
Valparaíso, Chile. Photo by rlatin/Flickr

Chile: The Capitalist Alternative to Venezuela in Latin America

BY RAINER ZITELMANN

Chile and Venezuela are the two counter-models in Latin America. Chile embodies the capitalist path, while Venezuela the socialist path. But Chile has also had its own troubles: First under the socialism of Allende and later under the dictatorship of Pinochet.

The contrast between these two Latin American countries could hardly be starker: Chile ranks 20th out of 180 countries in the 2018 Index of Economic Freedom, while Venezuela is at the very bottom, even behind Cuba and beaten to last place only by North Korea. While Chileans are better off today than ever before, Venezuelans are suffering from inflation, economic decline and growing political oppression. In the course of the 20th century, Venezuela went from being one of the poorest countries in Latin America to becoming the richest. In 1970, it ranked among the 20 richest countries in the world with a higher per-capita GDP than Spain, Greece and Israel, and only 13% lower than the UK.

Much as with Hugo Chávez's ascent to power 28 years later, left-wing intellectuals all over the world drew fascination and pride from Salvador Allende's election as Chilean president in September 1970. The Unidad Popular candidate was the first hardline Marxist ever to come to power as the result of a democratic election – albeit with a slim majority of 36.5% of the vote – rather than a violent revolution or a lost war, as was the case with the Soviet-imposed regimes in East Germany and North Korea after World War II.

The Unidad Popular was assisted in its ascent to power by the oligarchic nature of the Chilean economy and the huge income gap between the 1.5% share of total income that went to the poorest 10% and the 40.2% share for the richest 10%, while inflation stood at 36.1% in 1970.

Allende's nationalisations lead to ruin

In his first official act as president, Allende nationalised the copper mines that were Chile's most important source of income. Rather than paying compensation to the multinational corporations that had previously run the mines as part of the "negotiated nationalisation" agreement signed with Allende's predecessor, Eduardo Frei Montalva, in 1969, Allende's government presented them with deductions for "excessive profits" beyond "normal business practice" that exceeded the sale value of most of their holdings. Banks and other companies were also nationalised in quick succession. By the time Allende was ousted in 1973, 80% of the country's industrial production had been moved to the public sector. Rents and prices of basic food items were fixed by the government, which also provided free healthcare.

The socialist government's use of public spending to bolster its popularity saw social expenditure rise by almost 60% in real terms in a period of only two years. Between 1970 and 1973, employment in central government and public-sector firms expanded by 50% and 35% respectively. These measures were paid for, not from increases in tax revenue but by increasing public debt and expanding the money supply. The budget deficit grew from 3.5% of GDP in 1970 to 9.8% in 1971. A 10.3% increase in public-sector investment was counterbalanced by a 16.8% drop in private-sector investment – which is not surprising given the rate of expropriation of private business owners: 377 productive firms were nationalised between 1970 and 1973.

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Anti-Marxist women wave white handkerchiefs in Santiago, Chile as they demand the resignation of Salvador Allende (September, 1973).
Photo courtesy of: AP Photo

Economically, nationalisation was a failure. Highly skilled workers and experienced executives left the country in droves and were replaced by loyal party members. "Many nationalised businesses also recorded frequent incidents of undisciplined behaviour and absenteeism. In companies that hadn't been moved into state ownership yet, the workers themselves took initiative by occupying production facilities."

In addition, almost 16 million acres of land were expropriated. In some instances, collectives were set up in accordance with the familiar socialist model. Farmers made landowners by the 1960s reforms now had to work in agricultural collectives as public-sector employees. Expropriations or occupations happened at a rate of 5.5 agricultural estates per day; "every other day a productive firm was nationalised or taken over". Productivity took a dip, and by 1972 Chile had to spend a large share of its export revenue on food imports. The attempt to restructure the agricultural sector in accordance with socialist principles was as much a failure in Chile as it had been in China, East Germany and North Korea. Overall, the Unidad Popular's economic policy was a failure. This is true in the fiscal arena even more so than in the agricultural and industrial sectors. The government was no more able to control inflation than its predecessor had been – in fact, generous public spending only made it worse. Inflation, which had stood at 36% in 1970, skyrocketed to 605% in 1973, a pattern that would repeat itself in Venezuela three decades later – as would the protests that started breaking out in Chile. During a three-week state visit by the Cuban leader Fidel Castro in late 1971, thousands of Chilean women joined a 'March of the Empty Pots and Pans' on the presidential palace. They were attacked by Marxist activists and dispersed with tear-gas grenades by the police, resulting in dozens of injuries. In October 1972, half a million small business owners, farmers and self-employed professionals took part in anti-government protests.

The era of military dictatorship

In September 1973, the Chilean army, led by Allende's appointed army chief Augusto Pinochet, overthrew the socialist government. Allende killed himself shortly before the leaders of the coup d'état stormed the presidential palace. General Pinochet established a military dictatorship. Freedom of the press and other democratic rights were abolished; those who opposed the regime were arrested and tortured. In stark contrast to the authoritarian and anti-liberal thrust of his domestic policy, Pinochet's economic orientation was, for the most part, liberal and pro-market.

Chile's transformation into a free-market economy under Pinochet was masterminded by a group of economists who subsequently became known as the 'Chicago Boys'. They were admirers and former students of Milton Friedman, the Nobel Prize-winning economist and fervent proponent of free-market capitalism, at the University of Chicago. On their return to Chile, they drafted 189 pages of economic analysis and reform proposals for the attention of the generals, who initially "did little with the proposals". It was only when the military's own efforts failed to stem inflation that Pinochet appointed several of the Chicago Boys to positions of power.

Friedman himself gave a number of seminars and public talks in Chile during a six-day stint in March 1975. His perceived role as Pinochet's adviser has given rise to a lot of harsh criticism. In truth, Friedman only met the Chilean dictator once, and subsequently wrote him a letter in which he recommended a programme for fighting hyperinflation and liberalising the economy. He gave similar advice to communist rulers in the Soviet Union, China and Yugoslavia. But, while his supposed involvement with the Chilean regime triggered a global campaign against him, nobody seemed to be bothered about his role in advising communist regimes.

On the whole, Friedman was impressed by the economic policies implemented by the Chilean economists he had inspired – among them Sergio de Castro Spikula, who was Pinochet's minister of economic affairs and later became finance minister – although he was critical of Castro's decision to peg the Chilean currency to the US dollar. Castro and his followers started to instigate an economic agenda centred on reducing public spending, deregulating the finance and economic sector, privatising state-owned enterprises (except for the copper industry) and opening the economy to foreign investors, and generally reversing the policies of the Allende government: "The state and everything linked to the public sector was turned into the central cause of all the problems, the less it interfered in the economy, the greater and faster would be the growth of social welfare. This formed the background to the numerous economic reforms introduced during the military regime: privatisations and reprivatisations, reform of the state and fiscal reform, liberalisation, deregulation, opening up the economy and Central Bank autonomy."

From 400 state-controlled enterprises and banks in 1973, the number dropped to around 45 firms (including one bank) in 1980. Fiscal and tax reforms and deregulation measures introduced in the mid-1970s minimised government influence across the board by abolishing price controls, wealth and capital gains taxes and cutting income tax. VAT, set at a standard rate of 20% charged on all goods and services, became the government's main source of tax revenue. This resulted in an 'economic miracle' of a similar magnitude to those achieved by Margaret Thatcher and Ronald Reagan: lower tax rates led to a growth in revenue from 22% of GDP in 1973–1974 to 27% in 1975–1977, and the transformation of the chronic fiscal deficit into a surplus in the period from 1979 to 1981.

A comparison between key indicators for 1973 and 1981 clearly shows just how successful these policies were. Inflation, which had stood at above 600% in 1973, had dropped to only 9.5% by 1981, although progress had been slow. During the same period, Chile had seen its economic growth rate recover from -4.3% to a healthy 5.5%, while exports almost tripled from USD 1.3 billion to USD 3.8 billion. More impressive still was the growth of non-traditional exports (excluding copper and other natural resources) from USD 104 million to USD 1.4 billion. Real wages, which had dropped by over 25% in 1973, grew by 9% in 1981.

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The Chicago Boys. Photo courtesy of: Carlos Massad

The fiscal and economic policies introduced by the Chicago Boys were key to Chile's long-term recovery and its current economic stability. In the short term, however, their outcomes were less straightforward: as with Thatcher's and Reagan's reforms, positive long-term effects came at the price of an initial rise in unemployment.

With foreign investors increasingly putting their faith in the Chilean economy, exports started rising while the deficit decreased and the economy grew by a total of 32% over four years. Chile's economic miracle was hailed in the world of global finance and celebrated in the business press. Mass consumption increased as standards of living improved across the population, as reflected in the dramatic rise in the number of cars registered between 1976 and 1981.

In the early 1980s, a massive debt crisis swept across Latin America. In 1982, Mexico defaulted on its sovereign debt. In the same year, Chile – along with other Latin American countries – was plunged into recession by a drastic decline in capital inflow. In 1982–1983, Chile experienced its worst recession since the 1930s, with GDP plummeting by 15% and unemployment rising to 30% in real terms. The root causes of the 1982–1983 crisis are the subject of an ongoing debate. What is clear, though, is that Chile was able to get over the crisis much faster than its Latin American neighbours: "Chile led the continent in climbing out of this recession. It was the only debt-crisis country that got back to the pre-crisis levels of GDP before the end of the decade of the '80s, so for most of the countries, it was the full decade that they called the 'lost decade'."

Once the crisis was over, the government carried on with more reforms. The second round of reprivatisations took into account the lessons learned from the first, which had largely been a debt-based privatisation process.

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This time, companies were transacted on the stock exchange, giving them a debt-free start. The privatisation of the largest firms in public ownership – excluding the state-owned General Minerals Corporation – started in 1986, generating a total asset value of USD 3.6 billion.

After Pinochet: free-market economics and democracy

The political system started changing following Pinochet's 1988 defeat in a plebiscite on the extension of his rule for another eight years. The 1989 general elections were won by a democratic alliance led by the Christian Democrat Patricio Aylwin Azócar, who ruled as president from 1990 to 1994. Friedman emphasises the role that economic liberalisation, which in turn led to political liberalisation, played in the transition from dictatorship to democracy: "The Chilean economy did very well, but more important, in the end the central government, the military junta, was replaced by a democratic society. So the really important thing about the Chilean business is that free markets did work their way in bringing about a free society."

Although the liberalisation of the economy was clearly a contributing factor in ending the dictatorship by strengthening the Chilean civil society, Friedman's claim that the victory of democracy was a direct and inevitable consequence of the economic reforms is an unsubstantiated exaggeration. The fact that in other countries economic liberalisation has so far failed to produce a transition to democracy makes his contention difficult to uphold.

Nonetheless, there is no denying the long-term positive effects of the economic reforms instigated by the Chicago Boys. Although watered down somewhat by subsequent governments, these reforms laid the foundations for

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Chile's current economic success and led to the country's high ranking in the Index of Economic Freedom. Even the socialist incumbents Ricardo Lagos Escobar (2000–2006) and Michelle Bachelet (2006–2010 and 2014–2018) did not fundamentally alter Chile's orientation as a free-market economy. In 2010, Chile became the first South American nation to join the Organisation for Economic Co-operation and Development – a clear sign that, unlike most other countries in the region, Chile is part of the 'First World' of developed countries. This is all the more remarkable given that, prior to the reforms, Chile was among the most protectionist economies in the world.

The fact that neither the Christian Democrats who governed Chile during the 1990s nor the socialist governments elected in the 2000s made significant changes to the reforms introduced under Pinochet has to count as one of the strongest arguments in favour of their efficacy. As shown in Chapter 5, a similar observation holds true for the UK and the US, where neither Tony Blair's Labour government nor Bill Clinton's White House meddled with the substance of the reforms introduced by Thatcher and Reagan.

Critics of Pinochet's Chicago Boys reforms like to point to the rising social inequality that accompanied their undeniable economic success – to which Chile's former economy and finance minister Sergio de Castro responds: "In 1970, for instance, infant mortality was 80 to 1,000. By 1990, at the end of the military regime, it had dropped to 20 to 1,000. That is due to the economic health of the country and the fact that the government was able to spend more money on the poor."

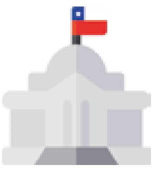
However, other economic and social indicators do show a high degree of inequality in Chilean society persisting into the present. The Gini Index, which measures the income distribution among residents, ranks Chile among the 20 most unequal countries in the world. The majority of Chileans seem to value the economic progress achieved in their country more highly than the 'social equality' bemoaned by critics – as evidenced by the successive socialist governments that largely adhered to a free-market course and by the 2010 election of Sebastián Piñera for president. A former close ally of the Pinochet government whose brother had been instrumental in rolling out a privatised social security system, Piñera was a staunch believer in the free market. His election victory, the German newspaper *Handelsblatt* commented at the time, "might herald the beginning of a new era of pure capitalism in Latin America". Piñera lost the 2013 presidential elections against Michelle Bachelet, who in turn was voted out of office in 2017 to make way for Piñera's second term, which started in March 2018.

In late June 2017, the leftist German weekly newspaper *Die Zeit* ran a feature on Chile that runs the gamut from dismay to grudging admiration: "Capitalism has an unusually powerful hold here, and the impact on social cohesion and the weaker members of society is equally strong. If you can't keep up, you don't belong: this mindset is part of the legacy bequeathed on Chile by the military dictatorship of Augusto Pinochet, who ruled the slim country on the edge of South America between 1973 and 1990. Long after Pinochet's death, his Chicago Boys live on … So far, his democratic

successors in government have continued his policy of very little market regulation."

On the other hand, even the *Die Zeit* journalist is forced to concede: "At six per cent, unemployment is about as low as in Germany, and inflation is almost non-existent too. Chilean government bonds have a good rating. Compared to their Latin American neighbours' reputation for economic chaos, Chileans are considered good business partners. They also have a functioning infrastructure, solid rates of construction and investment and well-organised transport networks. Improvements in the standard of living over recent years have benefited even the poor."

It's true: with a population of just under 18 million, Chile has a per-capita income almost twice as high as Brazil, while the percentage of the population living below the poverty line dropped from 20% in 2003 to 7% in 2014. During the same period, the poorest 40% saw their incomes rise more steeply than the national average. In 2017, Chile was the top-ranking Latin American country in the *Global Competitiveness Report* compiled by the World Economic Forum. It has the most stable banking system in the region and some of the best conditions for private enterprises worldwide. The most open economy in Latin America, it has signed free-trade agreements with countries that together produce 75% of the global economic output. Over the past 30 years, Chile's economy has achieved annual growth rates of around 5%.



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In the period between 1990 and 2005, Chile recorded one of the highest economic growth rates in the world – far higher than any other Latin American country and on a par with South Korea. In conjunction with the consistent privatisation of infrastructure assets from public transport over hospitals, prison and telecommunications to water and sewage management, low corporate tax rates and deregulated capital markets created incentives for investors.

On the negative side, Chile's economy continues to depend to a very large extent on copper. The country has the largest copper deposits in the world and around a 30% share of global copper production. The price of copper has hardly been stable over the past 20 years, soaring from a record low of USD 1,438 per ton in 1998 to a record high of USD 8,982 in 2008 before plummeting to USD 2,767 later the same year, followed by a 150% increase over the next year and a period of extreme fluctuations ever since.

These trends are obviously problematic for a country whose economy is largely dependent on copper. But unlike Venezuela, where the fluctuating oil price that initially triggered the economic boom and allowed Chávez to give away social benefits with both hands was subsequently blamed for the country's dramatic economic downturn, Chile's free-market economy was much better equipped to cope with the drops and fluctuations in the price of copper. Venezuela, too, might have thrived in spite of its high degree of dependency on oil – if it hadn't been for its state-controlled socialist economy.

Chile's development over recent decades not only demonstrates that capitalism is superior to socialism. Crucially, the Chicago Boys' attempt to roll out a capitalist system over night in the 1970s also highlights a key difference between the two. Unlike socialism, capitalism is not a system invented by intellectuals – and, thus, its sudden imposition from one day to the next is doomed to fail even under a dictatorship.

Rather, capitalism grows organically and spontaneously. As discussed in Chapter 1, China's successful transition from socialism to capitalism took many years of spontaneous bottom-up initiatives supported by changes in policy instigated by Deng Xiaoping and others. While the Chicago Boys' reforms constituted an important change of direction that marked the beginning of Chile's road to economic success, it took the country several decades to transition to a full-blown capitalist free-market economy.

This article is an excerpt from The Power of Capitalism by historian and sociologist Rainer Zitelmann.

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