

Up for Debate:
Reform Without Liberty: Chile's Ambiguous Legacy
Milton Friedman

The Chicago Boys

INTERVIEWER: Tell us about some of the abuse you had to suffer and the degree to which you were seen as a figure out on the fringes.

MILTON FRIEDMAN: Well, I wouldn't call it abuse, really. I enjoyed it. The only thing I would call abuse was in connection with the Chilean episode, when Allende was thrown out in Chile, and a new government came in that was headed by Pinochet. At that time, for an accidental reason, the only economists in Chile who were not tainted with the connection to Allende were a group that had been trained at the University of Chicago, who got to be known as the Chicago Boys. And at one stage I went down to Chile and spent five days there with another group -- there were three or four of us from Chicago -- giving a series of lectures on the Chilean problem, particularly the problem of inflation and how they should proceed to do something about it. The Communists were determined to overthrow Pinochet. It was very important to them, because Allende's regime, they thought, was going to bring a communist state in through regular political channels, not by revolution. And here, Pinochet overthrew that. They were determined to discredit Pinochet. As a result, they were going to discredit anybody who had anything to do with him. And in that connection, I was subject to abuse in the sense that there were large demonstrations against me at the Nobel ceremonies in Stockholm. I remember seeing the same faces in the crowd in a talk in Chicago and a talk in Santiago. And there was no doubt that there was a concerted effort to tar and feather me.

INTERVIEWER: It seems to us that Chile deserves a place in history because it's the first country to put Chicago theory into practice. Do you agree?

MILTON FRIEDMAN: No, no, no. Not at all. After all, Great Britain put Chicago theory in practice in the 19th century. The United States put the Chicago theory in practice in the 19th and 20th century. I don't believe that's right.

INTERVIEWER: You don't see Chile as a small turning point then?

MILTON FRIEDMAN: It may have been a turning point, but not because it was the first place to put the Chicago theory in practice. It was important on the political side, not so much on the economic side. Here was the first case in which you had a movement toward communism that was replaced by a movement toward free markets. See, the really extraordinary thing about the Chilean case was that a military government followed the opposite of military policies. The military is distinguished from the ordinary economy by the fact that it's a top-down organization. The general tells the colonel, the colonel tells the captain, and so on down, whereas a market is a bottom-up organization. The customer goes into the store and tells the retailer what he wants; the retailer sends it back up the line to the manufacturer and so on. So the basic organizational principles in the military are almost the opposite of the basic organizational principles of a free market and a free society. And the really remarkable thing about Chile is that the military adopted the free-market arrangements instead of the military arrangements.

The Fragility of Freedom

INTERVIEWER: When you were down in Chile you spoke to some students in Santiago. Can you tell me about that speech in Santiago?

MILTON FRIEDMAN: Sure. While I was in Santiago, Chile, I gave a talk at the Catholic University of Chile. Now, I should explain that the University of Chicago had had an arrangement for years with the Catholic University of Chile, whereby they send students to us and we send people down there to help them reorganize their economics department. And I gave a talk at the Catholic University of Chile under the title "The Fragility of Freedom." The essence of the talk was that freedom was a very fragile thing and that what destroyed it more than

anything else was central control; that in order to maintain freedom, you had to have free markets, and that free markets would work best if you had political freedom. So it was essentially an anti-totalitarian talk.

INTERVIEWER: So you envisaged, therefore, that the free markets ultimately would undermine Pinochet?

MILTON FRIEDMAN: Oh, absolutely. The emphasis of that talk was that free markets would undermine political centralization and political control.

INTERVIEWER: In the end, the Chilean [economy] did quite well, didn't it?

MILTON FRIEDMAN: Oh, very well. Extremely well. 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.

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Arnold "Al" Harberger

The Miracle of Chile

INTERVIEWER: One of the points Friedman was making was that free-market policies ultimately lead to a freer political system. Was he suggesting that the free-market policies would ultimately undermine Pinochet's [regime]?

AL HARBERGER: Oh, I think he always said that. He said that you cannot have a repressive government for long within a genuinely free economic system and that the freedom is going to have to pass over

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to the political side, and that of course, is exactly what did happen in Chile. The evolution took quite a number of years to make, but it happened, and in that sense, Chile is an example of a peaceful transition from [authoritarianism] to a civilian democratic government. Chile I think is the first place where coming out of a big collectivist mess, a coherent set of actions were taken that derived from a vision of how the economy works and what is the role of the state in the economy and so on [and] that was successfully implemented and with, I would say, great success.

INTERVIEWER: What do you mean by the Miracle of Chile?

AL HARBERGER: I think that there are two elements here. One is that all of Latin America, or nearly all, was beset by the so-called debt crisis of the 1980s. This started with the oil boom, oil price boom of 1979-80, when oil got to \$40 a barrel, and these petrodollars, as they are called, went to all the oil-producing countries. And the sheikhdoms, in particular Saudi Arabia, those guys, they didn't know what to do with this money, so they dumped it in the international banks, so here were the international banks with billions of dollars and nowhere to earn interest on it. They discovered Latin America, which had been moving in this free-market direction, and Latin America became their darling. Bankers were coming down, occupying all the hotel rooms in Santiago, Buenos Aires, Rio, and so on and shoving this money down the throats, almost, of the Latin American private sector [and] in some cases of government. The Chilean government didn't borrow much, but the private sector was the one where Chile's debt got big. Well, then, all of a sudden, as the country was getting used to an inflow of capital, [it] dropped by a full 10 points by 1982, and that swing -- it didn't even go to an outflow; it went from a big inflow to a small inflow -- was enough to throw the economy into a huge recession, and all these countries were in this huge recession. The Chilean one was maybe deeper than the others for reasons of it having a large amount of debt to begin with and of this problem coinciding with a copper bust, but anyway, 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." In Chile, it was the better part of it that was lost. But Chile was the first to come out. Chile came out growing at 5, 6 percent per year -- and long after. You see, you can say that when you're in a recovery period, you're recovering lost ground, [and] it's reasonable to think you'll do that fast, but after you've recovered the lost ground and you're going on, if you continue on the same or even increasing trajectory, that's even more of a miracle. And that is all part of the Chilean picture.

The other part is that the last half of this episode, from 1990 onwards, it was in totally opposite governmental hands, that the Chileans, Chile's free elections put the so-called Concertación [coalition party] in power in 1990, and since then, it has been the Concertación that has governed Chile. We are now in the third [Concertación] presidency. We had [Patricio] Aylwin; we had [Eduardo] Frei; and now we have [Ricardo] Lagos in Chile, all of them people who come from the opposition to the military government. Yet the economic policies have remained basically the same, have in some degrees carried forward. And in places where there were still things to be done, there had been steps taken in that direction, some people would say maybe not fast enough, but nonetheless enough to say that the big issues of economic policy are not partisan issues in Chile anymore. It is an open economy with low tariffs, without price controls, with plenty of reliance on the market, with building financial connections with the rest of the world. All this is matter of consensus in Chile, and I still find it a marvel to behold.

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Oswaldo Sunkel

The Chicago Experiment

INTERVIEWER: What happened in Chile, with Chicago Boys, was first of a kind. Was it influential on other countries, even on Britain or on

other Latin American countries? Or was the human rights record so ugly that people tended to shy away from it?

OSVALDO SUNKEL: The Chicago Boys' experiment in Chile was influential in other countries. But it was a part of a changing worldwide climate against the statism of the '50s and '60s. It happened very soon afterwards with Margaret Thatcher in England, with Reagan in the United States, and there was already, in the financial circles, the beginning of the end of the socialist experiments. The world climate was changing from what I call state-centric development to market-oriented development. This was something that was happening all over the place.

It was also very much a consequence of the tremendous expansion of the monetary and financial sphere of the economy. As a consequence of the petrodollar expansion, banks became much more important. [The] financial press became much more important, the economic profession became much more market-oriented. Keynesianism was being pushed aside. So there was a whole objective and subjective change in the world conception about economic policies and the managing of economies. And the Chicago experiment in Chile came right at that moment. It was in that sense very fortunate, and it began having consequences in other countries of the region where, by the way, many of these Chicago Boys were. All the other countries of the Latin American region had also studied [this]. There were many colleagues around in the various countries who were watching these experiments very closely and with much interest and hoping that in their own countries they would have a chance to do the same things.

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Sergio de Castro

"There's no doubt they're doing better"

INTERVIEWER: In the context of the time, how revolutionary did the Chicago ideas seem in Latin America.

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SERGIO DE CASTRO: I would say very revolutionary. The emphasis at the time was basically on protecting the national industry so that it could develop itself. Around the 1930s, after the Great Depression, exports fell 90 percent, and what this did was create a shortage of dollars, and there became a great trend to basically save dollars, which therefore led to the substitute of imports, and that was the theory that dominated the thinking from 1940 to 1970.

INTERVIEWER: Do you feel in the long term that your program sustained Pinochet or undermined him?

SERGIO DE CASTRO: I believe that the policies that we implemented allowed the country to develop. Proof of our success was that these reforms were copied throughout Latin America and the rest of the world. Remember that these reforms took place in 1973; Margaret Thatcher and her reforms took place in 1980, so we anticipated her reforms by several years.

INTERVIEWER: At the end of the day, looking at ordinary Chilean working people, the sort of people who might have voted for Salvador Allende, had great hopes of him, are they better off or worse off today?

SERGIO DE CASTRO: There is no doubt that they are doing better. 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. There are now lunches in school, milk is given to mothers, and all of these factors have helped improve the quality of life for Chileans.

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Alejandro Foxley

"A very high human price"

INTERVIEWER: What were your key criticisms of what we might call "Chicago-Boy economics"?

ALEJANDRO FOXLEY: When Pinochet finished his 17-year term, almost one half of the families in Chile were living below the poverty line -- to be more precise, 44 percent -- and that's not a very good record. [The Chicago Boys] were starting a very big process of transformation of the economy without any regard for what would happen to the people, and we ended up at one point in time with a 30 percent unemployment rate. I don't think that's a very nice way of opening up an economy to world markets. These days [the Chicago Boys] would be asked, "Didn't you know about human rights abuses?" Every time we asked this question from somebody in the political side of the government, they would say, "Don't ask any questions; you pay attention to the economy." If I were in their position, I wouldn't quite have accepted that answer.

... If you compare the performance of the economy in the best Pinochet years with the performance of the economy in 10 years of democracy, I challenge you to find one single economic or social indicator in which democracy hasn't performed much better. And that, I think, is a point that has to be made. Democracy can be more efficient in terms of growth, in terms of income distribution, in terms of solving the problem.

INTERVIEWER: What's the reason for that?

ALEJANDRO FOXLEY: You listen to people. You're not stubborn. You try and make it compatible, the need to modernize the [economic] structure of the country with a development effort on the part of the government to improve the lot of the very poor. You must develop some kind of social protection for those who are left out of the process of globalization.

INTERVIEWER: What would be your final verdict on the Pinochet years in terms of economy?

ALEJANDRO FOXLEY: It's a very mixed performance. The average growth rate in the 17 years of Pinochet was a mediocre 3.5 percent. That's an average. In 10 years of democracy we doubled our rate [to] 7 percent a year. So in that respect I don't think they have much to show. In terms of the deeper transformation of the economy, they certainly were able to anticipate what became a global trend afterwards. They were able to start a process of deregulating the markets, opening up the economy, and allowing everybody to have a share in world markets, to be able to compete, and the need to increase productivity. All of those things later became a global trend. That was their contribution. They were able to anticipate a global trend that Chile benefited from.

INTERVIEWER: But at a terrible price?

ALEJANDRO FOXLEY: At a very high price. Believe me, at a very high human price.

**Up for Debate:
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Domingo Cavallo**

Chile's Impact on Argentina

INTERVIEWER: Did the Chile experience impact your own thinking?

DOMINGO CAVALLO: The experience of Chile during the '80s was very instructive for most Latin American economies and for many politicians in Latin America, because Chile [became] successful by opening up and trying to expand their exports and in general their foreign trade and getting more integrated into the world economy. And they also succeeded in stabilizing the economy during the '80s. So most Latin

American economists and a few Latin American politicians looked at the Chilean experience. And of course we used, particularly here in Argentina, the experience of Chile to go ahead with our own reforms. So the experience of Chile was very instructive for us from the practical point of view, not that much from an ideological point of view. But we watched their reforms in the direction of opening up the economy to foreign trade and investment and deregulating the economy, and from that experience we were convinced that that was the right approach. And that's why, in Argentina and in many other countries, during the '90s we did implement pro-market reforms.

INTERVIEWER: Did the association with the Pinochet government make it difficult for you to accept some of these reforms, to accept free-market ideas as viable?

DOMINGO CAVALLO: You know, there were discussions on the feasibility of implementing market reforms in a democracy, because the only experience had been under Pinochet, in a dictatorship. But in 1990, President Patricio Aylwin, the first democratic president after Pinochet, maintained the reforms and also tried to improve on them, but keeping the same approach, keeping the economy open to the world. That facilitated the adoption by the young democracies of Latin America of the same approach, because it was demonstrated that it would be possible to implement similar reforms under a democratic regime. So I think that it was the successful transition from dictatorship to a democracy in Chile and the preservation of the reforms that helped to convince [people], particularly politicians, that it was good to adopt the same approach.

INTERVIEWER: Why is it that Chile's reform was successful and Argentina's wasn't?

DOMINGO CAVALLO: I think the big difference is that Chile was able to maintain fiscal discipline and Argentina was not. Some people say the monetary regime of Chile was different from the monetary regime of Argentina; the monetary regime of Argentina was too rigid, too inflexible. I don't think that that is the difference, because we would have been even less disciplined in the fiscal arena if we had been more

flexible in the monetary arena. And so it is not too much discipline that generated the crisis in Argentina. On the contrary, it is the lack of fiscal discipline that generated the crisis.

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Gonzalo Sanchez de Lozada

Stabilization and Democracy Are Not Mutually Exclusive

INTERVIEWER: Were you in any way influenced by what happened in Chile a few years before?

GONZALO SANCHEZ DE LOZADA: Yes and no. Remember, Chile was the paradigm that you couldn't stop a hyperinflation without an authoritarian government. [President Salvador] Allende and the Chilean democracy had gotten into deep trouble because they lost all control. For political reasons, ideological reasons, they started nationalizing industries, and they had a lot of problems and a great deal of conflict in the Chilean politics.

It ended up with a coup, and everybody felt if you got into trouble you had to bring in the military; you had to give up your civil liberties, your human rights to be able to solve the economic problem. They felt that was the price of solving hyperinflation, and we were able to show that it could be done in a democracy. We had to take very dramatic steps. We had a state of emergency, which is in our constitution. We had to take a lot of people prisoner who had started strikes at the oil refineries, and finally we had to get the full support of the Congress, set up a strong alliance, and make it work. And we had the credibility - - political, social, and economic credibility. The importance of the Bolivian experience was [it was] the first time in Latin America that stabilization had been achieved in a democracy without going against people's human liberties, letting people express themselves. And there were some very unhappy people, but convincing the people that this

was the only way out and that, although it hurt, they had to take the medicine.

INTERVIEWER: Just jumping back to Chile, would you be critical of people that knocked Milton Friedman [for his work in Chile during the Pinochet years]?

GONZALO SANCHEZ DE LOZADA: I don't know if I would. I've never liked to judge other people in the hope that they won't judge me. But personally I could not be a party to any sort of effort that was done outside of the context of democracy. My father was exiled for it; I was identified with it. I only became involved in politics when democracy returned to Bolivia. Then, unluckily in democracy, we ran into the inheritance of 20 years of military government, a great deal of debt, and a great deal of expense.

I wouldn't judge anybody, but I wouldn't do it, because I think that democracies are flexible enough, and they have enough authority if they are well run by people who know and that they've been truly elected by the people, to take the steps that have to be taken. I think we're in trouble.

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Joseph Stiglitz

Cutting the Dog's Tail

INTERVIEWER: Let's look at the example of Chile, where Milton Friedman once said that you can't cut the dog's tail little by little; you've got to hack it. And it seems that everybody was really impressed with Chile for a long time. What are the lessons?

JOSEPH STIGLITZ: Well, first of all, when they followed Friedman's prescription, Chile had a crisis, the free-banking experiment, that was

done under the intellectual leadership of that free-market hypothesis, [and] had the kind of boom and bust that we've seen around the world. And Chile, while it grew, then fell precipitously, and has now recovered from that and has been growing strongly. But that experiment in real free market was not a success. They went from that to a much more regulated market economy. They imposed capital controls, controls in the inflow of capital so they wouldn't be inundated in the way that Thailand was, that led to the [Asian financial] crisis. So it's not an example of free market; it's an example of a success of combining markets with appropriate regulation. Some parts of their achievement were achievements that in retrospect are beginning to be questioned, and even to the extent that they were successful are unique to the particular circumstances of Chile. For instance, one of the experiments of Chile was privatization of social security. When you privatize social security, you have a set of unfunded contingent liabilities of people in the future. Chile was lucky: It had these copper mines that it was able to privatize and use the revenues to fund that unfunded liability associated with a public pension program. But most countries don't have copper mines that they can privatize. And so in the process of trying to privatize or fully fund social security, you have to get the funds somewhere, from taxes or otherwise. And that has been a real problem in many of the other Latin American countries.

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Jeffrey Sachs

When Chile Became a Role Model

INTERVIEWER: Isn't it true, though, that in a way Chile was the real forerunner of free-market reforms, that the whole thing was tried out there about ten years [before Margaret Thatcher]?

JEFFREY SACHS: Chile was probably the country in Latin America that first started rather radical market reforms after a long period of heavy

state interventionism. Chile, though, instituted these reforms under a quite brutal military dictatorship. Bolivia was really the first example, in my view, of the combination of democratic reform combined with economic institutional change. And Bolivia much more than Chile showed that you could combine political liberalization and democracy with economic liberalization. I think that's an extremely important lesson to have both of those working in parallel and each one reinforcing the other.

INTERVIEWER: So would it be fair to say that Pinochet's regime and his methods -- basically killing people -- discredited those reforms to begin with?

JEFFREY SACHS: Chile's reforms as of 1985 were still a question mark, even in terms of their pure economic value, because when Pinochet came in in 1973 and instituted a first round of reforms, there was a quite rapid economic growth up till the end of the '70s. But in 1981 Chile had an extremely deep crisis linked to debt crisis and a collapse of the world copper prices. And the economy went into a huge downturn. So by 1985 Chile was just starting to recover in the context of those market reforms. Given the combination of Chile's own crisis and the brutality of the Pinochet regime, Chile was not taken as a role model by the rest of Latin America at that point. And I wouldn't say it was therefore a major inspiration directly at all for the Bolivian reforms or for other reforms in Latin America that followed. By the end of the 1980s the Chilean reforms were clearly working. And when Chile democratized on top of that, Chile then became a clear role model in a sense that you could have successful market reform and democracy, but only after this process had already started in some of the other countries.