

The Founding Fathers of Chile's Capitalist Revolution

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Over the past three decades, while the rest of Latin America has suffered widespread political and economic turbulence, Chile has become an example of stability and development. The so-called “Chilean model” is now cited as the paradigm toward which countries in the region should aim. However, Chile’s present state is the result of an amalgam of abrupt changes and more gradual transformations that have occurred since the 1970s. The Chilean model is all the more contentious because the cornerstone of Chile’s current success is the political and institutional framework established under the seventeen-year dictatorship of General Augusto Pinochet between 1974 and 1990. While the economic dimensions of Chile’s success have been widely reported on, Pinochet’s death in December 2006 revealed in sharp relief the contention that continues to surround his legacy in Chile and the world.

This article will explore the genesis of the Chilean economic model, suggesting that it constitutes the essence of Pinochet’s legacy—the institutional framework which, despite reforms, remains in force and the basis of Chilean democracy thanks to a consensus of ruling elites. In this sense, the “original sin of capitalist transformation”—the fact that it was imposed by force—was washed away in the 1990s when the country embarked on a transition to, and subsequent consolidation of, democracy, surmounting such difficult obstacles as demands for truth and justice vis-à-vis the human rights violations of the Pinochet regime.¹ Meanwhile, the market-economy model, first launched in April 1975 and consolidated in the 1980s, recovered anew after the Chilean economy plummeted in 1990. Yet the Chilean economy was still far from satisfying the expectations of the

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population, evidenced by President Patricio Aylwin's attempt to assume the "costs" of the model and the inequalities that it had generated. His challenge, "growth with equity," led him to introduce social programs that brought extreme poverty down by half but failed to do away with disenchantment.²

It was clear that the fledgling democracy remained afflicted by uncertainty. Nothing suggested the subsequent institutional and political stability. Yet the market-cooperative—and, hence, consensus-building—position, encouraged by a negotiated transition between the government and the opposition, allowed problems to be peacefully sorted out. In these initial years, the economic model Pinochet had implanted gradually attained social legitimacy. First, several important political agreements were reached. These, combined with efficient economic management and consistent receptiveness to social demands, created a consolidated polity.³ In fact, it was at this point that the Chilean experience was first considered as a "model" for the rest of Latin America, as it harmonized political and economic freedom simultaneously.⁴ As Joaquín Fernandois puts it, "Chile recovered thanks to a combination of search and serendipity, establishing a civilized equation between order and freedom, internalizing the hard and elusive art of self-discipline."⁵ This success has generated the idea that Chile experienced its best years of the 20th century during the 1990s.

The New Institutional Framework

The 1973 coup d'état should be understood as the breaking point in the recent historical development of Chilean society, particularly the period of upheaval between 1970 and 1990. Once in control of the country, several important questions confronted the government junta: What would be the purpose of their regime? Should they call for elections? Should they step down in favor of a more or less representative group of civilians? Perhaps the most pressing issue was how to reorganize the Chilean economy, which the regime of the Unidad Popular (UP) had destroyed. This situation in turn begged the question: What economic model should be implemented in this project of economic reconstruction? It is clear that the military government had neither a political nor economic program in mind when it came to power, and that the greatest decisions were made thereafter from proposals put forth by different sectors that empathized with the government—or, at any rate, supported political intervention by the military.

As for the political decisions to be made, some were in favor of a prompt return to the traditional Chilean democracy. Others saw Francisco Franco's

system in Spain as a model to imitate, with the military ruling the country for a long period and eventually establishing a corporatist political regime. The military and like-minded civilian groups, however, ultimately proposed profound reforms that would constitute the creation of a “new institutional framework.” This alternative, whose main proponent was Jaime Guzmán, culminated in a new constitution and ultimately a progressive transition to democracy.

TABLE 1: EVOLUTION OF THE MAIN ECONOMIC VARIABLES, 1970-1973 (PERCENTAGES)⁶

	1970	1971	1972	1973
Rate of economic growth (GDP)	3.6	8.0	-0.1	-4.3
Annual inflation rate (CPI)	36.1	22.1	260.5	605.1
Domestic unemployment rate	5.7	3.8	3.1	4.8
Real salaries annual growth	8.5	22.8	-11.3	-38.6

In economic matters the Chilean military, and the Latin American militaries more generally, inclined toward statism. However, Pinochet opted for a liberal development model advocated by a group of young economists graduated from prominent American universities, known collectively as the “Chicago Boys.” These young people had solid technical training that accounted for their coherent, homogeneous, and “apolitical” discourse. This last point is important, if one considers that the new government believed the politicization of society to be one of the causes of the crisis of democracy. The Chicago Boys were originally faculty members in economics at the Catholic University who had done postgraduate studies at the University of Chicago, where they developed a penchant for free-market economics. They offered an alternative model to the Import Substitution Industrialization (ISI) model of the Economic Commission for Latin America and the Caribbean (ECLAC), which was also far removed from Marxist Socialism. After years of influence limited to academic circles and the so-called Edwards Group of companies, which included the newspaper *El Mercurio*, the military government allowed them to have a direct influence on economic policy.⁷

Their proposal was summed up in *El Ladrillo*, written during the government of the UP by economists such as Emilio Sanfuentes, Pablo Baraona, Sergio de Castro, Sergio Undurraga, and Alvaro Bardón, among others. The publication is a fundamental text for understanding the economic reforms of the mid-1970s. Many of them later held important posts at the National Planning Office (ODEPLAN) led by Roberto Kelly and Miguel Kast, who boosted anew the sending of young people to Chicago. However, there were two central figures of the economic revolution who did not study at Chicago: Minister of Labour and Mining José Piñera—a Harvard University graduate; and Finance Minister Hernán Büchi, a civil engineer who gradu-

ated from the University of Chile and a former student of Columbia University. These were the actual “founding fathers” of the Chilean economic model. The second generational stream was that of *Gremialismo*, founded in 1966 by Jaime

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Guzmán, a traditionalist conservative who was a student and subsequently a professor on the Faculty of Law at the Catholic University. His philosophy was conditioned by the principle of subsidiarity and the Social-Christian doctrine and rejected the revolutionary spirit of the times. It was the Chicago Boys and the *Gremialistas*—united in their apoliticism from within the military

government—that were most vocal in their promotion of the bases of what they called a “free society” and of the way in which it was finally to be conceived through modernization and institutional transformation.

The Chilean Capitalist Revolution

Although Chilean democracy collapsed in September 1973, the Marxian statist approach to the economy remained unchanged for some time. Although the new government very quickly began to do away with price controls, dismantle regulations, reform the tax system, and return the nationalized companies to private hands, these measures did not constitute a coherent vision of the economic future of the country. Thus, to speak of the Chilean transition towards a market economy, it is necessary to turn to April 1975, when Finance Minister Jorge Cauas announced the “Plan for Economic Reconstruction.”

Initially, there were disagreements about which plan to adopt. The government had two alternatives to choose from: first, a cautious and gradual adjustment supported by growing international financial assistance; or, alternatively, a fiscal and monetary shock seeking the rapid recovery of balance-of-payments viability and the end of the upward spiral of inflation. Pinochet and his advisers opted for the latter and decided to undertake a radical transformation of the Chilean economy, giving it a liberal orientation. Several factors underpinned this choice: the failure of the preceding Socialist models; the formation of a working group that had a liberal slant; and the existence of a relatively elaborate plan, *El Ladrillo*. This decision was a historical milestone in the trajectory of Chile and Latin America, and marks the beginning of the Chilean capitalist revolution.

In the early stages, the Chicago Boys worked as advisers to the economic team. Given the crisis, there was a need for professionals—not to be found in

the Armed Forces—who were not politically “contaminated.” In addition to the need to persuade the polity, the new program also required training an entrepreneurial elite capable of redesigning the country. It was a revolutionary vision in the literal sense, which sought to topple the prevailing economic system and construct a new one. The young economists gained Pinochet’s confidence with their professional training and apoliticism, although they had to struggle against the military’s more nationalist economic vision, which averred that protectionist policies would better serve national security than a bet on free trade. Government control of so-called “strategic” economic activities also tended to extend to other activities in a natural way. Indeed, other military forces in Latin America were expanding their economic reach in precisely such a manner.

The Chicago Boys’ proposals were addressed to the whole of Chilean society and aimed to overcome the problems that had prolonged underdevelopment and created conditions of economic stagnation in the country. They embraced all areas of economic importance, seeking to dismantle the interventionist regime created by a redistributive state. Addressing these problems was not easy; there were some very complex stages, the most critical being the foreign debt crisis in 1982-1983. Moreover, their program generated conflicts within the government because of the misgivings of some sectors, namely, the Advisory Committee to the Government Junta, the National Intelligence Agency (DINA) and some groups of civilian supporters of the military regime known as the “*duros*” (hardliners). Yet the ideas of the Chicago Boys eventually gained favor with the dictatorship, due to their technical know-how underpinned by solid economic theory. Some external factors also came into play and tipped the balance in their favor: for example, the balance-of-payments crisis of 1975, which resulted from the hike in international oil prices of oil in 1973 and a drop in the price of commodities in 1974.

The main measures adopted were as follows: First, to encourage economic growth, the role of the state in the economy was drastically redefined through the elimination of price controls, reduction of fiscal spending and taxes, liberalization of markets, and privatization of most state enterprises along with part of the social security system, education, and health. Second, to increase trade, non-tariff barriers to imports were eliminated and tariffs were uniformly reduced. Third, a free capital market was created and measures were taken to liberalize foreign investment and establish an autonomous central bank. Fourth, in order to make labor markets more flexible, entry barriers were eliminated for most jobs, restrictions on dismissing employees were reduced, and governmental intervention in private sector negotiations was eliminated. Finally, the social network was strengthened so as to improve the

living conditions of the poor population, and protect them from the hardships of economic adjustment through several governmental programs targeted and conducted through ODEPLAN. These ideas, inspired by Friedrich von Hayek and Milton Friedman, were disseminated through *El Mercurio*, and the journals *Economía y Sociedad* and *Realidad y Estudios Públicos*, and they were openly promoted by renowned economists who visited the country, as well as by investors and officials of international bodies.

The outburst of optimism produced by the resulting economic boom and the ample diffusion of free market ideas caught the opposition groups off guard. For the first time left-wing intellectuals and politicians found themselves in a conservative position, defending the old order. In order to remain a politically viable alternative, many were forced to revise their positions, incorporating democracy and market solutions into their proposed programs.

The application of the economic reforms was carried out in two phases: 1974-1981 and 1985-1989. In the first phase, the efforts were directed at eliminating the deficit, which was achieved by reducing the size of the public sector and making it more efficient. As a result, companies expropriated under the UP were returned to their original owners and in addition, over 500 state-owned enterprises were privatized. Tax reform aimed at increasing fiscal revenue and expanding foreign trade contributed to a diversification that reduced the share of copper—traditionally Chile’s largest export commodity—in total exports.

TABLE 2: CHILEAN MACROECONOMIC INDICATORS, 1974-1981⁸

	1974	1975	1976	1977	1978	1979	1980	1981
GDP growth	1.0	-13.3	3.2	8.3	7.8	7.1	7.7	6.7
Unemployment rate (annual average) ⁹	n.a.	14.9	12.7	11.8	14.2	13.6	10.4	11.3
Gross Fixed Capital Formation (% GDP at current prices)	18.9	16.7	13.8	15.2	16.5	17.7	20.9	23.2
Gross Domestic Savings (% GDP at current prices)	n.a.	9.5	16.9	13.8	15.3	16.7	19.3	14.2
Deficit on Current Account (% GDP)	0.5	6.4	-1.4	3.9	6.8	5.6	7.1	14.5
Real Annual Growth of Salaries ¹⁰	2.3	-3.4	3.0	10.3	6.3	8.3	8.6	9.0
Real Exchange Rate (average 1986=100) ¹¹	n.a.	n.a.	n.a.	57.1	68.1	70.2	60.8	52.9
Inflation (CPI) (Dec.-Dec.) ¹²	369.2	343.3	197.9	84.2	37.2	38.9	31.2	9.5
Non-Financial Public Sector Surplus (% GDP)	-5.4	-2.0	4.0	0.4	1.6	4.8	6.1	0.8
Terms of Trade (1986=100) ¹³	225.9	121.4	132.6	122.3	120.9	134.7	132.7	122.3

The program began to show favorable results at the end of 1975, as inflation decreased and the balance of payments demonstrated improvement. Between

1976 and 1981, the economy underwent a healthy expansion led by exports, culminating in the investment and consumption booms of 1980-1981. In 1981, the GDP grew by 6.7 percent, exports by 10.7 percent, and the inflation rate came down to 9.5 percent from its 1974 level of 369.5 percent. Real salaries increased and the foreign debt decreased, although private indebtedness grew. Restrictions on the inflow of foreign loans were made more flexible, and the exchange rate was fixed at a parity of Ch\$39 to the US dollar. All of these measures translated into growth that attracted international attention.

Soon thereafter, a debt crisis was unleashed, and optimism came to an end. In 1981 the economy confronted a hike in international interest rates and a new drop in the terms of trade, causing it to plummet into depression. This crisis caused many to question the new model, so much so that opposition economists forecasted that there would be no quick recovery and that the root of the problem was an excessive liberalization of the economy. They went so far as to pronounce the liberal model "dead."

The situation did not begin to change until early 1985 with the appointment of Hernán Büchi as head of the new economic team. Büchi instilled new life into the market economy model. There was renewed growth in production and employment, with the added consolidation and reinforcement of several of the reforms implemented. The new plan included a rigorous fiscal adjustment, mainly in terms of public spending, and a strong devaluation of the Chilean peso to stimulate non-traditional exports and restore the balance-of-payments equilibrium. These and other measures brought about a strong and healthy recovery in GDP and employment, led by exports and investment, whereas consumption and real salaries experienced slow growth. Inflation and foreign debt declined after the restructuring of the debt, with the consequent recovery of national and international confidence. The Central Bank of Chile became fully autonomous in 1989.

The Road to Democratic Transition

Concurrent with the economic change was a political change involving a new constitution that made it possible to renew the institutions, consolidate the regime's achievements, and pave the way for the restoration of democracy. The 1980s witnessed the resurrection of the "political society," starting with the constitutional plebiscite of 1980 and continuing with the reorganization of the opposition and massive demonstrations during the early part of the decade. For the opposition, the Constitution was the culmination of one part of the institutionalization process of the authoritarian government. There was a renewal of political activism within the high party-political sphere,

which was initially very favorable to the military regime given its economic success. However, the crisis had shaken up the aura of invincibility of the military government, which subsequently triggered social protest.

TABLE 3: CHILEAN MACROECONOMIC INDICATORS, 1982-1990¹⁴

	1982	1983	1984	1985	1986	1987	1988	1989	1990
GDP growth	-13.4	-3.5	6.1	3.5	5.6	6.6	7.3	10.6	3.7
Unemployment rate (annual average) ¹⁵	19.6	14.6	13.9	12.0	12.3	11.0	9.9	8.0	7.8
Gross Fixed Capital Formation (% GDP at current prices)	15.8	13.7	16.3	17.7	17.1	19.6	20.8	24.5	24.2
Gross Domestic Savings (% GDP at current prices)	4.9	6.9	6.5	7.8	11.5	17.3	22.3	23.3	23.2
Deficit on Current Account (% GDP)	9.0	5.5	10.8	8.6	6.7	3.6	1.0	2.5	1.6
Real Annual Growth of Salaries ¹⁶	0.3	-10.9	0.2	-4.5	2.0	-0.2	6.5	1.9	1.8
Real Exchange Rate (average 1986=100) ¹⁷	59.0	70.8	74.0	90.9	100.0	104.3	111.2	108.6	112.7
Inflation (CPI) (Dec.-Dec.) ¹⁸	20.7	23.1	23.0	26.4	17.4	21.5	12.7	21.4	27.3
Non-Financial Public Sector Surplus (% GDP)	-3.4	-3.0	-4.3	-2.6	-2.1	-0.2	0.2	1.3	3.6
Terms of Trade (1986=100) ¹⁹	112.1	114.3	107.6	99.9	100.0	109.8	125.9	124.3	116.5

Many in the opposition mistook the situation for a terminal crisis, which implied that the government should opt for an incipient opening. However, despite the monthly protests anticipating the imminent end of the regime—with cries of “*¡y va a caer, la dictadura va a caer!*”—the economic debacle did not bring the fall of the regime. As time went on, the perception of the inevitable fall of the regime gave way to a measured debate in which the opposition decided to fight back against the regime with the very same weapons made available by the regime itself—within the rules of participation envisaged by the Constitution of 1980.

The new institutional framework promoted by the government was being slowly structured with the assistance of civilians concerned with moving toward democracy. In a climate of unrest, in 1983 the newly sworn in Minister of the Interior, Sergio Onofre Jarpa, developed a political opening that strengthened the government in difficult moments of the crisis. The so-called “Jarpa formula” sought to create the laws necessary for Parliament to operate as envisaged. However, the proposal of making gradual progress, albeit with the possibility of opening a dialogue between the government and the opposition, prevailed. The conditions for such dialogue materialized in August 1983 through several

political conglomerations: the *Alianza Democrática*, formed by small right-wing groups, Christian Democrats, some minor center-wing parties, and some Socialists; the *Movimiento Democrático Popular*, comprising Socialists, Communists and the *Movimiento de Izquierda Revolucionaria* (MIR); and the Socialist Bloc, which was an attempt to unite this sector and included the *Izquierda Cristiana* and the *Movimiento de Acción Popular Unitaria* (MAPU).

In August 1985, an important alternative proposal for political transition surfaced: the *Acuerdo Nacional para la transición a la plena democracia*, or the National Agreement for the transition to full democracy. The Agreement had its origin in negotiations conducted by the Catholic Church, which incorporated some members of the pro-democratic opposition, and some government supporters dissatisfied with the idea of Pinochet continuing in office. These discussions permitted a rapprochement between the different political streams of both the government and the democratic opposition, making it possible to build the necessary consensus for the peaceful transition to democracy. For the first time in contemporary Chilean history, when looking to the national future, there was an impression that both the political and the economic options would be more moderate than those that had generated the divisions of the past.

During this period, the military regime was primarily concerned with implementing the institutional framework that ensured compliance with the roadmap outlined by the Constitution, and with the promulgation of laws that complemented it—the law of political parties, electoral registers, voting and vote count, to name a few examples. While the regime was forced to implement some adjustments to the economic model, the basic foundations remained intact, and its relative success continued to dominate the terms of the debate about the political transition. In addition, as a consequence of the crisis and the subsequent adjustment of the economy, some cracks were detected among the government supporters themselves as some economic elites made their discontent public. A small but active self-defined “Democratic Right” made its appearance and devoted its efforts to the promotion of political liberalization. Between 1983 and 1988, all of this gradually made more room for public expression and activity. Even more important was that within the armed and police forces it was possible to detect unease at the prospect of Pinochet retaining power, despite the fact that the Army remained monolithically behind its Commander-in-Chief.

Meanwhile, there was a reinvigoration of civic culture, sparked by the revival of political parties, which made it clear that there were now two dominant forces, unlike the three-way political split of 1970. From the pre-plebiscite period of 1988 on, the political parties began to take over control of the debate between

the different sectors. Other spheres of political and cultural life were characterized by change at this time. Some student sectors, for example, became strongly radicalized, whereas others abandoned the revolutionary rhetoric of the 1960s. There was also a proliferation of think-tanks engaged in research on economics, politics, and social sciences. Although several of them had been created in the 1970s, it was in the 1980s that they came to play an important role in the generation of information, criticism, and strategies geared toward challenging the military regime.

More important, however, were profound changes like the renewal of the Christian Democrat Party—essentially in the sphere of the economy—and of the Socialist Party, while the Communists took up more radical positions. In fact, the ideological and political evolution of the Marxist parties conditioned the formation of new coalitions, doing away with the scheme that had prevailed prior to 1973. In this sense, the transformation within the Socialist Party was fundamental, because it evolved towards a position that favored democracy, leaving

PINOCHET'S LEGACY WILL BE ONE OF DARING ECONOMIC POLICIES ALONGSIDE EGREGIOUS HUMAN RIGHTS VIOLATIONS.

behind such utopias as the “dictatorship of the proletariat” or the defense of “real socialism.” In addition, contrary to what this party had proclaimed in 1967, the Socialists renounced violence as a means to gain power. The Socialists also showed themselves open to reconsidering the issue of property, which meant not only closing the door on decades of

state intervention and expropriation, but also moving toward a consensus on economic and social matters that would allow the conclusion of antagonism that dated to 1973 and beyond. Chilean Socialism gradually evolved with the changes produced in the world: the increased tendency toward a more liberal approach by some countries and the perception of the failure of Communism by more ample sectors of society.

Finally, in the international scene, the military government had powerful detractors from the outset including the international Marxist bloc, as well as some European countries and the United States, which had initially supported Salvador Allende's ousting. Thus, throughout the transition process, the international community managed to strike a balance between their satisfaction with the economic model and their criticism of the repressive nature of the government that had implemented it. In this way they applied pressure to encourage a restoration of democracy—albeit on a schedule defined by the military government itself.

Pinochet's Legacy

Coming to terms with the legacy of the dictatorship in contemporary politics is a major challenge for Chile as it continues to define its national identity in the 21st century. Recognizing that progress is not a linear process, Chile should internalize the changes and continuities that have occurred since the coup in 1973, and accept that 21st century Chile owes much more to the economic policies adopted by Pinochet's dictatorship than to the governments of Allende, Frei, and Alessandri. It is now clear that "Allende was a much better martyr than president," and clear as well that the present politico-economic institutional structure of the country owes to the military regime—even if its detractors reject this idea, and the *Concertación* governments insist that it was they who put a "human face" on the neoliberal model.²⁰ Undoubtedly, this statement rubs people the wrong way because Pinochet's legacy in the realm of human rights is as controversial as the man himself. To be certain, Pinochet's personal legacy will be one of innovative and daring economic policies alongside egregious human rights violations. Correctly understanding the dictatorship's role in developing, over time, a consensus of economic and political freedom is ultimately necessary to reinforce the preservation of that consensus—the very basis of Chile's success and that which has made it a model for the rest of Latin America today. ■

NOTES

¹ Arturo Fontaine "Sobre el pecado original de la transformación capitalista chilena" *El Desafío Neoliberal*, Barry Levine, ed. (Bogotá: Norma, 1992), 93-139.

² Edgardo Boeninger, *Democracia en Chile. Lecciones para la Gobernabilidad* (Santiago: Andrés Bello ed., 1997), 384-390.

³ Eugenio Tironi et al, *Cuánto y Cómo Hemos Cambiado los Chilenos: Balance de una Década* (Santiago: Cuadernos Bicentenario 2003), 15-17.

⁴ Angel Soto y Alejandro San Francisco, "Political and Economic Liberty in Latin America: Can They Coexist?" *Politics & Policy* 32:1 (2004), 139-156.

⁵ Joaquín Fernando, *Mundo y Fin de Mundo: Chile en la Política Mundial 1900-2004* (Santiago: Ed. Universidad Católica, 2005), 2.

⁶ Sources: Central Bank of Chile, CIEPLAN, ODEPLAN. Cited from Dornbusch and Edwards 1992, 229.

⁷ Angel Soto, *El Mercurio y la difusión del pensamiento económico liberal 1955-1970* (Santiago: Centro de Estudios Bicentenario, 2003).

⁸ Source: Central Bank of Chile. Cited from Larraín and Vergara 2000, 7.

⁹ Change of methodology in 1993.

¹⁰ Change of methodology in 1993.

¹¹ A rise in this indicator implies a depreciation of the local currency.

¹² For 1974-1978 Cortázar and Marshall corrected CPI was used (1980).

¹³ Defined as the price of exports of goods and services divided by the price of imports of goods and services.

¹⁴ Change of methodology in 1992. Used as CPI deflator corrected by Cortázar and Marshall (1980).

¹⁵ Change of methodology in 1993.

¹⁶ Ibid.

¹⁷ Change of methodology in 1992. Used as CPI deflator corrected by Cortázar and Marshall (1980).

¹⁸ For 1974-1978 Cortázar and Marshall corrected CPI was used (1980).

¹⁹ Defined as the price of exports of goods and services divided by the price of imports of goods and services.

²⁰ Navia, Patricio, *Las Grandes Alamedas: El Chile Post-Pinochet* (Santiago: La Tercera, 2004).