# An obituary for London's 'Chilean economic miracle'

by Dennis Small and Cynthia Rush

Chile: Margaret Thatcher's dream economy. Newt Gingrich's answer to the Welfare State. London's pride and joy, its rejoinder to those who, in the wake of the December 1994 Mexico crash, are increasingly rejecting the International Monetary Fund's (IMF) free-trade economics as a failure.

You've probably read about the "Chilean success story" in your newspaper, or seen it reported on TV. But is the sales pitch true?

No. In the nearly 22 years since British free-market policies were imposed on Chile by quack economist Milton Friedman's "Chicago Boys," most aspects of Chile's *physical economy*—which should not be confused with misleading monetary parameters such as Gross National Product (GNP)—have actually *fallen* in per capita and per household terms. Yet during this period, the speculative bubble of foreign debt grew more than sixfold, while interest on that debt was religiously paid to the creditor banks and the IMF.

These policies brought the country to national bankruptcy in late 1982, but then were continued in a slightly modified form from 1983 until the present. By imposing a new package of drastic forced savings—including the groundbreaking "privatization" (i.e., seizure) of the national pension fund—the bankers managed to keep looting the economy in order to pay the foreign debt. In short, they kept their beloved Chile Model afloat . . . or so they have convinced themselves. But the fact is that this phase of looting is also rapidly coming up to the limits of what the physical economy can withstand.

For the international financial elite, Chile is thus an experiment, a test tube case which they think proves that a country can be looted to the point of breakdown, and then looted again. As the London *Economist* wrote in its June 3, 1995 issue: "For 25 years Chile has been a laboratory for radical political and economic experiments, a social-scientific guinea pig."

London has promoted the "neo-liberal" Chile Model for a long time. As the *Times* of London put it back in 1980, Chile "hopes to minimize the role of the state and realize a Friedmanite dream world, where society subscribes to individualist rather than collectivist principles." In the past six months, the promotional drumbeat has stepped up dramatically, as the financial elite scrambles to keep nations from jumping from the sinking ship of the IMF world monetary system. From Buenos Aires to Caracas, from Kiev to Moscow, from Lagos to Khartoum, governments and other political layers are being told: "Yes, neo-liberalism may have suffered a setback in Mexico, but you should try the Chile Model instead. Theirs is truly a success story." For example:

- In April 1995, the U.S. State Department's Agency for International Development co-sponsored a conference in Kiev, Ukraine, to convince that country's parliamentarians of the virtues of the Chilean Model. Chile, the pitch went, shows how to achieve a successful transition from Marxist collectivism to free-market capitalism.
- In May 1995, former Chilean Finance Minister Hernán Buchi was virtually parachuted into Monterrey, Mexico, in the middle of an anti-IMF revolt by the business sector of that major industrial city, in order to lobby on behalf of the Chile Model of privatizations and budget austerity. Mexico should sell off Pemex, its national oil company, Buchi demanded, on the bankers' behalf.
- Throughout this period, phony "Catholic" economist Michael Novak, who in reality subscribes to the evil gnostic doctrine of Adam Smith, has been beating the drums for Chilean-style free trade wherever people are foolish enough to listen to him.



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• Chile is being promoted as the next country to be added to the North American Free Trade Agreement among the United States, Mexico, and Canada. Formal negotiations to include Chile in NAFTA began on June 7, and are expected to be successfully concluded by the end of this year. Free-trade advocates such as U.S. Trade Representative Mickey Kantor can regularly be heard praising Chile in this regard.

## Pinochet and the 'Chicago Boys'

In September 1973, Gen. Augusto Pinochet led a military coup which overthrew the socialist government of Salvador Allende in Chile. Economically, the Allende government's policies were a chaotic disaster. Politically, the situation was even worse, with Allende handing the country over to Fidel Castro, who had camped out in person in Chile for months before the coup.

Pinochet and the ruling generals were thus prime candidates to be sold British "individualism" and free trade as a supposed alternative to Marxist "collectivism." And buy it they did—lock, stock, and barrel—from such London traveling salesmen as Henry Kissinger. Chile under Pinochet became the first country in the world to adopt the economic quackery of 1976 Nobel Economics Prize winner Milton Friedman of the University of Chicago. From the outset, all of Pinochet's key economic advisers were "Chicago Boys," seconded directly by Friedman.

They quickly transformed Chile into a free-market showcase. Over the next decade, tariffs were slashed; the currency was left to float; most of the large state sector was privatized for a song; government spending, especially on social welfare items, plummeted; wages and employment went into free fall. And a speculative financial bubble of impressive proportions was fostered.

But these first ten years of the Chile Model are not what London is referring to in its current promotional campaign. In late 1982, the Chilean financial system went bankrupt, in a process which is strikingly reminiscent of what occurred in Mexico last December (see box, p. 19). But as the London *Economist* was quick to reassure its readers, "the 1982 crash did not, however, provoke any fundamental shift away from the basic aims of trade liberalization and a shrinking state sector." Instead, Chile slightly retreaded the same neo-liberal policies, got monetary inflation under control, and established a new, more "stable" basis for continued debt looting. This is what the bankers are so anxiously promoting at this time. They want Mexico today—and the string of other national bankruptcies that they fully expect to follow in Mexico's footsteps shortly—to do as Chile did in 1982-83. This is one way they hope to handle the expected upcoming crash of the world derivatives bubble.

As the June 6 *Washington Post* explained the matter, what Chile shows is that the "fallen can rise again. . . . After the country's spectacular economic collapse in 1982 . . . [Chile is] now a model for Mexico."

## Recovery or death rattle?

How did Chile supposedly return from the dead?

"The country was rescued," the *Post* argues, "by its internal savings, which were accomplished through tax measures; through the success of Chile's private pension plans; and by cutting back on spending."

These savings, according to Chile's apologists, were then reinvested to develop the domestic econonmy. A figure that is often cited is that Chile has achieved a national savings rate of close to 25% of GNP, as compared to 15-20% for other Ibero-American countries. The apologists are usually quick to admit that, as a result of such forced savings, the population's consumption and general welfare have suffered. More than one-third of the population, for example, lives below the poverty line, according to official statistics. But, they sagely explain, this is merely an unfortunate side-effect of an otherwise successful free-market strategy, a shortcoming which will be corrected over time by the economic boom now under way.

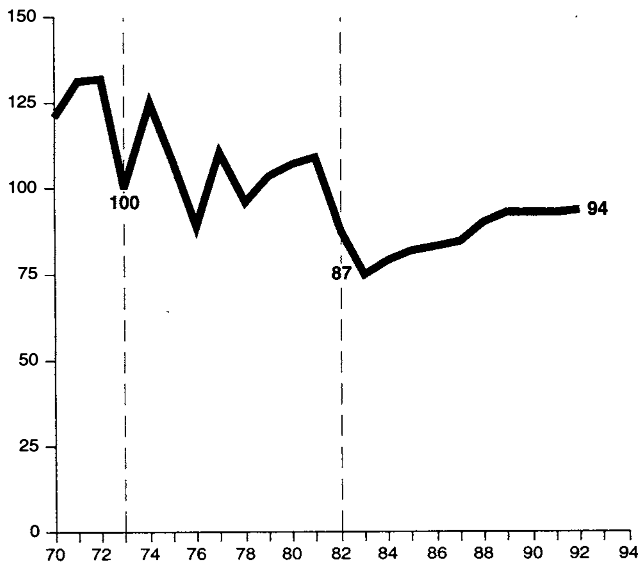
This is a Big Lie. Chile has, in fact, achieved relatively high so-called savings rates, in large measure through the privatization of its pension funds, as we explain below. But the question is: Was that wealth channeled into the productive economy? Or was it siphoned off instead as an income stream which was used to keep the speculative foreign debt bubble intact and growing? If it went to the productive economy, as the apologists claim, then that ought to show up in a significant growth of the country's physical economic parameters over the past 20 years. But if it went, rather, to feed the debt cancer, the physical economy will have stagnated and collapsed.

To get to the heart of the matter, *EIR* took a fresh look at Chile from the standpoint of the science of *physical economy* as developed by *EIR* founder Lyndon LaRouche. We studied the performance of Chile's physical economy over the past two decades, as measured in per-capita, per-household, and per-square-kilometer *physical units* (tons, megawatt-hours, and so forth). We compared this to the performance of other Ibero-American physical economies during this same time period. And we then looked at Chile's physical economic trends in juxtaposition to the growth of the country's foreign debt bubble over the past 20 years.

The results blow apart every myth that the British have propagated about Chile.

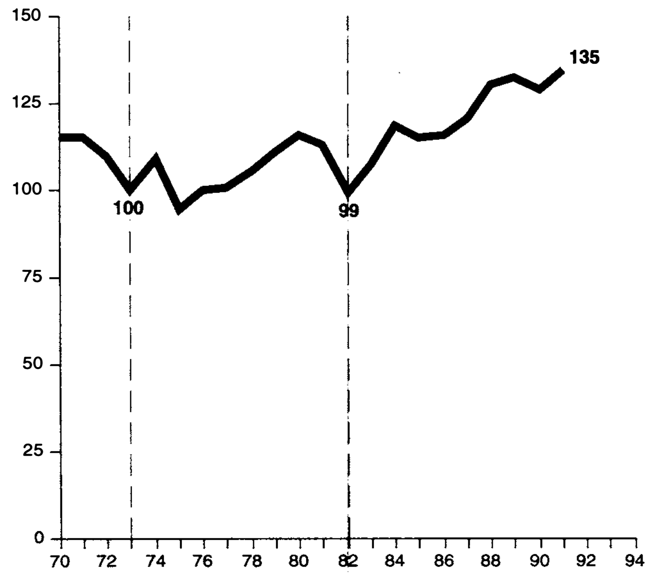
**Figure 1** looks at the production of a market basket of basic consumer goods in Chile, as measured principally in per-capita terms. Note that this is *not* an index of consumption—that would have to take imports and exports into consideration as well—but rather of the Chilean economy's ability to produce its own consumer goods. Although the items included in the index (grain, meat, milk, pulses, fruits and vegetables, autos, and television sets) are by no means comprehensive, and will be expanded for future studies, they are nonetheless sufficient to indicate the trend and the magnitude

FIGURE 1
**Chile's production of consumer goods**
(index 1973=100)




Sources: ECLA, Central Bank of Chile.

FIGURE 2
**Production of producer goods**
(index 1973=100)




Sources: ECLA, Central Bank of Chile.

of changes involved overall.

As the figure shows, Chile's production of consumer goods was already skidding downhill under Allende from 1970-73, and then it plummeted another 13% (from an index of 100 to 87) in the first nine years of the "Chicago Boys" reign. Although there has been a marginal recovery since 1982, the level in 1992 was still 6% below what it was in 1973. In other words, Chile's physical economy is even *less* capable today of producing its own population's consumption needs, than it was when the "Chicago Boys" took over 22 years ago. Within this category, the production of food items performed relatively better than that of manufactured consumer goods.

**Figure 2** shows an index of per-household production of a market basket of nine producer goods, which fared only marginally better than the consumer goods. After a decade of stagnation, the index rose to a level of merely 135 in 1991 (more recent data were not available for most categories). If we look back over the period since 1973, this averages out to a growth rate of less than 1.7% per year. Although this is certainly better than a decline, such a growth rate is pathetic when compared to actually successful cases of economic development, such as South Korea or Japan, which often display real growth rates of upwards of 10% per year in such categories.

It should further be noted that the category of producer goods includes both manufactured items as well as mining output and other raw materials production. When you look at the fine print, it turns out that the manufacturing component grew far more slowly than the average; in other words, most of Chile's post-1982 growth in producer goods comes from raw materials such as copper. Copper output per household grew by 79% between 1973 and 1993, which comes out to an average annual rate of 3%, nearly twice as fast as the producer goods category as a whole. The production of copper, like that of other raw materials, was geared for export rather than domestic consumption. We will discuss this pattern in more detail below, but what it points to is the fact that the few areas in which Chile's physical economy *has* grown over the last 20 years, are principally those that benefit exportation in order to service the foreign debt, and not the kind of industrial production that develops the internal economy.

**Figure 3** shows the behavior of our index of production of infrastructural goods. This includes both "hard infrastructure" items, such as freight shipments by railroad and installed electrical capacity per household, as well as "soft infrastructure" indicators including the number of hospital beds and school enrollment figures per capita. It is here that we see the most far-reaching impact of Chile's Conservative Revolution-style cutbacks in government spending, since infrastructure tends to depend more heavily on the direct role of the State than either the producer or consumer goods categories. As the graph shows, infrastructure was devastated in the first decade of "Chicago Boys" wrecking, and it continued to decay in the second decade. Over the 20-year period, Chile lost more than a quarter of its infrastructure capability.

## A tale of two meltdowns

### Chile

**1973-82**

*Foreign debt:* grew by 500%.

*Domestic debt:* A gigantic, unpayable bubble of corporate debt was created, as companies were asset-stripped by financial groups known as the *pirañas.* The most famous of these was the BHC group.

*Physical economy:* drop in the indices of production of consumer goods (13%), producer goods (1%), and infrastructure (22%).

*Privatizations:* Most state sector companies were sold off at very low prices, some at one-eighth of their actual worth. As part of the first big "shock therapy" of 1975, 25% of public sector workers were fired.

*Currency:* By the end of this period, the peso was frozen at the relatively "overvalued" rate of 29 to the dollar.

*Inflation:* lowered to 10% per year by 1980.

**1982-83**

The crisis began to hit in mid-1982. Falling international copper prices and unpayable domestic debt were taking their toll. The government announced the first of a series of devaluations that continued over the next few months. Most Chilean companies holding dollar-denominated debt couldn't keep up with their payments, so Finance Minister Luders offered a quarter of the state budget ($1.4 billion) to subsidize the difference in their loan-repayment costs.

As Chile lost $1 billion out of its $3 billion in foreign exchange reserves, the government on Sept. 30, 1982 announced exchange controls and a postponement of foreign debt principal repayments. It simultaneously asked the International Monetary Fund for an emergency $900 million loan.

Industrial production plummeted by nearly 20% in a matter of months. As the banks pressed their clients to repay unpayable loans, record numbers of them (almost 800) declared bankruptcy. By November, it became clear that almost all the banks held uncollectable debts worth far more than their capital and reserves.

On Jan. 11, 1983 one of the large companies of the BHC group defaulted on a $2 million debt payment. As rumors spread, Luders declared a bank holiday on Jan. 14 and announced the liquidation of three BHC banks and finance companies, and the government takeover of five others. On Jan. 19, a dozen companies belonging to the BHC and other *piraña* groups defaulted on another $1 billion in debts. By early February, the state had seized control of 86% of Chile's credit. The crash was on.

### Mexico

**1980-94**

*Real foreign debt:* grew by 400%.

*Domestic debt:* An un-supported domestic credit bubble grew up in tandem with the real foreign debt, as reflected in the absurd run-up of the Mexican stock market in the early 1990s.

*Physical economy:* drop in the indices of production of consumer goods (20%) and producer goods (27%).

*Privatizations:* Major chunks of the Mexican state sector were sold off, including steel and telephone, as well as the nationalized banking sector, for which the government was paid a mere $10 billion.

*Currency:* Predictable mini-devaluations were maintained for years; by 1994, the peso was being sustained at the relatively "overvalued" rate of 3.3 to the dollar.

*Inflation:* lowered to less than 10% per year by 1994.

**1994-95**

The crisis began to hit in early 1994. Mexico's joining the North American Free Trade Agreement (NAFTA) worsened an already serious problem of a large trade deficit, which was being covered by an influx of highly volatile international speculative capital. The predictable slide of the peso parity was facilitating massive illegal capital flight, which ended up totalling over $30 billion between 1993 and 1994.

Between March and April, domestic interest rates doubled from 8 to 16%. In a matter of months, growing numbers of farmers and other producers began to default on their debt payments, leading to high and rising non-performing debt ratios in the Mexican banking sector.

Mexico's foreign exchange reserves dropped from $29 billion in February to $12 billion in June. Then on Dec. 20, 1994, President Zedillo announced that the peso would float freely, and in the coming weeks it plummeted from 3.2 to less than 6 to the dollar. Reserves quickly dropped another $6 billion, despite the government's jacking up interest rates to over 50% in a desperate effort to hold foreign capital in the country.

Farmers and manufacturers are now filing for bankruptcy in record numbers. Over 2 million Mexicans have been laid off over the last six months. And the entire Mexican banking system is careening toward total insolvency. The government is trying to bail the banks out, and will shortly have spent more than the $10 billion that it earned by privatizing those banks in the first place, but to no avail. The crash is on.

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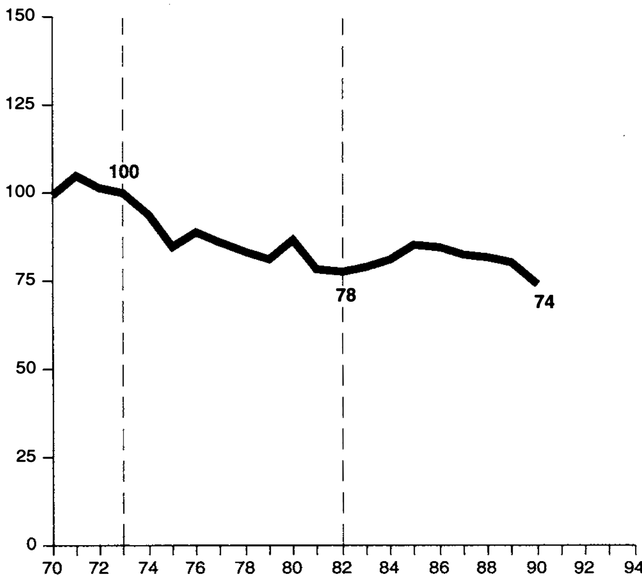
This is a physical economic catastrophe. Infrastructure development plays a crucial role in a viable economy by improving overall labor productivity. A 26% collapse of infrastructure thus implies dramatically decreased efficiency and rising social costs of production in all areas of the economy. This may not have fully expressed itself yet "downstream" in the actual production indices as such, but it will sooner or later, at which point a nonlinear collapse is to be

FIGURE 3
## Production of infrastructure
(index 1973=100)




Sources: ECLA, Central Bank of Chile.

expected across the board. This disinvestment in infrastructure—which is one of the hallmarks of neo-conservative insanity worldwide—is a time bomb waiting to explode.

## Chile and Ibero-America

It is also revealing to look at Chile's recent physical economic behavior in comparative terms. Besides the ups and (mainly) downs compared to where the country itself stood in 1973, how does Chile stack up in comparison to its neighbors? Is it doing better or worse? Does Mexico produce more grain per capita? Does Ibero-America as a whole produce more steel per household, or does it have greater electrical capacity?

Here too, the British Big Lie—that Chile is a powerhouse among its neighbors—comes crashing to the floor. In terms of per-capita production levels of both consumer and producer goods, Chile is in the middle of the pack in Ibero-America, and that is a state of economic collapse. In terms of relative growth rates since 1973, Chile did worse than the Ibero-American average, as **Table 1** indicates.

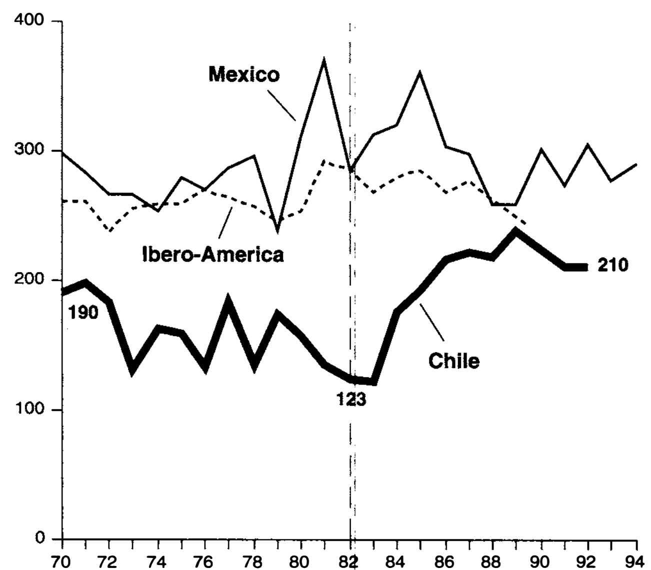
TABLE 1
## Indices of production
(1973=100)

| | 1973 | 1982 | 1992 |
|---|---|---|---|
| **Consumer goods** | | | |
| Chile | 100 | 87 | 94 |
| Mexico | 100 | 125 | 107 |
| Ibero-America | 100 | 102 | 94 (1990) |
| **Producer goods** | | | |
| Chile | 100 | 99 | 135 (1991) |
| Mexico | 100 | 109 | 79 |
| Ibero-America | 100 | 136 | 144 (1990) |

Where did this leave Chile in absolute terms, compared to its neighbors? Today, Chile is still below the continental average in a number of key parameters.

Take the case of per-capita grain production, the most important item in our consumer goods market basket (**Figure 4**). Chile may have taken a few steps out of the pit it was in in 1982, when it was producing a mere 123 kilograms per capita, but its current level of 210 kg per capita is still less than 75% of even Mexico's unimpressive 290 kg per capita. In comparison, Spain produced 495 kg per capita in 1990; the United States 1,181 kg per capita.

FIGURE 4
## Production of grain
(kilograms per capita)

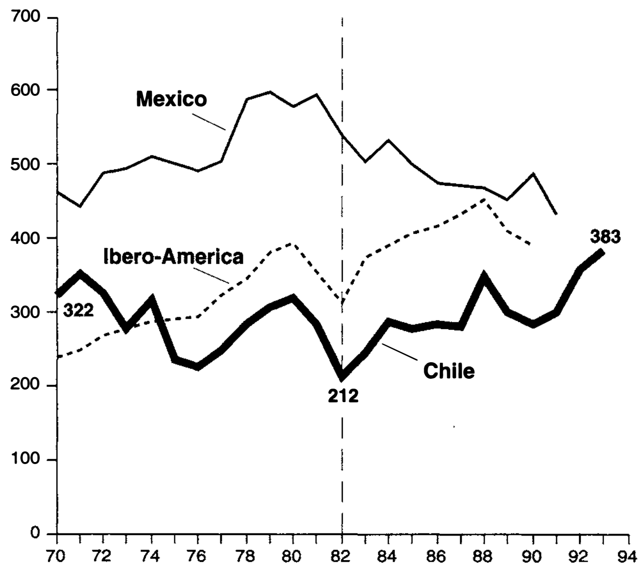



Sources: ECLA, Central Bank of Chile, INEGI (Mexico).

If we look to a critical producer goods item, steel production per household, we see a similar pattern (**Figure 5**). Chile's production rose slightly from the depths of 1982, but it is only now at about the average level for Ibero-America as a whole, which is still about 12% less than Mexico's per-capita production level. Again, compare Chile's 383 kg per capita to Spain's 1,406 kg in 1990, and the United States' 1,523 kg.

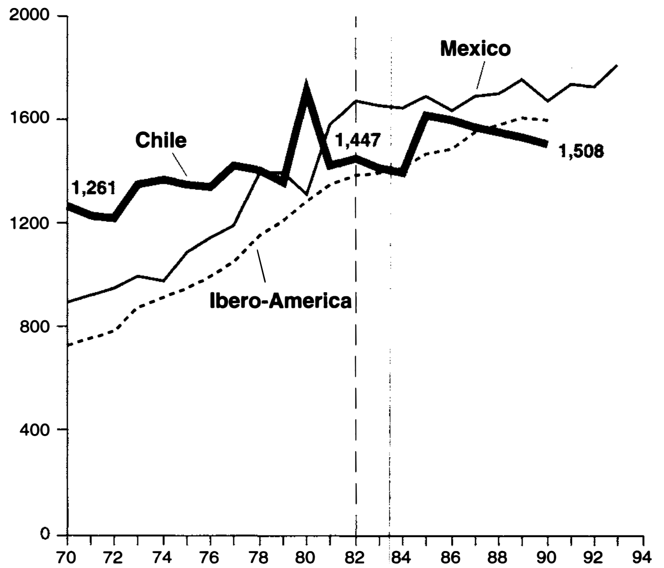
On the infrastructure front, installed capacity for electric-

FIGURE 5
**Production of steel**
(kilograms per household)




Sources: ECLA, Central Bank of Chile, INEGI (Mexico).

FIGURE 6
**Electricity: installed capacity**
(MW per household)




Sources: ECLA, Central Bank of Chile, INEGI (Mexico).

ity generation has been stagnant in Chile, while it was experiencing modest growth in Mexico and the rest of Ibero-America (**Figure 6**). As result, Chile's 1,508 megawatts per household in 1990 was well below Mexico's level and even below the average for the whole continent.

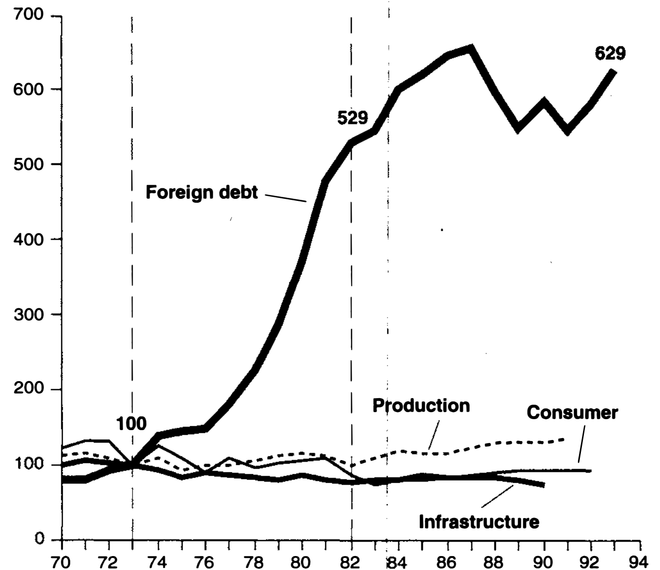
All in all, Chile is a far cry from being an "economic miracle" which stands head and shoulders above all Ibero-America, as the bankers' propaganda would have us believe—at least not if we are talking about the country's actual physical-economic performance. But perhaps that is not what they have in mind at all when they speak of Chile's spectacular "growth."

## The science of 'onconomy'

What the City of London and Wall Street are actually talking about, is the geometric growth of Chile's cancerous foreign debt, from 1973 to the present. For, while the country's physical economy was decaying for 20 years, a gigantic speculative foreign debt bubble was built up by the "Chicago Boys" and their international sponsors. From a mere $3 billion in 1973, it edged upwards for a few years, and then in 1977 it took off like a rocket. Within three years it had more than doubled, from $6 to $12 billion, and by 1982 it had gone past the $17 billion mark. As **Figure 7** shows, there has been a more than sixfold increase of Chile's foreign debt over the last two decades.

When cancerous financial processes dominate a country's physical economy in this fashion, one is tempted to call

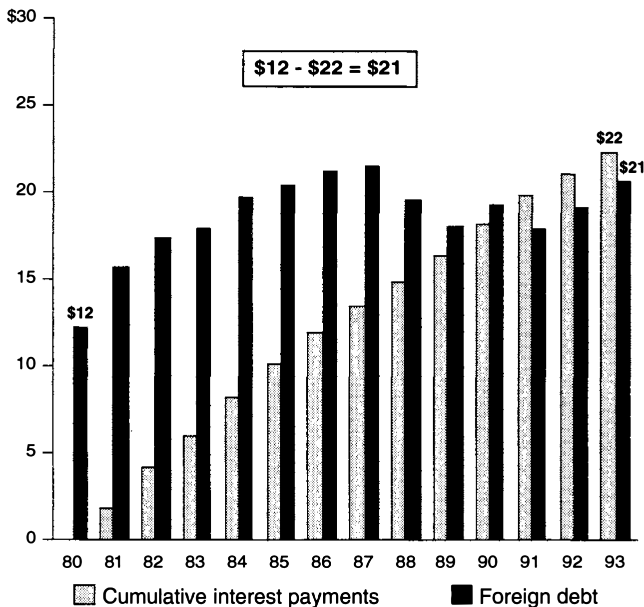
FIGURE 7
**Debt vs. physical economy**
(indices 1973=100)




Sources: World Bank, ECLA, Central Bank of Chile.

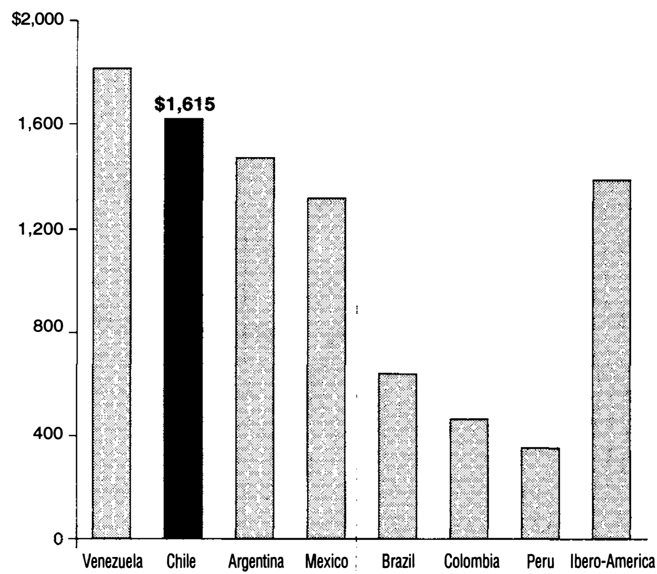
on the services of an oncologist, rather than an economist, to deal with the problem. Or perhaps it would be appropriate to establish a new discipline called "onconomy," whose as-

FIGURE 8
**Foreign debt and cumulative interest payments**
(billions $)




Source: World Bank.

FIGURE 9
**Cumulative interest payments, 1981-93**
(dollars per capita)




Source: World Bank.

signed task would be the treatment of cancer-like economic disease brought on by the grim application of the neo-liberal policies of the "Chicago Boys."

What any competent "onconomist" would detect, in examining the Chilean economy, is that the cancerous debt grew spectacularly, and was serviced abundantly over this period. As **Figure 8** shows, in 1980 the foreign debt was $12 billion, and over the next 13 years a total of $22 billion was paid by Chile as cumulative interest payments on that debt. Yet, despite the fact that nearly double the amount initially owed was paid over that period, by 1993 the foreign debt had *risen* from $12 billion to $21 billion. In other words, 12−21=22, it would appear. That is what "onconomists" call "bankers' arithmetic."

Such systematic servicing of its foreign debt at the expense of the physical economy, has actually placed Chile at the head of the pack of Ibero-American nations in its per-capita interest payments (see **Figure 9**), with a cumulative total of $1,615 paid between 1981 and 1993. Only oil-rich Venezuela has paid more than that, in relative terms.

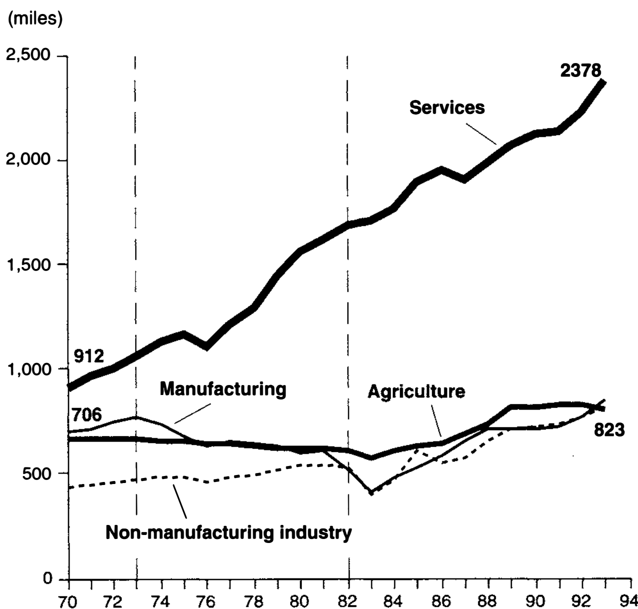
The way Chile was able to do this is that, especially from 1982 onwards, the entire economy was streamlined to drastically curtail domestic consumption, and instead channel an ever-larger share of national production into exports, in order to earn dollars with which to pay the debt. In the immediate aftermath of the 1982 crash, output shrank by 15%; unemployment went as high as 30%; the currency was drastically devalued, and so forth.

This national belt-tightening—which bankers euphemistically refer to as a "high savings rate," an achievement which they now propose to spread from Chile to the rest of Ibero-America and other debtor nations—was accomplished by sharp cutbacks in government spending (it fell from 33% to 23% of GNP from 1985 to 1989); by privatizing most state sector companies; by layoffs of workers, and major real wage reductions of those fortunate enough to hold on to a job; and, very significantly, by seizing the national pension fund worth about $22 billion, and putting it in the hands of 18 private investment companies, which have used it to prop up the debt bubble.

One of the results of streamlining the Chilean economy to meet the needs of the debt cancer, has been the stagnation of the workforce employed in manufacturing and other productive activities (see **Figure 10**). This evidence punctures yet another widely circulated myth about Chile's supposed employment boom: The only category of employment that has grown significantly in the last 20 years, has been that of the unproductive services sector, which rose 260% over that period, while employment in manufacturing is scarcely greater today than it was in 1973.

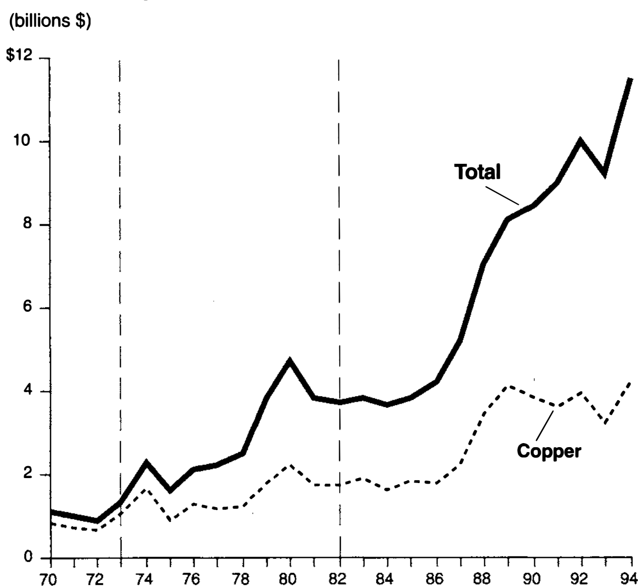
By applying such economic policies, Chile has managed to increase its exports at an exponential rate, especially since the 1982 reorganization of its economy (**Figure 11**). The lion's share of those exports has for decades come from copper exports, and that remains the case today. (Chile was also particularly lucky to have a relatively high and rising

FIGURE 10
**Employment by sector**
(miles)




Source: Central Bank of Chile.

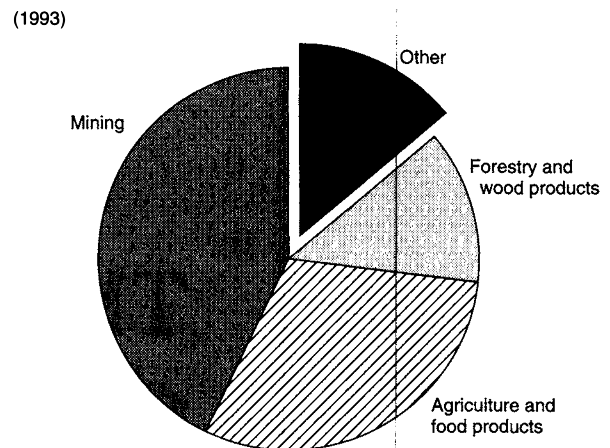
FIGURE 11
**Chile's exports**
(billions $)




Source: Central Bank of Chile.

international price for copper during most of this period.) The large majority of the remaining exports are also primary products from agriculture and forestry, and semi-finished products based on these items. As **Figure 12** indicates, in

FIGURE 12
**Chile's exports, by type**
(1993)




Source: Central Bank of Chile.

1993 only 86% of all of Chile's exports fell into these raw materials categories.

Over the 1990s, Chile's historic trade surplus began to fall, and then became a deficit in 1993, largely as a result of declining international prices for its exports (especially copper) and free trade liberalization of its imports. As Chile moves to joint NAFTA, its trade deficit will increase sharply, as occurred in the case of Mexico.

Chile has covered this gap so far, and the still larger current account deficit, by pulling in significant amounts of foreign investment over the last five years. But unlike Mexico or Argentina—as Chile's defenders are quick to point out—Chile has not succumbed to the quick fix of attracting volatile speculative capital. In fact, capital entering the country cannot be repatriated in less than a year; it is subject to a 30% reserve requirement, and portfolio investment is taxed at a 35% rate.

This has no doubt been relatively beneficial to the Chilean economy, compared to Mexico's lunacy, but such capital controls will be increasingly relaxed in Chile as well, beginning this year.

What foreign investment has come in has thus far gone into export-oriented sectors. And the prospects for 1995, the Bank of America has happily reported to its clients, are that "foreign direct investment in the mining sector will account for the bulk of the capital inflow."

Thus, Chile today maintains the classical colonial profile of being a raw materials exporter, to London and Wall Street's greater glory, while its own physical economy careens toward a breakdown.

That is the grim reality behind the so-called Chilean economic miracle.