CSGEF
Center for the Study of Global Economic Future

2024

PERSPECTIVE

The Chilean Experiment: Shock Therapy and Modern Applications - A Return to Basics

Future of Global, Regional & National Development Plans Program (GRAND)

CONTACT
CSGEF Research Unit.
SIT Tower, Dubai Silicon Oasis.
Dubai, UAE.
T: +971 4 330713
E: research@csgef.org
W: www.csgef.org

Disclaimer:

This document is solely intended for informational purposes. It is not intended to provide policy advice to any national government, corporation, academic institution, or organization responsible for shaping economic policies. Its purpose is to offer readers insight into a significant event in economic thought - the economic liberalization phase of Chile during the 1970s. It should be noted that various economic beliefs and doctrines, regardless of their alignment with either liberal or conservative strains of capitalism, existed before, during, or after this pivotal moment in economic history and had a similar impact. Therefore, when conducting analyses and determining the most effective economic approach and course of action, readers are advised to consider this information.

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Summary: *This Perspective offers an analysis of Chile's economic trajectory through the framework of the Chilean Project and Shock Therapy. It examines both historical and contemporary aspects of Chile's economy, with particular attention to the role of the Chicago Boys. The analysis scrutinizes the philosophy, implementation, benefits, drawbacks, and impact of shock therapy, providing a detailed investigation into the subject. Additionally, the Perspective explores contemporary applications of free-market economics, grounded in Friedmanite principles, in diverse economies such as Estonia, New Zealand, Hong Kong, and India. The Prospective further investigates the repercussions of these principles on the 2008 financial crisis, culminating in a discussion on the ongoing debate between market freedom and government regulation. In doing so, it underscores the importance of achieving a carefully balanced equilibrium to ensure both economic stability and equitable growth.*

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Paper Type: Perspective
Paper No. PES-2024- 01

I. Background

Chile's economic history presents a complex and contentious story, characterized by the interplay of left-wing and neoliberal ideologies and the influence of global economic forces. To fully understand Chile's economic history, it is essential to consider the diverse perspectives and dynamics that have shaped its trajectory. Furthermore, analyzing the role of political parties like the PDC can provide valuable insights into the broader political landscape and power dynamics within Chilean society. This dual adoption has resulted in conflicting dynamics and pronounced sociopolitical polarization. Neoliberal policies were first introduced in the 1970s under the rule of General Augusto Pinochet. During this period, the United States exerted significant influence over Chilean politics, overshadowed by the remanent of the Monroe Doctrine and Containment and Cold War Policies to South America, a region frequently perceived as within the U.S.'s sphere of influence.

In this context, left-wing ideologies were perceived as a significant threat, compelling effective countermeasures from the people of Chile and the Christian Democratic Party (CDP). CDP, being concerned with the global climate at that juncture in history and its potential repercussions, viewed the implementation of non-market-based strategies and the adoption of Marxist ideologies as a potential threat to the state and future of Chile. As a result, they decided to alter the course of economic history to pursue what they deemed to be a more prosperous path. The Christian Democratic Party led the effort to oust the left-wing government by forming strategic alliances with other opposition groups, such as the "Commando for No" coalition, which campaigned against left-wing government policies and gained a congressional majority in 1973. They also used economic pressure by organizing strikes and protests to create instability. Additionally, the party collaborated with military leaders, including its leader Patricio Aylwin, to support the military coup that ultimately ousted the left-wing government. One of the actions taken by opponents of left-wing movements, and possibly supporters of the PDC, was the implementation of "Friedmanite Educational Initiatives." aimed at promoting free-market principles and countering socialist ideas within academic institutions. This strategic effort led to the emergence of the Chicago Boys, a cohort of economists educated at the University of Chicago and deeply influenced by Milton Friedman's teachings. These economists played a pivotal role in shaping Chile's economic policies, advocating for privatization, deregulation, and free trade. These policies came to define the neoliberal era in Chile and have had a lasting impact on the country's economy and society by creating the Chilean Miracle.

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Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

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Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

II. The Chilean Miracle

The phenomenon known as the Chilean Miracle, or the "Economic Miracle of Chile," encapsulates the period of rapid economic growth and modernization experienced by Chile during the 1980s and 1990s. This era of economic prosperity is predominantly attributed to the implementation of free market policies by the military regime under Augusto Pinochet, who assumed power following a coup d'état in 1973.

Before the advent of the Chilean Miracle, the nation's economy had been beleaguered by extensive government intervention, nationalization of industries, and fiscal mismanagement. The Pinochet administration, influenced by the council of economic advisor and later Finance Minister Sergio de Castro, enacted a series of neoliberal economic reforms. These included privatization, deregulation, and trade liberalization, collectively termed the "Chicago Boys" model, reflecting the substantial influence of economist Milton Friedman and the Chicago School of Economics.

The rationale behind these reforms was primarily to rejuvenate a faltering economy and diminish governmental involvement in the market. The military regime perceived free market policies as a mechanism to attract foreign investment and catalyze economic growth. Additionally, there was a prevailing belief that the private sector would operate more efficiently and innovatively than state-owned enterprises.

The effects of the Chilean Miracle on the nation's economy were profound. Chile witnessed substantial economic growth, averaging 7% annually, alongside a reduction in poverty rates. The GDP per capita surged from $1,300 in 1980 to $5,000 in 1990. However, this growth was not uniformly distributed, resulting in increased income inequality during the period.

The Chilean Miracle remains a contentious topic, with divergent perspectives on its legacy. Proponents laud it as a model of successful economic development that transformed Chile into a prosperous and modern economy. In contrast, critics contend that it exacerbated the disparity between the affluent and the impoverished while neglecting social welfare programs.

The Chilean Miracle represents a significant epoch of economic expansion in Chile, driven by the free-market policies instituted by Augusto Pinochet's regime. While its impact on the nation was considerable, the discourse surrounding its successes and failures continues, reflecting the complex interplay of economic policies and social outcomes.

One of the main concepts emphasized in this paper is that the successful economic phenomenon known as the Chilean Miracle is often attributed to the free-market policies championed by the Chicago Boys, which greatly influenced Chile's economic strategies. However, it is essential to acknowledge that other significant factors, such as abundant natural resources, political stability, and strong governance, also played crucial roles in Chile's remarkable economic success.

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Paper Type: Perspective
Paper No. PES-2024- 01

III. The "Chicago Boys"

The "Chicago Boys" refers to a group of Chilean economists who were trained at the University of Chicago under the tutelage of Milton Friedman and Arnold Harberger[1]. The Chicago Boys included notable economists such as Sergio de Castro, Jorge Cauas, José Piñera, Rolf Lüders, Pablo Baraona, and Hernán Büchi. Their formation and influence are rooted in a combination of:

a) Academic Exchange Programs.
b) Institutional Collaborations.
c) Political Circumstances.
d) The Determination of The Conservative Chilean Intelligentsia.

They played a significant role in shaping economic policies during the 1970s and 1980s. Most of them were educated at the University of Chicago under prominent economists Milton Friedman and Arnold Harberger. Some also studied at the Pontifical Catholic University of Chile, which had an affiliation with the University of Chicago. Chile's Catholic University established scholarship programs with the University of Chicago's Department of Economics. Approximately one hundred students, chosen by the Chilean intelligentsia, received their initial training in Chile before advancing to post-graduate studies in Chicago.

C S G E F
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

The Ascendancy of the Chicago Boys from Academia

During General Augusto Pinochet's regime, the Chicago Boys ascended to significant influence, implementing early reforms under his leadership. Pinochet appointed several of them to powerful positions in the government to address economic challenges, including high inflation and recession. The Chicago Boys championed deregulation, privatization, and a suite of free market policies.

[1] Arnold Harberger, a renowned public finance economist, has mentored numerous luminaries in the field. Among his former students are 15 central bank presidents and approximately 50 government ministers.

Upon their return to Chile, the Chicago Boys assumed pivotal roles in administration and policymaking, particularly during the tenure of Augusto Pinochet. Their influence was instrumental in shaping the country's economic strategies and reforms from 1973 up until 1990. They helped develop and implement significant economic changes to stabilize the Chilean economy, liberalize markets, privatize state-owned firms, and lower tariffs and trade barriers.

Uncovering the Braintrust Behind the Chicago Boys: The Centro de Estudios Públicos

The Centro de Estudios Públicos (CEP) played a pivotal role in equipping the Chicago Boys, after their education at the Chicago School of Economics, for their subsequent ascent to influence and the execution of market-oriented reforms in Chile. Established in 1980 by a consortium of economists, including several affiliates of the Chicago School of Economics, CEP was dedicated to advancing free-market ideologies and policies through rigorous research and scholarly publications. The think tank provided a crucial platform for the Chicago Boys to disseminate their economic theories and influence policy formulation in Chile.

C S G E F
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

CEP functioned as a formative environment for the Chicago Boys, offering a nurturing space in which to develop and refine their economic doctrines. Through a series of seminars, conferences, and academic publications, the Chicago Boys were able to propagate their ideas and garner support from influential figures and institutions within Chile. This intellectual endorsement facilitated the broader acceptance of their economic principles among the general populace.

Moreover, CEP was instrumental in establishing connections between the Chicago Boys and the military regime of General Augusto Pinochet, who assumed power in 1973. The think tank actively advocated for the Chicago Boys' policies to the military government, underscoring their potential to foster economic growth and stability. Consequently, the Chicago Boys succeeded in securing the trust and backing of the Pinochet regime, which was crucial to their elevation to positions of influence.

Once in power, and with the continued support of CEP, the Chicago Boys executed their market-based reforms, encompassing privatization, deregulation, and liberalization. CEP sustained its endorsement of these reforms through ongoing research and publications, providing empirical justification for the policies and promoting them as essential for economic growth and modernization.

Crafting The Economic Blueprint: El Ladrillo

The "Bricks" document, also known as "El ladrillo," was a set of economic policy recommendations written by the Chicago boys. The document was formulated in the late 1970s and was presented to the Chilean government by the Chicago boys, who had been invited to advise on economic policies.

The document was initially written by Sergio de Castro, a member of the Chicago Boys and a Chilean economist who had studied under Milton Friedman at the University of Chicago. It was later revised and expanded by other Chicago boys, including José Piñera and Hernán Büchi. The document laid out a comprehensive economic plan that aimed to liberalize and modernize the Chilean economy, with a strong emphasis on free market principles.

The "Bricks" document had a significant impact on the economic transformation of Chile. The policies recommended in the document were implemented by the Chilean government under the regime of Augusto Pinochet in the 1980s. This led to a period of economic growth and development, with Chile becoming one of the most economically successful countries in Latin America. The "Bricks" document has been a subject of debate and controversy, with some praising its role in Chile's economic success and others criticizing its neoliberal approach. The document illustrates the significant influence of the Chicago School of Economics and the Chicago Boys on Chile's economic development and global economic policies.

C S G E F
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

Sergio de Castro

Sergio de Castro was Minister of Economy and later Minister of Finance. He was a pivotal figure in the economic liberalization of Chile during his tenure as Minister of Economy from 1976 to 1980 and subsequently as Minister of Finance from 1979 to 1980. His policies and initiatives were instrumental in transforming Chile's economy from a state-controlled system to a free-market one. de Castro was the first author of the "Bricks" document, which played a pivotal role in Chile's economic transformation. One of de Castro's significant initiatives was the implementation of a series of economic reforms known colloquially as the "Miracle of Chile." These reforms, grounded in the free-market principles of the Chicago School of Economics, aimed to liberalize the economy, reduce government intervention, and promote competition and private enterprise.

During his tenure, Chile observed a marked increase in foreign investment and exports, contributing to economic growth and a reduction in inflation. The privatization of state-owned enterprises and the elimination of trade barriers were also critical to the country's economic achievements.

José Piñera

José Piñera , an esteemed economist and politician, is widely recognized as the principal architect of the pension reform in Chile. During the 1980s, in his capacity as Minister of Labor and Social Security, he tackled the challenges of the nation's faltering pension system. Chile instituted a pioneering system based on individual retirement accounts, commonly referred to as the "Chilean Model." This model supplanted the traditional pay-as-you-go system with a privatized framework, wherein workers allocate a portion of their earnings into individual accounts overseen by private pension funds. These funds strategically invest the contributions in financial markets, to secure higher returns for retirees. Additionally, the government established a safety net for low-income individuals lacking sufficient savings.

Piñera's reform has augmented savings, yielded higher returns, and provided greater autonomy to workers, thereby enhancing economic growth and diminishing elderly poverty. They regard the privatized system as a sustainable solution for an aging populace. However, it elevated administrative fees, limited benefits for low-income individuals, and inadequate retirement income for many, particularly those without stable income or formal employment. Concerns also encompass financial market volatility and the potential for significant losses for retirees during economic downturns.

Hernán Büchi

Hernán Büchi was Minister of Finance and had an important role in promoting economic liberalization. Büchi implemented Milton Friedman's economic principles in Chile during the 1970s and 1980s as the finance minister. He is renowned for implementing the "Ladrillo" or "The Brick" policies, designed to foster economic growth and stability through liberalization and privatization. This term refers to the comprehensive document that outlined these policies . Influenced by the free-market ideologies of the Chicago School of Economics, these policies were enacted during Augusto Pinochet's dictatorship.

The primary objective was to open the Chilean economy to foreign investment and diminish the state's role. This strategy included privatizing state-owned enterprises, reducing trade barriers, and introducing a flexible exchange rate system. Privatization aimed to enhance market efficiency and competition by selling state-owned entities, including the national airline, banks, and telecommunications firms.

Lowering trade barriers facilitated greater international trade and investment, thereby diversifying the economy and enhancing global competitiveness. The adoption of a flexible exchange rate system allowed the value of the Chilean peso to be determined by market forces, thus stabilizing the currency and attracting foreign investment.

C S G E F
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

[2] José Piñera is presently a Distinguished Senior Fellow at the Cato Institute, a renowned libertarian think tank based in Washington, D.C. His role at the Cato Institute involves conducting research, publishing papers, and engaging in public discourse to promote libertarian ideals and policies.

Rolf Lüders

Rolf Lüders was a key participant in Chile's economic liberalization and change while serving as finance minister from 1982 to 1983. His policies and actions played a crucial role in the country's transition from a protectionist and state-controlled economy to a more market-oriented and open one. One of Lüders' primary contributions was his involvement in the implementation of the "economic shock therapy" program, which aimed to combat hyperinflation and reduce the budget deficit. Although economic shock therapy policies initially encountered resistance and criticism from various sectors, they ultimately resulted in a significant decrease in inflation and a more stable economy.

Lüders policies were essential for economic recovery and laid the groundwork for the country's sustained growth in subsequent years emphasizing Lüders' key role in negotiating external debt relief and securing foreign investment, which were pivotal for Chile's economic development.

CSGEF
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

Pablo Baraona

Pablo Baraona played a pivotal role in the economic liberalization and transformation of Chile as the Minister of Finance in the 1970s. During this period, Chile was grappling with economic turmoil and high inflation rates due to extensive government intervention in the economy. Baraona, alongside other economists known as the Chicago Boys, instituted free-market policies and significantly reduced government control over the economy. One of Baraona's notable contributions was the implementation of a new currency, the Unidad de Fomento, which was indexed to inflation, thereby facilitating more stable prices and investments.

In his role as a prominent economist and government advisor, he successfully advocated for policymakers to adopt the UF as an indexation unit, despite some opposition from certain segments of Chile's economic and social class. These groups, who stand to benefit from asset protection against inflation using the US dollar as a reference, raised concerns about the benefits of adopting the UF. Since its introduction in 1975, the UF has helped maintain economic stability and attract foreign investment, marking Baraona's significant contribution to Chile's monetary system. He also enacted policies aimed at attracting foreign investment and promoting exports, which subsequently led to economic growth and job creation.

Baraona's policies, though met with resistance from certain societal sectors due to the closure of state-owned enterprises and a reduction in government subsidies, ultimately resulted in a more efficient and competitive economy characterized by lower inflation rates and increased productivity. Baraona's policies laid the groundwork for Chile's economic success and continue to influence contemporary economic strategies in the country. While debates about the long-term effects of his policies persist, it is undeniable that Baraona played a crucial role in modernizing Chile's economy and setting it on a trajectory toward sustained economic growth and stability.

The ideas of the Chicago Boys had a significant impact not only in Chile but also on other countries in South America. Furthermore, their influence extended beyond the region, as evidenced by Ronald Reagan's "Reaganomics" and Margaret Thatcher's deregulation economic policies, which were inspired by Chile's successful policies and economic reforms.

Synergy Between Chicago Boys and the Business Realm

The alignment between the Chicago Boys and the business sector was noteworthy, though the long-term ramifications of their policies continue to be a subject of discussion. Such a relationship was characterized by mutual influence and support. The business sector, particularly large corporations, viewed these reforms as opportunities for growth and expansion.

The industrial sector had a vital role in supporting the Chicago Boys. This sector witnessed growth potential and the prospect of increased profitability under the free-market policies promoted by the Chicago Boys. Government regulations and oversight reduction enabled the privet sector to operate with greater autonomy and adaptability, nurturing a more competitive marketplace. This deregulation was particularly beneficial to industries such as mining, manufacturing, and agriculture. These sectors were subject to stringent governmental controls previously in a time frame spanning from 1930 up to the beginning of the 1970s.

Between 1930 and the early 1970s, the mining, manufacturing, agriculture, and finance in Chile operated under government controls, encompassing state ownership, price regulations, and labor practices. all meticulously designed to ensure economic stability and public welfare. However, these measures engendered considerable frustration within the business leaders within these sectors, precipitating a robust demand for pro-market reforms. This burgeoning discontent catalyzed strategic pressure for deregulation and liberalization in the early 1970s.

Center for the Study of Global Economic Future

Paper Type: Perspective
Paper No. PES-2024- 01

Mining

During the pre-Chicago Boys era, Chile employed stringent government regulations on the mining sector to enhance state control and optimize profits from mineral resources. The state-owned enterprise, CODELCO, held a monopoly on copper production, while private companies required governmental authorization to operate. The government regulated mineral prices and exports to protect state interests and stabilize the market. Although these regulations were designed to ensure national development and prevent exploitation, spectators asserted that such anti-market policies hindered growth, competition, and innovation, potentially resulting in inefficiencies and corruption.

The implementation of strict rules in the mining sector led to a deep-seated sense of dissatisfaction within the business. These rules were implemented to regulate the copper sector; however, they resulted in inefficiencies and decreased earnings. The industry leaders in the mining sector's dissatisfaction contributed to the endorsement of the market regime led by General Augusto Pinochet, perceived to reinstate stability and safeguard the interests of the industry.

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Paper Type: Perspective
Paper No. PES-2024- 01

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Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

Manufacturing

Another significant example of comprehensive government regulation was seen in the manufacturing industry under the policy of Import Substitution Industrialization (ISI). This economic strategy was meticulously conceptualized and developed by distinguished economists such as Raúl Prebisch, Hans Singer, and Celso Furtado. These economists argue that regulations were indispensable for establishing a domestic industrial base in a nation historically reliant on imports. They highlight the growth of certain industries, such as steel and textiles, during this period as evidence of ISI's success.

One of the rigid regulations imposed on the manufacturing sector required companies to secure "Government Approval" for any new investments or expansions. This measure aimed to control industrial growth and avert oversupply, which could potentially lead to price reductions and adversely affect profits. Additionally, the government instituted "Production Quotas" for certain goods, thereby limiting the quantity that companies could produce to safeguard local industries and mitigate competition.

The importation of raw materials and capital goods essential for manufacturing was also heavily regulated by the government. "High Tariffs" and "Import Licenses" were employed to make obtaining these resources both challenging and costly. Concurrently, the government provided "Subsidies" and "Tax Incentives" to industries deemed crucial for national development, while imposing significant taxes on industries not considered vital for national development.

These rigorous regulations resulted in a highly protected and controlled manufacturing sector, characterized by limited competition and innovation. Critics argue that this approach deterred efficiency and productivity, fostering a reliance on government support rather than market forces.

The combination of excessive government regulation and import substitution industrialization (ISI) policies had a profound impact on the manufacturing business. This led to an increasing disaffection toward the populist regime. Many business leaders within the manufacturing sector perceived themselves as being heavily constrained and their concerns inadequately addressed by the government. Consequently, the manufacturing business began to align with political groups that advocated for a more business-friendly environment.

Agriculture

During the same period, the agriculture sector was extensively regulated by the government under the ISI strategy, reflecting a structured approach to economic management, which sought to foster domestic production and diminish reliance on imports. Stringent regulations were implemented to shield local producers and promote self-sufficiency.

A pivotal regulation was the control of land ownership. The government-imposed limitations on landholdings to prevent monopolistic practices and to ensure equitable land distribution among small-scale farmers. This represented a departure from the laissez-faire approach, wherein large landowners previously dominated agricultural production.

Furthermore, the government instituted production quotas and price controls to guarantee a stable supply and reasonable prices for consumers. These measures were designed to protect small-scale farmers from price volatility and curb inflation.

The use of agricultural inputs such as fertilizers, pesticides, and seeds were also rigorously regulated. Only state-approved inputs were allowed, and their usage was meticulously monitored to ensure quality and environmental protection.

Additionally, strict export controls were enforced to prioritize domestic consumption. Farmers were not permitted to freely export their products; any exports required government approval to safeguard the local market and sustain self-sufficiency.

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Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

Excessive regulation and import substitution industrialization (ISI) policies under the socialist government in Chile before 1973 precipitated widespread discontent within the agriculture sector. The implementation of strict price controls, production quotas, and restricted access to imported goods significantly impeded business operations and profitability. Furthermore, government-led nationalization and land expropriation intensified fears and uncertainty among agricultural landowners. As a result, leading agricultural corporations began supporting political groups that advocated for a more favorable business environment.

Financial Sector

The financial sector also supported the Chicago Boys, as their policies favored the establishment of a free-market economy and encouraged foreign investment. This resulted in the liberalization of financial markets and the opening of the economy to foreign banks and investors. This allowed for an influx of capital into the country and created opportunities for financial institutions to expand their operations and profits.

Before the ascendance of the Chicago Boys, Chile's financial sector encountered considerable difficulties, primarily due to the government's adversarial stance towards it. An illustrative example of how government regulation impeded productivity in Chile can be observed in the financial sector before the reforms implemented by the Chicago Boys.

The Central Bank of Chile, established in 1925, was entrusted with the critical responsibilities of managing the money supply and interest rates to stabilize the economy and control inflation. An example of excessive regulatory measures is the establishment of the Superintendency of Banks and Financial Institutions (SBF) in 1926. The SBF introduced an additional layer of financial oversight, regulating the banking sector by establishing interest rates and supervising foreign currency transactions. Furthermore, there were rigorous controls on foreign investment and capital flows, characterized by high tariffs on imports and restrictions on foreign enterprises. The nationalization of the banking industry in 1971, wherein all banks became government-owned, further restricted foreign capital influence.

While these regulations aimed to develop domestic industries and maintain economic sovereignty, they inadvertently led to a scarcity of competition and innovation within the financial sector, as well as obstacles to foreign investment.

These measures encountered resistance from the investment and finance sectors, resulting in reduced foreign investment, credit shortages, economic instability, and social unrest. The adverse environment fostered by these policies led to opposition from the business community, a loss of trust, and increased support for the opposition, ultimately contributing to the military's decision to depose the government.

Sergio de Castro: Fashioning Friedmanite Economic Policies for Business Growth

For instance, Sergio de Castro, a founding member of the Chicago Boys, was appointed as the Minister of Economy and was instrumental in implementing neoliberal economic policies. This facilitated a direct linkage between the business community and the Chicago Boys, enabling them to exert significant influence over policy decisions. De Castro was instrumental in executing the economic reforms, advocating for minimal state intervention in the economy. This ideology was favorably received by the business sector, as it facilitated greater operational freedom and reduced government oversight.

De Castro's policies, which included deregulation, privatization, and tax cuts, were perceived to be expedient for businesses, leading to improved profits and economic growth.

CSGEF
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

A program that significantly strengthened his affinity with the private sector was the privatization of state-owned enterprises. As a result of his policy, many state-owned enterprises were sold to private companies. One of the main reasons is that privatization allowed for increased competition and efficiency in the market, which was seen as favorable by the business community. By selling off state-owned enterprises, De Castro opened the market to private companies, creating a more level playing field for businesses to operate in. This led to increased investment and economic growth, which in turn benefited the business community.

Additionally, privatization also allowed the business community to acquire previously state-owned assets at a lower cost. This was a major incentive for businesses to support De Castro's policies, as it allowed them to expand their operations and gain more rheostat over the market.

De Castro's policies further strengthened his relationship with the business community, as they saw it as a chance for expansion and financial gain. The business sector actively supported and lobbied for these policies, recognizing the potential for business expansion and heightened influence this not only strengthened their economic power but also their political influence, as they were seen as key players in the country's economic development and securing a more substantial portion of its economic prosperity.

CSGEF
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

IV. The Shock Therapy

The strategy of economic shock therapy in Chile was implemented during the decades of 1970s and 1980s. This strategy, tantamount to neoliberalism and termed the "Chilean Project," was significantly shaped by the theories of Milton Friedman, a renowned economist, who significantly influenced Chile’s economic policies during the 1980s. His theory emphasized free-market principles and minimal government intervention. Friedman advocated for laissez-faire policies, emphasizing that markets should operate with minimal interference. He believed that free markets lead to efficient resource allocation, innovation, and economic growth. Friedman supported monetary stability through a fixed exchange rate or a Currency Board System. This translated into a commitment to controlling inflation and maintaining a stable currency. Friedman endorsed privatizing state-owned enterprises to enhance efficiency and competition. The Chicago Boys implemented privatization measures in Chile, selling off nationalized industries. Friedman advocated for decreasing government spending to avoid crowding out private investment. Chile's economic reforms seek to downsize the public sector. Friedman advocated liberal trade policies to boost exports and attract foreign investment. Chile has negotiated free trade agreements with other countries, enhancing its economic connectivity.

C S G E F
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

Origins of Shock Therapy: Inside the Chicago School of Economics

The Chicago School of Economics was the intellectual cradle of the Chicago Boyes. The Chicago School of Economics is a renowned and highly influential approach to economic thought that originated from the University of Chicago in the early 20th century. Notable thinkers like Milton Friedman and George Stigler helped shape its principles. Its intellectual foundations can be traced back to the same institution, known then as the "Department of Political Economy", which was spearheaded by prominent economists such as Frank Knight and Jacob Viner. This group of scholars emphasized rigorous theoretical models and quantitative analysis, making it distinct from other schools of thought at that time. They also advocated for laissez-faire policies and rejected government intervention in the economy. The Chicago School's ideas on free market economics, individualism, and competition have had a profound impact on modern economics, shaping policies and theories all over the world.

The shock therapy strategy, the economic liberalization plan implemented in Chile, during the 1970s and 1980 featured a Dramatic Element: the abrupt and drastic changes to the country's economic systems and practices. These swift transformations, executed with little forewarning or alerting, resulted in significant upheaval. The sudden removal of subsidies and trade barriers, coupled with the privatization of government-run businesses, led to substantial price increases for essential products and services, ultimately causing a jolt to the population.

Furthermore, the shock therapy strategy was implemented alongside austerity measures, which encompassed substantial reductions in social spending and public sector employment. These actions led to a decline in living standards for many Chileans and induced short-term social and economic turmoil. Nonetheless, proponents of the shock therapy approach contended that these sacrifices were imperative for the long-term stability and health of the economy.

Center for the Study of Global Economic Future

Paper Type: Perspective
Paper No. PES-2024- 01

Today, it remains one of the most influential institutions in economic education and research globally, with its teachings continuing to shape economic thinking and policymaking around the world.

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The Power of Shock: Transforming Minds and Economics

Psychological Shock Therapy also referred to as 'psychological intervention,' endeavors to elicit a sudden and intense emotional response to induce significant changes in behavior, attitude, or mindset. The method is ordinarily employed in the treatment of trauma. Equally, Economic Shock Therapy entails the implementation of governmental or international policies designed to "Rapidly" transform an economy through deregulation, privatization, and market liberalization. This strategy is often utilized in developing nations or during economic crises to foster growth and enhance efficiency.

Although these therapies may appear disconnected, they are unified by the underlying principle of 'shock,' which signifies *a sudden, disruptive change that has a profound impact*. Both approaches aim to create a "*Sudden Disruption*" to achieve the "*Desired Transformation*". However, improper execution can result in detrimental consequences. In psychological shock therapy, compelling an individual to confront trauma without adequate support can lead to further psychological harm. Similarly, economic shock therapy, if not accompanied by protective measures and safety nets, can exacerbate poverty, unemployment, and social unrest.

The shock element in the economic liberalization strategy implemented in Chile during the 1970s and 1980s, commonly referred to as Shock Therapy, was the sudden and drastic changes made to the country's economic policies and structures. The shock element came from the speed and magnitude of the changes, which were implemented without much warning or preparation. The sudden removal of subsidies and tariffs, as well as the privatization of state-owned enterprises, led to significant price increases for basic goods and services, causing a shock to the public.

The complex nature of these therapies underscores the necessity for meticulous planning and implementation, ensuring that the intended positive outcomes are realized while minimizing potential adverse effects.

CSGEF
Center for the Study of Global Economic Future

Paper Type: Perspective
Paper No. PES-2024- 01

Neoclassicism: The Economic Principles Behind Shock Therapy

Neoclassicism represents a school of thought within the economic theory that adopts a traditional and conservative stance on macroeconomic policies and the role of government in the economy. Emerging as a dominant economic philosophy during the 1970s and 1980s, it became known as the "Neoliberal Revolution" and considerably influenced policies of "Shock Therapy" during the transition from centrally planned economies to market-based systems in Eastern Europe and the former Soviet Union.

A central tenet of neoclassicism is the belief in the efficiency of free markets for resource allocation, advocating for minimal government intervention and the determination of prices through supply and demand dynamics. This philosophy underpinned the "shock therapy" approach, which sought to expedite the transition from a centrally planned economy to a market economy.

Privatization of state-owned industries played a significant role in this transition, involving the transfer of state enterprises to private ownership. The assumption was that the private sector would manage these industries more effectively and innovate more readily. Shock therapy" involved comprehensive deregulation and privatization of industries, removal of price controls, and liberalization of trade and investment.

[4] Jolt definition: a sudden feeling of shock, surprise, or disappointment. an event or development causing such a feeling

The neoclassical economic premise was that by withdrawing government control and allowing market forces to function unimpeded, the economy would promptly adjust and enhance its efficiency.

The removal of price controls and subsidies, another critical aspect of "shock therapy," allowed market forces to set prices and allocate resources. This often resulted in a rapid spike in prices, leading to economic shock and hardship for many individuals. Nonetheless, proponents of neoclassicism contended that such shocks were necessary to transition to a more efficient and sustainable economic system.

Neoclassicism also emphasized individual responsibility, positing that individuals should be accountable for their economic success or failure and that government should not provide extensive safety nets. Consequently, "shock therapy" often entailed the elimination of social welfare programs and a reduction in government spending, aimed at fostering self-reliance and entrepreneurial spirit.

The neoclassical approach and the principles of "shock therapy" have continued to influence economic policies, especially in the United States and other Western nations. The emphasis on free markets and limited government intervention persists as a cornerstone of many contemporary economic policies. Therefore, it can be concluded that neoclassicism served as the economic ideology behind "shock therapy," advocating for "*rapid market transitions through deregulation and privatization*", despite the adverse effects experienced by the population.

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Paper Type: Perspective
Paper No. PES-2024- 01

The Policy Mix of Shock Therapy

But What the Shock Therapy entail? Shock Therapy entailed a rapid and radical change in the economic setting, they included monetary stabilization, fiscal austerity, trade liberalization, deregulation, privatization, and social security reform. These measures were justified as essential responses to economic crises and promoters of growth. The Chicago Boys used this strategy during Augusto Pinochet's regime (1973-1990). Chile's economy was in shambles by the early 1970s, with hyperinflation, widespread shortages, and stagnant growth. The Chicago Boys, motivated by Milton Friedman's monetarist and free-market doctrines and other University of Chicago economists, urged a major economic reform.

The idea of *Monetary Stabilization* can be broken down into two main aspects, "Management of Inflation" and "Exchange Rate Policy". Management of Inflation refers to the primary objective of mitigating hyperinflation. This was achieved by the implementation of stringent monetary rules, effective management of the money supply, and reduction in government expenditure. The exchange rate regime of Chile initially pegged the Chilean peso to the US dollar intending to achieve currency stability and curb inflation. The enactment of *Fiscal Austerity* was an essential element of shock therapy, encompassing both "Cuts in Government Spending" and "Reforms to The Tax System." Significant cuts in government spending, such as reductions in subsidies and social assistance programs, have been implemented. The tax reforms aim to enhance efficiency and generate more money by simplifying and expanding the tax system. *Trade liberalization* was enacted through a process of "Tariff Reduction," whereby import tariffs were decreased and trade barriers were eliminated to foster competitiveness and promote global integration. Furthermore, by implementing "Export Promotion" policies aimed at stimulating exports, the economy can be diversified, reducing its dependence on copper.

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Paper Type: Perspective
Paper No. PES-2024- 01

Deregulation And Privatization required the "Privatization of State-Owned Firms." The objective of the extensive privatization of state-owned enterprises was to enhance efficiency and eliminate public sector dominance. "Labor Market Deregulation" was the second component of Deregulation and Privatization, which involved reforms to enhance the flexibility of the labor market. These reforms included changes to labor laws and a reduction in union power. Pension System Overhaul was an aspect of Social Security Reform. This necessitates the establishment of a privatized pension system in which employees contribute to individual retirement accounts that private pension funds manage.

Economic stabilization and growth, as well as efficiency, are among the benefits of shock therapy. Disadvantages are composed of social costs. The immediate effect of Economic Stabilization was a significant decrease in inflation and the stabilization of the economy. Growth and Efficiency were additional outcomes as Chile experienced substantial economic expansion, increased foreign investment, and enhanced efficiency in numerous sectors over the long term. Yet, the reforms resulted in significant social unrest, increased unemployment, and social inequality, which became an unintended consequence. The poor and working class were disproportionately affected by the reduction in social expenditure and labor market reforms.

Shock therapy in Chile is often mentioned as an instance of economic liberalization. The social costs and disparity it exacerbated are offset by its effectiveness in stabilizing the economy and spurring growth. The legacy of these policies remains a topic of deliberation among economists and policymakers. Still, despite its shortcomings, the Shock Therapy approach continues to exert a global impact on contemporary economic policies.

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Paper Type: Perspective
Paper No. PES-2024- 01

V. Resuscitating Friedman: Contemporary Applications of Free-Market Economic

The application of Friedmanite economic principles remains the subject of serious discussion and research throughout modern discourse. Critics argue that the "shock therapy" model has disproportionately benefited the affluent over the middle and lower socioeconomic strata, even though it has facilitated economic growth and development, as proponents argue. The economic prosperity of numerous countries, such as the United States, Singapore, and Hong Kong, has been stimulated by the principles of personal responsibility, minimal government intervention, and free markets, as accentuated by its advocates.

United States

Milton Friedman prioritized the efficacy of monetary policy in the US. His findings concerning the correlation between inflation and money supply, as well as the role of the money supply during the Great Depression, remain germane. Friedman enhanced the Federal Reserve's ability to tackle inflation by tying inflation to monetary policy rather than unions or monopolies. He challenged President Nixon's economy-wide price controls in the 1970s, which ultimately contributed to their removal. In 1973, military conscription was abolished because of Friedman's advocacy[5]. Friedman's perspectives have had an extended effect on economic thought and policy, despite not having been universally acknowledged.

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Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

[5] Friedman argued that conscription violated individual rights and amounted to involuntary servitude. He advocated for a voluntary military staffed by individuals who choose to serve.

Estonia

Milton Friedman exerted a profound influence on economic thought and policy extending beyond the United States. A notable example is Estonia, which, after achieving independence in the early 1990s, adopted a flat tax structure. Estonia's adoption of a flat tax structure in 1994 was inspired by the principles advocated by economist Milton Friedman, who championed tax simplification. Friedman posited that a flat tax system would eliminate complex tax codes, alleviate the burden on both taxpayers and the government, and stimulate economic growth. In pursuit of these objectives, Estonia implemented a 26% flat tax rate, aiming to foster economic expansion and attract investment. The simplicity of this system has subsequently led to increased tax compliance and a reduction in tax evasion. Nonetheless, some economists contend that a progressive tax system is more equitable and effective in addressing income inequality.

New Zealand

In the same vein, New Zealand's economic policies occasionally evidenced Friedmanite principles, which prized individual liberty and market-oriented reforms. Education voucher schemes were explored by educational regulators in the Republic of New Zealand to help with school choices. Although somewhat different from Friedman's proposals, the fundamental principle of empowering parents is consistent with his convictions. Friedman advocated promoting parental choice in selecting schools. He believed that competition among schools would yield better educational outcomes.

The primary goal of the Education voucher scheme was to give parents greater choice and control over their child's education, aligning with Friedman's belief in individual choice and a free-market system. Vouchers allowed parents to select the school that best matched their child's needs. Friedman also believed competition would foster innovation and improvement.

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Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

Introducing competition among schools was expected to motivate them to improve performance and attract more students, thereby raising the quality of education. However, opinions on the scheme's efficacy in New Zealand are mixed. Critics argue it has created a two-tier system, where wealthier families can afford better schools, limiting options for lower-income families. Some also say the voucher system has not improved overall educational outcomes but has instead perpetuated existing inequalities.

Hong Kong

The government of Hong Kong follows a laissez-faire economic policy, creating an atmosphere in which minimum government interference is necessary for free markets to flourish. Milton Friedman's theories and policies profoundly influenced Hong Kong's economic model by advocating for minimal government intervention and fostering market competition.

A fundamental pillar of Hong Kong's economic success lies in its free market system, wherein the government's involvement is substantially limited, thus enabling businesses to function with minimal interference. This approach, shaped by Friedman's ideology, underscores the importance of individual freedom and choice in economic decision-making.

Friedman also championed the elimination of trade barriers, contributing to Hong Kong's status as one of the most open and liberalized economies globally. This policy framework has facilitated the unrestricted flow of goods and services, thereby attracted foreign investment and stimulated economic growth.

Moreover, Friedman's conviction that competition drives efficiency and innovation is reflected in Hong Kong's economic policies. The region's low tax regime and business-friendly environment have drawn numerous multinational corporations, solidifying Hong Kong's position as a global financial center.

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Paper Type: Perspective
Paper No. PES-2024- 01

Carried out by Manmohan Singh during his tenure t as finance minister., despite strong opposition, he carried out several structural reforms that liberalized India's economy.

India

The economic reform in India was initiated by former Finance Minister Manmohan Singh during his tenure, with a particular emphasis on liberalizing the country's economy. This happened in the early 1990s and was greatly influenced by the principles of renowned economist Milton Friedman. Singh carried out multiple structural reforms that aimed to modernize and open India's economy. Friedman emphasized the importance of individual choice and limited government intervention in economic activities. These principles were evident in the economic policies carried out by Mr. Manmohan Singh in India at that time. Or greater market competition, thereby promoting efficiency and economic growth. Friedman's belief in the indispensability of free trade for economic development was reflected in the Indian government's decision to lower tariffs and open the economy to foreign direct investment.

C S G E F
Center for the Study of Global Economic Future
Paper Type: Perspective
Paper No. PES-2024- 01

One of the pivotal reforms enacted was the liberalization of trade and investment policies. This initiative aimed to diminish government control and foster greater market competition, thereby promoting efficiency and economic growth. Friedman's belief in the indispensability of free trade for economic development was reflected in the Indian government's decision to lower tariffs and open the economy to foreign direct investment.

Additionally, the privatization of state-owned enterprises was another component of India's economic reform inspired by Friedman's principles. He contended that government-run businesses often suffered from inefficiencies and resource wastage. Aligning with Friedman's advocacy for minimal government intervention, the Indian government, with guidance from the International Monetary Fund, commenced the divestment of state-owned companies and scaled back its economic role.

However, perspectives on the efficacy of applying Friedman's principles to India's economic reform are varied., certain economists contend that the reforms should have been more gradual and tailored to address structural issues within the economy rather than rigidly adhering to Friedman's principles. They argue that a one-size-fits-all approach may not have been suitable for a diverse and complex economy like India's.

Friedmanite Economics and the 2008 Financial Meltdown

However, this model has precipitated adverse societal outcomes. The relentless pursuit of profit and self-interest has marginalized the collective good and societal well-being. The global financial crisis of 2008 has further questioned the validity of Friedmanite Economics, with many attributing the crisis's severe impacts to deregulation and diminished governmental oversight. The 2007-2008 financial crisis was a global economic downturn marked by bank failures, a collapse of the housing market, and widespread credit interruptions. Deregulation advocates frequently cite the Gramm-Leach-Bliley Act (GLBA) as an important deregulatory legislation. The GLBA overturned elements of the Glass-Steagall Act, allowing commercial banks to conduct investment banking activities. Friedmanite economics—free markets, low government intrusion, and deregulation—influenced this. Proponents contend that deregulation promotes innovation, efficiency, and economic progress. Contrary to the consensus, there was no dramatic relaxation in regulatory constraints before the crisis. Over the decades leading up to the crisis, the financial sector underwent increased regulation. The Patriot Act, the Sarbanes-Oxley Act, and Regulation NMS all contributed to regulatory development. The elimination of Glass-Steagall did not result in significant deregulation. Even the Financial Services Regulatory Relief Act of 2006 failed to stop the trend of increased regulatory costs in the financial industry. While deregulation is frequently criticized, the financial crisis was complicated and involved many complex elements in addition to deregulation.

VI. Striking the Balance: Market Freedom vs. Government Regulation

A concise examination of contemporary economic theories reveals ongoing disputes, particularly centered on Friedmanite economics. Critics argue that while these policies can stabilize economies and promote growth, they often increase inequality and social instability. Debates continue over the balance between market freedom and government regulation, highlighting differing views on achieving economic stability and equitable growth. Monetarism, connected with economist Milton Friedman, arose as an alternative to Keynesian economics. It emphasized how the money supply influences economic results. Monetarists thought that managing the money supply might stabilize the economy; however, others questioned their simplistic assumptions and application during complicated economic events. Keynesian theory, which was popular in the mid-twentieth century, argued for government involvement to manage aggregate demand. Friedman questioned Keynes' beliefs, claiming that markets could self-correct without government intervention. He supported the Phillips curve trade-off between unemployment and inflation and the natural rate of unemployment. Paul Krugman has faced criticism for his interpretation of Milton Friedman's legacy, potentially influenced by his own biases. Krugman suggests that Friedman's ideas are outdated, but Friedman's contributions to economics remain significant and continue to influence policies aimed at achieving economic stability and growth. Friedman's ideas affected contemporary monetary policy debates and central banks. His hostility to 1960s and 1970s macroeconomic policies informed his stance on inflation and monetary management.

The effectiveness of the economic model associated with the Chicago School of Economics hinges on striking a delicate balance between individual liberty and societal well-being. The Chicago School champions individual freedom as a fundamental principle. It argues that when individuals are free to make economic decisions without excessive government intervention, they can maximize their own well-being.

Market mechanisms, according to this viewpoint, allocate resources efficiently. Entrepreneurs may innovate in open markets, consumers can choose, and workers can freely negotiate their contracts.

However, an overly emphasis on individual liberty can result in income disparity, exploitation, and negative externalities. A thriving economy must consider society's overall well-being. This involves issues like income distribution, public goods, and social safety nets. Critics contend that unchecked individualism might hurt vulnerable communities. For example, insufficient healthcare or education might stymie society's advancement. Balancing individual liberty and social welfare entails correcting market flaws (e.g., monopolies, information asymmetry) and meeting necessities.

The delicate balance can be observed in policies, such as investing in education, which yields benefits for both individual liberty (by equipping people with knowledge and abilities) and societal well-being (by cultivating a skilled workforce). Regulation is another domain that demonstrates this equilibrium. While it is crucial to minimize government interference, a certain level of regulation is necessary to prevent market failures and safeguard the public interest. Social safety nets, such as unemployment compensation and healthcare, maintain equilibrium by preventing individual losses from causing societal catastrophes.

The problems encountered in this endeavor can arise from the complexity of attaining the optimal equilibrium. Unintentionally, policies that prioritize one feature may hurt the other. Certain behaviors, such as pollution, have effects that extend beyond the individual. To achieve a balance between individual freedom and overall welfare, it is necessary to address the external factors that impact both. Decisions necessitate making choices that involve sacrificing one thing in favor of another. For instance, taxing the wealthy to fund social programs may limit their liberty. The Chicago School's economic model thrives when it acknowledges the interplay between individual freedom and societal welfare. Striking this equilibrium requires thoughtful policies that promote prosperity while safeguarding the common good.

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Paper Type: Perspective
Paper No. PES-2024- 01

VII. Conclusion

In wrapping up, our study of Chile's economy, with a focus on the Chilean Project and Shock Therapy, has offered perspectives into its historical and contemporary economic journey. It dissected the role of the Chicago Boys and evaluated the philosophy, implementation, and impacts of shock therapy, and its subsequent impacts. Furthermore, the Article explored how contemporary global economies have adopted Friedmanite-inspired free-market approaches by exploring contemporary applications of free-market economics in economies such as Estonia, New Zealand, Hong Kong, and India. It also examined the aftermath of these economic protocols when faced with the 2008 financial crisis. Finally, the Article underscores the necessity of finding the perfect equilibrium between unrestricted markets and government control to secure economic stability and fair growth.

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Paper Type: Perspective
Paper No. PES-2024- 01

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Established in Dubai, UAE, in 2021, the Center for the Study of Global Economic Future (CSGEF) is a multidisciplinary policy research organization scrutinizing the economic, geoeconomics, socio-economic, and systemic forces that bear upon the future of the economic system worldwide. The aim is to offer an extraordinary methodical perspective on the socio-economic and systemic forces that sustain the global economy's future.

For further details, email us: info@csgef.org or Call us at +971(04) 330 6898

CSGEF Research Unit
research@csgef.org

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