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**DEVELOPMENT STRATEGIES IN CHILE, 1964-1983:  
THE LESSONS OF FAILURE**

by

**Paul E. Sigmund**  
Professor of Politics  
Director, Latin American Studies Program  
Princeton University, Princeton, New Jersey, USA

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One of the fascinating aspects of the study of Chilean development policy over the last twenty years is that it offers a series of case studies in the direct application of contrasting theories of development. The Christian Democratic administration of President Eduardo Frei (1964-1970) attempted to apply the ideas of the Alliance for Progress and the Economic Commission for Latin America to promote a mixed economy which could combine social reform and economic development within a free democratic political system-the "Revolution in Liberty." Salvador Allende's Marxist-dominated Popular Unity government <sup>(1970-73)</sup> promised a "transition to socialism" which would be based on the abolition of capitalism, carried out by a government based on "the power of the people" (poder popular), especially workers, peasants, and shantytown dwellers (pobladores). The Chicago boys, the economists and technocrats who dominated economic policy under the military junta led by Augusto Pinochet that overthrew Allende were committed to the promotion of free markets, an open economy, a sharp reduction in the role of the state, and the maximization of individual choice-in economics, if not in politics.

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Paul E. Sigmund is Professor of Politics and Director of the Latin American Studies Program at Princeton University.

Each of these policies may be said to have ended in failure. Yet each can also teach us important lessons about the problems and prospects of development--not only in Chile, but in the developing world in general--and some of those lessons have even wider implications for all contemporary political and economic systems.

### Frei's Revolution in Liberty

It is difficult to recapture the enthusiasm that greeted the election of Eduardo Frei in 1964. In retrospect, it should not have been surprising that he won such a large share of the vote--56% compared to 39% for the candidate of the Socialist-Communist coalition, Salvador Allende, since the rightist parties threw most of their support to Frei in a stop-Allende movement, offering only a token third candidate for those members of the anti-clerical Radical Party who could not bring themselves to vote for Frei because of his church connections. Frei's program contained three central elements--each of them a response to the challenge offered by the left. To the left's proposals to nationalize Chile's American-owned copper mines, Frei responded with the idea of "Chileanization" that is purchasing part ownership--if possible 51%--of the mines with the compensation to be used to develop refining and smelting facilities in Chile. To leftist efforts to mobilize the poor, Frei offered a program of Popular Promotion which would organize neighborhood committees, mothers' centers, and peasant unions to give effective expression to the needs of the lower classes. To the left's criticisms of Chile's oligarchical landholding patterns, Frei offered a program of agrarian reform which set upper limits on amount of

arable land and endorsed peasant cooperatives and independent family farms as a preferable alternative to collectivism, echoing the ideas advanced by the Alliance for Progress in the early 1960's. All of these programs were to be carried out by democratic processes through congressional legislation and where necessary, constitutional reforms.

How did Frei's "revolution" work out in practice? Initially there were political obstacles, since although he won an absolute majority in the 1964 presidential election, and control of the lower house of Congress in the legislative elections six months later, holdovers in the Chilean senate, only half of which was elected every four years, were sufficient to require support from other parties. Frei's strategy was to get the support of the left for his agrarian reform law, and of at least part of the right for the copper Chileanization. While he was successful in this effort, <sup>and</sup> both pieces of legislation were adopted by the Congress, it took until halfway through his term to get legislative approval, and the agrarian reform debates deepened the hostility of the right, already incensed by the tax increases required to finance the Christian Democratic welfare programs. The left sabotaged a good part of the Popular Promotion program which they correctly saw as an effort to win over what they thought of as their own clientele among the lower classes. The Chileanization proposals also ran into opposition from the Anaconda Copper <sup>Company</sup> which opposed any sharing of ownership of the lucrative Chuquicamata mine, the largest open-pit copper mine in the world which was able to produce copper at a very low cost. Frei ultimately secured U.S. government support for a negotiated deal with Anaconda that involved a phased-in transfer of ownership ("nationalization

by agreement") with retention of management and a sliding scale of compensation based on earnings.

If Frei was able to get the key elements of his program through the Congress, what went wrong? To answer this question we must look at events in 1967, half-way through his six-year term. In that year the Radical Party which had been aligned primarily with the right, switched alliances and began to negotiate with the Communists and Socialists to form what eventually became Allende's Popular Unity coalition. Within Frei's own party, the delays and compromises required for the adoption of the implementing legislation led to internal splits that ultimately resulted in the departure *in 1969* of the party's left wing to form the Movement of United Popular Action (MAPU) that also later supported Allende. Within the Congress, the left and right opposition began working together to frustrate presidential initiatives, particularly those of a financial nature-with the result that the Chilean inflation rate which had been dropping since Frei's election began to rise once more. Most important in terms of its impact on the 1970 election, the right began to promote the candidacy of former President Jorge Alessandri, at the same time that the Christian Democratic heir-apparent Radomiro Tomic (Chilean presidents may not succeed themselves, so that Frei was ineligible) was talking of an alliance with the left.

The result was that in 1970 instead of a two-way fight there were three major candidates for the presidency, Allende, Tomic, and Alessandri, and Allende won with 36.1% of the vote (less than the 39% he had received in 1964, but still more than the 34.9% of Alessandri or the 27% of Tomic). The Chileanization program which was just getting going, in terms of

increased production and refining, was junked in favor of outright nationalization. The agrarian reform which had so alienated the right had only resettled about 35,000 peasants, rather than the 100,000 promised in 1964. The Popular Promotion programs meant increased <sup>Christian Democrats</sup> votes in certain lower class areas, but the rising inflation was more important in persuading Chile's perennially dissatisfied electorate to vote against the Christian Democrats in 1970.

In retrospect, what should Frei have done to avoid the debacle of the election of a Marxist president in 1970? One obvious strategy would have been to broaden his government to include the Radicals <sup>who</sup> ~~which~~ like the Christian Democrats were a centrist-reformist party-but this was difficult when both parties were competing for the same voters. Another might have been to deemphasize the agrarian reform issue-or at the very least to make the compensation provisions somewhat less confiscatory. (Payment was in bonds, which were only partially readjustable for inflation.) In addition, further efforts to control inflation would have lessened the criticisms of the Frei government-and with Radical support this might have been possible. Most important, however, we now realize was an attempt to work out a candidacy more acceptable to the right than the leftist-sounding Tomic-but here Alessandri's personal prestige and popularity made things difficult. The American-supported strategy of persuading the Christian Democrats to vote for Alessandri in the October 1970 Congressional runoff between the top two candidates was another possibility, but the Christian Democratic commitment to Chile's democratic tradition, and Allende's rapid acceptance of Christian Democratic demands for the addition of a Statute of Democratic Guarantees to the constitution undercut that maneuver as well.

Perhaps, as some Chileans insist, the situation had all the elements of inevitability of Greek tragedy. Certainly, however, there were enough special circumstances to prevent the conclusion being drawn—as it was by *part of* the left—that democratic reform is impossible. Frei had broad support in the country, and there was a sense that his reforms were long overdue. Personalities, parties, and constitutional peculiarities (the prohibition on recandidacy of Frei, the lack of a second round electoral runoff which Alessandri would have surely won) were more important than systemic inhibitions on reform. Combined with the perennial problem of inflation they made Frei's administration look much less successful than in fact it was. He did after all, achieve all of the reforms that he promised—if at considerable political cost.

#### Allende and the Transition to Socialism

In his inaugural address in the National Stadium on November 5, 1970, Salvador Allende promised a via chilena to socialism, anticipated in the classics of Marxism (he quoted a speech of Engels) which would be characterized by "democracy, pluralism, and liberty" and would destroy the large landholdings, take over banking and credit, and nationalize foreign-owned mines and industries. His efforts to do so succeeded only in destroying the economy, polarizing the society, and provoking a bloody and repressive military coup.

At first, Allende made good on his promises to respect democracy and liberty. He nationalized the copper mines through the regular constitutional processes, achieving a nearly unanimous vote in the Congress, and he respected

Chilean institutions such as the courts, the military, and the Controller General. Yet there were other aspects of his policy that led ultimately to his downfall.

1) In his zeal to redistribute land and industry, he tolerated seizures of land and factories that undermined his effort to portray his program as one carried out within Chile's legal framework. It is true that his government used what ~~they~~<sup>it</sup> called "legal loopholes" (resquicios legales) to provide a legal justification for the seizures. The seized land was officially described as "abandoned by its owners," a category that permitted expropriation under the 1967 agrarian reform law. The factories were "intervened," supposedly on a temporary basis, under provisions for the settlement of labor disputes, or by the use of a 1932 law concerning the maintenance of supply of articles of basic necessity. However when the courts would not accept many of these justifications, their orders were simply ignored, while the Controller General's legal objections were overridden, as provided in the constitution, by a cabinet "decree of insistence." When the Congress attempted to limit the nationalizations by law, Allende vetoed the legislation and the executive and legislative got bogged down in dispute as to whether the veto could be overridden by a simple or 2/3 majority. The basic point, of course, was that over time the reliance on legalism which had permitted Allende to reach power in the first place was increasingly eroded as an atmosphere of lawlessness and arbitrary actions by the executive overrode the objections of the other two branches in ways that made Chilean constitutionalism appear to be inoperative.



2) A related and more serious problem was the increasing use of violence on the part of extremist groups of the left and the right. Allende himself had assembled a personal bodyguard which he called his Group of Personal Friends (GAP - Grupo de Amigos Personales) to defend himself against reported assassination attempts. In early 1971 he attempted to cover up Cuban arms shipments to the extreme left when they were discovered in Chilean customs. By 1973, he and several of the parties in his coalition were carrying out programs of arms training, which were duly reported by the intelligence branches of the armed services. On the right as well, a quasi-fascist group, Fatherland and Freedom (Patria y Libertad) was organized to oppose Allende's election, and by 1973 was resorting to armed terrorism. In addition some factories and shantytown areas organized their own internal police organizations and would not permit the national police (carabineros) to enter. Thus the threat to military control of the instruments of violence, the classic precipitant to coups d'etat in many countries, became increasingly evident during Allende's three years in office.

3) A third element that undermined the Allende program was his mismanagement of the economy. Chile's already existing price control system was extended to 3000 items--and requests for price increases were denied--partly as a way to subsidize consumption and in some cases as an effort to bankrupt private companies and replace them with state companies. In addition, the printing presses kept printing money to subsidize an increasingly large and inefficient state sector, while tax collection efforts were stymied both by rising inflation and political opposition (the opposition-controlled Congress would not impose new taxes). Thus after some initial success as

a result of post-election stimulation of the unused capacity of the Chilean economy by Keynesian-type spending, the inflation rate began to take off and by the time of the coup had reached an annual rate of 323% in official figures, and in excess of 600% as a real rate. Investment ceased, agricultural production ground to a virtual halt, savings were non-existent, and foreign exchange reserves were run down by the end of Allende's first year. Some credits from European and Latin American sources kept food imports coming but they too were not likely to be renewed after Chile declared a moratorium on nearly all her foreign debts. After three years of the transition to socialism the economy was in ruins, giving the military yet another reason to intervene.

On the positive side, the Allende experiment had forced the Chilean upper classes to recognize the magnitude of the distribution problem in their society - the enormous differences in social class and economic income that had been concealed by the veneer of social consensus that had been created by an almost-uninterrupted history of 140 years of constitutionalism with at least the trappings of democratic participation. (In fact, presidential manipulations of the vote, limitations on registrations, and landlord control of peasant voting had meant that it was not until the 1950's that Chile experienced the reality of universal suffrage.) The continuing problem of foreign control of Chile's most important natural resource, its copper mines, had been solved by a constitutional amendment which was a reflection of a genuine national consensus. And various experiments in worker control of industry in the Allende period had shown that economic democracy was not simply a wild theory, but a real alternative

to capitalist managerial relations. The Allende years had also shown that the Soviet Union was determined not to give the same kind of unrestricted support to a second Cuba that it had given to the original model.

What the Allende experiment had not shown is that a polarizing politics based on Marxist doctrines of the class struggle is an effective method of democratic reform. Indeed, it seemed increasingly clear during the Allende years that Marxist slogans were more effective in mobilizing the middle and upper classes in opposition to the regime than in expanding its support among the lower classes. If reform was to take place under democratic auspices it could not pit one group against another but needed to be based on the expansion, rather than the contraction of national support. To come to power with only slightly over one-third of the vote and then expect to carry out fundamental social and economic ~~and social~~ changes required at the very least negotiation with additional political and social groups besides the original electoral base if democratic legitimacy was to be maintained.

The Allende experiment then did not prove that democratic reforms to promote the welfare of the lower classes were impossible but only that they must be carried out more incrementally and consensually than the Marxist formulations of the Popular Unity leadership would argue. A via chilena was possible, but it was also very difficult. And crucial to its implementation was the maintenance of the democratic legitimacy that had enabled Allende to get to the presidency in the first place, since as Socialist Senator Carlos Altamirano <sup>later</sup> recognized ~~after the coup~~ during his years in exile in Europe all the talk about impending confrontations with bourgeoisie

only became a kind of self-fulfilling prophecy from which the very groups that the Marxists were attempting to assist would suffer the most - the peasants, the workers, and the poor.

Finally, another lesson of the Allende years was the importance of the economy in providing the wherewithal to carry out programs of social reform. Chile may not have been as dependent on the capitalist world-system as some of the Chilean left believed but cutting oneself off from the sources of investment, technology, and markets on the United States could only be viable if one were assured of alternative outlets in the ~~USSR~~ <sup>Communist world -</sup> - or as occurred for a time, in Europe and Latin America. The alternative was to engage in the kind of bargaining and manipulation that the Christian Democrats had practised with considerable success during the 1960's - proposing, for instance, that compensation for the copper nationalizations would be dependent on company performance in marketing and technology contracts, as the Venezuelans later did when they nationalized their petroleum companies in 1976, rather than using, as Allende did, a fallacious theory of excess profits to avoid paying compensation to the companies.

One additional lesson that other Latin American Marxists, notably the Sandinistas in Nicaragua, drew from the Chilean experience was the importance of control of the armed forces. Allende did better on this score than many expected at the time of his election, carefully cultivating the top military leadership, never opposing their views on important issues of national security, and, unlike Frei, maintaining the living standards of the military at a level at least equal to that of other sectors of Chilean society. His most successful accomplishment in this area was the conversion to his

support of General Carlos Prats, the army commander-in-chief, not only moving him from opposition to defense of Allende's programs but even encouraging him to believe that he might well be elected as his successor as president in the 1976 presidential elections.

### Pinochet and the Chicago Boys

After the September 1973 coup led by General Augusto Pinochet, Chile embarked on another and radically different experiment in development. Before the coup many political observers believed that the Chilean armed forces would embark on a corporatist nationalist program not unlike that being undertaken by General Juan Velasco in neighboring Peru. ~~was~~ *In fact, however,* their rejection of the statism of the Allende government, and their belief that the Christian Democrats had paved the way for that government by their populist measures in the 1960's led them to embrace a third alternative approach to development, the free market policies recommended by "the Chicago boys" - the professors of the Catholic University School of Economics who since the mid-1950's had been imbued by Milton Friedman and Arnold Harberger at the University of Chicago in the virtues of private enterprise and competitive markets. Under their direction and with the support of the military, the Chicago economists dismantled the huge statist bureaucracy developed by the left, removed most of the 3000 price controls and freed the exchange rate, returned the confiscated agricultural lands and industries (but not those, like the copper mines, that had been taken over by legal means), and lowered tariff protection from an average of 94% to 52% in 1975, 22% by 1977 and 10% by 1979. At the same time, the military dismantled

Chile's left-dominated trade unions, took over its universities, and dissolved or declared in recess its political parties and congress. The defenders of the Chicago economists argued that their attempt to create a libertarian economic system would provide the pre-conditions for a decentralized and depoliticized democracy which would maximize the possibilities for economic and political choice for all Chileans, but the economics and political changes were enforced by a repressive security apparatus (from 1974 to 1977 the dreaded DINA that was responsible for the torture and death of 1000s<sup>1</sup> of Chileans and thereafter the National Information Center which engaged in somewhat less repressive methods but still ~~ensured~~ that Pinochet would maintain control.)

More strictly economic arguments used by the Chicago reformers attacked the irrationality of the Allende economic system with six different exchange rates, subsidized food but controls on prices paid to farmers, negative interest rates, and statist protection of industry. The attack went ~~further~~ <sup>beyond</sup> ~~than~~ the Allende policies, and argued that they were only the logical extension of earlier statist and politically skewed policies that had crippled the Chilean economy for decades. Removing the state from the economy and letting market forces make most decisions <sup>would leave</sup> ~~left~~ government free to concentrate on a supportive social role which included targeted social programs such as nutritional aid to pre-school children, free lunch programs, subsidies to employment and public works, and educational reforms that emphasized primary and secondary education and put university education on a pay-as-you-go or low interest loan basis.

The Chilean Economic Miracle

What were the results of the Chicago program? It started slowly - partly because the Chicago boys did not have total control of economic policy in the first two years after the coup. Sergio de Castro, the former dean of the Catholic University Social Science Faculty and head of its school of economics, only became Minister of Economics in mid-1974 and Minister of Finance in 1976. By the latter date, however, the Chicago control over economics was complete, and de Castro remained as Finance Minister until April 1982, making all major economic decisions over a period of six years.

During the period of Chicago dominance, over 400 companies were returned to their former owners or sold to private interests. Only 2 of the 19 banks in state hands at the time of the coup did not become privatized. Thirty percent of agricultural holdings that had been taken over were returned to their owners, and another 35% was distributed to small holders. In 1975-76 public employment was cut by 20% and the economy contracted violently, with a drop in GNP of 11% and an increase in unemployment to 16%. Thereafter however, inflation began to drop rapidly. In 1976 and each year thereafter with the exception of 1979 (the year of the second OPEC price hike) it dropped in half, bottoming out at 9.8% in 1981. Economic growth took off, beginning in 1976 with a 4.1% increase, followed by 8.6% in 1977, and 7.3% in 1978, and similar rates for the following two years. As the Chilean "economic miracle" brought Japanese cars, Hong Kong television sets, Adidas shoes, and scotch whiskey at lower prices than in London and New York, it seemed that the Chicago policy was an astounding success.

Never mind, that critics complained of "the social cost" of the great experiment—unemployment rates in the 13-15% range, malnutrition among the lower classes that could not pay "realistic" prices for basic goods, low wages for the workers since ~~before~~<sup>until</sup> 1979 trade unions were not permitted to function, and a 20-25% drop in savings and investment as Chile's new affluence financed consumer imports and financial speculation rather than productive enterprise.

### Collapse of the Model

Yet as suddenly as the takeoff in the mid-1970's came the crash of the early 1980's. In mid-1981 the first bankruptcy of a large sugar refining company made the government violate its non-interventionist principles and bail the company out. Then several banks and financial holding companies were taken over in late 1981. By early 1982 a wave of bankruptcies and a soaring unemployment rate (reaching 23% by June) revealed that something was radically wrong with the economy. Pinochet reluctantly fired de Castro, but replaced him with another Chicago economist. Then after announcing that Chile would never devalue, the first of a series of devaluations took place, followed by interventions and takeovers of more banks, and a dizzying series of new Finance Ministers, a rise in inflation to 30%, and an increase in unemployment including government make-work programs to nearly a third of the population. The Chicago policy was in ruins. What had gone wrong?

At first the government blamed external factors - the drop in the price of copper, Chile's principal export to its lowest price since the depression,



combined with very high international interest rates especially for short-term loans. What the Chicago economists only admitted reluctantly, however, was that part of the problem was the direct result of their policies. In the first place, in order to bring inflation down, de Castro had first revalued the Chilean peso, then had fixed it in mid-1979 at a permanent rate of 39 to the dollar and kept it there regardless of the fact that in 1979 and 1980 Chilean inflation rose faster than the world rate, thus pricing Chilean exports out of the international market and making imports very cheap. In the second place, controls on dollar loans had been lifted in 1978 and 1979 and Chilean banks and even private individuals began to run up huge dollar debts because the world interest rate was so much lower than the internal rate in Chile. Thirdly, Chilean wages under the ~~no~~ 1979 Labor Plan were indexed and rose even faster than the cost of living. The result was that once confidence was shaken by the first bankruptcies, the whole "house of cards" collapsed. Yet the government refused to devalue for at least a year after the first signs of trouble, and ran up a 4 billion balance of payments deficit in 1981, increasing Chile's international indebtedness by mid-1982 to \$17 billion - on a per capita basis one of the highest in the world. Now, it is saddled with IMF austerity programs, bank renegotiation, and an economy in the depths of a depression from which there does not seem to be a way out.

What are the lessons to be learned from the failure of the Chicago experiment in Chile? Does it prove that the free market and export-oriented policies were wrong? Not really, since the only problem that was directly related to free market ideology was the refusal to regulate private foreign

borrowing, on the theory that such borrowing was being done at the risk of borrower and lender, and did not involve the government in any way. In fact, of course, once the private debtors got into trouble, the government was forced to step in both because of the domestic economic consequences and the adverse impact default would have on ~~Chile's~~ <sup>the Chilean government's</sup> ability to borrow on international financial markets. (The lack of public investment might also be related to the free market absolutism of the Chicago boys, although ~~some~~ efforts to encourage investment through tax benefits similar to the ones they employed to encourage employment would not seem to be out of line with a general free market approach.)

The other policies that got the Chileans in trouble, however, indexing of salaries, and above all, the dogged insistence on a fixed exchange rate did not follow directly from the Chicago approach - and indeed might be regarded as violations of its free market principles. Moreover, as Milton Friedman himself observed in 1981 a free economy is usually associated with free politics - and the lack of political freedom is what enabled the Chicago economist to override or ignore all criticism. It is also true that even the Chicago school accepts some protection for infant industries while Chile opted for an undifferentiated 10% rate which did not distinguish among desirable and undesirable, productive or unproductive imports - on the grounds that such distinctions would provide the opening wedge for a return to the politicization of the economy.

In the wake of the financial collapse, the Pinochet government has now allowed tariffs to double, inflation to rise to 20-25%, and ~~it~~ has taken over 85% of banking credit. Yet it still maintains that Chile is

basically a "social market economy," despite the criticism of the "Chicago way to socialism" on the part of the financial groups that have been adversely affected by the takeovers.

Further changes are likely in the future in the direction of a greater state role in the economy - if only to satisfy the IMF and Chile's foreign creditors - and even more if the anti-Pinochet feeling that has been fueled by the failure of the economic policy with which he had identified himself results in a change of government. Yet some elements of "the Chicago model" will remain - since there is no one who wants to return to the completely centralized statism of the Allende period, and, despite the recent reverses, there is still a <sup>widespread</sup> belief in the superiority of the market in making economic choices in many areas. Whether this belief has in fact taken <sup>permanent</sup> root in Chilean society will be tested when Chile returns at least to its historical tradition of constitutionalism, freedom of expression, and democracy.

Selected Bibliography

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