

**REQUIRED COVER PAGE**

**APPLICATION FOR FACULTY RESEARCH GRANT**

**\*\*All questions must be completed to be considered for grant award.**

Choose one: <input type="checkbox"/> Creative <input checked="" type="checkbox"/> Research	Date of Last FRG Award (Semester and Year awarded): _____ Date of ATU Faculty Appointment (Semester and Year): <u>07/06</u>
--	--

1. Project Title: Chilean Economic Transformation  
2. Name of Principal Investigator/Project Director: Adam Luther Dr  
3. School (abbrev): LFA 4. Department: SS&P  
5. Campus Mail Address: Witherspoon RM 2666 PI/PD Campus Phone: \*2025  
7. Amount Requested: \$ 380 8. Total Cost of Project: \$ 380  
9. Does this project involve: 10. Duration of Project: \_\_\_\_\_

Yes No

- ☐ ☒ human subjects?  
☐ ☒ animals/animal care facility?  
☐ ☒ radioactive materials?  
☐ ☒ hazardous materials?  
☐ ☒ biological agents or toxins restricted by the USA Patriot Act?  
☐ ☒ copyright or patent potential?  
☐ ☒ utilization of space not currently available to the PI/PD?  
☐ ☒ the purchase of equipment/instrumentation/software currently available to the PI/PD?

**NOTE:** If the answer is "yes" to any of the above questions, the investigator must attach appropriate documentation of approval or justification for use/purchase.

**SIGNATURES**

Department Contribution (if applicable): \$ \_\_\_\_\_

Account Number: \_\_\_\_\_

H. M. Tran 8-2-06  
Chairperson Date

School Contribution (if applicable): \$ \_\_\_\_\_

Account Number: \_\_\_\_\_

G. Duncan 9-11-06  
Dean Date

**This Section to be completed by the Office of Academic Affairs**

FSBA Committee Award Recommendation: Yes \_\_\_\_\_ No \_\_\_\_\_  
FSBA Committee Proposal Rank: \_\_\_\_\_ of \_\_\_\_\_ Total Proposals.  
Recommendation of VPAA: Yes \_\_\_\_\_ No \_\_\_\_\_  
Recommendation of President: Yes \_\_\_\_\_ No \_\_\_\_\_  
Award Date: \_\_\_\_\_

**PROPOSED BUDGET**  
**FACULTY RESEARCH/DEVELOPMENT GRANT**  
(include budget categories as appropriate)

1.	Graduate assistant stipend Fringe benefits: salary X .0012	\$ _____ _____
2.	Non-work study stipend Fringe benefits: salary X .0012	_____ _____
3.	*Supplies (please list items to be purchased and estimated price per item including taxes and shipping, if appropriate):	
	Item No. 1 (e.g., software)	Estimated Price _____
	Item No. 2 (e.g., copying costs)	Estimated Price _____
	Item No. 3	Estimated Price _____
	(additional lines as needed)	
	Total estimated supplies	_____
4.	Travel (please list travel expenditures by date and estimated costs):	
	Travel No. 1	Estimated Price _____
	Travel No. 2	Estimated Price _____
	Travel No. 3	Estimated Price _____
	(additional lines as needed)	
	Total estimated travel	_____
5.	*Capital Outlay (please list items to be purchased and estimated price per item including taxes and shipping, if appropriate):	
	Item No. 1	Estimated Price _____
	Item No. 2	Estimated Price _____
	Item No. 3	Estimated Price _____
	(additional lines as needed)	
	Total estimated capital outlay	_____
	TOTAL PROPOSED BUDGET	\$ <u>380</u>

\*Items purchased under \$2,500 (including taxes and shipping) are considered supply items. Capital Outlay items are those which cost \$2,500 or more (including taxes and shipping).

**Arkansas Tech University  
Faculty Research Grant  
Application of Dr. Adam Lowther  
Assistant Professor of Political Science**

***Chilean Economic Transformation***

- A. Funding request**
- B. Accepted paper**
- C. Vita**
- D. Journal material**

After two years of researching, writing and revising an article examining Chilean economic history and Chile's economic liberalization under General Augusto Pinochet, I received word on July 29 that my article was accepted by the *Journal of Development Alternatives and Area Studies* (JDAAS). This is an independent-peer-reviewed journal that is run by non-salaried academicians who seek to publish quality scholarship (See attached list of published articles). Like many other journals, particularly those in the hard sciences, JDAAS asks its authors to assist in covering part of the journal's cost of publication. Therefore, I request funding to cover the required page charges, totaling \$380.

In order to provide you with as much information as possible, included in this package is a copy of the article, my CV, and the latest edition of JDAAS. My request for \$380 is solely for the purpose of covering the partial contributor cost. Dr. Franklin Vi, editor of JDAAS, would like to publish my article in the fall issue and requests I provide support at the earliest possible date.

The *Journal of Development Alternatives and Area Studies* is an international journal published in English by scholars from Africa, Europe and Latin America. The journal focuses on the problems of developing nations and the methods used to address the problems. The added copy editing costs generated by publishing the work of non-native English speakers is one of the key reasons contributors are asked to provide partial funding.

The opportunity to publish in a scholarly international journal provides an occasion to generate exposure for both the University and myself while helping me progress toward tenure.

Again, I request \$380 for the purpose of providing a partial contribution for the costs of publication of, *Chile: A Successful Model for Economic Development*, an article accepted by the *Journal of Development Alternatives and Area Studies*.

Journal of Development Alternatives and Area Studies  
ISSN 1651-9728

**Editor**

**Journal of Development Alternatives and Area Studies**

**136 Antler Circle**

**San Antonio, TX 78232, USA**

Email: [journalstudies@aol.com](mailto:journalstudies@aol.com)

07.29.06

Invoice 39/2006

Adam B. Lowther  
Department of Political Science  
Witherspoon Bldg. Rm 266  
407 West Q Street  
Russelville, AR 72801-2222

Dear Lowther::

Publication fees to publish your paper.

Your number of pages 19 (single space, that is equal to 38 pages). According to our guidelines we request the authour to submit the paper in double space. Each page would cost us \$15 but we share some cost and ask you to share at \$10 per page. The total amount is  $38 \times 10 = \$380$ .

So send the amount	\$380
Electronic transfer fees	\$15 (option)
Total	\$395

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## **Journal of Development Alternatives and Area Studies**

Franklin Vi, Editor  
Journal of Development Alternatives and Area Studies  
136 Antler Circle  
San Antonio, TX 78232, USA  
Email: journalstudies@aol.com

07.29.07

Dr. Adam B. Lowther  
Department of Social Sciences and Philosophy  
Witherspoon Bldg. Rm. 266  
407 West Q Street  
Russellville, AR 72801-2222

Dear Dr. Lowther:

I have received your paper for possible publication. The peer review was positive and we have provided more information in the letter we mailed along with a few old copies of the journal. Tentatively, we plan to insert your article in the coming issue. We also mailed a publication invoice.

We do not belong to a multinational company rather we publish only one journal. JDAAS is a non-profit. Started by Africans, Latin Americans and Asians in 1982, the journal operates on the principle that the authors must share the production cost. Most of us work without any salaries.

We have made some changes in our publication policies. Recently we have decided that we are going to publish papers between 100 and 200 pages in length. At present the length is around 20-25 pages. This length would give a scope to authors that will enable them to publish more extensive research. Scholar suggestions led us to this decision. You are welcome to send papers 100-200 pages in length in the future.

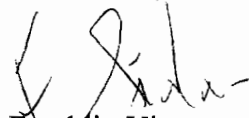
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I will provide more details after hearing from you. Ask for details before you begin writing. We are inviting papers on globalization, poverty in Africa, Oil industries and multinationals, education, energy issues, environment problems, democracy, corruption,

civil wars and economic consequences, human rights, gender studies, HIV- AIDS and health issues, trade, finance, international economics, labor, economic growth, labor, migration, environmentalism, foreign aid, sustainable development, North-South, South-South relations, technology transfers, communications, rural development, mineral resources, agriculture, demographic, third-world development and the IMF and World Bank. If your research is proceeding on the above topics, submit to us for possible publication in our journal. Finally, I wish to add that this is a peer reviewed journal.

Thank You,

A handwritten signature in dark ink, appearing to read 'Franklin Vi', written over the printed name.

Franklin Vi  
Editor

## Adam B. Lowther

121 Hawthorne Lane, Russellville, AR 72802 • (719) 494-4369 • adam\_lowther@hotmail.com

### **EDUCATION AND PROFESSIONAL DEVELOPMENT**

- 2001-2006    **University of Alabama, Tuscaloosa**  
*Doctor of Philosophy*, May 2006 (4.0 GPA)  
Areas of concentration: international security, international relations,  
comparative politics.  
Dissertation Title: "Asymmetric Warfare: Conflict in the 21<sup>st</sup> Century"
- 2000-2001    **Arizona State University, Tempe**  
*Master of Arts in Political Science*, August 2001.  
Thesis: "The Prospects for an Energy War in the South China Sea"
- 1997-1999    **Arizona State University, Tempe**  
*Bachelor of Arts*, December 1999.  
Political Science  
Summa Cum Laude

### **Publications and Submitted Works**

- *The American Experience with Asymmetric Conflict: Lebanon, Somalia and Afghanistan*, Praeger (Reviewed with contract recommended).
- "2,000 Years of Asymmetric Military Strategy," *London Security Studies Series*, (Submitted).
- "Chile: A Model for Successful Economic Development," *Journal of Development Alternatives and Area Studies*, Fall 2006.
- "Iraq," *The Arab-Israeli Wars*, ABC-CLIO (forthcoming).
- "Iran," *The Arab Israeli Wars*, ABC-CLIO (forthcoming).
- "Biological Weapons," *Encyclopedia of International Security* (forthcoming).
- "Chemical Weapons," *Encyclopedia of International Security* (forthcoming).
- "Nuclear Weapons," *Encyclopedia of International Security* (forthcoming).
- "Toward an Adaptive Naval Doctrine," *Proceedings*. (Submitted)
- "Lebanon, Somalia and Afghanistan: The Lessons of Asymmetric Conflict," *Military Review*. (Submitted)
- "Force Transformation, Military Theory and Asymmetric Warfare," Combat Studies Institute Press, Fort Leavenworth, KS 2005.
- Working Paper, Ludwig von Mises Institute, "Liberty or Democracy: Which Matters Most?" Available: <http://www.mises.org/asc/2003/asc9lowther.pdf>
- Working Paper, Economic History Association: Economic History Service "Chilean Economic Transformation." Available: <http://www.eh.net/lists/archives/abstracts/feb-2003/0020.php>

### **Papers Presented at Professional Meetings**

- Presenting a paper titled "Asymmetric Conflict in Lebanon Somalia and Afghanistan: Lessons Learned" at the American Political Science Association Annual Meeting, 2007.
- Presented a paper titled "Toward an Adaptive Naval Doctrine" at the International Studies Association Annual Meeting, 2006.
- Presented a paper titled "2000 Years of Military Theory" at the Southern Political Science Association Annual Meeting, Atlanta, 2006.
- Presented a paper titled "A Comparative Analysis of Economic Reforms in Bolivia, Chile and Taiwan" at the Southern Political Science Association Annual Meeting, Atlanta, 2006.
- Presented a paper titled "The War in Afghanistan at the APSA (ISAC)/ISA (ISSS) Annual Conference, Denver, 2005.
- Presented a paper titled "Force Transformation, Military Theory and Asymmetric Warfare" at the Combat Studies Institute of the Command and General Staff College, Fort Leavenworth, 2005.
- Presented a paper titled "The Future of Warfare: Asymmetric Conflicts in the 21<sup>st</sup> Century" at the International Studies Association-West, Las Vegas, 2004.
- Presented a paper titled "Rebuilding Iraq: Democracy or Free Markets?" at the International Studies Association-West, Las Vegas, 2004.
- Presented a paper titled "Liberty or Democracy: Which Matters Most?" at the Austrian Scholars Conference, Auburn, 2003.
- Presented a paper titled "Economic Reform in the People's Republic of China and Hungary" at the Alabama Political Science Association, Montgomery, 2002.

### **Professional Meetings**

- Discussant at the Southern Political Science Association Annual Meeting 2006.
- Panel Chair at the Southern Political Science Association Annual Meeting 2006.
- Panel Chair and Discussant for the Comparative Politics Panel at the Mississippi Political Science Association Annual Meeting 2003.

### **Courses Taught**

American Government, the American Presidency, Research Methods, International Relations, Comparative Politics, Early Political Thought, Political Economy and State and Local Government

### **Professional Memberships**

International Studies Association  
American Political Science Association



### **Awards and Grants**

2000-01 Graduate Assistantship, Arizona State University  
2001-04 Graduate Assistantship, University of Alabama  
2002 Rothbard Graduate Seminar Scholarship recipient, Ludwig von Mises Institute.  
2003 Austrian Scholars Conference Scholarship recipient, Ludwig von Mises Institute.  
2003 Mises University Scholarship recipient, Ludwig von Mises Institute.  
2005 Combat Studies Institute Travel Award (\$1,000)  
2006 Prestage-Cook Travel Award (\$250)  
2006 FDD Fellowship- Travel (\$5,000)

### **EMPLOYMENT EXPERIENCE**

2006- **Arkansas Tech University-Russellville, AR**  
Assistant Professor of Political Science  
Senior political scientist, in charge of the *Alpha Chi* Award and revising the political science curriculum, as well as teaching a variety of courses.

2005-2006 **Columbus State University-Columbus, GA**  
*Visiting Professor of Political Science*  
Offered courses in American Government, Political Theory and Political Economy.

2004-2005 **Yorktown University-Denver, CO**  
*Accreditation Advisor*  
Direct the University's effort to gain DETC accreditation. This includes working with faculty and staff to develop required measures of student satisfaction (student surveys, measures of achievement and course propriety), faculty compliance with DETC requirements, and working with the University President to complete all necessary accreditation forms and material.

2002-2004 **WTBC 1230-Tuscaloosa, AL**  
*Talk Radio Host*  
Host of *The Brent Adams Show* (2002). Co-host of *Sports Wrap*.

2003 **University of Alabama-Birmingham, AL**  
*Adjunct Instructor*  
Instructor of course in the American Presidency.

2003 **CrimsonTradition.com-Tuscaloosa, AL**  
*Senior Writer*  
Sports columnist covering all sports at the University of Alabama.

- 2001-2004    **University of Alabama-Tuscaloosa, AL**  
*Instructor*  
Instructor of undergraduate courses in American government,  
comparative politics and international relations.
- 2000-2001    **Arizona State University-Tempe, AZ**  
*Graduate Teaching Assistant*  
Copy editor, administrator and researcher for members of the faculty.
- 1999-2000    **MDS Communications-Mesa, AZ**  
*Account Executive*  
Program Manager of fundraising campaigns for member of the U.S.  
Congress.
- 1994-2000    **United States Navy/Naval Reserve**  
*Personnel Director*  
Personnel Director aboard *USS Ramage* (DDG 61) and Protocol  
Assistant at CINCUSNAVEUR, London.

#### **References**

Dr. David Lanoue  
Department Chair, University of Alabama  
205-348-5981

Dr John Oneal  
Dissertation Comm.  
205-348-5980

Dr. Donald Snow  
Dissertation Advisor  
205-348-3808

# Journal of Development Alternatives and Area Studies

(This is a journal of interdisciplinary social sciences specially devoted to the studies of genuine development related to basic human needs satisfaction such as socio-economic problems, political economy, politics and democracy, trade, finance, marketing, international economics, labor, economic growth, labor, migration, environment, foreign aid, sustainable development, North-South, South-South relations, health studies, technology, rural development, agriculture, demographic, human rights, third-world development)

Franklin Vi, Editor  
Journal of Development Alternatives and Area Studies  
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To:

I the undersigned \_\_\_\_\_ presented the

following paper entitled \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

for publishing in JDAAS.

I assure you this is my original work. This paper has neither been published before nor submitted elsewhere for publication. In addition, I am not planning to publish my paper in the future once it has been published in the JDAAS. I wish to bring it to the attention of JDAAS, if I plan to add my paper as part of a book or in any edition - I fully acknowledge that this has been published in the JDAAS.

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**March – June 2002**

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**Vol. 23. No 1 & 2**

**March – June 2004**

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**Versus Profit-Oriented Companies**

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## Chilean Economic Transformation

From its humble beginnings as an inhospitable Spanish colony devoid of gold and precious gems to its current position as Latin America's leader in economic liberalization and reform, Chile has made the most of its precarious position sandwiched between the western edge of the Andes and the Pacific Ocean. In the global recession that followed the September 11, 2001, attacks on New York City and Washington, D.C., Latin America's most prosperous state, Argentina, saw the monetary bubble burst. The precipitous decline in GDP per capita experienced by Argentines left Chile as Latin America's most prosperous economy, leaving many to wonder how and why?<sup>1</sup> This article examines the economic history of Chile as it seeks to show the effect of two centuries of relative economic liberalism in Chile.

Since independence on September 18, 1810, Chile has been one of Latin America's wealthiest and most stable countries. Chile's leading role in instituting liberal economic policies over the past three decades, offers an important case in examining the transition from the *latifundio* system of large landholdings worked by tenant peasants and owned by a stolid class of *latifundos* to a modern free market economy with social mobility for those willing to work and sacrifice for it.

With Argentina, Brazil and other Latin American states electing leaders from the left, there appears to be a backlash against the pseudo and half reforms of many Latin American states, calling into question the validity of economic liberalization.<sup>2</sup> Thus, an analysis of the changes that led to Chile's position within Latin American is timely. The effort here will be to analyze the structural and institutional policy changes that have shaped the Chilean economy over the last two centuries while placing these changes within the five-stage model of economic development of W. W. Rostow.<sup>3</sup> Free market theories developed by Friedrich von Hayek and Ludwig von Mises are also employed analyzing Chile's attempt at market socialism and its ultimate transition to a free market economy.

Analysis of Chilean economic reform is often overshadowed by condemnation of the Chilean government's failure to cure perceived social or political ills.<sup>4</sup> An effort will be made to avoid such dalliances into righting past wrongs as the analysis will be centered around analyzing Chilean reform efforts by employing Classical and Austrian School theories that have played a major role in the economic success of the West over the past two centuries.

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<sup>1</sup> Argentina's GDP per capita has fallen from \$12,200 to an estimated \$6,000 while Chile's has remained slightly above \$10,000.

<sup>2</sup> Brazil continues to have the largest economy in Latin America with a GDP of \$1.13 trillion. But, considering that Brazil has 179 million citizens compared to Chile's 15 million, Brazil's \$6,500 GDP per capita is a more accurate measure of Brazilian economic success.

<sup>3</sup> W.W. Rostow, *The Stages of Economic Growth* (Cambridge University Press, 1965) 4-16.

<sup>4</sup> For critical analysis of Chilean economic liberalization see Duncan Green, *Silent Revolution: The Rise of Market Economics in Latin America* (Monthly Review Press, 1995), James Petras and Fernando Ignacio Leiva, *Democracy and Poverty in Chile* (Westview Press, 1994) and William C. Smith, et al., *Latin American Political Economy in the Age of Neoliberal Reform* (Transaction Publishers, 1994).

## Rostow's Five Stages of Growth

Karl Marx is perhaps best known for his explanation of history as a linear progression of continuous economic change, which is causally linked to subsequent political change.<sup>5</sup> Because of history's dialectical path, society plods through each stage of economic and political history, which will ultimately culminate in the advent of communism. Marx's historical dialectical leaves little room for alternative explanations of economic transition that occur in many nations.<sup>6</sup> Rostow, rather, develops a non-communist explanation for the same phenomena that Marx sought to explain.<sup>7</sup> The "general theory," as it may be called, presented by Rostow is necessarily broad so that it adeptly describes the general characteristics of economic transition for all states.

A state begins as a "traditional society" in which a "structure is developed within limited production functions, based on pre-Newtonian science and technology, and on pre-Newtonian attitudes towards the physical world."<sup>8</sup> The lack of technology in traditional societies leads to a ceiling of attainable production within the agrarian societies at this stage. Improvements in material conditions are limited and a high percentage of efforts are expended in agricultural production. In the case of Chile and Latin America generally, this initial stage ended with the consolidation of Spanish power in Central and South America and the introduction of advanced technologies.

From the traditional society a transition to the second stage takes place as the "preconditions for take-off" develop. Rostow points out that these preconditions "arise not endogenously but from some external intrusion by more advanced societies."<sup>9</sup> It is also during this second stage that a society begins to view economic progress as not only possible, but also necessary for the greater good. The "greater good" may take the form of "national dignity, private profit, the general welfare or a better life for the children."<sup>10</sup> Whichever of these views individual members of society hold they must coalesce to form a societal desire for economic progress. One additional and important aspect of this stage is the necessity for the development of a consolidated state. Thus, in the case of Chile, the second stage could only be entered after the Chilean independence in 1810.<sup>11</sup>

The "take off" begins when the obstructions and resistance to growth are overcome. It is at this time that growth becomes a constant characteristic of the state. Much of this growth can be attributed to the successful implementation of new technologies. As economic expansion occurs, incomes increase and rates of savings increase. And, as savings increase, greater amounts of investment capital are made

<sup>5</sup> Karl Marx, *Das Capital* (Vintage Books, 1977).

<sup>6</sup> All nations do not transition from one stage to the next at the same time as other nations. One nation may remain in its current stage significantly longer than another.

<sup>7</sup> Marx saw history as a four-stage progression from feudalism to capitalism then to socialism and finally communism.

<sup>8</sup> Rostow, pp. 4.

<sup>9</sup> Ibid, pp. 6.

<sup>10</sup> Ibid, pp. 6.

<sup>11</sup> An argument can be made that Chile entered the second stage of economic growth when Europeans (exogenous shock) landed in South America and disrupted the traditional societies that covered the continent. Thus, the proceeding stages would begin and end at different periods than is suggested above. This alternative view of progression is not without some merit but describes the economic progression that has marked modern Chilean history less accurately.

available to entrepreneurs. Thus, new technologies are developed and used to exploit previously unused resources and methods of production.<sup>12</sup> Once the third stage begins, a gradual move to the fourth stage takes place. For Chile, the third stage of development encompassed the latter half of the nineteenth century and the first three quarters of the twentieth century and only ended with the institutionalization of the economic reforms of the Pinochet government.

It is in the "drive to maturity" that improvements in efficiency and technology continue unceasingly to improve the production capabilities of a state. During the fourth stage a state will take its place in the international economy and, as Rostow theorizes, states reach this fourth stage approximately sixty years after the beginning of the third stage. As stated in the preceding paragraph, Chile is currently engaged in the drive to maturity along with the leading states in Latin America.

From the fourth stage of economic growth states enter the final stage termed the "age of high mass consumption." Economies in this stage shift production from industrial goods to consumer goods and services. Workers tend to be employed in offices or as skilled factory workers. And, it is at this time that real wages and quality of life reach their highest levels. Interestingly, the age of high mass consumption is the time in which the welfare state develops and becomes the staple of government activity.<sup>13</sup> If, as has been suggested, Chile began its drive to maturity during the Pinochet era, then it still has several decades of growth and maturation ahead before it reaches this final stage.

Rostow's five stages of economic growth provide a framework in which to view the historical change that has taken place within the Chilean economy, but it does not, however, provide a model of growth so detailed that economic policy may only take one specific path to reach the age of high mass consumption. It is, therefore, necessary to provide greater theoretical understanding of the economic models employed by Chilean economic policy makers as Chile has transitioned through Rostow's stages of economic growth. But because of the changes that have occurred over the preceding two centuries, these models must be placed within the context of the periods in which they were employed.

### **The Era of Laissez-Faire Capitalism (1810-1876)**

Chile's exceptional economic success is striking considering its colonial Spanish heritage. Like most other Latin American countries Chilean social and economic life was dominated by a highly stratified system in which large landowners (*latifundos*) controlled the majority of wealth and economic power while the peasantry, which was largely landless day laborers, occupied a position within society that failed to produce high economic mobility. There was, however, a small but significant percentage of white collar and skilled professionals that constituted the middle class. The changes that began to occur soon after Chilean independence began a slow process of Chilean economic reform that would ultimately transform Chilean society.

Although Chilean independence was declared on September 18, 1810, it was not until 1831 that all Spanish elements had been forced from Chile and power was

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<sup>12</sup> Ibid, pp. 8.

<sup>13</sup> The United States, as the world's leading economy, spends more than 50% of the federal budget on social welfare programs while spending less than 20% on national defense.



consolidated under the newly selected president Joaquin Prieto, with the leading actor in government, Diego Portales.<sup>14</sup> But with stability finally achieved, Portales and the Conservative Party were able to dominate Chilean politics until 1861. During this period Chile saw unprecedented efforts at commercial and agricultural improvements. And when the Liberal Party, in combination with the liberal wing of the Conservative Party, came to power, they continued the same laissez-faire policies as the conservatives in addition to undertaking large infrastructure projects necessary for Chilean modernization. The government's hands-off approach toward their fledgling financial, industrial, agricultural and service sectors enabled Chile to develop at a modest rate of 2% annually.<sup>15</sup> Exports, however, grew at a phenomenal rate of 5.3% per annum from 1850-1900 as foreign direct investment was responsible for developing the mineral resources in Chile.<sup>16</sup> Efforts to extract the large nitrate deposits in the high desert of Chile stimulated other segments of the economy as entrepreneurs sought to meet the needs of the mining industry.

Government economic policy from 1820-1879 is accurately described as having followed the precepts of classical economics. This era of laissez-faire economics was marked by limited government regulation of the economy, low taxes, open markets and a national division of labor that sought to export the rich Chilean raw materials.<sup>17</sup> Governmental non-intervention in the economy greatly increased Chilean wealth, but a rigid social structure did not allow Chilean entrepreneurship among the peasantry. Thus, Chile did not see economic growth at a rate commensurate with the liberal economic policies that were in place during this period.

### **Growing Government Intervention (1876-1925)**

Chile, as the world's largest producer of copper (43.6% of world production in 1878) and nitrate, saw large export surpluses during much of the nineteenth and early twentieth century. From 1880-1930 Chile ran an average annual export surplus of 7.3% with the majority of this surplus consisting of nitrate and copper exports.<sup>18</sup> But, by the early twentieth century, synthetic products replaced nitrate as an additive in dynamite and Chile's share of world copper exports shrank to less than one quarter of the 1878 share. Thus, Chile was forced to begin diversifying its exports. It was during the early twentieth century that Chilean leaders began to question the foreign ownership of the large mining corporations that controlled the copper industry. And, beginning with the fall of world copper prices and months of drought, both occurring in 1876, the period of laissez-faire came to an end. During the following years the Chilean congress would pass the "law of inconvertibility" (July 1878), which prevented Chileans from seeking economic refuge

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<sup>14</sup> Royalist forces were completely expelled from Southern Chile in 1826, but turmoil in Chilean politics prevented effective government until General Prieto seized power in 1830.

<sup>15</sup> Markos Mamalakis, *The Growth and Structure of the Chilean Economy: From Independence to Allende* (Yale University Press, 1976) 5-7. These growth rates are based on estimations taken from production indices.

<sup>16</sup> Ibid, pp. 29. Nitrate was the primary Chilean export from 1880-1930 accounting for 50% of government revenues.

<sup>17</sup> Adam Smith, *Wealth of Nations* (Prometheus Books, 1991) 13, 24-29 and 499.

<sup>18</sup> Mamalakis, pp. 60.

in foreign currencies.<sup>19</sup> Additional laws were passed in an attempt to shield the Chilean economy and Chilean economic interests from the systemic changes that were taking place in the rapidly developing global economy. This shift away from classical economic policies continued and, by the beginning of the Chilean Civil War in which the Chilean Congress in cooperation with the Navy fought against President Balmaceda and the Army, Chilean economic policies had dramatically shifted away from the open model developed by Adam Smith and David Ricardo.<sup>20</sup>

Although Chile shifted away from the liberal policies that were the economic hallmark of the nineteenth century, it is clear that Chile was in the midst of Rostow's second stage of growth. The exogenous intervention required by Rostow to induce the transition to the second stage of economic growth took the form of European and American mining firms in Chile. Development of the mining industry was crucial to all other developments in the industrial, banking, service and agricultural sectors. Thus, by the time laissez-faire economic policies began to deteriorate Chile was progressing toward the third stage of economic growth.

### **Populism and Reform (1925-1930)**

During the first decades of the twentieth century Chilean leaders were finally forced to address the rigidity of the old social structure. As previously stated, there was a lack of freedom for the peasantry and poor urban workers to move from the lowest social class to a higher social class if they exhibited the same hard work and ingenuity that was making average men in the United States wealthy entrepreneurs during the same period. Just as in previous episodes in Chilean history, the failure of liberal and conservative politicians to carry out substantial reform polarized Chilean society and caused strongly reactionary elements to develop on the right and a militant communist movement to develop on the left. Events finally culminated as the military forced President Alessandri to push for reforms in a parliament that was institutionally stronger than the executive and opposed to the Alessandri reforms. But, with the intervention of the military, reforms were passed. The intervention of the military did, however, cause President Alessandri to resign and a military junta absolved the parliament and began running the government. In short order, changes in the military junta were made and President Alessandri returned to oversee the drafting of a new constitution with greater governmental control in the areas of wages, prices and rent controls. The new Constitution is best described as a populist solution to the labor unrest and social stagnation that so concerned the military.<sup>21</sup>

Under the 1925 Constitution, changes were made to governing institutions and the dominant social structure. Institutionally, presidentialism was restored through the following: presidential elections every six years, the elimination of "periodic laws," nullification of congressional votes of censure, the termination of the council of state, and

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<sup>19</sup> Simon Collier and William Sater, *A History of Chile: 1808-1994* (Cambridge University Press, 1996) 125-126.

<sup>21</sup> The Chilean military was dependent upon peasant conscripts and because of this dependency military leaders were much closer to the lower classes than were civilian elites. The military also served as a primary vehicle for men of humble birth and many talents to advance themselves to a higher status than would likely be possible in civilian life.

legislation deemed urgent by the president was required to be debated and voted on expeditiously.<sup>22</sup> In attempting to alter the deeply flawed social system, the new constitution made profound changes that would ultimately show their significance in the 1970 election of Marxist Salvador Allende.

First, the new constitution separated the state and the Catholic Church for the first time in Chilean history. Second, the liberty to vote was given to lower class industrial and agricultural workers.<sup>23</sup> Third, an income tax was instituted as a method of direct taxation of Chilean citizens.

The era of change that followed the 1925 Constitution brought about nearly three decades of populism in Chile that saw the lower classes come to play a major role in determining which party controlled Chilean government. Economic policy underwent dramatic change with the onset of the great depression, which began less than five years after the passage of the new Constitution. While the period of expanding government intervention and control of the economy had begun in 1876, Chile maintained an open economy in the decades that followed the initial intervention. But, during the Great Depression the Chilean economy began to close as Chilean politics moved left. Beginning in 1930 Chile undertook a policy of import substitution and market closure as the center-left government sought to insulate the country from the effects of worldwide depression.<sup>24</sup>

### **Import Substitution (1930-1938)**

When states adopt import substitution as a national economic policy they tend to make several policy changes. First, tariffs on imported goods are increased to a level in which the prices of imported goods become prohibitively expensive for consumers. National governments then begin heavily financing the development of local industries to supplant imported goods. Government protection is a necessary component of import substitution policy because developing industries generally produce low quality goods at high prices. When local markets become saturated with a given good, the state then tends to look outward in order to export protected products. Once industries are able to successfully compete in international markets, government subsidies are terminated and tariffs are reduced. Countries around the world have followed this pattern for the last three centuries with the United States and Britain serving as the two best examples.

This process was begun in Chile during the Great Depression as it also was in many other countries at the time. In many instances these policies served to deepen the depression and ran counter to policies advocated by both Classical and Austrian School economists. Both schools correctly point out that import substitution policies and the domestic monopolies they create by closing markets and providing government subsidies destroy the incentive necessary to develop high quality low cost goods. It is only when

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<sup>22</sup> This does not, however, mean that all urgent legislation was passed by the legislature.

<sup>23</sup> Collier And Sater, pp. 213-214.

<sup>24</sup> Beginning in 1928 Chile saw dramatic decreases in output productivity as importation of technologically advanced capital goods slowed. From the end of the 1920s to the 1940s production output increased by less than .5 % annually as opposed to the 1.5% growth it had seen in the preceding decades.

industries that benefit from closed markets must compete in an open global market that incentives to act efficiently are induced.<sup>25</sup>

These and other policies produced a fundamental change in the Chilean economy and society in general, but what is particularly interesting during this period is the case of Chilean agriculture. Beginning in 1914 Chile began to pursue import substitution policies in the agricultural industry much like the description above. These policies did not, however, produce the desired results and in 1937 Chile abandoned agricultural subsidies. When subsidies were abandoned and Chilean agriculture overcame the initial loss of subsidy revenue, the industry saw impressive growth rates in the decade and a half prior to the presidency of Salvador Allende despite employing a smaller percentage of the labor force and reduced capital investment.<sup>26</sup>

### **Chilean Radicalism (1938-1958)**

The period from 1938-1958 saw a succession of left wing governments continue to move Chile away from open markets and toward socialism, much to the detriment of Chilean economic development. Beginning with the administrations of Popular Front (radicals, socialists and communists) Presidents Pedro Aguirre Cerda (1938-1941) and Juan Antonio Rios (1942-45), the three decades that covered the latter half of the Great Depression, Second World War and post-war decade were characterized by heavy government interference in the economy through the efforts of the newly created (1939) Chilean Development Organization (CORFO), efforts to develop a centrally planned state economy and attempts to redistribute the earning of the upper classes to the lower classes.

As predicted by F. A. Hayek in *The Road to Serfdom* (1944), government efforts to equalize income through socialism failed as governments were forced to become increasingly totalitarian in order to implement their policies. Not only did Chileans feel the loss of liberty, but as Hayek theorized, government's attempt to induce economic growth only produced negative effects. Government debt rose while unemployment and inflation increased significantly. Efforts to control these problems led to greater governmental control, which created further disequilibrium in the Chilean economy.<sup>27</sup>

President Gabriel Gonzales Videla's (1946-1952) goals were less radical than the two previous administrations but his efforts to develop an "economic democracy" independent of the "great international monopolies" only further weakened the Chilean economy as incomes began to fall sharply in 1947. Gonzales's efforts to create an economically independent state failed to understand that Chile lacked comparative advantage in the many areas of the economy he sought to develop. The high cost of Gonzales's efforts would not, however, be paid until the following administration of

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<sup>25</sup> Milton and Rose Friedman, *Free to Choose* (Harcourt, Brace, Jovanovich, 1980) 41-54 and Henry Hazlitt, *Economics in One Lesson* (Laissez Faire Books, 1996) 59-69.

<sup>26</sup> Mamalakis, pp. In the years immediately following the termination of subsidies, Chilean agriculture was left impoverished because of its previous dependence on government subsidies. But as it slowly grew from 1937-1950, the capital necessary to invest in new technology was saved and responsible for the 21% growth rate in 1955-56, 40% growth rate from 1956-1963 and 2.6% growth rate from 1963-1969.

<sup>27</sup> It is interesting to note that during the Popular Front period, efforts to redistribute income only served to reduce the incomes of the poor industrial and agricultural workers who were the stated beneficiaries of redistribution.

General Carlos Ibanez del Campo (1952-1958). When, in 1954-55, incomes once again fell as inflation soared to new heights. General Ibanez was viewed by lower class Chileans as an apolitical candidate that might restore sensible policies in Chile. This did not happen, however, as Ibanez continued to increase the government spending while also concentrating on price controls in an effort to curtail inflation.<sup>28</sup>

It is important to note that this period of heavy government intervention and control in the economy runs counter to the model of growth developed by Rostow. This does not mean that Chile was regressing from the second stage back to the first. Rather, it simply means that Chile was not making significant progress toward entering the third stage of growth. Rostow's *Five Stages of Economic Growth* is a non-communist approach to economic change and, as such, views efforts to develop a utopian communist state as making little or no economic progress. Rostow, making it necessary to understand the importance of classical economic policies in the growth and development of national economies, employs an entirely different epistemology from Marx.

### **Chile Moves Right (1958-1970)**

By 1958 Chile had seen three decades of economic underperformance and the promises of left wing governments remained unfulfilled. The winds of change had finally shifted as a new breeze blew down the Pacific coast. Son of former president Arturo Alessandri and candidate of the Liberal/Conservative/Radical coalition, Jorge Alessandri won a narrow victory over his opponents the Christian Democrats and Socialists/Communists.<sup>29</sup> Alessandri was philosophically a classical economist who preferred for government to leave enterprise and the economy to function according to market forces. But, as in many other instances, President Alessandri was not an independent actor free to undo all that had been done in the preceding decades. He was, however, able to institute significant reforms.

President Alessandri began by eliminating property taxes on single-family dwellings and provided tax incentives to construction firms in the home building industry. As a result, home construction quadrupled in 1959-60. He also ended the prohibition on the many imports that had been instituted by previous governments. The required deposits on imports were reduced and then eliminated.<sup>30</sup> Accompanying these trade reforms were reductions in tariffs. As part of President Alessandri's efforts to increase trade and foreign investment in Chilean business, Alessandri created savings and loan associations, which offered incentives to facilitate the repatriation of capital, which had fled the country during previous governments. In addition to these efforts, the government allowed wages to be determined by the market. Without question, Alessandri's reforms were successful. GDP growth from 1960-1965 increased to a three-decade high of 5.4 per cent, unemployment fell from nine per cent to seven per cent and inflation fell to a new low of five per cent annually in 1960.<sup>31</sup>

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<sup>28</sup> Mamalakis, pp. 95. The Chilean government consumed 15% of GDP in 1945 and 18% by 1950. Under Ibanez this trend continued as Chilean presidents continued to attempt to solve economic crisis with increased government intervention and spending.

<sup>29</sup> Alessandri defeated Salvador Allende with a mere 31% of the vote to Allende's 29%.

<sup>30</sup> After the earthquake of 1961 and the devastating effect it had on the economy, Alessandri was pressured to reintroduce import prohibitions and market controls.

<sup>31</sup> Mamalakis, pp. 92 and Collier & Sater, 279-285.

Perhaps the most significant of Alessandri's reforms were the land reform efforts begun in 1962. Land that was abandoned, inefficiently cultivated or fallow (and corporately owned) was purchased by the government with a twenty per cent down payment and the rest paid in interest-bearing bonds. Alessandri stayed away from the temptation of confiscating land and paying inappropriately low levels of compensation. Land was then redistributed to landless peasants for agricultural production. As might be expected, agricultural production increased with the introduction of agricultural entrepreneurship.

Chile, a state perched on the edge of shifting tectonic plates, has historically been plagued by violent earthquakes, which have at times destroyed entire cities. 1961 was a year in which a major earthquake struck Chile causing a great deal of destruction. In order to repair the damage, Alessandri began borrowing funds, which necessitated the printing of notes, which predictably caused inflation to begin rising. By 1964 inflation had climbed to forty per cent from its previous low in 1960. Increasing inflation also caused Alessandri to abandon some market reforms in the trade sector. But despite these failures to allow markets to work unfettered, Jorge Alessandri was primarily responsible for Chile's best economic performance in more than three decades.

#### *Frei (1964-1970)*

Much to the dismay of the Liberal and Conservative parties the Alessandri presidency was used by the Communist and Socialist parties to regain much of the support and organization they had lost after their unsuccessful administrations (1938-1952). Because of renewed support for the left, the Conservative and Liberal parties joined with the centrist Christian Democrats behind the candidacy of Christian Democrat leader Eduardo Frei while the Socialists and Communists rallied behind third time candidate Salvador Allende. Frei's victory in the 1964 presidential election was one of the most uneven victories in recent Chilean history as Frei took 56.1 per cent of the vote to Allende's 38.9 per cent.<sup>32</sup>

Frei began his presidency as a philosophical populist who sought to cure the perceived ills of society through the use of government. His aims were similar to those of the left, but Frei was less inclined to expropriate private property from its rightful owners than were the socialists and communists. The Christian Democrat administration clearly believed that it was best equipped to guide the economy through the use of Keynesian governmental intervention.<sup>33</sup> Frei began his use of Keynesian economics by creating the National Planning Office (ODEPLAN), which served as the institution for governmental guidance of the economy. In addition to ODEPLAN, Frei created the Enterprise of Telecommunications (ENTEL) to serve as a national phone company, developed a large oil refinery at Concepcion through the use of ENAP (the National Petroleum Corporation), established a local tire manufacturer INSA and developed a large hydro-electric facility under the control of the National Electricity Enterprise (ENDESA). In addition, Frei encouraged American and European multinationals to

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<sup>32</sup> Collier and Sater, pp. 309. The Radical candidate won the third largest vote total with five per cent.

<sup>33</sup> See John Maynard Keynes, *The General Theory of Employment, Interest and Money* (Harcourt Brace and Company, 1964)



develop enterprises in Chile without requiring that they be partially or completely owned by Chileans.<sup>34</sup>

Aware of inflation's devastating affects for an incumbent President at re-election time, Frei went to great lengths to slay the inflation dragon. For the first time in Chilean history the Central Bank was given the authority to set interest rates. Wages were increased and prices were watched with an eagle-eye. But, these efforts were only modestly successful in Chilean terms as inflation remained slightly below the levels seen in the last years of Alessandri's administration.

Most important among the many reforms instituted by Frei's administration were continued land reform and efforts at seeking the "Chileanization" of the copper industry. Using old and new laws the Frei government began in 1967 to expropriate hacienda lands that were inefficiently run allowing owners to keep eighty hectares while the rest was expropriated and given to the peasants already working the land.<sup>35</sup> This round of expropriation was much less to the liking of *latifundos* who owned the properties and in some cases armed conflict broke out between farmers and government officials attempting to seize their property. By 1969, 1,300 haciendas had been seized and redistributed. The "Chileanization" of the copper industry was much less painful for the Chilean citizenry since it was the two American mining corporations Kennecott and Anaconda that were feeling the pain of government intervention. The newly created Copper Corporation (CODELCO) assumed a 51 per cent share in the three large mining operations (Chuquibambilla, El Salvador, and El Teniente) with the issue of nationalization delayed until a future date. Control now rested in the hands of the Chilean government and Frei took advantage of the situation by doubling the price of Chilean copper.

A new boom in governmental revenues occurred and assisted in paying for the numerous projects Frei had undertaken. It was largely due to increased copper revenues that President Frei was able to cover much of the government's budget, which had doubled between 1964-1970, without resorting to printing a great deal of additional notes. The mixed economy created by Frei was similar in many fashions to the mixed economy in the United States and Britain. Projects deemed too expensive for private industry became the purview of the government. Supposed market failure was mitigated by government oversight and guidance of the economy. Slow economic times called for increased government spending and in the case of Chile these policies were the exact plan the Frei government followed. By 1970 Keynesian economic policies had given Chile an economy that was better than during the period of control by the left. Growth and investment was, however, slightly lower than during the Alessandri years.

### **Market Socialism and the Allende Regime (1970-1973)**

Similar to the United States and Britain, the mixed economy provided unimpressive results in Chile. For the Liberal and Conservative parties, Eduardo Frei had gone too far in his intervention in the economy while at the same time he did not nationalize all major industries, seize the wealth of successful citizens and centrally plan

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<sup>34</sup> This final reform was one of his least restrictive but it was because of a special relationship between government and industry that it occurred.

<sup>35</sup> Owners were compensated in the same fashion as during the Alessandri presidency. Twenty percent was paid in cash and the rest was paid in interest-bearing government bonds.

the economy as was desired by the Socialists and Communists. Thus, the 1970 election was a three-way race between former President Jorge Alessandri (Liberal/Conservative), Radomiro Tomic (Christian Democrat) and Salvador Allende (Socialist/Communist).

When the votes were counted Salvador Allende received 36.3 per cent of the vote, Jorge Alessandri 34.9 per cent and Radomiro Tomic 27.8 per cent. For the third time since the passage of the 1925 Constitution, a candidate failed to receive a majority of the vote. As required by the Constitution the election was sent to Congress for a decision.<sup>36</sup>

In the two previous instances Congress chose the top candidate for the presidency without reserve, but this was not the case with Allende. His Marxist views were widely known by the other parties and were not shared by either of the two major groups in Congress. The Christian Democrats, which had formed out of the more conservative elements of the radical faction in the 1930s and 1940s knew that it was far more difficult to impose one's positions on the country than it might initially appear. Winning the presidency was no guarantee that your agenda would pass. With this in mind, the Christian Democrats in Congress were willing to select Allende as president if he guaranteed to honor a set of conditions that would uphold the Chilean Constitution. These guarantees were spelled out in the Statute of Constitutional Guarantees. Passing Congress with the support of the *Unidad Popular* (Socialist/ Communist) and the Christian Democrats, Salvador Allende became president in 1970.<sup>37</sup>

Often called the "Chilean Road to Socialism," Allende promoted a form of socialism that was less bloody than Stalinism but still required brutality and heavy-handed tactics. From 1971-73 Chile moved in the opposite direction as Hungary, the most reform-minded country in the East Bloc, which was attempting to move away from the Stalinist economic system and replace it with a more liberal market socialism. Hopes were initially high that Hungary would find a new level of prosperity, but this experiment would ultimately lead to the realization that market socialism was, while theoretically plausible, institutionally impossible.

Ludwig von Mises pointed out the weaknesses of market socialism some time earlier and had saw a vigorous response from socialist economists. But the inherent flaws in market socialism pointed out by von Mises went uncorrected as politicians attempted to develop market socialism in the decades after von Mises's critique. In order to better understand the inherent weaknesses in market socialism and the ultimate collapse of the Chilean economy under Allende, it is necessary to understand the von Mises critique and the response of Oskar Lange, an influential proponent of market socialism.

### *The von Mises Critique*

Prior to the development of a socialist state, Classical and Austrian economists made few efforts to respond to the theoretical developments of socialist economists such as Karl Kautsky. But with the creation of the Soviet Union, this quickly changed as prominent Austrian economist Ludwig von Mises published his critical essay *Economic Calculation in the Socialist Commonwealth* (1920) in which he challenged the ability of

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<sup>36</sup> Richard Pipes, *Communism: A History* (Modern Library, 2001) 136-137

<sup>37</sup> Ibid, pp. 137.



planned economies to accurately set market prices.<sup>38</sup> In his essay, von Mises pointed out that in a capitalist system the price of goods and services is set by repeated trial and error in the market. Buyers and sellers interact with one another to determine the value of goods and services. When demand increases the price of a good or service will tend to rise and when the demand for that same item decreases its price will tend to fall. When the market is able to freely set prices, the value of those goods and services is accurately determined.

Von Mises continued by pointing out that planned economies, which are theoretically designed to have the quantity of all goods and services determined by central planners, fail to accurately determine the value of goods and services because of the lack of a market mechanism. As von Mises illustrated, the probability of a central planning board accurately determining future demand for a good or service and setting the price based on that predicted demand is impossible to do with much accuracy. If, for example, one or more raw materials were to become more scarce and an increase in price occurred, central planners would fail to successfully change the price of affected goods and services because, as von Mises pointed out, there are thousands of prices that must be adjusted to account for the increase in price of a single raw material.

The inability of central planners to accurately determine the equilibrium price of a good creates an additional problem, which later plays an important role reform, as in the case of Hungary. When a firm manager in a capitalist economy attempts to determine his costs of production, he is able to accurately calculate the costs of all inputs and thus determine the costs of producing one unit. This calculation is, however, not possible in a centrally planned economy because the true costs of any given input are unknown. As previously stated, this is due to the failure of central planners to accurately determine the value of goods and services.

### *Lange's Theory of Market Socialism*

When von Mises's critique appeared in 1920 it began a debate among economists that was briefly interrupted with the onset of the Second World War. Oskar Lange's reply (1936) came nearly two decades after von Mises's original critique, but it became the standard theoretical reply for socialist economists in Western Europe and America. Initially, Lange's theory of market socialism seems similar to a capitalist economy. There is a high degree of labor mobility in the socialist market economy just as in market capitalism and the socialist market economy is a competitive market in which supply and demand determine the price of goods and services. The specific goods and services available in this economy are also determined by the demand of consumers.<sup>39</sup> It is, however, at this point that the similarities between the two systems end.

Lange's market socialism, like classical Marxism, is based upon the public ownership of the means of production. In Lange's model, the economy is planned by the Central Planning Board, which acts as the market mechanism setting the prices of goods

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<sup>38</sup> Ludwig von Mises, "Die Wirtschaftsrechnung im Sozialistischen Gemeinwesen," *Archiv für Sozialwissenschaften* 47 (1920) translated in F. A. Hayak, ed., *Collectivist Economic Planning*, (London: Routledge and Sons, 1935) 87-130.

<sup>39</sup> Oskar Lange, "On the Economic Theory of Socialism: Part One," *The Review of Economic Studies* 4 (Oct. 1936) 57-58.

and services.<sup>40</sup> Initially, it may seem that Lange has designed a model with the same weaknesses described by von Mises, but Lange attempts to overcome the problem of accurately determining the value of goods by enabling central planners to continually adjust prices until supply and demand reach equilibrium. The "trial and error" setting of prices is the basic method used in a capitalist economy and the method Lange attempts to employ in his model.<sup>41</sup>

At first glance, it may appear that Lange has solved the marketization problem but, as Janos Kornai pointed out, "Lange's model is based on erroneous assumptions concerning the nature of the 'planners.' The people at his central planning board are reincarnations of Plato's philosophers, embodiments of unity, unselfishness, and wisdom. They are satisfied with doing nothing else but strictly enforcing the 'Rule,' adjusting prices to excess demand."<sup>42</sup> In addition, it is difficult, if not impossible, for central planners to know and understand the market-wide ripple effect a single price change may incorporate.

Had Joseph Stalin not been the leader of the Soviet Union when socialist governments were established in Central and Eastern Europe, it is possible that the Lange model may have been the blueprint of choice. However, the Stalinist model was forced on the East Bloc. Stalinist economic systems were characterized by drastically limited labor mobility: a lack of competition among firms with central planners determining both the price and availability of goods and services without attempting to determine supply and demand accurately. Clearly, the key variables that are the cornerstone of Lange's model of market socialism were not present in the Stalinist economic systems of Hungary and other East Bloc states. Allende's Chile would have been the first socialist market economy had his policies not failed almost immediately requiring political and economic suppression destroying any hope for market socialism.

### *Chilean Socialism (1971-1973)*

Salvador Allende took office in September 1970 with the fortunes of the *Unidad Popular* (UP) at its high ebb. Although 67.6 per cent of voters had not voted for Allende, he was finally in office after four attempts to win the presidency. Without delay the socialists and communists that joined Allende in the new government began attempting to fundamentally change Chilean society and the economy. UP efforts to "overcome capitalism" took the form of five wide-ranging structural reforms: nationalization of Chile's main resources (copper, coal, nitrate, iron and steel), nationalization of large companies, confiscation of agricultural land and collectivization of agriculture, nationalization of the banking sector and state control of the main retail and distribution networks.<sup>43</sup>

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<sup>40</sup> It is important to differentiate between Stalinist central planning and that intended by Lange. In the Lange model, central planners allow consumers to largely determine what products are available on the market. Central planners are less interventionist and may be considered a type of facilitator that only seeks to intervene for the purpose of making sure that enough of essential items are available to society. They do not act in the coercive capacity of central planners in a Stalinist system.

<sup>41</sup> Ibid, pp. 60-65.

<sup>42</sup> Janos Kornai, "The Hungarian Reform Process: Visions, Hopes, and Reality," *Journal of Economic Literature* 24 (Dec. 1986) 1726.

<sup>43</sup> Patricio Meller, *The Unidad Popular and the Pinochet Dictatorship* (St Martin's Press, 2000) 29.

Early in the Allende administration the Minister of Economics, Pedro Vuskovic, made the aims of the new government clear, "State control is projected to destroy the economic base of imperialism and class domination by putting an end to private ownership of the means of production."<sup>44</sup> Edward Boorstein, an American communist that took part in the attempt to transform Chile echoes this sentiment in his account of Allende's Chile.<sup>45</sup> Contrary to the collected works of many Allende apologists the UP government was not seeking to simply introduce needed change but sought to institute a socialist economic system in Chile.<sup>46</sup>

The desire to "destroy capitalism" was not shared by the majority of the members of the Chilean Congress. Although Chile had a presidential system in which the executive branch was the most powerful branch of government, the president could not do as he pleased and Congress quickly showed that it was not willing to participate in Allende's socialization of the Chilean economy. In order to overcome Congress's unwillingness to pass his legislation, Allende relied on members of the executive branch willing to break the law to further the "revolution." Allende began in 1971 by increasing minimum wages for blue-collar workers 39 per cent. In addition, price controls were enacted. Initially these efforts saw Chilean GDP rise while inflation remained steady, but by the end of 1971 the economy began to unravel.

Increasing wages and controlling prices meant that industries could no longer cover their costs and began to declare bankruptcy. When bankruptcies occurred, the Allende government took firms into receivership and began operating them without paying compensation to the owners or creditors. When companies could not pay back loans, banks would no longer have sufficient reserves to satisfy legal requirements and would likewise be taken over by the government. This tactic was highly successful at increasing the number of nationalized industries. Before the end of the Allende regime all major companies would be in the hands of the government.

With government running industries, the goal of making a profit disappeared as UP apparatchiks sought to keep wages high and the price of goods low. Operating at a loss required the government to subsidize Chilean industries. State-owned enterprises quickly began running deficits which, by 1973, required 10.5 per cent of the Chilean GDP in subsidies.<sup>47</sup> In order to meet the expanding government budget Allende began printing bank notes. As expected, inflation began to rise and in 1972 inflation reached 260 per cent for the year, nearly ten times the rate of 1970.

Agricultural lands were confiscated in a similar fashion. Using the Agricultural Reform Act of 1967 as a basis, UP government officials began declaring vast tracts of land to be inefficiently run and thus ready for nationalization.<sup>48</sup> More than 3,000,000 hectares of farmland were seized in 1972. The 1967 Agricultural Reform Act was not the only method used to seize farmlands. Members of the UP would go into the countryside and organize peasant unions, which would then encourage their workers to occupy property. If an owner complained, the government would not help. Outnumbered and

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<sup>44</sup> Ibid, pp. 30.

<sup>45</sup> Edward Boorstein, *Allende's Chile* (International Publishers, 1977).

<sup>46</sup> See Atilio Boron *State, Capitalism, and Democracy in Latin America* (Lynne Reiner, 1995) and Frederick Weaver *Latin America in the World Economy* (Westview Press, 2000).

<sup>47</sup> Meller, pp. 41.

<sup>48</sup> In Marxist ideology all land not owned by those that do the laboring on it is inefficiently run.

without support from the government, landowners lost their lands. Newly seized lands were often turned into communes similar to those in the Soviet Union. Communes in Chile provided much the same results as they did in other socialist states. Food shortages occurred as agricultural production precipitously dropped.

Nationalization of agriculture and industry saw capital flight become a major problem for the UP government. No longer would Chileans invest their private savings into businesses, but neither would foreign firms. As agricultural and industrial efficiency rapidly decreased, Chile's export surplus disappeared. But with fewer goods to sell on the international market, Chile could no longer purchase the capital goods necessary to maintain agricultural and industrial production.

Unfortunately for Chileans, the picture was grim in 1972-73. The state controlled 400 of the largest companies and banks. General price controls were in effect. Multiple exchange rates existed. Prohibitions on many imports were accompanied by 10,000 per cent deposit requirements for imported goods.<sup>49</sup> Tariffs on imports ranged from 94-220 per cent. Sales taxes were indexed creating inefficiency and confusion. High public sector employment led to a bloated bureaucracy. Public debt soared. Government controlled interest rates, credit and all capital movement. Allende began taking out large loans from the Soviet Union and other socialist states. Powerful unions controlled wages. No employees could be fired. Mandatory wage increases were instituted. In essence, the Chilean economy was in ruins.

Patricio Mellar explains the evolutionary process of the Chilean economy during the Allende administration in the following way:

"According to this populist paradigm, expansionary policies initially generate a high growth rate with a rise in real wages, with price controls holding down inflationary pressure. The initial stage of a populist program produces highly successful results- high growth simultaneously with lower inflation and greater purchasing power for the workers. In the second stage, the strong expansion of demand generates growing disequilibrium: stocks become exhausted; the foreign sector acts as a safety valve, but foreign currency starts to become scarce. All of this stimulates the inflationary process, together with capital flight and a demonetization of the economy. The public sector experiences high deficits as a result of subsidizing mass consumption goods and the exchange rate; at the same time, tax revenue shrinks in real terms, and the public deficit rises substantially. The third stage ends in government attempts to apply a counter-inflationary adjustment policy, cutting subsidies and lowering real wages. Subsequently, a different government with greater credibility will apply a tough orthodox stabilization program whose consequences are unemployment and loss of purchasing power among low-income groups. In brief, this populist paradigm inflicts a terrible cost on the very group it was meant to favor."<sup>50</sup>

Chile had reached the third stage of Mellar's description by 1973. Inflation stood at 600 per cent as the economy continued to weaken and edge closer to collapse.

Society had become polarized by 1973 and as the economy collapsed workers, who had placed their hopes and dreams in the success of Salvador Allende, watched as inflation soared and their wages declined. Elites in society watched as their businesses sank into utter ruin. The military was becoming impatient with the Allende government because of the havoc it was wreaking on the economy, and the instability in society. Party cadres began propaganda campaigns among the enlisted men and low-level

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<sup>49</sup> This effectively eliminated many imports.

<sup>50</sup> Mellar, pp. 32-33.

officers, calling for them to rise up against their superiors and overthrow the senior military leadership.

This was, of course, against civilian and military law but the Allende government seemed unable or unwilling to control the party cadres. Senior military leaders were concerned about the possibility of civil war breaking out among differing factions in the military as it had done nearly a century earlier.<sup>51</sup> When on August 22, 1973, the Chamber of Deputies passed legislation by a vote of 81 to 45 condemning the actions of Allende as illegitimate and unconstitutional, the Supreme Court quickly concurred. Since the Chilean Constitution lacked a provision for the impeachment of the president, the Chamber formally requested that Army Chief of Staff Augusto Pinochet restore law and order to Chile. Eighteen days later Salvador Allende was removed from office ending what may be considered the most turbulent period in Chilean history.<sup>52</sup>

### **Economic Reform (1973-1989)**

Once Allende was removed from office it became clear to the Chilean military leadership that Chile was in a state of chaos and on the verge of economic collapse. There were, however, the problems of how a government should be run to save the Chilean economy. Quick to offer an answer to this question was a group of economists from the Catholic University in Santiago. This group of economics professors, which would later become known as the "Chicago Boys," offered the military a simple solution that required the government to disengage itself from its dominant role in the Chilean economy.<sup>53</sup> A system that relied on the individual effort and ingenuity of entrepreneurs acting in their own self-interest was a simple concept that naturally appealed to the military leadership. The Chicago Boy's support of free markets meant the Chilean economy would require a complete overhaul.

There was an immediate need to turn around the Chilean economy in September 1973 and almost immediately the new government began by dismantling the copper export enclave. In order to accomplish this high tariffs were reduced, state control of strategic sectors (financial) was eliminated and the first wave of privatization began. In a separate move, wages were reduced 30 per cent between 1973 and 1975.<sup>54</sup> The emphasis among these reforms was the reduction of public sector debt through decreasing the share of GDP expended by government.<sup>55</sup> The cascading sales tax instituted under Allende was quickly replaced by a 20 per cent value added tax. The simplification of the tax structure promoted increased efficiency in tax collection, which saw tax revenues move from 22 per cent of GDP in 1973-74 to 27 per cent of GDP in 1975-1977. The public sector deficits, responsible for the hyperinflation of 1972-73, were quickly eliminated as the government began running a surplus.

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<sup>51</sup> Ibid, pp.71.

<sup>52</sup> Pipes, pp. 138.

<sup>53</sup> See Juan Gabriel Valdes, *Pinochet's Economists* (Cambridge University Press, 1995)

<sup>54</sup> Meller, pp. 81.

<sup>55</sup> In 1973 government spending accounted for 24 per cent of GDP but within a few short years it had decreased to 15 per cent of GDP and by 1981 government spending stood at 12 per cent of GDP. Paul Craig Roberts and Karen Lafollette, *The Capitalist Revolution in Latin America* (Oxford University Press, 1997) 36.

As explained by Mellar, the difficult aspect of market corrections undertaken in the mid 1970s was the increase in unemployment and reduction in purchasing power that workers experienced as the economy attempted to return to profitability through increases in productivity.<sup>56</sup> Efforts to improve efficiency were extended to agriculture as well. The communes established in 1972 were abolished with the regime returning thirty per cent of the 10,000,000 hectares of government land to its original owners, 31 per cent was sold to new owners, 29 per cent was given to ex-tenants and ten per cent was retained by the state. The food shortages of 1972-73 were quickly erased.<sup>57</sup>

Industrial and agricultural reforms played an intricate role in Chile's economic recovery. The reduction in tariffs mentioned earlier was vitally important to Chile and deserve greater explanation in key areas. Tariffs averaged 100 per cent under Allende and ranging from 95 per cent to 220 per cent from 1971-73. They were reduced to a flat ten per cent rate across products (automobiles the exception). Shortages were alleviated but a trade deficit was the cost. With the return of businesses to private ownership over 3,000 price controls were lifted. Financial institutions, which had also been reprivatized were allowed to freely determine interest rates causing capital to begin returning to the country. And, as part of fiscal policy, capital markets were deregulated in addition to the central bank ending its role as primary lender.<sup>58</sup>

Chile began to recover by 1976 and was the beneficiary of the strongest economy in Latin America from 1976 to 1981 with average annual growth rates approaching eight per cent.<sup>59</sup> The Chicago boys were finally able to slay the inflation dragon as inflation moved from 650 per cent in 1973 to ten per cent in 1981. Chile had finally entered the third stage of growth. The long wait had finally ended; Chile had now developed the conditions necessary for sustained growth and the drive to maturity. Although Chile was entering the third stage of Rostow's model a century after many Western European states, Chile quickly established itself as one of the economic exemplars in Latin America.

Among the many reforms implemented by the Pinochet government, its most successful and revolutionary reform was the privatization of the Chilean retirement system. When Chile began allowing its workers to leave the publicly run social security and retirement system in May 1981, it was the first country in the world to make this transition. Participation in Chile's system is mandatory for all dependent employees entering the labor force after January 1, 1983, and voluntary for self-employed workers. Workers are required to put ten per cent of their salary into individual pension accounts, which are managed by one of eight or more Pension Fund Administrators (AFP) chosen by the employee. The funds are then invested in stocks, bonds and securities in Chile and abroad. Government requirements limit the amount of risk that can be taken in order to prevent any of the funds from developing a solvency problem. Minimum return levels are established at -2 per cent or 50 per cent of the average of all other funds over the past 12 months. Over the past eighteen years the private pension system has averaged an

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<sup>56</sup> In 1975 Chile experienced a recession in which unemployment increased significantly. Transitioning to a free market economy was painful in 1975 with the GDP seeing negative growth.

<sup>57</sup> Martinez and Diaz, *Chile: The Great Transformation* (The United Nations Research Institute for Social Development, 1996) 50-51.

<sup>58</sup> Alejandro Mizala Salces, *Financial Market Liberalization in Chile, 1973-1982* (Garland Publishing, 1991)

<sup>59</sup> Mellor, pp. 85.



annual rate of return of 11.3 per cent, far higher than the two per cent current recipients of social security receive in the United States.<sup>60</sup>

Soon after privatizing the pension system in 1981 Chile began to stumble due to macroeconomic policy errors and external shocks. Among the primary culprits was the fixed exchange rate.<sup>61</sup> The Chilean peso, long overvalued, encouraged excessive private borrowing from abroad. In conjunction with excessive borrowing was the problem of wage indexation equivalent to 100 per cent of the Consumer Price Index (CPI). Inflated wages led to excessive consumption, which further encouraged the importation of consumer goods purchased on credit. By early 1982 borrowers began defaulting on their loans causing banks to begin failing.<sup>62</sup>

External shocks were also affecting Chile during 1982-83. From 1980-82 Chilean copper prices fell thirty-two cents (each one-cent decrease represented a \$25,000,000 loss in export revenue). Just as copper prices were falling, international interest rates began to increase as international lending slowed to a trickle.<sup>63</sup> Chile saw its worst recession since 1973 and experienced a reduction in GDP of 14.4 per cent in 1982-83. Negative growth led to a general questioning of the success of the free market policies. Much to the dismay of Pinochet's economic team, the military leadership fired the Minister of Economics, increased tariffs, developed government-sponsored work programs and nationalized insolvent banks and major corporations.

But by early 1984 the recession was over and the counter-reforms of 1983 began to reverse (banks and corporations were reprivatized, tariffs were lowered and restrictions lifted). In addition, the half measures so pivotal in inducing the recession were corrected. By 1985, the market freely determined wages. A competitive currency developed as the peso floated on international currency markets. Both the public and private sector learned a valuable lesson.

The aftermath of the 1982-83 recession was a new policy of export-led growth in which Chile developed an outward-looking approach.<sup>64</sup> Efforts to increase exports led to a rationalization of the Chilean economy in which industries undertook a division of labor that concentrated Chilean efforts in areas where Chile was competitive in the international economy. Copper remained the primary export but agricultural goods and fishing increased their share of export revenue. Between 1985 and 1990 Chile quintupled its exports and saw subsequent increases in wages and the GDP.<sup>65</sup> Unemployment decreased as well. In essence, Chile moved into the ranks of the nearly developed states such as South Korea, Taiwan and Singapore.

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<sup>60</sup> L. Jacobo Rodriguez, "Chile's Private Pension System at 18: Its Current State and Future Challenges," (Cato Institute, 1999).

<sup>61</sup> Sebastian Edwards, *A Tale of Two Crises: Chile and Mexico* (Cambridge, MA: National Bureau of Economic Research, 1996) 8-11, Working Paper 5794.

<sup>62</sup> Meller, pp. 99-101.

<sup>63</sup> Ibid, pp. 100.

<sup>64</sup> Bela Balassa, et al., *Toward Renewed Economic Growth in Latin America* (Institute for International Economics, 1986).

<sup>65</sup> Meller, pp. 159.

## Conclusion

October 5, 1988, General Pinochet turned to Chileans, asking for an additional five years in office. By a margin of 54 per cent to 43 per cent the people rejected his request and in December 1989 Chile elected its first president in three decades. In the years that followed the National Commission for Truth and Reconciliation, established after the center-left coalition of President Patricio Aylwin took office in 1990, found that 2,279 deaths occurred due to human rights abuses during the military regime.<sup>66</sup> Any unnecessary loss of life is always a tragedy, but out of that tragedy has come a new Chile with an economy to be envied by many of the world's nations.

The decade following the end of the Pinochet regime has seen the center-left governments of Aylwin and the second Eduardo Frei (elected 1994) continue the same economic policies begun under Pinochet. Rather than attempting to reverse market reforms, the center-left governments have deepened the moves toward free markets by further reducing tariffs and privatizing a number of the publicly run firms that remained after Pinochet stepped down.

For the Chilean people the 1990s were a decade of significant economic growth. Economic growth rates remained around eight per cent annually while exports continued to increase.<sup>67</sup> Opponents of free markets and limited government now see the market as a way for even the poorest Chilean to prosper rather than an obstacle to be overcome. At the beginning of the 21<sup>st</sup> century elements of the Chilean political and economic reforms are being adopted by other Latin American states (Argentina, Bolivia, Mexico, Uruguay, Paraguay and Peru) as they have sought to make economic and/or political transitions to free societies with free market systems.

In recent years Chile has sought to join Canada, Mexico and the United States in the North American Free Trade Agreement. Its success as a member of the World Trade Organization and a primary trading partner for Latin America has proven the importance of classical and Austrian economics in remaking Chile into a Latin dynamo. If, as it appears, Rostow is correct, Chile is rapidly approaching the fourth stage of economic development. The drive to maturity may begin before the end of the present decade. And, when this occurs, Chile will enter the ranks of the world's elite economies.

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<sup>66</sup> Mellor, pp. 183.

<sup>67</sup> Chile's economic growth rate has been among the highest in the world since 1976.



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