Chile's economic disaster sets the record straight on Friedmanism

by Mark Sonnenblick

A few years ago, Nobel Prize-winning economist Dr. Milton Friedman lauded the Chilean experience as "a recovery comparable to the economic miracle of post-war Germany. . . . It will be regarded as one of the economic miracles of the 20th century."

Since 1973, Chile has offered Friedman a laboratory for the world's longest controlled experiment in "free-market economics." The results are now coming in.

On Jan. 10, Chile's Friedmanite Economy and Finance Minister Rolf Lüders celebrated the International Monetary Fund's bestowal of what he termed "a certificate of good conduct" on Chile's economic management. The next day, the Bank of Montreal refused to renegotiate a $2 million debt payment due from a lumber company owned by the gigantic BHC group, despite the loan being guaranteed by the government's Corporation de Fomento (CORFO). Thus, the foreign debt of Chile entered into technical default.

As rumors spread that the banking system would be "nationalized," Lüders declared a bank holiday Jan. 14 and announced the liquidation of three BHC banks and finance companies and the government takeover of five others, amid belated admonitions that they had been "mismanaged."

When the banks reopened Jan. 17, Gen. Augusto Pinochet had to call out the police to impose order on mobs of his erstwhile middle-class supporters desperate to keep their savings from going down the drain.

On Jan. 19, a dozen companies belonging to the BHC and Cruzat-Larrain groups defaulted on another $1 billion in debts. The president of the Association of Metalurgical Industries, Angel Fantucci, said that since one of these companies, Tecno Industrial "would not be able to pay bills owed to industrial suppliers, it would cause grave problems to the rest of the metal-working industry. Here comes an avalanche effect," he moaned, "and numerous companies will be caught up in financial difficulties." The labor minister announced that these, and all others which crash along with two of Chile's biggest private groups, would be put under government management.

What is bankrupt, however, is not just a few big companies, but Chile itself, and the economic model on which its economy has been based. The Chilean experience reveals that Friedman's "freedom to choose" has meant freedom for the British, Swiss, and Venetian oligarchy to sack a country which was once one of the most cultured and developed of the American republics. The total deregulation of the Chilean economy has meant "freedom to lose" for the Chileans and "freedom to loot" for the oligarchs.

Behind the bankruptcies stands the wreckage of Chile's industrial capacity and labor force.

Chilean industrial production fell by 17.7 percent during the first 10 months of last year, according to the Industrial Development Society (SOFOFA). As the banks pressed their clients to repay unpayable loans, record numbers of them (almost 800) declared bankruptcy. Since 1973, thousands of factories have closed down, their machinery stripped and sold for scrap.

Unemployment is now 10 times that of 1972 (see Figure 1). Under the "socialist" regime of Salvador Allende (1970-73), the consumption capacity of the Chilean people was sufficient to induce producers to earn high profits by running the plants three shifts per day. Real unemployment now stands at 30.6 percent when the more than 400,000 heads of families employed at around $24 per month sweeping streets and cultivating public gardens are included. These slave-labor job programs are only the most conspicuous example of the structural shift of employment in Chile from a labor force predominantly engaged in goods-producing activities to one which is pushing around papers on bank desks or in gutters.

There is little benefit to show from the foreign indebtedness, which Lüders put at $17.1 billion on the eve of his Jan. 25 arrival in New York to renegotiate it. When Henry Kissinger convinced General Pinochet to overthrow his freely elected Commander-in-Chief in September of 1973, that debt was just over $3 billion.

When he seized power almost a decade ago, Pinochet murdered 10,000 opponents and smashed all national labor unions and political parties, and entrusted his economy to a nest of Friedman's former students, known in Chile as "the Chicago Boys."

As Charles Douglas-Home wrote in the *Times* of London in 1980, the Chicago Boys "hope to minimize the role of the state and realize a Friedmanite dream world, where society subscribes to individualist rather than collectivist principles, while the major technical decisions are kept insulated from the distorting effect of pressure groups working on voters and legislators who are not equipped to judge such things."

Figure 1
Unemployment
(percent of labor force)

▬Official unemployment
Source: Instituto Nacional de Estadisticas
┅Disguised unemployment (Minimum Employment Program)
Source: Interior Ministry of Chile

The *Times* opines, "The Chilean counter-revolution is of a most radical nature and should not be underestimated on account of the conventional methods of repression which are being applied while more radical measures are worked out and put into operation." The program is called "the seven modernizations," like those of Chairman Mao. "The seven modernizations" concern labor, pensions, health, education, administration of justice, agriculture, and administration. . . . President Pinochet hopes to delay the reintroduction of democracy . . . until 1985, since most of the seven modernizations will need that time to be transferred from social market theory to practical programmes, with a chance to operate long enough for people to appreciate their advantages."

So much for the theory. The practice began in earnest when Dr. Friedman and his sidekick, Dr. Arnold C. Harberger, made a long visit to their students in 1975. They prescribed what they called "shock therapy" to cure an inflation problem. The shock included firing 25 percent of public workers, letting the currency devalue as international speculators saw fit, and leaving Chile's industry at the mercy of dumping from other "free-market" paradises like Hong Kong and Singapore. The Chicago Boys intone the racist Charles Darwin's doctrine, "the survival of the fittest."

Survival certainly became a challenge. By 1978, the total caloric intake had fallen by over 15 percent per capita and protein intake by over 17 percent per capita. Epidemics spread through the country. Of those who prospered, one group was called "the piranhas," another "the crocodiles," because they prospered by eating other people's flesh.

The natural history of the piranhas

This species of entrepreneur is exemplified by Mr. Javier Vial, who owns the BHC group. When the Chicago Boys auctioned off the state-owned industries which had been built at great sacrifice by Chilean taxpayers, they sold them for almost nothing. Depressed conditions and scarce credit meant that few Chilean capitalists had any cash to bid, so Vial won the prize public industries for a song. (He boasts that he paid only an eighth of what they are worth.) Vial acted as the Chilean front-man for the European aristocrats who lent to him from their century-old fortunes.

In a few years, Vial was successful in building up an empire of 40 companies, including the biggest lumber and home-appliance companies, mines, metal-processing plants, and a fishing fleet worth over $1.3 billion.

The government auditors who have seized the BHC group will find the piranhas left nothing but sucked out shells where 40 industries once stood.

The piranhas and related species legally withdrew every asset worth anything from Chile. They sent back to European aristocrats two or three fortunes for every one "invested." The former wealth of Chile is now safely stashed in Swiss vaults and California and Miami sunbelt real estate.

Their endeavor was conveniently eased by the policies of Chicago Boys Sergio de Castro and Jorge Cavas running the Finance Ministry. They permitted the banking sector almost total freedom from government regulation, inspection, and constraint. They froze an increasingly over-valued peso at 29 to the dollar, declaring that the purpose was to deflate the peso price of imported goods and thereby bring down domestic inflation. On this front, they had dramatic success; they were able to announce that 1980 inflation had been lowered to 10 percent, even below simultaneous U.S. levels.

This achievement was used as the proof of the success of Friedman's policies. The Chilean middle class engaged in an orgy of luxury importing and foreign tourism which bolstered the political base of the regime. However, the real reason for overvaluing the peso was that it provided ideal conditions for the piranhas to turn their peso assets into dollars and move them out of the country.

They disguised the looting by bringing in billion after billion of new loans (see Figure 2). Most of this money came from U.S. banks, which "supported" Chile on the ideological grounds that they did not want Ronald Reagan and the American people to discover the real results of "the magic of the marketplace."

Chile's notorious liberality with secret commissions and kickbacks to banks leading loan syndications, probably also contributed to the latter's eagerness to persuade smaller

American banks to puff up the Chilean bubble with money they may have known would never be repaid.

When it became clear that the bubble was going to burst, the Chicago Boys took refuge. Several of them moved over to professorships in Chile, from which they are still running the show, according to a Chicago bank official who recently visited them. Four of them became presidents of piranha banks taken over by the government in January (Banco de Chile, Banco de Santiago, Banco de Concepcion, and BUF bank). They were replaced by Lüders of the BHC, who is eclectic in comparison to Chicago School orthodoxy.

When the first of many devaluations was imposed in mid-1982 for example, Lüders got the government involved in business, by offering one quarter of the state budget ($1.4 billion) to subsidize the difference in loan-repayment costs for companies with dollar debts. When it became known in November that almost all the banks held uncollectable debts worth far more than their capital and reserves, he ordered government inspection of the private banks.

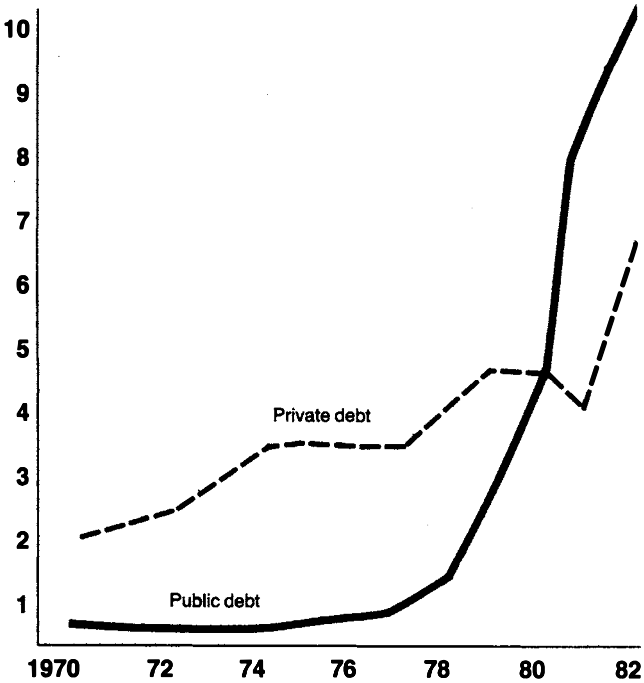
With the latest intervention, SOFOFA complains that the state now controls 86 percent of Chile's credit. What analysts of the authoritative *Hoy* weekly suspect is that the seizure of private enterprise was in fact demanded by the International Monetary Fund in order to make sure that foreign debt payments are protected and the Chilean depositors and investors are the ones who lose their shirts. It may be that Chile's rulers will once again try to "socialize the losses." But the crisis is such that the government has neither the foreign reserves nor credit to service its own debt, much less the private debt.

After dozens of denials that there was any need to renegotiate Chile's debts, Lüders turned up in New York on Jan. 25 to do just that with $3.5 billion in amortization due in 1983 and 1984. There is more than meets the eye in the closed meetings with Chile's dozen biggest loan-syndicate bankers. A clue is that the Jan. 24 meeting in Santiago de Chile at which the debt strategy was planned was attended by "bi-minister" Lüders, four other cabinet members and Thomas Kunkeg and Jackson Gilver of Morgan! In the light of the "theatre" for the "corruption of Congress by the corruption of public opinion" Morgan admits playing through its identical insider role in Brazilian debt renegotiations, (see *EIR*, Jan. 18), funny business can be expected on Chile's debt.

Figure 2

Comparison of public and private debt

(in billions of U.S. dollars)



Note: Shows long & medium-term debt as of Dec. 31 of each year. Excludes short-term debt.
Source: Banco Central de Chile.

'Freedom to lose'

The Chilean people have lost the most from the Friedman experiment. Using a Lloyds of London blueprint, BHC and the other banking groups set up private pension funds. In 1981, the government told wage earners to transfer to the new private funds, while it drained the public social security system on which the retired and disabled depended. Now with the BHC group and the Cruzat-Larrain group penniless, the pensions of Chile's present generation of wage earners have also evaporated.

The middle class, which clanged pots and pans to encourage Pinochet to overthrow Allende in 1973 has begun to regret its stupidity. While bank deposits may be partly insured by the government, at lest half the value of deposits in Chile's bankrupt finance companies are expected to be lost.

Victor Zuñiga, a farm district congressman who declared on television during the Allende regime that "the only good Marxist is a dead Marxist," now says of the Pinochet regime, "Force can inspire fear, but not confidence. The people don't believe in the authorities, because all those of us who believed are today broke or on the edge of going broke." His friend, Carlos Podlech, the head of the Wheat Growers Association, had told his members not to plant in 1972-73 to protest the formation of farm workers' unions. Now, the banks are taking their farms and turning them into migrant workers. Podlech tried to organize a protest. He was deported.

León Vilarín, is the head of the truckowner's association whose members had done Kissinger's dirty work with their famous 1972-73 trucker strikes against Salvador Allende. Vilarín got upset last September because "228 of our members are in debtors' prison and 11 have committed suicide" after they could not meet usury payments on their rigs. He, too, was banished from Chile.

Pinochet retorts, "Let them try a coup and they will see how hard I can squeeze." But his place is no more assured than that of his sponsor, Henry Kissinger.