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Miracle or Myth? Evaluating the Economic and Social Consequences of Liberalizing Pinochet’s Chile

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MIRACLE OR MYTH?
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Introduction

“The International Monetary Fund (IMF) and the World Bank are explicit about their role as transmitters of norms and principles from advanced economies to less developed economies.”\(^1\) They have clearly codified criteria for what they consider to be sound economic policy. However, while there is significant international support – especially from the United States – for the models and theories that these institutions promote, the implementation (both voluntary and coerced) of such economic policies throughout the world produces a wide range of results. In some cases, the policies cause significant damage to several parts of a country’s society while the positive economic growth that is produced benefits only a limited portion of the population.

In 1975, approximately two years after a military coup d’état overthrew President Salvador Allende and established Augusto Pinochet as Chile’s omnipotent dictator, a group of Chilean economists, known as the “Chicago Boys,” turned Chile into a virtual laboratory for implementing neo-liberal doctrines and free-market theories supported by the IMF and the World Bank. The Chicago Boys learned these particular theories through a special international exchange program with the United States.\(^2\) Their “success” under these neoclassical policies – indicated by high growth rates and low inflation -- led some historians and politicians to refer to Chile as an “economic miracle.” One article in The World Paper, a multinational publication, stated:

Chile’s economic miracle [is] a textbook example of the Chicago Boys’ success: a country opening to foreign investors, exporting and importing without limits...and

receiving A's and B's from international financial organizations and risk-evaluating agencies.³

Similarly, on December 6, 1990, at the close of the Pinochet regime, President George Bush spoke to the Chilean Congress and praised Chile as the role model for neo-liberal reforms:

Chile has moved farther, faster than any other nation in South America toward real free-market reform. The payoff is evident to all: seven straight years of economic growth...You deserve your reputation as an economic model for other countries in the region and in the world. Your commitment to market-based solutions inspires the hemisphere.⁴

And in a special report on the Latin America Region, the World Bank asserted, “Chile is widely recognized as having the most open, stable, and liberalized economy in Latin America,”⁵ also suggesting that Chile’s economic policy under the Chicago Boys was a successful example of liberal economic reform. Because international organizations, such as the IMF and the World Bank continue to use Chile as a model for other developing countries to follow, the full impact of the Chicago Boys’ free-market ideas on the Chilean economy and its society warrants further investigation.

In particular, this paper will analyze two aspects of the argument supporting the Chilean miracle: First, it will examine the economic statistics commonly used to prove the reality of the miracle. Second, it will investigate what compromises were made in other areas of society in order to achieve such levels of high economic growth. In doing so, this paper will assess whether the results of IMF and World Bank policies carried out by the Chicago Boys were all that they were made out to be – socially, as well as economically. – Did they truly produce a miracle, or was Chile’s prosperity during the Pinochet years more myth than a reality?

Background of the key players: The Chicago Boys

In the 1970s many countries in the Southern Cone of South America, including Argentina, Chile, and Uruguay, embarked on major attempts to liberalize their economies. Chile’s transformation was guided by a group of economists who had graduated from La Pontificia Universidad Católica de Chile. In addition to their studies in Santiago, each of these men had also completed graduate work abroad at the University of Chicago’s School of Economics through a special international exchange program. As such, they had been indoctrinated with the economic theories and neo-liberal models espoused by Milton Friedman, the IMF and the World Bank. Because of their training in the United States, the Chilean exchange students were commonly known as the “Chicago Boys.”

Like Friedman, the Chicago Boys believed that the market provides the most efficient mechanism by which resources are allocated to meet the interests of society at large. They maintained that since scarcity in society creates the necessity of choice between alternatives, the most efficient economy is one in which individuals can freely maximize his or her own utility.

A time for change: Implementing “shock therapy”

Shortly after the military coup in 1973, Pinochet appointed several of the Chicago Boys to important and influential government positions of power. Sergio de Castro and Pablo Baraona became advisors to the economics minister, and Sergio Undurraga joined the finance minister as an aide. The situation that the economists faced was daunting. On multiple fronts the national economy was in a state of crisis. In their book, “A Nation of Enemies,” authors Constable and Valenzuela summarize the Chilean economic situation saying:

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Inflation peaked at 600 percent, a dearth of essential goods existed, and the black market exchange rate was thirty times the official rate. In addition, international reserves had been depleted, and the government deficit equaled a staggering 24.7 percent of the gross domestic product. More than six hundred state-run enterprises, employing over 5 percent of the work force, were losing $500 million a year.\(^9\)

In another analysis of the Chilean economy, Collins and Lear add that “consumer prices also skyrocketed at an annual rate of 375% while joblessness reached unprecedented levels and wage hikes fell behind increases in the cost of living. The budget deficit ran at about 32 %.”\(^{10}\)

In order to transform Chile from an economy that was semi-isolated from the rest of the world into a liberalized world-integrated economy where market forces were freely left to guide most economic decisions, the Chicago Boys created an emergency plan to simultaneously stop inflation and encourage economic growth. It was called “shock treatment.”\(^{11}\) The first step in the plan was to cut both government spending and the money supply. “Public spending was cut by 27 percent in 1975, and within four years it had dropped to nearly half of the 1973 level in relation to the gross national product. Public investment was also slashed: between 1974 and 1979 it fell 13.9 percent.”\(^{12}\)

At first, the shock treatment wrecked havoc on the economy. The GNP decreased 13 percent, purchasing power dropped to 40 percent of the 1970 level, unemployment peaked to 6.8 percent in 1976, and industrial production decreased 28 percent.\(^{13}\) However, despite these disastrous effects, Chile’s acceptance and implementation of IMF-supported neo-liberal reforms pleased many foreign lenders, including the Inter-American Development Bank (IADB) and the World Bank, creating a surge of foreign investment.

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\(^{9}\) Ibid., 167.

\(^{10}\) Collins and Lear, 27.

\(^{11}\) Edwards, 11.

\(^{12}\) Constable and Valenzuela, 173.

Encouraged by the junta’s strong embrace of free-market tenets, Western-lending institutions that had shunned [Allende’s socialist policies] turned on the spigot again. Foreign lenders agreed to refinance Chile’s foreign debt on unusually generous terms, and after U.S. aid was banned by Congress in 1976, the pace of loans from the World Bank and the Inter-American Development Bank steadily increased. Between 1976 and 1986, these institutions made forty-six loans to Chile worth over $3.1 billion.\textsuperscript{14}

With new sources of capital pouring into Chile, the economy began to react positively. The ensuing years of growth formed the foundation for the beginnings of the Chilean miracle.

**Common statistics: Evidence supporting the Chilean miracle**

By the late 1970s the additional financial assistance from abroad coupled with substantial loans from the IMF and World Bank resulted in positive, short-term changes in a few major economic indicators. The rate of inflation which had passed 600 percent a year during 1973, dropped to 84 percent in 1977 and then lowered to less than 10 percent in 1981.\textsuperscript{15} In addition, Chile’s average annual rate of economic growth exploded, averaging more than 8\% from 1976 until 1981.\textsuperscript{16} These two statistics – lower inflation and rates of high economic growth – are repeatedly cited by the IMF and the World Bank as evidence to the reality of the Chilean miracle.\textsuperscript{17} However, while both sets of statistics are accurate in the sense that multiple sources have reported similar numbers, many of the interpretations drawn from this data fail to tell the whole story of the Chilean miracle.

**The rest of the story, part I: Problems with economic data**

One of the most common errors in evaluating the affects of the Chicago Boys’ economic policies and the Chilean miracle is using data from only a few select years. Like any other experiment, the sample size of data used – in this case, the time frame chosen for the analysis of

\textsuperscript{14} Constable and Valenzuela, 172.


the Chilean economy – greatly affects the assessment of the results. Frequently, proponents of the Chilean miracle focus on specific periods of time, such as 1977 to 1979 or 1987 to 1989, when the Chilean economy experienced rapid growth. Data from such narrowly focused studies suggest a stable and ever-improving economic situation. For example, in the *New York Times* on June 21, 1987, Shirley Christian wrote an article that was very favorable to the Chicago Boys’ policies. She cited gains in the inflation-adjusted gross national product and export growth, as well as small reductions in unemployment. However, her statistics were based on data collected during only two years of the regime. She neither addressed what happened before or after those years.\(^{18}\)

Numbers taken from a longer time period tell a very different story about the Chilean miracle. From 1973 to 1990 the Chilean economy actually experienced incredible instability and produced large-scale fluctuations in many economic indices (see Figure 1). Valdes notes that during the two subperiods of the Pinochet regime, GDP actually only grew by an annual average of 2.6 percent. This average includes the growth of over 8 percent in 1977 through 1979 and of 10 percent in 1989. When taking into account an annual population growth of 1.7 percent during

\begin{figure}[h]
\centering
\begin{tabular}{|l|l|l|l|l|}
\hline
Year & Rate of Growth & Year & Rate of Growth \\
\hline
1973 & -5.6 & 1982 & -14.1 \\
1974 & 1.0 & 1983 & -0.7 \\
1975 & -12.9 & 1984 & 6.3 \\
1976 & 3.5 & 1985 & 2.4 \\
1977 & 9.9 & 1986 & 5.7 \\
1978 & 8.2 & 1987 & 5.7 \\
1979 & 8.3 & 1988 & 7.4 \\
1980 & 7.8 & 1989 & 10.0 \\
1981 & 5.5 & 1990 & 2.1 \\
\hline
\end{tabular}
\caption{Annual Growth Rate of Chile (1973-1990)}
\end{figure}

\(^{18}\) Section 3, p. 9.
the 1980s, average per capita GDP growth during the Pinochet years would calculate to a mere 0.9 percent yearly,\(^9\) hardly a figure indicating an economic miracle.

Some advocates of the miracle suggest that the downswings in the Chilean economy simply reflect economic problems facing all countries during that time. However, evidence suggests that Chile’s reaction to world crisis was even greater than the rest of Latin America. According to Sheahan, the world-wide recession of 1981-1983 brought GDP for Latin America down by 4 percent, while the drop in GDP for Chile was over 14 percent.\(^{20}\) Other supporters of the Chilean miracle argue that the poor performance in the early years of the regime is best explained as a legacy resulting from the previous economic structures established by Salvador Allende and the Unidad Popular government. However, even if one overlooks the first couple of years of the Pinochet regime and uses a new benchmark to evaluate real growth performance, there remain subsequent periods of extreme fluctuations that reflect a severely unstable economy, rather than a well-orchestrated miracle.

Another important point to consider when evaluating the Chilean economy during the Pinochet years, is making a distinction between times of economic recovery and periods of actual economic growth. The deeper the recession, the steeper the recovery. In the case of Chile, the economic growth rates of 7 to 10 percent during the “miracle” years fail to compensate fully for the plunge in GNP of 13 percent in 1975 and 14 percent in 1982. In fact, real per capita GDP did not regain its 1971 level until 1989.\(^{21}\) Thus, much of the growth attributed to the supposed Chilean miracle can more accurately be viewed as part of a recovery process that

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\(^{20}\) Sheahan, 231.

started from a very low initial level of GDP in the mid-1970s and climbed back to its original level in later years. (see Figure 2 below)

![Figure 2: Chile's GNP per capita, 1971-1989 (calculated in 1987 USD)](image)


The final crucial element that challenges the economic data supporting the Chilean miracle is the sources of growth. Economic growth during the recovery years was fueled in large part by money borrowed in the banks by the private sector and also from substantial loans from international organizations like the IMF and the World Bank.\(^{22}\) Much of the borrowed money was spent on speculative endeavors such as consumer imports, real estate speculation, as well as the acquisition of all government-held enterprises.\(^{23}\) The maintenance of a fixed, low rate for the dollar also had a number of negative consequences. It not only encouraged an import boom, but also created a huge trade deficit. Because the fixed exchange rate made Chilean products, including agricultural goods more expensive on the international marketplace, it inhibited exportation. From 1973 to 1982 Chile’s foreign debt increased 2.1 times and the private sector


\(^{23}\) Dosworth, 9-10.
foreign debt increased 24.8 times.\textsuperscript{24} By 1982, Chile's foreign debt totaled more than $17 billion compared to only $3.67 billion in 1973.

Along with the high level of loans from international organizations and foreign investment, domestic savings remained low for the entire period. Ramos reports that Chilean savings decreased to an average rate of 12 percent per year for the first ten years after the coup, compared to an average of 17 percent of the GNP between 1963 and 1973.\textsuperscript{25}

Primary product exports in both the traditional sector and the non-traditional sector also formed a significant portion of the "growth" that occurred. The increase in capital flow for major exports, such as copper, resulted from higher world market prices, rather than actual increased production.\textsuperscript{26} It is critical to recognize that some of the economic growth reported during the years of the miracle occurred in the primary resource sector because the constant fluctuations in the world market meant that sustained growth in primary resources could not be guaranteed in the long run. Thus, the boom of the Chilean economy was based on a two-pronged illusion: 1) the spectacular growth recorded during the Pinochet years was in large part the reflection of a natural cyclical recovery from prior recession periods than an actual increase of production over previous years; 2) the short-term gains that were produced were achieved only after incurring a large foreign debt and relied greatly on loans from international organizations and fluctuating world prices for primary resources.

The rest of the story, part II: Negative effects on society

Misrepresentation of the full economic data is not the only weakness in the story of the Chilean miracle. Typically, advocates of Chile's neo-classical policies focus solely upon inflation and GDP statistics and exclude discussions concerning the other ways in which the

\textsuperscript{24} Ibid., 6.
\textsuperscript{25} Ramos, 48.
\textsuperscript{26} Bosworth, 165.
liberalization of the economy affected the rest of society. One of the most damaging consequences of the neo-liberal model was an increased concentration of wealth in the hands of a few accompanied by a greater disparity between the rich and the poor.

As part of the Chicago Boys’ plan to liberalize the Chilean economy, they privatized hundreds of enterprises that had been placed under state control during the Allende administration. Between 1975 and 1989, Pinochet’s Chicago Boys sold government ownership in 160 corporations, 16 banks, and over 3,600 agro-industrial plants, mines and real estate holdings, in addition to returning 30 to 40 percent of the land expropriated by the Allende administration.27 Usually, these companies were sold to a single bidder at a very low price. However, even at these low prices, relatively few buyers had the money or necessary access to foreign capital to make such purchases. Thus, much of the increased wealth found its way into the hands of a small number of domestic economic conglomerates, in particular, two groups controlled by Javier Vial, Manuel Cruzat and Emiliano Larraín. By 1978, the Vial group controlled 25 and the Cruzat-Larrain group owned 37 of Chile’s 250 largest companies. By 1982, the banks owned by these two groups controlled 60 percent of all credit and 42 percent of all banking capital.28 Six of the seven largest conglomerates had control of over 50 percent of the assets of the country’s biggest companies.29 Undoubtedly, the privatizing of the economy contributed to the translocation of wealth in the Chilean economy.

While the large conglomerates were prospering, life was arduous for smaller businesses. They first had to deal with a general decrease in consumer demand which resulted from the shock treatment at the beginning of the regime. Later, they discovered they could not compete

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29 Ibid.
with the cheap imports flooding into the country. The result was a growing number of bankruptcies. From the period 1977 to 1980, there were 1,338 bankruptcies. Between 1979 and 1982, more than a fifth of manufacturing companies failed and manufacturing employment dropped by over one fourth. In the textile industry alone, 35 to 45 percent of companies failed. Yet, because the large number of privatizations to large conglomerates yielded additional income for the government, Pinochet and the Chicago Boys were able to balance the national budget. Thus, while “on paper” the economy and the neo-liberal policies appeared to have optimistic results, many of the domestic Chilean businesses greatly suffered.

Neo-liberal policies not only affected the local businesses, but also greatly increased the number of impoverished Chileans overall. Real wages plummeted during the early years of the dictatorship, sinking in 1975 to 62 percent of their real value when compared to the base year 1970. By 1987, the minimum wage index was only 55 percent of its 1980 level. Even during the years of economic recovery real wages did not go up. In 1989, the last year of Pinochet’s rule, real wages were still only 90.8 percent of what they had been in the 1970 base year.

The results were devastating. Between 1978 and 1988, the richest 10 percent of Chileans increased their share of the national income from 37 to 47 percent; the next 30 percent of middle-income households saw their share shrink from 23 to 18 percent. And the income share of the poorest fifth of the population dropped from five to four percent. A study conducted in Santiago in the late 1980s showed that poverty had increased drastically throughout the region. In 1969 28.5 percent lived below the poverty line, but by 1987 the number had risen to 49

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34 Collins and Lear, 155.
percent.\textsuperscript{35} Statistics from other regions of the country also reflected a similar trend. Overall in 1970, before Pinochet took power, 17 percent of all Chilean household incomes were below the poverty line. By 1990 the rate had doubled, with 35 percent of the households living in poverty.\textsuperscript{36} This data illustrates that under the IMF-inspired neo-liberal policies of the Chicago Boys economic growth occurred, at least in part, at the expense of the poorer sectors of Chilean society. The economic policies did not produce an even distribution of economic progress. On the contrary, while a few wealthy businessman reaped the rewards of privatization, the rest of the general populace suffered. If the Pinochet years proved to be a miracle for some people, they were certainly more of the exception than the rule for the rest of society.

**Conclusion**

International organizations such as the World Bank and the IMF support certain economic models and frequently require developing countries to implement free-market reforms in order to obtain economic assistance. The Chilean economist, Alejandro Foxley, observes:

> ...the [developing country's] policies must conform to certain rules. These rules of 'sound economic management' are perfectly codified by the international financial community, including the International Monetary Fund (IMF), large private international banks, and business groups. They consist of reducing the rate of expansion in money supply, eliminating the fiscal deficit, devaluing domestic currency, deregulating prices and private sector activities, and opening up the economy to free trade. Given such explicit codification of what constitutes sound policies, the restoration of confidence requires abiding by them. In doing so, the economic policies acquire distinct orthodox flavor.\textsuperscript{37}

This paper has analyzed the effects of implementing such neo-liberal policies in Chile during the Pinochet regime. It is important to note that the Chicago Boys' reforms were not limited to revamping the country's economic policies. They also included making significant

\textsuperscript{36} Collins and Lear, 28.
\textsuperscript{37} Foxley, 31.
changes to the social security program, the healthcare system and the national labor code.\textsuperscript{38} However, because conditionary loans from the IMF and the World Bank often emphasize making adjustments to a borrowing country’s economic policies, this paper has focused on the effects of implementing economic reforms on Chilean society, rather than examining the additional changes to other national programs such as healthcare and social security.

Nevertheless, although the scope of this paper does not include discussion of modifications to the other programs, the economic data and statistics concerning the effects of the Chicago Boys’ economic policies expose some of the great weaknesses in the economic models espoused by the IMF and the World Bank. The evidence highlights the gap that can form between free-market theory and actual socioeconomic realities.

While it is true that the policies implemented by the Chicago Boys significantly decreased inflation and led to short-term, sporadic periods of economic growth, the overall track record is less than impressive. Analysis of the entire period of influence of the Chicago Boys, even during the final years when more pragmatic adaptations of neo-liberal ideas were made, shows that the boom periods barely made up for the periods of bust. In the long run, little real economic growth occurred. In addition, the sources of capital that spurred the period of recovery were themselves volatile and unsustainable.

Equally as important as criticizing the economic data used to support the miracle are the other ways in which the neo-classical policies negatively affected Chilean society. The privatization of multiple industries, in an attempt to let the free-market factors of supply and demand govern the economy, led to the concentration of wealth in the hands of very few Chileans. This not only led to the destruction of many smaller, local businesses, but also created greater disparities in income distribution among the general populace.

\textsuperscript{38} Oppenheim, 149-152.
Because the World Bank and the IMF continue to prescribe similar free-market economic models as solutions to developing countries throughout the world, the conclusions drawn from the Chilean experience have specific implications for future policy decisions concerning developing countries. Although free-market economics have been successfully adapted by many countries throughout the world, Chile during the Pinochet period provides an example of the negative effects that such neo-classical policies can produce for certain sectors of society. This suggests that before developing countries consent to blindly follow the precepts of neo-liberal theory in order to obtain financial assistance from international organizations, they should first consider the many ramifications of such actions. The example of Chile shows that while implementing such neo-liberal policies may indeed produce some positive results – such as lower inflation and sporadic periods of economic growth – it may also create additional problems for large parts of society. Failing to recognize (or admit) that such reforms also generate negative results and do not benefit all sectors of society creates the illusion of a miracle; a miracle similar to that of Pinochet’s Chile...more myth than reality.

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