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**Master in Others' House:  
Structuralism and the Contemporary  
Chilean Development Experience**

by

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Department of Political Science**

**Submitted in partial fulfilment  
of the requirements for the degree of  
Master of Arts**

**Faculty of Graduate Studies  
The University of Western Ontario  
London, Ontario  
January, 1997**

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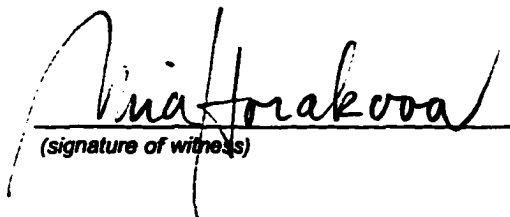
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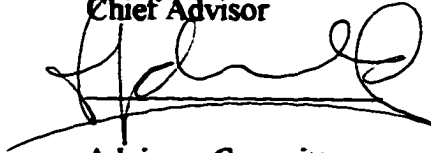
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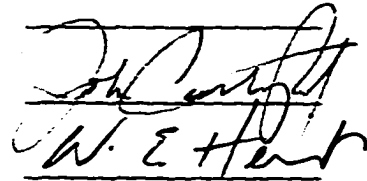


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The thesis by  
Sean William Burges

entitled  
Master in Another's House:  
Structuralism and the Contemporary  
Chilean Development Experience

is accepted in partial fulfilment of the  
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Chair of Examining Board

## **Abstract**

The accepted wisdom in Latin America is that development is most easily achieved through the pursuit of neo-liberal economic policies. This thesis uses the basic assumptions behind structuralist theory to demonstrate that neo-liberalism has not resolved the fundamental problem of Latin American vulnerability to the international economy -- the prime barrier to Latin American economic development. Through an examination of the developmental experience of Chile, a country widely hailed for its economic success, it will be shown that vulnerability to the international political economy continues to be a critical problem for the development of a peripheral country, irrespective of the success it may be experiencing through neo-liberal economic policies.

## **Acknowledgments**

I am indebted to Dr. Veronica Schild for more than her attacks of bibliographic terrorism, trenchant criticism, and endless supply of encouragement that were instrumental and irreplaceable in the writing of this thesis. Without her faith in my abilities, the chance for me to explore the problems of Latin American development would not have arisen. In this context, I also wish to thank the Department of Political Science at the University of Western Ontario - in particular Dr. Albelson, Dr. Mansur, Dr. Keating, and Dr. McDougall - for their assistance and understanding. Away from the politics department, I am forever indebted to Jennifer Cottrill for not only keeping my mind balanced, but also helping me keep sight of reality, irrespective of what the abstract neo-impressionists may have done to it. My parents I thank for their support, particularly in the final stages of the thesis. Finally, my deepest thanks to the staff at the D.B.Weldon Library and the Ivey Business School library for their assistance.



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## List of Acronyms

<b>BA</b>	<b>Bureaucratic-Authoritarian</b>
<b>BHC</b>	<b>Banco Hipotecario de Chile</b>
<b>CEPAL</b>	<b>Comisión Economía Para America Latina Y El Caribe (ECLAC)</b>
<b>COCHILCO</b>	<b>Comision Chilena Del Cobre (Chile Copper Commission)</b>
<b>CODELCO</b>	<b>Corporación Nacional del Cobre (National Copper Company)</b>
<b>COMEX</b>	<b>New York Commodities Exchange</b>
<b>CORFO</b>	<b>Corporación de Fomento (National Development Corporation)</b>
<b>CPC</b>	<b>Cofederación de la Producción Comercio (Production and Commerce Confederation)</b>
<b>ECLAC</b>	<b>Economic Commission for Latin America and the Caribbean</b>
<b>ENAMI</b>	<b>La Empresa Nacional de Minería (National Organization for Mining Promotion)</b>
<b>EOI</b>	<b>Export-Oriented Industrialization</b>
<b>FRAP</b>	<b>Frente Revolucionario de Acción Popular (Revolutionary Front of Popular Action)</b>
<b>GMM</b>	<b>Global Metals and Minerals</b>
<b>IDB</b>	<b>InterAmerican Development Bank</b>
<b>IMF</b>	<b>International Monetary Fund</b>
<b>ISI</b>	<b>Import-Substitution Industrialization</b>
<b>LME</b>	<b>London Metals Exchange</b>
<b>MG</b>	<b>Metallgesellschaft</b>
<b>MNC</b>	<b>Multinational Corporation</b>
<b>SEC</b>	<b>Social and Economic Council</b>
<b>SFF</b>	<b>Sociedad de Fomento Fabril (Manufacturers Society)</b>
<b>SIMEX</b>	<b>Singapore Commodities Exchange</b>
<b>SONAMI</b>	<b>Sociedad Nacional de Minería (National Mining Society)</b>
<b>UP</b>	<b>Unidad Popular (Popular Unity)</b>

To Jennifer Cottrill  
and a group of jumpers called  
the Western Airforce.

*Currere Celeriter,  
Salire Longe*

## **Chapter One**

### **Easy Come, Easy Go: Structural Power and Development**

During nights of guard duty, they had talked man to man, forgetting differences in rank and analyzing the reasons for the military uprising and its consequences. The country had been divided by anti-patriotic politicians who were weakening the nation and turning it into easy prey for enemies from outside, Lieutenant Ramírez had said. It is the first duty of a soldier to protect the nation's security; that's why they'd seized power, to make the nation strong again, and, in passing, to do away with their internal enemies.

*Isabel Allende*  
*Of Love and Shadows*

Chile is being hailed as an economic miracle, its success credited to its devotion to the principles of neo-liberal economics. This elongated South American country is presented by international development institutions like the IMF and the World Bank as unequivocal proof that neo-liberalism is the most reliable path to development. Through its embrace of the global political economy, the recent neo-liberal experience in Chile represents an explicit rejection of the structuralist theory that had previously dominated Latin American development thinking. However, despite the enormous growth that Chile has experienced via the pursuit of an export-oriented industrialization (EOI) strategy, the obstacles to development which structuralists identified as an inherent aspect of the global economy remain.

The intent of this thesis is to show that the problems isolated by structuralists in the 1940s persist, and continue to present a major barrier to development. All of these problems -- inability to create a competitive manufacturing sector, dependence on foreign credit, unequal terms of trade, endemic poverty -- point to the periphery's vulnerability to economic shocks emanating from the center of the international economy. Chile is an ideal case to demonstrate the continued validity of structuralist theory because it has experienced economic booms under both structuralist and neo-liberal economic policies that have collapsed due to structural restraints or shocks. The nature of the country's current economic 'miracle' further highlights Chile's suitability for a re-affirmation of the validity of structuralist observations. Although Chile has posted superior economic growth numbers through the pursuit of neo-liberal economic policies, this growth has by no means eliminated the inherent vulnerability of the peripheral state to the international

political economy. The country's contemporary economic miracle is not based on the kind of strong and viable value-added export sector that characterized the northern industrial revolution, but on the exploitation of the country's rich national resources.<sup>1</sup>

At the base of structuralist theory lies the recognition of a fundamental imbalance in economic power relations between the north and the south. As a result of this divide, the south finds itself at a perpetual trade and economic disadvantage. In an effort to overcome the divide between the developing and the developed a variety of competing theories of development have been advanced. However, neither the structuralist approach that emanated from the Economic Commission for Latin America and the Caribbean (ECLAC) in the 1940s, nor the neo-liberal strategies that came to prominence in the 1970s, have been successful in solving the development puzzle.

This introductory chapter will undertake a review of three prominent Latin American development theories: structuralism, neo-liberalism, and neo-structuralism. After presenting the initial problem of development, the chapter will proceed with a discussion of structuralist, neo-liberal, and emerging neo-structuralist strategies for development. Chapter two presents a history of the Chilean political economy between 1930 and 1975. The intent of this chapter is to show why the Pinochet government turned

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<sup>1</sup> For the importance of advanced manufacturing capacity during the industrial revolution see Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, (USA: Beacon Books, 1957). From a structuralist and neo-structuralist point of view, four sources that provide a good discussion of the importance of an export oriented capital goods sector for a developed economy are Raúl Prebisch, "Dependence, Interdependence, and Development," *CEPAL Review* No.34 (April, 1988), p. 197-205; Raúl Prebisch, "Notes on Trade From the Standpoint of the Periphery," *CEPAL Review*, No.28 (April, 1986), p. 203-214; Albert O. Hirschman, *A Bias for Hope: Essays on Development and Latin America*, (New Haven, Connecticut: Yale University Press, 1971.); Osvaldo Sunkel, ed., *Development From Within: Towards a Neostructuralist Approach for Latin America*, (Boulder, Colorado: Lynne Rienner Publishers, 1993); and Cristóbal Kay, *Latin American Theories of Development and Underdevelopment*, (London: Routledge Press, 1989.), Chapter two.

to neo-liberal economics in 1975 by demonstrating how structuralist economic policies not only failed to overcome structural barriers to development, but also acted to politically divide Chile. The third chapter explores the first great success of the neo-liberal 'Chicago Boys', the economic boom Chile experienced between 1978 and 1981. This chapter shows that, despite strict adherence to neo-liberal theory, a series of structural shocks commencing in 1981 resulted in a spectacular collapse of the nation's economy. The fruits of the resulting revised form of neo-liberalism, an economic 'miracle' built on the export of natural resources, is subjected to a critical examination in chapter four by focusing on the international copper market in the 1990s. Through an analysis of two recent price shocks in the international copper market, it will be shown that the contemporary neo-liberal EOI program, which focuses on the export of natural resources, has not resolved the fundamental issues of vulnerability identified by structuralists.

The analysis that follows relies upon a vast array of recent academic literature which seeks to explore the social and economic transformations that have occurred in Chile. Of particular relevance for the second and third chapters has been the work of Brian Loveman and Eduardo Silva. The fourth chapter makes extensive use of two electronic information sources. The *Chile Information Project* is a subscription based E-mail service that provides english language summaries and translations of leading stories from major Chilean newspapers.<sup>2</sup> *Lexis/Nexis*<sup>3</sup> is an electronic news and information

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<sup>2</sup> The *Chile Information Project* (CHIP) can be accessed on the world wide web at <http://www.chip.cl/>

<sup>3</sup> *Lexis/Nexis* is an electronic fee based information service.



database that was used to obtain full text copies of newswire reports, newspaper articles, and the *Latin American Weekly Reports*.

### **The Structuralist Problem**

The core of the Latin American development debate in the 1940s emerged from a dichotomous model of international economic relations. During the industrial revolution a tremendous socio-economic transformation took place in the dominant countries of the eighteenth century.<sup>4</sup> As Cristóbal Kay noted in his study *Latin American Theories of Development and Underdevelopment*, “the industrial revolution transformed the centre countries into industrial economies, while the peripheral countries were assigned the role of primary-producing countries.”<sup>5</sup> This division between the industrialized countries -- the old colonial masters -- and the periphery -- the colonies -- led to the creation of the core-periphery model.<sup>6</sup>

In essence, the core-periphery model categorizes countries into two groups, the developed center and the underdeveloped periphery. As the European colonial powers and the United States went through the industrial revolution, they developed an increased need for natural resources and markets for their manufactured output. Existing colonial arrangements already saw a massive outflow of raw materials from the colonies to the colonial centres.<sup>7</sup> At the same time, the colonies had seen their domestic manufacturing capacity artificially retarded by policies designed to turn them into a captive market. As

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<sup>4</sup> See Polanyi, *The Great Transformation*.

<sup>5</sup> Kay, *Latin American Theories of Development and Underdevelopment*, 30.

<sup>6</sup> For a summary of the theory behind the core-periphery model, see *Ibid*, p. 29-35.

<sup>7</sup> See Mark A. Burkholder and Lyman L. Johnson, *Colonial Latin America*, (New York: Oxford University Press, 1990.), and Bradford E. Burns, *Latin America: A Concise Interpretive History*, sixth edition. (Englewood Cliffs, New Jersey: Prentice Hall, 1994.)

Raúl Prebisch noted, the periphery was left on the sidelines of the industrialization process because of, "its appendicular role of producer and exporter of primary commodities."<sup>8</sup>

The division between the core and the periphery, however, did not result in complete isolation between the two spheres. Despite the restrictions inherent in MNC-owned natural resource extraction operations, the periphery still had at least nominal control over the production and export of raw materials. However, this was largely ineffective because of the differing levels of income-elasticity of demand for imports and exports between the centre and the periphery. As Kay summarized the problem, "the centre's imports of primary products from the periphery rose at a lower rate than its national income, while the periphery's imports of industrial commodities from the centre grew faster than its income."<sup>9</sup> The centre had the technological capacity to reduce its demand for raw materials as their price rose, and in the case of the United States, its own extensive reserves of natural resources. Furthermore, the exploitation of its near monopoly of technological advances allowed firms in the centre to reduce the quantity of natural resources required to produce a given quantity of goods, irrespective of raw material prices. Consequently, the health of a natural resource exporting periphery country was intrinsically vulnerable to changes in core consumption patterns and production techniques.

Inter-state competition in the periphery for a share of the raw material market created another problem for developing nations. Even if a southern country did attain full

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<sup>8</sup> Prebisch, "Dependence, Interdependence, and Development," 197-198.

<sup>9</sup> Kay, *Latin American Theories of Development and Underdevelopment*, 33.

control of the production of its natural resources, it could not be sure of the price of its produce. Varying levels of supply on the international commodities market could result in price levels that changed dramatically from year-to-year. Backwards integration of MNCs presented developing countries with another problem. As MNCs grew in size and number after the 1950s, they began to create networks of intra-corporation commerce.<sup>10</sup> In the 1950s and 1960s in Chile the national income from the sale of copper was at the mercy of the production and sales decisions of the American owned mines. The copper mines would sign guaranteed supply contracts with American firms for set volumes at prices that were often well below market prices.<sup>11</sup> Thus, to the frustration of Chileans, the income derived from copper sales frequently did not amount to the product of the volume of copper exported and the international price of copper. Chapter four of this thesis examines an even more pernicious problem associated with modern commodities markets: futures trading. Unlike the past where price was related to supply and demand and the business cycle was the main concern of peripheral countries, speculative futures trading and its concomitant price unpredictability presents developing states with a whole new set of problems.

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<sup>10</sup> See Mira Wilkins, *The Maturing of Multinational Enterprise: American Business Abroad from 1914-1970*, (Cambridge, Mass.: Harvard University Press, 1974.) and Richard J. Barnet and Ronald E. Müller, *Global Reach: The Power of the Multinational Corporations*, (New York: Simon and Schuster, 1974.)

<sup>11</sup> Income levels were further reduced by the arbitrary input pricing practices of MNCs. Intermediate products imported from the home corporation were often priced in a manner that allowed the MNC to use intra-firm trade as a method of profit repatriation. For a good summary of the debate surrounding this issue, see Theodore Moran, "Multinational Corporations and Dependency: A Dialogue for Dependents and non-Dependents," *International Organization*, 32 (1) (Winter, 1978), p.79-100. Codelco, the Chilean national copper producer, still engages in advance orders at set prices. However, unlike the past, futures contracts signed by Codelco bear a direct relation to international market prices.

Barbara Stallings summarized the dilemma faced by developing countries in 1978. She concluded that, "development is not a process that takes place in a nation in isolation, but rather is a process that is conditioned and limited by what is happening in the rest of the world."<sup>12</sup> The structuralist school maintains that what places the developing state at a disadvantage is the fundamental structure of the international system. By taking advantage of cheap resources and retaining control of the technology necessary for industrialization, the centre greatly facilitates its own continued economic growth. Thus, "for the structuralist, the removal of the main obstacles to development requires structural reforms of a social and political as well as an economic kind."<sup>13</sup> A key factor in the perpetuation of the periphery's vulnerability is one of these obstacles, the cyclical nature of the international economy:

During an economic upswing the terms of trade generally turn in favour of primary producers but during a downswing they turn against them to an even greater degree. This results in the long-run deterioration of the periphery's terms of trade, especially as the downswings tend to last longer than the upswings.<sup>14</sup>

The only way that this perpetual downward spiral can be avoided is to change the pattern of core-periphery relations. In effect, the periphery has to find a way to escape its role as natural resource producer, and develop a complex, globally competitive industrial sector.

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<sup>12</sup> Barbara Stallings, *Class Conflict and Economic Development in Chile, 1958-1973*, (Stanford, California: Stanford University Press, 1978), p.12.

<sup>13</sup> Kay, *Latin American Theories of Development and Underdevelopment*, 48.

<sup>14</sup> *Ibid.*, 33. In summarizing the key points of ECLAC's structuralist theory in 1962, Hirschman noted that a key theoretical underpinning of the structuralist school was their determination that, "the terms of trade are constantly moving against the primary producing countries." See Albert O. Hirschman, "Ideologies of Economic Development in Latin America," in Albert O. Hirschman, ed., *Latin American Issues: Essays and Comments*, (New York: The Twentieth Century Fund, 1962,) p. 14-15.

The entire structure of the international economy renders the periphery vulnerable to economic shocks that are caused by decisions made in the core. Disadvantages in terms of trade, credit, and production prevent the periphery from attaining any measure of equality with the core in terms of socio-economic development. This inequality leaves a peripheral country's economy vulnerable to changes in the supply of imports and the demand for exports. It is not the presence of the international economic shocks -- changes in international supply and demand levels -- which destabilize the peripheral country's economy that is the prime source of vulnerability, but the peripheral country's incapacity to dissipate the effects of these exogenous shocks. The resultant domestic economic insecurity prevents a stable and continuous pattern of domestic economic growth. This economic insecurity can, in turn, lead to extremely divisive class and intra-class conflict as different segments of society seek to protect their own interests.

### **Structuralist Solutions**

The structuralist solution for Latin America's inability to industrialize was to forcibly change the region's pattern of trade with the core through government intervention. The economic slowdown of the 1930s resulted in a reduction in purchases of peripheral raw materials and a fall in the quantity of capital and consumer goods that countries in the region could import. Many Latin American governments, including Chile's, realized that their economies were highly vulnerable to external economic shocks like declines in demand for their exports or restrictions in international credit. In an effort to overcome this vulnerability, and achieve a higher level of industrialization, South

American governments began to follow a set of policies called import-substitution industrialization (ISI); a restriction of imports through the implementation of high tariff and non-tariff barriers.

As Cardoso and Faletto noted, forced industrialization was not only seen as a key step in the economic development of a peripheral state, but also as a critical move for a country's social development.<sup>15</sup> The use of high tariff walls made it unprofitable for MNCs to act as import agents for their home operations. As the rising tariff barriers made it cost effective to establish branch plants in the periphery, MNCs began to move their productive operations into developing countries. ISI policy makers hoped that the establishment of a domestic manufacturing sector would not only reduce vulnerability to external economic shocks, but would also cause the kind of social transformation which was characteristic of the European industrial revolution.

As Osvaldo Sunkel noted in reference to Chile in 1966, it was hoped that industrialization and urbanization would result in an improvement of the living standards of all segments of society, with a particular emphasis on an improvement in the lot of the poor.<sup>16</sup> In an attempt to mirror the developmental process of the core, peripheral governments encouraged massive migration by the rural poor to urban areas. The problem was that after moving to the city in the hope of finding a good manufacturing job, many people discovered that the promised employment opportunities were simply not forthcoming. After attaining rapid economic growth in the initial 'easy' stage of ISI, many

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<sup>15</sup> Fernando Henrique Cardoso and Enzo Faletto, *Dependency and Development in Latin America*, trans. by Mariory Mattingly Urquidi, (London: University of California Press, 1979), p. 2.

<sup>16</sup> Osvaldo Sunkel, "Change and Frustration in Chile," in Claudio Veliz, ed., *Obstacles to Change in Latin America*, (London: Oxford University Press, 1966), p. 119.

countries discovered that they were unable to expand their industrial plant beyond the production of consumer goods for the domestic market. Consequently, the creation of a wealth of new manufacturing employment opportunities did not occur.

In order to expand and entrench the industrialization that had occurred under ISI policies, it was critical that peripheral countries develop manufacturing sectors that produced intermediate and capital goods not only for the domestic market, but also for export. Three of the four critiques that Hirschman has leveled against the manner in which ISI was pursued are directly related to this problem.<sup>17</sup> First, the consumer goods industry that was created by ISI remained dependent on imported intermediate and capital goods, thereby failing to resolve the initial problem of vulnerability which prompted ISI industrialization.<sup>18</sup> Second, ISI countries had a seemingly congenital inability to export their manufactured goods. The simple reality was that ISI industries were not internationally price competitive.<sup>19</sup> Third, and critical for explaining the eventual abandonment of ISI in Latin America, was the inability of new industries to solve the problem of unemployment. As Theodore Moran has observed, many "multinational corporations employ[ed] 'inappropriate' capital-intensive technologies when they move[d] in, adding to host country unemployment."<sup>20</sup> Indeed, as chapter two will demonstrate, given the opportunity to increase investment levels, most MNCs elected to invest in productive capital, not new productive ventures.<sup>21</sup>

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<sup>17</sup> Albert O. Hirschman, "The Political Economy of Import-Substituting Industrialization in Latin America," in Hirschman, *A Bias for Hope*.

<sup>18</sup> *Ibid.*, 100-101.

<sup>19</sup> *Ibid.* The industries which were created under ISI were sheltered by tariff walls as high as 500 per cent, implying that production of these goods was five times more costly than the alternative imports.

<sup>20</sup> Moran, "Multinational Corporations and Dependency," 85.

<sup>21</sup> *Ibid.*

The result of the half finished industrialization process in Latin America was incomplete national development. Thus, Sunkel was prompted to note that while it had, "been possible for Chilean society to change in many important respects, ... at the same time this change ha[d] not produced the expected egalitarian results."<sup>22</sup> Pursuit of import-substituting industrialization programs did cause the massive migration of people from rural to urban areas that was characteristic of the industrial revolution. However, unlike the northern experience, the sociological changes that occurred in the south were not the result of a gradual evolution. As Aníbal Pinto noted:

A considerable part of the inner structure and the institutional fabric which were the result of a lengthy period of evolution in the developed capitalistic and democratic nations were superimposed arbitrarily on to a basically traditional system of production.<sup>23</sup>

The rapid urbanization that was characteristic of the industrial revolution was a result of changing patterns of production that required a large urban population. Industrialization in the south occurred under the protective umbrella of a high tariff structure, not, like in Europe, because it was independently economically viable. The large demographic shifts caused by Southern governments were, therefore, incited to provide labour to an industrial plant which did not arise independently. As Pinto noted above, Latin American governments artificially caused the changes that had naturally occurred in Europe.

Unlike the northern experience, "in Latin America neither the state nor a rising industrial bourgeoisie has been the principle social force fostering rapid economic development."<sup>24</sup> The economic changes that occurred were largely a result of the

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<sup>22</sup> Sunkel, "Change and Frustration in Chile," 120.

<sup>23</sup> Aníbal Pinto, "Political Aspects of Economic Development in Latin America," in Veliz, *Obstacles to Change in Latin America*, p. 19.

<sup>24</sup> *Ibid.*, 12.



intervention of MNCs. Latin America did not experience the wide-spread rise of a new capitalist class that had its power based in the control of urban manufacturing. Consequently, a great deal of the industrial expansion that did occur had to be supported by the government through wage and price subsidies. Furthermore, the calls for this support came not from the traditional wielders of power, the landowners, but from a newly powerful political party system. Because this pattern of development was funded by government revenue, not private capital, in order to attain specific developmental goals, the end result was high inflation, rising deficits, and the beginning of a critical change in the organization of political power in Latin American societies.

The continued inability of ISI to generate more employment opportunities resulted in vocal demands from urban areas for price controls on a key basket of products, and the redistribution of land and productive resources: the expression of widespread social discontent. In a region where the state had traditionally made itself the servant of the ruling class -- the land-owners<sup>25</sup> -- a polarized political struggle for control of the levers of national economic policy ensued. The end result of these struggles was the rise of a new type of authoritarianism in Latin America which Guillermo O'Donnell called bureaucratic-authoritarianism (BA).<sup>26</sup> Fernando Henrique Cardoso characterized bureaucratic-authoritarianism as a:

situation in which military intervention occurred in reaction against leftist movements and in which the policies which served to reorganize the state and the economy in such a way as to guarantee the continued advance of

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<sup>25</sup> *Ibid.*, 18.

<sup>26</sup> Guillermo O'Donnell, "Reflection on the Patterns of Change in the Bureaucratic-Authoritarian State." *Latin American Research Review*, 13 (1) (1978), p. 3-38.

capitalist industrial development were implemented by the military regime.<sup>27</sup>

As distinct from previous forms of authoritarian government in Latin America, the BA regime<sup>28</sup> did not rely on personalist cliques, but instead was built around a series of technocratic<sup>29</sup> governing departments and institutions which, in an effort to resolve the socio-economic and political tensions which were destabilizing many Latin American countries, followed a new, depoliticized development ideology: neo-liberalism.

### **Neo-Liberalism<sup>30</sup>**

As the ISI stage of the Latin American development process came to a close, it became evident to one group of economists that government sponsored economic growth had resulted in a spiraling inflation rate and unsustainable budgetary deficits. The negative impact that inflation and foreign debt were having on Latin American economies were judged by this group to be the key source of the region's vulnerability. In the search for a solution to these problems, neo-liberal economics came to the fore. The essence of

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<sup>27</sup> Fernando Henrique Cardoso, "On the Characterization of Authoritarian Regimes in Latin America," David Collier, ed., *The New Authoritarianism in Latin America*, (Princeton: Princeton University Press, 1979), p.39.

<sup>28</sup> For more on the imposition of BA regimes, see Manuel Antonio Garretón, *The Chilean Political Process*, trans. by Sharon Kellum and Gilbert W. Merkx, (Boston: UnwinHyman, 1989); Cardoso, "On the Characterization of Authoritarian Regimes in Latin America."; David Collier, "Overview of the Bureaucratic-Authoritarian Model," Collier, *The New Authoritarianism in Latin America*; Robert R. Kaufman, "Industrial Change in and Authoritarian Rule in Latin America: A Concrete Review of the Bureaucratic Authoritarian Model." Collier, *The New Authoritarianism in Latin America*; and Guillermo O'Donnell, "Reflection on the Pattern of Change in the Bureaucratic-Authoritarian State." *Latin American Research Review*, 13 (1) (1978), p.3-38.

<sup>29</sup> David Collier defined a technocrat as: "An individual with a high level of specialized academic training which serves as a principal criterion on the basis of which they are selected to occupy key decision-making or advisory roles in large, complex organizations - both public and private." Collier, *The New Authoritarianism in Latin America*, 403.

<sup>30</sup> In the literature there is a frequent interchange of the term neo-liberal, neo-conservative, and monetarist to describe the ideology described in this section.

the neo-liberal solution was that the government should exercise fiscal discipline by not engaging in deficit spending, and encourage the growth of the economy by not interfering in the operation of the market.<sup>31</sup> Freed of government interference, the market would operate to efficiently allocate resources, create economic growth, and allow wealth to 'trickle down' through the economy, leading to the end of national vulnerability to international economic shocks.<sup>32</sup>

As Joseph Ramos noted in 1986: "According to Southern Cone neoconservatism, the poor economic performance of these countries in the post war period was due to the exaggerated and increasingly discretionary intervention of the state, which replaced the market as the principle mechanism of resource allocation."<sup>33</sup> Neo-liberals felt that the role of the government was not to direct economic development. Instead, the government should ensure that the market did not fail due to the intrusion of externalities or the presence of an incomplete sub-market. If any government intrusion into the free operation of the market should take place, it must only occur if the benefits of such an action clearly outweighed the costs.<sup>34</sup> The problem envisioned by neo-liberals was not that there was any particular fault in the basic socio-economic characteristics of Latin America which resulted in increased vulnerability. Rather, the belief was that government interference in the economy had retarded the region's development process. Neo-liberals felt that in order for Latin American economies to realize their full potential they, "must undergo a

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<sup>31</sup> "A Market Solution for the Americas?" in *NACLA: Report on the Americas*, 26 (4) (Feb., 1993), p. 16.

<sup>32</sup> John Brokman, *Popular Development: Rethinking the Theory and Practice of Development*, (Oxford: Blackwell Publishers Ltd., 1996,) p. 133.

<sup>33</sup> Joseph Ramos, *Neoconservative Economics in the Southern Cone of Latin America, 1973-1983*, (Baltimore: Johns Hopkins University Press, 1986), p. 7-8.

<sup>34</sup> Tariq Banwi, *Economic Liberalization: No Panacea. The Experience of Latin America and Asia*, (Oxford: Clarendon Press, 1991), p. 5.

painful but necessary anti-inflationary therapy to purge themselves of the distortions and obstacles to growth induced by inflation.”<sup>35</sup>

In a self-avowed ‘heroic simplification’, Roberto de Oliveira Campos produced a list of three key reasons why monetarists dislike inflation. First, “inflation has ceased to promote development and in fact has become incompatible with it.”<sup>36</sup> As Campos suggests, excessive inflation creates a great deal of uncertainty about future purchasing power. Consequently, in an effort to protect income, individuals choose to consume rather than invest. However, without continuous investment, continued economic growth becomes impossible. Second, “Inflation must be stopped quickly, before it degenerates into explosive tensions.”<sup>37</sup> As the population sees its buying power constantly eroded by inflation, it lobbies the government for price supports and wage subsidies. When the government becomes fiscally or politically unable to accommodate these demands, public insecurity can lead to calls for re-distributive policies in an attempt to re-distribute wealth throughout society in a more equitable manner. Third, “most of the alleged supply inelasticities and bottlenecks are not autonomous or structural, but are caused by price exchange rate distortions generated during the course of the inflationary process itself.”<sup>38</sup> A near continuous devaluation of the national exchange rate, coupled with insecurity about future returns on new investments, results not only in a decreased ability to import, but also in a fall of the domestic economy’s capacity to import-substitute.

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<sup>35</sup> David Felix, “An Alternative View of the ‘Monetarist’ - ‘Structuralist’ Controversy,” in Hirschman, *Latin American Issues*, 82

<sup>36</sup> Roberto de Oliveira Campos, “Two Views on Inflation in Latin America,” in Hirschman, *Latin American Issues*, 69.

<sup>37</sup> *Ibid.*, 69-70.

<sup>38</sup> *Ibid.*, 70.

While neo-liberalism did succeed in gaining control of inflation and other macro-economic indicators by, “radically transforming the way the economy operate[d] and, in its more radical version, the way society and political institutions [we]re organized,”<sup>39</sup> the problem of how to cause economic growth remained. To answer this question, neo-liberals pointed to the economic laws of comparative advantage as a clear indication that economic growth is most effectively achieved through trade.<sup>40</sup> As Jilberto and Mommen observed: “The hypothesis is that trade is an engine of growth and that there is an automatic relationship between economic development in less-developed countries along their economic growth tracks.”<sup>41</sup> Thus in order to encourage trade, both domestically and internationally, and its associated economic growth, the government had to remove itself from the economy. By allowing market forces to determine which firms would succeed and which would fail, scarce resources would be allocated where they offered the maximum return. This in turn would result in sustainable economic growth, free of the need for the kind of government support that neo-liberals felt had led to excessive vulnerability during the ISI period.

Joseph Ramos determined seven basic policy actions that are representative of a neo-liberal economic program; 1) freeing prices to reflect opportunity costs of goods and services, not government directed distributive goals; 2) reducing tariffs and establishing a stable and realistic exchange rate to allow economies of scale and the use of comparative

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<sup>39</sup> Alejandro Foxley, *Latin American Experiments in Neoconservative Economic*, (London: University of California Press, 1983), p. 184.

<sup>40</sup> Alex E. Fernández Jilberto and André Mommen, “Setting the Neoliberal Development Agenda: Structural Adjustment and Export-Led Industrialization,” in Alex E. Fernández Jilberto and André Mommen, eds., *Liberalization in the Developing World: Institutional and Economic Changes in Latin America, Africa and Asia*, (London: Routledge Press, 1996), p. 2.

<sup>41</sup> *Ibid.*

advantage; 3) promote the creation of a domestic capital market by freeing interest rates and removing capital controls<sup>42</sup>; 4) the promotion of the free entry and exit of capital to fully utilize external savings and allow domestic and foreign interest rates to converge; 5) prevent collusion that will distort supply and demand levels; 6) reduce public sector participation in the GNP; and 7) achieve and maintain price stability by eliminating fiscal deficits and controlling monetary growth.<sup>43</sup> In each case these policies involve the government undertaking, "reforms to ensure that international and domestic markets would work more efficiently."<sup>44</sup> After a thirty year history of ISI development in Latin America, the government had become the prime actor in the economy. Consequently, when the neo-liberal reforms altered the role of the government in the economy from that of market supporter to that of regulator, many sectors of the South American economy were rendered economically unviable.

Clearly, the domestic manufacturing sector in most Latin American countries, having evolved behind substantial protective tariff walls, was not globally competitive. When exposed to a central tenet in the neo-liberal ideology -- protectionism results in economic inefficiency, and massive price distortions<sup>45</sup> -- some Latin American countries saw the removal of protective tariff walls, and a near total collapse of national industrial capacity.<sup>46</sup> To replace these industries, the neo-liberals called on businesses in their

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<sup>42</sup> For more on the effects of capital controls on an economy, see David M. Andrews, "Capital Mobility and State Autonomy: Toward a Structural Theory of International Relations," *International Studies Quarterly*, 38 (2) (June, 1994), p. 193-218.

<sup>43</sup> Ramos, *Neoconservative Economics in the Southern Cone*, 9-10.

<sup>44</sup> Stephan Haggard, *Pathways from the Periphery: The Politics of Growth in Newly Industrialized Countries*, (Ithica, N.Y.: Cornell University Press, 1990), p. 11.

<sup>45</sup> Jilberto and Mommem, "Setting the Neoliberal Development Agenda," 1.

<sup>46</sup> For more on the industrial collapse that occurred in the initial stages of neo-liberalism in Chile, see Jaime Gatica Barros, *Deindustrialization in Chile*, (Boulder, Colorado: Westview Press, 1989); Barry P. Bosworth, Rudiger Dornbusch and Raúl Labán, eds., *The Chilean Economy: Policy Lessons and*

economies to take advantage of the relaxation of capital controls<sup>47</sup> and the inherent comparative advantages possessed by the country. While Chile, the case examined in this thesis, has thrived under neo-liberal economic policy, there is an inherent flaw in the export-oriented industrialization (EOI) model advocated by these policies.

As chapter four will demonstrate, the Chilean economic miracle is largely reliant, not upon a newly created manufacturing sector, but on the country's rich copper reserves. The 'trickle down' effect cited by neo-liberals appears to be largely absent in Chile and other Latin American countries. As a result, the growing criticism of neo-liberalism is not predicated on its ability to control macro-economic phenomenon like inflation. Criticisms leveled at neo-liberalism focus on the inability of the EOI model to provide manufacturing jobs to employ the masses of urban poor,<sup>48</sup> and ensure that economic development is achieved in a manner that is sustainable and free from the price shocks inherent in international commodity markets. In a search to reconcile the valid points of structuralism and neo-liberalism a new stream of development theory is emerging, neo-structuralism.

### **Neo-Structuralism**

In attempt to address the weaknesses of the neo-liberal development experience, some theorists are returning to their structuralists roots and attempting to combine the

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*Challenges*, (Washington, D.C.: The Brookings Institution, 1994); Sebastian Edwards and Alejandra Cox Edwards, *Monetarism and Liberalization: The Chilean Experiment*, (Cambridge, Mass.: Ballinger Publishing Group, 1987); Javier Martínez and Alvaro Díaz, *Chile: The Great Transformation*, (Geneva: The United Nations Research Institute for Social Development, 1996); and A.R.M. Ritter, *Development Strategy and Structural Adjustment in Chile: From the Unidad Popular to the Concertación, 1970-92*, (Ottawa: The North-South Institute, 1992).

<sup>47</sup> The potential for disaster by following this route is, as will be shown in chapter three, extremely high.

<sup>48</sup> German Sanchez Otero, "Neoliberalism and its Discontents," in *NACLA: Report on the Americas*, 26 (4) (Feb., 1993), p. 18-21.

lessons of both structuralism and neo-liberalism. Like structuralism, neo-structuralism affirms, "that the main economic problems and the underdevelopment still prevalent [in the periphery] ... are due, not so much to distortions induced by economic policies, as to historical causes of an endogenous and structural nature."<sup>49</sup> Where neo-structuralism differs from structuralism is in the nature and extent of intervention that should be undertaken by the state to promote national development. Learning from the failure of both ISI and neo-liberal EOI to generate any kind of lasting, self-sustaining industrialization, neo-structuralism can perhaps be best summarized as a reversion to pure structuralist theory with an acute awareness of the importance of maintaining the short-term fiscal and macro-economic stability called for by neo-liberals.

In response to the neo-liberal claim that the stabilization of a country's economic indicators will promote growth, Sunkel noted that: "An adjustment program will be efficient only if it helps to correct the permanent imbalances in the external accounts, not only the transitory imbalances."<sup>50</sup> It is not enough to correct a country's temporary balance of payments problems, the source of these problems must be addressed. As Ricardo Ffrench-Davis noted in 1988, the neo-structuralist paradigm, "acknowledges the existence of many different disequilibria and maintains that a number of them are of a structural origin."<sup>51</sup> As the structuralists noted, structural barriers -- inability to create a competitive manufacturing sector, dependence on foreign credit, unequal terms of trade --

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<sup>49</sup> Osvaldo Sunkel and Gustavo Zuleta, "Neo-structuralism versus Neo-liberalism in the 1990s," in *CEPAL Review*, No. 42 (Dec., 1990), p. 41.

<sup>50</sup> Osvaldo Sunkel, "From Inward Looking Development to Development from Within," in Sunkel, *Development From Within*, p. 48.

<sup>51</sup> Ricardo Ffrench-Davis, "An Outline of a Neo-Structuralist Approach," in *CEPAL Review*, No. 34 (April, 1988), p. 40.



are at the source of the disequilibria on which neo-liberals concentrated. On this basis, neo-structuralists reject the neo-liberal proposition that disequilibria are, "assumed to be the result of ill-advised public policies,"<sup>52</sup> and point to the unfavourable insertion of peripheral economies into the global economy as the prime source of national underdevelopment.

As Nora Lustig has noted, it is the manner in which the international economy has developed which serves as a critical barrier to peripheral development:

The development of the periphery has fundamentally depended not on continuing with the historical pattern of specialization based on exploiting static comparative advantages, but, instead on promoting industrial development. Such development can be achieved without import substitution. It can be achieved if the infant industries are furnished with the necessary protection.<sup>53</sup>

Unlike its forerunner, neo-structuralism has partially rejected the notion that massive government intervention in the economy is the only hope for a peripheral state to escape the restrictions inherent in the core-periphery model. As Sunkel and Ramos have noted, neo-structuralism has taken a highly critical look at structuralism's excessive reliance on state intervention and pessimistic outlook towards export possibilities.<sup>54</sup> Instead, there appears to be a growing acceptance that industrialization is possible within the current international economic structure.

It is not domestic demand and market size that are now the keys to development, but the ability to provide a high quality product to the international market at a very low

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<sup>52</sup> *Ibid.*

<sup>53</sup> Nora Lustig, "From Structuralism to Neostucturalism: The Search for a Heterodox Paradigm," in Patricio Meller ed., *The Latin American Development Debate: Neostucturalism, Neomonetarism, and Adjustment Processes*, (Boulder, Colorado: Westview Press, 1991), p. 31.

<sup>54</sup> Joseph Ramos and Osvaldo Sunkel, "Towards a Neostucturalist Synthesis," in Sunkel, *Development from Within*, 7.

cost.<sup>55</sup> Thus, "the aim is to generate an endogenous accumulation process that absorbs and generates technical advances -- including the use of foreign private investment."<sup>56</sup> The emphasis is on cross-sectoral utilization of resources and knowledge to not only more efficiently use available resources, but also to develop new pools of technology and resources with which to reduce the country's dependence on the core.<sup>57</sup> Consequently, a key role of government that is envisioned by neo-structuralists is the creation of organizations<sup>58</sup> to facilitate the cooperation necessary for the formation of new social and industrial capital.

Neo-structuralists do envision government intervention in the economy, but not the wide-sweeping kind experienced under ISI. One role of the government is to correct the sort of market inefficiencies discussed in chapter three.<sup>59</sup> However, a more important role, in terms of national development, is the facilitation of the growth of new industries with a strong export potential. Unlike neo-liberal EOI policies, the emphasis is on the creation of value-added manufacturing firms which will increase national employment levels. The emphasis is not on the present static comparative advantage, but on selecting industries in which the country can reasonably expect to attain a comparative advantage. To develop potential growth sectors, the role of government is not just to provide tariff or

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<sup>55</sup> Ramos and Sunkel, "Towards a Neostructuralist Synthesis," 8-9.

<sup>56</sup> Sunkel and Zuleta, "Neo-Structuralism Versus Neo-Liberalism in the 1990s," 41.

<sup>57</sup> Sunkel, "From Inward-Looking Development to Development from Within," 54-55.

<sup>58</sup> Examples would include business-government consulting agencies, national industrial councils, and most importantly, research institutes at universities which aim to convert pure research into applied uses.

<sup>59</sup> All five of the roles of government in a neo-structuralist state identified by Sunkel and Zuleta fall within the purview of this statement: a) the promotion and stimulation of markets which are lacking; b) the strengthening of incomplete markets; c) the elimination/reduction of structural distortions; d) the elimination/compensation for market defects arising from differing output scales; e) externalities and the learning process. See Sunkel and Zuleta, "Neo-Structuralism versus Neo-Liberalism," 41.

subsidy support to the infant industry, but to coordinate research and development efforts, business - labour negotiations, and reliable capital formation opportunities.<sup>60</sup>

The key lesson which neo-structuralists have learned from both the structuralist and neo-liberal experience with development policy is that no measure of economic reform will last if it does not, "achieve equity and social justice and ... strengthen democratic institutions."<sup>61</sup> Thus, the key goal of neo-structuralist theory is not to create the sort of growth rates that have characterized Chile's recent neo-liberal experience. The goal is to create an even and continuous rate of growth resulting in widespread industrial employment. Rather than perpetuating the pattern of growth through the export of primary commodities, as in the Chilean case, neo-structuralists argue that through the creation of the human capital necessary for the creation of an economy that is globally competitive in terms of, "quality, flexibility, the efficient combination and utilization of productive resources, the adoption of technological developments, creativity, the capacity for organization, [and] social discipline,"<sup>62</sup> it will possible to mediate the nation's vulnerability.

## **Conclusion**

The spirit of the current structure of the international political economy was captured by Gregory Millman in an interview he conducted with a currency trader:

**The thing you have to remember about bureaucrats and governments is that what they'd really like is for everyone to go away and just let them do**

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<sup>60</sup> See Sunkel and Zuleta, "Neo-Structuralism versus Neo-Liberalism," 42-46; French-Davis, "An Outline of a Neo-Structuralist Approach," 41-42; and Sunkel, "From Inward-Looking Development to Development From Within," 54-56.

<sup>61</sup> Sunkel and Zuleta, "Neo-Structuralism versus Neo-Liberalism," 42.

<sup>62</sup> Ramos and Sunkel, "Towards a Neostructuralist Synthesis," 8-9.

whatever the hell they like and be answerable to no one and sit on a big pedestal and announce to the little people below what's happening in the world. When the people in the world sit up and say that's nonsense, you guys are wrecking the economy, they get upset.<sup>63</sup>

International business actors want to function free from any governmental interference: they want the global adoption of neo-liberal economic policies. For a peripheral country like Chile, this implies an adherence to a static comparative advantage that will leave it vulnerable to variations in international demand identified by structuralists in the 1940s. Since the teachings of structuralist and dependency theorists have been rejected by present day Latin American governments, the question remains: How will a peripheral country create a sufficiently strong domestic industrial sector to attain social as well as economic development?

Economic gurus, particularly those at the World Bank and IMF, advocate the pursuit of export oriented development strategies as the most effective route to long term economic growth. The star pupil in this school is Chile. On the strength of massive natural resource endowments, Chile has one of the highest global economic growth rates. Indeed, Chile could be considered as being on the verge of joining the core through the consummation of major international free trade agreements.<sup>64</sup> Yet, the question remains, what does Chile actually produce?

All accounts of the industrial revolution focus on the development of a complex manufacturing sector as the key to industrialization, something that Chile manifestly does

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<sup>63</sup> Gregory J. Millman, *The Vandals' Crown*, (New York: The Free Press, 1995), 123.

<sup>64</sup> Chile has already signed free trade agreements with two of the three members of NAFTA, Canada and Mexico. In addition, Chile has a trading protocol that comes close to a free trade agreement with MERCOSUR. Agreements being developed include a special trading alliance with the EC, APEC, and the Andean Group.

not have. Chapter two will discuss the first Chilean attempt at industrialization through ISI policies. This historical account is important because it establishes the foundation for the emergence of the neo-liberal economic system that forms the backdrop for the third and fourth chapters. In fact, a key element of chapter three is its overt critique of the kind of freedom advocated by individuals like the trader quoted at the beginning of this section. Chapter four continues this critical theme by examining the operation of the international copper market in the 1990s. Indeed, the following three chapters suggest that the greatest barrier to sustained economic development is not a fundamental flaw in the people, but the construction of the international economy and the country's place in it. Irrespective of what form of development policy the Chilean government follows, it remains dependent on actors and resources in the core. This dependence means that a peripheral state must remain vulnerable to unexpected shocks from the international political economy. The result of these shocks can range from the collapse of successful development strategies, to the evolution of the sort of acrimonious domestic political debate that results in a bureaucratic-authoritarian regime. As the very structure of the system works to increase this dependency, it would appear that a peripheral country cannot escape the vagaries of the international political economy and must remain vulnerable to its structure.

## **Chapter Two**

### **From the American Dream To the American Nightmare: A Brief History of the Contemporary Chilean Political Economy**

During the months of September, October, and November the Colonel delivered his speech so many times that had it not been crafted from glowing and durable words it would have turned to ash as he spoke ... While he spoke from a platform erected in the middle of the plaza, El Mulato and his men handed out sweets and painted his names on all the walls in gold frost. No one paid the least attention to those advertising ploys; they were dazzled by the clarity of the Colonel's proposals and the poetic lucidity of his arguments, infected by his powerful wish to right the wrongs of history, happy for the first time in their lives. When the candidate had finished his speech, his soldiers would fire their pistols into the air and set off firecrackers, and when finally they rode off, they left behind a wake of hope that lingered for days on the air, like the splendid memory of a comet's tail. Soon the Colonel was the favorite.

*Isabel Allende,  
"Two Words"*

Chile has never had a large enough population to support a profitable manufacturing sector geared solely towards a domestic market. With a coast line that is some 4 000 km in length, Chile has a population of only 14 million, 85% of whom live in urban areas. The following is an account of how Chilean development policy started down the road to industrialization advocated by Hirschman and Prebisch, but lost its way.<sup>1</sup> Instead of attaining industrial diversification and social development, the pursuit of the dependency style industrialization strategy advocated by structuralists resulted in Chile becoming mired in national and international political and economic constraints. Structural factors in both the domestic and global political economy allowed the kind of restructuring of the nation's socio-economic fabric necessary for development, but did not allow for the creation of a vibrant, autonomous manufacturing sector to support the country's new class structure.

Neo-liberals point to the ever increasing nature of government interference in the economy that occurred in Chile during the Alessandri, Frei, and Allende administrations as one of the key reasons why import-substitution industrialization, and other structuralist theories, are intrinsically unable to facilitate the development of a peripheral country. They argue that the social and political conflict that arose from the struggle to control the government, and by extension the economy, resulted in an environment of open political conflict and the division of the nation. Consequently, elected governments were rendered politically unable to pursue the type of policies necessary to carry Chile to the next stage

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<sup>1</sup> The bulk of the research for this chapter is derived from Brian Loveman, *Chile: The Legacy of Hispanic Capitalism*, (Oxford: Oxford University Press, 1979), and Lois Hect Oppenheim, *Politics in Chile: Democracy, Authoritarianism, and the Search for Development*, (Boulder, Colorado: Westview Press, 1993).

of industrialization. The result was a revolt of the elites, and the call for military intervention. Thus, neo-liberals argue, if policies specifically designed to overcome the barriers to development identified by structuralists are defeated by the structure of the international political economy, then the route to development must lie in embracing this structure, not in trying to reform a nation's place in it.

Structural factors by themselves did not cause the military coup of 1973. However, the economic and political shocks that emanated in the structure of the international political economy did exacerbate a deteriorating domestic political situation and foreclose policy options to successive governments. This chapter is divided into five main sections centered around the different presidential periods involved in this history. During each time period, structural factors intruded into Chilean politics to influence, and in some cases direct, the course that national economic policy would follow. Of particular significance to Chile's development was the way in which these structural factors overlapped different political administrations and caused a specific action, irrespective of the ideology of the president.

### **Depression to Alessandri**

As far back as the mid 1800s Chile has been the site of a great deal of foreign investment. Initially, most foreign capital was concentrated in infrastructure and natural resource extraction. After several decades of accepting foreign control, predominantly British and American, of the key export commodities, Chile tried to retake control of its



own destiny by nationalizing the nitrate industry.<sup>2</sup> No sooner was this accomplished than technological innovation resulted in a massive decline in world nitrate demand.<sup>3</sup> However, while the nitrate industry was in decline, copper mining was on the rise. Once copper had been firmly established as an extremely successful alternative, albeit still predominantly foreign owned, Chile suffered yet another economic shock: the global depression of the 1930s.

The depression served as a watershed in the evolution of national development thought in Chile. With the disruption to global trade caused by the depression, Chileans found that it had become exceedingly difficult to import goods. Due to the global economic slow down, there was a sharp fall in industrial production in all countries. For Chile, this presented two problems. First, demand for its natural resource exports was falling, resulting in a decrease in foreign exchange earnings and a concomitant fall in the country's capacity to import. Second, Chile was reliant upon imports for many basic consumer goods. The fall in international production saw a decline in the availability of imports for the Chilean market. Realizing that this could be a recurring problem in an increasingly international market place, Chilean policy makers sought to isolate themselves from the vagaries of the world economy through the development of a domestic manufacturing capability.

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<sup>2</sup> For more on the foreign dominance of Chilean infrastructure and natural resources see Mira Wilkins, *The Emergence of Multinational Enterprise: American Business Abroad from the Colonial Era to 1914*, (Cambridge, Mass.: Harvard University Press, 1970), Chapter ???, and Thomas F. O'Brien, "'Rich Beyond the Dreams of Avarice': The Guggenheims in Chile," *Business History Review* 63 (1) (Spring, 1989), p. 122-159.

<sup>3</sup> This technological innovation was the creation of synthetic explosives. Much of the existing demand for nitrates had been for the manufacturing of gunpowder.

For the bulk of its consumer goods, Chileans had relied on the import activities of MNCs. As a result of the lessons learned in the depression and the post World War II experience, the government sought to isolate the country's economy from international structural shocks by instituting a series of regulations to *Chileanize* production. In an attempt to gain some measure of control over industrial production, the government implemented import quotas, licensing requirements, tariff barriers, a devalued currency, and multiple exchange rates, -- all classical ISI policy tools -- to create a business environment where it was no longer cost effective for the local arms of an MNCs to act as an import agent. Due to the impetus of the ISI policies, MNCs began to establish a local manufacturing sector, albeit one dependent on foreign capital, knowledge, and semi-processed inputs.

The end result of the protectionist policies was an increased flow of foreign investment into Chile. After the end of World War Two prevailing economic thought in the region called for just this approach to development. As discussed in chapter one, Raul Prebisch and the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) led the way in the development of structuralist and dependency schools of development theory. Through an historical examination of the development pattern of Latin America, the economists at ECLAC determined that a peripheral, resource exporting nation like Chile would be at a perpetual disadvantage in the struggle for economic development. It was only by forcing an inflow of capital and knowledge, resulting in an increase in domestic production, that a peripheral country could hope to attain parity with the core.

A forerunner of the ISI policies introduced in the mid 1940s was the 1939 creation of the National Development Corporation (CORFO), an institution created to help develop new Chilean industries. If growth in gross investment can be considered a measure of the success of CORFO, then the government agency did achieve its aim. The problem was that the new government agency did not cause a rise in domestic or foreign investment rates, more than half of the financing for the new ventures could be traced back to government ministries. As the 1940s drew to a close it became increasingly evident that the government was having to make massive expenditures to support CORFO enterprises. Instead of effectively taxing the exporting foreign owned mining corporations to take advantage of a ready source of foreign exchange, the government opted to finance its national development project through foreign loans. In effect, through CORFO, Chilean policy makers made their economy more vulnerable to the structure of the international political economy by increasing the nation's dependence on core sources of credit. The economic growth sponsored by government run organizations like CORFO resulted in a massive increase in public sector employment that far outstripped population growth, the number of public employees doubling between 1930 and 1949. Yet, despite this massive growth in the public sector, foreign owned private enterprises still accounted for the bulk of Chile's foreign exchange earnings. The failure of government funded enterprises to earn foreign exchange did not present a barrier to the continued pursuit of ISI policies. Repeatedly, between 1945 and 1973 governments of all ideological persuasion opted to continue funding import substituting firms without ever actively

seeking to encourage diversification into the area of export oriented intermediate and capital goods production.<sup>4</sup>

The real significance of the ISI policies lay not in the nature of the economic growth they fostered, but in the way in which they worked to transform the socio-political fabric of Chile. Increased participation in industrial enterprises and a growing bureaucracy all worked to create a larger, more urbanized middle class. From the late 1940s through to the late 1950s peasant farmers, who lived a near feudal lifestyle in the countryside, moved to the city in the hope of finding good manufacturing jobs and a better life. Concomitant with this demographic shift was a marked increase in unionization, primarily in urban areas. The removal of large numbers of farming families from the controlling hands of the *hacienda* owners, and the organization of previously non-politicized Chileans into groups antithetic to the aims of the traditional power elites caused a significant change in the nature of national politics. Political parties in Chile began to assume greater power with respect to the traditional framework of interest factions and personalist cliques as more votes left the control of the *hacienda* owners due to a peasant migration and unionization. proved to be a nightmare come true for Chilean land-owners, the real source of power in Chile.<sup>5</sup> The owners of the large *haciendas* in rural Chile were faced with a double threat from the evermore influential unions. Urban unions demanded price controls on food to allow their membership an affordable lifestyle. Rural

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<sup>4</sup> Both the structuralists and the neostructuralists severely criticize governmental policy makers for their decision not to use the ISI framework to promote the creation of intermediate and capital goods industries oriented towards an export market. As discussed in chapter one, the whole point to the ISI strategy was to give a peripheral country the capacity to develop export industries.

<sup>5</sup> The support of the land-owning class has always been critical to any regime. Pinochet finally began to acknowledge that his policies were problematical in the early 1980s when he began to lose support of the southern farmers and land-owners.

unions decried the injustices of the land tenure system with loud demands for comprehensive land reform. Fortunately, for the rural elites, the structure of land ownership gave the rural land-owners such a strong grip on the electoral process that they were able to effectively dictate how the people working on and around their land would vote, and, consequently, who would be elected to political power in Chile.

The power of the rural elites was perhaps the major factor behind a critical political move of President González Videla in the 1940s. Under increasing pressure from urban unions, Videla imposed price controls on a basket of essential goods and created a legal route to allow the spread of the union movement into the country. Videla used the second half of this move, rural unionization, to appease the land owners anger at the price ceilings he had placed on their produce. While the legal reforms did allow for rural unionization, they also made it a practical impossibility, ensuring that the rural elites would be able to retain their iron fisted control of the peasants who worked their land.

By 1952 stark divisions had emerged in Chilean politics. The struggle between the traditional power elites centered around the land-owners on the right and the urban unions on the left; in the center stood a large middle class, largely employees of the growing public sector. The sheer belligerence of the political debate alienated a very large portion of the Chilean electorate. When the votes were counted after the 1952 election, the former dictator Carlos Ibáñez emerged as victor. Ibáñez's success grew from a presentation of himself as an autocratic style leader who would be able to stand above partisan politics and take care of the nation's business.

In 1958 Ibàñez instituted a wide ranging program of electoral reforms that eliminated a key support strut of the rural elites power structure, setting the stage for fifteen years of deterioration in the national political debate. Among the measures he implemented was the introduction of a single, uniform ballot across the entire country, and increased penalties for electoral fraud and bribery. To further re-enforce these procedural changes, voting was made mandatory, failure to do so resulting in fines or jail terms. These measures had a highly disruptive effect on what had, until then, been an extremely stable political arrangement. In the past, rural land-owners had been able to manipulate the rural vote and thereby hold a disproportionate amount of power in Chilean politics, effectively thwarting the revisionist goals of the urban left. The imposition of truly anonymous, compulsory voting removed the supervisory eye of the *hacienda* owner from the polling booth, eliminated the king-maker role of the land-owners, and caused a massive split in patterns of electoral support. Results from the 1958 presidential election reflected the transformation that had taken place in Chilean politics. Unlike his predecessors who had won with majorities, the rightist victor of the 1958 presidential election, Jorge Alessandri, attained victory with a slim plurality.

#### **Jorge Alessandri, 1958-1964**

Alessandri had virtually no time to savour his victory. In the last two years of Ibàñez's rule Chile had reached the end of the easy stage of ISI development.<sup>6</sup> To

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<sup>6</sup> The 'easy stage' of ISI is the initial, rapid spurt of economic growth that accompanies the introduction of policies designed to discourage the importing of consumer goods. Generally, shifting the location of the final assembly of a product is not a significant barrier to an MNC continuing business in a country. However, this does not mean that it will be cost effective to produce good for export in this new plant. Consequently, after the internal demand is met by the newly installed consumer goods manufacturers.

compound matters Chile was once again hit with a structural shock; the Korean War ended and was accompanied by a fall in the demand for copper. The government found that its revenues were falling, wages in the public sector were set to rise automatically, and inflation was running at a high 86%. Chile was in the midst of a bout of stagflation: falling productivity and rising inflation. The pursuit of ISI policies had not left the country with the internal resources to deal with this situation, and the nation's debt load was becoming such that core creditors were increasingly reluctant to advance the government new loans. In an effort to combat this problem, Ibàñez had called for the help of the IMF and New York banks and accountants. The result was the Klein-Saks mission and its recommendation of what amounts to a modern day neo-liberal economic program: elimination of wage and price controls, restrictions on credit, cuts in government expenditure, reduced currency emissions, and a favourable attitude towards foreign investment. While the Klein-Saks mission was successful in reducing inflation, its contractionary economic program also resulted in a fall in the standard of living of most Chileans, a problem Ibàñez handed over to the newly elected Alessandri government. Thus, no sooner had Alessandri assumed office than he was beset with demands that he address the declining standard of living.

In the wake of the 1959 Cuban revolution, the problems Alessandri inherited from Ibàñez were exacerbated by US foreign policy. American policy makers concluded that a key factor in Castro's success had been his willingness to effectively address the issue of land-ownership. The architects of the Alliance for Progress recognized that it was

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there is little or no impetus for the MNC to turn this plant into an export platform, and, therefore, little or no expansion of economic activity and growth.

inequities in the structure of socio-economic relations that resulted in a communist revolution. Taking an unwitting cue from Castro, the Americans identified the source of this inequality as the structure of land-ownership in peripheral countries. Consequently, a key tenet in the Alliance for Progress was the need for comprehensive land reform. The American view was that redistributive policies would help to relieve some of the tensions that could lead to a communist revolution. As discussed in chapter one, part of the failure of ISI and neo-liberalism has been the failure to cause a simultaneous transformation in a country's internal social and economic relations. The Alliance for Progress proposed to affect a massive transformation in the social fabric of the peripheral nation *without* making sufficient provision for a parallel development of the nation's economy.

Throughout the previous thirty years of Chilean politics no other issue had met with such fierce opposition from the right as land reform. Alessandri, the right wing candidate in the 1958 presidential election, was now being asked to abandon his political support base. Despite the president's desire to remain loyal to his supporters, his need to guarantee credit from the core, the United States in particular, mandated that some form of land reform policy be pursued. Alessandri followed the example Videla set when dealing with the issue of rural unionization. Instead of implementing a serious package of reforms, Alessandri utilized a series of legislative and administrative devices that made land reform legally possible, but a practical impossibility.

The legacy of the election law reform enacted in 1958 began to make itself felt in the 1961 congressional election. In the presidential election, Salvador Allende's



candidacy for the Popular Action Front (FRAP)<sup>7</sup> had had far more success in rural areas than anyone had anticipated. The Socialist and Communist parties realized that the changes in electoral laws which removed the land-owners control of peasant political behaviour now made it possible for them to recruit support and develop a comprehensive party structure amongst the nation's peasants. The efforts by members of the FRAP to recruit support in the countryside bore fruit in the 1961 congressional elections, resulting in an increase in the number of leftist congressmen. Finding that the composition of congress had radically changed, Alessandri was forced to seek greater support from the Radical Party in order to retain the capacity to run a functional government.

Shortly after the 1961 congressional elections, Alessandri, a staunch believer in free markets and private enterprise, faced another crisis; he lost the congressional support of the Radical Party on the key issue of land reform. After reflecting on the success of the FRAP's 1961 congressional election campaign, the Radical Party decided that in order to win the 1964 presidential election it would have to adopt land reform as a key plank in its platform. Concurrent to this political development was the continued pressure from the Alliance for Progress to defuse a potential communist threat with redistributive policies. In order to prevent the government being entirely hamstrung by congress and a shortage of foreign aid and credit, Alessandri was forced to compromise and grudgingly implement some real measures of land reform.

Land-owners found themselves in a worsening political situation. The United States was using its powers as a core nation to exercise structural power over Chile,

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<sup>7</sup> The *Frente Revolucionario de Acción Popular* (FRAP) was a coalition of socialist, marxist, and communist political parties that represented, in general, the left side of the political spectrum.

forcing Alessandri to pursue redistributive policies he found politically troublesome. Domestically, the political shift of the congress from right to left resulted in concerted national political pressure for land reform. Facing a direct assault on its power base, the right counter-attacked by offering a viable alternative; nationalist sentiments were used to pull the American copper companies into the political debate. The right argued that the source of Chile's socio-economic ills was not the pattern of land ownership, but the capital outflows caused by foreign ownership of the copper mines. If the real problem was finding the foreign exchange necessary to fund the social and ISI policies, the right argued, then assuming greater national control of copper production would solve the problem. In a symbolic gesture of the seriousness with which he took this policy alternative, Alessandri imposed a 10-15 per cent tax increase on the revenues of the foreign mines. While not overly pleased by this action, the foreign mining companies accepted it and continued to make massive profits.

Throughout the copper debate the left never denied that Chileanization of the copper mines would return control of a significant portion of the nation's foreign income earning capacity to the country. However, it continued to attack the national pattern of land ownership as the root cause of the social malaise that was afflicting Chile. Citing rising food imports, due to declines in domestic productivity brought about by a lack of investment, the left orchestrated a concerted media attack on the land-owners. The net effect was to politically isolate the right by equating the nation's problems with their policies.

Throughout the copper and land reform debate, Chile continued to follow an ISI path of development, funded primarily by foreign aid and credit. At the height of the land reform debate in 1962, the United States once again exerted pressure on the Chilean policy making process. An official from the Alliance for Progress who had a great deal of power in USAID recognized that Chile was dependent on American aid and loans. By using the implicit threat of a withdrawal of US financial support for Alessandri's government he was able to force the implementation of meaningful land reform policies. Thus, Chile's dependence on the core for credit, and the intensification of this dependence caused by the ineffectual pursuit of ISI policies resulted in a fundamental change in the structure of the nation's socio-economic relations. With the creation of Law 15020, Alessandri unwillingly started a ten year long assault on the *hacienda* system that had always dominated Chilean society. This law created three government agencies to administer programs of land reform, agricultural extension, and agricultural planning. While Alessandri never really tried to fully use the power of these agencies, they became the legal base from which the subsequent governments of Frei and Allende would attack the traditional power structure of Chile; the monopoly on wealth and power held by the land-owning elites.

As the 1964 presidential election approached, the right found itself under siege. All parties felt that the by-election that would take place in Curicó six months before the presidential election would present an accurate reading of the nation's political mood. Much to everyone's surprise, the FRAP's candidate won a decisive victory. The specter of a leftist government after the October election became a very real possibility; an event

which would have been a disaster for the land-owners. Without any equivocation whatsoever, the FRAP had clearly stated in its election platform that it would radically restructure the very fabric of Chilean society by assaulting the traditional distribution of wealth and income. In short, it proposed to do this through massive and wide ranging land reform.

Realizing that the rightist candidate, Julio Durán, could not possibly win, and might well ensure an Allende victory, the right withdrew from the election. In a choice of the lesser of two evils, the right placed its support behind the Christian Democrat candidate, Eduardo Frei. Again, the United States intervened in Chilean politics. From an American perspective, the original intent of the Alliance for Progress, prevention of the spread of communism in Latin America, seemed in danger. The imminent victory of Allende appeared to American foreign policy makers as a harbinger of a communist takeover in South America. Consequently, the American government threw massive amounts of resources behind the eventual victor, Eduardo Frei, in order to prevent an Allende victory.

### **Eduardo Frei, 1964-1970**

The Christian Democrats, a centrist party, campaigned with the promise of a 'revolution in liberty'. At the root of this revolution was a promise to end the growing class conflict and harmonize relations between labour and capital. Frei intended to dramatically alter the fabric of Chilean society by redistributing income and wealth, improving living standards, providing broader opportunities for all, and democratizing

social and political life. Most of the elements that comprised the revolution in liberty presented a direct threat to both the land-owners and the left. The land-owners feared a loss of their estates due to the government's redistributive programs while the left was concerned about the influence that the Christian Democrats were gaining over organized labour.

From the very start, the revolution in liberty was doomed. The massive scope of change that it envisioned could not possibly be accomplished within one presidential term. As Brian Loveman observed,

The essential constraints on Chilean development could not be overcome without both improved distribution of wealth and income and increased production of goods and services. If redistribution occurred at the cost of current investment and reduced productivity, then any gains to the workers and peasants could only be temporary. Rising demand for goods and services without concomitant expansion of domestic production and export earnings could only lead to a renewal of the inflationary spiral.<sup>8</sup>

In order to achieve the redistributive goals of the program, the government would have had to engage in massive land re-distribution. Considering that the land-owners were already neglecting to partake in adequate investment, the uncertainty of a transition to peasant ownership of the land could have resulted in an even greater fall in agricultural productivity, resulting in an increase in food imports and a drain on foreign exchange reserves. Furthermore, the existing industrial infrastructure of Chile was not providing enough private investment funds to ensure the continued growth and expansion of the nation's manufacturing capacity. Rather than re-investing profits in new Chilean ventures, MNCs were using inflated prices for intra-firm trade and the formal profit repatriation

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<sup>8</sup> Loveman, *Chile*, 324.

system to take their profits out of Chile. What Frei, therefore, had to do, a task for which his administration lacked the resources, was effect the social transformation necessary for sustainable development while simultaneously stimulating sufficient growth in the economy to provide employment for a massive influx of new city dwellers.

To place the government in a position where it could pursue the re-distributive aspects of its revolution in liberty, Frei expanded the public sector to facilitate the distribution of consumer goods, agricultural inputs, and employment opportunities. The government intervened to offer the services that the private sector found unprofitable. In order to generate the kind of economic growth that would have been necessary to allow Frei's revolution, the government attempted to re-invigorate the ISI process by implementing new foreign investment regulations. The laws allowed for extremely generous profit remittances, liberal import regulations, a stable tax environment, and exchange rate controls for foreign investors. While these changes did bring about a sharp rise in capital inflows to Chile, they failed to resolve the nation's unemployment and economic growth crisis. Rather than using the new regulations to set up new operations, many MNCs took advantage of the new rules to modernize their production plants. The use of high technology production techniques meant that very little in the way of new labour was required. Despite the goals of Frei's new policies, their net effect was to increase, not reduce, Chile's vulnerability to the international economy.

Foreign control of the Chilean economy remained a key issue of contention in domestic politics. The left was impatient with the slowness of the land-reform measures which the Christian Democrats were following. Even within Frei's own party there was

dissent, some of the more militant factions pushing for more rapid change. For its part the right was becoming increasingly concerned. Again, the American copper companies, Anaconda and Kennecott, were vilified as the source of the ills afflicting Chilean society. In fact, resentment of the power of the foreign mines remained one of the few issues that retained support from all sides of the political spectrum. In an effort to implement a politically meaningful economic policy, Frei went one step further than Alessandri and partially nationalized the American copper mines. While the government did purchase just over 50% of the mines and increased the tax rate on their profits, Anaconda and Kennecott were appeased with an assurance that they would retain full management control.

As the 1970 presidential elections approached, the Christian Democrats found that they were increasingly isolated politically. After experiencing six years of continuous assault upon its political and economic position, the right decided that it could not depend on the Christian Democrats to respect property rights and withdrew its support. The left side of Frei's centrist party defected amidst complaints that the same policies that had alienated the right did not go far enough. In all, the policies that had been pursued between 1964 and 1970 had proved to be far too ambitious for a single six year administration. To this end, the Christian Democratic candidate, Radomiro Tomic campaigned on a platform of continuing a program that would work, provided it was given enough time.<sup>9</sup> The right threw their support behind an elderly Jorge Alessandri. The

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<sup>9</sup> *Ibid*, 324-330.

eventual victor, Salvador Allende, represented a new socialist/communist coalition called the Unidad Popular (UP).<sup>10</sup>

### **Salvador Allende 1970-1973**

The election of Allende to the presidency in 1970 was an unmitigated disaster for the traditional power elites of Chile. Furthermore, Allende's election highlighted the fragmented nature of Chilean politics. In a three way split of the votes, the UP emerged victorious with barely a third of the total vote, less than it had gathered in 1964. Lacking a clear victor, constitutional convention dictated that the congress declare the candidate with a plurality the winner. Congress, however, did have the legal right to award the victory to another candidate. Despite vociferous lobbying efforts by foreign business interests and the American government, Allende's victory was affirmed. With this decision, a three year long attempt to radically reshape Chilean society, a democratic revolution, began.

The UP sought to implement the programs that had been discussed throughout the previous twelve years. Among the short term goals of the Allende government was land reform, a massive redistribution of wealth and income. Land-owners and the newer generation of industrial capitalists, the traditional source of political power in Chile, found that they were fighting a losing battle to protect their interests. Allende stayed true

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<sup>10</sup> There has been a wealth of writing on the three years of Allende's government. However, one particularly salient point that is often missed is that Allende knew Chile like no one else. After a career that started as a member of Congress, followed by two failed bids at the presidency, virtually everyone had some personal connection with Allende. Whether or not they agreed with his politics, the bulk of Chileans did not feel animosity towards him, they felt for Eduardo Frei. For a greater exploration of the impact of these two figures on the life of Chile, see Lake Sagaris, *After the First Death: A Journey Through Chile, Time, Mind*, (Toronto: Somerville House, 1996).



to his belief that the key to resolving Chile's problems was a radical reconstruction of national socio-economic relations. Indeed, the initial spurt of growth that accompanied his administration's policies appeared to validate the UP government, but, as in past experiences, this growth was due largely to increased government spending. International business interests interpreted the Allende regime as a leftist/nationalistic government replete with threats of nationalization and property seizure. Consequently, there was an effective halt to the inflow of foreign investment and an increase in capital outflows.

Despite the initial success of the government, cracks quickly began to appear in the UP. Allende's coalition was not a unified group but rather a very loose conglomeration of leftist political parties. Each faction in the government demanded its share of the employment opportunities in a bureaucracy that had mushroomed over the previous twelve years. Consequently, a large number of highly qualified civil servants were displaced by political appointments. The politicization of public employment created a great deal of uncertainty for the middle class. It was not only the political appointments of the Frei administration that began to fear for their jobs. Under the UP there was a politicization of the civil service that resulted in the replacement of many highly qualified individuals by political appointments.

Within the bureaucracy itself, Allende found another challenge. Each faction within the UP differed in the degree to which it wished to see changes in the socio-economic fabric of Chile, and the militancy with which reforms should be pursued. When this lack of internal consensus was spread throughout the governmental administration by the political patronage network, chaos resulted. Not only was Allende unable to control

the actions of all the elements in his government, departments that should have communicated with each other to coordinate policies did not. Still more worrying for law and order supporters was the fact that the more militant factions in the UP began to participate in and organize guerrilla style economic and urban warfare when Allende refused to accelerate his program to meet their demands.<sup>11</sup>

By 1973 a great many Chileans were very dissatisfied with their government. Business and land-owners were devastated by the lack of respect for private property that was exhibited by the government's frequent expropriation of farms and businesses. A near constant shortage of basic consumer goods and food worked to create an increasing level of dissatisfaction amongst all sectors of the population. The widespread dissatisfaction and insecurity that was permeating Chilean society led to cries by some sectors, mostly the upper-middle and upper classes, for intervention by the military to 'restore democracy'. The common element in all of the pre-Allende regimes was that while there was grudging acquiescence to redistributive policies, it was usually accompanied by major concessions to the needs of the traditional power holders in Chilean society, the land-owners. As Brian Loveman noted: "Whenever this trade-off was threatened, political toleration ended. When the large estate finally forced their demise in the period after 1964, so too did Chilean formal democracy."<sup>12</sup> The unwillingness of the right to negotiate a transfer of resources or participate in the kind of economic development that had to

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<sup>11</sup> Official government policy did advocate the nationalization of businesses and *haciendas* in order to allow a more equitable distribution of wealth throughout society. The 'economic guerrillas', however, took matters into their own hands when Allende refused to accelerate this process. One of the events that became common near the end of the Allende government was the forced expropriation of firms and farms. Workers would occupy the premises and demand that its operation be surrendered to the employees.

<sup>12</sup> Loveman, *Chile*, 263.

accompany the social changes happening in Chile served only to stratify patterns of political support. After the election of Allende this trade-off was not threatened, it was all but obliterated. As Oppenheim noted: "One can understand how middle-class groups in particular would be nervous about supporting the Popular Unity coalition when its radical faction seemed openly hostile to the middle class and called for a worker-led revolution."<sup>13</sup> With this defection of the middle class to the right, the centre in Chilean politics disappeared.

Despite the growing polarization of Chilean politics, there was still consensus regarding the need to fully nationalize the American copper mines. Irrespective of political orientation, Chileans were almost universally concerned that a foreign actor should retain such control over their economic well-being. For decades, the decisions made by the American copper mines had directly affected the quantity of foreign exchange available to the Chilean government to finance social and economic policies. In an atmosphere of deepening crisis -- Allende saw the American government cutting aid flows and acting to block international loans -- the decision was made to take full control of the mines. However, unlike the Frei nationalization program, Allende's program deducted the excess profits taken over the years from Chile from the amount of compensation that the American companies would receive. Furthermore, the government proceeded to nationalize other foreign corporations operating in Chile on the same basis, most notable among them International Telephone and Telecom.<sup>14</sup> In effect, Allende's

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<sup>13</sup> Oppenheim, *Politics in Chile*, 99.

<sup>14</sup> IT&T was one of the most vociferous corporations lobbying the American government to work to supplant Allende's government and also clandestinely supporting anti-Allende groups in Chile. For an account of the lengths to which IT&T was willing to go to remove Allende, see "Bugging ITT in Chile." *NACLA*, 6 (4) (April, 1972), p. 5-23.

government was attempting to radically change the pattern of economic relations between the core and the periphery to allow Chile a chance at economic independence.

### **Enter the military, 1973-1975**

Despite the agreement on the nationalization of the copper industry, the political and social divisions in Chile continued to deepen. In order to 'protect the national security' the military staged an extremely violent coup on September 11, 1973.<sup>15</sup> General Pinochet justified the Junta's massive repression of civil and human rights by stating that Chilean society had to be restructured and economic life de-politicized in order to maintain the country's long term security. For the traditional power elites of Chile, the land-owners and industrialists, this meant that society would be returned to its pre-Allende condition. The middle class, terrified that the radical elements of the UP intended to take everything away from them, hoped that the military would restore a sense of security to their lives and allow the resumption of a pre-Allende lifestyle.

For the first two years of its rule the military regime concentrated on suppressing dissent within Chile and, in their own words, on 'ridding the nation of the cancer of communism.' For the right this would have appeared to be a windfall except for one very incisive observation made by the military. They determined that at the root of much of the political and social conflict in Chile was the issue of who would distribute government resources. As long as the government remained the main source of income for most parts

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<sup>15</sup> Violent is perhaps an understatement. For a series of truly chilling accounts of the repressive nature of the Pinochet government, see Sagaris, *After the First Death*. Contemporary Chilean literature also reflects the harshness of the measures of Pinochet's administration. One particularly pointed attack on the Junta is Isabel Allende, *Of Love and Shadows*, trans. by Margaret Sayers Peden, (Reading, Great Britain: Black Swan, 1987.)

of the country, the Junta felt that the specter of a communist/socialist resurgence would remain.

Within two years the cheers of joy and support for the military that had rung out from the upper and middle classes turned to shouts of anger and frustration. The military did not restore many former public employees to their old jobs, rather, it eliminated the jobs altogether. As part of its economic reform program, the Junta dismantled the government programs that had been used to support and subsidize industry and agriculture for the last thirty-five years. Unfortunately for land-owners and capitalists in Chile, Pinochet's government was doing exactly what it said it would. It was working to change the socio-economic environment in Chile to prevent the sort of acrimonious political conflict that had led to the coup in 1973.

The changes that Pinochet implemented did have a tremendous effect on how policy was set in Chile. While the first two years did not bring about the momentous changes covered in chapter three of this thesis, they did destroy the capacity for political opposition that had made lasting change impossible in the past. It was the dictatorship's capacity to function with an almost total lack of support that allowed it to remove the overt political elements that had swayed policy in the past, and replace it with a highly proficient technocracy after 1975.<sup>16</sup> This is not to say that the political element was removed from the policy process, rather the public competition for access to policy

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<sup>16</sup> The research of Philip Oxhorn provides a very interesting sidebar to this point. His work focuses on the role that the repression inherent in a military dictatorship plays in the formation of more responsive and self-sufficient grass roots political organizations during and after a transition to democracy. See Philip Oxhorn, "Understanding Political Change After Authoritarian Rule: The Popular Sectors and Chile's New Democratic Regime," *Journal of Latin American Studies*, 26 (3) (1994), p. 737-759; and Philip Oxhorn, *Organizing Civil Society: The Popular Sectors and the Struggle for Democracy in Chile*, (University Park, Pennsylvania: University of Pennsylvania Press, 1995.)

making circles was eliminated. While Pinochet still required support from key sectors in society in order to retain an effective grip on power, unlike past practice in Chilean politics, it was now the government that set the terms on which support would be accepted.

### **Conclusion**

As part of the industrialization process that occurred in the nineteenth century there was a massive transformation in the nature of socio-economic relations. This change was brought about by the creation of a new and powerful middle class rooted in a strong and independent manufacturing sector. Since the 1930s Chile has been trying to effect this same transformation. The problem faced by successive governments in Chile has been that the pattern of colonial relations that allowed the north to industrialize has created a structure that is preventing another wave of industrialization in the south.

In an attempt to break the pattern of core-periphery relations that was preventing Chile from developing, successive governments pursued a policy of forcing industrialization through the use of import-substitution industrialization strategies. However, rather than causing the desired socio-economic transformation, these policies facilitated only the social aspect of development, leaving the country vulnerable to the global economy. The Chilean ISI experience did not result in the establishment of capital and intermediate goods production for an export market as advocated by ECLAC. Instead, an inefficient domestic consumer goods industry evolved, supported almost entirely through government tariff protection and subsidy. The resultant increase in

government debt meant that the Chilean development policy became dependent on core sources of credit. Consequently, the primary source of this credit, the United States, was able to use its advantage in terms of relative power to influence the Alessandri government's decision to pursue an effective land reform policy.

As the ISI process continued, there was a demographic shift that saw a migration of the peasants from the country to the city looking for industrial employment. Without the presence of new manufacturing jobs to employ those who wished to join the middle classes, social and political conflict heightened, contributing to the formation of a bureaucratic-authoritarian government. Once in firm control of the country, General Pinochet's government decided that the existing approach to industrialization was fundamentally flawed and began to search for a new route to development. The result was the adoption of neo-liberal economics, the ideological source of Chile's current economic 'miracle'.

**Chapter Three**  
**Changes on the Outside,**  
**Changes on the Inside:**  
**External Economic Shocks**  
**and the Shift From**  
**Radical to Pragmatic Neo-Liberalism**

President Pinochet is extremely occupied with a tricky crossword puzzle, and gives strict instructions that he is not to be disturbed. He is furious when a man comes into his den.

“Who the devil are you?” he shouts. “Don’t you know that I’m the President of the Republic and I gave strict orders not to be disturbed?”

“Yes,” says the visitor, “but I’m Javier Vial (the financier) and I am the Republic’s principal shareholder.”

*A joke on the streets of Santiago in 1981.*



For thirty-five years Chilean policy makers sought to foster economic and social development in their country through the pursuit of ISI policies. When the socio-economic contradictions that these transformations helped to create reached a boiling point on September 11, 1973, the military staged an extremely violent coup. One intention of the military government, headed by General Augusto Pinochet, was to restructure Chilean society in order to prevent a repeat of the social tensions which it felt could lead to a communist take-over. In this respect the junta was highly successful, it did change the socio-economic fabric of the country. Yet, in one key aspect of this overall goal the junta encountered a major setback. After eight years of strong economic growth, the intrinsic vulnerability of a peripheral economy was again made evident when structural factors intruded to cause a dramatic social, political, and economic transformation in Chile.

By removing the government from daily economic life, and by opening Chile's market to the world economy, Pinochet's core of economic advisors -- the radical neo-liberal Chicago Boys -- hoped to force the creation of a strong, independent economy. As chapter two outlined, the attempt at industrialization through ISI policies resulted in a divisive political debate, not development. Structural factors served to limit the extent to which the ISI process could succeed and the range of policy options that could be followed. The neo-liberal experiment in Chile arose as a rejection of what was viewed as a fatally flawed development policy. However, the radical neo-liberal experiment that will be analyzed in this chapter encountered the same problems of vulnerability to the international political economy that plagued the ISI stage of Chilean development. While

the experiment facilitated rapid economic growth, it was unable to entrench this growth in any form of lasting productive investment.

In the early 1980s, Pinochet and his government were acclaimed by the international business community as miracle workers for resuscitating a crippled economy. Along with this acclamation of regeneration came a growing dependence by the bureaucratic-authoritarian regime on the radical neo-liberal coalition for legitimacy. The business conglomerates that had made the radical neo-liberal policies work had done so on the strength of foreign loans. The reliance on international debt which came to characterize the Chilean economy under the tenure of the radical neo-liberals served to increase national dependence on core sources of credit. When the international political economy imposed a series of structural shocks on Chile in the early 1980s, causing a near cessation of credit inflows, the radical neo-liberal pillar of support that buttressed the military regime collapsed. What resulted were a series of fundamental changes in the nature of the Chilean economy, policy making processes, and popular attitudes towards the authority and strength of the Pinochet dictatorship.

The following analysis will suggest that while neo-liberal policies can facilitate economic growth, their main effect is to increase a nation's vulnerability to the structure and vagaries of the international system. To accomplish this task, this chapter will be divided into four sections.<sup>1</sup> The first section will explain who and what the Chicago Boys were, and will then proceed to catalogue the rise, and ideas of radical neo-liberalism. In

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<sup>1</sup> The bulk of the factual information for this chapter has been derived from the work of Eduardo Silva. Specifically: Eduardo Silva, *The State & Capital in Chile: Business Elites, Technocrats, and Market Economics*, (Boulder, Colorado: Westview Press, 1996) and Eduardo Silva, "From Dictatorship to Democracy: The Business-State Nexus in Chile's Economic Transformation, 1975-1994," *Comparative Politics* 28 (3) (April, 1996), p. 299-320.

the second section the story of the radical neo-liberal experiment will be recounted. The third section will examine the nature and effect of the structural shocks that hit Chile in the early 1980s. And finally in the fourth section the transition to pragmatic neo-liberalism will be presented. Through these four sections it will become evident how the pursuit of neo-liberal policies increased Chile's vulnerability to the international political economy, and, subsequently, resulted in major domestic political and economic transformations.

### **Chicago Boys and Radical Neo-Liberalism**

A key feature of the three-year Allende presidency was the exclusion of the business elites from the policy making process. In an attempt to formulate some sort of counter-attack, a group of prominent businessmen and right wing economists began to meet weekly in 1971 in what became known as 'the Monday Club.'<sup>2</sup> In 1973 it became increasingly likely that there would be a coup of some sort and the members of the Monday Club began to work on an economic plan that would return Chile to 'normalcy.' The economists, the principal architects of the plan, were mainly from the Catholic University of Chile, an institution that maintained close ties with the University of Chicago. In fact, many of the economists at the Catholic University had either been trained at the University of Chicago, or embraced the theories of Milton Friedman and Frederick von Hayek. Due to their dogmatic adherence to the radical neo-liberal

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<sup>2</sup> Like the Allende period, the formation of independent think-tanks that could offer viable, academic alternatives to government policy emerged as a key bastion of opposition to the military regime. For more, see Jeffrey M. Puryear, *Thinking Politics, Intellectuals and Democracy in Chile, 1973-1988*, (Baltimore: Johns Hopkins University Press. 1994).

economics which had been developed at the University of Chicago, the group of economists in the Monday Club became known as the 'Chicago Boys.'<sup>3</sup>

The Chicago Boys began their rise in the aftermath of the coup. Between 1973 and 1975 business interest groups engaged in a mad scramble to attain access to key decision makers in the military regime. Each interest group tried to attach itself to the member of the Junta that it felt would emerge as the leader of the military regime. In the immediate aftermath of the coup, the Monday Club was the first organization to pursue a concerted strategy of attaining access to the individuals who would eventually form the government. The neo-liberal members of the Club presented a detailed economic revitalization plan to every key officer in the military within days of the overthrow of Allende. However, in the early days of the military government, the efforts devoted to defeating the communist 'menace' meant that many members of the Junta had little or no interest in discussing 'civilian' matters such as economic policy. Furthermore, the top leadership of the military had limited experience in running the social and economic aspects of the nation. Consequently, many of the generals either paid scant attention to the comprehensive plan that Monday Club members presented to them, or were unable to understand it. Thus, the celerity with which the first radical neo-liberal plan was presented to the architects of the coup did not translate into any immediate access to power for the Chicago Boys.

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<sup>3</sup> For an excellent discussion of the prominence of the technocratic economist in both authoritarian and democratic government in Chile, see Verónica Montecinos, "Economics and Power: Chilean Economists in Government, 1958-1985," Ph.D. diss., University of Pittsburgh, 1988, and Verónica Montecinos, "Economic Policy Elites and Democratic Consolidation," The Helen Kellogg Institute for International Studies, Working Paper #191 (May, 1993), University of Notre Dame.

In January of 1974 the radical neo-liberals<sup>4</sup> publicly announced the policies that they felt would restart the Chilean economy. This caused a schism within the Monday Club. Initially, only Javier Vial<sup>5</sup> and Manuel Cruzat, both very powerful businessmen, believed that the plan would be successful.<sup>6</sup> Vial and Cruzat also recognized a key characteristic in the very nature of the Chicago Boys' plan that would have direct appeal to Pinochet. As Lois Oppenheim observed: "The Chicago Boys were all technocrats rather than politicians. Their first loyalty was to their professional field, not to any political party. This latter characteristic was unusual in politicized Chile and made them additionally attractive to Pinochet."<sup>7</sup> When combined with a very adept political judgment that saw Pinochet becoming the head of the Junta, and an intimate knowledge of what was entailed in radical neo-liberal economics, Cruzat and Vial decided that it would not be long before the Chicago Boys would be asked to run the economic

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<sup>4</sup> I will borrow the two different terms used by Silva in *The State & Capital in Chile* to refer to the neo-liberal technocrats who ran the Chilean economy for Pinochet from 1975 to 1988. The *radical* neo-liberals, also characterized as *radical internationalists*, followed an internationalist form of monetarism that favoured free capital movements with virtually no government intervention. By contrast, the *pragmatic* neo-liberals felt that it was through trade, not financial dealings, that an economy could be strongest. They were not adverse to prudent adjustments of the macro-economic levers and some foreign investment controls to prevent speculative investment.

<sup>5</sup> An interesting side-bar to this chapter is the evolution of the ownership of the two conglomerates that would come to dominate the Chilean economy. After many years of working for Manuel Cruzat, Javier Vial became disgruntled with restrictions placed on him by the Cruzat-Larraín Empire and left the empire to form the Banco Hipotecario de Chile (BHC) conglomerate. Even after the collapse of his empire in 1983, prominent business observers still characterized Vial as one of those people who would always end up ahead, a perpetual success story. Indeed, Vial's name still appears in connection with new business ventures and academic commentary on the socio-economic climate in Chile.

<sup>6</sup> One of the oldest and most powerful conglomerates, The Edwards Group, quickly realized that Cruzat and Vial were correct in their assumptions. By 1977 the Edwards Group had recast its operations to reflect the internationally oriented finance based empires of BHC and Cruzat-Larraín. Shortly thereafter, Edwards was followed by another major conglomerate, the Matte Group; Silva, *The State & Capital in Chile*, 113.

<sup>7</sup> Lois Hecht Oppenheim, *Politics in Chile: Democracy, Authoritarianism, and the Struggle for Development*, (Boulder, Colorado: Westview Press, 1993), p.149.

ministries.<sup>8</sup> Consequently, Vial and Cruzat began to position their business empires<sup>9</sup> to take advantage of the radical economic changes that they foresaw in Chile's immediate future.

After two years of internal political battles over what sort of economic policy would be followed, and a dramatic deterioration in the national accounts, Pinochet decided that it was time to bring civilian economic advisors permanently into the government. In 1975 General Leigh recommended that Raul Saez be appointed as minister of the Economy. Saez, forced to decline the opportunity because of prior commitments, suggested Fernando Leniz for the post. At the time Leniz was the director of *El Mercurio*,<sup>10</sup> and a member of the Monday Club. After becoming minister of the Economy, Leniz brought in Sergio de Castro as his top advisor, a central Chicago Boy and a key architect of the 1973 radical neo-liberal economic plan.

By the end of 1976, the Chicago boys had come to dominate the key economic posts within the governmental framework. In a recent text on the inter-relationship between the state and capital in Chile, Eduardo Silva identifies four central Chicago Boys who attained ministerial rank in the military government by the end of 1976. Alvaro Bardón was president of the Central Bank with Sergio de la Cuadra, a future minister of

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<sup>8</sup> Manuel Cruzat headed the largest conglomerate in Chile, Cruzat-Larraín. Javier Vial headed the second largest Chilean business empire which was built around the *Banco Hipotecario de Chile* (BHC).

<sup>9</sup> In the wake of the economic restructuring that took place after the bureaucratic-authoritarian counter-revolution of 1973, a significant portion of the Chilean economy was privatized. A very small group of individuals had the resources to take advantage of this situation. The result was an economy dominated by a handful of large conglomerates, or *grupos economicos*. Of these conglomerates, Vial's BHC and Cruzat's Cruzat-Larraín were by far the largest and most powerful. For a presentation of the scope and size of these conglomerates, see Fernando Dahse, *El Mapa de la Extrema Riqueza*, (Santiago: Editorial Aconcagua, 1979).

<sup>10</sup> *El Mercurio* is the major daily newspaper in Chile, and a publication with a great deal of influence. Owned by the Edwards Group, it has always maintained a very clear pro-big business editorial position.

Finance, serving as his vice-president. Sergio de Castro had been elevated to minister of Finance and worked with the minister of the Economy, Pablo Baraona.<sup>11</sup> Perhaps of more significance was the fact that the Chicago Boys not only occupied top ministerial positions, but also staffed the economic ministries with their younger disciples.

The Catholic University of Chile and the University of Chicago remained the training centers for most of the radical neo-liberal technocrats. More important, however, was the interchange of personnel between the economic ministries and the radical international conglomerates.<sup>12</sup> As Silva noted in 1993: "In the newly installed authoritarian regime, groups that had direct access to power (the military and well placed civilian authorities) were privileged over those that did not enjoy those connections."<sup>13</sup> The connections between the economic advisors of the military regime and what were to become the two dominant conglomerates in Chile, BHC and Cruzat-Larraín, were extremely close (see table 3.1).<sup>14</sup> The cross-consultation between the Chicago Boys and the conglomerates from whence they came was to prove a critical factor in the rapid growth that the Chilean economy experienced in the late 1970s.

As noted in chapter one, a bureaucratic-authoritarian dictator must retain the support of certain key domestic constituencies in order to achieve the kind of economic

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<sup>11</sup> Silva, *The State & Capital in Chile*, 142-143.

<sup>12</sup> The four main radical internationalist conglomerates were the main supporters of radical neo-liberal policies: BHC, Cruzat-Larraín, Edwards, and Matte.

<sup>13</sup> Eduardo Silva, "Capitalist Coalitions, The State, and Neo-liberal Economic Restructuring Chile, 1973-1988," *World Politics*, 45 (4) (July, 1983), p.539.

<sup>14</sup> An examination of table 3.1 quickly reveals that the financial ministries were all but controlled by members of the four 'radical international' conglomerates: BHC, Cruzat-Larraín, Edwards, and Matte. In almost every case Silva found that the official was directly linked to the financial sector.

and social change that is the regime's *raison d'être*. In an examination of the Chilean transition to democracy Silva noted that:

The military interpreted its mission as one of restoring both economic growth and political stability. Consequently, the junta -- and increasingly Pinochet, as he consolidated his rule -- relied on groups that offered a double promise. First, they had to help discipline upper-, middle-, and, especially, lower-class groups whom the military believed were responsible for Chile's profound crisis. Second, their economic plans had to deliver economic growth; they had to recast the Chilean economy and, thus, society in order to establish the foundations for new institutions.<sup>15</sup>

The result was a kind of trade-off. In return for providing the conditions for economic growth that were central to the aims of the BA regime, the Junta would allow exclusive access to the policy making process. Because an important ideological tenet of the BA regime is its removal of the government from daily economic life, a further requirement is that economic growth be attained through industries that are capable of looking outward for finance and aid. Consequently, the government gravitates towards the group that is best able to demonstrate that it can facilitate new patterns of economic growth, independent of government assistance.

The vulnerability that characterized Chile's ISI period -- dependence on the core for credit and productive technology, and political interference in the working of the economy -- was isolated by the military regime as the main cause of the nation's ills. Pinochet's government was seeking a route to national development that would not result in the politicization of the economic ministries which had occurred under the preceding three presidents. It was the Chicago Boys, supported primarily by Vial and Cruzat, who

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<sup>15</sup> Eduardo Silva, "The Political Economy of Chile's Regime Transition: From Radical to 'Pragmatic' Neo-liberal Policies," in Paul W. Drake and Ivan Jaksic, *The Struggle for Democracy in Chile*, (USA: University of Nebraska Press, 1995), 99.



offered the answer. They proposed to control inflation through a restriction on government expenditure, and to promote economic growth by opening the economy to the global market. While acknowledging that there would be short term pain, the Chicago Boys convinced Pinochet that the long term results would bring a strong, independent national economy.

The policies of the Chicago Boys were couched in the 'scientific' maxims of pure economics, thereby avoiding the political tone of plans offered by business groups competing for access. For Pinochet, the supporters of the Chicago Boys -- mainly the Cruzat and Vial business empires -- appeared to be the ideal instruments of change and support needed by the military regime. Thus, the radical neo-liberal ideology attained the pinnacle of economic power in Chile. More significantly, however, BHC and Cruzat-Larraín were able to attain a distinct business advantage within the Chilean economy. The next section will discuss how individuals with close affiliation to the BHC and Cruzat-Larraín conglomerates came to dominate the economic ministries within the military government (see table 3.1), giving the two conglomerates preferential access to information that would be vital for the growth of their empires and the Chilean.

### **Chicago Style Radical Neo-Liberalism**

On April 24, 1975 the Chicago Boys announced the plan which they would follow to return the economy to health. The plan entailed the dismantling of nearly all of the state run economic instruments and corporations, and making Chile a fully integrated part of the global economy. Unlike the structuralist ISI policies that had been pursued in the past, radical neo-liberalism meant that the economy would be directed by the actions and

**Table 3.1 Conglomerates and Key Government Economic Institutions, 1978-1982.**

<i>Institution/ Position</i>	<i>Name</i>	<i>Tenure</i>	<i>Conglomerate Affiliation of Official</i>	<i>Conglomerate type</i>	<i>Official Linked to Finance Sector?</i>	<i>Official is Chicago Boy?</i>
<b>Ministers of Finance</b>	<b>de Castro</b>	<b>12/76 - 04/82</b>	<b>Cruzat-Larrain</b>	<b>Radical International</b>	<b>Yes</b>	<b>Yes</b>
	<b>de la Cuadra</b>	<b>04/82 - 08/82</b>	<b>Aetna</b>	<b>MNC</b>	<b>Yes</b>	<b>Yes</b>
	<b>Lüders</b>	<b>08/82 - 02/83</b>	<b>BHC</b>	<b>Radical International</b>	<b>Yes</b>	<b>Yes</b>
<b>Ministers of the Economy</b>	<b>Baraona</b>	<b>12/76 - 12/78</b>	<b>Cruzat-Larrain</b>	<b>Radical International</b>	<b>Yes</b>	<b>Yes</b>
	<b>Kelly</b>	<b>12/78 - 12/79</b>	<b>BHC</b>	<b>Radical International</b>	<b>Yes</b>	<b>No</b>
	<b>Federici</b>	<b>12/79 - 12/80</b>	<b>Cruzat-Larrain</b>	<b>Radical International</b>		
	<b>Ramos</b>	<b>12/80 - 04/82</b>				
	<b>Danús</b>	<b>04/82 - 08/82</b>	<b>Edwards</b>	<b>Radical International</b>	<b>No</b>	<b>No</b>
	<b>Luders</b>	<b>08/82 - 02/83</b>	<b>BHC</b>	<b>Radical International</b>	<b>Yes</b>	<b>Yes</b>
<b>Central Bank Presidents</b>	<b>Bardón</b>	<b>1976-1981</b>	<b>Banco Concepción</b>	<b>Undefined</b>	<b>Yes</b>	<b>Yes</b>
	<b>de la Cuadra</b>	<b>1981-1982</b>	<b>Aetna</b>	<b>MNC</b>	<b>Yes</b>	<b>Yes</b>
	<b>Kast</b>	<b>1982-1982</b>				<b>Yes</b>
	<b>Cáceres</b>	<b>1982-1983</b>	<b>Ibáñez-Ojeda</b>	<b>Neutral</b>	<b>Yes</b>	<b>No</b>
<b>Central Bank Vice Presidents</b>	<b>de la Cuadra</b>	<b>1976-1981</b>	<b>Aetna</b>	<b>MNC</b>	<b>Yes</b>	<b>No</b>
	<b>Errázuriz</b>	<b>1981-1981</b>	<b>BHC</b>	<b>Radical International</b>	<b>Yes</b>	<b>Yes</b>
	<b>de la Barra</b>	<b>1981-1982</b>			<b>No</b>	<b>No</b>
	<b>Tapia</b>	<b>1982-1983</b>	<b>Matte</b>	<b>Internationalist</b>	<b>No</b>	<b>No</b>

*Source: Silva, The State and Capital in Chile, 142-143.*

decisions of private individuals and firms, not the state. Neo-liberalism centered, not around a rejection of the structure of the global political economy, but, instead, upon embracing such global structures. The Chicago Boys proposed to fully embrace the dichotomous nature of the global economy characterized by structuralists in the core-periphery model, and use it in order to foster national growth. They announced that an openness to rest of the world -- instead of sheltering behind a wall of tariffs and import quotas -- was the only way that the Chilean economy could expect to achieve long term economic growth.

Inflation and massive government borrowing, both problems that were traced to the pursuit of ISI policies, were identified as the key economic problems faced by Chile. In order to bring both phenomena under control, the Chicago Boys decided that they must eliminate the tariff walls and government supports that had enabled ISI development. In order to protect domestic industries import tariffs had risen to levels in excess of 800 per cent. Overnight the government reduced these tariffs to a maximum of 200 per cent, and mandated that all tariffs be a uniform level of 10 per cent by 1979. In terms of fiscal policy, the government announced that it would no longer expand the monetary supply through increases in its spending, or by ordering the Central Bank to issue more money; in fact, in order to repay the nation's debt the government announced a series of sweeping expenditure cuts. To prevent a liquidity crisis the government relaxed capital controls, allowing Chilean business to freely seek credit on the international market.

Having removed itself from most day-to-day fiscal economic activity, the government removed itself from the productive side of the economy by privatizing farms

and corporations that had been nationalized by the Popular Unity government. Between 1974 and 1976, CORFO sold 99 firms to the private sector. In the midst of this flurry of economic activity there was a catch. The oil shocks and international distrust of Chilean investments, due mainly to the policies pursued by Allende's government, caused a significant shortage of liquid funds in Chile with which to purchase the newly privatized firms. Consequently, the government undervalued the companies for sale and offered a preferential exchange rate policy that resulted in an implicit subsidy between 30 and 50 per cent, a guaranteed profit opportunity for those able to muster the necessary credit.<sup>16</sup>

As discussed above, not many businessmen in Chile between 1973 and 1975 believed that the radical neo-liberal Chicago Boys would see their economic plans implemented. In fact, the only real supporters of the Chicago Boys had been the BHC and Cruzat-Larraín conglomerates. While other business conglomerates had been busy seeking to return the economy to pre-Allende days, BHC and Cruzat-Larraín had been preparing for a dramatic change in the structure of the Chilean economy. In 1974 the banking system was all but completely deregulated. One of the most significant changes to come from this process was the creation of the *financiera*, a new type of non-bank financial institution that offered very short term loans and higher interest rates on deposits. However, more important was the fact that the *financiera* was not subject to the same level of regulation as a traditional bank. As the deregulation process proceeded, the first two conglomerates to purchase newly privatized banks and establish *financieras* were BHC and Cruzat-Larraín.

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<sup>16</sup> Alejandro Foxley, *Latin American Experiments in Neoconservative Economics*, (Berkeley: University of California Press, 1983), p. 54-57.

With the financieras the Vial and Cruzat-Larraín conglomerates were able to capture a significant amount of the nation's savings, and more importantly, to translate loans obtained from New York banks into pesos on very favourable terms.<sup>17</sup> This allowed both conglomerates to create substantial pools of ready cash with which to purchase the firms being privatized by the government. When the ready supply of cash did not prove adequate, the conglomerates were effectively able to print their own money. By directing a bank that they owned to highly over-value loan collateral offered by another company in the conglomerate, the restrictions of reserve requirements became all but fictitious.<sup>18</sup> As 1978 ended, Cruzat-Larraín and BHC controlled, 37 and 25, respectively, of the 250 largest companies in Chile. In these two radical neo-liberal conglomerates lay just under 38 per cent of the total value of the largest 250 Chilean businesses.<sup>19</sup> In total, by 1978 Cruzat-Larraín controlled 109 separate companies and BHC controlled 60 separate companies, firms involved in almost any activity that can be named.<sup>20</sup>

While BHC and Cruzat-Larraín were busy taking over most of the Chilean economy, others were facing a great deal of hardship. The Chicago Boys succeeded in lowering the inflation rate and generating enormous improvements in key economic

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<sup>17</sup> The New York banks would issue their loans for a minimum term of two years without a state guarantee. The Chilean banks used this capital to issue short term peso loans with high interest rates and thereby turn a tidy profit.

<sup>18</sup> In June of 1982, when BHC and Cruzat-Larraín collapsed, it was discovered that the BHC owned Banco de Chile had issued 17% of its loans to BHC companies and Cruzat-Larraín's Banco de Santiago had issued 44% of its loans to companies in the Cruzat-Larraín conglomerate. To give an idea of the scale, the Banco de Santiago held 12% of all outstanding credit in Chile. In 1978, Cruzat-Larraín owned six separate banks and financieras, the most significant being the Banco de Santiago. Vial's BHC owned nearly all of 6 different financial institutions and had a significant stake in three others. The Matte conglomerate owned six financial institutions while the Edwards group had control of five institutions with significant shares in five others. Dahse, *El Mapa*, 30, 44, 52-53, 63.

<sup>19</sup> Silva, *The State & Capital in Chile*, 118.

<sup>20</sup> Dahse, *El Mapa*, 28,41. In his examination of the ownership of 'extreme wealth' in Chile in 1978 Dahse divided the holdings of the *grupos económicos* into eight sections: Real estate and investment. Banks and

Table 3.2 Selected Economic Indicators, Chile 1974-1980

	1974	1975	1976	1977	1978	1979	1980
Inflation Rate	375.9	340.7	174.3	63.5	30.3	38.9	31.2
GDP (\$mil.) <sup>b</sup>	20 900.3	18 314.0	18 982.7	20 674.3	22 267.5	24 013.4	25 788.9
GDP/capita <sup>b</sup>	2 051.9	1 769.5	1 806.2	1 938.9	2 058.8	2 058.8	2 314.8
Interest rate (%) <sup>c</sup>							
loans	...	...	...	163.15	86.12	62.11	47.14
deposits	...	...	...	94.92	63.53	45.19	32.72
Imports (\$mil.) <sup>d</sup>	1 681	1 338	1 684	2 414	3 002	4 218	5 138
Bankruptcies <sup>e</sup>	...	...	81	131	124	312	415

<sup>a</sup> Source: Comisión Economía Para América Latina Y El Caribe, United Nations, *Notas Sobre la Economía Y El Desarrollo de América Latina*, No. 373, 387, 388.

<sup>b</sup> Source: James R. Wilkie, *Statistical Abstract of Latin America, Vol.31*, (Los Angeles: UCLA Latin American Center Publications, 1995). 1980 US Dollars.

<sup>c</sup> Source: International Monetary Fund, *International Monetary Fund Statistical Yearbook*, Vol. XLVIII (1995).

<sup>d</sup> Source: B.R. Mitchell, *International Historical Statistics, 1750-1988*, second edition, (New York: Stockton Press, 1993).

<sup>e</sup> Source: Sebastian Edwards and Alejandra Cox Edwards, *Monetarism and Liberalization: The Chilean Experiment*, (Cambridge, Mass: Ballinger Publishing, 1987), p. 91-92.

statistics; the economist's measure of success at restarting an economy (see table 3.2).

However, the numbers do not tell the whole story. The dramatic success of the Chicago Boy's radical neo-liberalism, particularly at reducing inflation to single digits by 1981 (9.5%) came at a terrible price to the nation's manufacturing sector.<sup>21</sup> Between 1977 and 1980 there were some 1 295 bankruptcies.<sup>22</sup> As far as the Chicago Boys were concerned

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Financieras, Agriculture and Forestry, Minerals, Construction, Industrial, Commercial, and others. See Dahse, *El Mapa*.

<sup>21</sup> For more on the deindustrialization that occurred in Chile in the 1970s, see Jaime Gatica Barros, *Deindustrialization in Chile*, (Boulder, Colorado: Westview Press, 1989); Sebastian Edwards and Alejandra Cox Edwards, *Monetarism and Liberalization: The Chilean Experiment*, (Cambridge, Mass.: Ballinger Publishing Group, 1987); and John M. Kline, *Foreign Investment Strategies in Restructuring Economies: Learning From Corporate Experiences in Chile*, (Westport, Connecticut: Quorum Books, 1992).

<sup>22</sup> Edwards and Edwards, *Monetarism and Liberalization*, 91-92.

this was not a cause for alarm. It simply represented a natural corrective action of the market place.

As the Chicago Boys believed, some of the companies that failed were truly not economically viable. Yet, many of the corporations that declared bankruptcy were suffering not from economic inefficiency, but from cash flow problems. The rapid elimination of the protective tariff structure under which much of the Chilean economy had developed was a massive shock to industrial Chile. As the tariffs fell, imports became progressively cheaper. Consequently, many Chileans bought imported goods -- a trend reflected in the rapid rate of increase in total imports between 1975 and 1980 (see table 3.2) -- and domestic manufacturers lost their market share. Even if manufacturers were capable of adjusting to the suddenness with which the Chilean economy was exposed to the international economy, very often they were betrayed by an absence of affordable capital. Unlike the large conglomerates such as BHC and Cruzat-Larraín, most firms did not have access to cheap US dollar loans. They were forced to borrow on the relatively more expensive peso market.

Simply put, many firms ran out of the capital needed to withstand the opening of the domestic market, and, with no new loans forthcoming, were forced to declare bankruptcy. Naturally, this was of great concern to peak business associations such as the *Confederación de la Producción y Comercio*, *Cámara Nacional de Comercio*, and the *Sociedad de Fomento Fabril*: all groups with traditionally strong access to policy makers. However, even if these organizations could gain access to policy making circles as the 1970s ended, their concerns fell on deaf ears. Calls for a slow down in the

implementation of the economic policies, or some form of government support for small businesses in order to help them adjust were dismissed by the government as an attempt to pander to special interests.<sup>23</sup>

As far as the Pinochet government was concerned, the team of Chicago Boys, following their form of radical neo-liberalism, had succeeded in reviving the troubled Chilean economy. By 1980 inflation was under control, the GDP was growing rapidly, and, on the face of a rise in consumer spending, the nation appeared to be enjoying a rising standard of living. However, as Pinochet pushed his way to a victory in the 1980 referendum<sup>24</sup> that made him president until 1988, cracks were appearing in the economic miracle.

### **External Shocks<sup>25</sup>**

As a measure to help control inflation in 1979, and to prove to the international financial community that the government was committed to Chile's long run fiscal stability, the Chicago Boys announced that they were going to peg the peso to the US dollar at a ratio of 39 to 1. For the radical neo-liberal conglomerates this was a windfall.

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<sup>23</sup> The peak business and labour associations were excluded from the policy making process by the government which tended to treat them as special interest groups. For labour, this was not the end of the problem. In the aftermath of the 1973 coup, most of the leaders and members of labour groups were subjected to severe repression, violence, and death by the military in its drive to expunge the *communist* threat from Chile. The masses of individuals who were tortured, exiled, or killed in the 1970s meant that not only were there fewer people left to speak up against the military regime, but also that the remaining people in Chile were largely unwilling to do so.

<sup>24</sup> The 1980 referendum was precipitated by international concerns about the repressive nature of the Pinochet military dictatorship. Chileans were given two choices: They could vote to approve a new constitution that would institutionalize the reforms of the Junta and guarantee Pinochet the presidency until 1988, or they could vote not to approve the constitution and face the thinly veiled threats that this would entail a return to post-coup conditions.

<sup>25</sup> The following section borrows from the work of Edwards and Edwards, *Monetarism and Liberalism*, chapter 8, as well as Silva, *The State and Capital in Chile*.



Table 3.3 Selected Economic Indicators, Chile 1978-1984

	1978	1979	1980	1981	1982	1983	1984
Private Debt <sup>b</sup> (\$US mil)							
Medium and							
Long term	1 600	2 700	4 700	8 100	8 658	6 742	6 362
Short term	300	700	1 300	1 900	1 835	894	172
Money Bank Foreign							
Liabilities <sup>c</sup> (Pesos mil.)	17 000	27 300	52 200	76 000	147 400	124 400	85 200
Ratio of interest							
Payments to Exports <sup>d</sup>	17	16.5	19.3	38.8	49.5	39.4	50
Balance on current							
account <sup>e</sup> (\$US mil.)	-1 110.5	-1 205.4	-2 020	-4 805	-2 373	-1 160	-2 118
Trade Balance <sup>f</sup> (\$US mil.)	-680	-598	-1 056	-3 245	-379	578	-102
GDP <sup>g</sup> (1980 \$US mil.)	22 267.5	24 013.4	25 788.9	27 309.0	23 880.2	23 574.1	24 903.7
Bankruptcies <sup>h</sup>	312	344	415	431	810	...	...

<sup>a</sup> Source: 1978-1980: Economic Commission for Latin America and the Caribbean, United Nations, *Economic Survey of Latin America and the Caribbean 1983*, (Santiago: United Nations, 1985).

1981-1984: Economic Commission for Latin America and the Caribbean, United Nations, *Economic Survey of Latin America and the Caribbean 1988*, (Santiago: United Nations, 1989).

<sup>b</sup> Sources: 1978-1981: Economic Commission for Latin America and the Caribbean, United Nations, *Economic Survey of Latin America and the Caribbean 1983*, (Santiago: United Nations, 1985).  
1982-1984: Economic Commission for Latin America and the Caribbean, United Nations, *Economic Survey of Latin America and the Caribbean 1988*, (Santiago: United Nations, 1989).

<sup>c</sup> Source: International Monetary Fund, *International Monetary Fund Statistical Yearbook, 1995*, Vol. XLVIII, 1995.

<sup>d</sup> Source: Comisión Económica para América Latina y el Caribe, United Nations, *Notas Sobre La Economía Y El Desarrollo*, No.424/425 (Dec. 1985).

<sup>e</sup> Source: 1978-1979: Economic Commission for Latin America and the Caribbean, United Nations, *Statistical Yearbook for Latin America, 1974*, (Santiago: United Nations, 1976).  
1980-1984: Economic Commission for Latin America and the Caribbean, United Nations, *Economic Survey of Latin America and the Caribbean, 1986*, (Santiago: United Nations, 1987).

<sup>f</sup> Source: James W. Wilkie, ed., *Statistical Abstract of Latin America, Vol.31*, (Los Angeles: UCLA Latin American Center Publications, 1995).

<sup>h</sup> Source: Sebastian Edwards and Alejandra Cox Edwards, *Monetarism and Liberalization: The Chilean Experiment*, (Cambridge, Mass: Ballinger Publishing, 1987), p. 91-92.

Replete with advance warning of the decision to peg the peso to the dollar, they took out large quantities of foreign loans. By the end of 1980, the foreign liabilities of the banks were 191 per cent of their value at the end of 1979. In fact, all statistics relating to increases in foreign indebtedness reflected rapid growth between 1979 and 1982 (see table 3.3).

Yet, despite this incredible exposure to the international financial market place, no alarm signals were raised by government officials.<sup>26</sup> The Pinochet government's main interest was to create a boom in the country's economic growth statistics. As discussed earlier, the legitimacy of the BA regime was dependent on its ability to demonstrate that it was solving the country's economic problems. In order to achieve this growth, it needed the cooperation and support of the most dynamic sectors of the economy. Until 1983 the primary support group of the BA regime had its activities concentrated in the financial sector. As long as the radical neo-liberal faction, led by the BHC and Cruzat-Larraín conglomerates, could provide the means for continued economic growth, they would retain privileged access to the policy making process. This presented a problem for economic planners because it guaranteed that they would receive only one, very biased, view of the state of the economy.

Vial and Cruzat liked the support arrangements concomitant with a BA regime because they were the main benefactors of the government's fiscal policy. Again, the apparent success of the radical neo-liberal conglomerates gave Pinochet the support he

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<sup>26</sup> In the Minister of Finance's yearly report in 1981, Minister of Finance Sergio de Castro claimed: "There is no doubt that the current account deficits ... are highly beneficial to the country, and that we should make an effort to maintain them at the highest possible level and for the larger possible period of time." Sergio de Castro cited in Edwards and Edwards, *Monetarism and Liberalization*, 72.

needed to maintain power, and the security to ignore the protestations of those who were not benefiting from the policies of the Chicago Boys. In fact, by 1980, it had become apparent to the other business conglomerates that the only way to survive in the Chilean business environment was to embrace radical neo-liberal economics. Thus, the Chilean business community underwent a mass, but temporary, conversion to radical neo-liberal economics in order to gain access to policy makers.

As Eduardo Silva noted in 1996: "The evidence suggests that damaging policies may result when a highly autonomous state overinsulates ideologically rigid technocrats with organic links to a narrow range of business interests operating outside the confines of business peak associations."<sup>27</sup> Through 1981 the major domestic and international economic actors in Chile failed to take serious notice that the growth that was occurring in the Chilean economy was almost entirely through the use of money borrowed for financial and property speculation.<sup>28</sup> In fact, by 1981 the private sector held 64.8% of Chile's net foreign debt, virtually none of which had been invested in any real long term productive enterprises.<sup>29</sup>

As 1981 ended, the source of Chile's rapid economic growth had been cut off. An American recession and a careful re-evaluation of existing Chilean loans by international commercial banks resulted in a massive drop in capital inflows. For the main financial conglomerates, BHC and Cruzat-Larraín, this presented a key problem. They had built up

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<sup>27</sup> Eduardo Silva, "From Dictatorship to Democracy," 305.

<sup>28</sup> An examination of the composition of the major *grupos económicos* catalogued in Dahse's *El Mapa de la Extrema Riqueza* reveals that property and investment firms along with financial institutions were the predominant parts of the most successful conglomerates under the radical neo-liberal technocracy.

<sup>29</sup> In 1981 total private sector debt in Chile was \$10 493 million, 64.8% of a total foreign debt of \$15 542 million. Edwards and Edwards, *Monetarism and Liberalization*, 71.

their commercial empires by borrowing from their own banks at favourable interest rates with near fictitious collateral. The ability to continuously roll-over these loans was dependent on the ready availability of large pools of foreign capital. By rendering themselves financially dependent on sources of capital situated in the core, not in Chile, BHC and Cruzat-Larraín were unable to survive the structural shocks that spurred the global recession of the early 1980s. The problem for the rest of Chile was that national dependence on the financial institutions of these conglomerates left the entire country extremely vulnerable to the economic shocks of the global recession of the early 1980s.

In an effort to once again capture domestic savings and garner enough income to roll-over existing loans, Chilean financial institutions, led by the banks and financieras of BHC and Cruzat-Larraín, began to raise interest rates to usurious levels. In 1982 the situation continued to deteriorate. Eduardo Boetsh, a prominent Chilean businessman, wrote to *El Mercurio* and pointed out that the Chilean economy could not possibly earn enough to repay its foreign obligations. This was a particularly apt observation as hundreds of previously viable Chilean manufacturers were being forced into bankruptcy<sup>30</sup> due to a flood of imports rendered inexpensive by a highly overvalued currency.<sup>31</sup> Combined with the massive de-industrialization that had taken place in the mid-1970s, the Chilean manufacturing sector suffered yet another massive decline.

In a move that was reminiscent of the style of economic policy making pursued under Frei and Allende, Javier Vial addressed the conglomerates' concerns regarding the

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<sup>30</sup> Over 800 separate firms declared bankruptcy between 1981 and 1982, *Ibid.*, 78.

<sup>31</sup> One result of the pegging of the peso to the dollar was that as the US dollar appreciated in value it pulled the Chilean peso along with it. Consequently, the relative cost of goods in most other currencies fell for holders of American dollars and of Chilean pesos. This problem is examined extensively in Edwards and Edwards, *Monetarism and Liberalization*.

fall in foreign capital inflows when he met with Finance Minister Sergio de Castro in March, 1982. Vial presented the case that the only way to restore damaged financial inflows to Chile was for the state to act to restore international confidence in the private sector, a move that would have been diametrically opposed to the neo-liberal ideology that had been responsible for the economic growth of the very early 1980s. Vial argued that financial flows could be restored by using state run banks and enterprises to borrow internationally. For BHC this was to prove a critical issue. Facing imminent financial collapse due to a cessation in foreign loans, BHC was desperate for some form of governmental assistance to allow the conglomerate to continue operations.

In 1982 the international price of copper collapsed. To cope with this disaster and further stem the destruction of domestic industry by extremely cheap imports, the government gradually devalued the peso and then floated it. Consequently, in the period of a few weeks the value of the peso fell by 50%. Almost overnight the peso value of outstanding foreign loans doubled. The strain that this placed upon the Vial and Cruzat-Larraín empires proved to be too much for their resources and they collapsed. For the millions of Chileans who had been living an elevated lifestyle on borrowed credit it seemed as if the ground had disappeared from beneath their feet. Free market capitalism went wild as people who had lost their jobs and savings due to the collapse of the major grupos sought to sell everything they owned in order to continue to meet their financial obligations.

With the collapse of the Vial and Cruzat-Larraín empires, and the realization that the financial sector would not return to its pre-1981 strengths, the peak business

associations that had joined the radical neo-liberal coalition began to desert it. In fact, as the state of the economy worsened through 1983, Pinochet found that he was losing support from traditionally strong sectors of support like the rural landowners. Partly as a move to appease the concerns of traditional elites, but more as a measure to prevent the total collapse of the Chilean economy, the government assumed control of over 80 per cent of the national banking system in January 1983. The paper empires of BHC and Cruzat-Larraín, built upon inadequate collateral for foreign loans, had left the bulk of the national economy extremely vulnerable to international shocks. To mitigate this vulnerability, the government could have engaged in counter-cyclical fiscal policy, but would not contemplate such a dramatic ideological reversal.

The external economic shocks that Chile experienced in 1981 and 1982 combined with the government's outright refusal to contemplate alternate policy arrangements resulted in a severe degree of economic hardship for most of the population. The economic problems being experienced by Chile, and the associated criticisms of national economic policy led to a perception that perhaps the military's hold on power had weakened. This factor, combined with the frustration of a massive portion of the population that simply had nothing left to lose, led to a resurgence in popular political activity. Starting in May of 1983 the first of a series of monthly days of protest occurred. To demonstrate their disapproval of the regime, the people of Santiago closed their businesses, refused to go to work or school, and took to the streets in mass demonstrations.<sup>32</sup> Pinochet's suppression of Chile's traditional political parties had been

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<sup>32</sup> Eduardo Silva credits the start of these protests as one of the events that allowed the ideologically different components of the opposition to finally unite for a common purpose and eventually form the *Alianza Democrática*. See Eduardo Silva, "The Political Economy of Chile's Regime Transition."

successful. It was not traditional political actors that sparked the street protests, but spontaneous grass roots level activity by non-political actors who wanted a chance to improve their life.<sup>33</sup>

From the perspective of the peak business associations, the public protests against the regime presented an ideal opportunity to try to change the pattern of access to policy makers in the military government. The protesters on the streets of Santiago guessed that Pinochet was quickly losing the support of the business community that he had depended on for the last ten years. They felt that they could use this leverage to force an early return to democracy. Pinochet, becoming increasingly concerned about the size and scope of the street protests, was looking for support to bolster his regime. The failure of the radical neo-liberals had left the economic legitimacy of his regime in tatters. Thus, the business associations hinted that they would assume the role of the BHC and Cruzat-Larraín conglomerates if they were given preferential access to the policy making process. Alternatively, they could throw their weight behind the pro-democracy movement.<sup>34</sup>

Pinochet attempted to diffuse the political threat presented by the days of protest by appointing Sergio Jarpa as minister of the interior. Jarpa was given a mandate to

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<sup>33</sup> There is currently a debate underway that questions the role of traditional political actors - unions, political parties, business groups, industrial confederations - in the re-emergence of public political protest in Chile. For a good introduction to this debate, and a presentation of the new ideas behind the analysis of the days of protest, see Philip D. Oxborn, *Organizing Civil Society: The Popular Sectors and the Struggle for Democracy in Chile*, (University Park, Pennsylvania: The Pennsylvania State University Press, 1995).

<sup>34</sup> In Bolivia, Ecuador, and Peru business groups played a key role in forcing a transition to democracy in order to create a climate that was conducive to their interests; see, Catherine M. Conaghan, James M. Malloy, and Luis A. Abugattas, "Business and the Boys': The Politics of Neoliberalism in the Central Andes," *Latin American Research Review*, 25 (2) (1990), p. 3-30. This is much the same threat that business groups used in Chile in 1983 and 1984. One key element in the eventual peaceful transition that is identified by Eduardo Silva is the assurance that the pragmatic neo-liberals received that the economic model would not be radically altered; see Eduardo Silva, "Capitalist Regime Loyalties and Redemocratization in Chile," *Journal of Interamerican Studies and World Affairs*, 34 (4) (Winter, 1992-93), p. 77-117.

negotiate with the opposition groups. Pinochet's hope was that through these negotiations Jarpa would be able to drive a wedge between the different opposition groups and diffuse the threat that they presented. While the minister of the interior did meet with some degree of success, it was effectively defused by the actions of the peak business associations. By continuing to hint that they may come out in support of democracy, the peak business associations gave the protest movement some ground for hope, and, consequently, a stronger position in negotiations with Jarpa.

Seeking a more advantageous result for himself, throughout early 1983 Pinochet continued to play the radical and pragmatic neo-liberals off against each other.<sup>35</sup> Pinochet's slow shift from radical to pragmatic neo-liberalism had begun in February of 1983 with the replacement of Rolf Lüders<sup>36</sup> as minister of finance and minister of the economy. Carlos Caceres was moved from the Central Bank presidency to assume the role of minister of finance. Caceres, a relative neutral in economic ideology but sympathetic to the Chicago Boys was assisted by Manuel Martín, a clear representative of the interests of the domestic market producers. Pinochet's hope that this combination

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<sup>35</sup> In early 1983 the peak business groups presented Finance Minister Rolf Lüders with a set of policy demands including specific sectoral policies, a high exchange rate, debt relief, increased monetary emissions, lower interest rates, tax reform, public works projects, and protection from imports. At the time these were all rejected. However, over the last ten years many of these policies have been implemented.

<sup>36</sup> Rolf Lüders had strong links to the financial sector through his former high level employment in Javier Vial's BHC conglomerate. Furthermore, Lüders was also a strong proponent of the Chicago school of radical neo-liberalism.



**Table 3.4 Conglomerates and Key Government Economic Institutions, 1983-1987**

<i>Institution/ Position</i>	<i>Name</i>	<i>Tenure</i>	<i>Conglomerate Affiliation of Official</i>	<i>Conglomerate or Business type</i>	<i>Official Linked to Finance Sector?</i>	<i>Official is Chicago Boy?</i>
<b>Ministers of Finance</b>	<b>Cáceres</b>	<b>02/83 - 04/84</b>	<b>Ibáñez-Ojeda</b>	<b>Neutral</b>	<b>Yes</b>	<b>No</b>
	<b>Escobar</b>	<b>04/84 - 02/85</b>		<b>MNC</b>	<b>Yes</b>	<b>No</b>
	<b>Büchi</b>	<b>02/85 -</b>			<b>No</b>	<b>No</b>
<b>Ministers of the Economy</b>	<b>Martin</b>	<b>04/83 - 08/83</b>	<b>Lúksic</b>	<b>MDM/Competitive</b>	<b>Yes</b>	<b>No</b>
	<b>Passicot</b>	<b>08/83 - 04/84</b>			<b>No</b>	<b>No</b>
	<b>Collados</b>	<b>04/84 - 07/85</b>		<b>Construction Int'l Mkt. Oriented</b>	<b>No</b>	<b>No</b>
	<b>Délano</b>	<b>07/85 - 07/87</b>			<b>No</b>	<b>No</b>
<b>Central Bank Presidents</b>	<b>Errázuriz</b>	<b>1983-1984</b>	<b>BHC</b>	<b>Radical Internationalist</b>	<b>Yes</b>	<b>No</b>
	<b>Ibáñez</b>	<b>1984-1985</b>			<b>Yes</b>	<b>No</b>
	<b>Seguel</b>	<b>1985-</b>			<b>No</b>	<b>No</b>
<b>Central Bank Vice Presidents</b>	<b>Tapia</b>	<b>1982 - 1983</b>	<b>Matte</b>	<b>Internationalist</b>	<b>Yes</b>	<b>Yes</b>
	<b>Ossa</b>	<b>1983 - 1984</b>			<b>No</b>	<b>No</b>
	<b>Ruiz</b>	<b>1984 - 1985</b>		<b>Int'l Mkt. Oriented</b>	<b>No</b>	<b>No</b>
	<b>Serrano</b>	<b>1985 -</b>			<b>No</b>	<b>No</b>

*Source: Silva, The State and Capital in Chile, 188-189.*

would diffuse the pressure from the pragmatic neo-liberals was in vain. The highly restrictive emergency economic plan unveiled by Cáceres, the true power in the Ministry of Finance, served only to intensify the opposition of Chilean industrialists and exporters to the Pinochet government's economic policy.

However, by the end of 1983 Pinochet began surrendering to the political pressure of the pragmatic neo-liberals. As the year drew to a close, tariffs were raised from 10 to 20 per cent; later to be raised to 35 per cent in 1984. Between 1983 and 1984 holding a seat at the cabinet table turned into a high stakes game of musical chairs as Pinochet tried to appease the political requirements of maintaining power (see table 3.4). By 1984 the composition of the top posts at key government ministries had changed. Gone were the days when radical neo-liberal Chicago Boys controlled the reigns of the economy. To appease the mounting political pressure, Pinochet had replaced the Chicago Boys with pragmatic neo-liberals.

### **Pragmatic Neo-Liberalism**

In May 1984, Pinochet's new Ministers of the Economy and Finance, Modesto Collados and Luis Escobar, modified the business-government consultation process. They created a group called the Social and Economic Council (SEC). As an advisory body to the President, the SEC brought together representatives of private and public business and labour associations to discuss economic policy. Just as the radical neo-liberal policy era saw the consultation process dominated by the financial conglomerates of Vial and Cruzat, the SEC was dominated by peak business associations like the CPC and the SFF.

The tide had changed. The pragmatic neo-liberal school supported by the peak business associations had taken control of the policy making process.

Even with the appointment of Hernan Büchi as the minister of finance in 1985, a slight shift back to radical neo-liberalism,<sup>37</sup> the peak business associations still held sway in the policy making process. The domestic supply re-activation plan that was announced by Collados in June of 1984,<sup>38</sup> continued on through 1985. In fact, the emphasis of the economic plan shifted from the exploitation of financial intermediation to a focus on export oriented industrialization. Consequently, the government adopted a policy of a strong, but stable, exchange rate that was allowed to float within a narrow band. The shift in economic policy resulted in the second great change in the country's economic structure in ten years. Chile had shifted from an import-substitution-industrialization manufacturing economy to the radical neo-liberal's international finance oriented economy and finally towards the pragmatic neo-liberal's export oriented economy.

## Conclusion

A central fulcrum of political action in Latin America has always been the struggle for political power in order to determine how wealth will be distributed throughout society. In Chile, conflict over different distributive priorities reached a climax during Salvador Allende's presidency, helping to cause a military coup. Citing

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<sup>37</sup> Büchi was essentially a neutral figure with no private economic interests and a long career in the government under Pinochet. While he did lack the form of close private connections to key business groups that had characterized the Chicago Boys' relationship with the Vial and Cruzat-Larraín conglomerates, he also possessed a very technocratic policy making style tempered with a willingness to negotiate and arbitrate conflicts.

<sup>38</sup> "Chile; Finance Minister's June Speech to Nation," *BBC Summary of World Broadcasts*, June 12, 1984.

concern that the destabilizing effect of this political conflict was a threat to the national security, a military Junta was set up under the control of General Augusto Pinochet. In an outright rejection of the theory behind the ISI, Pinochet intended, and appeared to have succeeded in, depoliticizing the struggle for wealth distribution. In reality, what the General had achieved was an almost complete isolation of the policy making process from competing domestic political pressures, removing political conflict from the policy making process. Through the internationalization of the economy advocated by the radical neo-liberal Chicago Boys, and the military suppression of all opposition, the junta succeeded in attaining truly astounding economic growth. Yet, it was the very internationalization of the economy that left the existing political arrangements behind the policy making process vulnerable to the exigencies of the international political economy.

The three governments that preceded Pinochet had all been following a model of development that was fundamentally a reaction *against* Chile's position in the structure of the international political economy. Radical neo-liberalism, however, embraced the structure of the international system. The core has always cried out for free trade between nations, yet, as Prebisch observed: "The centres have been defending themselves with all sorts of restrictive measures which are adopted unilaterally in disregard of GATT commitments."<sup>39</sup> The neo-liberal success of the Chicago Boys was achieved by subscribing to the free market ideology advocated, but not necessarily followed, by the centre. The existence of a large market for loans in the periphery allowed the financial

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<sup>39</sup> Raúl Prebisch, "Notes on Trade From the Standpoint of the Periphery," *CEPAL Review*, No. 28 (April, 1986), p. 205.

institutions of the centre an opportunity for an easy profit. Secure in the knowledge that it would be able to exert sufficient pressure to force the Chilean government to cover the nation's private debt, the core was manifestly unconcerned that Chile's growth was solely a paper phenomenon. The structure of the international system allowed for a short-term economic boom, but made no provisions for entrenching this growth in sustainable productive industries by taking steps to encourage the growth of Chilean exports. Thus, with the fundamental problem of vulnerability to international economic shocks unresolved, the foundation of Chile's economic miracle was destroyed by the international recession of the early 1980s. The economic damage extended to the political arena by contributing to a crisis of legitimacy for the Pinochet dictatorship, shaking the foundation of the political stability that had been imposed upon Chile by the military.

The changes forced in Chile's economy by the withdrawal of foreign capital removed the pillars of support buttressing Pinochet's regime. When the international recession in the early 1980s led directly to the collapse of the Vial and Cruzat-Larraín empires, the key building blocks of the radical neo-liberal coalition that had provided economic growth vanished. The collapse of the financial empires deprived Pinochet's government of the instruments with which it had provided the extraordinary economic growth rates upon which its legitimacy of the regime was based. Pinochet's political vulnerability was epitomized by the re-emergence of popular protests at the height of Chile's economic difficulties. Vial and Cruzat-Larraín's inability to provide the economic growth, or support, that the military government needed resulted in Pinochet withdrawing

his support from them and seeking a new sector of the economy that could fulfill his needs.

The effects of a cyclical change in the international economy resulted in a change in the governmental policy making process. This in turn brought about a change in the way in which economic growth would be sought, the pragmatic neo-liberal emphasis on export-oriented industrialization. However, as will be discussed in the next chapter, a reliance on comparative advantage -- the current mantra of the IMF and World Bank -- does not necessarily resolve the problems that the structuralists raised in the 1940s and the radical neo-liberals failed to solve in the early 1980s. Vulnerability to the structure of the international political economy remains a key problem for a peripheral country.

## **Chapter Four**

### **History Repeating Itself?: Chile and the International Copper Market in the 1990s**

The dragon swooped once more lower than ever, and as he turned and dived down his belly glittered white with sparkling fires of gems in the moon - but not in one place. The great bow twanged. The black arrow sped straight from the string, straight for the hollow by the left breast where the foreleg was flung wide. In it smote and vanished, barb, shaft and feather, so fierce was its flight. With a shriek that deafened men, felled trees and split stone, Smaug shot spouting into the air, turned over and crashed down from on high in ruin.

*J.R.R. Tolkien  
The Hobbit*

In October of 1996, David Gallagher, a prominent financial consultant in Santiago, drew a comparison between the Saudi Arabian and Chilean economies. He noted that the sole difference between the two was that copper was the source of Chile's wealth, not oil. In his words: "The mentality is that you can get by exploiting natural resources, and that for anything brain-intensive, you imitate. And that translates into a serious weakness for the Chilean economy and its future prospects."<sup>1</sup> This observation stems from the policy path that the government followed in the aftermath of the financial collapse of the mid-1980s. The pragmatic neo-liberals who replaced the radical neo-liberals discussed in chapter three, remained in control of the economic ministries after the transition to democracy in 1989. As civilian rule took effect in 1990, the decision was made to continue following an export-oriented industrialization program.<sup>2</sup> In order to avoid the credit dependency that had characterized the 1975-1984 period, neo-liberalism dictated that Chile should specialize its production in areas where it had a comparative advantage -- the natural resource sector.

Traditionally, Chile has relied on income from the sale of its rich copper deposits to fund its national development plans. Thus, it was to copper that policy makers turned

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<sup>1</sup> Margaret Orgill, "Copper -- Price Slump Ruffles Chile Government, Not Mines," *Reuters Financial Service*, June 27, 1996.

<sup>2</sup> Throughout the transition process a key obstacle for the *Allianze Democratica* was obtaining the support of the business community. The business groups, particularly those with an export orientation, did not give their support to the pro-democracy forces until they were assured that the basic economic model would not be changed. For more on transitions to democracy in general, and Chile in particular, see Paul W. Drake and Ivan Jaksic, eds., *The Struggle for Democracy in Chile*, revised edition, (USA: University of Nebraska Press, 1995); Stephen Haggard and Robert R. Kaufman, *The Political Economy of Democratic Transitions*, (Princeton: Princeton University Press, 1995); James M. Malloy and Mitchell A. Seligson, eds., *Authoritarians and Democrats: Regime Transitions in Latin America*, (Pittsburgh: University of Pittsburgh Press, 1987); Guillermo O'Donnell, Phillippe C. Schmitter, and Lawrence Whitehead, eds., *Transitions From Authoritarian Rule*, (Baltimore: Johns Hopkins University Press, 1988); and Eduardo Silva, "Capitalist Regime Loyalties and Redemocratization in Chile," *Journal of Interamerican Studies and World Affairs*, 23 (2) (May, 1991), p. 77-117.



to revive the national economy in the wake of the 1984 financial collapse. Indeed, the veins of copper running through the Chilean countryside that have been the life blood of Chile's fiscal arteries are flowing with renewed vigor. Mining in general accounts for over 40 per cent of the value of the nation's exports, copper by itself accounting for at least 30 per cent of exports per annum.<sup>3</sup> The status of the international copper market is, therefore, a critical issue to the economic health of Chile, and because of this importance, a key factor in the nation's ability to develop.

Twice in less than three years Chile has been forced to absorb major financial losses due to the vagaries of the international commodities market. The CODELCO/Davila trading scandal of early 1994 resulted in the loss of 204 million dollars by CODELCO, losses that had to be covered by the government. In 1996, the massive 1.8 billion dollar loss that Japan's Sumitomo Corporation's head trader, Yasuo Hamanaka, suffered in the international copper market brought the price of copper tumbling down from \$1.14 a pound to less than \$0.90 a pound, an event which is likely leave the Chilean government with a minimum 1996 budgetary shortfall of 100 million dollars. The story of the Davila and Sumitomo futures trading fiascoes which will be presented in this chapter illustrate the volatile nature of international commodity markets. Chile has based its current burst of economic growth on the strength of its rich natural resource reserves. Thus, the ramifications of the case in this chapter are particularly important to understanding the fragility of the Chilean economic miracle. As discussed in

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<sup>3</sup> To the credit of the neo-liberal economists who worked to alter the structure of the Chilean economy under Pinochet it should be noted, that during Allende's presidency, copper comprised close to 70 per cent of the nation's exports.

<sup>4</sup> "CODELCO Takes \$200 million Hit," *Futures*, 23 (3) (March, 1994), p. 14.

chapter one, a peripheral country that depends on its natural resources for development will be at a perpetual disadvantage because of cyclical fluctuations in the international economy and an inability to control the demand for, and price of, its principal exports.<sup>5</sup> Chile should have the capacity to act, at least nominally, as a swing producer in international copper markets. Yet, despite the volume of copper it produces, and advance knowledge of copper supply levels, Chile is unable to exert even marginal control over the international price of copper.

In order to examine the significance of the two recent copper crises for Chile's development process, this chapter will be divided into three sections. First, there will be an account of the CODELCO and Sumitomo affairs. Second, the effects of both crises will be placed within the Chilean context through a discussion of the reaction of key Chilean actors and the effects the crises had on the Chilean political debate. Finally, these cases will be used to make a more general statement about the structural barriers that prevent the development of a peripheral country.

### **Crashes in the international copper market**

Chile has historically been afflicted with economic shocks from recurring collapses in the international price of copper due to cyclical fluctuations in the market. However, the two most recent episodes stand apart. Both the Hamanaka/Sumitomo scandal of 1996 and the Davila/CODELCO scandal of 1994 resulted in a sudden and dramatic fall in the price of copper, not because of a change in demand, but because of

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<sup>5</sup> Raul Prebisch, "Notes on Trade From the Standpoint of the Periphery," *CEPAL Review*, No. 28 (April, 1986), p.207-208.

miscalculations on the part of futures traders. Sumitomo and CODELCO both claim that the losses they suffered in the copper futures markets were the actions of rogue traders acting independently. However, when compared, there appears to be a strong connection between the actors involved in each case. To present both of these debacles and to illustrate how they may be interconnected, this section will first present the Davila/CODELCO case, then the more recent Sumitomo scandal, and finish with the connecting links between both cases.

### *Juan Pablo Davila*

In January of 1994, auditors examining the financial records of CODELCO discovered a series of major improprieties at the company's futures trading desk. Over the course of five years their head trader, Juan Pablo Davila, had lost some 207 million dollars in international futures trading: 164 million dollars in copper markets, 31 million dollars in silver markets, and 12 million dollars in gold markets. At the time, the total losses incurred by Davila amounted to approximately one half of one per cent of the Chilean GDP. In light of the restrictions that CODELCO placed on its international traders, it was simply astounding that one individual could lose this much money.<sup>6</sup>

Originally, CODELCO was formed by the Allende administration to ensure that Chile had full access to the foreign earnings of the copper industry. After the Pinochet dictatorship, CODELCO was no longer accorded a privileged position as the prime income earner of the government. Rather, the state-run copper corporation was expected to operate like a private corporation, at peak efficiency free from government

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<sup>6</sup> "Chile: Sumitomo Deal Forced Davila to Admit Losses - Paper," *Reuter News Service - Central and South America*, July 1, 1996.

intervention. Thus, the decision to allow CODELCO to become involved in the international futures market was primarily based on a desire to take advantage of the company's advance knowledge of international copper supplies and to make a small profit on the futures market. In order to guard against the kind of losses that were experienced by Davila, CODELCO traders were restricted to a position of not greater than 20 000 tons and a maximum loss of one million dollars. Through these controls, the government hoped to prevent the kind of large speculative losses that resulted in the collapse of Barrings Bank. However, through a combination of deceit, fraud, and lack of supervision, it is evident that the restrictions placed on the futures trading desk failed.<sup>7</sup>

The losses began when Davila entered a number of incorrect transactions into the computer and then traded against them. In order to correct the mistake that he had made, Davila began to trade via larger and larger operations in order to recoup his loss, eventually compounding his original loss to approximately 40 million dollars. Yet, even at this point it was not unreasonable for Davila to expect to recover his losses, all he needed was for the market to move in the right direction. It was not until Sumitomo Corporation of Japan intervened in the international copper market and pushed the price of copper down 300 dollars a ton that Davila's paper gamble collapsed.<sup>8</sup>

The popular outcry in Chile regarding Davila's losses centered around how one individual could have been allowed to take such a tremendous gamble with public money. According to Juan Villarzu, executive Vice President of CODELCO, "the systematic deceit by Davila ... was possible thanks to the massive use of unusual operations and the

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<sup>7</sup> "CODELCO Takes \$200 million Hit."

<sup>8</sup> Julia Meehan, "Chile: CODELCO Calls Board Meeting to Determine Error," *Reteur News Service: Central and South America*, Jan. 31, 1994.

ease in obtaining a rise in the margins of guarantee.”<sup>9</sup> While the attempt by CODELCO executives to place all of the blame for the fiasco on Davila was successful, public and political pressure still elicited a rash of resignations and firings of top executives at the copper company. As will be shown later, some of the personnel involved in the 1994 crisis re-appeared in the aftermath of the Sumitomo affair of 1996.

At first, Davila willingly took the blame for everything, but in 1996 he recanted. After claiming that his client felt that the others involved were *untouchables*, Christian Espejo, Davila’s lawyer, released a statement which declared that, “Davila acted within a legal framework, which was authorized by the directors of CODELCO and he acted to fulfill the instructions of his immediate supervisors ... They authorized these futures operations ... It is incomprehensible that they did not control them.”<sup>10</sup> In fact, a two year long fraud investigation bears out the story that Davila did not act alone. The same investigation also revealed that Davila was not involved in a simple case of bad trading practices, but was instead part of a complex web of fraud and deceit.<sup>11</sup>

Davila was a familiar figure at the London Metal Exchange (LME) black tie dinners where he was often seen surrounded by a group of brokers vying for his attention.<sup>12</sup> From these dinners emerged a series of agreements with European trading houses to make trades for CODELCO on the floor of the LME. Among the companies involved were Metallgesellschaft (MG), Sogemin, Birch Brokerage, and Global Minerals and Metals (GMM). These brokerage houses readily granted Davila the unauthorized

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<sup>9</sup> “Chile: CODELCO Copper Inquiry Points to Fraud,” *Reuters News Service - Central and South America*, Aug. 19, 1994.

<sup>10</sup> “Davila Was Not Alone, Says Attorney,” *Chile Information Project*, Aug. 15, 1996.

<sup>11</sup> “Three More Indicted in CODELCO Case,” *Chile Information Project*, June 20, 1996.

<sup>12</sup> *The Observer*, June 16, 1996. p.37.

increases in credit ratios that were necessary for him to continue trading after he had exceeded CODELCO trading limits. Yet, with CODELCO's trading regulations being public knowledge, why would these trading firms be so eager to allow Davila to incur greater losses?

In 1996, a Chilean judicial investigation resulted in law suits being launched against two trading houses, MG of Germany and Sogemin of England, for engaging in fraudulent copper trades with Davila.<sup>13</sup> The suits claim that instead of acting as agents for CODELCO on the LME, the two trading houses colluded with Davila to deliberately make trades that would cause CODELCO a loss. In return for conducting loss making trades, Davila is alleged to have received a commission from the foreign trading houses which had counter-traded to make a profit. The most substantive evidence to support this case alludes to two payments which were made to off-shore bank accounts owned by Davila; in October of 1994 Sogemin paid 9.77 million dollars into a Cayman Island bank account while in 1990, MG had deposited 1.5 million dollars into a similar account.<sup>14</sup>

Davila was not alone in reaping the 'rewards' of his activities. In June of 1996 three others were indicted alongside Davila. Patricio Hirsch, Marcelo Avendano, and Anibal Frias were all implicated in the operation of *Servicios de Negocios S.A.*, a trading house surreptitiously operated by Davila while he worked for CODELCO. The main clients represented by this company were MG and Sogemin. A third trading house, Birch Brokerage, was included in the web of deceit when it was revealed that it had handled the trades that resulted in approximately 30% of CODELCO's losses.<sup>15</sup> Judge Jose Benquis,

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<sup>13</sup> As of writing these proceedings are still underway.

<sup>14</sup> "Three More Indicted in CODELCO Case," *Chile Information Project*, Aug. 21, 1996.

<sup>15</sup> "CODELCO Exec. Looks at Suspect Trades by Davila," *Chile Information Project*, July 4, 1996.

head of the investigation into the CODELCO trading affair, found this trading pattern unusual because Birch was a very small and new company. More importantly, Judge Benquis discovered that a key Birch trader, Janet Mirasol, was a close personal acquaintance of Davila.<sup>16</sup> As Chilean investigations began to wind down in 1996, the picture that emerged was one of a complex web of personal relationships, centered around Davila, used to engage in fraudulent trades.

### *Yasuo Hamanaka*

CODELCO's losses at the hands of Davila and associates pale in comparison to the 1.8 billion dollar loss incurred by Sumitomo Corporation's head trader Yasuo Hamanaka. Also known as 'the Hammer' and 'Mister 5%', Hamanaka's copper trades were regularly twice the volume of Sumitomo's nearest competitor. The size of Hamanaka's trades had the power to change the direction in which the market would move. In fact, Sumitomo regularly held such a large position in the copper market that it was forced to leave the New York commodities exchange, COMEX, for the less stringent regulatory environment of the LME.<sup>17</sup>

For over ten years Hamanaka had dominated both the international paper and physical markets for copper on behalf of Sumitomo Corporation. In a Sumitomo Corporation annual report Hamanaka attributed his success to his "expertise in risk management."<sup>18</sup> On June 13, 1996 his expertise failed him and Sumitomo's copper

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<sup>16</sup> *Ibid.*

<sup>17</sup> The COMEX imposes a limit on the volume and size of trades that members can make whereas the LME does not. Further to the advantage of Sumitomo was the fact that the rules of operation on the LME do not stipulate that you must be a member to trade on it. Individuals are free to trade on the exchange through brokers. By using brokers, Hamanaka was able to escape regulatory control of his trades.

<sup>18</sup> "Coming a Cropper in Copper" *The Economist*, June 22, 1996. p.69.

trading apparatus collapsed to reveal a loss of 1.8 billion dollars in copper trading. As in the Davila case, Hamanaka was attributed with full blame for this trading disaster. What is more worrying about the Hamanaka case are charges that he not only conspired to fix the price of copper, but also attempted to partake in fictitious trades.<sup>19</sup>

While there is still a great deal of investigation to be done in this case, it has begun to become apparent that Hamanaka could not have acted alone. As Davila said in a *Financial Times* interview in July of 1996, :“He [Hamanaka] had a team ... its impossible to maintain that kind of position for more than a week, a month at most, not four years. What happens with credit lines, the banks?”<sup>20</sup> Davila further substantiates this assertion by relating personal experiences with Sumitomo: “When I sat and negotiated physical sales with the Japanese [Sumitomo Corporation], one executive would be talking and the rest would be sitting there taking notes. And ... if I tried it on a bit, they would have an exact record of the conversation and what we had said to them.”<sup>21</sup> The sheer volume and size of the trades that Hamanaka made indicated to many in the industry that it would have been logistically impossible for him to act alone. When this factor is combined with rumors of unusual linkages between producers, brokers, and purchasers, it begins to appear as if Hamanaka was part of a group that attempted, and succeeded, in manipulating the international copper market.

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<sup>19</sup> As of this writing, these charges have not been legally substantiated. The basis for this claim are solely a number of different press reports hinting, and occasionally directly stating, that Hamanaka was involved in a number of trading improprieties.

<sup>20</sup> “Hamanaka Could Not Have Acted Alone - FT Interview,” *Reuters World Service*, July 2, 1996.

<sup>21</sup> *Ibid.*



*The market*

At the end of his investigation into the CODELCO scandal of 1994, Judge Jose Benquis came to the conclusion that there was an 'informal bloc' of futures traders operating in the copper market. His finding was that, "the losses were distributed among all the brokers, and we can't rule out any broker being involved."<sup>22</sup> While this does account for the actions of Davila and his co-conspirators, it still does not address the issue of how the tragedies that befell CODELCO and Sumitomo could be related. For his own part, Judge Benquis did acknowledge that Hamanaka's name surfaced in his investigations, but chose not to elaborate on its significance.<sup>23</sup> When linked with Davila's concern that there were *untouchables* involved in the case, it is possible that Benquis was concerned about the political ramifications of a clear statement linking Hamanaka to the Davila affair. However, the most likely scenario is that Benquis felt that there was not sufficient evidence to make this connection in his report.

CODELCO, however, categorically denied that there had been secret meetings between that organization and Hamanaka of Sumitomo. Juan Eduardo Herrera, Senior Vice President of Sales<sup>24</sup> at CODELCO, stated that, "CODELCO has never held any formal meeting with Sumitomo to discuss futures business. These meetings have never been mentioned before in our investigation or in any analysis of this period."<sup>25</sup> Even in the quote cited in the paragraph above, Davila was discussing physical trades, not futures

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<sup>22</sup> Roger Atwood, "Hamanaka's Name Came Up in CODELCO Probe - Judge." *Reuter News Service - Central and South America*, June 26, 1996.

<sup>23</sup> *Ibid.*

<sup>24</sup> This is the position responsible for overseeing international commodities trading at CODELCO.

<sup>25</sup> "Chile: Chile's CODELCO says unaware of Sumitomo Meeting." *Reuter News Service - Central and South America*, July 2, 1996.

or paper trades with Sumitomo. Yet, simply because there was no direct and formal encounter between the two parties does not necessarily mean that interaction between the two corporations did not take place.

Owen Guerini and Carlos Derpsch had been Davila's direct superiors before their dismissal following the 1994 scandal. Shortly after the revelation of the huge losses of the futures trading desk at CODELCO, both Guerini and Derpsch paired up to represent the American trading house, GMM. Previous to his employment at CODELCO, Guerini had worked for GMM in the 1980s. What makes these events significant is that a key client of GMM was Sumitomo Corporation. It is this connection that is now under investigation by a New York grand jury as part of its examination of Sumitomo's global dealings.<sup>26</sup> Adding an even stranger twist to this connection was CODELCO's cancellation of its long standing contract with GMM just three days before Hamanaka's paper castle collapsed. While both GMM and CODELCO deny that the two events were connected, they do tend to lend credence to the hypothesis that there exists a series of deeply rooted informal links between international copper traders.

The trading firms that are under investigation in light of the Sumitomo affair also appear to lend support to the existence of strong informal personal links between different actors in the international copper market. Winchester Commodities, Birch Brokerage, GMM, and Icen Commodities are all currently being investigated regarding Hamanaka's trading history. Of these four, Birch and Winchester are also included in the Chilean government's investigation of Davila's trading activities. While not directly included in

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<sup>26</sup> "US Grand Jury to Investigate Former CODELCO Execs" *Chile Information Project*, June 20, 1996.

Judge Benquis's investigation, Icenis traders Wolfgang Becker, Jane Walsh and Stuart Gordon have also appeared in the CODELCO inquiry.<sup>27</sup> Not to be forgotten, GMM could be brought into the picture by the New York grand jury's questioning of the activities of Guerini and Derpsch.

When questioned about the connection between the CODELCO and Sumitomo scandals, Juan Herrera, CODELCO vice-president - trade, said that: "We have precious little factual information, and too many questions."<sup>28</sup> While it is far too early to clearly state whether there was some form of a conspiracy between Davila, Hamanaka, and other commodities trading houses, it is clear that they were all caught up in questionable trading practices. Irrespective of the validity of claims that the two 'rogue' traders acted alone or as part of a conspiracy, the evidence does a great deal to support a conclusion that the free functioning of the international copper market was obstructed by the actions of a small group of individuals.

### **Reactions**

The Chilean government's reaction to both the CODELCO and Sumitomo scandal was centered on two key tenets: Chile's copper production cost advantage and the presence of the copper stabilization fund. After the huge losses of 1994, Minister of the Economy Alvaro Garcia said: "One hundred million dollars is a significant amount of resources, but it will not affect the running of the economy. The copper fund is of such magnitude that it can absorb this loss without difficulty."<sup>29</sup> The finance minister at the

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<sup>27</sup> "Sumitomo Links to CODELCO Explored," *Chile Information Project*, July 18, 1996.

<sup>28</sup> *Ibid.*

<sup>29</sup> "New Minister says Chile Can Absorb CODELCO Losses," *Reuters Financial Services*, Jan. 28, 1994.

time, Alejandro Foxley, supported Garcia with the statement that: "There are the resources to allow the government to absorb the losses of CODELCO without affecting the need for economic adjustment nor for paralyzing government programs."<sup>30</sup> Foxley announced that 145 million dollars of the loss would be covered by the copper stabilization fund and the remaining 61 million dollars would be covered by profits gained from efficiency improvements in CODELCO.<sup>31</sup>

In the wake of the collapse of international copper prices due to the Sumitomo scandal, the Chilean government again turned to the copper stabilization fund. Jose Pablo Arellano, the Chilean Budget director, sought to assure domestic and foreign observers that, "there is no doubt that falling copper prices will generate a short fall and this could affect our planning for this year and the next. But because of the copper price stabilization fund, there is no chance of crisis developing."<sup>32</sup> In the wake of the financial collapse of the early 1980s, the architects of Chile's new EOI model recognized that copper would be a pre-eminent export. Both the IMF team and the Chilean economic planners realized that the structure of the international commodities market made it extremely difficult to forecast copper prices. Since Chilean government spending was directly tied to the price of copper, the copper stabilization fund was created to protect against unexpected price falls in the international market.

As the government reaction to both artificial price crises indicates, the copper fund has indeed provided policy makers with a great deal of security. The safety net of the copper fund, combined with copper production costs as low as 45 to 55 cents a pound,

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<sup>30</sup> *Ibid.*

<sup>31</sup> "CODELCO Takes \$200 million Hit."

<sup>32</sup> "Government to Use Special Copper Fund." *Chile Information Project*, Sept. 2, 1996.

has given Chileans the feeling that their economy can continue to grow despite depressed global copper prices. Yet, this is a distressing aspect of Chilean economic policy. Policy makers appear not to have noticed the significance of the observation made by David Gallagher in the first paragraph of this chapter. Chile *is* dependent on one commodity for the majority, well over 30 per cent, of its export earnings.<sup>33</sup> Gallagher is simply repeating the base assumption behind structuralist theory; a dependence on one natural resource for national income results in excessive vulnerability to the structure of the international political economy, and a permanent disadvantage in terms of trade.

Neo-liberal economics was introduced to, and entrenched in, Chilean policy making by the Pinochet government in order to try a new escape route from the dependency trap in which the country appeared to be stuck.<sup>34</sup> The intention of the authoritarian regime was to avoid this problem by developing a strong export sector in the national economy. By attracting foreign investment capital, Chile would be able to develop a strong industrial base. While there was success in reducing the nation's dependence on copper, the new industrial developments have come mainly in other primary resource areas. Thus, while the government was able to reduce the national dependence on copper

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<sup>33</sup>While national dependency has fallen from 70 per cent of export earnings during the Allende governments, it appears to be rising again. Many predictions on the development of the Chilean economy see copper growing to account for as much as 50 per cent of the nation's exports.

<sup>34</sup> See chapter 3.

**Table 4.1**  
**Selected Economic and Copper Market Indicators, Chile 1980-1994**

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
<b>GDP Growth Rate (%)<sup>a</sup></b>	7.3	5.8	-12.6	-0.5	6.0	2.2	5.4	5.3	7.2	9.5	3.3	6.8	10.6	5.9	4.1
<b>GDP/capita Growth Rate (%)<sup>a</sup></b>	5.7	3.5	-14.5	-2.2	4.3	0.7	3.7	3.6	5.4	7.7	1.6	5.0	8.8	4.2	2.4
<b>Copper Price (LME) US c/lb<sup>b</sup></b>	99.12	79.05	67.21	72.23	62.46	64.29	62.13	80.79	117.93	129.15	120.72	106.07	103.64	86.86	104.58
<b>% of Exports as:<sup>a</sup></b>															
<b>Primary Products</b>	91.1	92.6	92.6	93.0	92.6	93.3	91.5	91.3	91.1	89.9	89.1	87.3	86.8	83.9	83.6
<b>Manufacture</b>	11.3	7.4	7.4	7.0	11.9	6.7	8.5	8.7	8.9	10.1	10.9	12.7	13.2	16.1	16.4
<b>Copper (%) Share of Exports<sup>a</sup></b>	46.8	...	48.4	47.3	43.3	46.2	41.6	41.7	46.0	40.1	46.5	41.4	39.4	36.7	36.7
<b>% Share of Global Copper Mkt.<sup>c</sup></b>	16.3	14.9	18.0	17.6	16.6	13.2	12.3	11.8	12.9	12.8	16.2	13.5	14.1	12.7	13.8
<b>Manufacture Employ.<sup>c</sup></b>	89.2	83	65.6	65.3	72.8	79.9	89.1	100	112.2	125.8	128.8	132.8	144.4	147.1	....

<sup>a</sup> Source: Economic Commission for Latin America and the Caribbean, United Nations, *Statistical Yearbook for Latin America and the Caribbean*, (Chile: United Nations), years 1986-1995.

<sup>b</sup> Source: International Monetary Fund, *International Financial Statistics Yearbook*, (Washington, D.C.: International Monetary Fund, 1996).

<sup>c</sup> Source: Department for Economic and Social Information and Policy Analysis, United Nations, *1994 International Trade Statistics Yearbook: Volume II Trade by Commodity*, (New York: United Nations), years 1992 and 1995.

that was discussed by Theodore Moran,<sup>35</sup> it did not succeed in solving the structural problems that had led to the nationalization of the copper mines in the late 1960s and early 1970s.

Chile had occupied the classical role of a peripheral country during the time period covered by Moran's study. Raw materials, copper, were exported to the core and value-added goods, intermediate and capital goods, were imported into Chile. As discussed in chapter one, this resulted in the peripheral country, Chile, being at a permanent disadvantage in terms of trade. The industrial diversification which occurred during the military dictatorship has reduced Chile's dependence on copper, but it has not remedied the country's fundamental disadvantage in terms of trade with the core. Chile is still reliant on the export of primary commodities to earn foreign exchange (see table 4.1). There remains an inability to overcome structural barriers to development and create a strong, export-oriented manufacturing sector.

In light of the two recent artificial crashes in the international price of copper, it is significant to note that concern is not being raised by the government, but by an extremely successful private sector. Ken Pickering, CEO of Escondida, one of the largest copper mines in Chile,<sup>36</sup> said in July that, "it is not fair that future traders have become the gods of the copper trade, controlling prices and creating the debacle that we have seen with Sumitomo and CODELCO. As producers we are worried ... because of the brusque price changes that occur day to day."<sup>37</sup> The irony is that the main beneficiaries of the neo-

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<sup>35</sup> See Theodore Moran, *Multinational Corporations and the Politics of Dependence: Copper in Chile*, (Princeton: Princeton University Press, 1974).

<sup>36</sup> Escondida is one of the three Chilean copper exporters that accounts for 27.5 per cent of *all* Chilean exports. The other two are CODELCO and ENAMI.

<sup>37</sup> "Escondida's Pickering makes no Estimate," *Chile Information Project*, July 2, 1996.

liberal revolution in Chile have been the first to complain about the structure of the international commodities market. For Escondida, and a few other very large mines with production costs under sixty cents a pound, the wild price swings caused by international traders are a major inconvenience. However, for the small and medium copper producers, the source of over a third of the nation's copper production, the wide swings in copper prices can lead to bankruptcy.

Not all of Chile's massive copper production comes from the larger international mining ventures. There are still over 700 small copper mines that have an average production cost of 1.05 to 1.10 dollars a pound. In light of the fall in copper prices, the state owned company with a mandate to assist small producers, ENAMI, is expecting a 48 per cent fall in profits in 1996. With the price of copper falling below the production costs of many of its suppliers, ENAMI is being forced to subsidize many of its suppliers by paying above market prices for copper ore.<sup>38</sup> While the August price average of 1.07 dollars per pound is just under the small mine production cost of 1.05 to 1.10 dollars a pound, the question remains, what will happen when the price of copper averages between 80 and 90 cents a pound?<sup>39</sup> How long will ENAMI be able to continue subsidizing the small mines?

The national copper mining society, SONAMI has come to the conclusion that in the short term copper prices will settle in the range of 85 to 90 cents a pound. Walter Riesco, SONAMI's president, fully acknowledged that this would have a negative impact on the small producers, but concluded that, "the industry will have to learn to live with

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<sup>38</sup> "ENAMI Earnings Fall by Nearly One Half," *Chile Information Project*, Sept. 23, 1996.

<sup>39</sup> Some estimates see the price of copper settling in the 85 cent per pound range.



the current prices."<sup>40</sup> As if this did not paint a bleak enough picture for the small producers, CODELCO and COCHILCO, the state run company formed to assist small mines, both estimate that 1997 copper prices will average between 0.95 and 1.00 dollars a pound, as much as 10 cents a pound over private sector estimates. While the government is, to a certain degree, committed to using the copper stabilization fund to support its smaller producers, if prices remain low and a large number of small mines have to cease operations, will the government be politically and economically able to provide assistance?

Both CODELCO and COCHILCO have an incentive to over-estimate the global price of copper. A higher predicted price for copper results in the government having an expanded revenue base from which to make its expenditure plans. To fully appreciate the significance of this kind of political maneuvering, it must be remembered that during the Frei and Allende governments the extent to which social programs could be pursued was largely dependent on the revenue generated by copper exports. The Chilean government still makes its budgetary spending estimates based on predicted copper revenues. Should revenues fall short due to lower than expected prices, then a withdrawal is made from the copper stabilization fund to cover the difference.

Indeed, the banking sector would appear to accept this logic and use private sector price estimates when making risk assessments before issuing loans for new mines. The opening of two major new copper mines in Chile has been delayed due to financing problems caused by low current copper prices and forecasts that suggest these prices

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<sup>40</sup> "Low Prices Will Not Hurt Investment," *Chile Information Project*, Sept. 30, 1996.

rising very little. Canada's Gibraltar Mining company has had to delay the opening of its Lomas Bayas copper mine, and Australia's Luksic corporation was forced to split its Tesoro mine into two phases in order to obtain financing.<sup>41</sup> Yet, despite these private sector setbacks, CODELCO attained a flood of very favourable bids for a 500 million dollar financing package for modernization.<sup>42</sup>

The ease with which CODELCO is able to attain financing relative to its private sector counterparts points to a deep-seated problem within the method by which the copper stabilization fund is used. Control of credit, production, and technology by the core introduces a structural element into any financial transactions with CODELCO. Foreign creditors know that the government will use the copper fund to cover any financial problems that CODELCO will face. As was the case with the banking sector in 1984, should CODELCO incur massive international debts, the global financial community would force the government to cover the loans through the implicit threat of a suspension of credit.

In and of itself, social spending is creating a great deal of political conflict, left leaning parties wanting more, rightist parties less. A key cause of the social conflict that resulted in the increasingly interventionist governments in the 1960s and 1970s<sup>43</sup> was the debate about how wealth and income should be redistributed throughout Chilean society. The current problem is that policy makers have little concern about the state of the international copper market because of their 1.5 billion dollar safety net. With one of the

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<sup>41</sup> "Tesoro Copper Project Reconsidered," *Chile Information Project*, Aug. 2, 1996.

<sup>42</sup> As this thesis was being written, speculation was that CODELCO would receive its financing on extremely favourable terms, interest rates between 30 and 35 points above libor.

<sup>43</sup> See the discussion of the Alessandri, Frei, and Allende governments in chapter two.

worst income differentials in the world, the Chilean government has committed to devoting close to 70 per cent of its budget, money largely raised from copper mining and related activities, to social programs.<sup>44</sup> Socio-economic conditions in the 1990s mirror those of the two presidencies before the coup. The Chilean right worries that there will be a resurgence in the kind of confrontational politics that characterized national politics before the coup. Consequently, the real test that the current government faces is not in the 1997 budget debate, but in future years when a shrinking copper fund is used to cover copper revenue shortfalls.

The low forecast price of copper presents Chile with a three-fold problem, a set of problems envisioned by structuralists in the 1940s. First, its export earnings will be dramatically reduced. Even though Chile does have the capacity to increase production to account for lower world prices, after a certain point the increase in supply will only serve to depress the price still further. Second, the small and medium producers that supply ENAMI were responsible for the production of 860 million dollars of Chile's 6 487 million dollars of copper exports in 1995. With prices forecast to be as much as 25 cents a pound under their production costs, Chile could experience a 13 per cent fall in its copper earnings because of producer bankruptcy. More significantly, the 750 mines that would be affected, largely due to lower production efficiency, employ a significant portion of the Chilean work force. When the supply and service industries that cater to these smaller producers are taken into account, it becomes apparent that widespread

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<sup>44</sup> "Budget Debate Begins," *Chile Information Project*, Oct. 4, 1996.

bankruptcies could greatly expand the ranks of the unemployed and impoverished in Chile. This, in turn, would add more fuel to the volatile fire of the budgetary debate.

The third part of the problem facing the Chilean government lies in its chosen path of development. Current government policy seeks to foster economic growth through the exploitation of natural resources, particularly copper. As both *Gibraltar* and *Luksic* have discovered recently, low copper prices result in a dearth of financing for new projects. If this is a harbinger of the future, then many foreign investments in Chilean natural resource industries might never get off the ground because of a lack of financing. Without access to domestic pools of credit with which to develop a nation's natural resources, a peripheral country's capacity to pursue the kind of EOI development strategy present in Chile remains dependent on core sources of credit.

### **A Structuralist View**

The Chilean economic miracle may be a mirage. The events that have been catalogued in this chapter may not represent a distortion in the operation of the international commodity market, but a correction (see table 4.1 -- copper price). For the last four years, the international copper price has been at record levels, averaging in excess of \$1.20 per pound. It is entirely possible that this elevated price was maintained by the actions of Davila and Hamanaka as they sought to extricate themselves from a steadily worsening trading position. If this is the case, then a substantial amount of the income that has fueled the recent boom in Chilean economic growth is, in fact, an artificial phenomenon. Continued depression of copper prices, however, could result in a

radical fall in foreign investment in new mining ventures in Chile and a related decrease in the nation's economic growth rate.

The whole point to the EOI model which has been pursued in Chile since the mid 1980s is to diversify the country's economic base. In the early 1970s Chile was dependent on copper for 70 per cent of its export income. The EOI model has reduced copper's share of national exports to 30 per cent, but this figure is forecast to rise to 50 per cent within the next ten years<sup>45</sup> (see table 4.1). Areas into which the Chilean economy has diversified -- fisheries, agriculture, forestry -- face the same potential for price uncertainty as copper. For Chile, then, the problem remains one of creating a diversified *industrial* economy that can address the social, as well as economic, needs of the country.

Irrespective of what Chilean officials may declare in their press releases, the Chilean economy is dependent on the sale of natural resources, primarily copper, for its growth (see table 4.1). The events catalogued in this chapter clearly indicate that the price of copper is beyond the control of the Chilean government, irrespective of world demand levels. However, beyond this lies a much deeper, more pernicious problem. All peripheral countries are seeking a route to attain a stronger economy and its associated social transformation. Even we accept that the laws of comparative advantage are correct, and that most peripheral countries should seek development through the export of primary resources, there remains one crucial question: How is the development of a primary resource industry to be financed?

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<sup>45</sup> Roger Atwood, "Clouds Mar Chile's Sunny Economic Horizon," *Reuter Financial Service*, Oct. 9, 1996.

As the examples of the Lomas Bayas and Tesoro copper mining projects in this chapter illustrate, the development of a peripheral country's primary industries require an infusion of foreign investment. In this particular instance, structural uncertainties in the market for copper proved a barrier to obtaining financing. Of more significance, however, is the fact that Chile had to look to a foreign investor to develop the project and to core credit markets to obtain the necessary capital. A further problem associated with foreign ownership of natural resource industries is that, by necessity, it entails a substantial portion of the profits from the project leaving the developing country. As discussed in chapter two, this can lead to significant domestic political tension.

For their part, neo-liberals hold that the issues in the Lomas Bayas and Tesoro mines do not represent any real problems. By its very nature, a free functioning economy will act to distribute resources where they can yield the maximum return. Therefore, as business opportunities become more attractive in the periphery they will attract higher levels of investment. This, in turn, will create a greater rate of domestic investment, eventually building in scale until the country becomes fully industrialized. The structuralist response is that while this may be a theoretical possibility, the structure of a peripheral country's economy is such that it lacks a sufficiently sophisticated capital market to accomplish this task. Indeed, neo-structuralist theory does not call on the government to direct all economic policy as structuralists did, but rather to act as a coordinating agent to facilitate the creation of a stable industrial sector and a functional capital market.<sup>46</sup>

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<sup>46</sup> For some recent neo-structuralist writing, see Patricio Meller, ed., *The Latin American Development Debate: Neo-structuralism, Neomonetarism, and Adjustment Processes*, (Boulder, Colorado: Westview Press, 1991); Osvaldo Sunkel, ed., *Development From Within: Towards a Neo-structuralist Approach*

Structuralism points to a more important problem associated with foreign ownership of these industries. The extraction of natural resources represents a one-time profit opportunity. For example, once Chile has mined all of its copper deposits it will have exhausted this natural resource, and, consequently, will no longer be able to earn foreign exchange from the sale of copper ore.<sup>47</sup> To the neo-liberal economists running the Chilean economic ministries, when this occurs, Chile's industrial focus will shift to a different sector in which the country has a comparative advantage. This presents a problem for structuralists. Natural resources represent the capital from which a developing country must seek to grow. It is only by investing this foreign exchange in the creation of intermediate, capital goods, and consumer goods industries that a developing country can hope to elevate itself to the developmental level of the core. Thus, the profit outflow attached to foreign ownership of natural resource industries represents a depletion of the developing country's inherent capital stock. A reduction in available capital means a reduction in the country's capacity to develop new industries in which it will have a comparative advantage when copper supplies are exhausted.

The need to look to core credit markets to obtain financing in order to develop natural resource industries represents another structural barrier to development. When credit is obtained from a foreign financial institution, an enterprise must adhere to set performance criteria or risk foreclosure of the loan. The theoretical logic behind this is that it prevents the waste of valuable capital resources. For a developing country, it also

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*for Latin America*, (Boulder, Colorado: Lynne Rienner Publishers, 1993); and José Antonio Ocampo, "New Economic Thinking in Latin America," *Journal of Latin American Studies*, 22 (1) (Feb., 1990), p.169-181.

<sup>47</sup> Estimates give the Chilean copper reserves an estimated lifespan of eighty to one hundred years.

serves to increase national vulnerability because a core bank's criteria for success may differ greatly from a country seeking development. Chapter three demonstrated what can happen when a developing country becomes dependent on foreign capital. Fiscal dependence on core credit deprives a peripheral country of the freedom to protect its own interests. Through the threat of a withdrawal of credit or an unwillingness to roll-over existing loans, core financial institutions and states are able to dictate what type of policy the government will pursue. The \$500 million financing package sought by CODELCO which was discussed in this chapter is a case in point. Unless prices fall below the 50 cent per pound range, CODELCO will continue to make a respectable profit. The state copper company is also a key income earner for the government, providing a substantial amount of the income necessary to fund national social programs. Therefore, it would appear to be a reasonable proposition that the government should invest public money in the company rather than force the corporation to seek financing on international credit markets. However, despite the presence of \$1.5 billion in the copper stabilization fund, the government, like CODELCO, would have to borrow any money it wished to invest.

Under the terms of a 1986 IMF financing agreement needed to rescue the country from the banking sector collapse, the copper fund may only be used when copper revenues fall short of expectations. To date, the largest withdrawal from the copper fund has been \$165 million, barely 10 per cent of its current size. Thus, the need to abide by financial agreements with the core to guarantee continued access to credit is preventing the government from making -- based on the eagerness of international banks to loan CODELCO \$500 million -- a sound business decision. Despite a latent capacity to



mitigate national vulnerability by removing one source of dependence on core sources of capital, this is prevented by restraints that have been imposed by core financial institutions.

The hegemonic control of the neo-liberal ideology that advocates EOI is prevalent in Chilean attitudes regarding alternate economic policies. Shortly after his election as the president of the Confederación de la Producción Comercio (CPC), Walter Riesco<sup>48</sup> said,

I don't think we will see a return to the Popular Unity (UP) government of Allende ... You have to ask yourself what would happen in the event of an economic crisis. What would be the tendency of the parties that support Lagos [a potential socialist presidential candidate]? Would they solve problems by improving the current economic model, or by resorting to government intervention? ... We are not afraid of Lagos, we just have doubts. But it is certain that we don't risk a return to the UP with Lagos. That is far behind us.<sup>49</sup>

Pinochet's efforts to transform the course and nature of the Chilean political debate were successful. Riesco's lack of concern about a fundamental change in the nature of the economic model that Chile is following reflects a virtual suspension of the developmental policy debate in Chile. In its place, there is a near universal adherence to the maxims of neo-liberalism.

Unwillingness by policy makers and the business community to consider alternate routes to development means that Chile must attempt to develop through the export of primary commodities. The immediate problem this presents the government is the plight of the urban poor. Not only is there a heated political debate about what should be done to help the 25 per cent of the nation living in poverty, despite the assurances of Riesco, there

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<sup>48</sup> In December 1996, Walter Riesco was elected as the president of the CPC. Shortly thereafter he left his job as president of SONAMI.

<sup>49</sup> "New CPC President Riesco Speaks Out: Victor In Thursday's Election Gives His First Interview," *Chile Information Project*, Dec., 9, 1996.

may also be a re-emergence of the political tensions that led to the 1973 coup. As was discussed in chapter one, the development process entails social *and* economic transformation; there is a marked shift of population from rural areas to cities. In Chile, this demographic shift took place in the 1950s and 1960s, but was not accompanied by a sufficient rise in industrial employment.<sup>50</sup> In fact, despite the tremendous economic growth that has occurred in Chile, the mostly urban country is still plagued by the massive unemployment problems that Alessandri, Frei, and Allende had to face.<sup>51</sup>

A concern which is beginning to be expressed in the Chilean media is that the national income stratification may result in the election of a socialist government and congress.<sup>52</sup> While this prospect has not yet raised a great deal of alarm, the similarity of current events to the history discussed in chapter two is unmistakable. The Allende government did not occur overnight. It was born of Frei's attempts to broker the interests of the poor and the powerful. Likewise, contemporary Chile may experience the same problem. In the midst of an economy that is permitting those involved with the natural resource sector and some service industries prosper, the vast majority of people have been left waiting for manufacturing jobs that have never appeared. Consequently, there is a growing class segregation within Chilean society. As the EOI model has not addressed this issue adequately, and has tied national development tightly to the natural resource sector, a question that remains to be answered is: What happens if there is a slow down or reversal of foreign investment in natural resource industries?

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<sup>50</sup> The breakdown of exports in table 4.1 supports the statement that the base nature of the Chilean economy has not been changed by the nation's current spurt of growth.

<sup>51</sup> See chapter two.

<sup>52</sup> *Ibid.*

## **Conclusion**

The real weakness in the Chilean 'miracle' is not its temporary reliance on copper for foreign exchange, but its failure to use this income to create a lasting industrial sector that is capable of competing in the global market place. By not acting as an agent to encourage the creation of value-added sectors in the economy, the government has committed Chile to a development strategy that is dependent on the international price for primary commodities, leaving the nation vulnerable to international economic shocks. Both the CODELCO and Sumitomo affairs demonstrate that international commodity markets are extremely volatile and irrational. Speculation has become such a large part of international commodity trading that it is impossible to be sure of any price level. If a small fall in the price of copper results in a fall in national income, the multiplier effect will be sure to ricochet its effects around the country. This makes the creation of a strong export oriented manufacturing sector essential.

Like neo-liberals, neo-structuralists recognize that the wealth which can be garnered through the exploitation of natural resources is critical to the development of a peripheral country. Where they differ is in the role that government should play in maximizing the potential of this opportunity. It is their view that government should be actively involved in the development of the economy. As Ramos and Sunkel have noted:

**It is not demand and markets that are critical. The heart of development lies in the supply side: quality, flexibility, the efficient combination and utilization of productive resources, the adoption of technological developments, an innovative spirit, creativity, the capacity for organization**

and social discipline, private and public austerity, an emphasis on savings, and the development of skills to compete internationally.<sup>53</sup>

Even if the development process is to be totally reliant on the exploitation of a nation's natural resources, it behooves the government to facilitate the most sustainable method of extraction of these resources, and structure the industry in such a way that it remains competitive internationally while allowing local labour as significant a role as possible. However, the crux of neo-structuralism lies not in a dependence on natural resources, but on their use to encourage industrialization.

Sunkel and Ramos are pointing to the need for government to encourage the creation of value-added industries that build on the country's inherent wealth, natural resources. As Nora Lustig notes, "development can be achieved through import substitution. It can also be achieved if the *infant industries* are furnished with the necessary protection."<sup>54</sup> The new role of government in the development process, as envisioned by neo-structuralists, is not to provide the kind of support to industry that occurred with the ISI process discussed in chapter two, but to aid in the establishment of new industrial sectors through initial support, and more importantly, through the creation of institutions and instruments that would allow domestic industry to help itself.

The risk that Chile faces is not that its copper reserves will be pre-maturely exhausted, but that the strict adherence to neo-liberal economics will retard the diversification of the national economy beyond primary industries. Currently, one of the

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<sup>53</sup> Joseph Ramos and Osvaldo Sunkel, "Towards a Neo-structuralist Synthesis," Osvaldo Sunkel, ed., *Development From Within: Towards a Neo-structuralist Approach for Latin America*, (Boulder, Colorado: Lynne Rienner Publishers, 1993), p. 8-9.

<sup>54</sup> Nora Lustig, "From Structuralism to Neo-structuralism: The Search for A Heterodox Paradigm." in Meller, *The Latin American Development Debate*, 31.

most pressing political issues in Chile is unemployment. There are masses of people living in urban slums who want to work. These people hear the stories of the Chilean economic 'miracle', but have yet to see any of its benefits come their way. Despite the claims of the neo-liberal technocrats running the Chilean economic ministries, the nation's natural resource driven growth does not appear to be trickling down to the 25 per cent of the population who live in poverty. The structure of the international political economy is not permitting the industrialization of Chile; employment opportunities that should be a result of massive economic growth are simply not evident. In order for Chile to entrench its current success, the nation's unemployment and poverty problems must be addressed and solved. If they are not, despite the assurances of Walter Riesco, there is a very real prospect that the social tensions that resulted in the 1973 coup could reappear.

## **Chapter Five**

### **Conclusion**

This planet has -- or rather had -- a problem, which was this: most of the people living on it were unhappy for pretty much of the time. Many solutions were suggested for this problem, but most of these were largely concerned with the movements of small green pieces of paper, which is odd because on the whole it wasn't the small pieces of paper that were unhappy.

*Douglas Adams*

*The Hitch Hiker's Guide to the Galaxy*

Chile is being held up as an example to the developing world of a case of how to generate strong economic growth and create a successful economy. The neo-liberal experience, partially inspired by the failure of import-substitution industrialization, is predicated on embracing the structure of the global political economy through the pursuit of an export oriented industrialization strategy. Through a focus on maximizing the nation's comparative advantage, and specializing in economic sectors where this advantage is at its greatest, Chile has indeed experienced exceptional economic growth rates. Yet, in the midst of its acclaim as an economic 'miracle', there remain signs of Chile's continued vulnerability to the international economy: a lack of a strong, globally competitive manufacturing sector and resultant high unemployment and widespread poverty.

Structuralists have not disputed that a peripheral state may achieve significant growth rates on the strength of natural resource endowments and agriculture, the basis for Chile's current growth. Where structuralists differ is in their claim that the actual structure of the international political economy is biased in favour of the core northern industrialized nations; a central proposition that is shared by this thesis. A developing state has no choice but to render itself vulnerable to the exigencies of the international system because it is unable to either fund the development of its own natural resources internally, or develop a strong, diversified, and internationally competitive manufacturing sector. The current wave of neo-liberalism in Chile was partially motivated by the economic insecurity caused by the collapse of a reasoned political debate in the early 1970s. Chapter two explored how the structure of the international political economy contributed to the failure of policies that were specifically geared towards overcoming

structural barriers to development. A need to garner the knowledge and productive capacity necessary for development was one factor behind the pursuit of import-substitution industrialization. Domestic political restraints and international economic barriers resulted in these policies being largely funded by foreign loans. The resultant dependency on the core for credit left Chile vulnerable to coercion by the United States and international financial institutions. This vulnerability became evident during the land reform debate and the increasingly nationalistic approach to Chilean industrialization; the government found that it had to act in a manner that would not overly offend its chief financier/creditor -- the United States.

Chapter three addressed the fantastic growth rates that occurred between 1978 and 1981, and the consequent collapse of the Chilean economy. Partly inspired by the counter-revolutionary tenor of the 1973 military coup, the radical neo-liberal economic policies pursued by the first generation of Chicago Boys sought a new approach to development. Rather than attempting to reject the structure of the international economy as structuralists had done, the neo-liberals embraced it, opening all aspects of the Chilean economy to the global economy. Of particular consequence was the massive deregulation in the banking sector. It was through the use of easily obtainable foreign credit that the radical neo-liberal conglomerates were able to support high national growth rates. Yet, these growth rates did not resolve the nation's vulnerability problem. A structural shock, the international recession, served not only to destroy the basis of the Chilean economy, but also to temporarily destabilize a firmly entrenched military regime.

Structuralists reject the experiences of the 1950s and 1960s as flawed because of an imperfect adherence to the theory behind ISI. Likewise, neo-liberals blame the failure



of the Chilean economy in the early 1980s on the government's failure to play its proper regulatory role. Thus, chapter four is of critical importance because these regulatory oversights have been corrected, thereby adhering to the dictates of neo-liberal theory. This chapter shows that despite Chile's widely acclaimed adherence to neo-liberalism, the problems that structuralists identified persist, and present a direct threat to the country's future economic growth and political stability. The instability of international copper prices illustrates the unpredictable nature of international commodity markets. With a market built upon the exploitation of natural resources, Chile has left itself vulnerable to the exigencies of the international futures markets.

It is the conclusion of this thesis that the structural barriers to development that were identified in the 1940s persist and continue to leave a peripheral country vulnerable to shocks from the international economy. While not dealing specifically with solutions to the problems of economic growth that these barriers create, the analysis in this thesis clearly suggests that neither neo-liberalism, nor structuralism provide a reliable method of mitigating this vulnerability. A new stream of development theory which seeks to address the weaknesses of both structuralism and neo-liberalism, neo-structuralism, is attempting to cut a middle ground. It envisions free acting markets with the government acting as an assistant to domestic industries seeking an export market. However, there has not yet been a sufficient disenfranchisement with neo-liberalism to cause this emergent stream of development theory to be applied to structural barriers which prevent Latin American development.

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