

Preliminary Draft, do not reference

A Neoliberal Experiment: Myths and Reality of the Chilean Model

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Fundacion Terram
January 2007**

Introduction: Chile's way

Rafael Correa in Ecuador and Daniel Ortega in Nicaragua are the latest of a series of Latin American elected Presidents which declare themselves openly critical of neoliberal economic policies. Chavez has gone even further declaring, in the opening speech of his third successive mandate, his commitment to move toward a Venezuelan form of socialism.

This new wave of left-wing populist governments in the Latin American region as well as the center left wing governments of Brasil and Argentina, contrasts with the conservative governments of the nineties which enthusiastically applied the economic policies of the Washington Consensus.

The dramatic failure of neoliberal policies, not only produced an economic collapse but triggered a profound political crisis in different countries in Latin America. This was, without a doubt, the turning point of political change in the region and the return of populist left-wing governments with, at least, a heterodox economic agenda.

Only Chile stands out as the beacon of hope for neoliberals. Not only has there been political stability during the post-Pinochet era, but also economic consensus, based on a strict Washington Consensus agenda. A center-left coalition (the Concertación) led intermittently by Christian Democrats and liberal Socialists, has been in government since 1990. The economic policies have been apparently successful and applauded everywhere. As a successful export economy based on natural resources, Chile has generated enormous economic growth and, more importantly, a significant reduction in poverty.

Chile stands out, almost alone, as the success story in Latin America. Not only is there political consensus between progressive forces historically at odds with one another in Latin America, Christian Democrats and Socialists, but political stability and economic consensus with other political forces.

The center-left governing coalition has followed a neoliberal economic model which apparently has been successful. Neoconservatives –as well as the Bretton Woods institutions- everywhere place Chile as the example of how neoliberal economic policies should be applied, to the annoyance of most Latin American governments, and how these policies can bring growth and progress. In this way Chile has become the poster child of the Washington Consensus and the ultimate neoliberal paradigm in Latin America.

The advent of the Chicago Boys

In 1973 Chile initiated a profound transformation in the economic model applied since the thirties by an ideologically diverse sequence of governments. The new vision was based on the criticism of a group of young Chilean economists who had studied in the University of Chicago.

Though these economists, who became known as the 'Chicago Boys', came together originally to generate an economic proposal in opposition to the economic policies applied by the Socialist experiment of President Allende's Popular Unity Government, they went further, much further. The Chicago Boys argued that the government of President Salvador Allende only continued and perfected a series of mistaken economic policies applied between 1930 and 1970¹.

They argued that Chile's road to socialism was only partially the problem, the main one was the import substitution industrialization (ISI) model, which had guided Chile's economic development strategy since the world depression. What was needed was a complete revision of the economic model. They were, in fact, proposing an economic revolution.

Though the assessment of the Chicago Boys was perhaps too harsh on the ISI policies applied in Chile during that period, and later recent revisions have been fairer². It was clear, in hindsight, that they identified a change in economic cycle and the end of the viability of an economic strategy.

Globalization and neoliberalism was ad portas. A small economy like the Chilean one, in this context, could not continue with an economy based on State ownership and import substitution, though how far Chile went is still open to debate.

Fortunately for the Chicago Boys, though not for democracy, the Socialist experiment ended abruptly, with a bloody military coup led by General Augusto Pinochet the head of the army. Without an economic plan or any ideas, Pinochet was only clear about his anti-communism. With no other alternative, and rather counter-intuitively for a military leader, he went along with the Chicago Boys and incorporated them into the new Government. Chile was on its way to a major economic transformation.

The proposal for Chile then, was together with political authoritarianism and the absence of democracy, to open spaces for private democracy (one dollar one vote), through the liberalization of markets, the privatization of State companies, the opening up of the economy, labor flexibility, and the transnationalization of natural resources.

From the Chilean way to Socialism, the pinnacle of the import substitution strategy, Chile became a world reference and paradigm for authoritarian neoliberalism, unheard of before and which is still being applied today, 16 years after the end of the dictatorship.

¹ El Ladrillo, 1972

² See Rodrick and French-Davis for example

The stages of economic policy in Chile.

The current economic model was not, however, conceived and implemented perfectly. In fact economic policies as well as different emphasis and priorities changed during the Pinochet era and the later with the democracy.

One can identify four distinct periods of economic policy. The first is the initial experiment with economic orthodoxy between 1973 and 1981. This was characterized by sudden liberalization, a return of nationalized companies to their owners, a reversal of land reform and the exchange rate peg. Especially traumatic was the liberalization of the financial sector, which together with the Latin American debt crisis and the exchange rate peg, generated a profound economic crisis in the early eighties. This first period ended what can be considered the worst economic crisis of all the Latin American countries. GDP fell over 30% and unemployment reached unprecedented levels.

The authoritarian government only survived due to the repression, any democratic government could not have survived politically such a profound crisis. Nonetheless the economic crisis was instrumental in reorganizing the democratic forces which eventually culminated in the peaceful overthrow of the dictatorship, with the plebiscite in 1988.

In any case, in order to deal with the economic crisis, Pinochet called upon a conservative, more traditional economist. Led by the newly named Minister of Finance Escobar Cerda, the crisis was dealt with heterodox policies, tariffs were raised, the exchange rate was devalued, the financial sector was intervened and a series of employment plans were implemented.

But once out of the crisis, Pinochet returned to economic orthodoxy and the Chicago Boys recipe. A third period of economic policies can be identified with the leadership of Hernán Buchi, a young Finance Minister, who reversed the tariff hikes and extraordinary controls, particularly to the collapsed financial sector. Buchi reactivated the privatization program now concentrated on major state public utilities. More significantly he continued to open the economy, but this time with a distinct strategy, the natural resource export economy. Together with an undervalued exchange rate, a series of subsidies, investor facilities and sectoral deregulation were put in place to promote the export sector, especially successful were forestry, fisheries and mining, as well as agriculture. Chile was on the way to becoming a resource exporting economy.

Also relevant in the Buchi era was the social model applied, the philosophy being to introduce market criteria and the private provision of public goods, albeit to relatively small proportion of the population. Privatized pension system and health insurance and deregulation of public education, among other innovations were the trade-mark of the Chilean economic model. Now neoliberal policies were extended to areas only discussed in academic circles before.

Democracy did not change substantially this development strategy, rather it perfected it. The new center-left coalition continued the privatization program now including the water treatment companies and introduced the novel incorporation of the private sector through the concession of public roads, ports, even prisons. Also the opening of the economy continued, with significant reductions in general tariffs and bilateral, regional and multilateral trade agreements. Also the specific sectoral benefits and subsidies were

quietly eliminated, though the investor rights and the strengthened property regime were maintained.

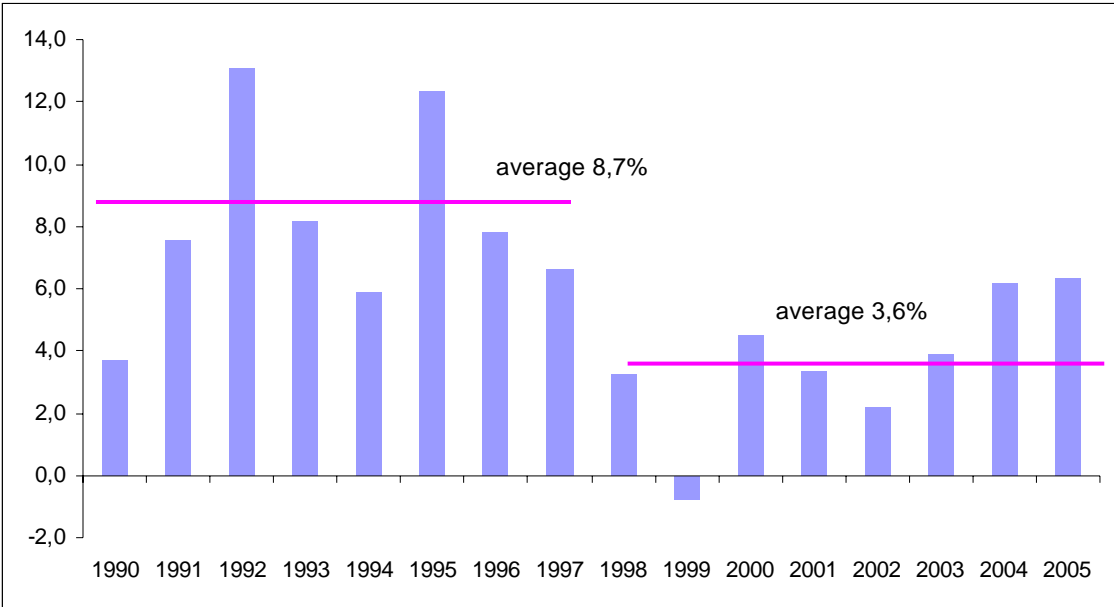
With respect to social benefits and welfare, though the democratic government maintained the logic of the Dictatorships social policy, that is a subsidiary state with focalization, it did substantially increase financial resources to vulnerable sectors, public health and education, therefore dealing with the unacceptable inequality generated by the model.

The 'model' matured in the democratic period, and though there was significant growth in the later stages of the Pinochet regime, growth, exports and poverty reduction really took off with the new democratic regime led by the Concertación a coalition of center-left parties.

The 'success' story

The Chilean economy has experimented significant growth between 1990 and 2005, averaging a GDP growth rate of 6% a year. However two distinct periods can be identified. Between 1990 and 1997 the Chilean economy experienced its highest growth rate of 8.7% on average a year, whereas between 1998 y 2005 growth fell significantly, averaging 3.6%. This was due first to the Asian crisis, but later studies have shown that the Chilean economy experimented diminishing returns due to the end of an investment cycle with the last of the large public utility privatization.³ By 2004 recovery was underway, though with a lower GDP growth, mainly due to the slow recovery of investment.

Chile: Economic growth 1990-2005. GDP average percentage growth

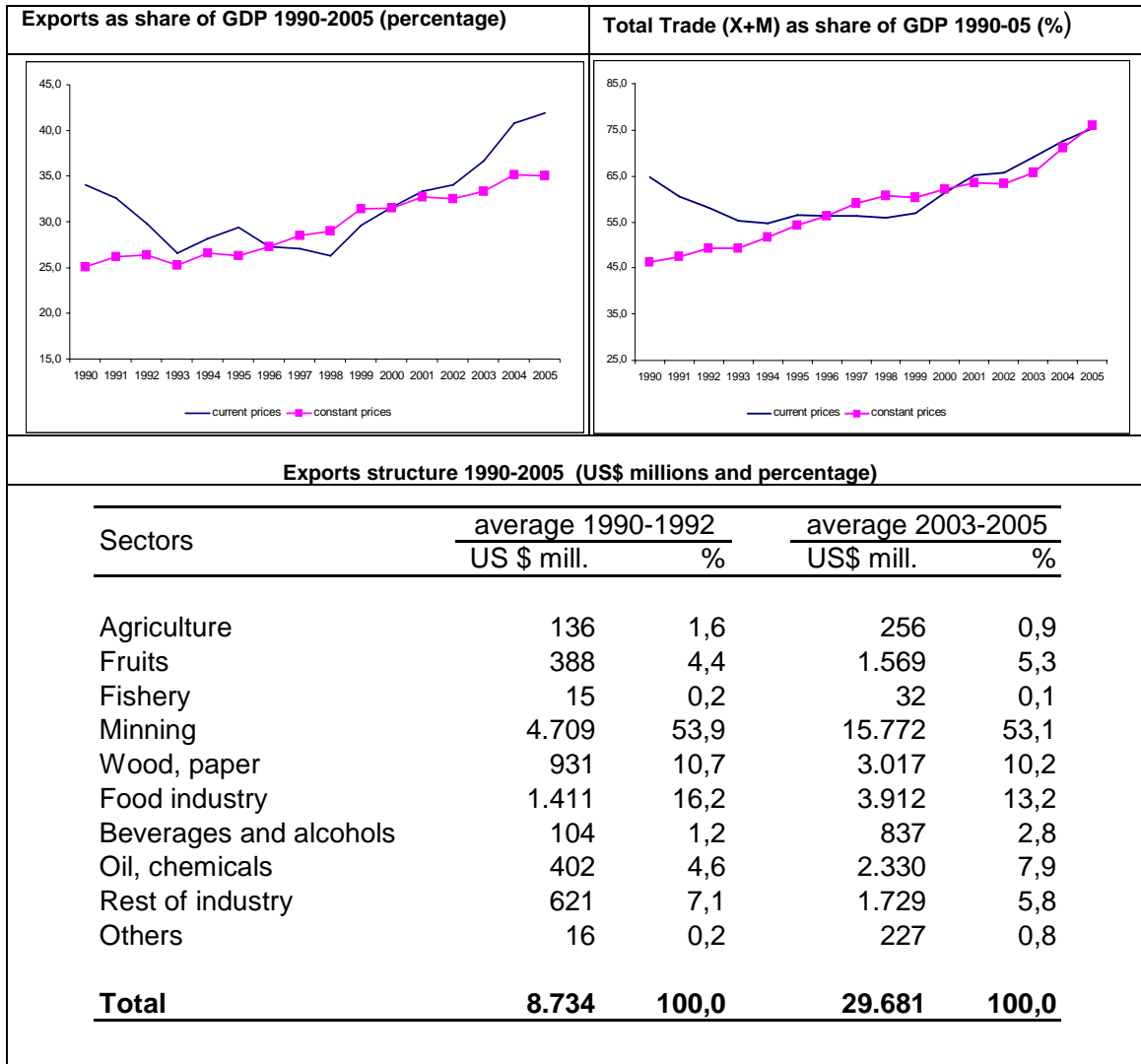


³ See Moguillanski, CEPAL, 1999, for a discussion

Economic growth was based on the export of natural resources. Between 1990 and 2005 Chileans insertion into the global economy has strengthened, consequently there was a significant impact on exports. Total exported value grew from nearly US\$ 9 billions in 1990-92 average to US\$ 30 billion in 2003-2005 average. In 15 years exports were multiplied by three.

Though mining exports increased their share in total exports from 47,4% in 1990-92 to 53,1% in 2003-05 this was mainly due to a significant price change, the structure of total exports shows a diversification of exports from the traditional copper sector, but still based on primary sectors, for instance wine and salmon have been two significant non-traditional exports. Another change is the increase in Oils and Chemical exports (in this case mainly methanol) whose share in total exports grew from 5,3% to 8%.

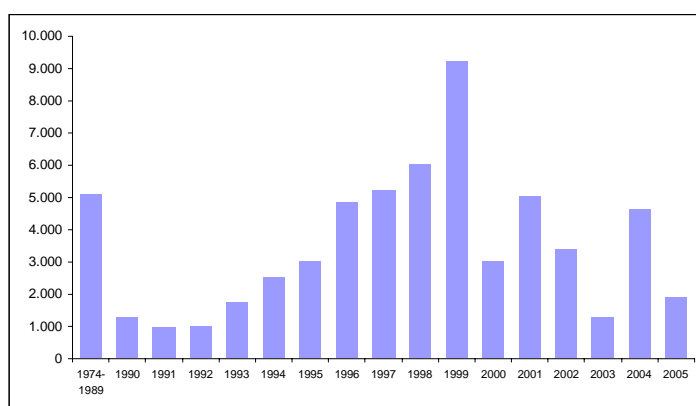
But exports also grew in relation to GDP. The share of exports to GDP at current prices increased from 34% in 1990 to 42% in 2005, and from 25% to 35% in constant prices. Considering total trade (exports and imports) as share of GDP the percentage increased from 64,7% in 1990 to 75,4% in 2005 at current prices, and from 46,3% to 75,9% at constant prices. Chile has become one of the most open economies in the world.



During the nineties, in particular the second half, FDI flows accelerated notably, falling however after 1999, and becoming more erratic. Between 1990 and 2005 total FDI flows reached US\$ 55 billion, ten times more than the period 1974-1989. However, an important part of that amount was directed towards buying existing companies, such as banks, communications and electricity, either privatization or change in property of already privatized companies.

In terms of sectors, the main destiny has been mining which, during the nineties, experienced a significant contribution of private capital. Mining received US\$17.6 billion, representing 32% of total FDI, followed by Electricity, gas and water, with US\$11.6 billions and 21% of total FDI and finally Communications, with US\$6.2 billion, representing 11% of total FDI. All recently privatized companies or natural resource sectors.

Foreign Direct Investment 1974-2005 (US\$ millions)

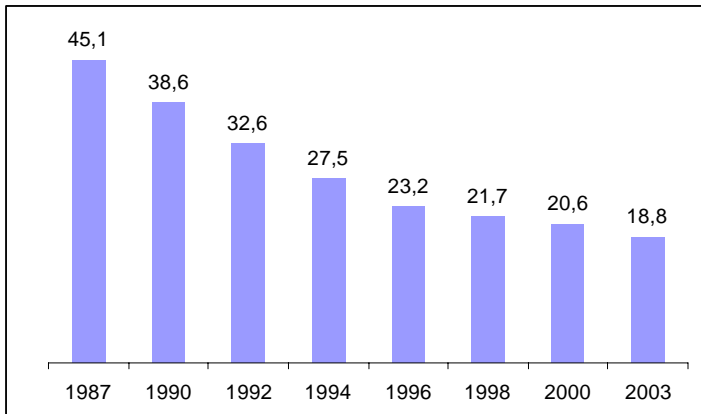


Foreign Direct Investment by sector 1974-2005 (US\$ millions)

Sector	1974-1989		1990-2005	
	US\$ mill.	%	US\$ mill.	%
Agriculture and Livestock	80	1,6	184	0,3
Forestry	11	0,2	239	0,4
Fishing and aquaculture	18	0,3	279	0,5
Mining and quarrying	2.399	46,9	17.577	31,9
Food, beverages and tobacco	215	4,2	1.895	3,4
Wood and paper products, printing and public	100	2,0	1.079	2,0
Chemical, rubber and plastics	525	10,3	2.393	4,3
Other manufacturing industries	316	6,2	1.154	2,1
Electricity, gas & water supply	0	0,0	11.590	21,0
Construction	123	2,4	1.291	2,3
Wholesale and retail trade	154	3,0	1.154	2,1
Transport and storage	21	0,4	507	0,9
Communications	283	5,5	6.192	11,2
Financial services	779	15,2	5.463	9,9
Insurance	37	0,7	2.031	3,7
Engineering and business services	23	0,4	545	1,0
Sewage, sanitation and similar services	0	0,0	522	0,9
Other Services	29	0,6	1.054	1,9
Total	5.112	100,0	55.150	100,0

More significantly for the supporters of the neoliberal policies applied in Chile poverty was reduced dramatically. Poverty defined in terms of a basket of goods and poverty line was 45% of the population in 1990, and fell to 18.8% in 2003.

Poverty 1987-2003 (percentage of population)



The dark side of the success story

Today one can define the Chilean economic model as essentially a neoliberal one, albeit with a considerable social expenditure. In essence the Chilean economic model rests on three fundamental pillars. First, macro-economic stability and fiscal discipline. Secondly, a subsidiary State, with horizontal non-discriminatory public policies and the aggressive use of market instruments, even in the provision of public goods, from the pension system to public infrastructure. Thirdly, the no-discriminatory opening of the economy, though a series of free trade agreements have been signed.

However economic growth is sustained by the extraction and light processing of natural resources. In fact the 'Chilean economic model' is based on cession of natural resource rents to the private sector, through a series of sectoral regulatory frameworks which give private investors, especially foreign, property rights over public resources. In this way enormous economic concentration has occurred and a significant environmental impact.

Furthermore globalization has forced companies, in order to compete in the international market, to merge and get bigger. This has meant the vertical and horizontal integration of firms and, consequently, a process of acute economic concentration.

The logic of Chile's incorporation into the international market has meant the economic concentration in a few mayor economic groups linked to the extraction of natural resources and the export economy, as well as the financial and retail sectors. In this way worsening the acute asymmetry of power between different sector, especially capital and labor, but also the export sector vis-a-vis the import substitution sector and especially large firms to small and medium sized firms.

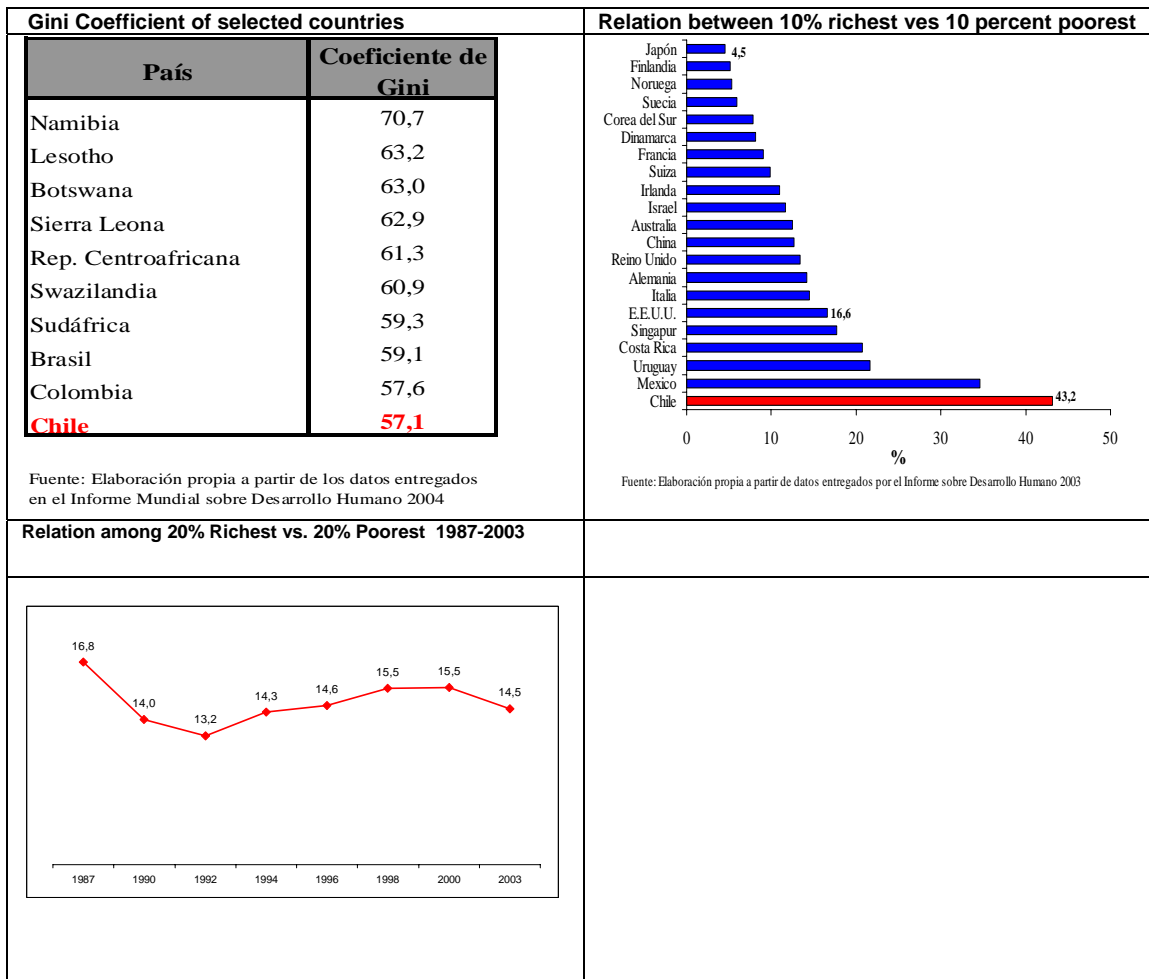
Oligopolies are common as is monopsonic behavior in the retail sector. Finally, the weakness of the labor movement and civil society exacerbate this asymmetry of power,

and consequently, and perhaps unsurprising, Chile retains one of the worst income distributions in the world.

The necessity to compete in the world market and an enfeebled civil society, permits companies to externalize costs to more vulnerable sector, firstly workers, but also local communities who perceive significant environmental impacts.

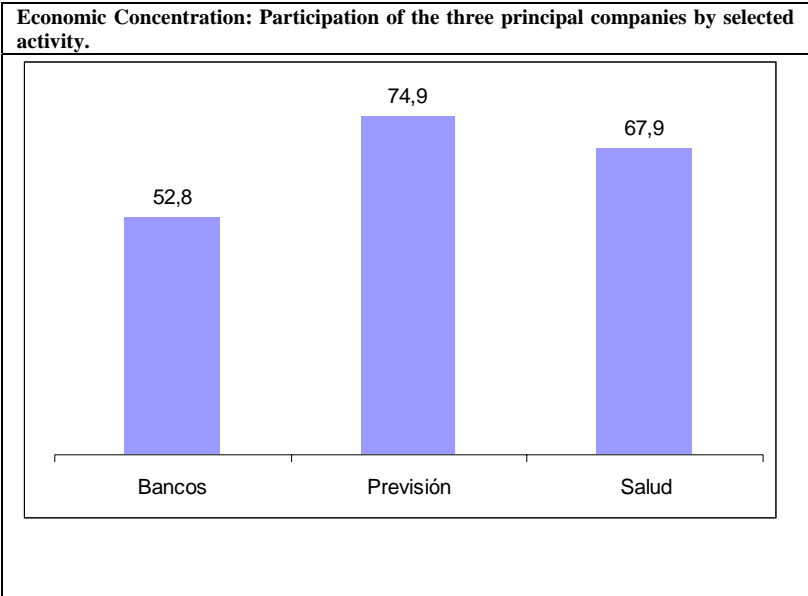
Therefore, it is not possible to separate the 'Chilean Model' with the advance of globalization and environmental impact with the weakening of workers rights. They are two sides of the same coin.

Chile today holds one of the most unequal income distributions in the world. According to UNDP, Chile has the eleventh worst income distribution in the world. Moreover, the inequality has as been more or less constant during the democratic period, as represented by the 20/20 relationship.



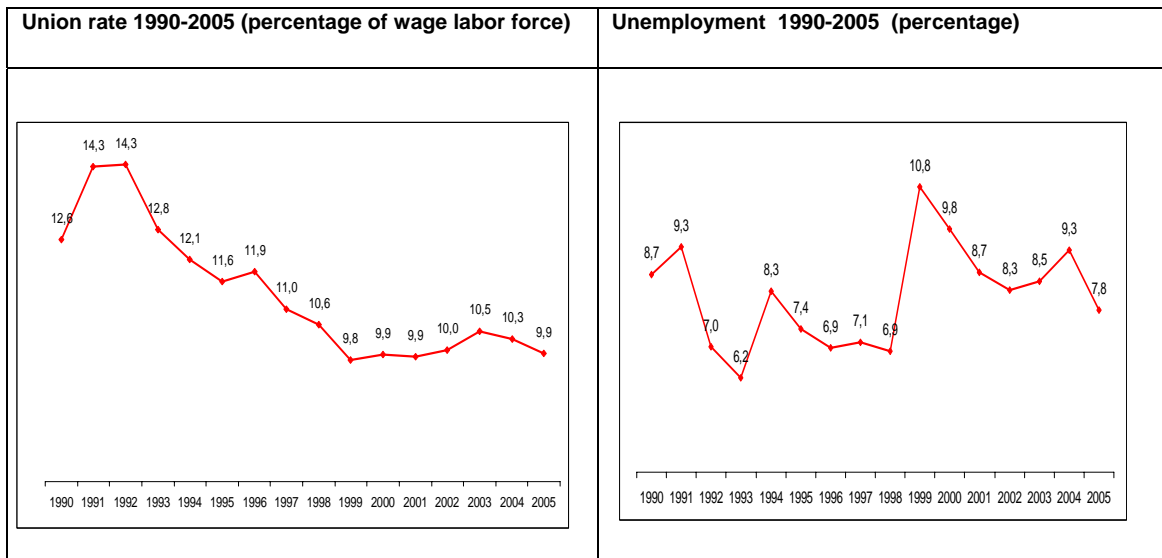
Economic concentration is one of the main characteristic of the new economic model. Twenty seven firms control over 50% of exports, of these only 10 concentrate over 35% of exports. Moreover 16 economic groups control over 80% of GDP. Four banks dominate the financial sector, seven private pension companies control over US\$50 billion in pension funds. Two companies control 54% of the supermarket sales. Not to mention the public utilities which are privately owned and only partially regulated.

If you consider the three areas of greater social concern, the degree of concentration is remarkable. The graph shows the participation the three principal companies in each activity, banking, private pensions and health.



The bad income distribution can be linked to concentration and a the weakening of union organization and to a labor regulatory framework which permits a high labor flexibility. Union rate shows a systematic fall since 1992, stopping only after the Asian crisis. Furthermore 83% of Chilean workers labor over 11 hours a day. There are over 500 thousand workers subcontracted, under barely formal regimes, and 4 out of every 10 jobs are informal

Moreover in contrast to neoliberal theory predictions a high labor flexibility and a low union organization has not meant higher employment. In fact unemployment has been relatively high and related to growth not labor flexibility. Even during the most dynamic period, that is, from 1990 to 1997, the unemployment rate did not fall below 6%. From 1998 this situation worsened, reaching more than 10% in 1999, and falling only in 2005 less than 8%.



Other social impacts

Higher competition coupled with a weak labor regulatory framework and a decreasing union rate have meant tension. Chilean society is increasingly expressing signs of social and individual stress.

As highlighted by Mental Chilean Society, psychosocial illnesses, like anxiety and depression in Chile have increased rapidly. According to the World Health Organization, Chile holds one of the highest mental illness rates in the world, and Santiago the capital city, has an incidence of 52% with some mental illness. The principal problems presented by the citizens of Santiago is depression (29,5%), anxiety (18,5) and alcohol dependence (2,5%)⁴

More than 50% of the patients in the local public health clinic have some kind of mental distress⁵. Naturally those most affected are the low income groups, around 30%, whereas high income groups are only 13,8%.⁶ Also there is an increase in consumption of anti-depressants as well as other anti-psychotic medication.⁷

The structure of illness has changed dramatically in the last 15 years. Are these related to new developed country illnesses or part of the new type of infirmities associated with an economic model which cannot solve peoples problems, is yet to be seen. Hypertension and self inflicted injuries, are among the five causes whose mortality rates grew faster between 1990 and 2004⁸.

⁴ WHO, 2001

⁵ Unidad de salud mental del Ministerio de salud, Segundo semestre 2001.

⁶ Estudio de salud mental en el Gran Santiago, 1998, Universidad de Chile.

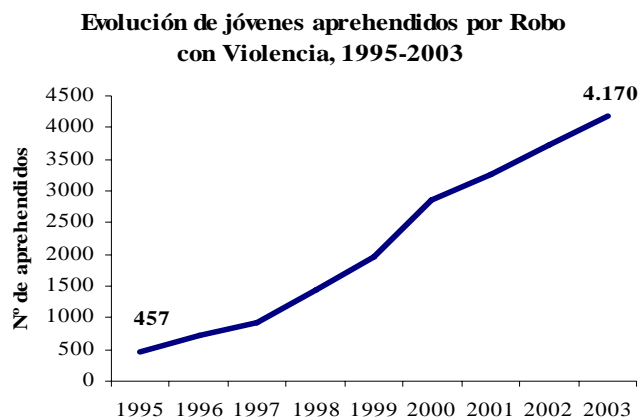
⁷ "Aumenta el consumo de sicofármacos", El Metropolitano, 24 de marzo del 2002.

⁸ INE. 2005

Chile: Mortality by main causes 1990-2004

Mortality causes	Mortality rate (every one hundred thousands)		Variation	
	1990	2004	percentage	
			points	percentage
HIV	0,5	2,5	1,9	353,8
Hypertension	9,0	19,5	10,4	115,5
Diabetes	10,4	21,2	10,8	104,3
Self inflicted injuries	5,6	10,8	5,1	91,2
Prostate tumor	10,7	18,4	7,6	70,7
Colon tumor	3,7	6,2	2,5	67,3
Skin tumors	1,1	1,8	0,7	66,1
Pancreas tumors	3,7	5,6	1,9	50,2
Trachea, bronquis and lung tumors	10,8	13,8	3,0	28,3
Cronich obstructive lung deseases	14,0	17,6	3,6	26,0
Chest tumors	12,3	13,5	1,1	9,2
Vesicle tumors	10,2	11,1	0,9	8,7
Liver tumors	4,7	4,7	0,0	0,9
Esophagus	4,5	4,4	-0,1	-1,6
Stomach tumors	19,5	19,0	-0,5	-2,6
Cirrhosis and other liver disease	30,9	26,0	-5,0	-16,1
Respiratory sistem deseases	73,1	51,9	-21,2	-29,1
Uterine neck tumors	11,8	8,3	-3,5	-29,7
Infectious deseases	18,8	11,3	-7,4	-39,6
Neumonía	48,3	21,2	-27,0	-56,0
Tuberculosis	5,0	1,7	-3,3	-66,9

Unsurprisingly Chile is becoming an increasingly more violent society. Even though violence is still well below Latin American standards, the growth rates are surprising, especially young people, who cannot compete in a socially structured society inserted in the global economy.



Fuente: Paz Ciudadana

Consequently the sensation of vulnerability and insecurity is not surprising for a great many people, even though according to macroeconomic indicators the country is performing exceedingly well. The sensation of being unprotected is expressed in different ways, for instance the growing dissatisfaction with politics and the political system.

This is confirmed by surveys like a UNDP study in 2001, where 74% of people replied negatively, angrily or with a sense of loss in relation to the economic model. According to the same source only 7% of Chileans consider the dominant economic model the only one that can function, the rest consider that it can and should be changed⁹.

Moreover a survey by Latinobarómetro reflected a worrying tendency, less and less Chileans adhere to a democratic system. Whereas in 1990, 75% of Chileans supported democracy, by 2001 this support fell to 45%¹⁰, The same survey applied in 2002, shows that only 27% were satisfied with the political system and 52% of Chileans said that they wouldn't care if an undemocratic government was in power¹¹. This is comparable to 19% of the population, which in 1995 preferred an authoritarian government¹².

Some final reflections

This paper does not pretend to be a fully comprehensive study of the Chilean economic model, rather a brief reflection. Chile is a success story in terms of macroeconomic stability and economic growth, perhaps even the reduction in poverty. Without a doubt Chileans are wealthier and have access to more material benefits than they did fifteen years ago.

But things are not what they seem. Different indicators suggest a society which presents growing dissatisfaction with this new reality. Individuals are stressed, unhappy and generally dissatisfied.

People have a sense of vulnerability, they feel unprotected. Families are broken. Clearly inequality is a major issue, it is expressed in many ways, not only income. Education, health, pensions, transport, even recreation and access to culture are new expressions of an economic model based on a two-tier system, one modern and inserted into the global economy the other old, poor and isolated. Inequality, has become a new more subtle form of poverty.

It is true a poor person in Chile has access to a range of goods she could never access before, even education and health. But in a way that will never allow her to truly develop her abilities or form part of that the new global society.

At least in Chile, neoliberalism has meant a new form of economic apartheid, increasingly two different worlds separated by the power of the market.

Whether Chile will continue this economic model is yet to be seen. Clearly there is no significant crisis ahead, and the government has been successful in maintaining a balance between the logic and profound inequity the economic model and more focalized resources for the poor.

But in our view this only delays the inevitable, since the economic model by definition only replicates the vicious circle of inequality.

⁹ PNUD, Desarrollo Humano en Chile, 2002.

¹⁰ Marta Lagos, presidenta de MORI consultores. Entrevista en Programa Archivos del Subdesarrollo, Radio Universidad de Chile, 15 de diciembre del 2001.

¹¹ Encuesta Latinobarómetro 2002.

¹² Idem. Año 1995