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Author(s): MICHAEL MOFFITT
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MICHAEL MOFFITT

Chicago Economics in Chile

The stringent application of monetarist theories to the Chilean economy under the Pinochet government has greatly worsened the lot of the poor and the middle class.

In the last couple of years, a number of articles have appeared about the relationship of University of Chicago economists Milton Friedman and Arnold Harberger to the Chilean military dictatorship, headed by General Augusto Pinochet. Friedman and Harberger have been criticized as the theoretical architects of what *Business Week* called the "Draconian cure for Chile's economic ills," implemented by Chicago-trained Chilean economists, often referred to as "the Chicago Boys." According to the critics, the massive violation of human rights and the destruction of democracy in Chile are inseparable from the junta's economic policies. Friedman and Harberger applaud these policies, thus, say the critics, giving a *de facto* endorsement to the Pinochet dictatorship. When Friedman was awarded the 1976 Nobel Prize in Economics, Nobel Laureates Linus Pauling, Salvadore Luria, David Baltimore, and George Wald asserted that his association with the Chilean regime was a valid reason for denying him the prize.

All of this has drawn angry responses and disclaimers from the Chicago professors. Harberger, an advisor to Chile during the Frei and Alessandri years, denies any relationship to the junta. Friedman, who says he has only been in Chile six days in his life, declares that he "was not then and never [has] been an economic adviser to the Chilean junta" (*New York Times*, May 22, 1977). As for the junta's economists, many of whom studied at Chicago under the auspices of a program sponsored by the Agency for International Development, Harberger and Friedman refuse to criticize their involvement with the present regime. They maintain "great

MICHAEL MOFFITT is a Fellow of the Transnational Institute of Washington, D.C. and was an associate of the late Orlando Letelier, Ambassador to the United States of the Allende government of Chile.

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sympathy for our former students. We know them to be honorable and compassionate men and women. ... We are not willing to turn our backs on them" (*Wall Street Journal,* December 10, 1976).

My own view is that a debate which proceeds along these lines inevitably dwells on the personalities involved, and slights the fundamental issue of what has happened in Chile since September 11, 1973, when the military overthrew the government of Salvador Allende. Former students of the Chicago school of economics are now making the junta's economic policies. The task of the social scientist is to evaluate what they have done and to base any further judgments on that performance. How have they implemented Chicago theories in Chile and what have been the results? What exactly have the "Chicago Boys" done to the Chilean economy?

Historical background

It is impossible to deal adequately with these issues without historical perspective. In many ways, Chile is a typical dependent, underdeveloped country. The copper industry has accounted for a disproportionate share of the country's Gross Domestic Product, a large part of the government's annual revenues, and most of the country's foreign exchange earnings.

During the 1950s and 1960s, Chileans were optimistic about the prospects of development. "Trickle-down" development strategies, supplemented by the agrarian reform laws and expansion of the public sector under Eduardo Frei, seemed to be working reasonably well. Moreover, Chile's political system demonstrated remarkable stability and Chile managed to avoid the totalitarianism to which countries like Brazil had succumbed. But the reforms of the Frei years were not enough. In 1970, socialist Salvador Allende won the presidential election and began the process of a democratic transition to socialism.

The primary aim of the Allende government was to improve the lot of the workers and the poor. Allende quickly implemented existing land reform laws and used fiscal policy and price controls to redistribute income toward lower income groups. Wage increases often exceeded productivity gains, while the government controlled prices. This effectively reduced capital's share of national income and raised labor's share. As a result of an increasing demand for goods by those with low incomes, Gross Domestic Product increased 8 percent during 1971, the first year of the Popular Unity (UP) government. Unemployment fell to less than 4 percent. The UP government made extraordinary advances in reducing infant mortality rates and extending basic health care and social services to the lower classes.

For a variety of reasons, including Nixon's attempts to "make the economy scream," weak copper prices, the pressures of Chile's foreign debt, and the severe limits on expanding productive capacity, the economy deteriorated after the middle of 1972. Despite the economic problems, however, electoral support for the Popular Unity coalition remained strong. This was an anomaly which Professor Rosenstein-Rodan's judgment—that Allende was incompetent—cannot account for (*Challenge,* May/June 1974). The UP was unique in Chilean history in that the administration's electoral support increased while it was in power, as the March 1973 congressional elections attested. Nonetheless, Chile's socialist administration ended in September 1973, when a military coup overthrew the UP. Thousands of unionists, students, intellectuals, and political leaders were arrested and crammed into makeshift prisons like the National Stadium. Victims of torture and executions have, according to various estimates, exceeded 30,000. Since the coup, all opposition political parties, workers' organizations, and newspapers have been banned.

Politics and economics

Milton Friedman denies that there is a relationship between political conditions in Chile and its economic policies, but it is important to emphasize that the military junta has consistently stressed the closeness of that relationship. The junta's ultimate goal, as Pinochet has said, "is not to make Chile a nation of proletarians, but a nation of entrepreneurs."

To implement this vision, the junta put the "Chicago Boys," like Sergio de Castro, Minister of Finance, and the team of economists under the direction of former economic czar Jorge Cauas, in charge of managing the economy. Since their training at the University of Chicago, they have dreamed of making Chile a showplace of free market capitalism. The *Wall Street Journal* noted in December 1976 that, right after the September 1973 coup, this group was "champing to be unleashed on the Chilean econ-

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omy." Until that time, the political climate had never been favorable to such an experiment.

Chicago theories at work

How did the Chicago-trained Chilean economists perceive the economic problems of post-Allende Chile, and how did they go about implementing Chicago theories to solve them?

Most economists would agree that in an underdeveloped country like Chile, development should be the principal goal of economic policy. As free marketeers, the group of Chilean economists naturally believes that the market provides the most efficient allocation of economic resources. State intervention, by distorting the functioning of competitive markets and the price mechanism, reduces efficiency and impedes the process of development. Inflation is also said to be a major obstacle to economic progress. These economists are monetarists: they hold that the level and rate of growth in the supply of money—the velocity remaining relatively stable in the short run—determine the rate of inflation and the level of economic activity. Other factors, such as monopolies, government deficits, or trade unions, may also affect the level of demand or produce inflation, but only insofar as they affect the money supply through monetary policy. In Friedman's words, "if any of these factors produces a rise in the stock of money, it will produce inflation. But if it does not produce a rise in the stock of money, it will not produce inflation" (*Inflation: Causes and Consequences*).

From the perspective of the junta's economists, two things had to be done. The first was to restore competitive markets by reducing the role of the state in the economy and the second was to reduce Chile's rampant inflation so that the price mechanism could begin to function properly.

Because excessive expansion of the money supply is believed to be the principal cause of Chile's inflation, and because monetarists consider inflation to be the biggest obstacle to economic progress, fighting inflation with tight monetary policy quickly became the junta's top priority. Traditionally higher than that in most other Latin American countries, the inflation rate in Chile averaged about 25 percent per annum during the 1960s. Annual price changes reached as high as 500 percent during the Allende years (even higher during the final months), and hit 370 percent during 1974, 340 percent in 1975 and 180 percent in 1976.

During the Frei years (1964-70) and especially under Allende, the Chilean government had become increasingly involved in ownership and control of major industries, a course clearly unacceptable to the junta's economists. At the time of the coup, the Public Development Corporation (CORFO) owned 492 firms. Most of these were oligopolies and monopolies that had simply been absorbed into the public sector, in order to capture private benefits for public usage. Of these, the junta has returned roughly half to their former owners and solicited bids for most of the rest. Because the junta courted foreign investment from the outset, several U.S.-based multinationals, such as Firestone Tire, repurchased their former Chilean subsidiaries. Most of the state enterprises, however, were sold to local financial interests, often dominated by single firms or families. The absence of real "competitive bidding" for the state-owned industries virtually ensured that most of them would be gobbled up at low prices. Occasionally, the bids for large firms, such as Celulosa Arauco, a major pulp and paper complex offered for sale earlier this year, have been so embarrassingly low that the government has withdrawn the offers.

The end result of denationalization was hardly a return to free and competitive markets (which implies numerous and independent buyers and sellers), but rather meant increasing economic concentration. The chief beneficiaries of denationalization have been local businessmen and multinational corporations, who supported the military takeover and have easiest access to the present regime. ITT, which once offered the CIA up to one million dollars to prevent Allende from coming to office, has the inside track on most telecommunications projects and is using $25 million compensation from its nationalized subsidiary CHILTELCO to finance research by the Chilean subsidiary of its Continental Baking Company. The big local firms have also learned some lessons from their long association with the multinationals. Since the coup, they have chosen to shift production either to luxury goods, which only a small percentage of the population can afford, or to goods destined for export, rather than producing goods aimed at a mass internal market. Faced with falling demand, they have also chosen to cut quantity rather than prices, which has also negated a good deal of the anti-inflation program.

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However, the junta's economists had at least a theoretical solution to the problem of local monopolies. In fact, one of their recurring themes has been that, historically, the government has victimized Chilean consumers by erecting barriers to imports which protected inefficient local industries. To augment the return to a competitive market economy, the junta has also promoted a policy of free trade: local firms would henceforth be required to compete on an equal footing with imports. In this way, according to the conventional theory of comparative advantage, inferior firms would be weeded out, yielding greater economic efficiency and freeing resources for other uses.

This is fine in theory, but scarcely practical in the real world of international trade. Firms based in less developed countries can seldom compete with the foreign-based multinationals, which usually edge them out of the market in the absence of state intervention to protect them. (The exception is tertiary or comprador industry, historically relegated to local firms.) This is why most less developed countries, whatever their political outlook, have relied on protectionist and import substitution policies to keep imports in check.

At one time, Chile was a leading member of the Andean Pact, an organization of six Latin states to control the operations of multinational corporations, promote trade, and rationalize local industrialization. In October 1976, after repeatedly trying to alter its rules on foreign investment, Chile dropped out of the Andean Pact, and nearly destroyed the organization in the process.

The junta economists hoped that by reducing real wages, eliminating restrictions on profit repatriation, and improving Chile's credit standing, they would encourage a rush by the multinationals to invest in Chile. The junta's view, according to *Latin America Economic Report*, August 1976, is that "foreign investment is a panacea for all economic ills, ranging from poverty and unemployment to malnutrition and poor housing." The implication is that even if multinational corporations took over the country's key industries, as they had done before the election of Allende, their superior efficiency would increase society's total welfare. But these investments have not materialized. Several factors account for this: the isolation and instability of the regime; criticism of investments in Chile by trade unions and other groups in the United States and Europe; and postponement of investments pending Chile's break with the Andean Pact.

The contraction of demand

Clearly the most important factor, which we shall examine in detail below, has been the relentless contraction of demand and its regressive impacts on income distribution and mass purchasing power. By slashing government spending, abandoning most price controls, returning expropriated lands to the landlords, banning traditional trade unionism, and reducing the size of the public sector, the junta has facilitated a massive redistribution of actual and potential income from workers and the poor to business and large landowners. A 1976 International Monetary Fund study showed that in 1972, wage and salaried workers received 63 percent of total income, with 37 percent going to the propertied sector in the form of profits, dividends, and rent. By 1974, income shares had literally been reversed: 62 percent accrued to the propertied sectors, and 38 percent to labor.

Because demand is primarily determined by the distribution of income, such a regressive shift in income shares has a depressing effect on the whole economy. Nowhere is this more apparent than in an underdeveloped country like Chile, where a small part of the population controls a disproportionate share of the purchasing power with which consumers cast their "votes."

Consequently, redistributing income, dropping import barriers, and letting the market take its course, has also destroyed a great deal of local industry in Chile. Those who now command most of the purchasing power have metropolitan, not Chilean, tastes. They prefer expensive imports from the United States and Europe (or those manufactured by their multinationals operating elsewhere) rather than local goods. Recent visitors to Chile report that there have never been so many European autos and other foreign delicacies in Chile. During 1975, only imports of *non-food* consumer goods increased, while all other categories of imports (including petroleum) dropped precipitously. While employment in the depressed textile industry has fallen by roughly 50 percent, Chile's textile imports (especially French fabrics) totalled $51 million from September 1976 to March 1977. Local production of automobiles is roughly half the 1969 level and even less if com-

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pared to production levels of 1971.

To be sure, dropping the barriers to imports has eliminated local producers, but it is questionable what this has to do with efficiency—or what efficiency means to an underdeveloped country like Chile. Because economic conditions have been so depressed and precarious, the multinationals have been content to increase their exports to Chile. The junta's inability to stimulate investment, its dropping of import barriers, relatively weak copper prices, and the continuing high rate of inflation, have interacted to produce what *Business Week,* in October 1976, called "the worst depression in the country's history."

Contracting demand and limiting the availability of credit are the hallmarks of Chicago economics in Chile. In April 1975, when the original austerity measures adopted in 1974 had proved ineffective in reducing Chile's inflation, former economic czar (currently Ambassador to the United States) Jorge Cauas decided to put the economy through the wringer again. In one year, he cut overall government spending by 20 percent and government capital spending by more than half. The result was predictable. In 1975, Chile's Gross Domestic Product (GDP) fell by about 15 percent and industrial production declined 23 percent. Per capita income declined 24 percent to roughly the level of 1962. Construction fell 35 percent and mining output by nearly 10 percent. According to official government statistics, unemployment in greater Santiago reached 18 percent at year-end 1975 and Chile's total average wage bill declined 12 percent in real terms. While GDP increased about 3.5 percent in 1976, dissident and exiled economists predict that Chile will not regain 1971 production levels until after 1980.

It is ironic that the junta's fanatic free market policies have discouraged investors even more than did the socialist policies of Allende. This is revealed by the drastic fall in the ratio of domestic investment to GDP. The historical norm for Chile is roughly 16 percent, which was maintained during the Allende years. Under the junta, the ratio has fallen to slightly more than 8 percent.

If Milton Friedman were Chile's Central Banker, this is precisely the policy he would have pursued. Indeed, when he visited Chile in March 1975, he told *El Mercurio* that the monetary squeeze "is the only medicine. Absolutely. There is no other. There is no other long-term solution." "My only concern," he said later (*Business Week,* January 12, 1976), "is that they push it long enough and hard enough."

De que mal morira? (What will he die of?)

Chile's depression has been so severe that without a sizable injection of credit from multilateral lending institutions, U.S. bilateral aid programs, and private commercial banks, the country would surely have defaulted on its large external debt, which now consumes one-third of the value of its exports. Between late 1973 and early 1976, lenders extended \$2 billion in lines of credit to the Pinochet regime. However, until 1976, private multinational banks, like the corporations, shied away from Chile.

Recent evidence suggests, however, that Chile's deflationary policies have finally elicited a positive

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response from the banks. While Chile obtained no Eurocurrency loans in 1974 or 1975, its publicized 1976 borrowing was roughly $180 million. According to CORFO, Chile received a total of $594.5 million in foreign credits in 1976. In early 1977, after a visit to West Germany by Central Bank President Alvaro Bardon, Chile received several new lines of credit from Deutsch Bank A.G. A consortium led by Citibank is also reportedly arranging a new $100 million Eurocurrency loan for CODELCO, the state copper firm.

The gradual reduction in the inflation rate, increasing creditworthiness, and allocation of resources to service the external debt, have been celebrated by the junta's economists, by Milton Friedman, and by the business press. This has been interpreted as a sure sign that government deficits and excessive monetary expansion were the source of the problem and that the "shock treatment" is having the desired effects. According to the junta's economists, 5 percent per month inflation will signal that the financial squeeze has run its course, competitive markets will reassert themselves, and a noninflationary expansion can proceed—all of which apparently vindicates the monetarist vision.

What deflation has brought

Monetarism as a body of theories and a guide to policy-making is open to substantial criticism. As James Tobin has pointed out, to show how "money matters" does not prove that "money alone matters." Or as Franco Modigliani puts it, a return to monetarism impels "turning back the clock forty years by discarding the basic message of the *General Theory*." The brave economist can even agree with Harry G. Johnson that price stability is simply less important than full employment and that some level of inflation may be the inevitable price of the latter. For these and other reasons, most countries long ago abandoned monetarism as a serious guide to policy-making.

However, for our present purposes, the most convincing criticism of monetarism has come not from the left, but from the right. Writing in the business magazine *Forbes* in November 1976, David Walsh and Lawrence Minard call the mechanistic identification of the expansion of the money supply with the occurrence of inflation "a little like saying that growing crops makes the sun shine." Monetarism ignores the social forces upon which the expansion or contraction of the money supply rests. It was not simply the profligacy of the German Treasury after World War I that led to hyperinflation, but the hefty tax the victorious Allies levied on Germany, which responded by printing money. In our own time, monetary theory can never explain the power of OPEC, to cite one example. The point, according to Walsh and Minard, is that "inflation is not—as [John] Maynard Keynes thought and Milton Friedman thinks—a simple matter with social *consequences*. It is an infinitely complicated business with social *causes*."

The causes of inflation when Allende was President of Chile are well-known. Under Allende, rising real wages, the foreign exchange crisis (due to low copper earnings and the inability to obtain foreign credits) and the conservative backlash (refusing to invest, black market operations, hoarding consumer goods) severely taxed the production system and inflation resulted. Only after the junta seized unlimited power was it possible to reverse economic policy and pursue a total deflation. The point is that in either case, monetary policy is the *dependent* variable—dependent on the goals of those in power and the balance of social forces they represent. The junta and those who support it have simply decided that the lower classes should bear the entire burden of restoring the capitalist economy which the UP government had tried to replace.

Inflation in Chile has subsided slightly only at the price of a staggering depression, which shows no sign of abating in the near future. Inflation has subsided because government spending, on which the welfare of a large part of the population depends, has been cut to the bone. In turn, this has resulted in a severe contraction in the level of aggregate demand, caused a tenfold increase in the level of unemployment and underemployment, and forced many firms into bankruptcy. Though the government has attempted to paint a brighter employment picture in recent months (Santiago's labor force "decreased" by 42,000 during the second half of 1976), the situation in some major industries appears to be worse than ever. The government's National Institute of Statistics reports that 42 percent of the country's construction workers are currently unemployed.

While the monetarists no doubt see the spread of bankruptcies and the rise in unemployment as inevitable by-products of market place competition, the

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subsequent political reaction has been disastrous. Pablo Barona, current Minister of Economy, admits that "more than 90 percent of the people are against our policies" (*New York Times*, December 8, 1976). What the monetarists fail to understand is that Chilean entrepreneurs and the middle class supported the 1973 coup because Allende threatened the social system under which the local elites and the multinationals prospered. Now, with large local firms like Ambrosoli, the confectionary, and SODIMAC, the country's thirty-fourth largest firm, going bankrupt, many who supported the coup seem to be asking, "Whom was the coup for—the monetarists and the multinationals, or us?" The increasing disenchantment of the middle class and small businessmen with the Chicago shock treatment is a big reason why the government has recently cracked down hard on the centrist Christian Democratic Party, which was outlawed in March 1977, after previously having been declared "in recess."

Not only can the anti-inflation policy be criticized as harmful to the interests of the vast majority of the population, but its underlying rationale, the superior efficiency of an unfettered market system (according to traditional criteria with no imperfections) does little for an underdeveloped country like Chile. In this connection, the drive to increase nontraditional agricultural exports in order to reduce Chile's dependence on copper is illustrative. For many years, the government controlled the prices of foodstuffs like black beans, and prohibited exports. The aim was to insure the availability of these staples for local consumption, but in conventional terms this was surely inefficient. Now that the junta has abandoned price controls and other "stifling restrictions," black beans and other foodstuffs are exported at higher prices than the local population can afford to pay. In 1974, the value of such exports nearly tripled over the 1972-73 average and doubled again during 1975. (The drive to increase agricultural exports and the reduction in food imports are chiefly responsible for the government's current account surplus in 1976 and its ability to retire some of Chile's huge foreign debt.)

In some ways, turning toward the export market makes agriculture more efficient, eases the balance of payments crisis, and strengthens the currency, but it also means that the local population will eat less. In 1969, according to a study sponsored by the Catholic Church in Chile, a worker making the legal minimum wage could purchase a "people's basket" of basic food items with a little more than half his income. Today, spending his entire income, he receives only 80 percent of the items. According to the *New York Times* (December 8, 1976), the same study found that nearly 12,000 children out of a sample of 19,000 were chronically undernourished. The problem of malnutrition in Chile is so grave that, as one worker in a church "popular canteen" (the basic source of food for the poor and unemployed) puts it, "the only thing we can hope for now is to keep the worst cases from starving to death."

Theory and reality

Moreover, it seems highly unlikely that Chile's present laissez-faire policies will generate anything beyond the uneven, dependent development that similar policies have produced in the past. Here the most fundamental flaw of orthodox economics as a basis for policy recommendations becomes obvious. The orthodox economists believe that relying predominantly on the market to allocate resources and reward factors leads to maximum individual and social welfare. While this might be true within the framework of its own narrow assumptions (numerous and independent buyers and sellers, perfect mobility of factors, etc.), such assumptions hardly correspond to Chile's reality. Despite Milton Friedman's protestations to the contrary (*Challenge*, March/April 1977), the world which Adam Smith so eloquently described two centuries ago no longer exists, least of all as regards underdeveloped countries like Chile.

As positivist economists, of course, the Chicago-trained group agrees with Friedman that a theory "cannot be tested by comparing its assumptions with reality." The task of positive economics, according to Friedman, "is to provide a system of generalizations that can be used to make correct predictions about the consequences of any change in circumstances." But the assumptions of orthodox theory are so divorced from the conditions of international oligopoly capitalism that this seriously impairs the ability of the monetarists to predict the results of their policy recommendations.

Chile's historical experience with laissez-faire in copper, its major industry, bears this out. Throughout the 1950s, the U.S. firms which dominated the industry pressured the Chilean government to reduce taxes and exchange controls in order to stimulate

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capital formation. Lower taxes and higher profits, they argued, would provide incentives for exploration and production, which would facilitate economic development. Because Chile's share of world exports had steadily declined, the country clearly needed new policies and the companies' arguments seemed convincing. Consequently, in 1955, Chile responded with the *Nuevo Trato*, which gave the companies most of what they wanted and created the "favorable business climate" they said was indispensable for Chile's development.

In his fine case study of Chile's copper industry (*Multinational Corporations and the Politics of Dependence: Copper in Chile,* Princeton, 1974), Theodore H. Moran demonstrates that the dismal experience of the *Nuevo Trato* resulted from the failure to understand the structural characteristics of the copper oligopoly and how this affected the predictive powers of the conventional theory of the firm. To be sure, as a result of the *Nuevo Trato,* the companies' profits rose. However, Moran demonstrates that what "would have been rational from the perspective of a single firm producing a single product in a single country under conditions of perfect competition" was not necessarily so for the integrated, multinational copper companies. Larger profits did not translate into increased production, a greater share of the world market, or added investments in Chile. Kennecott, for example, used its higher rate of return to finance construction of a $100 million refinery for Chilean copper in Maryland. According to Moran, "Chile wanted new capital for its development; instead it seemed to be exporting capital to finance the 'development' and diversification of the multinational corporation!"

Though the junta has decided to retain ownership of the copper mines nationalized under Allende, its increasing emphasis on primary commodity exports (in which Chile is said to have a relative advantage) suggests that the country will once again find itself financing the operations of multinational corporations and depending on the vagaries of world commodities markets for the bulk of its export earnings.

Speculation and investment

From the foregoing discussion, it appears that the impacts of the junta's economic policies have been thoroughly devastating, taxing everyone—capitalists, workers, those dependent on the public sector—and sparing no one. From this it would follow that, however harsh their policies may seem, the junta's economists are fulfilling an essentially technical function in Chile. To use Friedman's favorite analogy, they are like medical doctors treating a plague. They are rebuilding an economy plagued by inflation and socialism, not crudely defending the interests of the rich or propping up a dictatorship.

Yet such an interpretation is fundamentally mistaken. In addition to the top military officers, the Pinochet dictatorship has had its civilian beneficiaries. Chiefly, they are the biggest entrepreneurs and landlords, who had the most to lose from socialism and the most to gain from an unregulated system of private enterprise. From their perspective, the coup was the only alternative to socialism, and massive repression was the only way to insure that the socialist threat would never arise again. However, it is one thing to engineer a coup d'état to insure the survival of a given social system, and quite another to manage what Raul Prebisch has called a peripheral capitalist economy, using theories and policies which even the advanced countries discarded long ago.

The junta's policies remain clearly contradictory. Indicative of the chaos which it has brought to Chile is the unavoidable fact that the most lucrative activity in Chile since 1974 has been speculation. Why? The financial squeeze, we have seen, precipitated a severe contraction of demand and ultimately a major depression. Many local businesses were losing money hand over fist and needed ample credit just to remain solvent. With inflation still raging, and multilateral lending institutions like the International Monetary Fund pressing for still further deflation as a precondition for debt relief, something clearly had to be done to stimulate investment. Despite their preoccupation with inflation, the junta's economists could not remain indifferent to the problem.

They said that the solution was to create a capital market in Chile. Naturally, to do this, investors needed the freedom to seek the highest possible rates of return. Consequently, the government encouraged the formation of finance companies exempt from government regulation. Known in Chile as *financieras,* they are often centered around individual families or firms, and bear such names as the *Piranhas,* the *Crocodiles* and the *Sharks*. Firms and individuals with surplus funds to invest deposited them in the *financieras* and have received interest rates as high as 18 percent per month on their deposits, much more than

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the regulated banks offer and without effective reserve requirements. The *financieras,* in turn, lent these funds out at even higher rates to businesses struggling to stay solvent in Chile's depressed economy. With the rest of the deposits, the *financieras* bought up state enterprises in order to improve their respective groups' competitive positions vis-à-vis other financial groups. This not only fed the speculative fever but led to an even greater concentration of the country's wealth and power. (Because the *financieras* were, in effect, creating money, they also negated much of the effectiveness of the financial squeeze.)

The house of financial cards the *financieras* constructed came crashing down last January. It began when *La Familia,* a financial group based at the Catholic University of Chile, lent nearly half its total funds to one firm. When the firm went down the drain, so did *La Familia.* Another *financiera, Finregio,* defaulted when the local division of Citroen went bankrupt and could not fulfill its outstanding obligations to *Finregio.* Since many people lost their life savings, investors stormed the institutions' headquarters demanding repayment, which brought on a full-scale panic and paralyzed the country. This forced the government to clamp down on the *financieras'* activities and compensate some of the investors for their losses. One of the country's largest banks, *Banco de Osorno y La Unión,* has been placed in virtual receivership by the government and its president has been in prison for several months. Mounting evidence that insiders escaped with their savings before the *financieras* defaulted also explains why those executives who have not been arrested have fled the country.

The temptation is to blame Chile's financial crises on corruption and careless lending. But this interpretation confuses the results of the Chicago policies with their principal causes. The real reason for rampant speculation and related scandals is the severe depression resulting from the contraction of demand and the monetary squeeze. The accompanying foreclosure of investment opportunities made speculation inevitable. Because the consuming power of the vast majority of Chileans has been reduced and the barriers to imports have dropped, a downward spiral has begun which can only be reversed by rescinding the policies which set it in motion; this the junta and its economists are not likely to do. In the meantime, the *Latin America Economic Report* of January 14, 1977 succinctly states, "the government is caught in the contradictions of its laissez faire policies. If it maintains the fierce restrictions on credit through the official capital market, it risks new forms of illegal credit companies springing up or a massive flight of capital from the country. . . . *There is no way, under the rules it has laid down itself, to force capitalists to invest in the country*" (emphasis added).

Economic orthodoxy and political repression

Is there any logical justification for the continuing rigidity of the Chilean junta's economic policies? The government's reasoning is that a thorough deflation must precede a noninflationary expansion and, as Harberger puts it (*Wall Street Journal,* December 10, 1976), that "the restoration of political freedom is impossible without a restoration of economic health." This remark does not explicitly condone the repressive practices of the military dictatorship, but viewed in its proper context it nonetheless provides a subtle justification for the existence of the dictatorship. The implication is that once competitive markets are restored, the economy will move toward full employment, price stability, and self-sustained growth. As the population's faith in the government's policies increases, the need for repression will wane. Thus the political dictatorship, like the program of economic austerity, is a temporary affair, performing a painful but necessary function.

The recent history of the Third World contradicts both the economic predictions and the political implications. In 1974, Milton Friedman praised Brazil as the world's latest economic "miracle." Three years later, the Brazilian miracle has collapsed and, in April, the ruling military officers suspended the Congress just as easily as they had ten years earlier. The history of such economic "miracles" in the Third World is that they are usually short-lived and that the authoritarianism which generates the miracle remains long after the miracle has ended. Even if such a boom as Brazil enjoyed were possible in Chile, which is highly unlikely, there is no evidence that it would generate anything resembling full employment, price stability, relatively equitable income distribution, or indeed a return to political democracy.

Moreover, there seems to be a curious correlation between the spread of authoritarian regimes in the

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Third World and the development of favorable attitudes toward private enterprise and foreign investment. In August 1976, with 14 of the 19 Latin American nations (excluding the Caribbean) under repressive military regimes, *Business Week* proclaimed: "There is good news coming out of Latin America for hundreds of U.S. and other foreign companies with a stake in the vast region. . . . major countries are opening their doors wider to private enterprise. . . . Multinational executives who have been watching one Latin American country after another pull back from the radicalism of the early 1970s consider the region to be one of the world's major investment opportunities." Chile now offers foreign investors "tranquility and stability in all sectors of the labor force," amidst overall "conditions of social calm and peaceful coexistence . . . in contrast with the situation in many other parts of the world."

What the junta has done is to turn the clock of social change back fifty years. Though the Chicago-trained economists claim that prosperity and individual freedom are their ultimate goals, the reality is that this particular kind of freedom has required the destruction of the livelihoods of a sizable percentage of the population. Is it, therefore, surprising that such a regressive program requires large-scale political repression to succeed? "The economic plan has had to be enforced," Orlando Letelier wrote shortly before his death, "and in the Chilean context that could only be done by killing thousands, the establishment of concentration camps all over the country, the jailing of more than 100,000 people in three years and the prohibition of all political activities and forms of free expression."

"When the process of democratization develops unrestrictedly," Prebisch has written, "the upper strata turn in the last resort to force to overcome the distribution crisis." Three and one-half years of military dictatorship and Chicago economics have indeed solved the distribution crisis and restored the social peace and harmony which the Allende years did so much to disturb. Only it is a peace, as Chilean Cardinal Raul Silva Henríquez puts it, of the graveyard.

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