Stepan 1996: 403). This happened through the deportation of national Estonians, and the importation of a Russian-speaking workforce to support industrialization in heavy industry. The incorporation of this relatively large minority into the new polity was a second major issue.

nians and the other ethnic minorities.²⁸ External events, however, would tilt the balance of power (Lauristin/Vihalemm 1997: 95–97). In January 1991, fierce suppression of the Baltic independence process became open military hostility when Gorbachev sent Soviet troops to crush uprisings in Latvia and Lithuania. This fueled the majoritarian pro-Soviet attitudes of the Russian-speaking minority in Estonia and the attempts of their representatives at the Supreme Council to create an autonomous Russian territory inside Estonia. The CCs’ “legal restorationism” doctrine (Pettai/Hallik 2002: 508) successfully echoed public opinion regarding these events. They advocated a radical break with the Soviet past through the restoration of the pre-1940 state and its nation base, the denial of citizenship rights to the “Soviet settlers” and their descendants, and a strong rejection of state intervention and industry²⁹.

These events and the quick declaration of independence in August 1991 after the conservative putsch in Moscow helped to forge a tight connection between the independence process, the ethnic question, and economic policy orientations (Lauristin/Vihalemm 1997: 97; Pettai/Hallik 2002: 512–513). The constitution of the new state under permanent military threat from the Former Soviet Union and the formation of a market economy under emergency conditions contributed to an open rejection of Soviet legacies and the embracement of national economic institutions as symbols of unity and pride, converting radical reformers into true nation builders (Lauristin/Vihalemm 1997: 96–100; Erixon 2010: 19; Smith 2002: 68–69; Bohle/Greskovits 2012: 107). It also crystallized the idea that the achievement of an independent state and nationhood required harsh measures and sacrifices (Lauristin/Vihalemm 1997: 102–3; Smith 2002: 81). The appointment of neoliberal Sim Kallas to the Bank of Estonia (BOE) and an interim Supreme Council led by technocratic Tiit Vähi signaled the shift towards a more radical approach to economic reform (see Knöbl/Sutt/Zavoico 2002: 6).

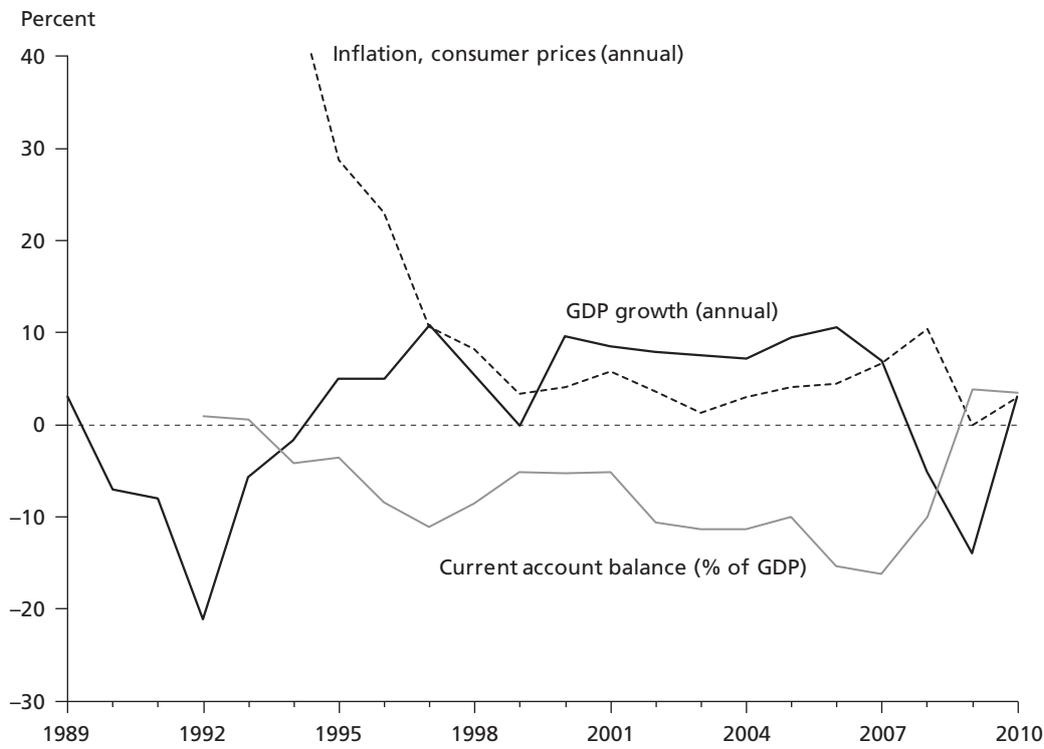
Neoliberal orthodoxy and restricted citizenship (1992–1994)

The implementation of an orthodox neoliberal regime rested on three decisive steps. First was the establishment of the new monetary system by the government of “unpoliticized experts” (Lauristin/Vihalemm 1997: 102; Knöbl/Sutt/Zavoico 2002: 8) led by the Kallas/Vähi tandem. They quickly reintroduced the national currency – the Estonian Kroon (EEK) – and a Currency Board Arrangement (CBA) was implemented to regulate interest and exchange rates. Although the latter could be justified for strict economic

28 More exclusionary stances would however develop inside the PFE over time (Lauristin/Vihalemm 1997: 97).

29 According to Pettai and Kallik (2002: 515), at the end of the Soviet era fewer than 40 percent of the industrial workforce was ethnic Estonian. The concentration of the Russian-speaking minority in the industrial sector, their dominance of the main trade union organizations, and their participation in the pro-Soviet movements of the pre-independence days contributed to a perception that they were an obstacle to independence (see Lauristin/Vihalemm 1997: 90).

Figure 7 Estonia: Evolution of selected macroeconomic indicators, 1989–2010



Source: World Development Indicators (WDI), World Bank.

reasons given the size of the country and the necessity to ensure financial stability in the existing situation of emergency and soaring inflation (see Figure 7; Knöbl/Sutt/Zavoico 2002: 6), it also signaled major political goals: namely, a strong preference for price stability and fiscal discipline, an invitation to external investors to play a central role in the domestic economy, and the expectation of convergence towards the European integration process (see Bank of Estonia 1999: 3–4; Bohle/Greskovits 2012: 104–111).

The creation of the CBA at the top of the institutional hierarchy and its identification with the nation-building process gave strong support for neoliberal policies while helping to generate a set of *complementary* policies and institutions around it to narrow their degree of interpretability (see Knöbl/Sutt/Zavoico 2002: 12–17, 23). In the first place, the ER parity was set by a law-like decree, requiring the parliament's consent for any change (Bank of Estonia 1999: 6). A stand-by agreement with the IMF to support the new monetary system and cope with the instability inherited from the Soviet breakdown would also help to bind future electoral promises (Knöbl/Sutt/Zavoico 2002; Lauristin/Vihalemm 1997: 103; Smith 2002: 96). Especially important was the approval of the new constitution in June 1992. It established a government obligation to maintain a balanced budget, a provision that could be modified only with a two-thirds majority vote in parliament (Smith 2002: 118).

The approval of the new constitution represented a second step in the implementation of the Estonian neoliberal regime, namely the institutionalization of the restorationist principle for the new polity (Pettai/Hallik 2002: 512). With the new Citizenship Law, voice was given to the descendants of pre-1940 Estonians living abroad while the Russian-speaking minority was disenfranchised and harsh naturalization requirements established (see Pettai/Hallik 2002: 514; Smith 2002: 74).

Finally, in the parliamentary elections of September 1992 held under the new constitution's dispositions, Mart Laar, a representative of the younger generation of Estonians, free from ties to the Soviet past and a serious advocate of shock therapy reforms, was elected as the first prime minister (Smith 2002: 83; Erixon 2010: 35; see also Lauristin/Vihalemm 1997: 106). Laar engaged in an acute neoliberal reform program with a technocratic and nationalistic flavor. In line with the high-hierarchy monetary and fiscal arrangements already in place, the country reached full liberalization of the capital account in 1994 (Bank of Estonia 1999: 19). Conversely, industrial policy followed a neoclassical orientation privileging clarity, credibility, and non-discriminatory rules over state intervention and selectiveness (Sutela 2001: 19). The main highlights were the introduction in 1994 of an – at that time – innovative flat-rate tax on corporate and personal income, the elimination of previous tax benefits for foreign investors including an open rejection of tax holidays, free trade zones and other such selective instruments (Sutela 2001: 19), a policy of aggressive unilateral trade liberalization and a large-scale privatization program.

Dynamics of change: Turning points and reactive sequences (1992–2004)

An early banking crisis in the new nation-state (1992–1994)

Before political independence and following the Soviet Law on Economic Independence (1989) that granted the Baltic States a certain degree of economic autonomy, private banks mushroomed in Estonia.³⁰ They exploited the existing loose supervisory rules to generate fast private gains, rapidly engaging in excessive lending, high interest rates and corporate practices that “bordered illegality” (OECD 2000: 105–107; see Fleming/Chu/Bakker 1996: 29). These elements together with widespread mismanagement, resulting in poor quality loan books, and a low capacity for risk management in the context of rapid change, provided the breeding ground for a banking failure (OECD 2000: 105).

30 From five state banks in 1987, the total number of banks went up to 43 in 1992 (25 new banks, 14 branches of the Agriculture Bank, and 4 other state banks; Fleming/Chu/Bakker 1996: 4)

In early 1992 and some time before the CBA was in place, two large Russian banks froze the assets of Estonian banks that were held in Moscow, triggering substantial liquidity problems and producing a chain of failures.³¹ These problems were exacerbated with the implementation of the CBA in June, making it impossible for commercial banks to get new credit to back their loan portfolio, and triggering a crisis in the banking system at the end of 1992 when the new independent parliament had just been elected. Consequently, payments began to slow down and banks started to freeze company accounts, including state enterprises, hoping that this would force the government to bail them out (Fleming/Chu/Bakker 1996: 9). Contrarily, Prime Minister Laar and BOE Governor Kallas announced very quickly that no bail-outs would be provided, not even to the state companies under stress (Fleming/Chu/Bakker 1996: 14, 20).

Compared to the Chilean situation of 1982–1983, the small economic impact and political consequences of the banking crisis in Estonia made the orthodox response by the authorities easier. In fact, banking intermediation relative to Estonia's real sector was rather small, and output was in decline following the transition process (Fleming/Chu/Bakker 1996: 18; Knöbl/Sutt/Zavoico 2002: 19). A deeper look at the conditions under which this first turning point developed for both countries provides, however, a stronger basis to understand their different responses and the ensuing sequences of institutional change. Unlike the Chilean case, the conditions surrounding the Estonian banking crisis greatly favored the maintenance of the orthodox institutions at the top of the hierarchy. In the first place, the prevailing political context was still overwhelmingly dominated by the independence process and the ethnic politics dynamic, insulating the neoliberal reformers from possible competitors.³² Additionally, the privatization process had not yet taken off so there were no special interests to accommodate; in fact, in contrast with Chile, the state still controlled a majority of the banking system (Fleming/Chu/Bakker 1996: 7), and relatively few depositors were involved in the banking collapse (Fleming/Chu/Bakker 1996: 18). Conversely, the strict institutionalization of the monetary arrangements gave no room of maneuver for internal change. In fact, the constitutional constraint on fiscal policy was one of the reasons invoked for the limited policy responsiveness (Fleming/Chu/Bakker 1996: 14).

The outcome of the first turning point for the Estonian neoliberal regime was then a strengthening of the existing institutions and of their support base through a *marginal adjustment*. The authorities introduced a series of measures to reinforce the existing ER

31 Before independence, most of the financial resources collected by local branches of the Soviet state banks were sent back to the main headquarters of each bank in Moscow. In the context of a meltdown of the ruble zone in early 1992, state banks in Moscow froze all assets belonging to non-Russian banks, causing problems throughout all the former Soviet republics (Fleming/Chu/Bakker 1996: 8).

32 Apart from the temporal proximity of both processes (independence and the banking crisis), a fundamental indicator is that the decisive issue of the normalization of borders with Russia and the withdrawal of Russian troops from Estonian soil had still not been solved, and would not be until late August 1994 (see Lauristin/Vihalemm 1997: 112).

policy framework: banking licensing was strengthened, new regulatory and supervisory measures were introduced as well as international accounting standards and stronger capital requirements, regular auditing was required, and a new Law on Credit Institutions was passed in 1994 (Fleming/Chu/Bakker 1996: 28; OECD 2000: 106–107). Taken together, these actions were crucial to fix the expectations of economic actors on the commitment of the authorities to an orthodox neoliberal developmental path (cf. Fleming/Chu/Bakker 1996: 19–20).

Conversely, the decision not to intervene constituted a rejection of the possibility of forging an alliance with the company managers and bank supervisors – i. e. the emerging domestic capitalist class – and an indirect wink to foreign capital (cf. Fleming/Chu/Bakker 1996: 26). Indeed, this was confirmed with the privatization program launched by the Laar administration in 1993. In stark contrast with the case of Chile – and with the early Estonian privatization process started in 1991 – the *Treuhand*-type privatization³³ implied an explicit decision not to favor insiders (because of the ethnic concentration of big companies and industries) and a bias towards the attraction of FDI (OECD 2000: 126–136). This model of privatization was largely responsible for the importance of foreign capital in the structure of the industry by the late 1990s (see Tiits 2007: 332; OECD 2000: 131).³⁴

The Asian-Russian crisis in an under-institutionalized political system (1997–1999)

After strong export performance in 1995–1996, investor confidence in the Estonian economy increased (OECD 2000: 108). The year 1997 showed an exceptional growth of 10.4 percent, the highest in Europe for that year, increasing concerns about the economy overheating (Sutela 2001: 55). Macroeconomic imbalances accumulated (see Figure 7): the current account deficit exceeded 14 percent in spring, bank credit increased around 80–90 percent, the production of financial services another 30 percent, and the Tallinn Stock Exchange, opened in 1996, was rallying (Bank of Estonia 1999: 14; Sutela 2001: 55; OECD 2000: 69). With the triggering of the Asian crisis in 1997, the stock exchange plummeted and fears about the local currency mounted (OECD 2000: 73; Sutela 2001: 55).³⁵ While the stabilization mechanism of the CBA helped to avoid a run on the EEK, it cooled down the expansionary dynamic, putting the pressure of adjustment on the

33 The “Treuhandanstalt” was the method of privatization used in East Germany. It consisted in setting an international tender where the enterprise would be sold to the best bid. In addition to the price offered, other criteria were considered, e.g. potential buyers had to submit plans setting out their business strategy, the proposed investment, and expected employment (OECD 2000: 126).

34 In 1997, and before the Asian crisis hit the Estonian economy, one third of the Estonian output generating over 50 percent of its exports was controlled by foreign capital (Sutela 2001: 19).

35 By the end of 1997 the Tallinn Stock Exchange lost nearly three-quarters of its value with losses concentrated in the banking sector (OECD 2000: 104).

private sector (OECD 2000: 73). The start of the Russian crisis in 1998 slowed down export demand from both the former soviet bloc and the EU, transforming the "cooling down" into a recession by 1999 (Bank of Estonia 1999: 13).

The crisis setting seemed perfect for a policy reversal. It severely hit the main opposition to the neoliberal regime (the agricultural sector and the eastern regions highly dependent on the Russian economy) who increased their ongoing yet incipient mobilization (Smith 2002: 103–104). The incumbent government led by pragmatic T. Vähi could now draw on economic stress and mounting social discontent to put its reformist program into effect.³⁶ The government indeed devised a package of subsidies to farmers, and a 10-percent increase in tariffs on non-EU imports. Nonetheless, the crisis would prove unable to shift the balance of power in a direction away from neoliberal orthodoxy. An important element in understanding this is the enduring effects of the ethnic question.

Although the more stringent conditions feeding the nationalistic stance were fading away, it continued to yield effects through the under-institutionalization of the political system. In the mid-1990s, Estonians still held a perception that parties related to the old *nomenklatura*, i.e. those at the left of the political spectrum, were "overly compliant towards Russian-speaking settlers" (Smith in O'Dwyer/Kovalčík 2007: 15). As several scholars have pointed out, this pervasive ethnic divide was one of the main factors hindering the emergence of a coherent and credible non-liberal opposition.³⁷ The under-institutionalization of the Estonian political system (Pettai 2005; also O'Dwyer/Kovalčík 2007) and the lag in the adjustment of the political culture to the advancement in institutional reforms (Smith 2002: 67) further aided this result.³⁸

The impossibility of forming a non-liberal governing coalition became evident when the subsidy package decreed by Prime Minister Vähi was banned by the Constitutional Court (Smith 2002: 104). The ensuing policy responses were similar to the ones given in 1992, i.e. strengthening the existing policy framework by adjusting its parameters or what we have called *marginal adjustment*. Authorities increased reserve requirements for the CBA, higher capital-adequacy ratios, and liquidity requirements for private banks among others (OECD 2000: 69; Bank of Estonia 1999: 8, fn2). Additionally, in order to

36 Elected in 1995, Vähi's government had committed to increase pensions, reduce unemployment, and protect agriculture, but alleged that the existing institutions left no room for maneuver to implement these promises (Smith 2002 94–95).

37 According to Kitschelt, the presence of multiple social divides in the electorate "frustrate[s] the development of a left-right spectrum structured by a dominant socio-economic cleavage" (in O'Dwyer/Kovalčík 2007: 10). Consequently, Pettai (2005: fn18) shows that the only opposition alternative in the political spectrum (represented by old PFE members) could not be taken as a true left-of-center alternative.

38 Together they contributed to the instability of parties and coalitions and a greater salience of personalities rather than political programs (Smith 2002: 81; Bohle/Greskovits 2012: 102), the narrowing of electoral competition (see also Linz/Stepan 1996: 426–427), the fragmentation of the opposition vote, its incapacity to cooperate over substantive matters and its susceptibility to co-optation, and the difficulty of interest representation (Ruutsoo 1996: 111–112; Smith 2002: 117).

narrow down the margin of maneuver in institutions with lower barriers to change, the authorities introduced a series of *solidifying* measures: the fiscal policy framework was tightened in 1997 with the introduction of a Stabilization Reserve Fund (SRF) to save budget surpluses abroad, and in 1999 with a reformed version of the Law on the State Budget to improve fiscal financial management (OECD 2000: 96). The stabilization fund would be actively used to constrain liquidity and strengthen the performance of the CBA in the following years (Bank of Estonia 1999: 14; OECD 2000: 99).

On the political side, the Asian/Russian crisis consolidated the links between external interests and the maintenance of the institutions in the top of the hierarchy. Low asset prices and bankrupt companies were rapidly taken over by external companies (Eamets/Varblane/Sõstra 2003: 6).³⁹ Conversely, industrial policy started to slowly change towards a more embedded regime with the reorientation of economic relations towards the west. In fact, the pre-accession process to the EU in the late 1990s opened up the possibility of adopting a new framework of industrial policy (Tiits/Kattel/Kalvet 2006: 60). Unlike in the case of Chile where international integration in the 1990s produced pressures for further liberalization, in Estonia pressure was in the other direction: as duties and other regulations were already low, many of them had to be increased and new regulation adopted in the process of adopting the respective EU and WTO agreements (see Kuusk/Jürgenson 2008).

With a political context more open to change given the process of EU accession and the westward orientation of Estonian elites, but with little room for maneuver given the tight fiscal spending rules, industrial policy underwent a process of *layering*. EU accession implied the introduction of pockets of pragmatic industrial policy in the context of a “neutral” regime. This is reflected by the introduction of two public bodies Enterprise Estonia and the Credit and Export Guarantee Fund from which a variety of grant schemes emerged.⁴⁰ At first this new policy framework was strictly constrained by higher-hierarchy price stability policies. In fact, industrial policy developments were exclusively restricted to the arrival of EU funds under specific projects. Over time, however, the new layers of pragmatic industrial policy have worked in a way that government spending in these programs has increased (Tiits/Kattel/Kalvet 2006: 59).

39 About 85 percent of the Estonian banking sector, 90 percent of leasing, and 30 percent of the insurance market became concentrated into two major foreign-controlled financial groups (OECD 2000: 106; Sutela 2001: 34).

40 These ranged from grants to start-up businesses, training, contracting consultancies, developing infrastructure and R&D, to loan programs and guarantees to overcome collateral problems (Kuusk/Jürgenson 2008: 2–3; OECD 2009: 142–143).

The global financial crisis and EMU accession as heritage (2008–present)

During 2000–05 Estonia showed an outstanding rate of growth, diminishing unemployment, and a rapid convergence towards EU income levels (OECD 2009: 20). After 2005, however, the economy began again to show signs of overheating and macroeconomic imbalances (see Figure 7; OECD 2009: 20): rising inflation and wages and increasing current account deficits threatened the much-expected EMU accession despite the fulfillment of the Maastricht criteria on fiscal accounts. Initially the BOE tried to use the same instruments to constrain liquidity that it had used in the previous two crises (Deroose et al. 2010: 5). However, these proved ineffective due to the magnitude of the imbalances: financial and construction bubbles, a current account deficit reaching 18 percent of GDP, and foreign debt rising up to 114 percent of GDP in 2007 (Åslund 2010: 41).

The bursting of the housing bubble in the United States rapidly spread to Estonia through the financial channel. Amid increasing international restrictions, foreign banks tightened the conditions for credit roll-overs and slowed down lending (Åslund 2010: 25). As a consequence, housing prices plummeted together with investment and private consumption (Åslund 2010: 25), leading to a downturn in 2008 that had major consequences in Estonia's small and overheated economy. Analysts labeled the fall of 15.6 percent in the first quarter of 2009 "epic" (Erixon 2010: 2).

With the crisis already underway, policymakers insisted on the goal of EMU accession and started a process of internal devaluation, hoping that it would ultimately help meeting the inflationary target for adoption of the euro (Raudla/Kattel 2011: 175). Domestic analysts and the right-wing authorities continuously stressed the necessity for austerity in order to maintain the confidence of investors (Raudla/Kattel 2011). At the same time, two key external actors provided support for the advocates of the deflationary stance (Kuokstis/Vilpišauskas 2010: 6–7): the Swedish government and the European Commission. The former was concerned with the problems a devaluation of the EEK would bring to the Swedish banks controlling the Estonian banking and financial systems. The latter feared that a deep devaluation in Estonia would produce a collapse in the other Baltics causing a domino effect across the rest of the region. With such wide support for internal deflation, a first set of measures was devised to cut expenditures: budget cuts amounted to 9 percent of GDP with massive layoffs and rocketing unemployment (OECD 2009: 23). A second set of measures was intended to raise government revenue through indirect taxes (OECD 2009: 23), further enhancing the contractive reaction to the crisis.

A surprisingly rapid return to growth in 2010 helped convince the public that in spite of the hardships, the decision to defend the CBA and engage in an acute internal deflation was the best option (Åslund 2010: 41). In fact, thanks to the decrease in inflation provoked by the recession, the maintenance of ER parity and the ability to maintain low levels of fiscal deficits, the EU Commission announced the acceptance of Estonia to the eurozone in 2011.

5 Comparative perspectives: The political economy of neoliberal continuity

The following comparative exercise aims to provide a set of hypotheses on the processes that make institutional continuity possible in neoliberal developmental regimes. After reviewing the commonalities between Chile and Estonia, I present the factors explaining the diverse trajectories of continuity of both countries.

Common processes of neoliberal continuity ...

The trajectories of change in Chile and Estonia show common processes that make the continuity of their neoliberal developmental regimes possible. Unlike the mechanisms influencing ER and IP, these processes do not impact the institutions themselves, but rather the conditions under which they change: status quo bias, barriers to internal change, and institutional hierarchy. Future sequences of change thus move away from *compromise* to *marginal adjustment* (see Figure 5). Four processes can be observed: 1) *opposition blockade* (increases the status quo bias in the political context), 2) *institutionalization* (increases the barriers to internal change), 3) *creation/empowerment of supporters* (increases the backing of the institutional hierarchy,) and 4) *strategic yielding* (concessions to defend higher hierarchy policies). I will briefly elaborate on them drawing on the two cases.

Opposition blockade corresponds to the narrowing of democratic competition by institutionalizing rules that make the democratic representation of potential critics to the neoliberal regimes more difficult, making the political context more biased to the maintenance of the status quo. This is especially important in the Estonian case, where a context of ethnic politics was used to disenfranchise the Russian-speaking population that constituted the biggest potential opposition to the implementation of an orthodox neoliberal regime in its early phase. In the Chilean case, opposition blockade can be observed in the transition to democracy, which imposed a political system where “non-democratic enclaves” made reforms almost impossible without the consent of the political right, as well as in an electoral system that moderated competition, augmenting the representation of the right (in relation with its actual votes) and making the representation of the left difficult.

Institutionalization refers to the crystallization of the meaning of rules via a stricter codification, thus making future changes and alternative interpretations (i.e. internal change) more difficult. It can be pursued by attaching the rules to more encompassing normative regimes that can be better enforced and are more difficult to change, i.e. from agreements to laws, from ordinary laws to constitutional laws, etc. This was particularly important in the Estonian case with the early institutionalization and strict definition of the CBA and its complementary arrangements, which narrowed the possibility for internal change at successive turning points. In the Chilean case, the return

to democracy marked a constant search for higher and better institutionalization of the higher-hierarchy institutions and their complementary arrangements. This can be seen, for example, in the amelioration and better specification of the inflation target mechanism and in the improvement of the fiscal spending rule from a tacit commitment to a law on fiscal responsibility.

The *creation/empowerment of supporters*, or the provision of power resources to potential allies, represents a major reproduction process insofar as it helps to ensure future support for the neoliberal policies and institutions, i.e. reinforce the backing of the institutional hierarchy. Two means of generating support can be identified from the examined cases. A general one relates to the liberalization measures that generate new business niches where economic groups can be formed and – often – reproduced. In the case of Chile, for example, financial liberalization was essential to generate a basis of support for the neoliberal experiment unrelated to the reluctant business sector in the earlier phases of the experiment. At the same time, the privatization of social security provided a constant and increasing flux of fresh resources to nurture the economic groups produced by the previous liberalization. The second consists of the alienation of state assets through mechanisms by which reformers directly target potential supporters. In the case of Estonia, the method of privatization was carefully designed in order not to favor the Russian minority-controlled industry, and increase the chances for foreign capital. Interest from external capitalists in the Estonian economy was crucial to withstand the Asian/Russian crisis through massive investments that helped stabilize the economy and reinforce existing arrangements, and later on to maintain the deflationary stance in the 2007–2008 financial crisis. In the case of Chile, the designated managers of SOEs and the state officials in charge of privatization benefited directly. These created close links with right-wing parties and became the more recalcitrant defenders of the neoliberal regime after the return to democracy.

While not directly implying the creation/empowerment of supporters, the constant allusion to the expectations of external agents and the necessity to set a good “business climate” for investment as crucial for economic performance appears to be an additional, less direct, but equally important way of providing support for the neoliberal arrangements.⁴¹ While these external sources may not necessarily produce further liberalization, the Estonian case shows that they can exert diverse degrees of leverage. One example is setting conditions for loans or integration agreements (as in the case of both Chile and Estonia with the IMF and the WTO, and especially the case of Estonia with the EU). They can also exert other *softer* forms of coercion such as generating certain expectations with respect to institutional change and stability and thereby facilitating the compliance of oppositions (for example, in the case of Chile with the return to democracy).

41 Cf. the idea of “investment strike” in Kalecki (1943).

Finally, *strategic yielding* can be described as the concessions made by dominant groups in order to preserve the higher-hierarchy institutions in a context where subordinated groups increase their bargaining power. This process is particularly present in the Chilean case, especially at the first two turning points where the dominant groups had to accept concessions to other groups, such as subsidies to the business sector and higher social spending, in order to maintain the price stability goal on the top of the hierarchy. This process appears particularly relevant in connection with the “complementarity” and “compatibility” dimensions of institutional change. Again following the Chilean case, one can view the overall trajectory of the high-hierarchy institutions as an interesting story of how increasing incompatibility, by incorporating new interests and goals that potentially conflict with the existing hierarchy, increases the instability of the developmental regime. Strategic yielding in this context opens up the possibility of preventing the formation of a more powerful opposition bloc, but cannot prevent growing incompatibility of the developmental regime.

... and yet divergence: Timing, sequences and contingent constraints

The particular trajectory of each developmental regime can be captured by the combination of mechanisms of change in sequences that are context- as well as time-specific. Timing affects the way the sources of change (performance of institutions and power balance) impinge on the determinants of change (status quo bias of the political context, internal barriers to change, and institutional hierarchy). The room for maneuver produced by these factors explains the contingencies surrounding the strategies of the interested actors at each turning point and the deployment of specific mechanisms of continuity.

The timing of the first turning point in relation to the critical juncture appears to be an important element providing a political context favorable to continuity, as evidenced by the Estonian case. The tight neoliberal trajectory in Estonia owes much to the contingencies presented at the initial turning point, where the conditions insulating neoliberal reformers were still in place. The fact that the trajectory of the high-hierarchy institutions followed a combination of sequences of marginal adjustment is illustrative of this point. Conversely, the slow-growing embeddedness of its industrial policy in the 2000s exemplifies the fact that political strategies and orientations can have unintended consequences. The much expected accession to the EU and the WTO does not put pressure on the compatibility of Estonia’s tight neoliberal trajectory, but it certainly adds policy measures not envisaged by the neoliberal orthodoxy.

Following on from this, one could hypothesize that Chile would have followed a similar pattern had the first turning point come earlier when the conditions insulating the military/orthodox alliance were still in place. The time elapsed since the path-setting

period made it possible for new economic groups to emerge. Their support, which vanished with the financial crisis, counted heavily to tilt the balance of power towards a pragmatic position.

The character of the Chilean trajectory is particularly well explained by drawing on the relationship between high- and low-hierarchy institutions and the strategic actions of interested groups at each turning point. The succession of sequences of compromise and solidification as mechanisms of change is indicative of the need to tie up the top of the institutional hierarchy after new interests were included in the dominant bloc with each turning point. Conversely, the sequences of displacement and conversion of the lower-hierarchy institutions capture the existence of these contending interests and the ability of the more progressive ones to re-embed industrial policy. Finally, it also captures the growing incompatibility of Chile's developmental regime and the increasingly destabilizing effect of institutional complementarities on the existing balance of power.

6 Conclusions

This paper has explored the mechanisms of institutional continuity in two neoliberal "success stories": Chile and Estonia. While existing theories of institutional change tend to either overlook change by emphasizing continuity, or overlook continuity by emphasizing change, I have presented a framework that allows a better observation of these phenomena as processes of continuity requiring constant change. The paper adds new mechanisms of change to the existing literature on endogenous institutional change, provides a number of working hypotheses regarding the process of continuity in neoliberal developmental regimes, and advances the study of institutional change in non-advanced political economies. In the context of encompassing international pressure towards liberalization, neoliberal institutions at the capitalist periphery do not remain unchanged but are subject to constant modifications. These modifications depend heavily on the relationship between different institutions and how this relationship is conceived by interested groups, i. e. the institutional hierarchy. Using these analytical tools, the study has shown that while in Estonia dominant groups have been able to institutionalize a tight neoliberal path binding the development of both the ER and IP, in Chile they have had to surrender lower-hierarchy IP in order to maintain control of higher-hierarchy ER.

The incorporation of the notion of institutional hierarchy into an extended version of gradual institutional change seems a promising way to understand institutional resilience. First, it provides a way to incorporate politics into the study of path dependency. In fact, the analysis makes it possible to understand how societal actors try to alter or maintain existing developmental regimes, how turning points translate into institutional continuity (or change), and how particular sequences of change can build the pos-

sibility for substantive change in the future. Institutional hierarchy has also provided a multi-level explanation of regime continuity. Together with the analysis of change at the level of individual institutions it permits an analysis of change at the level of the determinants of change. Thus, we have reviewed four mechanisms that underpin the changes of individual institutions at different turning points, but also four broader processes that help us understand regime continuity over the long run. Politically, the former can be seen as highlighting contingent disputes and alliances over the definition of specific institutions, while the latter are more substantive movements of societal actors struggling over the definition of the polity.

While the paper focused less on the effect of external sources of change and their relation to domestic ones, it showed that external resources can exert diverse degrees of leverage that reinforce neoliberalism and act as obstacles to change towards more embedding directions.

Finally, further research is needed to better specify and test the proposed mechanisms and processes of change. A more systematic study of the commonalities and divergences in neoliberal developmental regimes using a more comprehensive comparative framework would be particularly well suited.

Appendix

Table A.1 Exchange rates, policy goals and developmental regimes

Policy goal and developmental regime	Exchange rate regime	Description	Government discretion
Price stability (<i>neoliberal</i>)	"Dollarization" ("Euroization")	A country stops issuing its own currency and adopts a common currency with other nations or one issued by some other country. The country loses autonomous monetary policy.	--
	Currency board	Explicit legislative commitment to fix the nominal ER (exchange rate) at certain parity. The authority guarantees full convertibility of foreign exchange. The country loses autonomous monetary policy.	
	Simple peg	NER is fixed at a certain parity, but without an explicit legislative commitment or necessarily guaranteeing full convertibility.	
	"Tablita"	A variant of peg where authorities commit to a pre-announced schedule of ER variation at a decreasing rate	
	Pure float	Commitment of the monetary authority not to intervene in the market, leaving the NER to be determined by the FX market; enables capital mobility and allows central bank to conduct monetary policy to alter internal prices.	
Price stability and national competitiveness (<i>embedded neoliberal</i>)	Adjustable peg	Authorities commit to defend a particular parity, but reserve the right to change it under certain circumstances.	--+
	Crawling peg	Authorities tie the ER to the evolution of selected macroeconomic indicators.	
	ER bands or crawling bands	Authorities set margins for ER flotation and intervene when it hits the margins. The margins can be adjusted gradually over time.	
National competitiveness (<i>embedded</i>)	Managed float	Authorities are not committed to defend any particular rate, but nevertheless intervene in the FX market at their discretion.	
	Multiple exchange rates	Authorities impose restrictions on FX transactions. Different regimes and/or parities are devised according to the type of agents and operations.	++

Source: Author's own design based on Frenkel/Rapetti (2010: 11–13).

Table A.2 Industrial policy, policy goals and developmental regimes

Policy goal and developmental regime	Industrial policy regime	Description	Government discretion
"Get prices right" No market intervention or only to protect or enhance market competition (<i>neoliberal</i>)	Neutral state ^a	Industrial policy reduced to market regulations. The role of industrial policy is to be played by other policy domains, e.g. international integration.	--
	"Regulatory state" ^b	The state assumes an active role in supervising market competition, e.g. by establishing anti-trust agencies and other supervisory bodies.	
	Microeconomic policy ^a	The role of industrial policy is to reduce costs, e.g. through flexible labor markets, reduced taxes, and other business support measures.	
"Align prices" Tackle market imperfections through functional interventions (<i>embedded neoliberal</i>)	Horizontal promotion ^{a,c}	Based on the recognition of recurrent market failures that can be specific to certain sectors (e.g. SMEs). Provision of an array of public measures understood as a common infrastructure that levels the playfield, but does not privilege any sector in particular.	-+
	Open-economy industrial policy ^d	Low but not necessary uniform tariffs, fiscal and credit incentives for exports, FDI attraction, pro-export bias	
"Alter prices" Actively induce a pattern of industrialization through selective interventions (<i>embedded</i>)	Developmental state ^{a, d}	Strategic use of protectionism, selective subsidies, embedded in domestic capital, importance of state bureaucracy.	++

Source: Author's own design based on diverse sources; a: Kosacoff/Ramos (1999), b: Muñoz Gomá (1993), c: Román (2003), d: Schrank/Kurz (2005).

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