

# **Miracle or Misery?**

The accomplishments of the Chicago Boys in Chile  
1960-1990

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# 1 – Introduction

“What few citizens knew, and what officials could not admit, was that the “Chilean miracle” was partly an illusion. Built on unrealistic economic assumptions and a fragile edifice of debt, high interest rates, and speculation, it was highly susceptible to world market downturns and excessively dependent on the fortunes of a few conglomerates whose intricate financial activities were virtually unsupervised.”<sup>1</sup>

More than forty years have passed since the Pinochet Regime in Chile started monetarist reforms of the kind that are now being termed ‘neoliberal’. The group of economists that led these reforms were called ‘the Chicago Boys’, because many of them had studied at the University of Chicago. The neoliberalism of the Chicago School of Economics inspired them to pursue political careers during the high tide of economic structuralism. The 1973 coup opened to them a window of opportunity to decisively change the structure of the Chilean economy. The Pinochet Regime became a sixteen year long socio-economic experiment, starting several years before Margaret Thatcher and Ronald Reagan could crown these ideas a new political standard.

The effects of the reforms of these Chicago-schooled economists have given rise to great controversy, which exists up to this day. Although the Regime came to an end after a majority of the Chilean people voted ‘no’ in a plebiscite on Pinochet in 1989, the basic neoliberal structures of society were kept in place. The Chilean economy has performed remarkably well since the 1990s, so well, that it is fashionable to talk about a ‘Chilean miracle’. This economic boom has been ascribed to the reforms by the Chicago economists during the Pinochet Era. Their policies are said to have ‘modernized’ the Chilean economy in such a way that would make an enduring prosperity possible in the first place. Other authors have emphasized the shaky foundations on which the reforms were built and point to the vulnerability regarding price fluctuations, the high unemployment number and the recession of 1982. According to them, the Pinochet period resembled a period of stagnation, only in the 1990s to be followed by significant economic growth.

The purpose of this thesis is specifically to answer the question: ‘what have been the outcomes of the policy measures taken by the Chicago economists during the Pinochet Era?’ To answer this question, I focus on four criteria: economic growth, inflation, export stimulation and privatization. These criteria are based on the goals that the Chicago economists set out to accomplish in Chile. Shifts or alterations that I may find, are put into perspective by drawing a comparison with the period before the Pinochet Era: this broadens the period under research from about 1960 to 1990.

1 P. Constable and A. Valenzuela, *A Nation of Enemies: Chile under Pinochet* (New York 1991) 193-194.

## 1.1 Theoretical background

Throughout the twentieth century a dividing line can be drawn between the supporters of a free market and those that defend intervention by a state. This issue has gained such weight, that it apparently compels us to choose sides: somehow, it is hard to approach this subject neutrally. The neoliberal ideology of the Chicago economists comprised the rebirth of a point of view that had been in demise since the late nineteenth century on and had, since the Great Depression, virtually lost its control over economic policy. It had, moreover, no roots whatsoever in Chilean society.<sup>2</sup> In the forty years before the coup, Chilean economic policy had been deeply influenced by developmentalist theories and dependency analysis. To underline the magnitude of the change in thinking, I briefly discuss this theoretical background.

Against a neoclassical background in which a broad Smithian and Ricardian framework still held sway, new ideas, based on a highly active role of the state, were starting to gain ground at the beginning of the twentieth century. The Great Depression proved a critical juncture in this respect: it was widely believed that the state had to interfere in the market to curtail its extreme instability. During the 1930s the British economist John Maynard Keynes gained widespread influence with his theories on money, the role of the market and that of the state. He argued that a system based on supply and demand did not necessarily result in full employment. It was, according to Keynes, the role of the government to create demand in periods of rising unemployment, thereby stimulating the economy as a whole.<sup>3</sup>

In postwar Europe and the United States, economists and political thinkers were expressing ideas about the states' role in the development of poor economies. The Ricardian idea of the comparative advantage of each country was widely criticized, for example by Ragnar Nurkse, who argued that the advantage less-developed countries had in exporting primary commodities was a factor that held back their development, because of the continuing decline of the prices of these commodities. His answer was a state that invested in certain supply-sides, while at the same time boosting demand side. Another famous developmentalist economist, Sir Arthur Lewis, wrote in the 1950s about a hidden labor reserve in the agricultural sector in less-developed countries: a systematic investment in labor-intensive manufacturing could tap into this reserve, without driving up food prices. Albert Hirschman, on the other hand, argued that a disequilibrium had to be created by stimulating one crucial sector, say electricity, which would lead to shortages and bottlenecks that would stimulate a great many other sectors. All these ideas shared the optimistic assumption that the state

2 J. G. Valdés, *Pinochet's Economists: The Chicago School in Chile* (Cambridge 1995) 12-15.

3 I. H. Rima, *Development of Economic Analysis* (London 2001) 458-461.

would be able to introduce into the economy the beginnings of a swift industrialization process, which could bring a country on the path to development.<sup>4</sup>

This optimism had started to wane in the 1960s. More pessimistic messages about a periphery being exploited by a core, consisting of industrialized countries, started to emerge. One of the earliest of these thinkers was Raul Prebisch, an Argentinian economist who had a pioneering influence in ECLA, the UN Economic Commission for Latin America. Prebisch argued that oligopolistic business structures and strong labor organizations in the developed countries combined with deeply competitive markets and weak labor institutions in less-developed countries, had led to better terms of trade for the first and deteriorating ones for the latter. The developed countries could maintain their price level, while the prices of the primary commodities of less-developed countries would continue to fall. As the solution to this problem Prebisch mentions a combination of import substitution industrialization – whereby a less-developed country would develop its industry, shielded against foreign competition by tariff walls – and export diversification – a strategy to cure the dependency on a single commodity, present in many less-developed countries. Prebisch' ideas on core and peripheral countries were very influential in the social sciences, shaping what is often called *dependency analysis*. What characterizes this method is the assumption that a lack of development in poorer countries will not be cured by state investments or a free market: underlying this poverty is a structural system of exploitation that can only be changed by radical measures.

Both developmentalist thought and dependency analysis have in common a certain structuralism: anonymous, sociological structures determine the fate of nations and of the individuals in them. Often the state is proposed as one of the few sources of agency in this structuralist world: especially developmentalist writers like Rosenstein-Rodan, Nurkse and Hirschman, expected a great deal from state action.<sup>5</sup> Although the importance of individual agency has always been present in the ideas of the 1960s and 1970s, the individual was often embedded within a certain group, be it a nation, a generation, a class, an economic branch, etc. Compared to this, the revival of classical liberalism was truly different from the structuralist mainstream: it placed the individual at the center of all action. The liberalism of Friedrich Hayek and Milton Friedman is in its essence a bottom-up philosophy: it is rooted in the belief that an individual, when left a considerable freedom to act as he thinks best, will generally choose the most profitable solution. From here it follows, that a large collection of such individuals – provided that a centrally backed law protects them against each other – will use freedom to establish progress. The place where this liberty is put to use, in neoclassical thinking, belongs naturally to the marketplace, which is viewed as the sphere that suits voluntary action best. The prospects of the state, which has at its disposal a monopoly of violence, as a vehicle of progress, was greeted by neoclassical economists with skepticism. In

4 J. M. Cypher and J. L. Dietz, *The Process of Economic Development* (London 1997) 140-153.

5 *Ibidem*, 171-179.

Chapter 3, I further elaborate on the political implications of this ideology: for now, it will suffice to point at the fundamental difference between arguing for a state-led industrialization plan and arguing that refraining from any such plan is the best solution, confident that free individuals being in a free market will spontaneously bring about prosperity.

This revival of neoclassical ideas is usually attributed to the administrations of Margaret Thatcher and Ronald Reagan. These two politicians certainly have exerted an enormous influence on governments throughout the world, as well as on the IMF and the World Bank. What is significant about the Chilean case, however, is that it provides us with an extreme version of neoliberalism, that started a full five years before Mrs. Thatcher was elected into office.

## **1.2 Historiographical overview**

The historical debate on the economic reforms during the Pinochet years has focused on two issues. The first regards the extent to which the Chicago economists have been complicit in the repression by the regime. The second focuses on the effects of the economic reforms and specifically raises the question how beneficial these have been for the Chilean population.

Juan Gabriel Valdés was one of the first to focus extensively on the background and ideas of the Chicago economists. His book 'Pinochet's economists' attempts to shed light on these reforms. Valdés signals a striking gap between the rejection of the violence of the regime of General Pinochet and the praise and prestige acquired by the General's economic team. He argues that these ideas would have been able to institute a 'viable pattern of development', but did not, the reason being the dogmatism of the economists themselves. At their stated aim, the reduction of inflation, they turned out only marginally successful, certainly when one takes into account the tremendous power that was given to these men. Valdés argues instead that the real goal of the economists had been, from the start, a radical change of the structure of society.

Valdés casts a negative judgment on the results of the reforms. Aside from a worsening impact on income distribution, he shows that the period from 1974-1982 was characterized by very unstable growth, a low level of investment, unregulated privatizations, a concentration of money – the benefactors of the private sector often being the same people as the ones publicly in charge – and an unbridled growth of foreign credit into an economy more and more based on mining, fishing and agriculture and less on industrial development.<sup>6</sup>

What Valdés interprets as the ideological dogmatism of the Chicago economists is interpreted by others as a next step in a process of technocratization. In her book 'Economists, Politics and

<sup>6</sup> Valdés, *Pinochet's economists*, 21-28; 261-267.

the State', Veronica Montecinos traces the emergence of the economist in the Chilean state apparatus during the second half of the twentieth century. She relates this rise of the economist within government to the growth of economic planning and, later in the century, of free market policy. Montecinos focuses on the 1958 to 1994 period. According to her, it was Eduardo Frei, who made economic planning the center of his 'Revolution in Liberty'. He proved much more receptive to developmental economics and appointed many economists to his government in order "to rationalize government decision-making". Like Frei, Salvador Allende tried to shield the professional economists from the ideological suspicion of the parties of his coalition. The heavy politicization in these years made this an impossible endeavor: the revolutionary rhetoric of the parties of Allende's Unidad Popular-coalition inevitably transformed everything into politics.<sup>7</sup>

As Montecinos shows, it was the military dictatorship of Augusto Pinochet that really contributed to the rise of technocratic economists in government. "The degree of influence economists achieved during the previous decades never reached the degree of control obtained in this period. [...] Economists acted as true generalists, displacing other professionals, talking directly to the public, inspiring constitutional reforms and changing the terms of the political discourse." At the same time, it meant literally the end of developmental economics. Pinochet, a man of "revolutionary aspirations", helped the orthodox Chicago economists to attain an unprecedented amount of influence. Shielded from that part of society that was affected by their policies – mainly the poor – and protected by Pinochet himself, they were able to maintain their radicalism, until the crisis of 1982 forced Pinochet to consider a more pragmatic approach.<sup>8</sup> Montecinos argues that Chile, until the coup a country divided by political lines, arrived in the 1990s into an era of "technification of politics".<sup>9</sup>

In his book 'In the Name of Reason', Patricio Silva, like Montecinos, stresses the growing importance of technocrats within Chilean politics. According to Silva, the phenomenon 'technocrat' gained prominence from the late 1920s on, only to lose a little pace during the Frei and Allende-years, in what he terms 'the reformist decade'. From 1973 on, technocracy is on the rise again, developing further since the return to democracy. He views technocrats as specialists with an academic background, different from intellectuals in their scientific, non-political outlook. They often constituted "a sort of mediating group" between the forces of Left and Right.<sup>10</sup> Silva further argues that the "case of the Chicago Boys shows how a technocratic vision can transcend the original group and obtain a hegemonic status in society".

Silva holds the Chicago economists responsible for creating a consumer society, speaking even of a "consumption boom" and the "Chilean Wirtschaftwunder" in the years 1978-81. Not only

7 V. Montecinos, *Economists, Politics and the State: Chile 1958-1994* (Amsterdam 1998) 44-59.

8 Ibidem, 61-68.

9 Ibidem, 130-133.

10 P. Silva, *In the Name of Reason: Technocrats and Politics in Chile* (University Park 2009) 17.

would an abundance of consumer goods legitimate the regime, especially when set against the “trauma of the early 1970s”, it moreover celebrated the individual. The collective identities that dominated Chile’s past were being progressively undermined by the Pinochet government. In the end, according to Silva, it was their success that legitimized the Chicago economists’ “neoliberal technocracy” among the Chilean population. Calling them “true pioneers”, he views the contribution of the Chicago economists as a modernization of the country. The fact that the Aylwin administration left the basic principles of the reforms intact is regarded by Silva as further proof for the success of the technocratic reforms.<sup>11</sup>

Carlos Huneeus’ book ‘The Pinochet Regime’ is an important objection to the economic success of the Pinochet regime. The Chicago economists’ rise to power is seen by Huneeus first and foremost as a political strategy. The coup was seen by the regime as the ousting of an economically unsuccessful government, so the new government had to show economic results in order to legitimize itself. “The importance of the economic model to the authoritarian regime’s legitimation strategy explains the obsession for demonstrating success and refusing to admit any weakness.”<sup>12</sup> The ideological restructuring of society is masked by a veil of technocracy: right-wing neoliberal politics disguised as post-political science.

Huneeus points at the partiality of the modernizations: progress was mixed with traditional ideas and institutions. Their policy was based on favoritism, with a tendency to give priority to business interests. He also emphasizes that the Chicago economists were not technocrats, but driven by “considerations of power”. It was a main interest for them to neutralize other schools of thought, which they accomplished by denying these schools funds and selecting for projects scholars that had affinity with their neoliberal ideas.<sup>13</sup>

The crisis that struck Chile in 1982-3 is seen by Huneeus as a product of the Chicago economists’ policy. The amount of deregulation combined with the opening of the country to the international financial markets, caused a surge in private credit. The liberalization of the countries’ import barriers caused imports to rise, with the domestic economy staying behind, leaving an export economy based on copper. So, when the copper price fell dramatically and interest rates started to rise and the availability of foreign capital dried up, Chile was hit hard.

The crisis period was followed, from 1984 on, by a period with a more pragmatic economic policy, which was characterized by a new round of privatizations. Huneeus argues that these were characterized by a lack of transparency. No measures were taken to avoid abuse, making it possible for senior executives to become controlling partners in the newly privatized firms. Huneeus uses two examples to demonstrate this lack of transparency: the privatization of the pension system and that of the electricity system. The substitution of the distributive pension

11 Ibidem, 159-167; 171-172.

12 C. Huneeus, *The Pinochet Regime* (Boulder 2007) 162-168

13 Ibidem, 271-275; 283-286.

system by an individualized scheme led to an agglomeration of capital by a few major pension funds in the 1980s. At the same time, according to Huneus, the coverage of the system was lower and the deficit – the part to be paid by the state – was to become higher (as a percentage of GDP) than it had been in the 1970s. Huneus moreover shows that the privatization of the electrical sector led executives to mobilize their workers' pensions in order to increase their influence over the sector, and to establish a de facto monopoly on the whole of electricity production and distribution, leaving them enormous economic and political power.<sup>14</sup>

Ricardo Ffrench-Davis can be regarded as 'the dissident Chicago Boy', because he participated in the university exchange in the early 1960s, but chose to oppose the Pinochet Regime, being one of the creators of the oppositional think-tank, CIEPLAN. From the start of the Regime, he has been very critical on the Chicago economists' handling of the economy, in particular criticizing their disregard of macroeconomic imbalances and the worsening of income distribution. His work 'Economic Reforms in Chile' is essentially a comparison between the economic policy of the Pinochet Regime with that of the Concertación governments that followed it<sup>15</sup>. He argues that the Pinochet reforms made the Chilean economy particularly vulnerable to external shocks, as was demonstrated in the 1982-3 recession.

Ffrench-Davis is especially depreciative about the measures taken to curb inflation. Falling copper prices and rising oil prices contributed to a deterioration of terms of trade in 1975, which propelled the government to install restrictions on demand and to a devaluation of the exchange rate. This resulted in a considerable drop in industrial production. The government discovered that it could use the exchange rate to influence inflation, which it systematically did after 1975, resulting in an external disequilibrium.<sup>16</sup> The period of 1982-89 was characterized by pragmatic adjustments, such as devaluations, increases of import tariffs, nationalization of private debt (especially by the re-nationalization of the financial sector) and the imposition of regulation for the financial system. These measures were taken to recover economic activity, but were, however, strongly biased to the upper classes, causing further deterioration in income distribution. From 1986 on, economic activity recovered, supported first by international loans and then by a soaring copper price. Ffrench-Davis argues that this acceleration of economic activity overheated the economy, which is why inflation was on the rise again during 1989.<sup>17</sup>

To summarize, one can distinguish two main variables. On the one hand, there is the question of how political or ideological the Chicago economists actually were: can they be regarded as pragmatic technocrats, driven by scientific motives, or is the emphasis on science merely a

14 Ibidem, 314-322; 332-344.

15 The four governments that followed the Pinochet regime were headed by the Concertación-coalition. *Concertación* is Spanish for 'concertation' or 'agreement'.

16 R. Ffrench-Davis, *Economic Reforms in Chile: From Dictatorship to Democracy* (New York 2010) 9-19.

17 Ibidem, 20-24.

legitimation strategy, used to disguise their partisanship in a politically deeply divided country? The other variable concerns the effects of the reforms: did these cause economic growth and stability and did the restructuring of society form the necessary basis of the prosperity in the post-dictatorship period? Or did these reforms lead to severe instability, corruption and stagnation, which were only to be repaired in the 1990s?

It is these closely related disputes that I attempt to clarify. The purpose of this master's thesis is to provide a clear picture of the economic legacy of the Pinochet regime. To do this one should steer clear of the ideological rift between Left and Right, between social-democratic and neoliberal ideas about 'what works', about the right course to prosperity. In order not to get lost in this ideological minefield, I look at some parameters that have been used by the Chicago economists themselves, to be complemented by other often-used variables like the level of inequality and – public or private – indebtedness. With these I am able to draw a picture of the effects of the Chilean reforms, which can be used to consider the ultimate aims of the reforms and the level of technocracy or ideology involved in these.

### **1.3 Sources and method**

To answer my research question – 'what have been the outcomes of the policy measures taken by the Chicago economists during the Pinochet Era?' – I use three main collections of data. These are: 'Historical Statistics of Chile', compiled by M.J. Mamalakis and published in six volumes from 1978 to 1989; the Penn World Table, provided by the Groningen Growth and Development Center (GGDC) and DataBank, the online database of the World Bank. It is especially a collection within the latter, labeled the World Development Indicators, that provide me with a vast collection of statistics on Chile in the period 1960–1990.

My aim is twofold. On the one hand, I want to place the Pinochet Era into its proper historical perspective, to explain in what environment the Chicago ideas took hold. On the other, I want to show the outcome of the Chicago reforms in Chile. This two-sided aim means that I combine the creation of a historical narrative in which to place the Chicago reforms, with a statistical analysis of broad macro-economic data about both the Pinochet Era and the decade directly preceding it. The data analysis is used as a way to test common assumptions about the reforms being either the birth ground of a Chilean miracle or a period of deep economic misery.

### **1.4 Layout**

The next two chapters are devoted to the historical and theoretical background. First, I briefly sketch the parameters of socioeconomic and demographic Chile, followed by a short overview

of the history of Chile from about 1960 to 1973. Such a narrative is necessary to put the findings of the chapters that follow into their proper historical perspective.

Chapter III further elaborates on the theoretical framework used by the Chicago economists. What were the ideas of the Chicago School of Economics? How did the exchange of ideas between Chicago and Santiago take place? Moreover, I use the 1973 study 'El Ladrillo' by Centro de Estudios Públicos, which was used as a blueprint for the later economic policy of the military regime, to draw conclusions about the proposals and priorities of the Chicago economists. Finally, I sketch briefly the events following the 1973-coup.

What effect these reforms had on the Chilean economy is the subject of Chapter IV. To explore these effects, I use four criteria. I start off with their attempt to stimulate economic growth. What did the Chicago economists do to stimulate growth? What influence did such policy measures have on the growth rate of per capita GDP between 1974 and 1989? How was this growth distributed by sector and what parts of the population profited the most from this growth? How did Chile compare to other Latin American countries and to world average? I also look briefly into the scale of inequality.

Inflation is the next topic of discussion. How did the Chicago economists handle inflation and what influence did these policy measures have on the value of the Chilean peso and on price levels within the country? What effects were to be expected from the pegging of the peso to the US dollar in 1979 and how did this turn out? Moreover, how did Chile's inflation rate compare to other countries?

Furthermore, I discuss the regime's policy regarding foreign trade and especially stimulation of exports. I try to establish what influence these had on foreign trade. What kind of products were exported the most and how did this situation differ from the exports of the Frei and Allende periods? And how did the growth in international trade correspond to developments in other Latin American countries?

Finally, I explore the consequences of privatization. What government sectors were privatized during the Pinochet Era? How did this happen and what influence did privatization have on the productivity of the economy as a whole?

On the basis of these four criteria I reassess the accomplishments of the Chicago economists and present concluding remarks on the value of their legacy. Although the Pinochet Regime has been responsible for an extensive amount of repression and severe human rights abuses, I do not investigate this side of the dictatorship, as it falls outside of the scope of this thesis. Therefore, I am applying a purely economic perspective: it is my intention to establish if the Chicago revolution bestowed upon Chile an economic miracle or if it left only misery in its wake.

## 2 – A Time of Turbulence

The coup of 1973 did not happen in a vacuum. To understand why it happened and consequently why the Chicago economists went to such extremes in their reforms, it is necessary to cast some light on the political events that happened before the coup, as well as to give a brief overview of the demographic and economic developments the country went through in the decades before the coup. An exhaustive list of causes that led to the coup, lies beyond the scope of this thesis. Arturo Valenzuela, for example, has given a full explanation of the background of the coup.<sup>18</sup> My main objective is to provide the economic and political background, against which the Chicago economists put their reform efforts to work. Without such a framework, we will not be able to understand the results of these reforms.

In the first part of this chapter, I briefly discuss the economic and demographic developments between 1950 and 1973. The following parts of the chapter are devoted to the turbulent political times preceding the coup and especially to the ideological tenseness of the last ten years before the coup. The second section describes some basic tendencies within Chilean society before 1973, the third section centers on the period of the Frei presidency, while the last part is about the Allende presidency.

### 2.1 Growth, copper, and inequality

A proper understanding of the magnitude of the reforms can only be achieved by an adequate background knowledge of Chilean society, which I therefore sketch. Chile, like many other Latin American countries, experienced a strong population growth in the second half of the twentieth century. Between 1950 and 1973 the population size almost doubled, from 6.14 to 10.09 million.<sup>19</sup> The highest growth percentages were achieved in the 1950s and 1960s with an annual growth of 2.21 and 2.17 percent respectively.<sup>20</sup> The cities were able to attract an increasing number of inhabitants: the percentage of the population living in an urban environment increased from 57.8 percent in 1950 to 78.4 percent in 1975. The size of these cities more than doubled in these years from 3,55 to 8,17 million people, the Greater Santiago area housing more than a third of them. In 1950, already 1.3 million people lived in or nearby the capital, a number that doubled to 2.6 million in 1970, reaching 3.14 million in 1975<sup>21</sup>.

18 A. Valenzuela, *Chile: The Breakdown of Democratic Regimes* (Baltimore 1985).

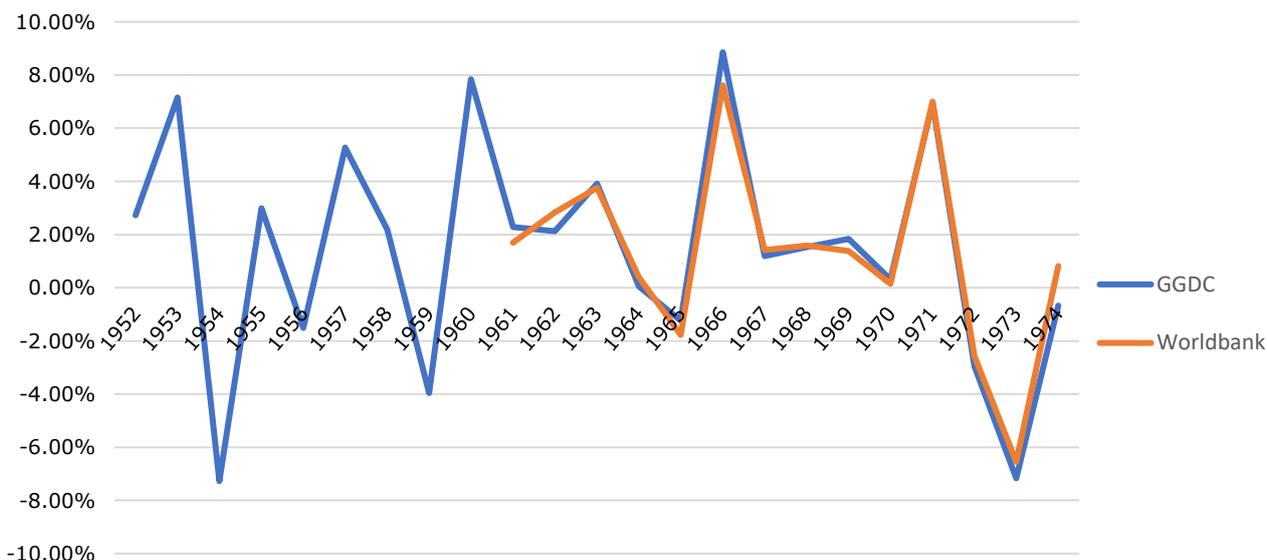
19 United Nations, Department of Economic and Social Affairs: World Economic Prospects, the 2015 Revision, retrieved on June 15, 2017, from: <<https://esa.un.org/unpd/wpp/DatasQuery/>>.

20 D. E. Hojman and M. Ramsden, 'Employment and the Labour Market in Chile: Trends, Fluctuations, and Prospects for the 1990s' in: A. Angell and B. Pollack ed., *The Legacy of Dictatorship: Political, Economic and Social Change in Pinochet's Chile* (Liverpool 1993) 108.

21 United Nations, Department of Economic and Social Affairs: World Economic Prospects, the 2014 Revision, retrieved on June 15, 2017, from: <<https://esa.un.org/unpd/wup/CD-ROM/>>.

One of the reasons for the growth of the population was a significant decline in infant mortality. In 1940, out of every thousand Chilean infants 192.8 did not survive their first year.<sup>22</sup> In 1960 this number had fallen to 127.6, to further decrease to 63.7 in 1973.<sup>23</sup> This increased survival rate was of major influence on the overall life expectancy. Between 1939-42 women could expect to live up to 43.06 years and males to 40.65.<sup>24</sup> This increased to 60.3 and 54.8 respectively in 1960 and to 67.6 and 61.3 in 1973.<sup>25</sup> Furthermore, an increasing part of the population was able to read and write, the share of illiterates in the total population (of fifteen years old and over) decreasing from 16.1 percent in 1960<sup>26</sup> to 9.9 percent in 1981<sup>27</sup>.

**Figure 2.1: Annual Growth GDP per Capita in Chile**



**Source: Groningen Growth and Development Center, Penn World Table, retrieved on June 15, 2017, from: <<http://www.rug.nl/ggdc/productivity/pwt/>>. GDP per capita is converted to 2011 US Dollars.**

Chile is currently one of the richest countries of the South American continent. In terms of GDP per capita, the country, in 2015, ranked third just beneath Uruguay and Argentina. Compared to the rest of the continent, Chile has remained at a remarkably stable position for more than fifty years, especially considering its history of radical economic reforms. Between 1951 and 1973 per capita GDP rose by 36 percent, from \$4,959 to \$6,753, amounting to an average growth of 1.5 percent per annum. When one looks at the growth numbers per decade, a more interesting development becomes visible. In the 1950s the average growth of per capita GDP was 0.95 percent, while in the 1960s this percentage rose to 3.55 percent. In the 1970s growth slowed down again to an average 0.70 percent. What stands out, however, is the

22 M.J. Mamalakis, *Historical Statistics of Chile: Demography and Labor Force, Volume II* (Westport 1980) 43.

23 The World Bank, World Development Indicators DataBank, retrieved on June 15, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.

24 Mamalakis, *Historical Statistics, Volume II*, 47.

25 The World Bank, World Development Indicators DataBank, retrieved on June 15, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.

26 R. Austin, *The State, Literacy, and Popular Education in Chile, 1964-1990* (Lanham 2003) 110.

27 The World Bank, World Development Indicators DataBank, retrieved on June 15, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.

instability of the country's growth number: years of growth were alternated with years of deep economic decline (Figure 2.1).<sup>28</sup>

Not only did the country experience a huge economic growth, a great deal had changed in the composition of the different economic sectors that made up GDP. The share of agriculture in GDP decreased significantly from 15.4 percent in 1940, to 11.5 percent in 1960<sup>29</sup>, further dwindling down to 6.7 percent in 1973. Manufacturing, on the contrary, increased its share from 16.7 percent in 1940, to 19.3 percent in 1960, to 26.9 percent in 1970.<sup>30</sup> Thereafter its share in the economy stagnated, amounting to 26.1 percent in 1973. The share of the service sector in this period fluctuated between 50 and 60 percent, with retailing typically taking up between 17 and 23 percent of Chilean GDP (Table 2.1).<sup>31</sup>

**Table 2.1: Industrial Origin of Gross Domestic Product in Chile**

	Agriculture	Mining	Construction	Manufacture	Retail	Other	Total
<b>CORFO</b>							
<b>1940</b>	15.38%	8.60%	2.26%	16.74%	18.10%	38.91%	100.00%
<b>1950</b>	13.19%	5.56%	2.34%	21.53%	17.11%	40.28%	100.00%
<b>1960</b>	11.54%	6.40%	2.38%	19.28%	19.93%	40.47%	100.00%
<b>ODEPLAN</b>							
<b>1960</b>	11.06%	9.11%	4.16%	23.29%	20.99%	31.39%	100.00%
<b>1970</b>	7.26%	10.32%	3.78%	26.91%	19.14%	32.59%	100.00%
<b>1973</b>	6.61%	8.93%	3.20%	26.12%	25.27%	29.87%	100.00%

**Source: Mamalakis, Historical Statistics of Chile: National Accounts, Volume I (Westport 1978) 137; 199**

The other sector whose share kept fluctuating was mining. As the copper mines made up the lion's share of the mining sector – amounting to 88 percent of all mining exports in 1970<sup>32</sup> – fluctuations in the world copper price highly determined the revenue to be gained. Furthermore, while in 1970 only 6.8 percent of GDP was earned by the mineral sector, the sector was responsible for 85.2 percent of total exports.<sup>33</sup> Chilean exports thus meant copper exports. As a share of GDP, imports and exports maintained a relatively stable 12 to 16 percent during 1960-73, with exports only falling below 12 percent in 1971 and 1972. This shows a remarkable difference with the international trading practices today, with imports amounting to an average 32.8 percent of GDP for the period 2006-15 and exports to 37.1

28 Groningen Growth and Development Center, Penn World Table, retrieved on June 15, 2017, from: <http://www.rug.nl/ggdc/productivity/pwt/>. GDP per capita is converted to 2011 US Dollars.

29 This percentage is taken from the CORFO tables, the ODEPLAN tables mention 11,06 %.

30 This percentage is taken from the CORFO tables, the ODEPLAN tables mention 23,29 %.

31 M.J. Mamalakis, *Historical Statistics of Chile: National Accounts, Volume I* (Westport 1978) 137; 199 (I took the liberty of combining the statistics from CORFO and ODEPLAN tables).

32 The World Bank, 'Chile, An Economy in Transition' (Washington 1979) 354, retrieved on June 20, 2017, from: <http://documents.worldbank.org/curated/en/645231468769210794/pdf/multi0page.pdf>.

33 N. Reinhardt, W. Peres and N. Correa, 'Structural Change in the Chilean Economy: The Sectoral Impact of Economic Reforms, 1970-2000' in: P.A. Aroca and G.J.D. Hewings ed., *Structure and Structural Change in the Chilean Economy* (New York 2006) 15-6.

percent. This has to do in part with the heavy import restrictions that were common before the coup, amounting in 1973 to an average 94 percent.<sup>34</sup>

Regarding the share of agriculture in total employment, the trends follow the same course as the sector's share in GDP. In 1940, 35 percent of the population was employed in agriculture, fishing, or forestry. This share saw a substantial decrease, until it reached 21.1 percent in 1970. The mining sector provided a relatively smaller share of total employment, decreasing from 5,4 to 3 percent between 1940 and 1970. Employment in manufacture, while initially increasing from 16.9 percent in 1940 to 19.1 percent in 1952, declined to 16.6 percent in 1970. The service sector, on the other hand, was able to provide employment to a rising share of the population, just like the transport and construction sectors, respectively increasing from 24.3, 4.2 and 3.3 percent in 1940, to 26.5, 6.1 and 6.5 percent in 1970.<sup>35</sup>

And how about the ones without a job? In 1960, 7.1 percent of the labor force was officially registered as 'unemployed'. This decreased to 4.7 percent in 1967, after which it started to rise again to 6.1 percent in 1970. During the government of Allende, unemployment was reduced again, this time to 3.1 percent.<sup>36</sup> Due to a scarcity of reliable data, a picture of the amount of poverty in Chile centers on its capital. Carol Graham estimates the share of 'indigent' - defined as "those whose family income is insufficient to meet basic food needs" - at 8.4 percent of the capital's population of 1969, while the share of the city's poor stood at 28.5 percent. Her definition of 'poverty' consists of those that had twice as much income or less as the 'indigent', which are themselves included.<sup>37</sup> Stefan de Vylder mentions that, in 1970, 26.8 of all dwellings in the cities lacked direct access to drinking water, while between 1960 and 1970 the number of individuals per dwelling increased from 6.8 to over 7 percent.<sup>38</sup>

Income inequality is a permanent aspect of Chilean society, as one can conclude from Table 2.2. Although figures pertaining to the pre-1973 period are scarce, a World Bank Report from 1980, entitled 'Chile: an Economy in Transition', stated that in 1967 the poorest 60 percent of the population could dispose of 24 percent of the country's income, while the richest 20 percent earned 56,5 percent.<sup>39</sup> Carol Graham, moreover, noted that, in 1969, the share of income of the poorest 60 percent was 23,4 percent and that of the richest 20 percent amounted to 56,4 percent.<sup>40</sup> The GINI Coefficients of Chile, for 1960 and 1970, were 0.468

34 French-Davis, *Economic Reforms in Chile*, 12.

35 The World Bank, 'Chile, An Economy in Transition' (Washington 1979) 12, retrieved on June 20, 2017, from: <http://documents.worldbank.org/curated/en/645231468769210794/pdf/multi0page.pdf>.

36 Mamalakis, *Historical Statistics, Volume II*, 271.

37 C. Graham, 'From Emergency Employment to Social Investment: Changing Approaches to Poverty Alleviation in Chile' in: A. Angell and B. Pollack ed., *The Legacy of Dictatorship: Political, Economic and Social Change in Pinochet's Chile* (Liverpool 1993) 55.

38 S. De Vylder, *Allende's Chile: The Political Economy of the Rise and Fall of the Unidad Popular* (New York 1976) 8

39 The World Bank, 'Chile, An Economy in Transition' (Washington 1979) 579, retrieved on June 20, 2017, from: <http://documents.worldbank.org/curated/en/645231468769210794/pdf/multi0page.pdf>.

40 Graham, 'From Emergency Employment to Social Investment', 55.

and 0.459, which were fairly beneath Latin American average, standing at 0.507 and 0.516 respectively.<sup>41</sup> We return to the issue of inequality in Chapter 4.

**Table 2.2: Distribution of Income in Chile**

	<b>1967</b>	<b>1969</b>	<b>1979</b>	<b>Increase / decrease</b>
<b>1st decile</b>	1.50%	1.30%	1.40%	-6.67%
<b>2nd decile</b>	2.50%	2.40%	2.40%	-4.00%
<b>3rd decile</b>	3.30%	3.30%	3.20%	-3.03%
<b>4th decile</b>	4.40%	4.30%	4.10%	-6.82%
<b>5th decile</b>	5.40%	5.40%	5.00%	-7.41%
<b>6th decile</b>	6.90%	6.70%	6.50%	-5.80%
<b>7th decile</b>	8.50%	8.60%	8.40%	-1.18%
<b>8th decile</b>	11.10%	11.60%	11.80%	6.31%
<b>9th decile</b>	16.30%	17.40%	18.10%	11.04%
<b>10th decile</b>	40.20%	39.00%	39.10%	-2.74%

**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>; C. Graham, 'From Emergency Employment to Social Investment: Changing Approaches to Poverty Alleviation in Chile' in: A. Angell and B. Pollack ed., *The Legacy of Dictatorship: Political, Economic and Social Change in Pinochet's Chile* (Liverpool 1993), 55.**

In summary, one can conclude that Chile was in many aspects a development country. It had a high population growth, while many migrated away from the agriculture in the countryside, to become city dwellers, employed in manufacture and services. The country's economic growth rate was erratic: years of high economic growth were often followed by years of decline. Part of the reason for this was the dependency on copper: as the only major export product, shifts in the world copper price had a substantial impact on the country's balance of payments, which had considerable repercussions on the rest of the economy. Compared to the present-day situation, moreover, Chile could be considered autarkical, with high tariffs blocking international trade. In other aspects, though, the country was modernizing. As health care and education levels increased, Chileans could expect to live longer lives and a greater proportion of them was able to read. The benefits of modernization were not distributed equally within the country, although the level of inequality was low to Latin American standards and was further decreasing.

I return to these issues in Chapter 4. First, I consider political developments in the years preceding the coup of 11 September 1973.

<sup>41</sup> P. G. Pieró, 'Desigualdad y pobreza América Latina y Europa Desde 1950', *Política y Cultura*, Vol. 20 (Autumn 2003) 36

## 2.2 Chile's presidential era 1925-73

The Chilean political order that came into being with the constitution of 1925 was marked by extremes. A relatively large part of the electorate either voted for parties that wanted to radically change the system or for those that pledged to defend the institutional order against any kind of change. At the same time, this system contributed to fragmentation: in 1930 there were about thirty parties represented in Congress. Although by 1970 this number had shrunk down to ten, as a rule no party was able to secure more than 30 percent of the votes in congressional or municipal elections – the only exception to this being the Christian Democratic Party (PDC) in the 1965 and 1967 elections, assuring itself of 43.6 and 36.4 percent of the votes respectively<sup>42</sup>.

The parties of the center were usually able to secure the leading role within coalition governments. Between 1938 and 1953 the Radical Party (PR), then at the height of its power, could use its center position – contrary to what their name suggests – to stay in power. From 1953 until 1958, the political center was taken over by General Carlos Ibañez with his Agrarian Labor Party (PAL). After this short (although democratic) intermezzo, the right-wing candidate Jorge Alessandri was elected president. Already in 1961, he felt himself compelled to invite the Radical Party into his administration, when the congressional elections meant a loss of his majority. The center reemerged triumphantly with the election of Eduardo Frei Montalva of the PDC in 1964, ushering in a few years of bold self-confidence for the Christian democrats, until the election of Salvador Allende's Unidad Popular-coalition in 1970.

The center, however, was challenged by strong flanks. On the left side, there were the socialists (PS) and the communists (PC), on the right there were conservatives (AN) and liberals (PL), who formed the National Party (PN) in 1966. In addition, within both the PR and the PDC strong left and right wings would at times arise, which could substantially weaken the party: a classic problem for center parties in a polarized society. That this polarization increased sharply becomes clear when one observes the number of party divisions, taking place since the late sixties: in 1969, the right wing of the PR formed the Radical Democrats (DR) and the left wing of PDC became MAPU, the Popular Unitary Action Movement. In 1971 dissident, leftist radicals founded the Radical Left Party (PIR). In the same year, again a leftist group from the PDC formed a separate party, naming it Christian Left (IC).

Arturo Valenzuela identifies this polarization as Chile's "centrifugal tendencies", forces ensuring that society tended to pursue extreme objectives in a period of crisis. At the same time, as neither left nor right managed to gather a majority, Valenzuela discerns a tendency to aim for consensus. Moreover, there was clientelism: an electoral system in which parties for their

42 P. E. Sigmund, *The Overthrow of Allende and the Politics of Chile, 1964-1976* (Pittsburgh 1977) 58

position in the congress and senate, were directly dependent on local elected officials, functioned as a way to bring local promises into parliament. This was facilitated by a willingness to negotiate. As much as the quest for consensus had shaped political history, from the late sixties on, it became increasingly difficult to find this kind of unity in a deeply divided Chile. One could question whether the crisis emerging around 1970 was due to centrifugal tendencies that have always been a problem in the Chilean political system, or that this should be seen as an exceptional situation, the erosion of a political center, that had always been the decisive factor in shaping governments.<sup>43</sup>

One can conclude, however, that the Chilean political system, which had until then been held in check by the arbitrating powers of a center, that aimed for consensus, had, by the end of the 1960s, given way to a situation where polarization was spinning out of control. The role of the Christian Democrats is pivotal in this regard.

### **2.3 La revolución en libertad 1964-70**

The roots of the Christian Democrats in Chile reach into the 1930s. Under the heading National Falange (FN) some young members chose to split off from the Conservative Party in 1935. Partly imitating elements of European fascism, they strove for a social Christian alternative to the socialism of the Russian Revolution and to the unbridled capitalism of the Great Depression.<sup>44</sup> Their political philosophy was influenced by innovative doctrines from Rome, such as the encyclical *Rerum Novarum* in 1891 and *Quadragesimo Anno* in 1931. The leaders of the Falange, including Eduardo Frei Montalva, Bernardo Leighton and Radomiro Tomic, disapproved of the idea of a class struggle and demonstrated a strong belief in the democratic state, which would assume a neutral position with regard to religion. The frontal piece of their political thought consisted of communitarianism, the idea that a citizen provides his life with meaning through a vast web of associations in which citizens are represented in all aspects of their daily lives, such as trade unions, churches, parent associations, youth clubs, residents' associations, etc. This civil society between state and individual was to be strengthened, in order to connect the individual to the community, of which he is a member, thereby doing justice to both individual and social aspects of human nature.<sup>45</sup>

It was the popularity of the left side of the political spectrum, which brought about the PDC gain during the presidential election of 1964. The possibility that the Marxist leader Salvador Allende would win the elections frightened the Liberals and Conservatives so, that they advised their voters to vote for Frei. At the same time, this fear had been reinforced by the Communist threat posed by the coming to power of Fidel Castro in Cuba and the Cuban missile crisis. The

43 Valenzuela, *Chile*, 6-11.

44 S. Collier and W.F. Sater, *A History of Chile, 1808-1994* (Cambridge 1996) 305-308.

45 Sigmund, *The Overthrow of Allende and the Politics of Chile*, 23-25.

popularity of Allende was likewise a major reason behind the U.S. support to his opponents. Between 1962 and 1969 Chile gained more support from Kennedy's 'Alliance for Progress' than any other Latin American country: amounting to more than one billion dollars.<sup>46</sup>

The PDC program was ambitious. The Revolution in Liberty that Frei wanted to introduce was based on a stimulation of the entire economy through industrialization, a reduction of inflation and the elevation of the poorer segment of society. These goals were to be achieved through four policy measures: the partial nationalization of the copper mines, a redistribution of land, large investments in the public sector (industry, education, housing) and the so-called *Promoción Popular*, which meant to organize the population into associations, through which everyone would be more capable to defend his interests. Inflation was a pressing concern for Frei, who stated in his last address to Congress in 1969 that: "controlling inflation was perhaps the only fundamental proposal of my program that I had not come to fulfill."<sup>47</sup> While inflation had proved a recurrent problem, annual inflation surging from 12 to 86 percent during 1952-1955,<sup>48</sup> Alessandri managed to bring inflation down to 7.7 percent, only to see it increasing again in the last years of his presidency, hitting 43.9 in 1963 and 46.4 in 1964. During the first years of the Frei presidency, inflation again declined to 18.1 percent in 1967, thereafter steadily increasing to 32.5 percent in 1970.<sup>49</sup>

Copper constituted, as we already saw, the main export product of Chile and an important source of employment. Due to the frequent use of export duties it was also a great source of income for the Chilean government. It is for this reason that every Chilean government tried to stimulate the production of copper. This production was controlled mainly by three American companies: Kennecott, Anaconda and Cerro. Although it proved relatively easy to reach an agreement about the partial nationalization (*Chileanization*) with the companies themselves, it appeared considerably more difficult for Frei to get Congress and Senate approval for his proposals. When Frei finally came to agreement with the parties on the Right, he had not only alienated the parties on the Left, but the left wing of his own party as well.

For the second major policy challenge, land reform, Frei needed the support of the Left. This proved more difficult than expected. Land reform was a controversial measure bringing about a lot of discussion about how this reform would take place. In 1965, 55.3 percent of the land was in the hands of a few dozen large latifundia, while 9.7 percent of the land was owned by minifundia: accounting for 82 percent of the total number of farms. Even though Frei put 80 acres as the maximum standard for each estate, various exceptions that were named in the bill in practice enabled the estates to keep a total of four times as much land. Combined with the support for the Chileanization project by the right-wing parties, this meant a further

46 A. Angell, 'Chile since 1958' in: L. Bethell ed., *Chile Since Independence* (Cambridge 1993) 146-149.

47 Montecinos, *Economists, Politics and the State*, 50.

48 Ffrench-Davis, *Economic Reforms in Chile*, 5.

49 The World Bank, World Development Indicators DataBank, retrieved on May 5, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

deterioration of relations with the left parties, which felt that the proposal did not go far enough. To the parties on the Right, on the other hand, the measures led to a large amount of consternation. In the end, 3.5 million hectares of land were expropriated: this amounted to 1,400 estates.

The public sector grew considerably during the 1960s. During the presidency of Alessandri the state controlled 38 percent of GDP. This rose to 43 percent under Frei and would continue to grow to 53 percent during Allende's presidency. Public expenditure as a share of GNP increased from 35.7 percent in 1965 to 46.9 percent in 1970. In 1961 the share of public investments formed 46.6 percent of total GDP in that year: this grew to 74.8 percent in 1969. At the same time, private investment declined: the industrialization project of Frei leaned heavily on the state's support. Fiscal innovations doubled the tax yield during the Frei administration, making it possible to invest a great deal in housing, education and health.<sup>50</sup> On housing alone, in 1965, public expenditure rose by 70 percent in real terms.<sup>51</sup>

In part, it was the ambitious plans with which Frei had won the presidency, raising the public's expectations, that brought disappointment when economic growth started to slow down and inflation was on the rise again in his last years. By choosing first to work with the Right and then to cooperate with the Left on a land reform proposal, which was regarded as unacceptable in right-wing circles, Frei had made sure that his successor would not be supported by the National Party. At the same time, a number of leftwing PDC-members had split off in 1969 to form MAPU, which was to join the Unidad Popular-coalition of Allende. The constitutional battles, moreover, by which Frei aimed to increase the power of the executive, were observed with distrust by both Left and Right and regarded as another example of Christian Democratic power hunger. Although Frei himself cannot take the whole blame for the polarization of the late 1960s, his policies did contribute to this environment. His aims to state-based modernization were followed by an extreme program of democratic socialism.

## **2.4 La vía chilena al socialismo 1970-73**

By 1970, both sides of the political spectrum had become disappointed by the achievements of Eduardo Frei. The conservatives, who had supported Frei in 1964 against Allende, now despised Frei, because of the reforms in the countryside, and were even less prone to support the new PDC candidate, Radomiro Tomic, who promised even more radical reforms. They instead announced their support for Jorge Alessandri, who seemed to have the greatest chance to win the presidential election.<sup>52</sup> The left, which despite their internal differences had united itself behind Salvador Allende as Unidad Popular, wanted radically to change the economic

50 Collier and Sater, *A History of Chile*, 317-318.

51 Angell, 'Chile since 1958', 134-136, 150.

52 Valenzuela, *Chile*, 39-41.

system. A majority of the parties of the left saw the democratic system as a temporary stage toward a more socialist future: a transformation of economic power would automatically make a transformation of political power possible. How remote or nearby these two transformations would prove to be was a matter of fierce debate within this coalition. Allende eventually won the presidential election with 36.3 percent of the vote, after which Chile experienced some weeks of turmoil. It caused the Santiago Stock Exchange, for example, to fall over 50 percent within two weeks.<sup>53</sup>

The highlights of Allende's program were the nationalization of the bigger part of the private sector, a massive redistribution of income, the end of the power of land lords in the countryside and greater popular participation (*poder popular*).<sup>54</sup> During Frei's last years, sales had become depressed, leaving companies with large stocks while discouraging imports. Set against a high copper price, this meant a large amount of foreign reserve. At the same time, the decrease in production meant idle capacity. These factors facilitated a quite successful first year for the Unidad Popular government. By the end of the year, in December 1971, only one-tenth of the foreign reserve, inherited from the Frei period, was left.<sup>55</sup> The greater part had been spent on the payment of imports, which were significantly higher, set against a declining amount of exports.<sup>56</sup>

The Unidad Popular managed to forcibly take over the existing private share of the copper mines, which triggered their former owners, Kennecott and Anaconda, to start a lawsuit against the government. The nationalization should have been a major source of income, were it not for a fall in the world copper price of 35 cents per pound, during 1970-73. The Left had always supported higher wages when the companies were still foreign owned: now, it felt itself obliged to press for a moderation of wage demands. A significant number of high-ranking technicians left the business, partly because they were no longer paid in dollars anymore, but partly also because of inefficient government policies. They were often replaced by non-technical personnel – sociologists, psychologists – whose priorities were mostly political. In the end, the expropriation of the copper mines did not bring about the expected result: between 1967-69 and 1973 the number of people employed increased by 45 percent, the production per capita fell by 19 percent.<sup>57</sup>

In addition to the copper mines, the Allende government during its first year nationalized nearly 80 companies, including nearly the whole financial sector.<sup>58</sup> In October 1971 the government proposed to take over 253 of the largest companies, but due to the resistance of Congress, it had to resort to other measures. It used two forgotten laws in order to legitimate

53 De Vylder, *Allende's Chile*, 29-40.

54 Angell, 'Chile since 1958', 158.

55 De Vylder, *Allende's Chile*, 60-61.

56 Collier and Sater, *A History of Chile*, 344-346.

57 Ibidem, 334-337.

58 Angell, 'Chile since 1958', 161.

the seizure of essential parts of the economy and pursue the expropriation nonetheless, despite a lack of support. By 1973, the government owned 80 percent of industrial output. As a share of GNP, a total of 60 percent of the economy was in state hands.<sup>59</sup>

Meanwhile, the traditional land-owning class was all but gone: in 1965, farms consisting of more than 80 hectares owned 55 percent of the land, in 1972 this share had shrunk to 3 percent.<sup>60</sup> The Allende government had decided that an attempt to change the existing legislation would take up too much time. For this reason, it chose to use existing legislation for more radical purposes. It managed between December 1970 and July 1971 to expropriate nearly the same number of farms as the previous government had taken over in six years. Thereafter, it further accelerated the expropriations, until by the summer of 1972, the latifundia – the class that had dominated the Chilean countryside for centuries – had ceased to exist.<sup>61</sup> The revolutionary movement MIR had on its own seized more than 1700 land properties, which happened without consideration for legal procedures, but was often endorsed by the government and by 1972 had become a regular part of the expropriation-process. The government merged these newly appropriated farms into CERA's (Centro de la Reforma Agraria), a collective state-owned farm, on which farmers worked as employees. This seemed not the kind of change the farmers had anticipated: in September 1971 and at the beginning of 1972 a major group of farmers demanded the land to be divided into individual plots of land. At the same time, the land under cultivation fell by one-fifth, when comparing 1972-3 with 1969-70.<sup>62</sup>

In the end, inflationary pressures proved too high to be put down by price controls. From May to August 1973 annualized inflation escalated to 700 percent. Nor did the nationalizations lead to an increase in production: in 1972 and 1973 GDP declined by 4.1 percent.<sup>63</sup> In 1971 fiscal expenditure had risen by 70 percent and continued to grow, while at the same time tax income declined, leading to a fiscal deficit of 12 percent in 1972-73.<sup>64</sup> At the same time, a state controlled supply in popular neighborhoods combined with price controls and increases in the wages of workers, led to a decrease in food supplies to more well-to-do areas, resulting in empty shops and soaring prices on the black market.<sup>65</sup> When one adds to this the lawlessness of the expropriations – more often than not initiated by workers or paramilitary groups, such as the *Commandos Comunales*, without government authorization – and a government that increasingly acted without Congress approval, a sense of acute political crisis can be felt.<sup>66</sup> It

59 Collier and Sater, *A History of Chile*, 340-344.

60 Ibidem, 337-340.

61 P. Winn and C. Kay, 'Agrarian Reform and Rural Revolution in Allende's Chile', *Journal of Latin American Studies*, Vol. 6, No. 1 (May 1974) 141-3.

62 Collier and Sater, *A History of Chile*, 337-340.

63 French-Davis, *Economic Reforms in Chile*, 7-9.

64 De Vylder, *Allende's Chile*, 55-56.

65 L. H. Oppenheim, *Politics in Chile: Socialism, Authoritarianism and Market Democracy* (Boulder 2007) 58.

66 Collier and Sater, *A History of Chile*, 349-351.

was during these months of economic disaster and feverish political infighting that a group of army officers conspired to bring down the Allende government.

It seems appropriate to label the decade before the coup 'a time of turbulence'. The country had not seen this many social, economic, and political change since its Independence Wars. Moreover, a political system that had in earlier times been able to mend its differences, was giving way to an escalating polarization, the ruling coalition being less and less inclined to seek cooperation. In addition, the state had rapidly increased its share in an economy, that was autarkical by our present standards. Furthermore, in 1973, the economy was in a chaotic condition, with mounting inflation and declining production, a shortage of foreign reserve because of rising imports, and a rapidly growing black market.

In many ways 'la vía chilena al socialismo' can be seen as an extension of the reforms that began during the presidency of Eduardo Frei. Both presidents aimed at a reduction of inequality by radical measures, both saw the state as the main instrument to modernization, and both had a profoundly revolutionary influence on the countryside. They encountered many of the same problems: a hostile opposition, polarization tearing apart the ruling party or coalition, rising expectations that could easily turn against the government, the recurring theme of inflation – although the hyperinflation during Allende's presidency was unprecedented in modern Chilean history. Moreover, they both contributed to an acute radicalization of the Right, in which a group of economists from the Universidad Católica in Santiago came to occupy a central role. These economists are the subject of the next chapter.

### 3 – Bringing Chicago to Chile

The presence of a group of neoliberal economists within a Latin American country might not sound that remarkable to readers today, but in the Chilean context of the 1960s and 1970s this was not a self-evident fact at all. These economists had in a certain sense been *planted* into the Chilean environment, educated as they were by the University of Chicago. Along with CIA involvement in the 1973 coup, the coming to power of Chicago economists has been a potent source of speculation about Pinochet being an American puppet. As Naomi Klein states, looking back upon these events: "For three decades, [Milton] Friedman and his followers had methodically exploited moments of shock in other countries [...], starting with Pinochet's coup on September 11, 1973."<sup>67</sup>

What interests me here is the specific form the Chicago ideology took in the years leading up to the crisis of 1973. Therefore, I first outline in what context the Chicago School of Economics came into existence and what ideas it entails. Next, I describe the transfer of these ideas to Chile and how a specific group of Chicago economists was able to strengthen its position within the Universidad Católica in Santiago. In the final part of this chapter I outline the events that followed the coup of September 1973. The economic reforms during the Pinochet Era is treated in the following chapter.

#### 3.1 The Chicago School of Economics

Founded in 1890 by a donation from the oil-magnate John D. Rockefeller, the University of Chicago has ever since become associated "with a conservative, pro-business reputation".<sup>68</sup> At the Economics Department, there appeared, in the late 1940s, an influential group of monetarist thinkers with a rather coherent set of ideas. Juan Gabriel Valdés argues that the university and its economics profession have not at all been representative of this groups' line of thinking, harboring many progressive, left-wing thinkers. While this is undoubtedly the case, it is for its monetarist and neoliberal ideas that the Chicago School became most famous.

The monetarist group shared an aversion to the ideas of John Maynard Keynes, which were at the peak of their influence in government circles in the years immediately following World War II. Back in 1936, Keynes had published his 'General Theory of Employment, Interest and Money', a work in which he analyzes what went wrong during the Great Depression. Keynes' most important contribution was his criticism on the then dominant neoclassical theory, which assumed that a market economy with flexible prices and wages would automatically generate

67 N. Klein, *The Shock Doctrine: The Rise of Disaster Capitalism* (New York 2007) 12.

68 Valdés, *Pinochet's economists*, 53; "in A. W. Coats' words, "John D. Rockefeller's munificent donations bestowed upon the new institution the opprobrious title of The Standard Oil University.""

full employment. If unemployment still existed, neoclassical economists argued that it was caused by the workers' being unwilling to accept a real wage that corresponds with their productivity. Wage reduction was presented as a way to increase employment. Keynes pointed to the fall in aggregate demand that would follow from such reduction of wages: this would only lead to a reduction of the price level, thereby having no significant effects on employment. To escape from this 'low employment equilibrium' a government would need to invest to keep effective aggregate demand on a high level. This way, the general price level would rise, causing a reduction of *real* wages, which would ensure a rise in employment.<sup>69</sup>

At the University of Chicago, Jacob Viner and Frank Knight uttered harsh criticism after *The General Theory* was published. These two pioneers are often regarded as the founding fathers of the later Chicago School of Economics, together with Henry Simons, although the latter could not get along with the former two. Although economists like George Stigler and Milton Friedman have undoubtedly been influenced by them, there are important differences between these men and the later monetarists. Viner agreed with Keynes that government spending could restore profitability for companies in a time of falling prices, as long as this was paid by government credit, instead of monetary expansion. While Keynes' ideas could thus be useful in the short run, Viner regarded neoclassical theory true in the long run. Frank Knight argued in his article 'Unemployment: and Mr. Keynes's Revolution in Economic Theory' that Keynes's assumption that unemployment will not decline because of a wage reduction, was fundamentally false.<sup>70</sup> Knight was a staunch defender of neoclassical theory, arguing that the economist necessarily needs to abstract from reality, in order to concentrate on those aspects that most accurately explain economic behavior.<sup>71</sup> He regarded the perfect market as the expression of complete personal freedom.

Henry Simons viewed a healthy private sector as a fundamental safeguard to individual freedom. For this sector to be healthy, he argued it was necessary to dispense of all forms of monopoly. Large corporate conglomerates were the main threat to freedom as such and were, according to Simons, the main reason for the Great Depression. He was not the average neoclassical economist, supporting for example a progressive tax on every form of income and a required bank reserve of 100 percent. He also recommended the use of the total money quantity as a tool by which a government could limit mass unemployment.<sup>72</sup> Moreover, he wanted to curb spending on advertising, which he considered "the squandering of our resources". Although such ideas differed remarkably from the ideas of the Chicago School of

69 Rima, *Development of Economic Analysis*, 516-521; 554-556.

70 F. H. Knight, 'Unemployment: and Mr. Keynes's Revolution in Economic Theory', *The Canadian Journal of Economics and Political Science*, Vol. 3, No. 1 (February 1937) 100-123.

71 Rima, *Development of Economic Analysis*, 526-528.

72 Valdés, *Pinochet's economists*, 56; 70-71.

Economics, Simons was to play an important part in its early formation, until his death in 1946.<sup>73</sup>

The main instigator of the Chicago School is Friedrich von Hayek, an Austrian-born economist, who had been working for fifteen years at the London School of Economics before coming to Chicago. In 1944, he published 'The Road to Serfdom', which brought him renown throughout the world. Hayek argued that a massive rise in government planning in western societies was greatly endangering the existence of personal freedom. Not only had this led to totalitarian societies, such as Soviet Russia and Nazi Germany, but societies traditionally regarded as liberal, such as Great Britain, were traveling on this 'road to serfdom' as well. The solution was a restructuring of society based on a free market, while the government would restrict itself only to the most necessary tasks, and the reestablishment of government procedures based on the Rule of Law. The latter can be regarded as a permanent body of rules, having the same effect on each citizen, thereby enabling him to predict the working of the law. Economic planning, with its inherent tendency to widen the scope of government, is regarded by Hayek as the main threat to this predictability, therefore endangering individual rights as such.<sup>74</sup>

It was this sense of urgency, that struck a sympathetic chord with a great many American readers, having just witnessed the rise of totalitarianism in Soviet Russia and Nazi Germany. In 1945 Hayek had tried to establish a society at the Chicago University with the help of Henry Simons, in order to further the aims of liberalism. The idea was to gather a group of economists to write an American version of *The Road to Serfdom*, which was heavily based on British society. They were helped in this endeavor by the William Volker Fund, originally a charity foundation to provide health care and education for the poor, but which under leadership of Volkers' nephew Harold Luhnnow had shifted to an ideological project, championing the cause of liberalism. It was with Luhnnow's support that Hayek could, in 1946, create the Chicago School of Liberal Economics and then, in 1947, establish another gathering point for liberal intellectuals, the Mont Pèlerin Society.<sup>75</sup>

The American version of *The Road to Serfdom* was never to be written. In fact, it was another famous Chicagoan, Milton Friedman, who in 1962 published what was to become one of the most popular books on political economy of the twentieth century, 'Capitalism and Freedom'. Friedman had quickly risen to prominence, becoming the de facto leader of the Chicago School in the 1960s. 'Capitalism and Freedom' can be regarded as the manifesto with which the neoliberals – as they were called – were attempting to undo the Keynesian heritage. From its conception in the late 1940s, the School had been ideological in outlook. Friedman maintained that every hypothesis necessarily had to be false in its assumptions, because real-life

73 R. van Horn and P. Mirowski, 'The Rise of the Chicago School of Economics and the Birth of Neoliberalism' in: P. Mirowski and D. Plehwe ed., *The Road from Mont Pèlerin: The Making of the Neoliberal Thought Collective* (London 2009) 139-178.

74 F. A. Hayek, *The Road to Serfdom* (London 2007) 112-123.

75 Van Horn and Mirowski, 'The Rise of the Chicago School of Economics', 139-178.

circumstances would lose their relevance when a hypothesis would successfully explain a phenomenon. Valdés argues that the hypotheses of the Chicago economists construct “an isolated, stationary, and recurrent universe”. Not only were they altering the real phenomena to fit to their hypotheses, they saw themselves as the ‘real’ economists in a profession filled with fallacy and economics as the ‘real’ science, better equipped than sociology or political science to explain societal phenomena. In this respect, the commitment that was expected from fellow Chicago economists has been characterized as religious.<sup>76</sup>

The foundation on which the neoliberal ideological structure is based, is a believe that, individuals – if left unhampered in their freedom – will, in general, rationally pursue their own material wellbeing and self-realization. Freedom is defined negatively: the greatest amount of freedom is gained when outside interference is decreased to a minimum. A second assumption is that the collective strivings of free, unfettered individuals generate a more affluent and better society. This does not necessarily mean that humans will naturally strive for good things or abstain from harming others: a central force is needed to protect men against his fellow man, to make sure that every individual receives the maximum amount of freedom without curtailing the freedom of others. The basic tasks for a government consist in preventing coercion, enforcing private contracts and property rights, and providing a basic monetary framework.<sup>77</sup>

The natural and universal arena for all this voluntary human activity is provided by the market. It is here that an individual can exercise his free will, can create new products or ideas or enjoy the products and services of others. Because each individual knows best how to pursue his own personal interests, the market is best left free. Chicago economists believed that the results of individual activities need to depend on capability, diligence, courage and, occasionally, on plain luck. The framework of a free market society provides each individual with equality of opportunity, but the outcomes can never be equal. The free market system thus pushes society on a path of development: it rewards the strong and capable and “punishes those who make mistakes or are incapable”.<sup>78</sup> It is this believe in the natural rightness of the market outcome that leads Chicago economists to be less concerned with differences in income or wealth.<sup>79</sup> Not only does the market guard individual liberty and lead society toward development, it is moreover a democratic force, where everyone can ‘vote’ for the companies that represent their interest. In this sense, it is regarded as more democratic than the parliamentary democracies of the West, in which a majority overrides the interests of a minority.

76 Valdés, *Pinochet’s economists*, 76-80.

77 M. Friedman, *Capitalism and Freedom* (Chicago 2002) 22-36.

78 J. Collins and J. Lear, *Chile’s Free-Market Miracle: A Second Look* (Monroe 1995), 41-42.

79 Rima, *Development of Economic Analysis*, 537-539.

Interventions in the marketplace by a government will bring about imbalances in the market, such as scarcity or monopolies. The main source of such distortions is the state, but intermediary organizations such as professional organizations or labor unions can interfere in the market as well, by demanding that their interests be given priority to those of others. Although a free market is ideally based on perfect competition, Chicago economists tended to prefer a private monopoly over a state monopoly.<sup>80</sup> Their faith in the workings of the state was in general very low: the private realm of society is presented as a bulwark against the inclination of the state to encroach upon basic individual liberty. The state has a natural tendency to represent the interests of some established groups at the expense of the rest of society. For example, protection of the home market by tariffs or quotas will only protect one group, while it hurts other groups within society. Naturally, the Chicago School advocated free trade between all nations.<sup>81</sup> Another measure they defended was the principle of subsidiarity: this means that a task is always to be performed by the least centralized institution possible. So, when a task can both be performed by a government institution and a private party, the private party is to be preferred; when it can be performed by both central and local government, one should opt for the latter. The central principle at work here is variety: an individual would still be able to choose the district that suits his wishes best.<sup>82</sup>

Against the centrality of unemployment as a parameter within Keynesian theory, the Chicago School put forward the supply of money and correspondingly, the value of the currency. They argued that the Keynesian policies of government spending had resulted in inflation plaguing Western societies.<sup>83</sup> When a government increases the money supply to pay for expensive stimulation budgets, it simultaneously taxes every other reserve of money. Although inflation has this negative effect, a positive effect is that it stimulates borrowing and lending – thereby boosting investment – because inflation decreases the value of debt as well. Monetarists like Milton Friedman argue therefore to keep inflation at a steady low level of about two percent, thus establishing predictability, which would inspire confidence into consumers and investors. It was, according to Friedman, the unpredictable actions of the Federal Reserve in the early 1930s with regard to the supply of money, that caused a recession to become the Great Depression.<sup>84</sup>

In the 1950s, Friedman became the rising star of the Chicago firmament. His work *Capitalism and Freedom* from 1962 is often regarded as the centerpiece of Chicago thought. The ideas and charismatic personality of Professor Friedman would have a significant impact on the Chilean students that were enlisted to the economics faculty from 1956 on. These students form the subject of the next part.

80 Valdés, *Pinochet's economists*, 70-71.

81 Hayek, *The Road to Serfdom*, 112-123.

82 Friedman, *Capitalism and Freedom*, 1-6; Collins and Lear, *Chile's Free-Market Miracle*, 38-39.

83 Valdés, *Pinochet's economists*, 61; 71-72.

84 Friedman, *Capitalism and Freedom*, 37-55.

### 3.2 The Quest for an Alternate Modernity

The fact that Chile would become one of the first countries to introduce neoliberal ideas into its political arena, can strike one as peculiar, given its history of state-based politics. In this section, I elaborate how the aforementioned Chicago ideas were introduced into Chile. This throws some light on the origin of the group that came to be called Chicago economists and the ideological baggage with which they carried out their reforms during the Pinochet Era.

Chile has often been referred to as the 'Fatherland of the State'. The Great Depression of the 1930s had caused a shock throughout the countryside, with basic food prices sharply decreasing and cities flocking with ex-peasants in search of some form of livelihood. This caused an awareness in government circles of the need to modernize the country. Beginning with the creation of CORFO in 1938, the Chilean state started to play an active, guiding role in the effort to industrialize. The decades that followed were characterized by a steady growth of the influence of government in society, a development that went hand in hand with a kind of clientelism and a search for consensus in politics.<sup>85</sup>

It was during these same post-depression years that the United States took an interest in Latin American cooperation, expressed in the Good Neighbor Policy. It initiated cooperation programs, which were focused on public health, agricultural development and education. The coming of the Second World War made this a matter of some urgency, as the United States needed its southern neighbors to strengthen its own war capacity. Valdés argues that these programs were motivated by a belief in US exceptionalism: the idea that the United States had followed a specific course to modernity, to be copied throughout the rest of the world.<sup>86</sup>

The coming of the Cold War reinforced this need to modernize Latin America, in order to preclude a communist takeover. It was against this background that in 1953, that the Foreign Operations Administration – named the International Cooperation Administration (ICA) from 1955 – came to oversee a series of foreign assistance programs. These were mainly focused on education, establishing inter-university cooperation between the US and developing countries. Men like the agricultural expert Albion Patterson and Theodore W. Schulz, economist at the University of Chicago, both experienced that Latin America's development was held back by an insufficient level of education. Patterson, who had spent considerable periods in Latin America, met with Schulz in Santiago, where both agreed on the necessity of better-trained economists.

At this time, developmentalist economics, as expounded by Raúl Prebisch, was at the height of its influence in Latin America. It was the leading ideology of the United Nations Economic

<sup>85</sup> Valenzuela, *Chile*, 15-20.

<sup>86</sup> Valdés, *Pinochet's Economists*, 84-87.

Commission for Latin America (ECLA), established in 1948, with Santiago as its headquarters. The main university in Santiago, the Universidad de Chile, was regarded as the prestigious center of structuralist economics in the whole of Latin America. This formed a thorn in the side to many a Chicago economist. It was Patterson who contacted the Universidad de Chile to inquire if they would be interested in a project involving the exchange of Chilean students to the University of Chicago in order to attain a postgraduate degree in economics. The university showed no interest in such a project, because of the conservative reputation of the Chicago University.

This caused Patterson to conclude an agreement with another university in Santiago, the Universidad Católica, a distinctly conservative institution, which at the time contained a school in commerce, but no real economics faculty.<sup>87</sup> The first students, Sergio de Castro being one of them, arrived in Chicago in 1956. From this year until the beginning of the 1970s some 30 to 50 Chilean students received a two-year training at the economics faculty in Chile.<sup>88</sup> During these years they were taught about price and monetary theory, mathematics and the history of neo-classical economics. Although they were stimulated to use these theories on the Chilean case, no attention was given to the specific historic context of Chile. This context was seen as irrelevant to economic development: the working of markets was assumed to be the same throughout the world.

What stands out is the warm and fatherly attention the students received by figures such as Arnold Harberger, Gregg Lewis and Larry Sjaastad. These men would continue to look after them when they returned to Chile, making sure that the results of the 'Chile Project' remained intact. The projects' objective was for Chicagoan ideas to gain an enduring presence in Chile. Back from Chicago, many of the former students started as teachers at the new economics faculty at the Universidad Católica. Although they soon dominated this faculty, their ideas fell to deaf ears in the rest of society. To radically scale down the role of the state in the economy was something even the right-wing parties did not appreciate: in their view, this would come down to removing the axis around which the economy revolved. Their electorate counted on the state to deliver the specific benefits that each company needed, be it in the form of a subsidy, a restriction on foreign competitors, or in the states' role as a producer. Their outright rejection, moreover, of the policies of the right-wing Alessandri-government did raise some eyebrows within conservative circles.

The students had been taught to cope with this kind of isolation in Chicago, where the staff had anticipated the kind of environment the students would enter. The young economists were being criticized for using a circular logic, for being close-minded and arrogant. Furthermore, their knowledge seemed irrelevant to Chilean development. Their uncompromising and

87 Ibidem, 114-118.

88 G. Biglaiser, 'The Internationalization of Chicago's Economics in Latin America', *Economic Development and Cultural Change*, Vol. 50, No. 2 (January 2002) 269-286.

adversarial stance towards other economists in the country placed them in an isolated position and contributed to their cohesion as a group. This was further strengthened by the continuing presence of men like Arnold Harberger, who, even after the project was formally ended in 1964, took many a trip to Santiago to ensure the well-being of the former students.<sup>89</sup>

It was the Frei administration and the opposition to its reforms that led to a convergence of interests between the Chicago economists and the more conservative elements of the Universidad Católica. Some of these elements had taken over the faculty of law, labeling themselves as *gremialistas*. They abhorred all forms of Marxism and the high level of state intervention and the revolutionary spirit of the Christian Democrats. Instead, they proposed a society based on intermediary organizations (*gremios*, which means 'guilds'), which could protect the individual against the state. The *gremialistas* did not agree with the centrality of the market, advocated by the Chicago economists, which they thought would lead to an immoral order. What they shared with the economists was their belief that the path to modernity that Chilean society had taken since the 1930s was fundamentally flawed and that a complete restructuring of society was needed to ensure a kind of development that was to be more stable and less politicized.<sup>90</sup> It was the occupation of the Universidad Católica by radical students in 1967, which united the two groups in their belief that they had to join forces against the powers of the Left.

Both groups were no longer solely focused on the Universidad Católica. Increasingly, they started to rally against the government. In this they were supported by Agustín Edwards, owner of the influential newspaper *El Mercurio*, and SOFOFA, an organization representing the interests of employers. These groups and organizations started to actively propagate against the government reforms and as they worked together they grew more familiar with each other's ideas and interests. At the same time, the Left was becoming more radical: the developmentalist theories about industrialization had started to give way to more radical ideas about world systems which were keeping countries like Chile in a dependent position. Nationalization and a more autarkic state were proposed as radical alternatives to these systems. The Right attempted to formulate an answer to these leftist tendencies in Chile, through initiatives as Centro de Estudios Socio-Económicos (CESEC), in which the Chicago economists were able to strongly express their ideas.<sup>91</sup>

When Allende, with the support of the Christian Democrats, became president in 1970, the combination of *gremios* and Chicago economists were able to gain support for their ideas. This election marked a turning point after which right-wing organizations like SOFOFA progressively lost their faith in the democratic process and from 1971 on, started to dedicate themselves to the overthrow of the Allende administration. This led to informal gatherings called 'Monday

89 Valdés, *Pinochet's Economists*, 149-158.

90 G. van der Lee, *Contesting Modernities: Projects of Modernisation in Chile, 1964-2006* (Amsterdam 2007) 185-197.

91 M. Pollack, *The New Right in Chile, 1973-1997* (London 1999) 38-47.

Club', at which different kinds of influential persons on the right came together to discuss ideas about a post-Allende Chile. It was during these meetings that contacts were established with high officers, such as José Merino, admiral of the Chilean navy.

It was Merino that first wanted to see a detailed economic plan before supporting a coup against Allende. Within CESEC, a team was formed, consisting mostly of Chicago economists, who within weeks produced a program for a reform of the Chilean economy, called *El Ladrillo* (The Brick).<sup>92</sup> This document starts by summing up all that they thought to be wrong with Chilean development, culminating in the Unidad Popular government. What is followed is a seriatim discussion of the ways in which a radical restructuring of the economy should take place. Not only is it possible to discern in this discussion the form that the later reforms would take and the priorities in the thinking of the Chicago economists, also some ideas become visible that are not traditionally associated with neoliberalism, such as a progressive income tax or companies run by workers themselves.

The main focal point of the document lies in its analysis of the Chilean policies on international trade. It asserts that the Chilean currency has since the 1930s been valued too high in relation to foreign currency, which made its exports relatively expensive and imports relatively cheap. The idea was that the country was thus able to import cheaply the inputs needed for its planned industrialization. What actually followed was a gradual depression of the agricultural sector, which had a hard time competing with the cheap foreign foodstuffs, preventing investments to mechanize agriculture and increase productivity. The decrease of agricultural output caused even larger food imports. This is further complemented by pricing regulations with the intention of providing the working classes with cheap food.

At the same time, the overvalued currency discourages exports, making Chilean products relatively expensive. The high import tariffs for certain capital goods – installed to develop a import substituting industry – lead to a manufacturing sector that needs to focus itself on a relatively small domestic sector. As the growing imports are not matched by a comparable value of exports it leads to a negative balance of payments, which tend to eliminate the reserve of foreign currency. As this is solved by foreign loans, a potentially disastrous structure becomes visible, which reached its climax during the Unidad Popular. The solution that the document proposes is threefold: gradually lower the import barriers, set the exchange rate to a more realistic value and let the market determine prices. In this way, the agricultural sector would see a swift revival, not only being able to provide the country with basic foodstuffs, but turning into a net exporting sector as well, thereby restoring the country's balance of

92 K. Fischer, 'The Influence of Neoliberals in Chile before, during, and after Pinochet' in: P. Mirowski and D. Plehwe ed., *The Road from Mont Pèlerin: The Making of the Neoliberal Thought Collective* (London 2009) 305-346.

payments. In addition, it would diversify exports, which was until then mainly based on copper.<sup>93</sup>

Another issue that the Chicago economists addressed is the inability of the government – and especially the proliferation of organizations in the public sector – to run a tight budget and the tendency to fill these fiscal deficits by foreign indebtedness and by increasing the money supply. This constitutes one major cause for the endemic inflation, the other being government policies to increase wages beyond any increase in productivity. This increased purchasing power continuously pushes up prices. Not only does the instability of prices tend to discourage investments, the relatively high wages result in the share of profits that could be used for investments being relatively small. The solutions, the document proposed to these problems, is to slash government expenses, in order to balance the budget and to let the market decide the price for labor. This will automatically lower wages to a more natural level and decrease the unemployment rate.<sup>94</sup>

This would, moreover, stimulate investment, although, the document stipulates, the capital market is blocked in an important sense. In order to increase the level of investment Chilean governments have maintained an artificially low interest rate. Such a rate has encouraged loans so cheap, that the return on investment has become less important. More importantly, the artificially low rate has discouraged private savings, which is why the lions' share of Chilean investment has been taken up by government institutions, who in general are inclined to make bad investment decisions. The solutions, therefore, to this depressed private capital market is to increase the interest rate and to deregulate the financial markets, so that financial companies will be able to compete with each other to attract savings.<sup>95</sup>

These issues – bad foreign trade policy, bad monetary policy to relieve budget deficits and bad investment policy – are regarded as core themes that run through the whole document. Many of the other problems the Chicago economists discern, can be traced back these three themes. In addition to this, decentralization is often suggested as a solution to organizational inefficiency, because of the more flexible aspects of bottom-up structures. For example, a decentralized school system would be able to adapt to the needs and wishes of the specific local community involved. Privatization is also mentioned as a form of decentralization, whereas private companies will better adapt to the wishes of their consumers than a centralized public institution.<sup>96</sup> An example of this that is mentioned more than once in the document is the pension system, which should be organized into a number of funds, competing

93 "El Ladrillo": *Bases de la Política Económica del Gobierno Militar Chileno*. Centro de Estudios Públicos (Santiago 1992) 73-91.

94 *Ibidem*, 91-103.

95 *Ibidem*, 108-118.

96 *Ibidem*, 57-71.

with each other for the savings of pensioner, who is free to switch to the fund of his choosing.<sup>97</sup>

So far, the solutions treated in *El Ladrillo* fit quite well into the neoliberal context of Chicago economics. However, there are some suggestions in the document that can be considered rather 'leftist'. One is their concern with income distribution. The document argues for a reduction of poverty through distributive measures, such as a system of progressive taxation or direct money grants to the poor, although such measures can only be successful when combined with a robust growth of the economy. Another remarkable feature of the document, is the different options it proposes as an alternative to the nationalized 'Social Area' of the Allende government. Aside from the 'traditional enterprise', privately owned or with mixed private and government ownership, the Chicago economists suggest 'participation companies', 'self-management companies' and 'user companies'. These kinds of firms would be partly or wholly run by its workers, whereas in the case of 'self-management companies' the company would be leased by the government to its workers.<sup>98</sup>

The inclusion of such leftist ideas is seen by Gerard van der Ree as a strategy to provide solutions applicable in multiple scenarios, which should "therefore not be too controversial". The military coup was at this time still a hypothetical one and what it would result in was unknown at the time.<sup>99</sup> Although such pragmatic concerns seem natural for a group of economists so close to attaining influence, it is still surprising when one considers all the efforts made in the years before to retain ideological purity. Nevertheless, with *El Ladrillo* the Chicago economists did have a compelling manual at their disposal, that could be implemented when a shift in power would occur.

### **3.3 The Coup and its Aftermath**

On the 11<sup>th</sup> of September 1973, the Chilean air force bombed La Moneda, the presidential palace, leaving it a burning ruin. Allende himself died during the assault, according to official sources by committing suicide. The army leaders responsible for the assault installed a military regime that would last for sixteen years. One of them, Augusto Pinochet, managed to increase his powers during the years that followed the coup, in a way that made him become the center of a fierce dictatorship, responsible for the disappearance and/or death of thousands of people.

The coup itself took a only few hours and – aside from the fighting surrounding the palace and some skirmishes in shantytowns such as La Legua – occurred without major resistance.<sup>100</sup> In the days following the coup Congress was disbanded and the Unidad Popular parties were

97 Ibidem, 118-137.

98 Ibidem 160-171.

99 Van der Ree, *Contesting Modernities*, 196.

100 Constable and Valenzuela, *A Nation of Enemies*, 15-18.

ordered to dissolve. The parties that had opposed Allende were put “in recess”, allowing for the possible cooperation with the new military government, although the National Party dissolved itself voluntarily a few days after the coup. In the years that followed the political freedom of the PDC was increasingly circumscribed until, in March 1977, all parties were officially dissolved. In the days following the coup, the government replaced most of the mayors, fired civil servants and schoolteachers and banned Chileans abroad who “propagated or encouraged doctrines that tend to destroy or alter through violence the country’s social order” from entering the country.<sup>101</sup>

The relative calm of the coup itself was followed by a reign of terror. The day following the coup, the military announced a state of siege, restricting civilian rights and broadening the powers of military courts. The next week, the country was proclaimed an emergency zone, expanding the authority of the junta to practically all civilian activities. In the weeks that followed, at least 45,000 Chileans were detained “in army barracks, navy training camps, air force hospitals, soccer stadiums, and even merchant ships anchored off Valparaiso”.<sup>102</sup> The Report of the Chilean National Commission on Truth and Reconciliation stated that the Regime between 1973 and 1989 was responsible for the execution or ‘disappearance’ of 2,189 people. The number of these victims killed in the last four months of 1973 has been estimated at 1,261.<sup>103</sup> The National Commission on Political Imprisonment and Torture found in 2011 that there had been 27,255 victims of torture of which 58 percent was younger than 30 years old at the time.<sup>104</sup> This kind of terror was legitimized by the regime as an attempt to save the country from a Marxist plan to kill military officers, political leaders and journalists, a plan referred to as Plan Z. This plan had been made up by the military men themselves, but worked as an instigator for fear and fury.<sup>105</sup>

It is in this environment of terror that the Chicago economists entered the political stage, supporting economic ideas that were more orthodox than the prevailing structuralism of the era. This new development was marked by the appointment, in 1974, of Jorge Cauas and Sergio de Castro as Ministers of Finance and Economics, Pablo Baraona as President of the Central Bank (1975) and Miguel Kast as Director of ODEPLAN (1973) – the main institution for economic advice, which had also acquired important executive powers. These economists, assured by the support of Pinochet, were able to swiftly spread their monetarist and neoliberal

101 Huneus, *The Pinochet Regime*, 43-46.

102 Constable and Valenzuela, *A Nation of Enemies*, 19-20.

103 United States Institute of Peace, Report of the Chilean National Commission on Truth and Reconciliation, retrieved on May 5, 2017, from: <[https://www.usip.org/sites/default/files/resources/collections/truth\\_commissions/Chile90-Report/Chile90-Report.pdf](https://www.usip.org/sites/default/files/resources/collections/truth_commissions/Chile90-Report/Chile90-Report.pdf)> 1122-1126.

104 Fundación Acción Pro Derechos Humanos, Comisión Nacional sobre Prisión Política y Tortura, retrieved on May 5, 2017, from: <<http://www.derechoshumanos.net/paises/America/derechos-humanos-Chile/informes-comisiones/Informe-Comision-Valech.pdf>> 559

Instituto Nacional de Derechos Humanos, Nómimo De Personas Reconocidas Como Víctimas, retrieved on May 5, 2017, from: <<http://www.indh.cl/wp-content/uploads/2011/10/Valech-1.pdf>>

105 J. De Kievit, *Brood, Werk, Gerechtigheid en Vrijheid: Chili tussen Dictatuur en Democratie* (Amsterdam 1993), 81.

ideas.<sup>106</sup> It is to the policies they were able to implement and the outcome these resulted in, that we turn our attention in the next chapter.

In summary, the Chicago School of Economics succeeded in planting a specific set of economic ideas into the Chilean political arena. These represented a reaction to the predominance of the ideas of John Maynard Keynes in the 1940s and 1950s. The essence was a belief in individual self-realization, made possible by a reduction of outside interference, especially in the form of government. It was believed that the growth of government planning was threatening this freedom of the individual, because such a gigantic planning task would require an ever-expanding state power in order to gain control of all aspects of production involved. The free market economy was presented as the better alternative to a planned, state-based economy. Because of its competitive nature, the free market would simultaneously distribute economic power to different parties and establish greater efficiency and prosperity. These ideas were combined with a belief in the necessity of monetary stability and in realistic, 'market-based' exchange and interest rates and wages.

The establishment of a growing, influential group of Chicago-schooled economists at the Universidad Católica changed this institution into a bastion of right-wing ideas. Their shared antipathy to the Frei and Allende administrations led the Chicago economists to bundle forces with a group of Catholic conservatives known as the *gremialistas* and with representatives of big business interests. Ultimately, these three groups would conspire with army officers against the Unidad Popular government. Anticipating a possible overthrow of Allende, a group consisting mainly of Chicago economists wrote down an analysis of the economic problems of Chile together with a few basic measures to solve these problems. The measures proposed would come to play a pivotal role in the formation of a new order, following the violent military coup of 1973.

106 Ibidem, 283-289.

## 4 – Restructuring Chile

In the previous chapters, I have sketched the political events that happened in Chile between 1960 and 1975. It is necessary to have this background knowledge to understand the context in which the Chicago economists would implement their reforms. The economic structure in Chile was centered on the state and policy had for decades been based on structuralist ideas of state-induced industrialization. This structuralist policy had been radicalized in the decade before the coup, during the administrations of Eduardo Frei and Salvador Allende. The ideas that the Chicago economists were trying to spread had been alien to Chile and were not particularly popular in the years leading up to the coup. When this violent overthrow of power finally came, it was through this violence that these ideas could be implemented, in a rather radical fashion.

The Chicago inspired reforms can thus not be detached from this authoritarian environment, that contrasted sharply with the consensual practices of the Presidential Era. It is in the Pinochet Era that the country was depoliticized. Beforehand, many parts of society had been divided between different ideological currents, different truths, so to speak. Pinochet ended this: from now on, there was to be only one truth. The Chicago economists skillfully used this reality to establish their neoliberal ideas as pertaining to this 'truth'. Within two years they managed to color the military dictatorship with their creed. Propaganda in newspapers, television and radio was used to spread the logic and sense of their policies. With all parties suppressed and the power of the unions diminished, they had a near absolute freedom to pursue their goals.<sup>107</sup>

This chapter is divided in four sections. First, I outline the different policies that were implemented and consider to what extent these resulted in a growth of GDP and if so, what sectors profited from this. I also consider the amount of inequality the reforms resulted in. The second section is devoted to inflation: what did the Chicago economists do to decrease inflation and to what extent did they succeed in this? Thirdly, I consider what they did to open up international trade and what these policies resulted in. The last topic of discussion is the privatizations and their results.

### 4.1 Growth

Substantially raising economic growth had been the main aim of the Chicago economists from the start. El Ladrillo claimed that a country like Chile could have perfectly reached an annual GDP growth of between 7 and 9 percent, had the right policy been implemented since the

<sup>107</sup> Huneus, *The Pinochet Regime*, 274-275; 283-286.

1930s.<sup>108</sup> A high and stable economic growth rate is mentioned as a precondition to achieve other goals such as income distribution or educational improvement.<sup>109</sup>

Likewise, it was one of the first priorities of the new regime was to boost the Chilean economy. Because the military leaders had boasted that they had saved the country from the disastrous economic effects of Marxism, the only way to retain a sense of legitimacy was to repair the critical state the economy was in. This first and foremost involved restricting the money supply, because inflation was at a record high: in October alone the value of the Chilean peso fell by 88 percent.<sup>110</sup> Another measure that was taken in the regime's first year was the abolition of price controls. Before the coup, the prices of some 3,000 products had been controlled, in the course of 1974 some 30 controls for 'essential products' were left in place.<sup>111</sup> Next to this, a first wave of privatizations was initiated, concerning the 500 companies and 3,700 farms in state hands, giving priority to those expropriated during the Allende administration. Furthermore, efforts were made to liberalize international trade, with the military government lowering the tariffs walls of the country from an average of around 100 percent in 1973 to one of 70 percent in 1974.<sup>112</sup> More importantly, the Chilean currency was devalued from 50 escudos per US dollar to 250 escudos.<sup>113</sup> Also interest rates were freed in December 1973 and a more liberal foreign investment code was introduced.<sup>114</sup> Lastly, wages were controlled and reduced, until the average wage, in 1975, stood at 62.9 percent of its 1970 value.<sup>115</sup> A declining copper price, combined with a rising oil price, prompted the new regime to look for more extreme measures.<sup>116</sup>

In 1975, the Chicago economists now being fully in charge, further measures were taken, the most important being a significant decrease in real government expenditure of 27 percent. The amount of government investments was cut by 50 percent. Expenses on health care, housing and education decreased with 50 percent as well.<sup>117</sup> These cutbacks allowed for a decrease in budget deficit from 8.9 in 1974 to 2.9 percent in 1975. Next to this, the annual real interest rate increased from 49.9 to 178 percent, while simultaneously the average tariff rate was reduced from 67 percent in June 1974, to 44 percent in August 1975.<sup>118</sup> Furthermore, in September 1975 the currency was reformed: the escudo was substituted by the peso at a rate

108 "El Ladrillo", 19-24.

109 Ibidem, 137-144.

110 Ffrench-Davis, *Economic Reforms in Chile*, 13-14.

111 De Kievid, *Brood, Werk, Gerechtigheid en Vrijheid*, 102-106.

112 J. Martínez and A. Díaz, *Chile: The Great Transformation* (Geneva 1996) 54.

Ffrench-Davis, *Economic Reforms in Chile*, 12.

Angell, 'Chile since 1958', 182.

113 Collier and Sater, *A History of Chile*, 365.

114 Martínez and Díaz, *Chile*, 57-58.

115 Wages would remain low throughout the Pinochet Era: in 1989, the average wage level still only stood at 90.8 percent of the real value of 1970 (Oppenheim, *Politics in Chile*, 132).

116 Huneeus, *The Pinochet Regime*, 162-168.

117 De Kievid, *Brood, Werk, Gerechtigheid en Vrijheid*, 102-106.

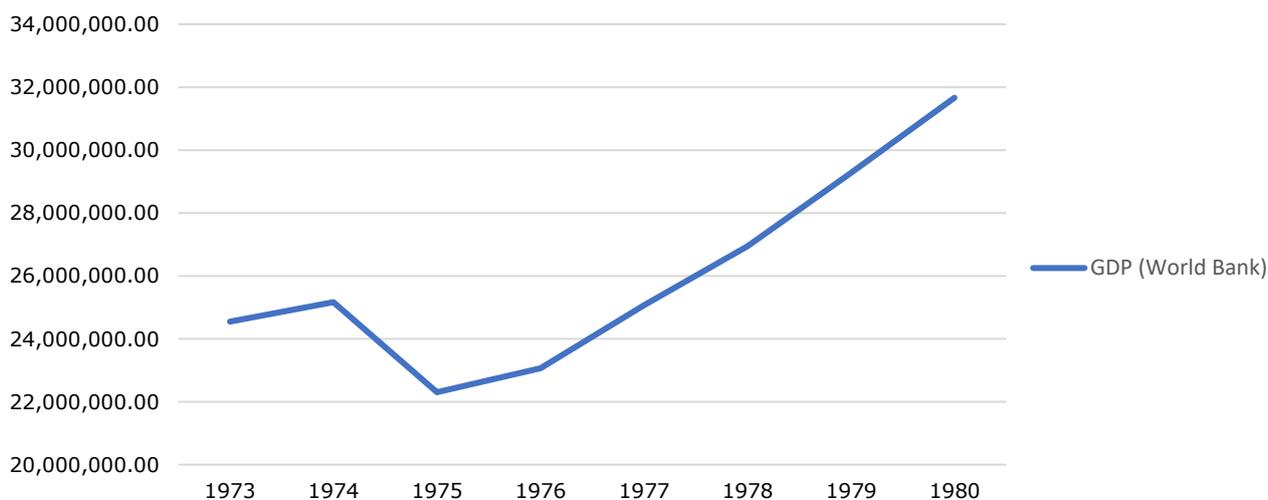
118 Angell, 'Chile since 1958', 182.

Ffrench-Davis, *Economic Reforms in Chile*, 56.

of 1000 to 1.<sup>119</sup> This was followed by two revaluations of the real exchange rate in June 1976 and March 1977.

Also in 1975, the regime privatized the banks and deregulated the financial sector, giving rise to new financial institutions and products.<sup>120</sup> The savings and loan associations, until then a regular part of the financial system, were allowed to operate without interest restrictions from the end of 1974 on. Their freedom was curtailed, however, when the government initiated a restriction on withdrawals to once a month in June of 1975. As this restriction did not apply to banks, in September of this year, a severe crisis erupted among the associations, causing all but one of them to disappear within a year. In 1976, the government curtailed the freedom of banks as well, by increasing the minimum capacity of banks by 600 percent.<sup>121</sup> The failure and takeover of Banco Osorno in January 1977 and some others in the year that followed, led the government in January 1978 to introduce new financial offenses in penal law, thereby extending the protection of creditors and debtors. The use of external auditors to assess the banks' account became mandatory during that year.<sup>122</sup> In the basis of these facts, the period of total financial deregulation seems to have been a short one.

**Figure 4.1: Gross Domestic Product of Chile (in 1965 pesos)**



**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.**

When we look at the country's (expenditure-based) GDP during these first years, a clear image emerges. While the economy was still growing in 1974, a deep decline of 11.36 percent occurred during 1975. The next year showed some recovery, but the years 1977-80 witnessed a real take-off, with an average annual growth rate of 8.25 percent (see Figure 4.1).

119 Collier and Sater, *A History of Chile*, 366.

120 Ffrench-Davis, *Economic Reforms in Chile*, 13-15.

121 Martínez and Díaz, *Chile*, 57-58.

122 S. Valdés-Prieto, 'Financial Liberalization and the Capital Account: Chile' in: G. Caprio, I. Atiyas, J.A. Hanson ed., *Financial Reform: Theory and Experience* (Cambridge 1996) 357-409.

During 1973-80 the Chilean population grew by 13.29 percent. To correct this fact in the growth numbers, one has to look at GDP per capita, which is shown in Table 4.1. To correct for the soaring inflation of the 1970s, the amount is expressed in 1965 pesos (which equal to 1,000 1965 escudos). When the increase in GDP is corrected for population growth, the 1975 decrease becomes more severe and the growth numbers of 1974 and 1976 are close to stagnation. It is only at the end of the decade that the numbers of the beginning of the decade were for the first time exceeded. The average annual percentage of growth for the period 1974-80 was 2.37 percent. This percentage is comparable to the country's average per capita growth in the 1960s, which amounted to 2.31 percent. It also exceeds the growth of Argentina, which in 1974-80 experienced only 1.31 percent per capita growth per year. Certainly, it does not reflect the kind of development that would justify the use of the term 'miracle', since Uruguay and Brazil during those same years manage to produce an annual average of respectively 4.06 and 4.31 percent. At the same time, the annual world average growth of GDP per capita for these years stood at only 0.91 percent.<sup>123</sup>

**Table 4.1: GDP per capita in Chile (in 1965 pesos)**

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
<b>GDP per capita</b>	2.50*	2.67	2.60	2.43	2.45	2.14	2.18	2.33	2.47	2.64	2.82
<b>Growth percentage</b>	0.15%	7.39%	-2.79%	-6.66%	0.68%	-14.32%	2.20%	8.76%	6.08%	6.80%	6.36%

\* 2.50 pesos equals 2,500 escudos, the currency in use at the time

**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from:**  
<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

The year 1975 is the main reason for the low yearly average. So, what caused such a significant recession? A possible answer to this question is the rise in oil prices during the middle of the 1970s. In 1974 the OPEC price per oil barrel increased with 307.41 percent, from \$2.70 to \$11, to increase further in 1979 by 128.23 percent.<sup>124</sup> Due to industrial stock, such price increases may have taken some time to materialize in a net oil-importing country like Chile. However, when one compares Chile with Argentina, Uruguay, and Brazil – net oil-importing as well – the differences suggest that oil was not the main cause: Argentina's GDP per capita shrank by 1.65 percent, while Uruguay and Brazil kept on growing at rates of 5.87 and 2.72 percent respectively (see Table 4.2). The world average stood at -1.08 percent.<sup>125</sup> So, what *did* cause the decline? The causes were domestic. As we see in the next section the country experienced hyper-inflation during 1973 and 1974, only to decline a little in 1975. The removal of price controls did not contribute to stabilization of the crisis. Furthermore, the

123 The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from:  
<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

124 Statista GmbH, retrieved on July 5, 2017, from:  
<https://www.statista.com/statistics/262858/change-in-opec-crude-oil-prices-since-1960/>.

125 The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from:  
<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

sudden withdrawal of state subsidies, the devaluation of the currency and the lowering of import barriers, took away an important level of protection in a country as state-centered as Chile. These facts combined with rising oil prices and declining copper prices to produce bankruptcies on a massive scale, causing a substantial unemployment of 20 percent: of the purchasing power of the average Chilean in 1970 only 60 percent was left by the end of 1975.<sup>126</sup>

**Table 4.2: growth of GDP per capita in Four Latin American Countries and in the World as a Whole**

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1974-80
<b>Chile</b>	0.15%	7.01%	-2.57%	-6.55%	0.82%	-12.77%	1.81%	7.06%	5.87%	7.09%	6.57%	2.35%
<b>Argentina</b>	1.47%	3.95%	-0.08%	1.06%	3.76%	-1.65%	-3.54%	5.34%	-5.90%	8.60%	2.59%	1.31%
<b>Brazil</b>	6.04%	8.56%	9.35%	11.27%	6.46%	2.72%	7.20%	2.15%	0.81%	4.27%	6.57%	4.31%
<b>Uruguay</b>	1.80%	-0.55%	-1.43%	0.25%	2.82%	5.87%	3.52%	0.90%	4.68%	5.46%	5.13%	4.06%
<b>World</b>	2.49%	2.17%	3.64%	4.47%	0.03%	-1.08%	3.50%	2.23%	2.22%	2.36%	0.23%	1.36%

**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from:**

<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

Ultimately, in the course of seven years, the structure of the Chilean economy was radically changed. An important change was the decrease of the share of the state in the economy: public investment as a share of GDP declined from 32.4 percent in 1974 to 23.1 percent in 1980.<sup>127</sup> Next to this, the tariff barriers were gradually lowered to a uniform flat rate of 10 percent in June 1979, resulting in increasing imports and exports.<sup>128</sup> At the same time, the government managed to gradually decrease the deficit until, in 1979, a budget surplus appeared. Fiscal expenditure as a share of GDP declined from 29.1 percent in 1972 to 19.7 percent in 1978.<sup>129</sup> As the unemployment rate stood at a stunning 10 to 15 percent in 1975 and 1976<sup>130</sup>, the government in 1975 introduced Minimum Employment Programs (PEM): the number of persons employed increased to 200,000 in 1976, further expanding to 500,000 in 1983.<sup>131</sup> Another change was a drop in the amount of union members: before 1975, 300,000 of the 1,000,000 union members had been fired. By 1981, only 395,000 union members were left. Some of these members were arrested, but most were simply ousted from the unions.<sup>132</sup>

In the financial sector, legislation controlling the ownership of banks was abolished in 1978 and the next year restrictions on foreign borrowing were removed. These measures, combined with a new legal code on foreign investment, led to a major inflow of foreign capital into the country. In 1975, the total debt numbered 5.45 billion US dollars (current value), of which

126 Collins and Lear, *Chile's Free-Market Miracle*, 28-30.

127 Martínez and Díaz, *Chile*, 46.

128 Ffrench-Davis, *Economic Reforms in Chile*, 56.

129 Angell, *Chile since 1958*, 184.

130 R. Caputa, S. Saravia, 'The Fiscal and Monetary History of Chile 1960-2010' (April 2014) 20, retrieved on June 24, 2017, from: [https://bfi.uchicago.edu/sites/default/files/research/Monetary\\_and\\_Fiscal.pdf](https://bfi.uchicago.edu/sites/default/files/research/Monetary_and_Fiscal.pdf).

131 Collier and Sater, *A History of Chile*, 366; 370-371.

132 De Kievit, *Brood, Werk, Gerechtigheid en Vrijheid*, 113-117.

85.59 percent was publicly borrowed. This foreign credit increased nearly threefold to 15.7 billion US dollars in 1981. From this debt, only 35.82 percent consisted of public loans, the remainder being lent to private parties.<sup>133</sup> In December 1978 Chile's per capita debt of \$ 644 per inhabitant was the highest in the world. Public debt actually shrank: from \$ 3,918 million to \$ 2,541 million between 1973 and 1979<sup>134</sup> The recession of 1982-3, initially caused by an increase of the U.S. prime interest rate in 1981, reversed the tide. The government took over 14 out of 26 banks, their debts being bought by the Central Bank. The same fate was shared by 8 out of 17 other financial institutions.<sup>135</sup> In 1983 total foreign debt amounted to 80 percent of GDP, as to 8.2 percent in 1970.<sup>136</sup> By the time these companies were re-privatized, their debt had effectively changed into a public debt. Out of a total debt of 20.7 billion US dollars in 1986, 82.81 percent was of a public nature (See Table 4.3).<sup>137</sup>

**Table 4.3: Total foreign loans and total public foreign loans in Chile (in billions of current USD)**

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
<b>Total Debt</b>	5.45	5.39	5.76	7.15	8.79	11.33	15.70	17.26	18.13	19.75	20.61	20.72
<b>Public Debt</b>	4.67	4.43	4.48	5.20	5.37	5.30	5.62	6.77	10.50	13.21	15.24	17.16
<b>Public Share</b>	85.59%	82.23%	77.72%	72.67%	61.08%	46.83%	35.82%	39.22%	57.89%	66.91%	73.97%	82.81%

**Source: R. Ffrench-Davis, *Economic Reforms in Chile: From Dictatorship to Democracy* (New York 2010) 111**

During the 1982-3 recession, Chile lost 13.72 percent of its GDP<sup>138</sup> and unemployment rose to 30 percent. At the beginning of 1982, pressured by Pinochet, Sergio de Castro resigned his post as Minister of Finance.<sup>139</sup> At the time there was a steep fall in sales, output and employment. Not being able to reduce wages, the government opted for devaluation: within a period of five months in 1982 the exchange rate was devalued by over 70 percent.<sup>140</sup> Moreover, as many as 800 companies were declared bankrupt in a single year.<sup>141</sup>

133 Ffrench-Davis, *Economic Reforms in Chile*, 111.

134 P. O'Brien, 'The New Leviathan: The Chicago School and the Chilean Regime 1973-80', *The IDS Bulletin*, Vol. 13-1 (December 1981) 38-50.

135 Martínez and Díaz, *Chile*, 59.

136 Angell, 'Chile since 1958', 191.

137 The World Bank, World Development Indicators DataBank, retrieved on May 5, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.

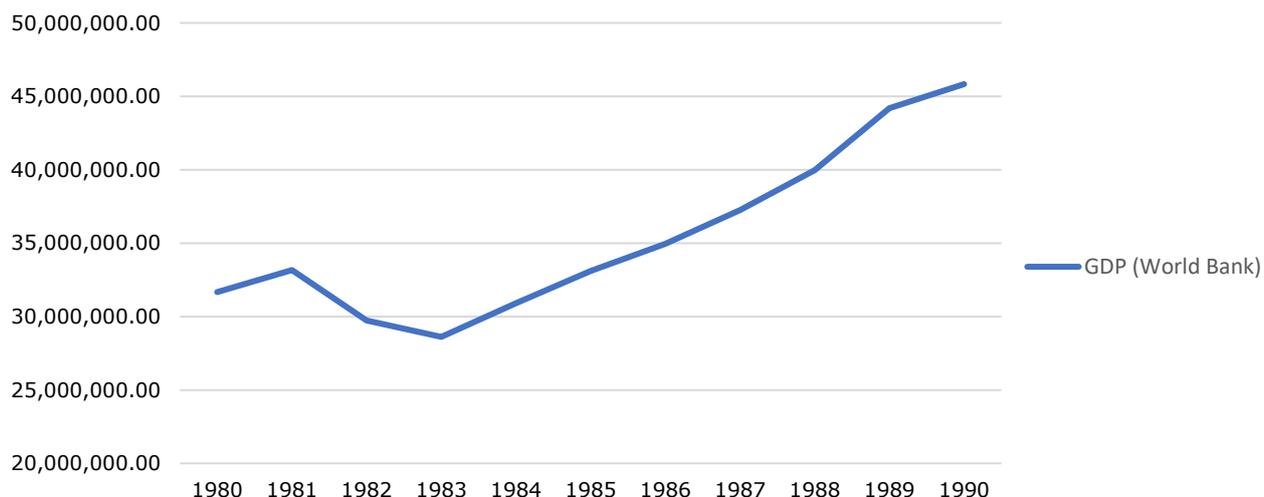
138 The World Bank, World Development Indicators DataBank, retrieved on May 5, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.

139 Ffrench-Davis, *Economic Reforms in Chile*, 3.

140 Ibidem, 9-19.

141 Collier and Sater, *A History of Chile*, 370.

**Figure 4.2: Gross Domestic Product of Chile (in 1965 pesos)**



**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.**

When from 1985 on, the economy started to recover, a new round of reforms was initiated, this time under the leadership of Hernán Büchi. These reforms followed a more pragmatic and cautious course, but nonetheless followed the same logic as the previous reforms in the 1970s. A second wave of privatizations was initiated, beginning with the re-privatization of the financial system, followed by some of the essential sectors that had been kept in the hands of the state in the 1970s, such as electricity, telephone communications, steel mines, etc. However, the copper mines would stay in the hands of the state, remaining far too important a source of state income.

So how did Chilean Gross Domestic Product develop during the 1980s? Although still growing in 1980 and 1981, the extreme growth numbers of the late 1970s were slowing down to 4.74 percent. Then GDP collapsed, decreasing 10.32 percent in 1982 and 3.79 percent in 1983. However, the next year fast growth reemerged, with an average annual growth of 7.53 percent between 1984 and 1989. Although this slowed down to 3.70 percent in 1990, the 1990s saw an average annual growth number of 6.38 percent. This compares favorably to the average annual growth number for the 1980s, amounting to 4.39 percent.

Looking at GDP per capita, growth percentages are again humbler and the recession is shown to be somewhat deeper, amounting to a fall of 12.37 percent in 1982 and 6.48 percent in 1983. On average, GDP per capita grew with an annual 1.92 percent in the 1980s. This seems a low number, but it compares favorably to neighboring countries, such as Argentina, where the GDP per capita actually shrank by an annual average of 2.23 percent during the 1980s. Brazil and Uruguay did a little better, amounting to annual averages of 0.80 and 0.06 percent respectively. Finally, Chile did also better than the world average of 1.25 percent annually. Likewise, when comparing the period 1974-90 as a whole, Chile's growth rate of 1.83 percent

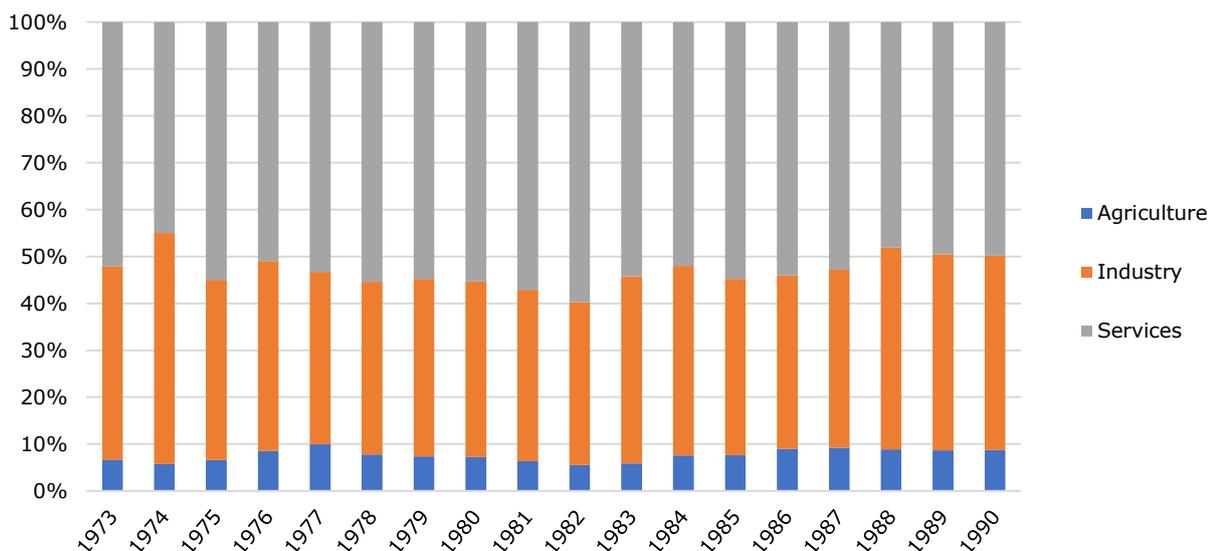
per annum is somewhat better than its neighboring countries and than the world average. Such a growth number is not enough to speak about a 'Chilean miracle', but it cannot be called a disaster either. What can, however, be established, is that the two recessions (1975 and 1982-3) are remarkably deeper than that of neighboring countries and leads to questions about the stability of the countries development.

**Table 4.4: growth of GDP per capita in Chile**

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1980-90
<b>Chile</b>	6.36%	4.92%	-12.37%	-6.48%	2.47%	2.34%	3.65%	4.68%	5.54%	8.09%	1.65%	1.92%
<b>Argentina</b>	2.59%	-7.13%	-6.43%	2.25%	0.62%	-9.01%	6.24%	1.37%	-3.99%	-8.84%	-3.79%	-2.23%
<b>Brazil</b>	6.57%	-6.61%	-1.73%	-5.59%	2.96%	5.66%	5.79%	1.57%	-2.00%	1.39%	-4.83%	0.80%
<b>Uruguay</b>	5.13%	0.89%	-10.35%	-10.85%	-1.78%	0.82%	8.12%	7.32%	0.85%	0.45%	-0.38%	0.06%
<b>World</b>	0.23%	0.17%	-1.43%	0.61%	2.75%	2.09%	1.52%	1.76%	2.83%	1.97%	1.24%	1.25%

**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from:**  
<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>.

**Figure 4.3: Share of GDP per Sector in Chile**



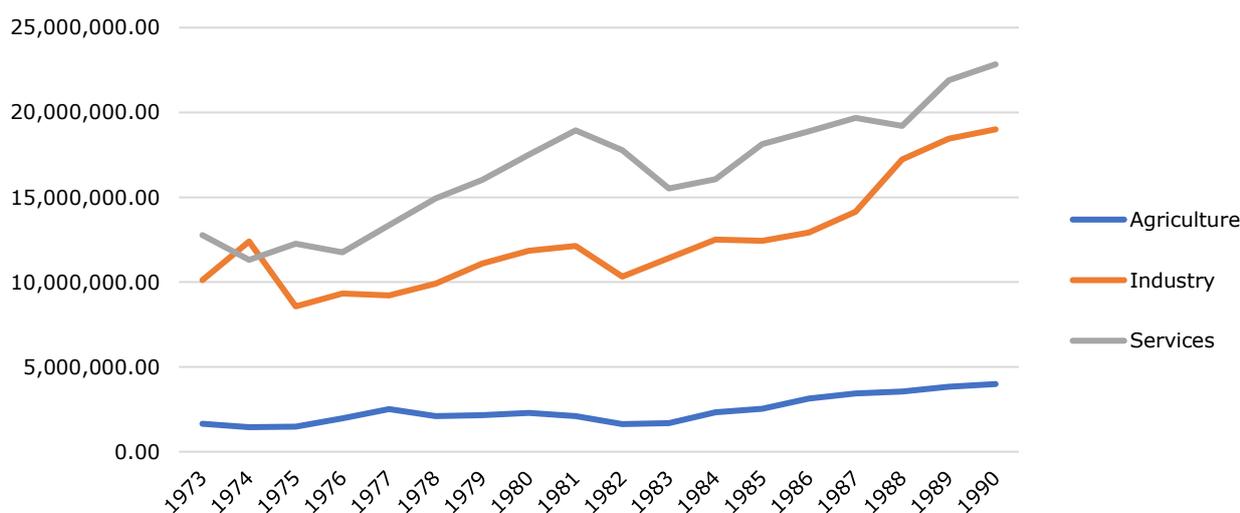
**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from:**  
<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

Gross Domestic Product is a helpful instrument to describe Chilean development, but it does not tell us how the different sectors within its economy developed. Figure 4.3 and especially Figure 4.4 clearly show that the industrial sector saw a tremendous decrease in output in 1975, but that during the 1982-3 recession, all three sectors were hit hard. As a share of GDP, a rise of the service sector is visible until the recession of 1982-3 and its decreasing share thereafter. This development has more to do with developments in agriculture and industry,

than with the output of the service sector itself, which increased its output considerably during this period.

In agriculture, output increased sharply from 1975-7, possibly due to the combined effects of a decrease in input barriers and a settlement of the question of land reform. In 1978, however, the share of agriculture decreased markedly, to recover slightly in 1979 and 1980, until in 1981-2 output fell again sharply, nearly returning to 1974 levels. Nevertheless, from 1984 on, the sector literally boomed, more than doubling its output within five years.

**Figure 4.4: Total Output per Sector in Chile (in 1965 pesos)**



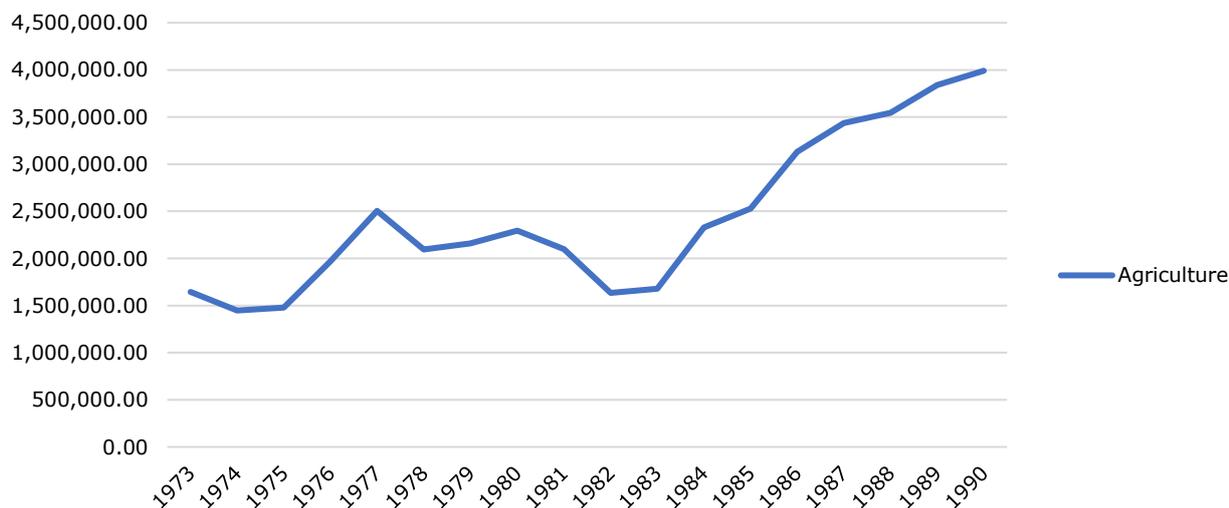
Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

The industrial sector witnessed a decrease of more than 30 percent in 1975, a fall so devastating that it took until 1984 to reach its 1974 level again. From 1983 on, the industrial sector was growing at an average rate of 8.1 percent per year, the only year of stagnation being 1985, while in 1988 the sector increased by 21.75 percent. The service sector, not so much hit by the 1975 recession itself, saw a slight decrease in output in 1976, which can be attributed to the problems in the financial sector described earlier. The sector had, however, already experienced severe difficulties during the 1973-4 period, decreasing 18.33 percent during these years. In the late 1970s the sector was booming, growing at an annual average of 10.03 percent between 1977-81, forming the backbone of the economic expansion of this period. This ended in the 1982-3 recession, in which the sector shrank by 18.07 percent. The period following 1984 was again a period of remarkable growth, this time at an annual average of 5.8 percent.

When one compares the annual growth of the different sectors over the period 1974-90, what it most striking is the growth of agriculture, growing at 6.58 percent per year. This matches the analysis of El Ladrillo that agriculture was depressed because of import barriers and an

overvalued currency. We focus more deeply on this issue in the third part of this chapter. Industry, despite its enormous decrease in 1975, still managed to grow at an annual average of 4.58 percent. More surprising, however, is that the service sector that was behind the late 1970s boom – the one so successfully marketed by the Chicago economists – only grew at a rate of 3.81 percent.<sup>142</sup>

**Figure 4.5: Total Output of Agriculture in Chile (in 1965 pesos)**



**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>**

We established that Chilean GDP, when looking at 1974-90, grew at a higher rate than Argentina, Brazil or Uruguay, and higher than the world average as well. This fact itself does not tell us how this growth was distributed within Chilean society. The question of the inequality that resulted from the economic reforms has often been raised.<sup>143</sup> So, when one compares the share of total income of the richest and poorest 10 percent of population for 1969 and 1990, one can conclude a rising inequality, the richest portion increasing from 39.00 to 47.05 percent, while the poorest share fell from 1.30 to 1.19 percent. What is interesting to note, however, is that this increase in inequality between the richest and the poorest happened mainly in the 1980s: in 1979, the richest 10 percent earned 39.10 and the poorest 1.40 percent. When we broaden our scope to the richest and poorest quintiles, this conclusion is affirmed: the richest share increased from 56.4 percent in 1969 to 57.2 percent in 1979, to 62.46 percent in 1990, while the poorest part shrank from 3.7 to 3.8 to 3.36 percent in these same years. When one combines the second, third and fourth quintile, a gradual worsening of the position of the middle class in Chile becomes visible, receiving 39,9 percent of income in

142 The World Bank, World Development Indicators DataBank, retrieved on May 5, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.

143 For example, in Marcus Taylor's *From Pinochet to the 'Third Way'* (London 2006), in Joseph Collins and John Lear's *Chile's Free-Market Miracle: A Second Look* (Monroe 1995) and in Naomi Klein's, *The Shock Doctrine* (New York 2007).

1969, 39 percent in 1979, but only 34.18 percent in 1990.<sup>144</sup> This can be due to the starting point of reference, namely 1969, being before the Chilean Road to Socialism, thereby distorting the comparison. Unfortunately, I have not found any reliable data on income distribution in 1973 or 1974.

**Table 4.5: Distribution of income in Chile**

	1967	1969	1979	1987	1990	1998
<b>1<sup>st</sup> quintile</b>	4.00%	3.70%	3.80%	3.34%	3.36%	3.51%
<b>2<sup>nd</sup> quintile</b>	7.70%	7.60%	7.30%	6.70%	6.56%	6.94%
<b>3<sup>rd</sup> quintile</b>	12.30%	12.10%	11.50%	10.62%	10.32%	10.85%
<b>4<sup>th</sup> quintile</b>	19.60%	20.20%	20.20%	17.94%	17.30%	18.02%
<b>5<sup>th</sup> quintile</b>	56.50%	56.40%	57.20%	61.40%	62.46%	60.68%
<b>Middle class</b>	39.60%	39.90%	39.00%	35.26%	34.18%	35.81%

**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>; C. Graham, 'From Emergency Employment to Social Investment: Changing Approaches to Poverty Alleviation in Chile' in: A. Angell and B. Pollack ed., *The Legacy of Dictatorship: Political, Economic and Social Change in Pinochet's Chile* (Liverpool 1993), 55; The World Bank, 'Chile, An Economy in Transition' (Washington 1979) 579, retrieved on June 20, 2017, from: <<http://documents.worldbank.org/curated/en/645231468769210794/pdf/multi0page.pdf>>.**

When one looks at the Gini-coefficient, a different picture of the 1970s emerges. In 1974 this coefficient stood at 0.45 – slightly lower than 0.468 of 1960.<sup>145</sup> This number increased to 0.48 in 1975 and then to 0.53 in 1976, to reach 0.579 in 1990. Chile was thus markedly becoming a more unequal society. One can, however, ask the question how the country compares with other Latin American countries in this regard. Most of these countries tended, between 1970 and 1990, to a more equal distribution of resources in this period. Of the sixteen countries measured, only six saw an increase in the Gini-coefficient, of which only in Guatemala income equality worsened faster than in Chile, from 0.452 in 1970 to 0.591 in 1990.<sup>146</sup>

144 Graham, 'From Emergency Employment to Social Investment', 55.

The World Bank, World Development Indicators DataBank, retrieved on June 26, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>.

145 J. E. Rodríguez Weber, *Income Inequality in Chile Since 1850* (2015) 26, retrieved on May 28 2017, from: <[http://cienciassociales.edu.uy/wp-content/uploads/sites/6/2015/05/DT\\_PHES\\_No-36-Rodriguez-Weber-Income-inequality-in-Chile-since-1850.pdf](http://cienciassociales.edu.uy/wp-content/uploads/sites/6/2015/05/DT_PHES_No-36-Rodriguez-Weber-Income-inequality-in-Chile-since-1850.pdf)>.

146 P. G. Peiró, 'Desigualdad y pobreza América Latina y Europa Desde 1950', *Política y Cultura*, no. 20, (Autumn 2003) 36.

**Table 4.6: GINI Coefficient of Latin American Countries**

	<b>1960</b>	<b>1970</b>	<b>1980</b>	<b>1990</b>	<b>Increase / decrease</b>
<b>Argentina</b>	0.434	0.44	0.41	0.378	-14.09%
<b>Bolivia</b>	0.496	0.53 (1968)		0.42	-20.75%
<b>Brazil</b>	0.53	0.576	0.578	0.596	3.47%
<b>Chile</b>	0.468	0.459	0.532	0.579	26.14%
<b>Colombia</b>	0.579	0.52	0.538	0.512	-1.54%
<b>Costa Rica</b>	0.508	0.449	0.462	0.461	2.67%
<b>Dominican Republic</b>		0.45	0.441	0.505	12.22%
<b>Ecuador</b>	0.35	0.654	0.445	0.43	-34.25%
<b>El Salvador</b>	0.506	0.442	0.484		9.50%
<b>Guatemala</b>		0.452	0.507	0.591	30.75%
<b>Honduras</b>	0.615	0.611	0.572	0.54	-11.62%
<b>Mexico</b>	0.553	0.578	0.502	0.55	-4.84%
<b>Panama</b>	0.509	0.57	0.475	0.299	-47.54%
<b>Peru</b>	0.618	0.55	0.427	0.428 (1986)	-22.18%
<b>Uruguay</b>	0.458	0.428 (1967)	0.4237	0.423 (1989)	-1.17%
<b>Venezuela</b>	0.473	0.476	0.411	0.441	-7.35%

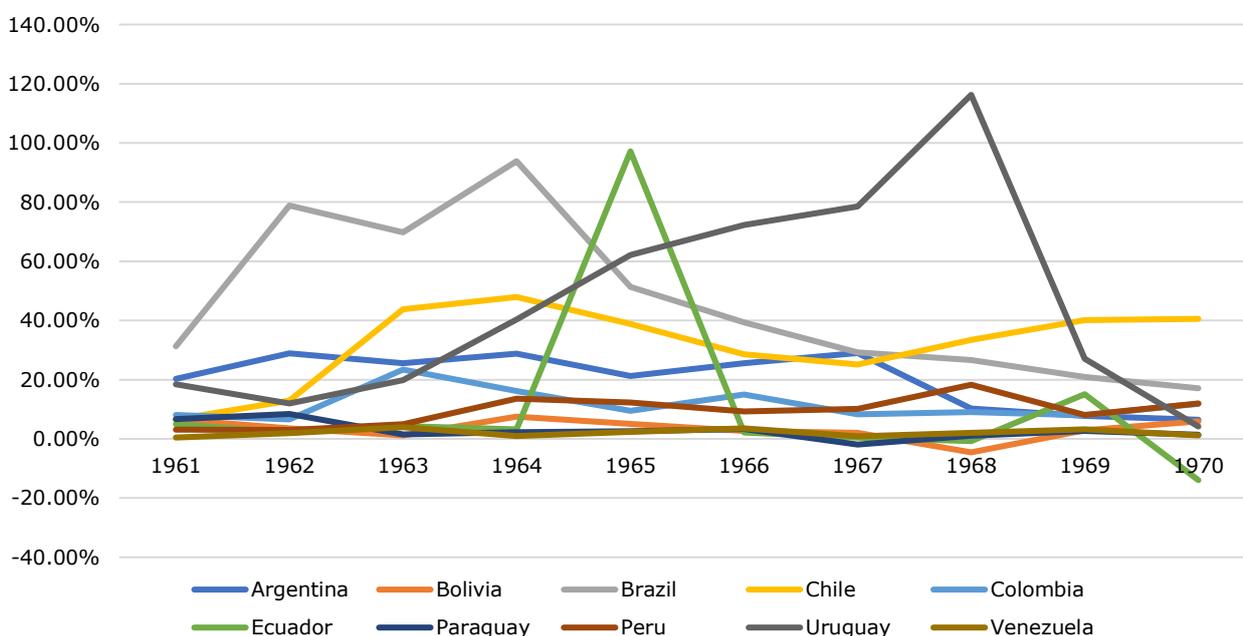
**Source: P.G. Peiró, 'Desigualdad y pobreza América Latina y Europa Desde 1950', *Política y Cultura*, no. 20, (Autumn 2003) 36**

To summarize, we can conclude that Chilean development between 1974 and 1990 was marked by instability, experiencing two deep recessions, both followed by periods of swift recovery. The average annual growth of GDP per capita of 1.92 percent is still higher than that of other Latin American countries or than the world average, but it is not a number that justifies the use of the term 'miracle'. Looking at the distribution of GDP by sector, the agricultural sector is growing the fastest, making a comeback following a period of decline in the 1950s and 1960s. The industrial sector was so devastated by the recession that it took the sector ten years to recover to pre-Pinochet levels of output, but by then it was growing at significantly high rates. The service sector is characterized by a somewhat erratic growth: despite very high growth rates in the late 1970s, the annual average for the whole of the Pinochet period stood at a meager 3.81 percent. This growth of GDP did especially benefit the richest quintile of the Chilean economy and worsened the position of the middle class. Inequality was increasing especially during the first years of reforms (1974-6) and during the second reform period (1986-90). Finally, the rate at which Chilean society became more unequal was one of the fastest in Latin America, second only to Guatemala.

## 4.2 Inflation

A central theme within El Ladrillo is the Chilean monetary policy. A continual push for higher wages by a strong union movement had led to ever increasing prices, which in themselves inspired more wage demands. This spiral was fed by all kinds of government spending, which caused budget deficits, because an inefficient tax system would not suffice for the ambitious government policy. There are two classical ways to 'solve' a budget deficit without having to cut back expenses: to borrow the needed amount or to roll the printing presses. The first as a rule causes extra expenses, the second causes a decrease in the value of the currency. This last phenomenon was endemic not only in Chile, but throughout the whole of South America, as Figure 4.6 shows with regard to 1961-70.

**Figure 4.6: GDP Deflator of Latin American Countries**

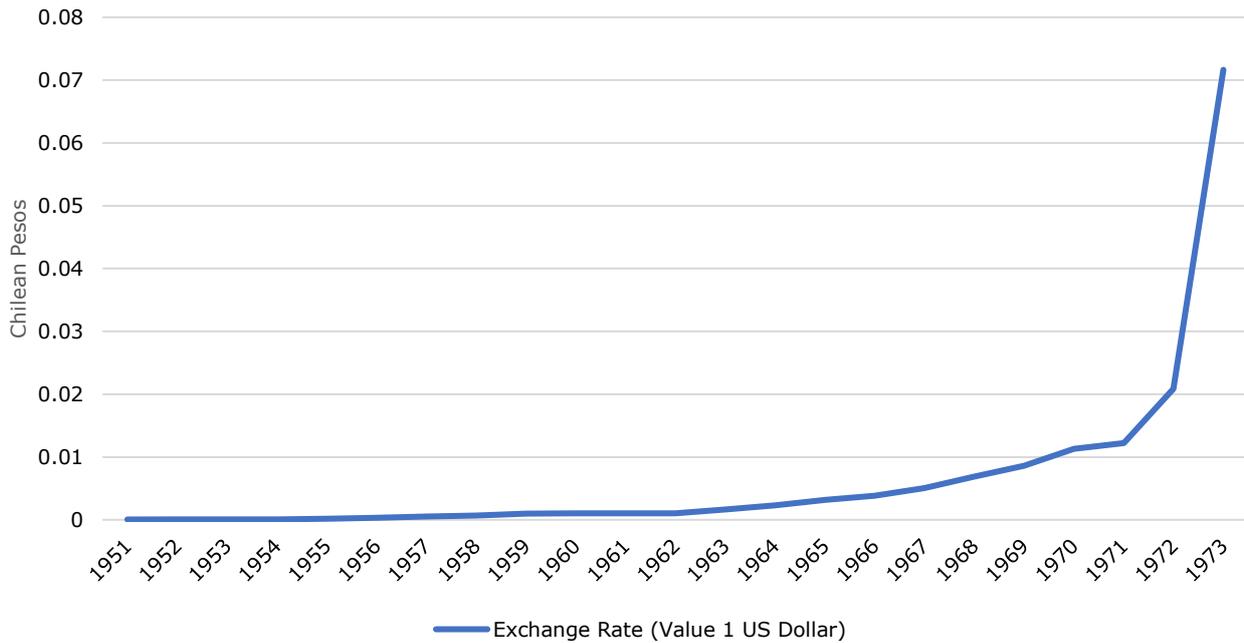


**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>**

This inflationary dynamic is all the more understandable, given the structuralist view on inflation. Structuralists argued that price stability could only be achieved through economic growth. Monetary policy, in their view, was not able to take away the root causes of inflation – which were structural in nature – but could only fight against its symptoms.<sup>147</sup> To counteract the effects this chronic inflation would have on international trade, the Chilean currency was kept at an artificial high rate, making it easier to import foodstuffs and industrial inputs. Still, the fall of the internal value of currency had to be translated into the exchange rate, because otherwise exports would be impossible altogether, which – given the Chilean dependency on copper exports – was something the country could not afford.

<sup>147</sup> Valdés, *Pinochet's Economists*, 106-7.

**Figure 4.7: Nominal Exchange Rate (Value 1 US Dollar in Chilean Pesos)**



Source: Groningen Growth and Development Center, Penn World Table, retrieved on June 15, 2017, from: <http://www.rug.nl/ggdc/productivity/pwt/>.

Figure 4.7 shows the nominal exchange rate of the Chilean peso to the US Dollar: it demonstrates the number of pesos needed to buy one US Dollar and vice versa. These are 1975 pesos. On the 1<sup>st</sup> of January 1960, the Chilean peso was replaced by the escudo at a rate of 1,000 pesos = 1 escudo, while on 29<sup>th</sup> of September 1975 the Chicago economists replaced the escudo itself by the peso, again at a rate of 1,000 escudos = 1 peso. So, in order to convert to the currency valid at the time, one has to multiply by 1,000,000 for the period before January 1960 and by 1,000 for the period between January 1960 and September 1975. For example, in 1970 the exchange rate stood at 0.011277504, which means that at the time one US Dollar could be converted to about 11.28 escudos.<sup>148</sup>

The hyperinflation during the Allende government is clearly visible in Table 4.7 and Figure 4.9. This enormous surge in inflation was caused by an increase in imports (which is the subject of section 4.3), coupled with an explosive expansion of the amount of money in circulation, as is shown in Table 4.7. This trend continued into the Pinochet Era: only in the late 1970s the Chicago economists managed to stop this monetary expansion. It certainly is remarkable that a club of economists, who had made it their top priority to decrease monetary expansion, and who had from 1975 to 1981 acquired an unprecedented amount of influence, still seemed unable to solve this expansion, letting the monetary base grow by a factor 86 between 1975 and 1981. What kind of policies did they implement to counteract this growth of money in circulation?

148 M.J. Mamalakis, *Historical Statistics of Chile: Money, Prices, and Credit Services, Volume IV* (Westport 1983) 7

**Table 4.7: Monetary Base Chile in January of Each Year (in 1975 pesos)**

	<b>Monetary Base</b>	<b>Growth Percentage</b>
<b>1960</b>	177,566.00	
<b>1961</b>	253,902.00	42.99%
<b>1962</b>	303,990.00	19.73%
<b>1963</b>	476,000.00	56.58%
<b>1964</b>	549,000.00	15.34%
<b>1965</b>	815,000.00	48.45%
<b>1966</b>	1,302,000.00	59.75%
<b>1967</b>	1,990,000.00	52.84%
<b>1968</b>	2,310,000.00	16.08%
<b>1969</b>	3,400,000.00	47.19%
<b>1970</b>	4,104,000.00	20.71%
<b>1971</b>	9,660,000.00	135.38%
<b>1972</b>	20,886,000.00	116.21%
<b>1973</b>	63,928,000.00	206.08%
<b>1974</b>	361,924,000.00	466.14%
<b>1975</b>	1,048,476,000.00	189.70%
<b>1976</b>	3,920,558,000.00	273.93%
<b>1977</b>	15,445,662,000.00	293.97%
<b>1978</b>	29,244,762,000.00	89.34%
<b>1979</b>	45,520,000,000.00	55.65%
<b>1980</b>	66,979,000,000.00	47.14%

**Source: M.J. Mamalakis, *Historical Statistics of Chile: Money, Prices, and Credit Services, Volume IV* (Westport 1983) 26 - 31.**

The most important policy measure in a country where 60 percent of the economy was in state hands, was a decrease in government spending. As we saw earlier, government expenses were brought under control in the second half of the 1970s, leading to a budget surplus in 1979. As said, fiscal expenditure as share of GDP fell from 29.1 % in 1972 to 19.7 % in 1978.<sup>149</sup> Next to this, the government restricted price controls, in order to let the market decide a more 'natural' price level. Furthermore, the government made sure that wages would not increase too much, by circumcising union membership: in 1975, a total of 300,000 out of 1,000,000 union members was either fired, arrested, or executed. In 1981, only 395,000 members were left.<sup>150</sup> The new labor code of 1979, moreover, made it possible for employers to fire workers

149 Angell, 'Chile since 1958', 184.

150 De Kievid, Brood, Werk, Gerechtigheid en Vrijheid, 113-117.

without cause and to temporarily replace workers in the event of a strike, during which the employer was not obliged to continue payment of the strikers.<sup>151</sup>

**Table 4.8: Real Exchange Rate Chile (1986 = 100)**

	Real Exchange Rate*	Percental change
<b>10/1973</b>	59.20	
<b>04/1975</b>	98.98	67.20%
<b>07/1977</b>	59.96	-39.42%
<b>06/1979</b>	68.46	14.18%
<b>1980</b>	60.9	-11.04%
<b>1981</b>	51.8	-14.94%
<b>1982</b>	60.1	16.02%
<b>1983</b>	72.1	19.97%
<b>1984</b>	74.3	3.05%
<b>1985</b>	91.0	22.48%
<b>1986</b>	100.0	9.89%
<b>1987</b>	104.3	4.30%
<b>1988</b>	111.2	6.62%
<b>1989</b>	108.6	-2.34%

\* For the years 1973-9 are given monthly averages; for 1980-9 are given annual averages

**Source: R. Ffrench-Davis, *Economic Reforms in Chile: From Dictatorship to Democracy (New York 2010)*, 58; 138.**

Regarding the exchange rate, the military government had, in 1974, devalued the currency by more than 300 percent.<sup>152</sup> This was the first step in a continual process of devaluation until, by 1979, the nominal exchange rate stood at only 1.6 percent of its 1974 value in US Dollars.<sup>153</sup> In 1979 the exchange rate was pegged to the US dollar. The theory was that domestic inflation would converge with international inflation, due to the combination of a fixed rate and free imports. This convergence indeed took place, but slowly, with the resulting loss of purchasing power of the exchange rate. This appreciation of the real exchange rate is pictured in Table 4.8. The consequent drop in monetary liquidity was expected to automatically adjust domestic prices and wages, but this did not happen. The result was a fall in sales, output and employment. Not being able to further reduce wages, the government opted for devaluation: within a period of five months in 1982 the exchange rate was devalued by over 70 percent.<sup>154</sup> The experiment with a pegged currency was not repeated in the 1980s. Between 1985 and 1990 the government carefully and gradually devalued the exchange rate, using an alternative

151 Martínez and Díaz, *Chile*, 60-61.

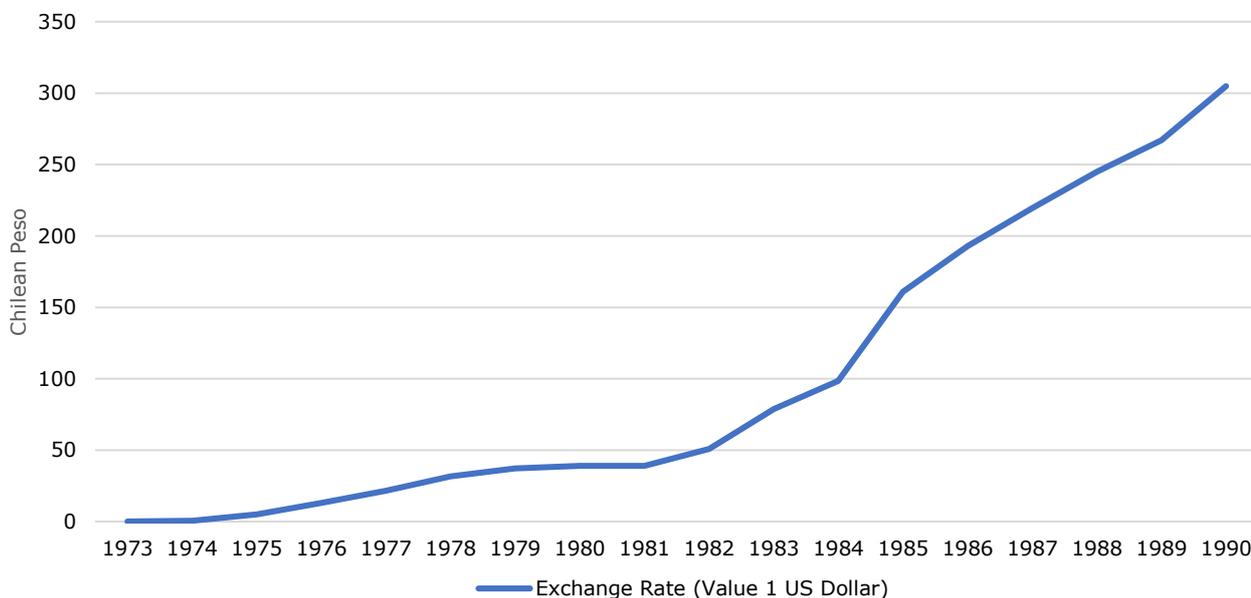
152 De Kievid, Brood, Werk, *Gerechtigheid en Vrijheid*, 103.

153 Groningen Growth and Development Center, Penn World Table, retrieved on June 15, 2017, from: <http://www.rug.nl/ggdc/productivity/pwt/>.

154 Ffrench-Davis, *Economic Reforms in Chile*, 16.

rate – the *Dólar preferential* – for those with foreign currency loans, to protect them against the effects of a devaluation.<sup>155</sup>

**Figure 4.8: Nominal Exchange Rate (Value 1 US Dollar in Chilean Pesos)**



Source: Groningen Growth and Development Center, Penn World Table, retrieved on June 15, 2017, from: <http://www.rug.nl/ggdc/productivity/pwt/>.

So, how did inflation develop during the Pinochet years? As one can see in Figure 4.9, a return to the hyperinflation of the middle years of 1970s was prevented. From 1978 on, inflation again fell beneath the 100 percent mark and between 1981 and 1990 it stood at an average level of 20.21 percent. However, the level of inflation did not represent a continual downward slope. In both 1983 and 1985 it again surged to levels exceeding 30 percent (see Figure 4.10). Moreover, although it is less than the averages of the periods 1961-70 and 1971-80 – at 31.92 percent and 200.64 percent respectively, 20.21 percent is a substantially higher number than the average of the period 1991-2000, which stood at 9.29 percent.

To better be able to evaluate inflation in Chile, we can compare it to other Latin American countries, and to the world average, as is done in Table 4.9. For the whole of the Pinochet-period, the situation in Chile compares favorably to Argentina and Brazil, countries who experience a period of hyperinflation in the late 1980s and early 1990s that was considerably worse compared to the Chilean hyperinflation of 1972-7. This kind of hyperinflation did not affect Uruguay, which had – for most of the period – inflation levels exceeding that of Chile. Looking at the period 1976-90 – hereby considering the inheritance of a wave of hyperinflation by the Pinochet government from the previous government, and the fact that a stabilization policy takes some time to bear fruit – we see that Chile compares favorably to the other three

155 Collier and Sater, *A History of Chile*, 371.

Latin American countries. However, when compared to the world average, Chile during this period experienced more than five times the amount of inflation.<sup>156</sup>

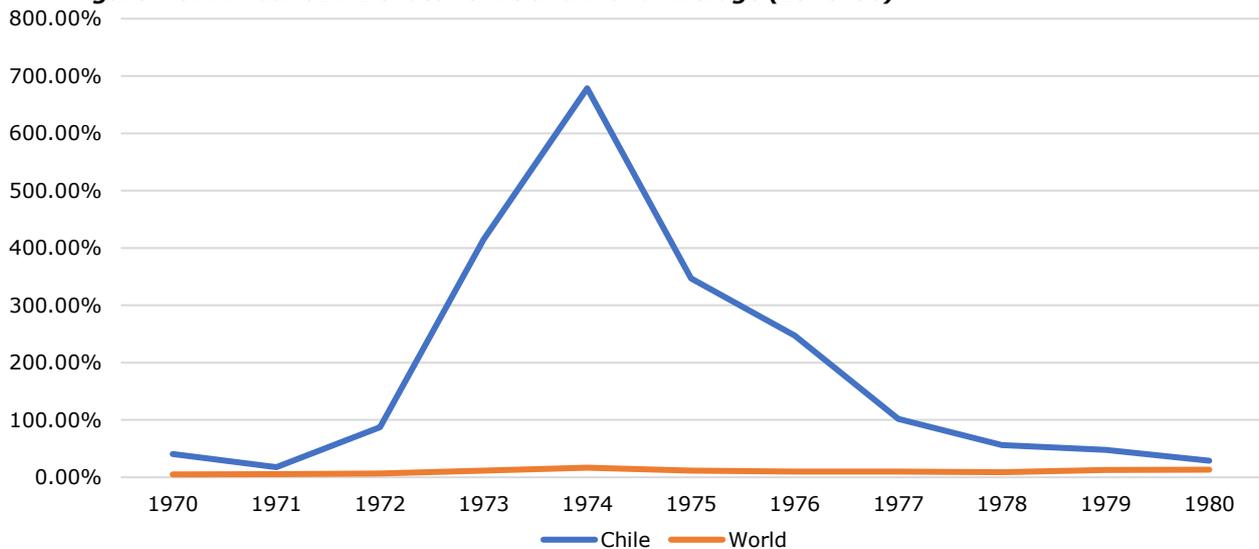
**Table 4.9: Annual GDP Deflator of Latin American Countries and World Average**

	<b>Argentina</b>	<b>Brazil</b>	<b>Chile</b>	<b>Uruguay</b>	<b>World</b>
<b>1974</b>	30.63%	34.80%	678.61%	28.49%	16.71%
<b>1975</b>	197.70%	33.86%	347.20%	65.98%	11.63%
<b>1976</b>	438.32%	47.63%	247.31%	47.29%	9.98%
<b>1977</b>	159.43%	46.18%	101.77%	55.61%	9.80%
<b>1978</b>	161.37%	41.06%	56.28%	46.80%	8.60%
<b>1979</b>	147.38%	56.48%	47.98%	79.21%	12.62%
<b>1980</b>	90.84%	87.31%	29.12%	54.76%	13.20%
<b>1981</b>	106.36%	107.21%	11.57%	27.34%	10.65%
<b>1982</b>	207.62%	104.83%	7.66%	18.16%	8.31%
<b>1983</b>	382.35%	140.20%	30.96%	53.73%	7.71%
<b>1984</b>	606.74%	212.79%	15.74%	56.35%	7.88%
<b>1985</b>	625.80%	231.72%	41.68%	74.02%	5.46%
<b>1986</b>	74.46%	145.27%	21.45%	70.96%	5.25%
<b>1987</b>	127.09%	204.10%	25.85%	72.78%	6.54%
<b>1988</b>	388.49%	651.11%	21.72%	74.64%	6.40%
<b>1989</b>	3057.63%	1209.12%	13.76%	76.08%	6.90%
<b>1990</b>	2076.79%	2700.44%	22.47%	106.84%	7.60%
<b>1974-90</b>	522.29%	356.12%	101.24%	59.36%	9.13%
<b>1976-90</b>	576.71%	399.03%	46.35%	60.97%	8.46%

Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

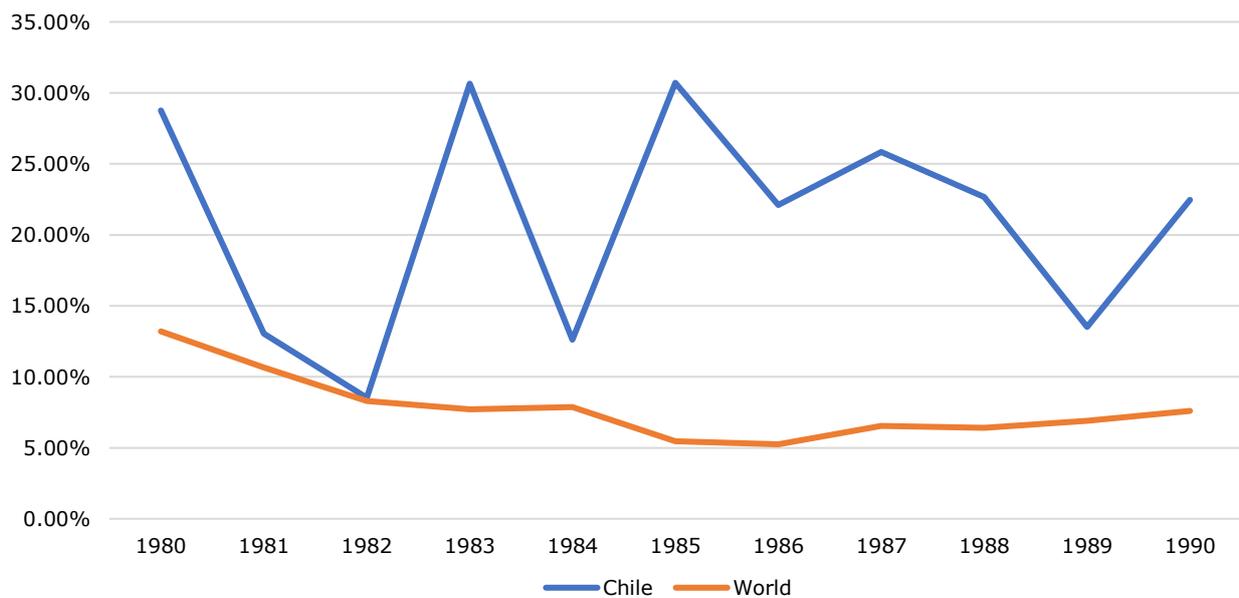
156 The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

**Figure 4.9: Annual GDP Deflator Chile and World Average (1973-80)**



Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

**Figure 4.10: Annual GDP Deflator Chile and World Average (1980-90)**



Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

In conclusion, the policies of the Chicago economists had some effect, in the sense that a return to the hyperinflation of 1972-7 was avoided. Despite this fact, the total monetary base was still growing at alarmingly high levels, which was at odds with the economists' own intentions to monetary strictness. In part, this has to do with the deregulation of the financial sector and particularly, with the massive inflow of foreign credit we saw in the first paragraph. The economists had succeeded in cutting back public expenses to the point of a budgetary

surplus, but at the same time private expenses based on debt were growing at an alarming level, which meant the amount of currency in circulation kept on growing as well.

This was one of main reasons that the inflation level was never below the 10 percent mark, except in 1982, the year the bubble burst and the Chilean economy went into a deep recession. While the Chilean government, from 1979 on, managed to keep the inflation rate below that of countries like Argentina, Brazil and Uruguay, its average annual number of 46.35 percent in 1976-90 was considerably higher than the world average of 8.46 percent. At the same time, the Pinochet Era saw a continual devaluation of the nominal exchange rate, which was worth 1.5 percent of its 1975 value in US Dollars. The real exchange rate depreciated in the 1970s, saw an appreciation between 1979 and 1982 (influenced by the pegging of the peso to the dollar). Thereafter, it rapidly depreciated by 130 % until 1988, when a slight appreciation took place.

In all, it would be ungrounded to conclude from these facts that the inflation policy of the Pinochet Era was a success, let alone that it gave birth to a miracle. One gets the impression that the reduction of inflation was not so much a priority for the Chicago economists. In the last two parts of this chapter, I discuss two policy aspects that had top priority in their view.

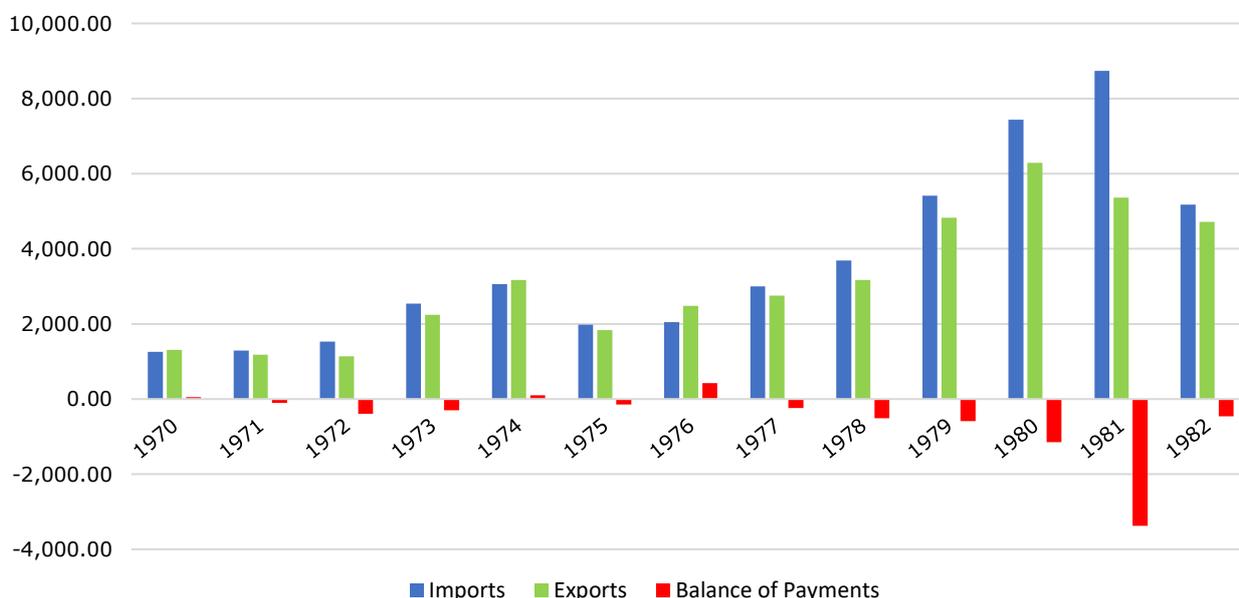
### **4.3 Trade**

To free the Chilean trade from the vast amount of protective measures installed by previous governments, was one of the key aims of the Chicago economists. This would free a vast amount of export potential, especially giving a boost to the agricultural sector, which, they argued, had been in a state of depression since the 1930s. The levelling of the trade barriers and the devaluation of the nominal exchange rate to a level more in tune with its real value, would lead to a reallocation of productive energies toward cheaper imports financed by an expansion of exports. It was this shift in the Chilean economy that would swiftly and automatically bring about modernization. In this part, I first briefly summarize the policies regarding trade in the 1970s. I then examine what effects these reforms had in the period 1974-82, to subsequently look into the policies that followed the recession of 1982-3 and their effects on the Chilean trade volume. Finally, I explore the effects of the reforms by economic sector.

The lifting of Chilean trade protection consisted of three components, the first being the lowering of tariffs and the removal of all other non-tariff trade barriers, such as import quotas. This also involved combining the different tariffs into one uniform tariff. The goal as to the level of this tariff changed over time: in May 1974, it was announced that there would be no tariff higher than 60 percent in 1977; in 1975, this was adjusted to 35 percent by early 1978; while from late 1977 a uniform tariff was announced that would decrease by monthly steps to

10 percent by June 1979. Non-tariff barriers had been eliminated in late 1973. The second component was the unification of the nominal exchange rate and its adjustment to its real economic value. During the Unidad Popular years there had been multiple exchange rates in use for various products: within a month after the coup these were merged into one.<sup>157</sup> As we saw in Chapter 4.1, the nominal exchange rate was devalued from 50 escudos per dollar to 250.<sup>158</sup> By 1975 this had risen to 4910 escudos.<sup>159</sup> As I showed in section 4.2 this was joined by a depreciation of the real exchange rate by 67.2 percent between October 1973 and April 1975.<sup>160</sup> The final component of the liberalization of international trade consisted of the removal of price controls: of about 3,000 price controls existing in September 1973 only 30 remained.<sup>161</sup>

**Figure 4.11: Imports, Exports and the Balance of Payments of Chile (in millions of Current US dollars)**



**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>**

As is shown in Figure 4.11 both imports and exports increased in size in 1973 and 1974, nearly doubling in the case of imports, while exports nearly tripled. This was followed by a sharp decrease of both during the 1975 recession. In a single year, imports shrunk by 35.30 percent and exports by 41.95 percent. Thereafter, both showed an immense growth until 1980, imports increasing by 440.92 percent between 1975-81, while exports grew by 342.28 percent between 1975-80. The amount of exports notably decreased between 1980 and medio 1982, caused by the appreciation of the real exchange rate (as discussed in section 4.2), until a

157 Ffrench-Davis, *Economic Reforms in Chile*, 55-57.

158 Collier and Sater, *A History of Chile*, 365.

159 Groningen Growth and Development Center, Penn World Table, retrieved on June 15, 2017, from: <<http://www.rug.nl/qgdc/productivity/pwt/>>.

160 Ffrench-Davis, *Economic Reforms in Chile*, 58; 138.

161 Martínez and Díaz, *Chile*, 54.

substantial depreciation (accompanied by a devaluation) opened up the possibilities for export recovery. As is shown in Table 4.10, the period 1974-81 saw an annual average growth of imports of 16.71 percent, while exports increased by 11.53 percent. Both are far below the annual average of Uruguay for this period, which stood at respectively 23.97 and 19.17 percent. Chilean imports were growing at a rate comparable to Brazil and to world average, with only Argentinean imports growing at a much slower pace. Chilean exports, however, were increasing rather slowly, compared to Brazil, Uruguay and the world average. When one looks at the share of imports and exports as a share of GDP, Uruguay held a higher annual average for this period. The average share of exports of total world GDP was also somewhat higher than the Chilean share.

**Table 4.10: Trade - Annual Averages of Latin American Countries (1974-81)**

	As a share of GDP			Percental yearly change of total	
	Imports	Exports	Balance of Payments	Imports	Exports
<b>Argentina</b>	6.43%	7.33%	0.90%	8.59%	3.93%
<b>Brazil</b>	10.11%	7.76%	-2.35%	16.65%	18.11%
<b>Chile</b>	19.97%	16.04%	-3.93%	16.71%	11.53%
<b>Uruguay</b>	20.24%	17.07%	-3.17%	23.97%	19.17%
<b>World</b>	18.14%	17.44%	-0.70%	16.64%	15.22%

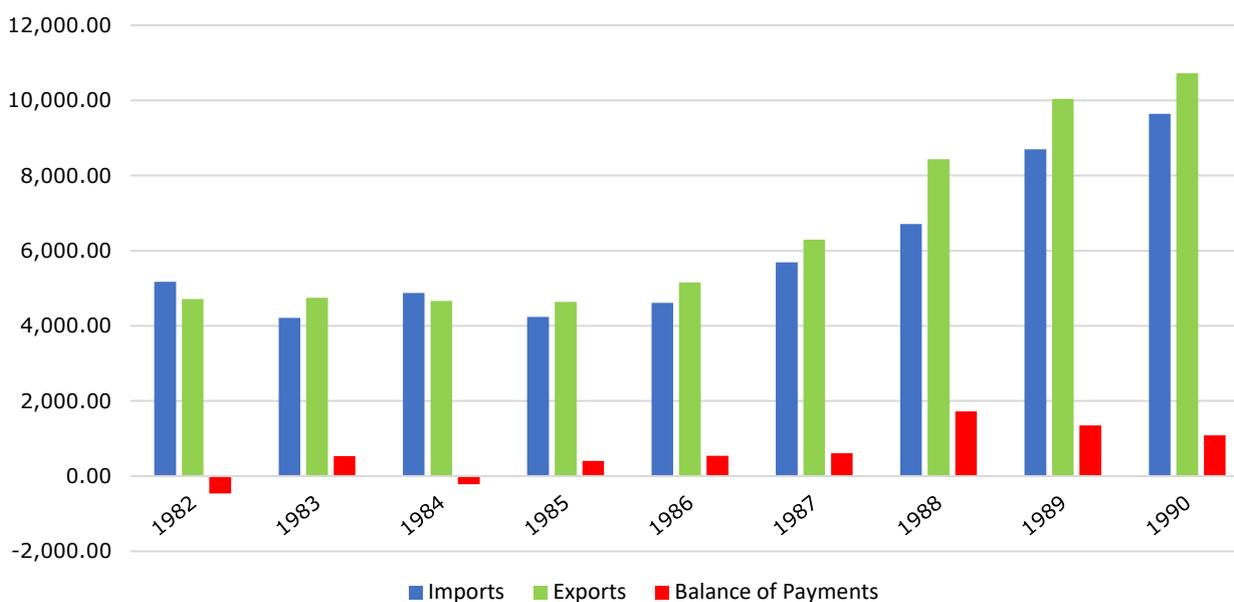
**Source:** The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

The amount of imports exceeded that of exports for six consecutive years, 1977-82, causing a considerable balance-of-payments deficit in 1980 and 1981. The annual average balance of payments-deficit of Chile of 3.93 percent for 1974-81 was remarkably higher than the world average of 0.70 percent. This is reflected in the decline of foreign currency reserves in 1977 and again between 1980-2 (see Figure 4.13). According to Ricardo Ffrench-Davis, the main reason for the stagnation and fall of the amount of exports, was the appreciation of the exchange rate, first in 1976-7 and then in 1980-2. This caused Chilean exports to become relatively expensive, compared to previous years. At the same time, there was, between 1974-81 little active stimulation of the export sector – of which, a large part was struck hard by the 1975 recession.

The years following the 1982-3 recession saw a more active involvement by the government with regard to the export sector. An important stimulating measure was the 'tariff drawback', which enabled exporters in non-traditional exports to be compensated for the tariffs on imported inputs. Similar measures consisted of tax rebates, a VAT refund and the reintroduction of price bands (for wheat, sugar and oilseeds). More importantly, an Export

Fund was introduced which serviced credits on advantageous conditions. Although these measures certainly had their effect on the total amount of exports, it is plausible that the main cause of the growth of exports was the exchange rate. As shown in section 4.2, the real exchange rate depreciated during the years 1982-8, while in 1988-9 the real value increased again. In 1988, the real Dollar value of the Chilean peso stood at 42.27 percent of its value in June 1982. From 1985 on, the government gradually devaluated the nominal exchange rate, using it as a tool to influence the balance-of-payments.

**Figure 4.12: Imports, Exports and the Balance of Payments of Chile (in millions of Current US dollars)**



**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>**

Figure 4.12 shows the development of imports and exports from 1982 to 1990. As is clearly visible, the growth of both imports and exports started to take off from 1986 on, after four years of near-stagnation. Between 1985 and 1989 both exports more than doubled. As a percentage of GDP however, the growth started much earlier, the 'near-stagnation' being the recovery of the recession by the Chilean economy as a whole. Between 1982 and 1989 imports grew from 21.25 to 30.65 percent as a share of GDP, while exports – the low point here being 1981, due to the aforementioned appreciation of the exchange rate – increased from a meager 16.42 percent (the lowest since the coup) to 35.39 percent in 1989. The take-off point for exports in this regard was the devaluation of the peso in June 1982 and, although the export sector suffered severely from the 1982-3 recession, it managed to increase its share in the years that followed, helped by the continuing devaluations. The foreign capital that was generated by this export expansion helped finance the similar growth of the import sector, although it was only in 1990 that it surpassed its 1981 level.

How impressive was the Chilean growth of international trade, when compared to other countries? The annual average share of GDP of both imports and exports is quite impressive, when compared to other Latin American countries. This is depicted in Table 4.11. During the period 1982-89, Chilean imports amounted to an average of 25.60 percent, while this was only 6.26 percent in Argentine and 7.00 percent in Brazil. Exports took up an even larger share of 28.08 percent in Chile, while these equaled 9.52 and 10.37 percent in Argentine and Brazil respectively. Chile had opened up its market to the world, its share of trade significantly exceeding the world average. When one looks at yearly growth of imports, all four Latin American countries saw a net decline between 1981 and 1989, the reason being the debt crisis of 1982 that especially damaged the import sector. In 1982 the amount imported by Chile fell by 40.77 percent, while that of Uruguay declined by 24.52 percent and that of Brazil by 9.76 percent. Argentinian imports were hit less severely, declining by 5.21 percent in 1982, but was struck by another crisis in 1984, causing a fall of imports of 38.01 percent. Although the Chilean fall in imports had been the greatest of these four countries and continued to decline in 1983, the import sector recovered remarkably well in the second half of the 1980s. The average growth percentage of the period 1982-9 was, however considerably less than world average. Exports did remarkably better, growing at an average roughly a percentage point above the world average, but does it justify the use of the word miracle?

**Table 4.11: Trade - Annual Averages of Latin American Countries (1982-89)**

	As a share of GDP			Percental yearly change of total	
	Imports	Exports	Balance of Payments	Imports	Exports
<b>Argentina</b>	6.26%	9.52%	3.26%	-1.73%	7.90%
<b>Brazil</b>	7.00%	10.37%	3.37%	-1.31%	5.47%
<b>Chile</b>	25.60%	28.08%	2.48%	-0.05%	8.17%
<b>Uruguay</b>	19.79%	23.35%	3.56%	-4.18%	2.09%
<b>World</b>	19.12%	18.69%	-0.43%	6.99%	7.38%

**Source:** The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

To answer this question, it is important to review the Pinochet Era as a whole. As depicted in Table 4.12, Chile had succeeded in opening its doors to the world: imports and exports as a share of GDP both amounted to nearly a quarter, significantly more than that of the three other countries, or than the world average. The growth of the export sector, however impressive, turned out lower than that of Brazil or Uruguay, or than the world average for that matter. This difference is to be explained by the starting point in 1973, at which time Chilean imports took up 15.47 percent of the country's GDP, while exports amounted to 13.65 percent. In the same year, Brazilian imports and exports only reached 9.50 and 8.27 percent

respectively, while those of Uruguay equaled 9.51 and 10.42 percent. In other words, although their exports grew at a larger rate, they never reached the share in GDP than was the case in Chile.

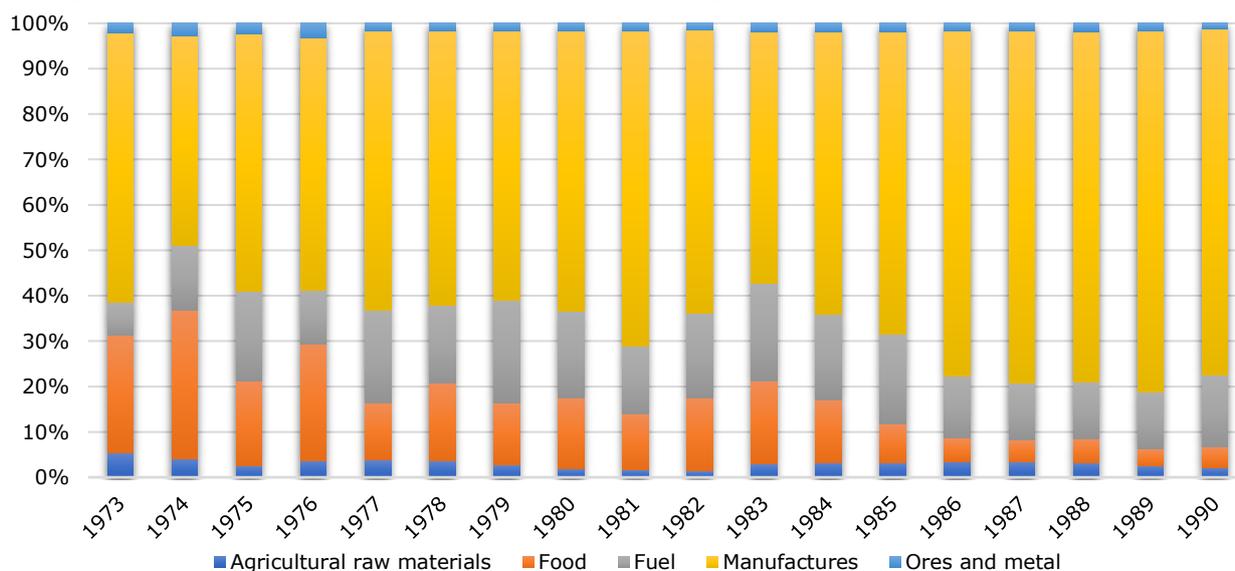
**Table 4.12: Trade - Annual Averages of Latin American Countries (1974-89)**

	As a share of GDP			Percental yearly change of total	
	Imports	Exports	Balance of Payments	Imports	Exports
<b>Argentina</b>	6.34%	8.43%	2.09%	3.30%	5.90%
<b>Brazil</b>	8.56%	9.06%	0.50%	7.30%	11.61%
<b>Chile</b>	24.93%	24.95%	0.02%	8.01%	9.84%
<b>Uruguay</b>	20.01%	20.21%	0.20%	8.99%	10.30%
<b>World</b>	18.63%	18.07%	-0.56%	11.71%	11.23%

Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

What sectors profited from this growth of international trade? As depicted in Figure 4.13 the share of imported foodstuffs fell from 32.66 percent of total merchandise imports in 1974 to 3.58 percent in 1989. During this same period, agricultural raw materials decreased from 4.14 percent to 2.48 percent, although this equals to about twice the amount in US Dollars, as total merchandise imports increased threefold during this period. What is interesting to see is that manufactured goods came to occupy the lion's share of total merchandise imports, increasing from 45.89 to 77.88 percent between 1974 and 1989.

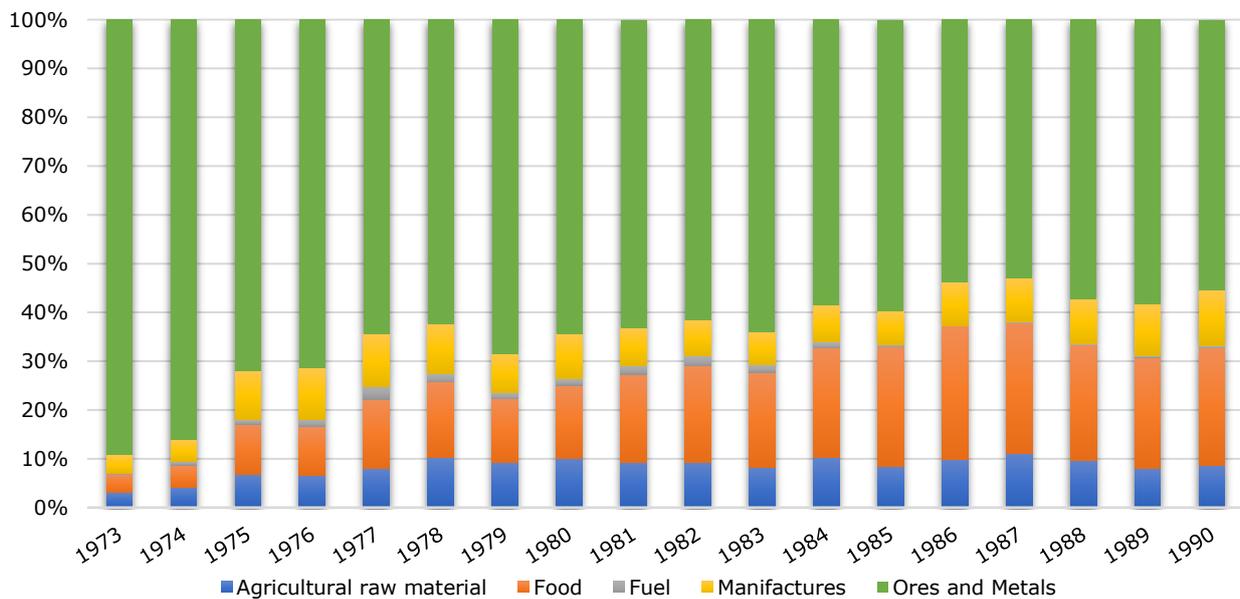
**Figure 4.13: Imports per Sector in Chile (as a Percentage of Merchandise Imports)**



Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

The export of manufactured goods grew as well during this period, as shown in Figure 4.14, increasing from 4.41 to 10.19 percent. Although the sector reached percentages of 10.43 and 10.69 in 1976 and 1977, from 1981 on the export of manufactured goods began to fall. Between 1980 and 1983 the exported amount decreased by 39.74 percent. The export of foodstuffs, on the other hand, experienced a continuing increase from 4.49 percent in 1974 to 27.12 percent in 1986. Thereafter, although the share merchandise export began to decline, the sector continued to increase until by 1989 the total exported output had grown to 16 times its 1974 size. The share of ores and metal, while forming 86.08 percent of total merchandise exports in 1974, shrank to 57.89 percent, despite a duplication of the 1974 amount.

**Figure 4.14: Exports per Sector in Chile (as a Percentage of Merchandise Exports)**

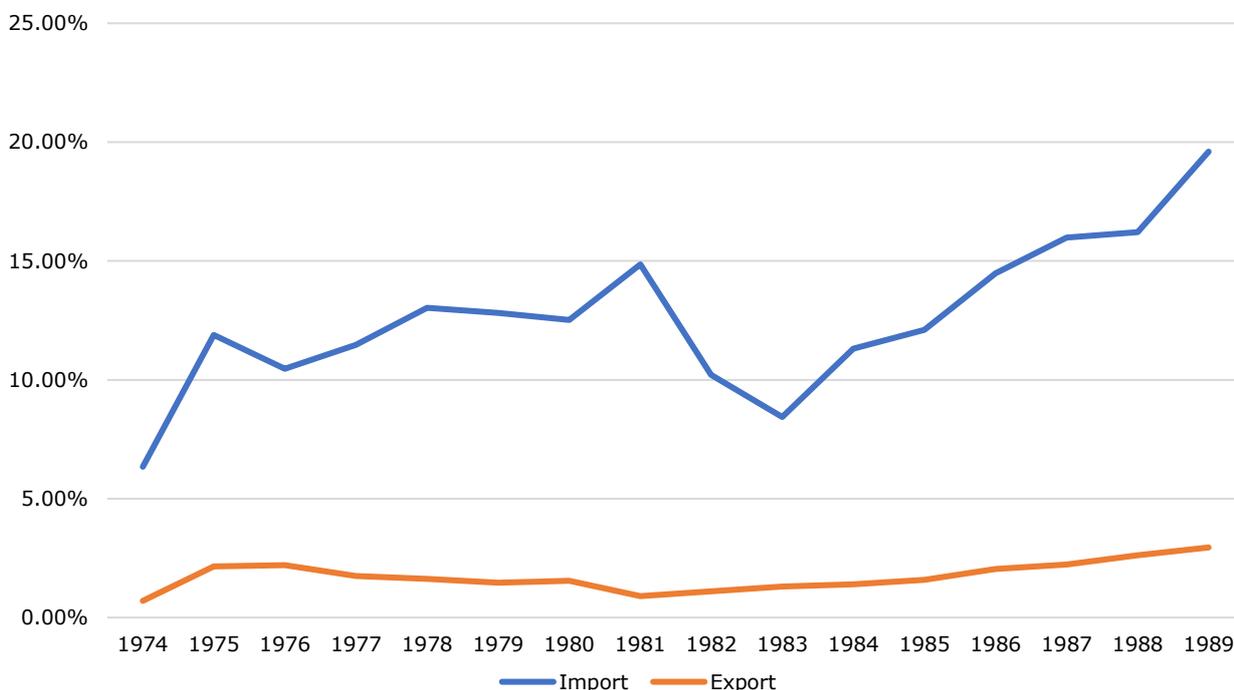


Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>

In effect, Chile had thus grown from a mono-exporting country, heavily dependent on the price of copper, to a country with a more diversified assortment of exportable products. The agricultural sector had profited the most from this export boom, which did not change the country's focus on the export of primary products. The manufacturing sector also managed to increase its exported output by a factor 8, but the share of manufactured imports grew as well, leaving the country a net importer of manufactures by a ratio of 1 : 6.5. In fact, as is shown in Figure 4.15, the vast increase in imported manufactures between 1976 and 1981 was accompanied by a decline in exports of these goods. It is highly probable that it was the fall in tariff protection followed by the appreciation of the exchange rate that damaged the exporting sector, while at the same time flooding the country with imported manufactures. As these products were often purchased with foreign credit, as we saw in section 4.1, it was the

financial crisis of 1982-3 and the decreasing availability of foreign credit that made it increasingly harder to import these manufactures.

**Figure 4.15: Manufactured Imports and Exports in Chile as a Share of GDP**



**Source: The World Bank, World Development Indicators DataBank, retrieved on July 4, 2017, from: <<http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators>>**

To conclude, the reforms of the Chicago economists led to the opening to international trade of a rather closed country, by today’s standards. In 1989, Chile was more involved in international trade than its Latin American neighbors Argentina, Brazil and Uruguay, although this had also been the case in 1973. Nevertheless, while imports as a share of GDP in Brazil and Argentina did not change significantly and Brazilian exports increased from 8.27 percent to 8.92 percent of GDP, Chile managed to increase the share of imports from 15.47 to 30.65 percent and that of exports from 13.65 to 35.39 percent between 1973 and 1989. In absolute terms, imports grew by a factor 3.5 and exports by 4.5 during this period.

This growing interdependency of international trade changed Chile from a country based on food imports and copper exports, to one with a diversified international trade. The agricultural sector profited most from this interdependency, Chile being transformed from a net importing into a net exporting country of agricultural products. One could, however, question the new reallocation of resources. Its focal point lay on the exporting of primary products, while importing manufactured goods. This does not mean it was the kind of outcome that the developmentalist economists of the 1950s and 1960s had been trying to prevent: Chile as a relatively poor exporter of primary products, while being dependent on the richer, developed countries for high quality manufactured products. In 1973 the amount of manufactured

imports was about 17 times the amount of manufactured exports, while in 1989 these imports were outnumbering exports by 6.5 times. International trade had actually decreased the country's dependency.

All in all, despite the speed with which the tariff walls were broken down and the damage the pegging of the exchange rate caused to the exporting sector, the outcome of the reforms was a remarkable success. In part, this can be ascribed to the pragmatic state support of the later 1980s, but this could not have been possible without the tariff and exchange rate reforms of the 1970s. Regarding international trade, the Chilean reforms did cause something that can be called a miracle.

#### **4.4 Privatization**

One of the first priorities of the Chicago economists was to be the fundamental reduction of the entrepreneurial role of the state within the Chilean economy. It was their objective to change a society based on groups achieving their aims through a powerful state apparatus into a society based on atomized individuals operating in a market economy. As mentioned in Chapter 2, during the Unidad Popular administration the public sector controlled 53 percent of GDP, with public investment forming the lion's share of total investment. In September 1973, the state had a controlling interest in 15 banks and 179 companies. In addition to this, CORFO, the public organization that promoted the development of Chilean industry, had 'intervened' in more than 259 companies.<sup>162</sup> According to the Chicago economists this was the outcome of a process of 50 years of state encroachment upon the private economy. The undoing of this process was to be achieved through privatization.

In this section attention is given to the effects of the privatizations in the Pinochet Era. I first provide an overview of the different periods of privatization and the total amount of companies privatized. Following this, I further look into the procedures and methods used to transfer companies from the public to the private sector and the effects of the privatization on Chilean society. Special attention is given to the healthcare reforms and the new private pension system. In the final part of this section, I concentrate on the productivity of the Chilean economy, to establish if the privatization of the Chilean economy brought about an increase in production per person.

One can distinguish four distinct stages of privatization in the Pinochet period, all characterized by their own logic and procedures. The first period started with the privatization of property

162 R. Fischer, R. Gutiérrez and P. Serra, *The effects of privatization on firms and on social welfare: the Chilean case* (May 2003) 13, retrieved on August 2, 2017, from: <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.9140&rep=rep1&type=pdf>.

expropriated during the Allende period. This concerned a wide array of banks, manufacturing companies and farmlands. During 1974-75, a total of 241 companies was to be returned to their former owners. The rest was sold by auction, sold directly, or was closed, their assets sold off.<sup>163</sup> The first stage continued from the coup until 1979, when the regime announced the Seven Modernizations. These formed an intensification of the free market program, entailing a new labor law, a privatized pension system, a healthcare reform, decentralized education, and so on.<sup>164</sup> This stage lasted until the end of 1981, when – as mentioned in Chapter 4.1 – the recession forced the regime to nationalize 14 of the country's 26 banks, and 8 out of 17 other financial institutions.<sup>165</sup> Next to this, the government took over four of the private pension funds. All had been reprivatized again by 1985, by which time the state had taken over their debts, which amounted to a stunning 18 percent of GDP.<sup>166</sup> The last stage lasted from 1985 until the end of the Pinochet Regime in 1990 and involved the privatization of certain core public services, such as telecommunications, airlines, electricity, and steel production.

Overall, the state privatized more than 500 companies (when one includes the companies that had been 'seized' during the Allende years). In 1990, when the Concertación government was installed, a total of 41 companies and one bank remained in state hands. Among the companies that had been excluded from this process were CODELCO, the copper mines, ENAMI, the copper refinery, and ENAP, the oil refinery, the privatization of which had been blocked by the military.<sup>167</sup> These companies were regarded as of too much strategic and economic importance to become privatized.

The first phase of privatization was characterized by a lack of transparency and a concentration of wealth. By 1979, 135 of the 250 largest companies of Chile had become dominated by the ten largest financial conglomerates. The two largest of these – the grupo Vial and the grupo Cruzat-Larraín – had a controlling interest in 25 and 37 of these largest companies, respectively. The selling of most of the companies owned by CORFO took place during the recession years of 1975-6, during which there was a severe shortage of capital. As a result, companies were often sold to a single bidder at low prices.<sup>168</sup> To ease this process, debt-constructions were allowed, in which a minimum of 20 percent was to be paid directly, the rest being paid by loans. In some privatizations, the assets of the companies themselves could be

163 R. Fischer, R. Gutiérrez and P. Serra, *The effects of privatization on firms and on social welfare: the Chilean case* (May 2003) 13, retrieved on August 2, 2017, from:

<<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.9140&rep=rep1&type=pdf>>.

164 Silva, *In the Name of Reason*, 153.

165 Martínez and Díaz, *Chile*, 59.

166 R. Fischer, R. Gutiérrez and P. Serra, *The effects of privatization on firms and on social welfare: the Chilean case* (May 2003), retrieved on August 2, 2017, from:

<<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.9140&rep=rep1&type=pdf>>, 15-16.

167 R. Fischer, R. Gutiérrez and P. Serra, *The effects of privatization on firms and on social welfare: the Chilean case* (May 2003), retrieved on August 2, 2017, from:

<<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.9140&rep=rep1&type=pdf>>, 3.

168 Oppenheim, *Politics in Chile*, 129-130.

used as collateral.<sup>169</sup> Often the requirements and procedures of the privatization process were written by the same people who led the privatizations themselves, and who ended up with a share in the new company. Carlos Huneeus calls this a “revolving-door relationship [...] that gave rise to patronage and exploitation by unethical individuals.”<sup>170</sup> Unlike privatizations in a democracy, in Chile no precautions were taken to prevent abuse, which is why senior executives became major shareholders in the newly privatized companies.

The large financial conglomerates managed to expand their position during the Seven Modernizations that followed in the next phase. In the two months that followed the privatization of the pension system, the grupos Vial and Cruzat-Larraín acquired three quarters of the shares in the new pension funds. In this process, these conglomerates were supported by the banks – that were often owned by themselves – which financed these investments with foreign credit. It was the recession of 1982-3 that ended this phase and that severely damaged the Chilean conglomerates. The Vial and Cruzat-Larraín-conglomerates went bankrupt during this phase and had to be liquidated.<sup>171</sup>

The banks, financial institutions and pension funds that were nationalized, were reprivatized in 1984-5, but this time most of their assets were bought by US financial conglomerates, such as Banker’s Trust and Aetna. These consortia used the pension funds to gain a significant share in the companies that were privatized during the fourth phase of privatizations, that started in 1985. These privatizations were supposed to lead to what was termed ‘popular capitalism’: a diffusion of property among a wide section of the population, starting with the employees of the companies themselves. To achieve this, workers were able to use their retirement money to attain shares, CORFO offered cheap credits and purchases of shares could lead to tax benefits. Despite these measures, there was to be no vast increase of owners in Chile. In 1988, Chile numbered about 56,000 shareholders, most of whom were employees of the recently privatized companies.<sup>172</sup> Instead, the companies were principally sold to foreign companies, who would own between 18 and 95.5 percent of the newly privatized firms.<sup>173</sup> The privatizations of the late 1980s were, moreover, carried out with the same lack of transparency, or of written procedures for that matter, as those of the 1970s.<sup>174</sup>

In 1981, Chile replaced its distributive pension system with a scheme based on individual capitalization, managed by private fund administrators (AFPs). The workers would be able to freely choose in what fund they would invest their money. Young people who entered the labor market would automatically be part of the new system. Those that were part of the old system

169 R. Fischer, R. Gutiérrez and P. Serra, *The effects of privatization on firms and on social welfare: the Chilean case*, retrieved on August 2, 2017, from:

<<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.9140&rep=rep1&type=pdf>>, 10-31.

170 Huneeus, *The Pinochet Regime*, 310.

171 Oppenheim, *Politics in Chile*, 131.

172 Huneeus, *The Pinochet Regime*, 314-317.

173 Oppenheim, *Politics in Chile*, 131-132.

174 Huneeus, *The Pinochet Regime*, 307-313.

of *Cajas de Prevision*, but not yet retired, were given the choice to enter the new system or to stay in the old system. Choosing for the new system was made advantageous by the regime, by adding a Recognition Bond, an extra sum of money to be collected at retirement age and which the members of the old system would not receive.<sup>175</sup> These and other measures resulted in a massive switch to the new system: in 1990, half of the labor force consisted of AFP-members. The result was that the old *Cajas* were overburdened with retirees, who were not able to switch. This deficit was mainly paid for by the government, who tried to cut back these vast pension costs. At the same time, the new system did not cover the part of the workforce that had to resort to low-paid, informal work, the pensions of which also had to be provided for by the government.<sup>176</sup> Furthermore, the pension payments by the AFPs no longer had the distributive function of the *Cajas*, but were based solely on the income one was able to generate. This meant that about 34 percent of the men and 45 percent of the women will save less than the minimum amount of pension money needed, in which case the state will have to provide the rest.<sup>177</sup>

The new system had to overcome resistance within the military, who feared for large conglomerates and who were also concerned that the military pensions would be less than adequately backed by the model. For this reason, the military pensions were left out of the new system. The fears of large conglomerates proved granted: the three largest pension funds were holding 66 percent of total funds in 1985.<sup>178</sup> Moreover, during this year it became possible for AFPs to invest in stock of companies that were to be privatized. By 1989, they had acquired a 32 percent share in the newly privatized companies. The AFPs themselves, by this time, were bought by foreign consortia, who together controlled about 55 percent of Chilean retirement funds.<sup>179</sup>

In the same year as the new pension system was introduced – 1981 – Chile also acquired a new healthcare system. Although the old system was not radically changed during 1974-80, it had experienced major cut backs: per capita expenditure at this time was down to 64 percent of its 1974 level. The new system was based on a division between private insurance companies (ISAPREs), who had to compete with each other to make profit, and a public system (FONASA). When an ISAPRE-member, a worker, employee or retiree would initially pay 4 percent of their monthly income to one of 15 ISAPREs, but by 1987 this had increased to 7 percent. The level of insurance was dependent on the amount represented by this 7 percent.<sup>180</sup> These insurance companies were unrestricted in their ability to discriminate on terms of age, gender and health: they could reject clients or require higher premiums. Because of this, the

175 Collins and Lear, *Chile's Free-Market Miracle*, 167-169; 171.

176 M. Taylor, *From Pinochet to the 'Third Way', Neoliberalism and Social Transformation in Chile* (London 2006), 92-95.

177 Collins and Lear, *Chile's Free-Market Miracle*, 177-178.

178 Huneeus, *The Pinochet Regime*, 329-334.

179 Collins and Lear, *Chile's Free-Market Miracle*, 179-180.

180 Taylor, *From Pinochet to the 'Third Way'*, 92-95.

ISAPRE system became a privilege for rich, young, healthy males, while many others had to resort to the public system. The result was that the healthcare provided by ISAPREs was of a different quality altogether than that provided by FONASA, which had to deal with continuous economizing by the state. In 1990, only 15 percent of the population was a member of one of the ISAPREs.<sup>181</sup> In 1988, of the population older than 65 years only 6.7 percent was a member an ISAPRE; this counts for only 3.1 percent of the lowest income quintile.<sup>182</sup> At the same time, of the total amount of money spend on healthcare in 1990, about 57 percent went to ISAPRE-members. In sum, both quality and quantity of healthcare were based upon the individual's ability to pay.<sup>183</sup>

**Figure 4.16: Total Factor Productivity in Chile (2011 = 1)**



**Source: Groningen Growth and Development Center, Penn World Table, retrieved on June 15, 2017, from: <<http://www.rug.nl/ggdc/productivity/pwt/>>.**

How much did these privatizations contribute to productivity? In Figure 4.16 is shown the Total Factor Productivity of the Chilean economy. This variable enables us to compare the level of productivity per worked hour. One can see that this total productivity decreased substantially during the Allende years, from 1974 to recover somewhat, only to fall for a second time in 1981 and 1982. From then on, it recovered again, but during the whole of the Pinochet Era the factor productivity of 1970 was not again to be reached. In part, this had to do with the deindustrialization that took place between 1975 and 1982, when a sizable part of the import-substituting industry no longer was able to compete with cheap imports flowing freely into the

181 Collins and Lear, *Chile's Free-Market Miracle*, 99-100.

182 R. Fischer, R. Gutiérrez and P. Serra, *The effects of privatization on firms and on social welfare: the Chilean case*, retrieved on August 2, 2017, from: <<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.199.9140&rep=rep1&type=pdf>>, 70-75.

183 M. Taylor, *From Pinochet to the 'Third Way'*, 92-95.

country. Between 1977 and 1980, a total of 1,338 companies went bankrupt. As Figure 4.16 shows, productivity did not recover from this blow.

To summarize, the privatizations during the Pinochet Era had far-reaching consequences for the population of Chile. A country that had become more and more state-led since the 1940s was radically put on a different path toward private enterprise. This is certainly one of the aspects of their reforms for which the Chicago economists received much acclaim. The pension system, for example, had transformed Chile into “the pioneering country in the western hemisphere”.<sup>184</sup>

Although one could question whether or not privatizations were the necessary policy choice in post-Allende Chile, the way in which these were executed did certainly not cause a miracle. Both the privatizations in the 1970s as those in the later 1980s led to an extensive concentration of wealth. In the 1970s, moreover, this concentration had partly been based on foreign credit, a vulnerable basis, as would be proven during the recession of 1982-3. Most of the banks and financial institutions again ended up in the hands of the state. That these privatizations were carried out in a dictatorship, with much less concern for public opinion than would have been the case in a democracy, was clearly visible in their lack of transparency, without written procedures or regulations to prevent abuse power. In this sense, the privatizations would foreshadow the breaking down of state enterprises in the Soviet Union in the 1990s, where public property was split up between powerful men, while the larger part of the population experienced chaos and poverty.

The privatization of healthcare, education and the pension system brought about the end of distributive policy. From now on, one had to pay for its own pension: a fixed percentage of ones' salary would be put in an individual account, which would accumulate over the years. This might sound fair, but in a country where many worked in the informal sector and where the minimum wage was barely enough to live off, this meant that the state had to finance the resulting pension gap. In terms of healthcare, privatization meant a deterioration of healthcare access and facilities for about seventy percent of the population, while the richer part of the population enjoyed a healthcare standard that outshone even that of the United States. For most of the Chilean population the privatizations meant utter misery: they would, in fact, be free to choose options that they would never be able to afford.

184 Collins and Lear, *Chile's Free-Market Miracle*, 167.

## 5 – Conclusion

In the preceding chapter, I have tried to paint a comprehensive picture of the economic situation during the Pinochet years. I have focused mainly on four variables: economic growth, inflation, international trade, and privatization. With these I am able to give an answer to the beforementioned research question, namely: what have been the outcomes of the policy measures taken by the Chicago economists during the Pinochet Era? Before answering this question, I first place the reforms into the broader context of the decade of reform, which preceded it directly.

The Revolution in Liberty considerably intensified the polarization in the country. The ambitious program, with which Eduardo Frei wanted to find a middle ground between capitalism and socialism, had the effect of estranging both Right and Left. The forces of the Right were shocked by the expropriations in the countryside, while the Left wanted to push the Revolution further. This self-confidence of the Left was not a mere Chilean phenomenon: in the late 1960s, the world was characterized by a growing movement of young revolutionaries who wanted to alter the basic structures of society. Although this can be said about the Chicago economists as well, their objectives differed markedly from the socialists and communists so abhorred by them.

The coming to power of Salvador Allende represents the point where a polarized society was spinning out of control. While the state sector had been growing substantially during the Frei period, under the Unidad Popular it became a main objective to expand the public sphere at the expense of the market. Extra-legal measures were used to nationalize private companies, often without any regard to their owners. This was moreover done with remarkably little consideration for the opposition parties, who felt themselves locked out. The forces of the right were thus pushed out of their economic positions and were ignored politically. Combined with the economic disaster of 1972-3, these developments caused the convergence of various interests against Allende. Christian-Democrats, *gremialistas*, the army, big business, the middle class and the Chicago economists, all wanted the Unidad Popular government to end.

The reforms of the Chicago economists have to be understood against this turbulent background. The Right was increasingly put on the defensive, fearful as they were for a Cuban scenario. In the analysis of the Chicago economists, furthermore, the Unidad Popular was but the final chapter in a long evolution of encroachment upon private property by the state. To make sure that the Chilean road to socialism would be forever closed, merely returning the country to the status quo ante, was not an option for them. A more permanent restructuring of society was needed. Although not everyone within the military government agreed to the kind of reforms the Chicago economists proposed, there was a consensus that the Marxist danger had to be completely eradicated.

'Depoliticization' meant the destruction of Le Différend, a denial of legitimate dispute. Not only would the military do their best to completely erase leftist ideology, by way of executions, penal colonies and torture chambers, they would also install a regime that can be named 'the revenge of the rich'. The coup signified the moment that the richer elements of Chilean society went from defensive to offensive. The Chicago reforms were an expression of this revenge: both a way to prevent another socialist episode, as a way to empower the rich. The latter objective gained in importance in the later 1970s, during the privatization of the financial sector, and the reforms of healthcare and the pension system. These measures greatly empowered the rich elite of the country.

That this was the prime objective of the Chicago economists' reforms is reflected in their policy priorities. Their most important aims were to free international trade from state protection and to privatize the greater share of the economy. The first made possible the inflow of enormous amounts of foreign credit into the country, as well as an increasing inflow of luxury products. This liberalization badly damaged the country's industry, of which it only started to recover in the later 1980s. During the 1970s and early 1980s, the damage done to industry as well as to the export sector, did not seem to bother the Chicago economists, who reasoned that weaker industries were destined to perish, when not being able to compete. It shows among other things that the liberalization of trade was more important to them than a solid economic development of the country.

When reviewing the privatizations, both in the 1970s as the 1980s, what strikes one, is the lack of transparency, the lack of regulation and the enormous concentration of wealth that followed. The privatizations of the 1970s especially resemble not an orderly transfer to the private sector, but rather a small elite reaping the benefits of their control of state power, dividing up the bounty. When the dictatorship was coming to an end after failing to achieve a majority in the 1988 plebiscite, the process of privatization intensified, in order to make sure that the new government would not be able to reverse the privatizations. This, and other measures, such as the requirement that Pinochet remained the head of the armed forces, were taken to prevent a return of the socialist threat that had prompted the regime in the first place.

Other aims, such as inflation, economic growth, the reduction of poverty or an increase in the quality of healthcare or education, were of a considerably lower importance to the regime and its economists. Only during three years did inflation fell below 20 percent, which is remarkable given the fact that the Chicago economists called themselves monetarists, emphasizing the importance of a stable money supply. The low priority given to economic development is reflected in the low average growth rate of the country and in the preference of free imports over a strong industrial sector. The reforms caused a substantial increase of poverty and a strong reduction in quality and quantity of the healthcare of most of the Chilean population.

This was mostly accepted as a by-product of the reforms and virtually nothing was done to repair these effects.

The policy decisions made by the Chicago economists were therefore most certainly not an expression of technocracy, as Montecinos and Silva have argued. The reforms were conducted without proper care to important technical aspects such as the prevention of the abuse of power or the grave macroeconomic imbalances caused by the reforms in the financial sector. At the same time, these imbalances were only in part a result of ideological dogmatism, as Valdés contends. During the 'radical reforms' in the 1970s, certain core sectors of the economy were left untouched, while the financial sector was saved by the state in the early 1980s. At the same time, the outcome of the privatizations was in large part decided by nepotism and shady deals, within government and big business circles, instead of by pure neoliberal principles.

Instead, I agree with Huneeus that the reforms were in important respects influenced by the existence of an authoritarian dictatorship, which made possible a certain recklessness in the 1970s. This was to be partly corrected by the 1982 recession, but was able to continue during the later 1980s. What followed was an economy which mainly favored a small military-business elite and was, as is shown by French-Davis, markedly unstable. This certainly was not an objective of the regime, but was rather *caused* by its objectives. Technocracy, neoliberalism, nationalism and 'military virtues' were at least in part ideological structures to mask a regime based on the support of the wealthy against the poor and middle classes.

In the end, the question should not be *if* the reforms helped the Chilean population, but which part of the population benefited. My conclusion is that the regime consistently favored the interests of the rich, while in order to do so, worsening the situation of the poor and the middle classes. What started as vengeance for the Allende years, developed into a dualistic system in which the wealthy would come to live in a miraculous society, completely different from the misery in which their countrymen lived.

## Epilogue - The Concertación Governments 1990-2010

In November 1988, the regime organized a plebiscite to ensure itself of popular support for the next eight years. The amount of opposition, however, was miscalculated and the Chilean population voted 'no' to a continuation of military rule. A year later, the first elections in sixteen years were held, bringing about the first democratic government. The Concertación de Partidos por la Democracia is the name given to this alliance of center-left parties, which governed from 1990 until the election of Sebastián Piñera in 2010. Although the new rulers made considerable policy adjustments concerning social regulation, education and health care, the basic principles of the reforms of the 1970s and 1980s stayed intact. Indeed, the wave of privatizations continued in the 1990s and Chile was more than ever connected to the world market. Although the new government was slightly left-wing and many of its leaders had criticized the market reforms of the Pinochet Era, the world that Chile now entered had changed remarkably since the 1970s. Thatcher and Reagan had spread the neoliberal ideals, the Soviet Union was falling apart and the European socialists were starting to embrace the market.<sup>185</sup> There were legal constraints to the new government in the existence of appointed senators, mayors, judges and heads of army and police that had all been appointed during the military regime, that could not be replaced. The binomial voting system that had been installed thwarted majority rule by ensuring the right-wing minority with half of the parliamentary seats.<sup>186</sup>

Despite these constraints, the achievements have been considerable. From 1990 to 2005 annual GDP growth was 5.6 percent.<sup>187</sup> This growth has been even higher when one focuses on the period 1990 to 1996, amounting to an annual 7.8 percent. At the same time, poverty declined from 38.6 percent in 1990 of the total population to 20.3 percent in 2000, while extreme poverty fell from 12.9 percent to 5.7 percent. Real wages rose from 1990 to 1997 by an annual 4 percent, with worker productivity in the first half the 1990s increasing by 4.3 percent annually. The government maintained an average fiscal surplus of 1.5 percent between 1989 and 1997, which was partly used to pay back the significant public debt left by the military regime. Inflation, moreover, was kept low at 3.72 percent, between 1992 and 2001. The tariff rates were maintained at a low level of 11 percent until 1999, when they were gradually lowered to 7 percent in 2002. All these developments led many observers to comparisons with 'Asian tigers' like Taiwan and South-Korea.

The Asian Crisis of 1997-98 on the other hand, showed the vulnerability of the Chilean economy. Although the growth during the 1990s has been particularly based on increasing exports, these were mainly primary products characterized by unstable prices. When these prices plummeted in 1998-1999, the economy went into a recession. Moreover, the focus on

185 Oppenheim, *Politics in Chile*, 171-172.

186 Ibidem, 213-214.

187 Ibidem, 169.

primary products, which had started during the Pinochet years, left little room for investment in industry. Indeed, the high copper prices of the nineties led investors to outsource the further refining of the raw copper ore to countries in South-East Asia, because of cheaper labor circumstances. This meant that the massive investments in the copper sector and the tax breaks made possible by the government, amounted in the end to a loss of jobs. Finally, the economic growth and reduction of poverty notwithstanding, the country experienced a significant increase in inequality, with opportunity and enormous riches mainly obtained by the small network of conglomerates, who had established themselves in the Pinochet Era.<sup>188</sup>

Although the gap between rich and poor has decreased significantly, especially during the governments of Ricardo Lagos and Michelle Bachelet, Chile still remains one of the most unequal societies of Latin America. Inequality, but also a failing pension system and the lack of access to education, until this day remain hotly debated political issues within the country. This, among others, comprises the Chicago legacy to Chile.

188 M. Taylor, *From Pinochet to the 'Third Way'*, 123-126; 136-144.

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