

# Shock Treatment in Chile: A Retrospective



Economics of Latin America - Case Study  
ECON 3235 Fall 2017, Darryl McLeod, Lecturer  
Presentation by Dana Nelson

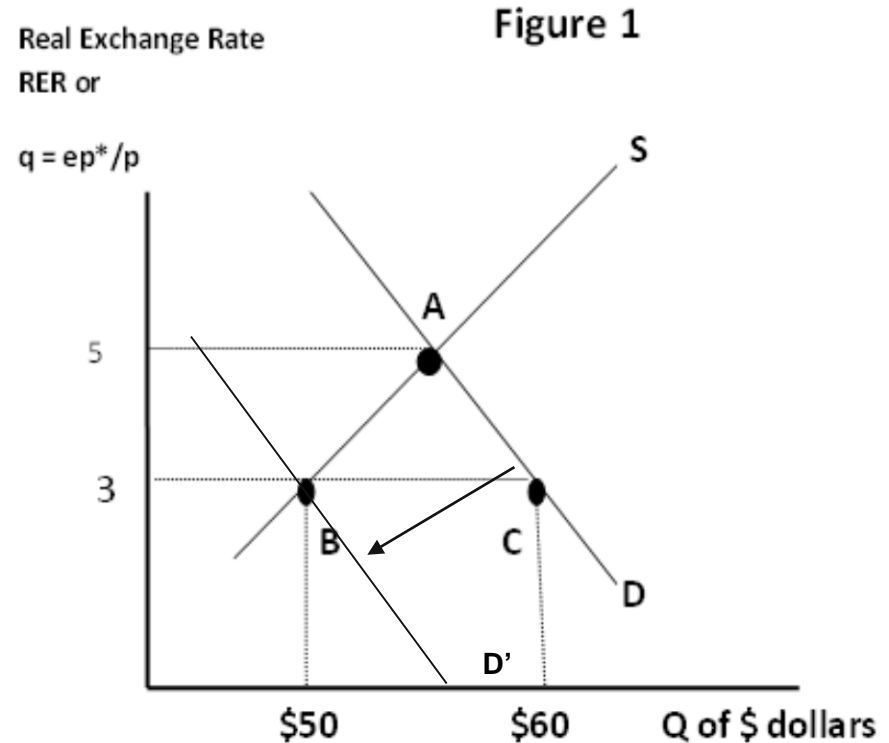
# Essential Points



- Shock Therapy initiated in 1977 “Chicago Boys”
- Shock Therapy ended in the 1982 Financial crisis
- Shock Therapy was not necessary to end inflation
- Heterodox policies have lower social costs
- Failure led to Chile’s redistribution with growth policies
- Aversion to shock therapy austerity still seen today in political movements and student protests

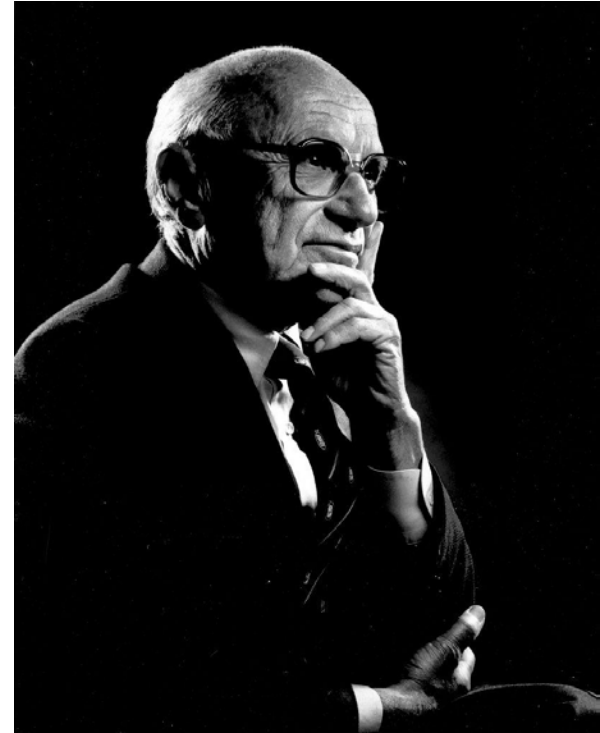
# What is Shock Therapy?

- Economic restructuring to decrease inflation through...
  - Economic stabilization
  - Liberalization
  - Privatization
  - Free trade
- Theoretical Origins
  - Milton Friedman (monetarist/orthodox)
  - Stabilization/demand-side economics



# Shock Therapy Western Influence

- Cold War initiative to promote capitalism and fight socialism - create radical market reform
- The “Washington Consensus” endorsed by the Bretton Woods Institutions (IMF, World Bank, etc.)



Source: Murrell, Peter. “What Is Shock Therapy?” *Post-Soviet Affairs*, vol. 9, no. 2, 1993, pp. 111–140,  
<http://econweb.umd.edu/~murrell/articles/What%20is%20Shock%20Therapy.pdf>.

Milton Friedman - Source: mises.org, 1998

# The Case of Chile: Precursors

- Allende - Socialist Policies
- '73 Coup - Pinochet
- US Involvement (Klein p. 78)
  - Copper Investment
  - ITT
  - CIA funds Chile's National Association of Manufacturers



*Sources: A&L 2017 pg 151, David-Hamel 2012 pg 81, Klein 2008 pg 78-80*

Source: [SBS](#), 2008

# The Case of Chile: Implementation

Chicago boy technocrats - “The Brick”

- Cut expenditures
- Eliminate price controls
- Privatize industries
- Immobilize organized labor



Source: [Tom Pepinsky](#) 2017

Source: David-Hamel 2012 pg 81

# The Case of Chile: 1982 financial crisis

- 1982 - debt crisis then massive devaluation; capital outflows of credit
- Shock therapy abandoned

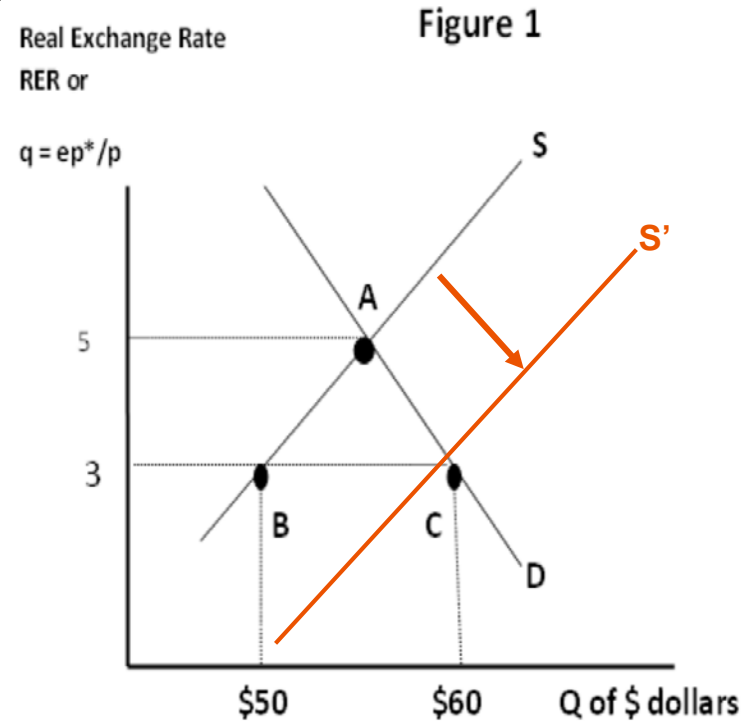
Source: IMF, World Economic Outlook Database, Oct 2017.

<https://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx>



# Alternative Heterodox Stbzl Policy

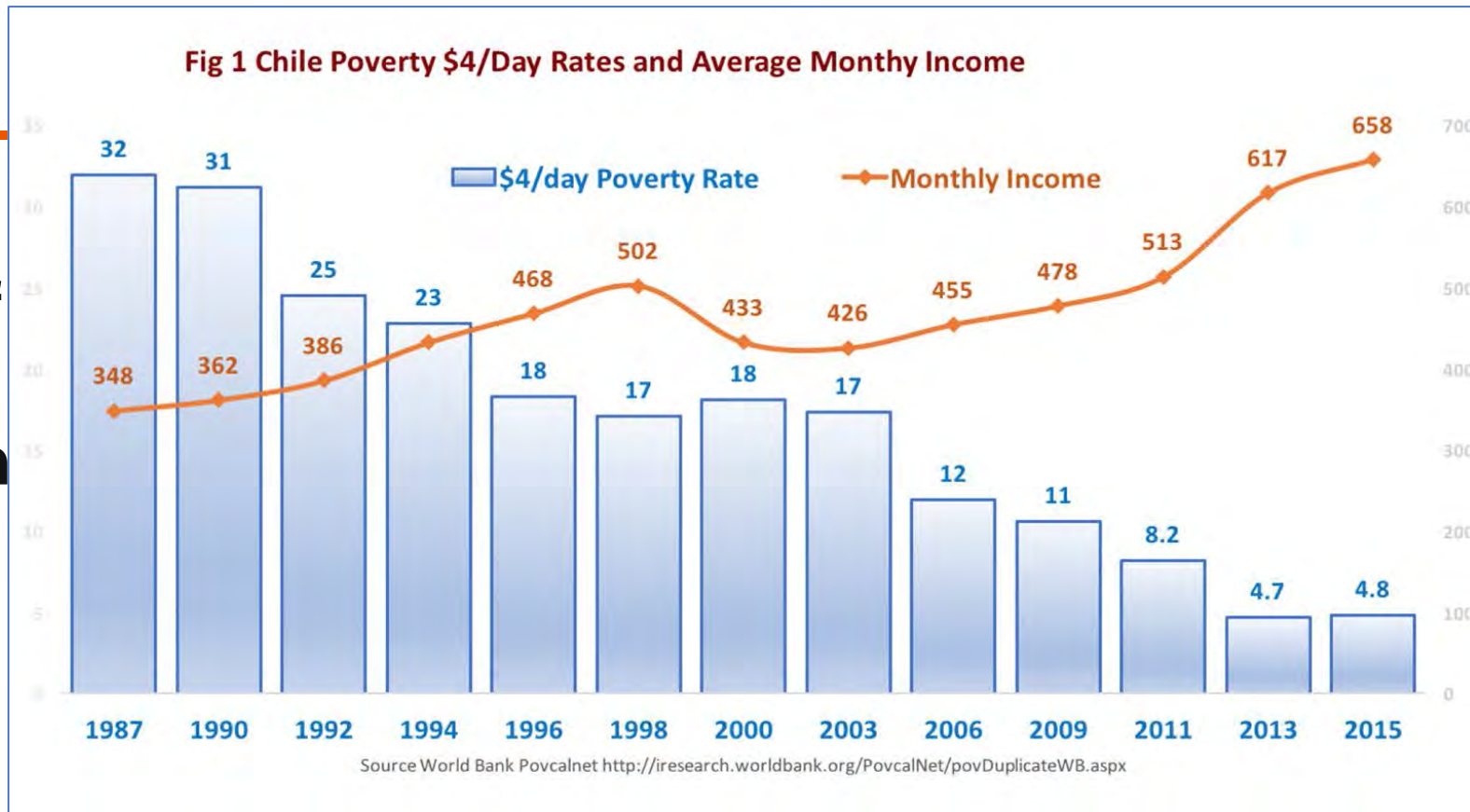
- Reducing inflation tax increases the demand for money,
- Wage and Price Controls gradual move to flexible fx rate
- Increase Productivity/Lower Costs,



Calvo, Guillermo A, and Carlos A Vegh. "Inflation Stabilization And Nominal Anchors." Contemporary Economic Policy, XII, 1994, pp. 35–44.



# Lasting Effects of Shock Treatmen Equity



# Lasting Effects of Shock Treatment: Equity



Source: International Monetary Fund, World Economic Outlook Database, Oct 2017, <https://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx>

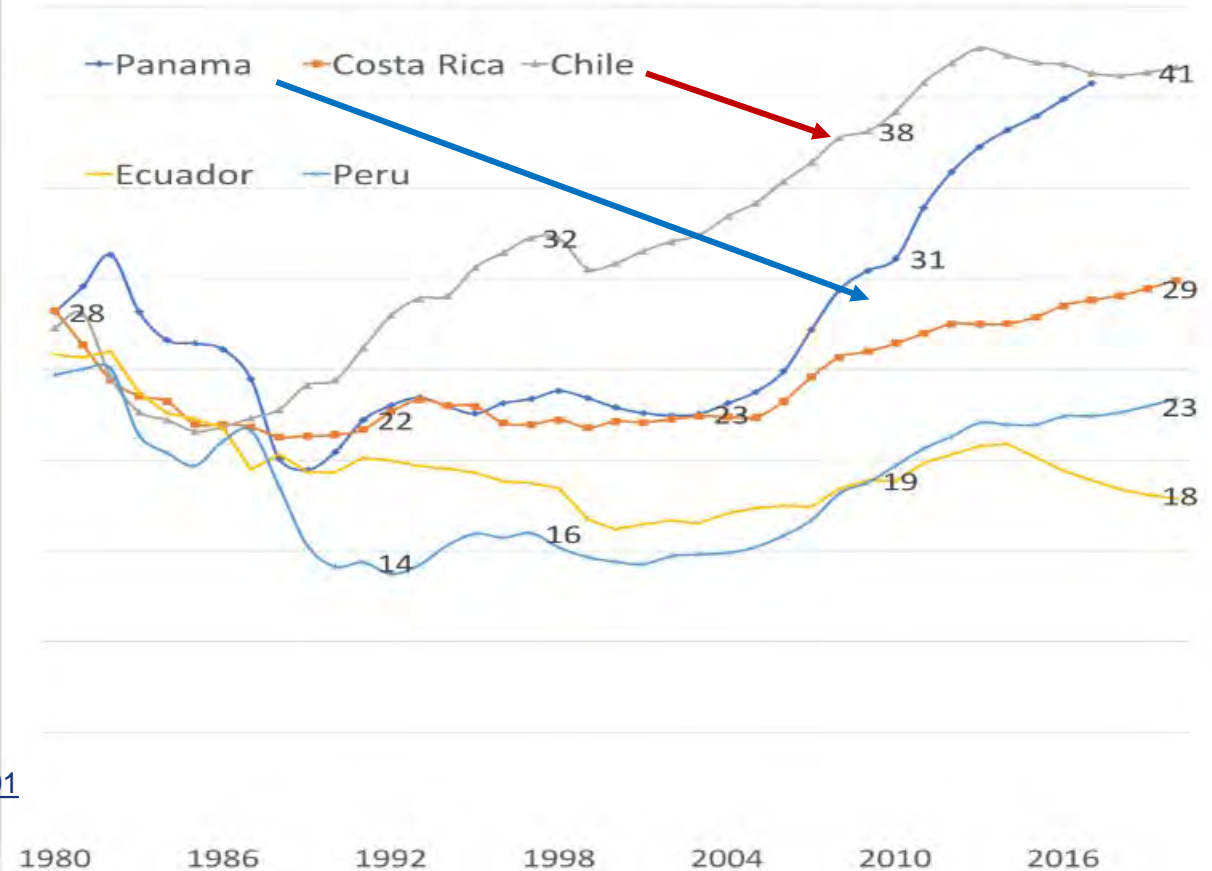
Figure 2 - Chile Inequality Measures



Source: World Bank Povcalnet, accessed 11/2017

# Lasting Effects: Growth

Figure WEO-1 Per Capita Income as a % of U.S.



Source: IMF, World Economic Outlook  
Database, Oct 2017.

<https://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx>

# Lasting Effects: Business

High ranking versus  
comparator countries  
which include the United  
States!!!

“Doing Business 2017: Economy Profile  
Chile.” International Bank for  
Reconstruction and Development, The  
World Bank, 2017.

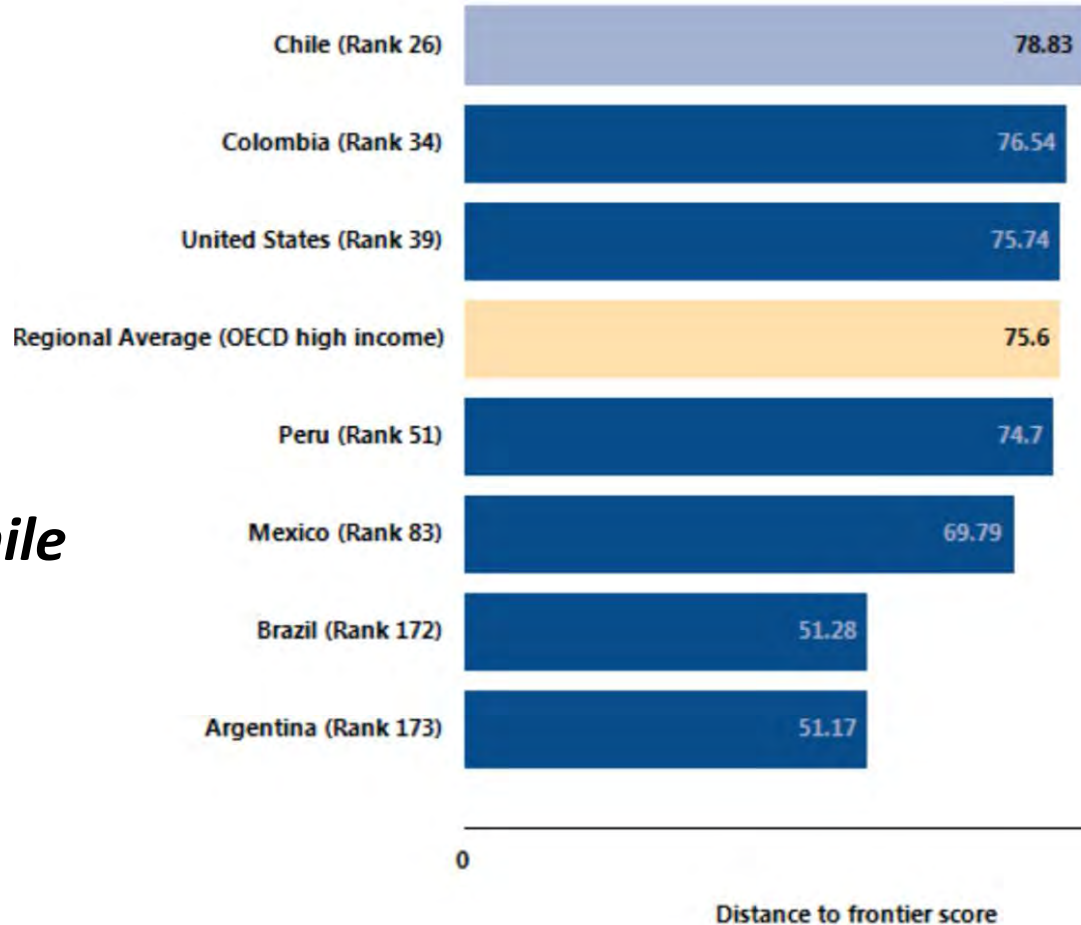
Indicator	Chile DB2017	Chile DB2016	Argentina DB2017	Brazil DB2017	Colombia DB2017	Mexico DB2017	Peru DB2017	United States DB2017	Best performer globally DB2017
Starting a Business (Rank)	59	56	157	175	61	93	103	51	1 (New Zealand)
Starting a Business (DTF Score)	89.84	89.84	73.56	65.04	89.57	85.74	85.01	91.23	99.96 (New Zealand)
Procedure – Men (number)	7.0	7.0	14.0	11.0	6.0	7.8	6.0	6.0	1.0 (New Zealand)
Time – Men (days)	5.5	5.5	25.0	79.5	9.0	8.4	26.0	5.6	0.5 (New Zealand)
Cost – Men (% of income per capita)	0.7	0.7	9.3	5.2	7.5	17.8	9.9	1.1	0.0 (Slovenia)
Procedure – Women (number)	7.0	7.0	14.0	11.0	6.0	7.8	6.0	6.0	1.0 (New Zealand)
Time – Women (days)	5.5	5.5	25.0	79.5	9.0	8.4	26.0	5.6	0.5 (New Zealand)
Cost – Women (% of income per capita)	0.7	0.7	9.3	5.2	7.5	17.8	9.9	1.1	0.0 (Slovenia)
Paid-in min. capital (% of income per capita)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0 (127 Economies*)
Dealing with Construction Permits	26	22	173	172	34	83	51	39	1 (New Zealand)



# Lasting Effects: Business

*It is easier to get a  
construction permit in Chile*

“Doing Business 2017: Economy Profile Chile.”  
International Bank for Reconstruction and Development,  
The World Bank, 2017.



# Lasting Effects: Current Political Landscape

## Presidential Election

- Sebastian Pinera - former president and billionaire (36% Nov '17 vote)
- Alejandro Guillier - backed by Bachelet
- Beatriz Sanchez - Frente Ampiloo
  - Combined 46% Nov '17 vote)



Photograph: Pablo Vera/AFP/Getty Images 2017

# Lasting Effects: Educational Reform

## Youth Movement

- Demands free higher education
- Resists neoliberal privatization of education system
- Reflects inequality of Opportunity



Source: [The Atlantic](#), 2011

# Summary of key Points

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- Shock Therapy was first implemented through the “Chicago Boys”
- Shock Therapy failed in Chile in 1982
- Shock Therapy wasn’t necessary (alternative heterodox policies reduced inflation more effectively in other Southern Cone Countries)
- Failure empowered social democratic policies in Chile which succeeded with redistribution with growth
- Aversion to shock therapy austerity still seen today in political movements and student protests, especially after



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International Monetary Fund, World Economic Outlook Database, Oct 2017, <https://www.imf.org/external/pubs/ft/weo/2017/02/weodata/index.aspx>

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