

An Odd Free Market Success

Despite a dictatorship, Chile's "Chicago Boys" make good

"Chile," says a U.S. State Department official grudgingly, "is a casebook study in sound economic management." Chile? The country where two months ago the Catholic Church demanded an investigation into the identities of more than 300 bodies found crammed into unmarked coffins in a Santiago cemetery? Chile? The international pariah that refuses to extradite to the U.S. the former head of the Chilean secret service and two other army officers indicted for murder by a federal grand jury? Yes, Chile, where Military Dictator Augusto Pinochet is simultaneously tightening his grip on the government and freeing up the economy.

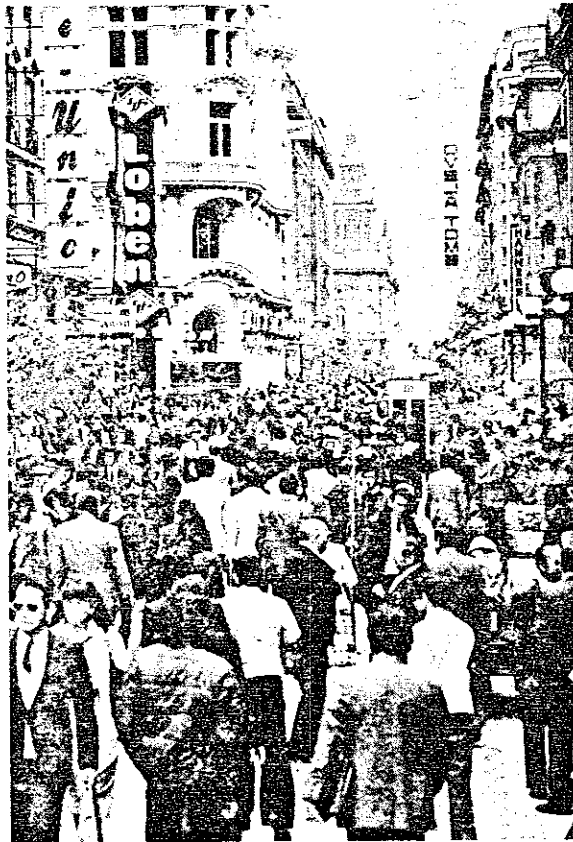
Today a six-block stretch of Calle Ahumada in Santiago is one of South America's busiest commercial malls. Brightly painted signs pull shoppers into new boutiques stuffed with madras dresses from India, art supplies from Germany and motorcycles from Japan. The adjoining streets are jammed with honking hordes of shiny cars and trucks of every modern make. Workers are digging trenches for an extension of the Santiago subway. However, La Moneda palace, where Pinochet's predecessor, Marxist Salvador Allende, was killed in 1973, remains begrimed and run down.

Repressive political regimes do not normally dictate laissez-faire economic systems, but that is what is happening in Chile. The result is that inflation, which was as high as 1,000% in 1973, has been beaten back to about 38%. Real growth spurted 7.3% in 1978 and rose another 7.5% or so last year. Per capita income is up to \$1,500; in real terms, the people are at least back around the income levels of 1970. That was when Allende was elected and began to crank up the printing presses to cover spiraling government deficits that led to economic disaster.

Chile's economy, which was highly protected under Allende, has become much less restricted and more entrepreneurial. The transformation has been largely the work of those whom Chileans call the "Chicago Boys," a handful of officials and academics led by Planning Minister Miguel Kast, 30, Finance Minister Sergio de Castro, 49, and Central Bank President Alvaro Bardón, 39. All have graduate degrees in economics from the University of Chicago, the spiritual home of Free Marketeer Milton Friedman. Like most Chilean economists, the Boys were fervent opponents of Allende, and the military junta picked many of them for top jobs. They were given

broad authority to cope with emergency in 1975, when the country lay in ruins, hammered by three blows in succession. First there was the economic chaos that preceded and immediately followed Allende's bloody ouster, then the surge in oil prices, and finally the collapse of the price of copper, which accounted for more than 80% of Chile's exports.

The Chilean Friedmanites tried some shock tactics. They clamped down hard on the money supply and slashed expenditures. The government stopped subsidi-



A shopping mall in downtown Santiago shows the new boom
In an important area of life, much less restriction.

dizing inefficient industries; more than 400 state-owned banks and companies, many of which had been nationalized during Allende's years, were sold back to private hands. At first, these reforms made things worse. Unemployment rocketed because a number of businesses failed in the new competitive environment, and the government was also cutting its own swollen payroll. But many of the old jobs were eventually replaced by new, more productive employment, and the government allowed the Chicago Boys to continue unshackling the economy. They concentrated on three areas:

Taxes: High taxes have been virtually eliminated to stimulate investment.

Corporate and personal income taxes have been "indexed" so inflation does not automatically push payers into higher brackets; and the double taxation of corporate dividends has been abolished. The treasury is recovering lost revenues with a 20% value-added tax on everything from food to cars. In short, sales taxes have increased so that income taxes could be reduced, freeing up funds for investment.

Tariffs: The boldest move was to reduce tariffs, which had ranged from 100% to 1,000%, to a more uniform 10%, forcing Chilean industry to become competitive almost overnight. Now Chile is shipping refrigerators to Argentina, shoes to Peru and logs to Japan. In the process, the country is transforming itself from a "monoproduct" economy into one in

which noncopper goods are now 51% of exports. Forests are being planted with high-yield pine trees; U.S. authorities estimate that by 1990 forest products could become as important as copper to the economy.

Foreign Investment: The government in 1977 took many steps under a new law to woo foreign investors, including removing limits on their remittances of profits and capital and granting them the same rights as local investors. Money has been pouring into the country ever since. U.S. companies in the past two years have invested \$600 million, and a third of that has gone into mining. By the end of the 1980s, foreign investment, mainly from the U.S., should exceed \$5 billion.

Not everyone is thrilled with the changes. Some critics charge that the Chicago Boys' reforms have only concentrated more of the country's wealth in fewer hands. Says Ricardo Lagos of the U.N. Program for Employment in Latin America: "About 20 years ago we had some very important companies in the economy. Now we have only three big financial groups in Chile."

Unemployment, although down from 18.7% in 1975, still hovers at a depressing 12%. Like most developing nations, Chile has been badly hurt by OPEC price increases. The country imports 75% of its oil, and most of that had come from two of the shakier cartel members, Iran and Ecuador. In March, Iran broke its contract, and Ecuador has also stopped selling oil to Chile, forcing it to pay the sky-high spot-market price. Fuel bills jumped to an estimated \$771 million last year, from \$429 million in 1978, torpedoing projections for an inflation rate of under 20%.

For many economists who deplore its authoritarian government, Chile remains a model of what can be achieved in restructuring an aging, prostrate economy into a streamlined machine. The ironic reason for the success is that the dictator is allowing the economists to free business from state control.