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EIR Feature

The fraud behind Chile's economic 'success story'

by Peter Rush and Dennis Small

For more than a decade, it has been commonplace to hear bankers, government officials, and journalists from around the world trumpet the wonders of Chile's "success story" in applying "free trade" economic policies. Especially in recent years, when Chile has boasted allegedly significant growth rates in its Gross Domestic Product (GDP), this chorus of praise for Chile's post-1973 economic "reforms" has become a roar. It is cited as vindication of free market principles, and as a proof that total liberalization of the economy is the way to economic growth and prosperity.

Today, as the nations of Ibero-America begin to rebel against the International Monetary Fund (IMF) and its liberal dictates, and as the newly freed nations of central and eastern Europe debate what course to chart for their economies, the promoters of the "Chile Model" have become shrill and insistent: "The policy has worked in Chile; your country must apply it, too."

Nothing could be further from the truth. Examination of the performance of the Chilean economy over the last 18 years, since Gen. Augusto Pinochet headed up a military coup in 1973 which turned over economic policy-making in that country to Wall Street's free market ideologues, reveals that the Chilean economy was first shattered by a decade of "shock therapy," under which employment tumbled, investment dried up, and living standards took a nose-dive. Only after several years was there a slow turnaround, and by 1990 the economy was more or less back to ground zero, barely at the per capita levels of output and income of 20 years earlier.

In fact, Chile's objective economic performance over the entire period, as we shall demonstrate, is fairly typical of the rest of Ibero-America: It is neither much better nor much worse. Like the rest of the continent, the majority of Chile's population today lives in abject poverty; its infrastructure is horribly deficient; it has a stunted manufacturing sector and a bloated, unproductive service sector; and, like most colonial economies, it continues to export mostly raw materials to

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You can't eat it, drive it, or wear it, let alone use it to enhance productivity, but the original Chicago Boy, Milton Friedman, seems entranced by a sheet of monetary instruments.

the nations of the North.

Throughout this period—and this is the *real* reason the bankers promote Chile as their "success story"—Chile's debt soared, and yet Chile faithfully paid every dollar owed in interest payments. In fact, Chile has paid more cumulative interest per capita in this decade, than any other nation of Ibero-America, with the exception of oil-rich Venezuela.

How did this bankers' "success story" come about?

The stage was set by the communist economic policies of President Salvador Allende (1970-73), which drove the country to the edge of the precipice. Then, with the 1973 Pinochet coup, and to Wall Street's delight, Chile became the first country in the world to adopt, whole-hog, the economic theories of Milton Friedman of the University of Chicago, the "Chicago School" of liberal economics. The top economic advisers to the Pinochet government were Americans seconded directly by Friedman, and came to be known around the world as the Chicago Boys. Under their tutelage, most of the "free trade" reforms now being pushed by the IMF, Jeffrey Sachs et al. around the world, were given their first trial run. These included: eliminating most tariffs and tariff barriers (permitting easy importing of low-priced items); letting the currency float; cutting spending for social welfare and infrastructure in order to balance the budget; privatizing hundreds of state enterprises; and privatizing the social welfare system itself. On the political front, trade unions and political parties were banned in order to impose "labor discipline," which in turn made it possible to sharply reduce real wages.

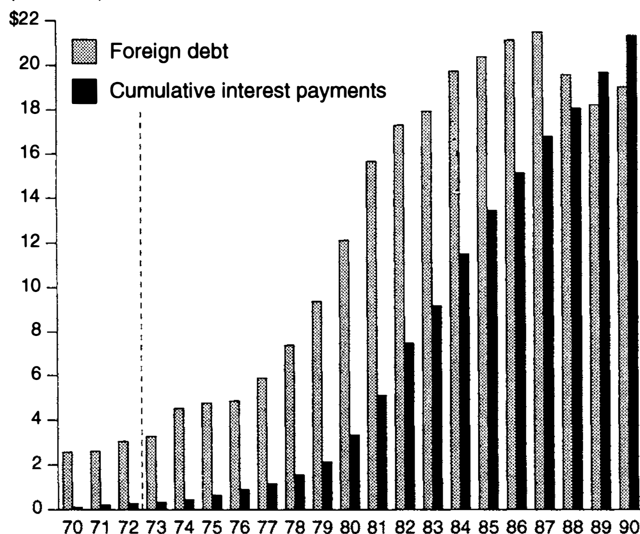
Chile, the bankers' favorite debtor

One of the lesser ironies of the Pinochet coup was the hypocrisy of the charge by Pinochet and his Wall Street sponsors that one of Allende's major failings was having run up a huge foreign debt. There are many things Allende can be blamed for, but this is not one of them.

As **Figure 1** shows, debt hardly rose at all under Allende's three years, and interest paid was almost negligible. Chile's foreign debt jumped significantly only in 1974, the first year after the coup. There it stayed for a couple of years, until it began rising at a phenomenal rate, doubling between 1977 and 1980, and tripling between 1977 and 1983, to $18 billion. It continued rising to nearly $22 billion by 1987. Although an early Brady Plan deal with the bankers lowered that amount back to under $19 billion in 1990, the country today is still running a close third behind Argentina and Venezuela in the level of foreign debt per capita of any major Ibero-American country.

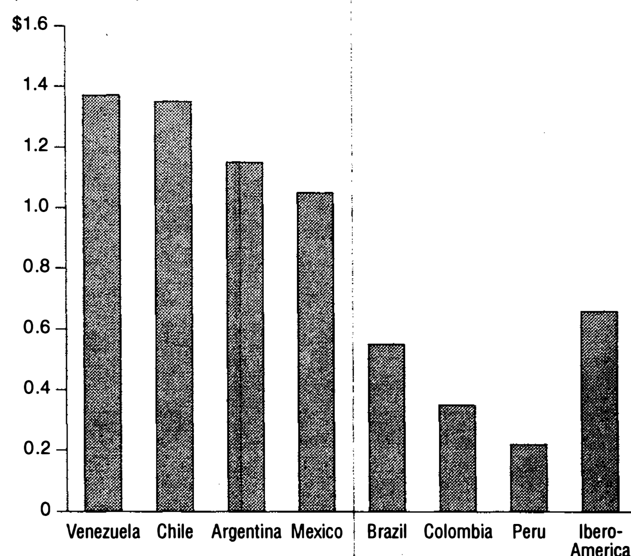
Through all of this, including the enormous run-up of interest rates from 1979 to 1981 brought about by U.S. Federal Reserve Chairman Paul Volcker, Chile faithfully managed to pay the interest on its debt. **Figure 2** shows that over the period from 1981-90, only Venezuela has had a marginally higher per capita level of cumulative interest payments. At $1,366, Chile's figure is almost double the average for all of Ibero-America at $711 per capita. In the early 1980s, Chile

FIGURE 1
Chile's foreign debt and cumulative interest payments
(billions $)



Source: World Bank.

FIGURE 2
Accumulated interest payments per capita in various Ibero-American countries, 1981-1990
(thousands $)



Sour e: World Bank.

paid its debt service the same way Brazil, Argentina, Mexico, etc. did—by borrowing new money. But while those countries were barred by the banks from more borrowing after 1982, Chile was viewed so kindly by the international banks that Chile alone was not frozen out of new borrowing. Through 1986, that nation was permitted to borrow much of what it required to keep current on interest payments.

Then, in 1988, a year before the announcement of the famous Brady Plan for debt reduction, "bankers' boy" Chile was permitted to renegotiate its debt, reschedule its maturities, and actually lower its total amount of debt by more than $3 billion, accounting for the decrease in net debt shown in Figure 1 for that year. Since 1989, the debt has begun rising again.

There are certain features about Chile's debt and interest paid profile over the past 20 years that are worth noting. The first is that, as of 1990, Chile had paid more in cumulative interest alone—$21.3 billion—than the entire value of its total outstanding debt, at $19.0 billion. In this, it is in good company with a number of other Ibero-American countries. However, unlike virtually all of the others, Chile has the distinction of never having been in arrears, of never having failed to pay its interest on time. It has been a consummate "good boy."

Second, note the enormous increase in debt between 1976 and 1982, a total of nearly $12 billion. This debt run-up was the direct product of the reforms of the Chicago Boys, since, with the freeing of the banking system and the end of government involvement in regulating currency exchange rates, the private banking system was free to, and did, contract this enormous new debt without regard for the economic or financial best interests of the nation. This debt run-up also accounts for the apparent recovery of the 1978-81 years.

Where did all this new debt go? The large-scale reduction or elimination of tariff barriers during this period permitted the relatively free import of everything that importers could find a market for, while exports—contrary to what was supposed to happen according to monetarist theory—did not rise appreciably. The result was an enormous trade deficit, which was financed precisely by the $12 billion that was borrowed. Moreover, the vast bulk of the imports were for consumer goods, not for capital goods. Total employment in Chile rose substantially, but not in the crucial manufacturing and agriculture sectors: Goods-producing activity continued to decline. The debt fed nothing but middle and upper class consumption, and the creation of service sector jobs that did not add to the national wealth.

In short, until 1981-82, the economy was "booming," based solely on a madcap credit binge made possible and encouraged by the "free market."

This pattern was unlike that in Brazil, Mexico, and many other countries which also ran up huge debts in the late 1970s and early 1980s. In these cases, apart from periods of organized flight capital such as late 1982 in Mexico, a large proportion of the debt acquired went for the purchase of capital goods. Mexico in 1982 was in the midst of a vast

expansion of its port, railroad, road, and industrial infrastructure. Brazil had embarked on the vast Carajas mining project, huge hydropower projects, and other such developments. But Chile under the Chicago Boys was merely consuming, not producing.

The bubble collapsed in 1982-83, when the pressure of the post-1979 huge increases in interest rates and oil prices was more than the weakness of the underlying economy could sustain. That weakness was centered on a gigantic growth of a speculative business and financial sector which had prospered by buying up former state sector companies for a song, asset-stripping them as rapidly as possible, and launching corporate raids on any remaining productive areas of the economy. So voracious were these early versions of Ivan Boesky and Michael Milken, that they were popularly known in Chile as "piranhas."

In January 1983, the piranhas went bust—and the Chilean government stepped in and picked up the tab. A few months earlier, when it was already clear that the bubble was going to burst, a number of the Chicago Boys took refuge in academic posts in Chilean universities. They left a new economics team behind to pick up the pieces, and to go back to the drawing boards to design a new austerity policy—which flattened the economy once again. Many of the free market reforms were revoked, some import controls were reinstituted, while average tariffs were raised 10-35%. These measures, and the cessation of new borrowing, slashed imports in half. The result was a modest trade surplus in 1983, and a slowly growing surplus since 1985.

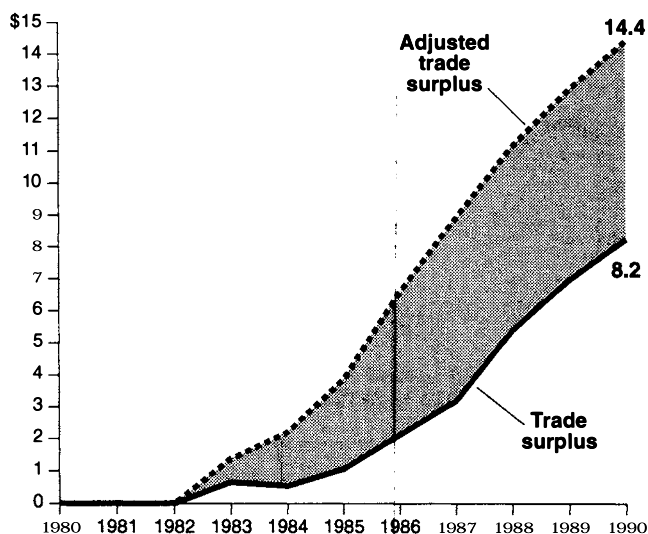
Trade surplus, on rotten terms

In investment terms, this net trade surplus represents a net outflow of physical resources. In modern history, every developing nation has remained a debtor nation, importing more than it exports, until it has achieved a significant level of development. This was historically true for the United States, Germany, and Japan as well. The net inflow of capital goods—not consumer goods—is required to achieve rapid enough growth to properly develop.

Since 1982, the entirety of Ibero-America has been forced into a sharp reversal of this pattern, exporting more, in many cases much more, than they were importing. Chile was no exception. This net export of physical wealth is nothing but looting, and Chile has been looted just like every other country in the continent. **Figure 3** shows the accumulated looting of Chile since 1982. As of 1990, it had exported a total of $8.2 billion more than it had imported in the same period.

The other component of the looting of Chile came about between 1982 and 1987 via the deterioration of its terms of trade. This means that the unit price of Chile's imports rose, while the unit price of its exports dropped. Specifically, the price for copper, Chile's major export, collapsed in the mid-1980s. The cumulative loss on terms of trade was $6.2 billion during this period, $5.3 billion of which occurred between 1982 and 1987. After this date the price of copper rose dramatically on world markets and began favoring Chile.

FIGURE 3
Accumulated physical loot, 1980-1990
(billions $)



Sources: Interamerican Development Bank, World Bank, and our calculations.

If we add this terms of trade factor to the nominal trade deficit, the total cumulative physical looting was of $14.4 billion as of 1990, and probably reached $16-17 billion by 1991.

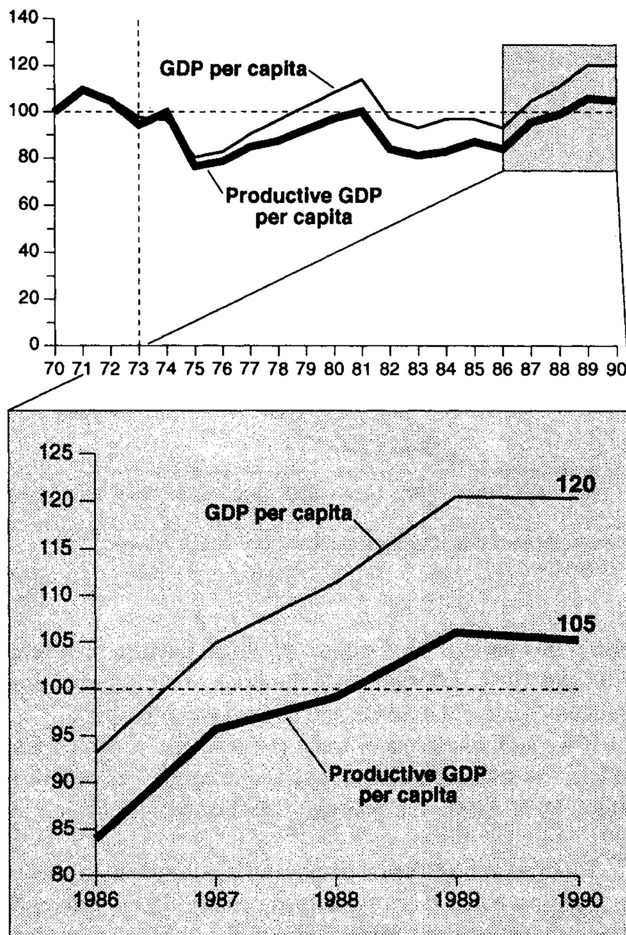
There is a third factor of physical looting which shows up in almost every Ibero-American country, but is strikingly absent in the case of Chile: capital flight. While the international banking elite in the early 1980s organized and encouraged nationals of Mexico, Venezuela, Argentina, and other countries to send vast amounts of money abroad into their banks in Miami, New York, Switzerland, and elsewhere, they did not do so in Chile. So, whereas Mexico under President José López Portillo, for example, was robbed of upwards of $20 billion which was maliciously stampeded out of the country in response to his nationalist economic policy, Chile was left relatively unscathed by its banker friends.

Stable as a corpse

The lower half of **Figure 4** is the sum and substance of the "Chile model success story": the appearance of robust economic growth from 1986-89, although 1990's lackluster performance has already taken some of the polish off the image. GDP per capita grew at 5-10% a year for these three years.

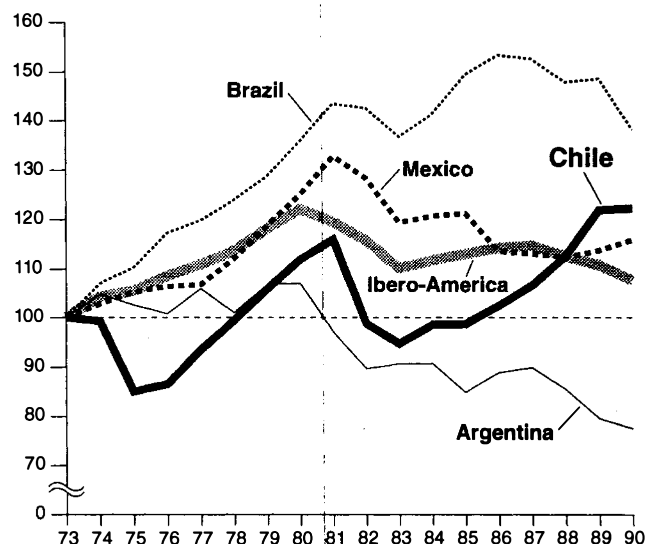
But what is missing in this rosy picture, is the context. The upper half of Figure 4 shows the same parameters going

FIGURE 4
GDP and productive GDP per capita, 1970-1990
(index 1970 = 100)



Sources: Interamercan Bank and our calculations.

FIGURE 5
GDP per capita in selected countries, 1973-1990
(index 1973 = 100)



Sources: Economic Commission for Latin America and Interamerican Development Bank.

back to 1970, revealing that the "recovery" of 1986-89 barely restored GDP per capita to levels previously reached in 1971 and then destroyed by a combination of Allende's policies and the Chicago Boys' free market lunacy. Productive GDP—the tangible physical output from farms, factories, mines, and the construction industry—fared worse, and has yet to recover to the levels of the early 1970s. So the only "success" in Chile is that of partially resuscitating the economic corpse which the Chicago Boys themselves created.

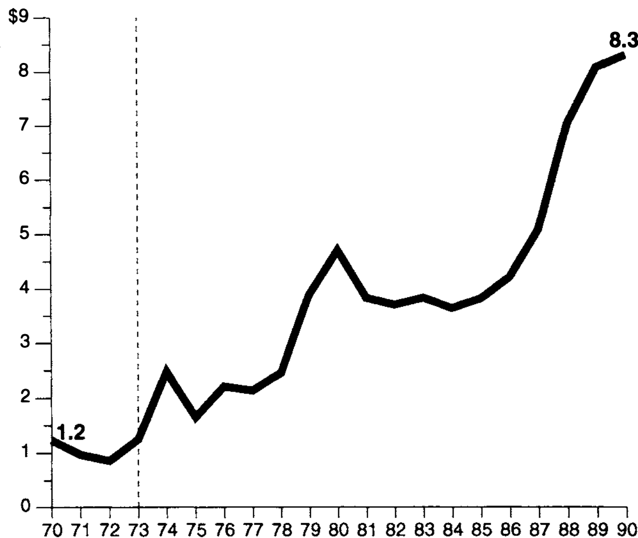
The pattern displayed is that of a roller-coaster. GDP per capita plunged 20% after the 1973 coup, rose gradually to a 1981 level above that of 1970-73 (based, as we have noted, purely on foreign borrowings for consumption imports), only to fall another 20% between 1981 and 1983. This time, the collapse was even more persistent than in 1973, and only began to improve again in 1987, based, as we shall see, largely on a sharp increase in international copper prices, and not on any economic policy success of the country.

The case is even worse if we look at productive GDP per capita, which refers to those sectors that are directly involved in physical goods production, and which is a better measure of the real health of an economy. The collapse in physical goods production per capita in 1983 was just as severe as in 1975, dropping to about 80% of its 1970-73 levels, and even in 1990 it was just barely above its level in 1970—total stagnation over two decades.

If we were to look at similar categories for Korea, Taiwan, Thailand, and Malaysia for the same time period, they would show a doubling, in many cases a tripling or more, of GDP per capita, and of productive GDP per capita. A model that takes 18 years to return to ground zero is hardly a model worth emulating.

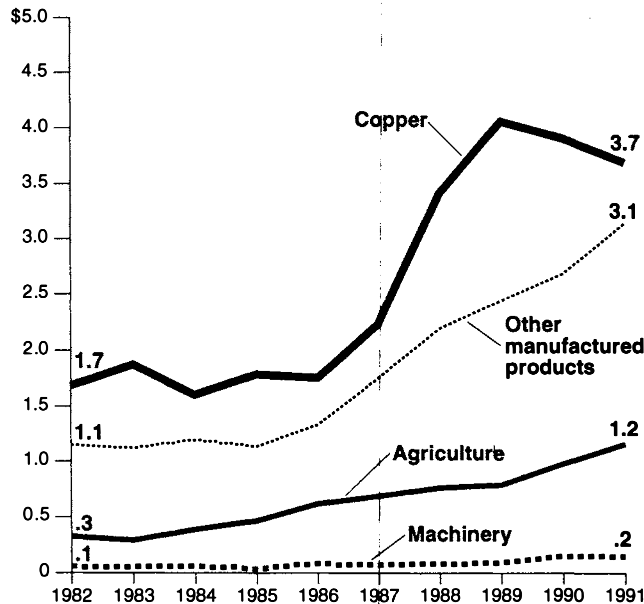
Nor is Chile's economic performance particularly impressive even by Ibero-American standards. **Figure 5** compares Chile, in relative terms, to three other major Ibero-American countries, and to the average for the continent as a whole. The most striking feature to be noted is that until 1988, Chile had the worst performance of any country but Argentina, a total economic basket case since the tenure of Finance Minister José Martínez de Hoz wrecked the place in the late 1970s, sending it into a tailspin from which it has not recovered to this day. Only in 1988 did Mexico's decline

FIGURE 6
Exports, 1970-1990
(billions $)



Source: Interamerican Development Bank.

FIGURE 7
Composition of exports, 1982-1991
(billions $)



Source: Economic Commission for Latin America.

under the government of Miguel de la Madrid intersect the belated upturn in the Chilean economy. And only in that year did Chile begin to show a greater increase in GDP per capita than the average for all of Ibero-America—and not by much. And it is still faring significantly worse than Brazil.

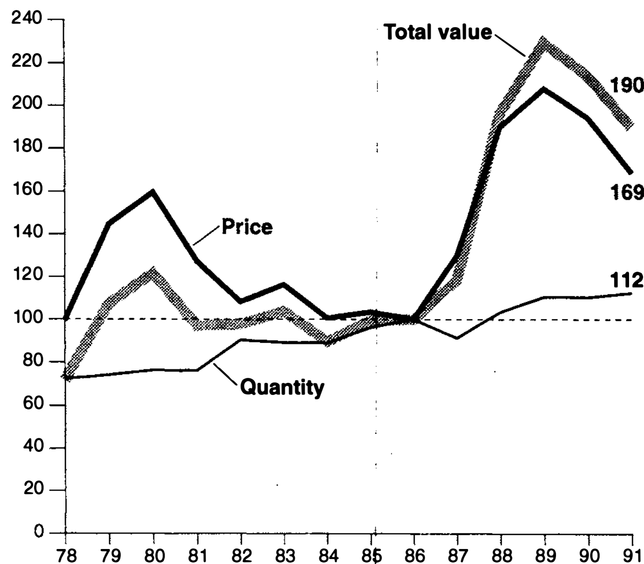
'Export-led recovery' based on copper

The doubling of the value of Chile's exports after 1984 is one of the central aspects of the late-1980s "recovery" (see **Figure 6.**) But was this due to the success of the government's free market economic program? **Figure 7** shows that, through 1990, fully 50% of Chile's export revenues came from copper, and that the majority of the increase in total exports after 1985 was due to this one commodity. Copper exports jumped more than 100% in total value between 1986 and 1989, exceeding $4 billion in 1989, a higher figure than the total of Chile's exports prior to 1979. **Figure 8** makes clear that this increase in export revenues had nothing to do with Chilean economic performance as such: It was due solely to an abnormal increase in the world price for copper, which rose more than 100% between 1986 and 1989.

In short, Chile experienced an enormous windfall between 1987 and 1991 in its export revenues, and hence in its foreign exchange. This windfall had much to do with the ability of the economy to continue to service its foreign debt and to post the modest rates of growth of GDP which began precisely in 1987.

Latest indications are that the economy stalled once again in 1991, posting, according to one preliminary estimate, only

FIGURE 8
Copper exports: value, price, and quantity, 1978-1991
(index 1986 = 100)

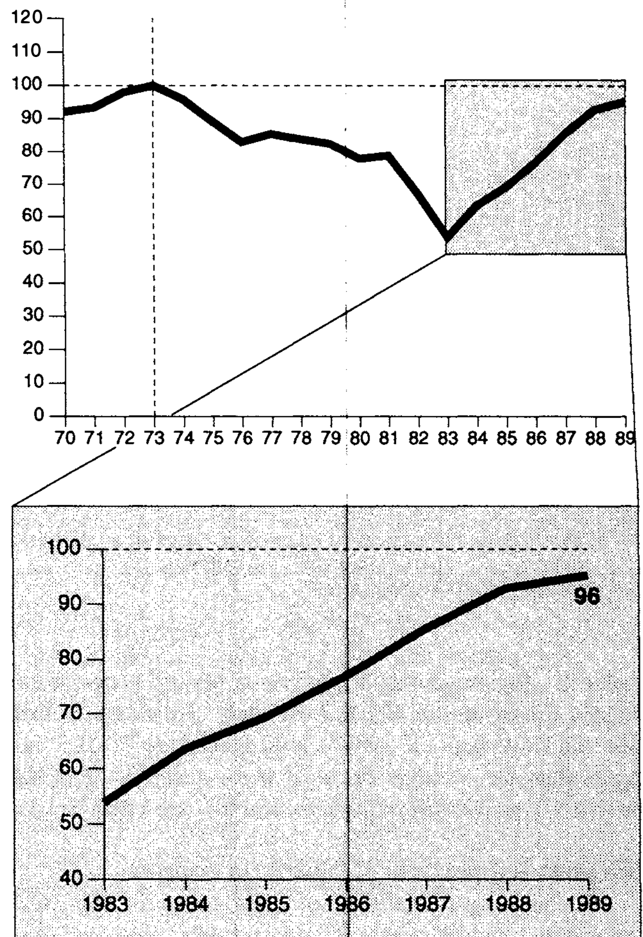


Sources: Economic Commission for Latin America and International Monetar Fund.

a 1% growth rate (which is a 1% per capita decline). At the same time, copper prices have dropped substantially, and copper has fallen to less than 40% of total export value. The economy is clearly quite sensitive to trade fluctuations—a not-unexpected result for a "free market" economy—making it hostage to the vagaries of the international trade picture which are beyond its control.

Returning to Figure 7, "other manufacturing" exports have also risen quite substantially, from under $1.2 billion in 1985 to over $3 billion in 1991. "Other manufacturing" refers to all manufactured exports other than machinery and equipment, which is graphed separately. Here again, it turns out, after 1986 there was a substantial price increase in many of the major components of this category as well, including wood, pulp and forest products, and other metal ores. Only the steady increase in agricultural exports represents actual growth in physical output, based on the decision made in the 1970s to invest heavily in exportable crops, especially in fruits.

FIGURE 9
Employment in manufacturing, 1970-1989
(index 1973 = 100)



Source: World Bank.

Manufacturing sector stagnates

The slower growth of productive GDP compared to total GDP, shown in Figure 4 above, reflects the slower growth of manufacturing and agricultural output, relative to the service sector. This pattern is hardly unique to Chile. Every nation of Ibero-America shows the same thing. It shows up most dramatically in the area of employment.

Judging from the lower half of **Figure 9,** one might be led to think that Chile has been creating jobs hand over fist—a frequent claim of the free market apologists. But again, this is only an illusion. The scale is an index based on 1973 = 100, by which measure manufacturing employment in 1989 still had not regained its level of 1973, and had just barely returned back to its 1970 level. The upper half of Figure 9 shows the full picture.

The data speak for themselves. They show that the Chicago Boys' 1977-81 economic "boom" was absolutely not based on manufacturing, in which sector there was a continual decline in employment even at the supposed height of the "boom," between 1979-81. And then, at the trough of the depression in 1983, manufacturing employment fell to barely more than 50% of its 1973 level. The steady increase since then represents a barebones recovery of former levels, not real growth.

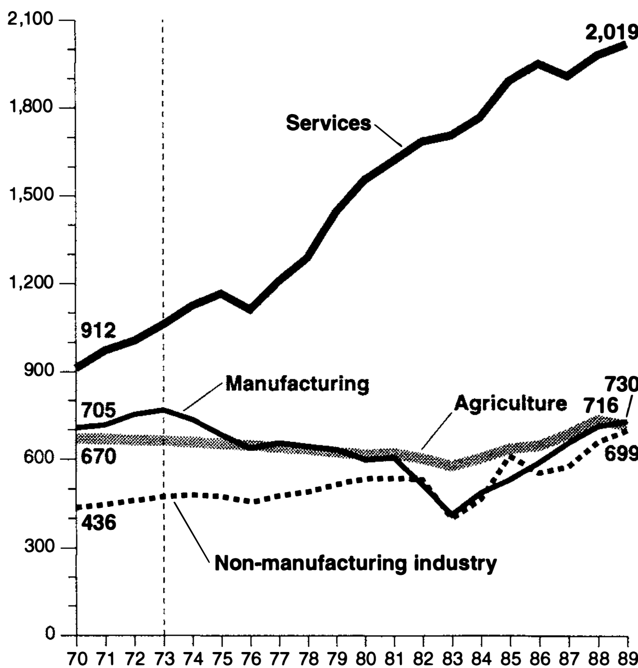
When this figure is converted into a per capita figure—that is, the number of manufacturing workers per inhabitant—the picture is far bleaker: The proportion of the population and of the work force engaged in manufacturing declines faster and further, and doesn't recover nearly as much. On an index of 1973 = 100, the index of manufacturing workers per capita in 1989 was only 74.

Figure 10 makes clear how disastrously Chile's employment profile has shifted. Virtually all growth in employment since 1973 has been in services. Agriculture employment has been almost flat, and manufacturing employment is still below its 1973 level, as we saw in Figure 9. Meanwhile, employment in services shot up from 900,000 in 1970 to over 2 million in 1989, and is still rising. Outside of services, only employment in non-manufacturing industries (mining, construction, and public utilities) has risen somewhat.

It should be pointed out that the service sector is properly dependent on the productive sectors, since only the latter create new wealth in the economy. Service sector growth unsustained by productive activity growth is pure economic rot.

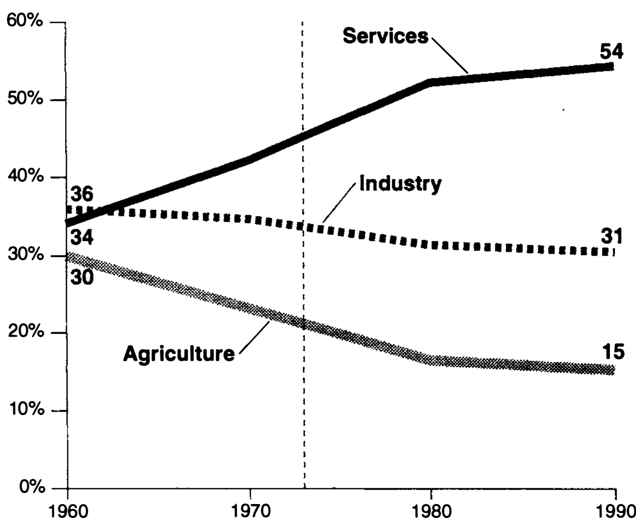
Figure 11 shows, in percentage terms, this same shift into an unhealthy services economy. Agricultural employment has shrunk from 30% to barely 15% of the labor force in 30 years, which in itself is a healthy sign of a modernizing agriculture. But the entirety of the workers so freed up—

FIGURE 10
Growth of employment, by sector, 1970-1989
(thousands of employees)



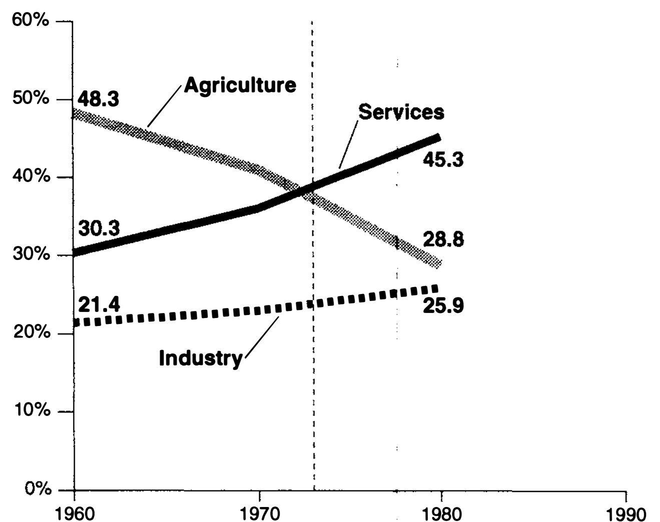
Sources: World Bank, Economic Commission for Latin America, and our calculations.

FIGURE 11
Chile: composition of labor force, 1960-1990
(percent of total)



Sources: World Bank and Economic Commission for Latin America.

FIGURE 12
Ibero-America: composition of labor force
(percent of total)



Sources: World Bank and Economic Commission for Latin America.

and then some—went into services, not industry. In fact, industrial employment itself shrank steadily as a percentage of the labor force during that period, a totally unhealthy progression.

The best one can say about this trend is that it is not much worse than that of the rest of Ibero-America (see **Figure 12**).

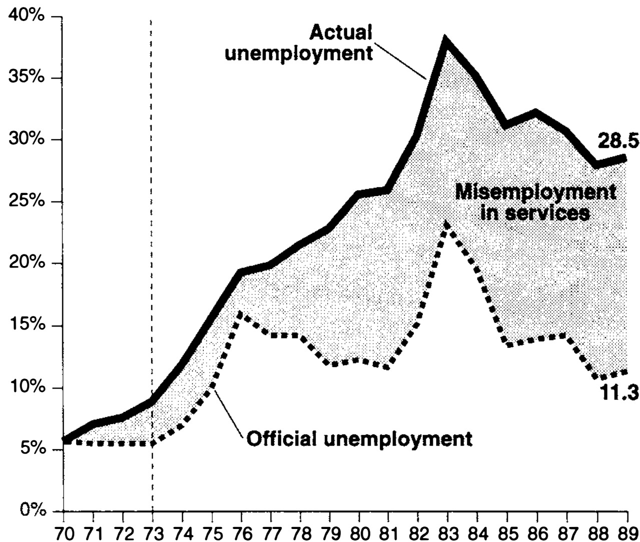
This is the lawful result of "free market" policies.

Official and actual unemployment

Figure 13 shows that official unemployment has been extraordinarily high for the entirety of the period since the 1973 coup. This fact alone ought to disqualify Chile as anyone's model for economic growth. The "shock" program of Friedman's boys more than tripled unemployment between 1973 and 1976, and even the phony "boom" through 1981 only lowered it to 12%. The 1983-induced depression pushed it up to an extraordinary 23% of the labor force, a full-scale depression level. Although it has come down by half since then, it was still at 11.3% in 1989. Later figures are not yet available, but it is unlikely to have dipped below 10% as of the end of 1991.

Besides official unemployment, Figure 13 also shows another category: "misemployment in services." This category, necessarily very rough, is an attempt to measure the spread of non-productive "employment" in services which is out of proportion to the increase of real wealth creation in the economy. If industry and agriculture are growing strongly, there is a sound economic basis for services to also grow. But when the productive sectors are stagnant, the ability to effectively employ more people in services is likewise

FIGURE 13
Actual unemployment, 1970-1989
(percent of total labor force)



Sources: Interamerican Development Bank, World Bank, Economic Commission for Latin America, and our calculations.

FIGURE 14
Average wage, 1970-1988
(index 1970 = 100)

Sources: Central Bank, National Institute of Statistics, and Corporation for Economic Research for Latin America.

stagnant. Nonetheless, a great many people manage to find "jobs" of one sort or another there. The greatest employer in this regard goes by the name of the "informal sector," and it includes everything from street peddlers and garbage pickers to drug traffickers. It is essentially disguised unemployment.

Figure 13 shows our best estimate of this category over the last two decades, and of the combined total true unemployment, which reached a peak of over 37% of the labor force in 1983, and was still at a staggering 28.5% in 1989.

Figure 14 shows starkly how the Chicago Boys supposedly solved the ecomomic problems of the Allende period: By 1975 they had slashed real wages down to 60% of their 1970 level. Although they crept up gradually after that low point, as of 1989 real wages had still not recovered their level of 20 years before.

Again, comparative figures for the Asian countries that have actually developed in the last 20 years show average increases in real wages that are steady, leaving the average wage earner in these countries vastly better off now than in 1970 or 1973.

Investment, the proof of the pudding

Many free market apologists justify this undeniable decline of real wages in Chile as a temporary, necessary evil. It was needed, they claim, to free up resources for investment. The apologists then cite some version of the lower half of **Figure 15** to prove that, from 1983 to 1990, gross domestic investment in Chile soared.

But it turns out, once again, that we are looking at only part of the picture. The full reality is that the last few years have at best been a recovery from the depths of depression, back to former levels of two decades earlier. This is not net growth. The upper part of Figure 15 shows the full picture. The toll of the 1974-76 and 1982-84 depressions on investment, measured per capita, was a decline of more than 50% in 1975 and a nearly 70% decline in 1983. In 1989 and 1990 it was barely above the level of 1970.

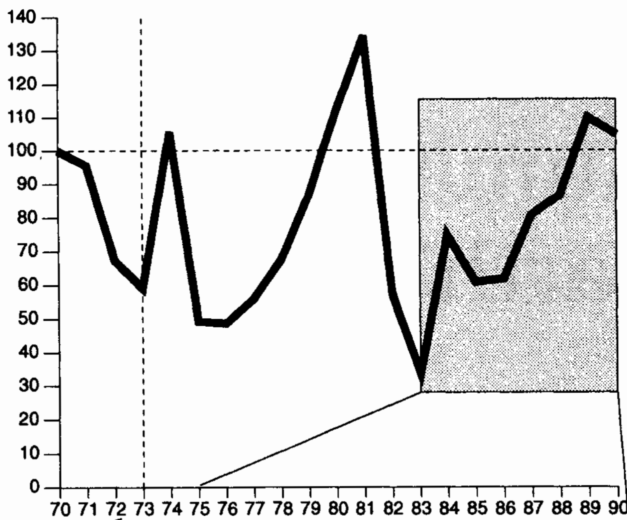
It should be noted that investment plummeted under the Chicago Boys not at the point of the 1973 coup, but more than a year later, as a direct result of their policies, which made credit prohibitively expensive and generally strangled economic activity. Then, investment rose along with GDP until 1981. However, the bulk of this investment was not in infrastructure or in manufacturing. Some was in mining, based on foreign investment, and a great portion of it was in services, including tourism. These latter categories are economically unproductive.

It should also be noted that "gross domestic investment" is a poor indicator of genuine investment, and is only used here for lack of better statistics which distinguish between productive and unproductive investments.

Poverty worse than in 1970

The net result of Chile's free market program, as of the most recent data on income distribution and poverty, has

FIGURE 15
Gross domestic investment per capita, 1970-1990
(index 1970 = 100)



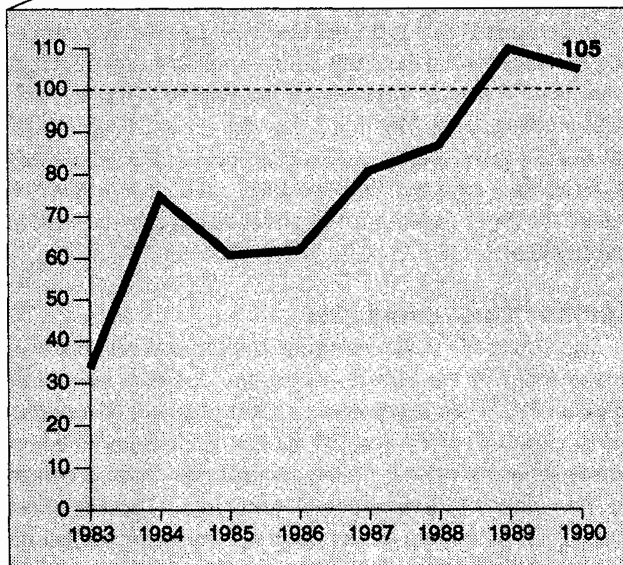
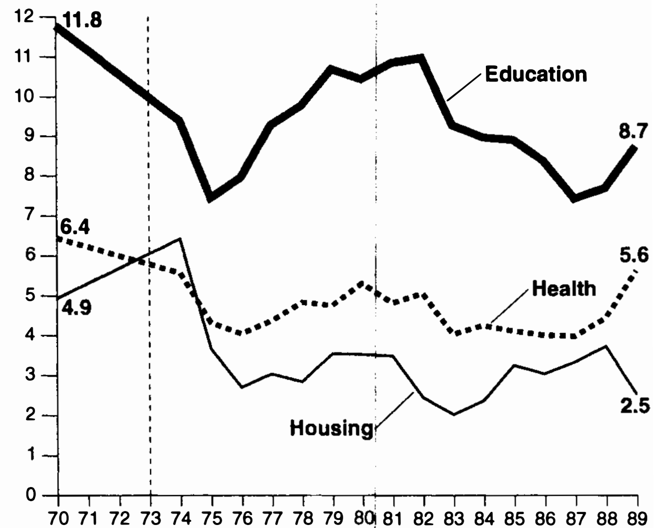


FIGURE 16
Government social expenditures, per capita, 1970-1989
(thousands of constant 1988 pesos)



Source: Interamerican Development Bank.

been a severe worsening of poverty as compared with 1970. This is hardly surprising, given the failure of real wages to recover former levels, and the erratic increases in (mainly unproductive) employment. That a financial and commercial upper stratum has grown in numbers and wealth is undeniable. But for the majority of the population, life is no better now than 20 years ago, and for a large number, it is measurably worse.

In a study published in 1990, the U.N.'s Economic Commission for Latin America and the Caribbean released the results of a 1987 study on poverty, and contrasted them with the results of a comparable study done in 1970. Entitled "An Estimation of the Magnitude of Poverty in Chile in 1987," the study is based on surveys carried out in 1970 and 1987, and shows that the percentage of people in poverty between those two years has increased from 20% to 44.4% of the total population, and the number of families in poverty from 17% to 38.1%. The percentage of people defined as indigent rose from 9.8% to 16.8%, and of families from 6.5% to 13.5%.

Translated into absolute numbers, in 1987 there were 5,493,000 people defined as poor, and of them, just over 2 million were defined as indigent—those whose incomes don't even cover the most essential nutritional needs of their family members. This, out of a population of under 12 million in 1987!

There may have been some improvement between 1987 and 1991, but there is little doubt that the situation today is considerably worse than it was 20 years ago.

The figures for per capita expenditures by government for social services indicate one of the reasons why poverty has gotten worse. Since 1970, expenditures have fallen, sharply for education and precipitously for housing, as shown in **Figure 16.** And there is a time-bomb hidden in this, given that the privatization of the social security system—which Wall Street is using as a model for the rest of Ibero-America today—is wiping out one of the last barriers against having its standard of living plummet to the levels of the poorest African countries.