

An Obituary for London's 'Chilean Economic Miracle'

by Dennis Small and Cynthia Rush

For over two decades, EIR has been exposing the fascist reality behind the so-called "Chilean economic miracle" touted by Wall Street and the City of London. For example, in our Sept. 1, 1981 issue, Mark Sonnenblick wrote an article entitled: " 'Free Enterprise' Doesn't Work: The Chilean Model," which reported: "The Friedmanite reforms have markedly reduced the productive efficiency of the economy; resource allocation is increasingly irrational." In the April 3, 1992, issue we published a feature called "The Fraud Behind Chile's Economic 'Success Story.'" And on July 21, 1995, EIR published an in-depth analysis of Chile's economy, with the above title. Although written almost a decade ago, the central points remain fully valid today; and so we publish the following excerpts:

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." . . .

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. 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?

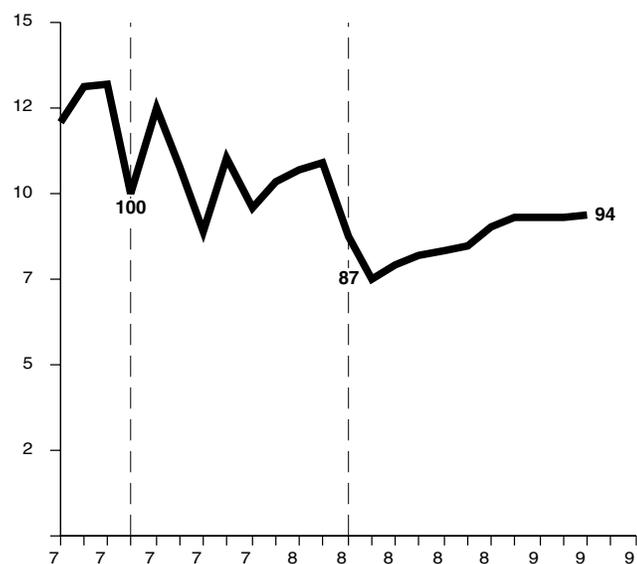
"The country was rescued," the *Post* argues, "by its internal savings, which were accomplished through tax measures; through the success of Chile's private pension plans; and by cutting back on spending."

These savings, according to Chile's apologists, were then reinvested to develop the domestic economy. 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

FIGURE 1
Chile's Production of Consumer Goods

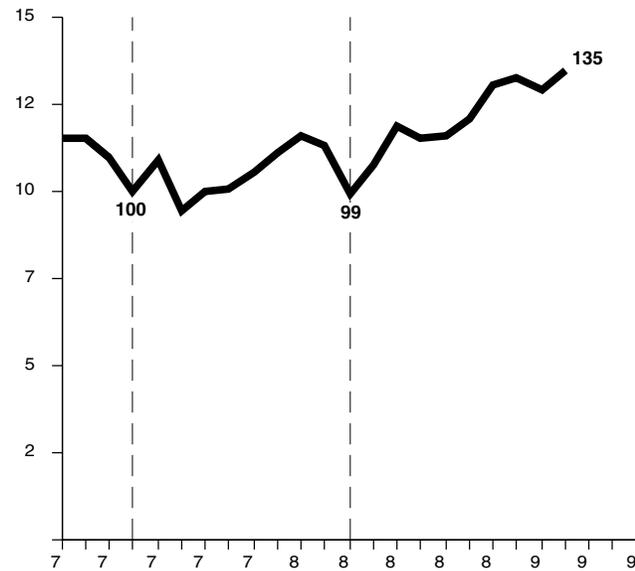
(Index 1973=100)



Sources: ECLA, Central Bank of Chile.

FIGURE 2
Production of Producer Goods

(Index 1973=100)



Sources: ECLA, Central Bank of Chile.

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.

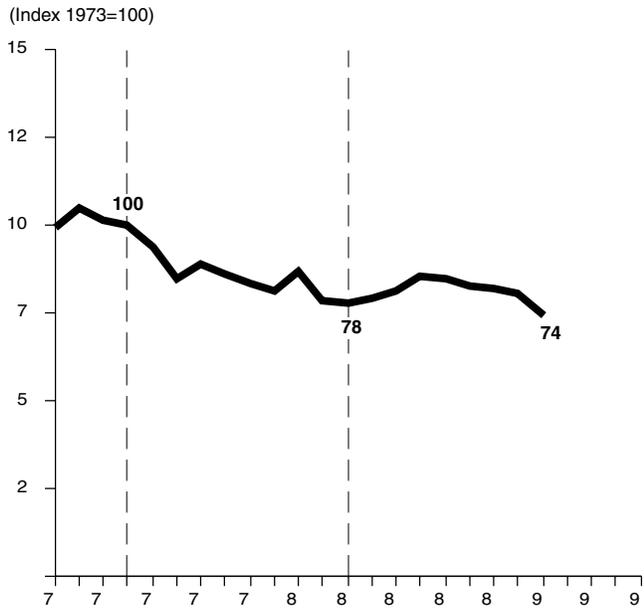
Figure 1 looks at the production of a market basket of basic consumer goods in Chile, as measured principally in per-capita terms. Note that this is *not* an index of consumption—that would have to take imports and exports into consideration as well—but rather of the Chilean economy's ability to produce 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 com-

prehensive, and will be expanded for future studies, they are nonetheless sufficient to indicate the trend and the magnitude 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 cate-

FIGURE 3
Production of Infrastructure



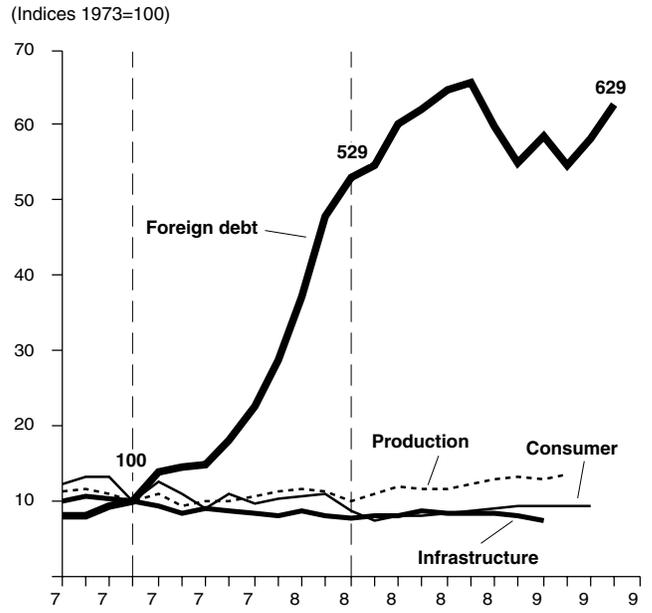
Sources: ECLA, Central Bank of Chile.

gories.

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

FIGURE 4
Debt vs. Physical Economy



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

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.

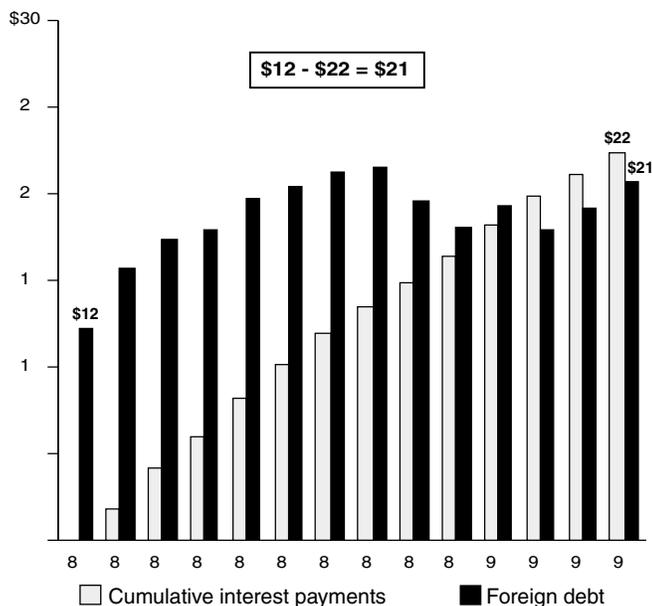
This is a physical economic catastrophe. Infrastructure development plays a crucial role in a viable economy by improving overall labor productivity. A 26% collapse of infrastructure thus implies dramatically decreased efficiency and rising social costs of production in all areas of the economy. This 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 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. . . .

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 4** shows, there has been a

FIGURE 5
Foreign Debt and Cumulative Interest Payments

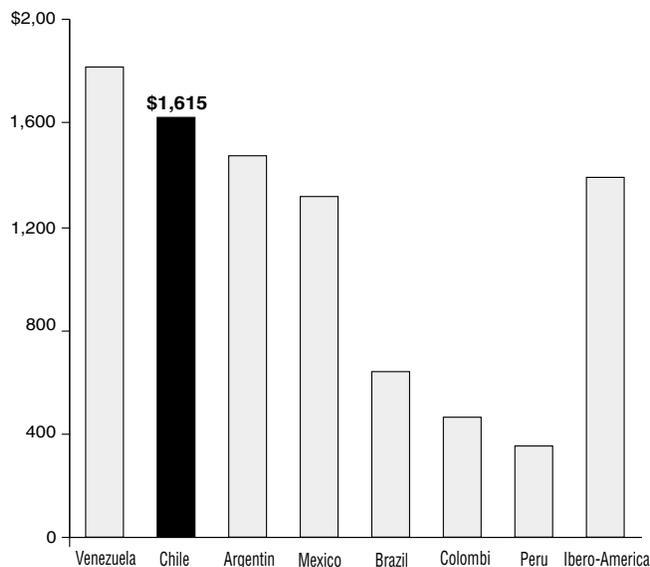
(Billions \$)



Source: World Bank.

FIGURE 6
Cumulative Interest Payments, 1981-93

(Dollars per Capita)



Source: World Bank.

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 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 assigned 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 5** 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 6**), 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. . . .

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.