

## **Friedman's two visits to Chile in context**

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### **Abstract**

This paper will explore Friedman's two visits to Chile in March 1975 and November 1981. The press coverage, his interviews and the lectures Friedman gave, will be analyzed. Also, the Chilean context will be briefly considered. Although Friedman's 1975 visit has been widely discussed, a complete record of what actually happened has not yet been written. And his 1981 visit, just before the 1982 US recession, has been neglected. However, his last visit to Chile was particularly important as the recession was a severe stroke to the Chilean economy. It also put at risk the "Chicago Boys" influence and the economic liberalization process. And contrary to the generalized view, Friedman got more involved with Chilean affairs during his second visit.

### **1. Introduction**

Forty years ago, while Pinochet was in power, Milton Friedman visited Chile at the end of March, 1975. He accompanied his University of Chicago colleague and friend Arnold "Al" Harberger, who had a close and longstanding relationship with Chile. For six days Friedman participated in seminars and public talks, and gave some interviews for newspapers and magazines. Inflation in Chile had fallen from its peak of 606.1% in 1973, but was still a major problem in early 1975, reaching 369.2% during 1974. During his visit Friedman, together with Harberger and Langoni, had a forty-five minute meeting with Pinochet in which he recommended, among other measures, a dramatic decrease in the rate of the increase of the money supply to get inflation under control. Friedman later sent Pinochet a letter in which he outlined this and other policies (Friedman and Friedman, 1998, p. 399 and for the letter, see pp. 591-4).

The outcry and clamor that his first visit to Chile generated, has been much discussed and debated. It was, indeed, a visit with unanticipated and cumbersome consequences for Milton Friedman. In fact, more than twenty years after his visit, Friedman felt the need to set the historical record straight. In *Two Lucky People* (1998), he devoted a complete chapter to his polemical 1975 visit and its consequences, including an appendix with most of the available information (Friedman and Friedman, 1998, Chapter 24 entitled "Chile", pp. 397-408, and Appendix A, with Documents on Chile, in pp. 591-602).

In 1975 Friedman was an active public figure promoting economic freedom and monetary policy. And Chile had radically changed. Between 1970 and 1973, Salvador Allende, a Marxist President who had promised the "Chilean Road to Socialism", promoted and implemented socialist policies during his *Unidad Popular* government. The state took an overwhelming control of the economy and, after an economically successful 1971, in 1972 the economic situation began to spiral down into a severe crisis. On September 11, 1973 a military

coup overthrew Allende's government and the military Junta supported the liberalization of the economy following the "Chicago Boys" influence.<sup>1</sup> All this was done under a dictatorship that committed brutal crimes and abuses on human rights. The latter was the moral question that Friedman tried to face claiming that he had also advised other countries like China, Russia and Yugoslavia. Ironically, perhaps, his defense of a "free market democracy" also became the moral ground to criticize him. However, as it will be shown, while Friedman was in Chile, he was explicit about his commitment with free markets and democracy. Moreover, apparently his experience with Chile motivated him to adapt and improve his simple causal explanation between economic freedom as a necessary condition for political freedom (Friedman 1962, pp. 7-21).

The first part of this paper will deal with the context and events of his 1975 visit to Chile. The reactions and circumstances until his 1976 Nobel Prize award was announced, will be analyzed. Special attention will be given to his lecture "The Fragility of Freedom." His personal direct influence on Chilean events during his first trip has been exaggerated and overestimated. The second part will tackle Friedman's neglected second visit to Chile in November 1981, when he was invited to participate in the Regional Mont Pèlerin Society Meeting at Viña del Mar, a coastal resort near Santiago. The captivating economic issues and the intriguing political circumstances during Friedman's second visit, have remained practically unnoticed. Yet his second visit is not even mentioned in *Two Lucky People* (1998). However, his last visit to Chile was also controversial. It occurred just before the 1982 economic and financial crisis. As the US recession hit particularly hard the Chilean economy, the severe economic effects were politically perceived as a failure of the "Chicago Boys" policies. Therefore what Friedman said during his 1981 visit and right after the crisis, is relevant to understand this important and unexplored episode. In fact, contrary to the generalized perception, during his second visit Friedman played an active role supporting the Chicago Boys and the polemical fixed exchange rate. And Friedman improved, probably inspired by his experience with Chile, his account of economic freedom leading to political freedom. The paper will finish with some brief conclusions.

## **2. Context and consequences of Friedman's first visit to Chile.**

### **2.1. Brief account of the Chilean context<sup>2</sup>**

During the 1950s and 1960s the development theories promoted by the United Nations Economic Commission for Latin America (ECLA), were quite influential in Latin America. And particularly in Chile. It is not a coincidence that ECLA, established in 1948, was based in Santiago. Raúl Prebisch, who became the main political and intellectual force behind ECLA,

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<sup>1</sup> For an interesting and fascinating history of the "Chicago Boys" in Chile, see Valdes (1995).

<sup>2</sup> There is a huge amount of literature about the rise, fall, and aftermath of Allende and his Unidad Popular government. Collier and Sater (1996) presents an excellent and objective account of the historical context; Fernando (2013) focuses on the Allende's government and its context; Moss (1973) on the Marxist experiment; Valenzuela (1978) on some political aspects; and Larrain and Meller (1990, 1991) on the economic conditions under the Allende government. For a brief summary of the Chilean political and economic situation, see Caldwell and Montes (section 2, forthcoming).

lived in Chile and was buried there during Pinochet dictatorship in 1986.<sup>3</sup> Although dependency theories and import substitution theories actually have a rich previous history in economics, they provided the leading development paradigm for most countries in Latin America, including, of course, Chile. Besides, these economic ideas were also permeated by the widespread influence of Marxism.

These theories considered protectionism and planning as the two most important imperatives for development. In this context the project that would shape Chile's subsequent history, the "Chile Project," the cradle of the "Chicago Boys," was born. It had its origins in 1953 with Albion Patterson's *Plan Chillán*. This plan involved an agricultural development program for an area in the south of Chile. Through it, the first connections with the University of Chicago, specifically with Theodore W. Schultz, were established (see Valdes 1995, pp. 109-14). But the real and influential "Chile Project" actually began with the signing of a contract between *Pontificia Universidad Católica de Chile* and the Department of Economics of the University of Chicago in 1956 (ibid., pp. 115-26). The project was supported by the United States Agency for International Development (USAID). If Chilean history during the 1970s and 1980s may be seen as a political laboratory, as a reflection or even as a trophy of the cold war, the economic intellectual forces behind this period had developed well before the political and ideological struggle took place.

The program with Chicago included teaching support and financial help for a group of Chilean students. Best students would follow a postgraduate degree in Economics at Chicago, mainly MA's and later MBA's.<sup>4</sup> Due to the exchange program, almost a hundred Chilean students from Economics at *Pontificia Universidad Católica de Chile* would study at Chicago under tight economic conditions. But only six Chilean economists obtained a PhD in Economics at Chicago before 1973.<sup>5</sup> In the beginning, these Chilean economists trained in Chicago, the so-called "Chicago Boys",<sup>6</sup> were considered mavericks or simply a rare intellectual breed in Chile. In fact, these academics were not influential at all in the two administrations that preceded Salvador Allende. Their market oriented ideas were so radical at the moment, that not even the center-right candidate, Jorge Alessandri, gave them credit.

In the late 1950s, Chile was politically divided in three thirds: right, center and left. In 1958, Jorge Alessandri (1896-1986), with the support of conservative parties was elected President for the period 1958-64 with only 32% of the vote. Then Eduardo Frei Montalva (1911-

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<sup>3</sup> For his life and context, see Dosman (2008).

<sup>4</sup> See Rosende (2015).

<sup>5</sup> They are: Ernesto Fontaine ("The Sugar-Beet Industry in Chile: A Cost Benefit Analysis", 1964), Marcelo Selowsky ("Education and Economic Growth: Some International Comparisons", 1967), Rolf Lüders ("A Monetary History of Chile: 1925-1958", 1968), Ricardo Ffrench-Davis ("Economic Policies and Stabilization Programs: Chile, 1952-1969", 1971), Dominique Hachette ("Revaluation of the Escudo and Distribution of Income", 1973) and Sergio de Castro ("Differences in the Santiago Labor Market", 1973). Only Rolf Lüders, who would become Finance Minister during the 1982 economic and financial crisis, had Milton Friedman as supervisor.

<sup>6</sup> This name was apparently coined by Carmen Tessada, director of student's affairs at the Department of Economics at *Pontificia Universidad Católica de Chile*. She worked at the Department of Economics for more than 45 years and died in 2004.

1982), supported by his own party, the Christian Democrats, the United States,<sup>7</sup> and a broad spectrum of center right voters that feared Allende and the left, was elected for the period 1964-70 with an majority of 55.7% of the votes.<sup>8</sup> In 1970 Salvador Allende, as the leader of a left and center-left collation, run for his fourth presidential attempt. And in September 4, 1970, with 36.2% of the votes, he was elected as the first Marxist President. The relative majority required ratification by Congress. After tense negotiations, and attempts promoted by CIA to impede his accession to office, he was finally ratified on October 24, 1971. Ten days later, on November 4, 1973, Allende assumed power and his Unidad Popular government rapidly embarked on a number of controversial socialist structural reforms. Following the socialist program, copper industry was fully nationalized, the expropriation of land was drastically accelerated, and the state acquired an overwhelming control of the economy. To give an idea, by the end of Allende's government, approximately 85% of the financial sector belonged to the state (Larrain and Meller 1991, p. 188). And the state corporation *Corporación de Fomento de la Producción* (Corfo), a state corporation that promoted productive activities, expanded from owning 46 firms and no banks in 1970, to controlling 488 firms and 19 banks in 1973 (Edwards and Cox, [1987] 1991, pp. 95-8). Moreover, "[b]y mid-1973 the government fixed and monitored more than 3,000 retail prices, prices of all utilities, and all interest rates" (ibid., p. 102).<sup>9</sup>

In the peak of the Cold War period, the promotion and political defense of all these socialist measures was accompanied by a passionate and heated anti-imperialistic, anti-capitalist and anti-oligarchic discourse. The class struggle was an inspiring and underlying feature of the narrative followed by the Unidad Popular government. For example, in a famous and widely translated interview with French journalist Régis Debray, a controversial Marxist who had fought with Che Guevara and travelled from Bolivia to Chile after been released, Allende says; "Indeed, the people of Chile chose the road of revolution and we have not forgotten a fundamental principle of Marxism: the class struggle... As for the bourgeois State at the present moment, we are seeking to overcome it. To overthrow it!" (Debray, 1971, pp. 81-2).

The so-called "Chilean Road to Socialism" received wide international attention.<sup>10</sup> A Marxist president had gained power not by violent means, but using the democratic ballot box.

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<sup>7</sup> His political campaign received substantial financial support from the United States government and the CIA (Fernandois 2013, pp. 129-31 and p. 189). Under President Kennedy's "Alliance for Progress" Chile received additional funding, "around US\$720 million between 1961 and 1970, the largest amount, on a per capita basis, given to any Latin American nation" (Collier and Sater 1996, p. 310).

<sup>8</sup> Under President Kennedy's "Alliance for Progress" Chile received "around US\$720 million between 1961 and 1970, the largest amount, on a per capita basis, given to any Latin American nation" (Collier and Sater 1996, p. 310). And Frei Montalva's political campaign, with the motto "Revolution in Liberty," received substantial financial support from the United States government and the CIA (Fernandois 2013, pp. 129-31 and p. 189).

<sup>9</sup> To give a feeling on how the intellectuals in Chile believed in a central planned economy, it is worth reading the fascinating history of Cybersyn (Medina, 2001). The project was closely linked to Allende's aggressive nationalization process.

<sup>10</sup> As an example of the attention Allende and Chile were receiving worldwide with this unique and original democratic road to socialism, the interview with Debray was immediately translated into English, Italian, French and Dutch (*The Chilean Revolution. Conversations with Allende*, Verso, United Kingdom, 1971, and Pantheon Books, USA, 1971, *Entretiens avec Allende sur la situation au chili*, Maspero, Paris, 1971, *Salvador Allende. Der chilenische Weg*, Neuwied, Darmstadt, Berlin, 1971, *La via cilena. Entrevista con Salvador Allende, presidente del*

With the promise of a socialist Chile, an optimistic atmosphere emerged. Moreover, the Chilean economy experienced an unprecedented growth of 8.9% in 1971, inflation fell to 28.2% and unemployment reached a historical low of 3.8%. To the eyes of the world, Allende's socialist measures had fulfilled, and even surpassed, all expectations. People from around the world came to Chile to witness the successful and peaceful democratic transition to socialism. Even the skeptical Fidel Castro visited Chile to see this institutional and democratic revolution.<sup>11</sup> In sum, by 1971 the "Chilean Road to Socialism" appeared to be feasible and successful.<sup>12</sup>

But the economic success was not sustainable. The political and economic policies, fueled by public spending, resulted in significant increases in the fiscal and trade deficits, a decline in international reserves, and a large drop in foreign investment. To maintain its programs, the government began printing more money.<sup>13</sup> In 1972 the Chilean economy began to spiral down. And in 1973 the economic situation was seriously aggravated by scarcity and rocketing inflation. A high degree of political polarization in the Chilean society, explained by ideological tensions and further exacerbated by scarcity and the economic situation, led to manifestations and violence. As 1973 progressed, there was a massive transport strike. Several incidents of violence, from the right and the left, would promote intense civil unrest and intolerance. Following the "Road to Socialism", Chile had become a deeply polarized society. One side would blame "the enemies of the people", that is, the oligarchs, imperialists, capitalists and fascists, who were accused by Unidad Popular government of creating shortages for their own profit. And the other side would blame Allende and his Unidad Popular government for the evident economic failures of their Marxist ideology and socialist policies. As the economy spiraled downwards, the social and political atmosphere became severely strained:

"Families were divided: old friendships were strained to the breaking point: tempers were comprehensibly lost. It was a time when many of the traditional Chilean virtues, above all the virtue of *convivencia*, the ability to respect alternative points of view, seemed totally in abeyance" (Collier and Sater 1996, p. 355).

On March 5, 1973, former President Frei Montalva declared to *The Times* that Allende's government was "trespassing on the law or using it arbitrarily and contrary to its spirit, they have tried to impose this totalitarian *étatiste* model". He concluded that "Chile is following step by

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*Cile, con una prefazione, e un documento inedito del MIR*, Feltrinelli, Milano, 1971, and *De toestand in Chili - gesprek met Allende*, Bruna & zoon, Utrecht/Antwerpen, 1971). Extracts were also reproduced in several magazines around the world.

<sup>11</sup> Castro arrived on November 10, 1971. And although his visit was not supposed to be a long one, the Cuban dictator stayed for almost a month, between November 10 and December 4, 1971. At the end, with his long discourses, heated rhetoric, and open defense of an armed revolution, even his comrade Allende became uncomfortable (see Fermandois 2013, pp. 519-28).

<sup>12</sup> The Unidad Popular government promoted and publicized the initial economic success. For example, *The Times* published a full page advertisement celebrating the 1971 economic success of Allende's socialist measures (see "Chile – The Economic Achievements", *The Times*, May 22, 1972). In it, the causes of the economic success would be explained by "transferring control of basic means of production to the people." And Allende is quoted claiming "a rapid and frontal attack on the capitalist system's vices".

<sup>13</sup> As early as 1971, M1 increased by 119% (Larrain and Meller, 1991, p. 197)

step the path of Cuba.” (*The Times*, March 5, 1973).<sup>14</sup> In June 1973, the Chilean Supreme Court openly criticized Allende, stating that the country was facing “a crisis of the rule of law”. In August 1973, just a month before the military coup, inflation would reach an annualized rate of almost 1,000%.

Some socialists would perceive this situation as an opportunity for political consolidation, and even for an unavoidable armed revolution. For many political leaders, the “Chilean Road to Socialism” was simply a matter of “the primacy of politics.” For example, Pedro Vuskovic, who had been Allende’s minister of Economy from 1970 through 1972, thought that “Economic policy is subordinate, in its content, shape and form, to the political needs of increasing Popular Unity support...: a central objective is to widen support for the government” (quoted in Collier and Sater 1996, p. 346). And Carlos Altamirano, another prominent and influential socialist, launched his slogan *avanzar sin transar* (it can be translated as “move forward, without agreements or negotiations”). In sum, many members of the Unidad Popular government believed that the socialist revolution simply could not fail. And many members of the right thought that Chile was at the verge of a violent revolution that would lead to a civil war.

On August 22, 1973 the lower chamber of the Chilean Congress adopted a resolution accusing Allende’s government of breaking the laws and violating the constitution. This declaration blamed the Unidad Popular government for violating the laws and Constitution by attempting to gain “total power, with the purpose of submitting people to the strictest economic and political control of the state in order to attain a totalitarian system absolutely opposed to the representative and democratic system established by the Constitution.” The document concluded by urging the government to restore the rule of law. Given the tone and content of this declaration, Collier and Sater have argued that the resolution stopped “just short of advocating a coup d’état” (1996, p 356).<sup>15</sup>

In this strained political, economic and social atmosphere, the prospect of a coup was a reality. At the end of June, there was a naïve and unsuccessful coup attempt dubbed el *tancazo* or *tanquetazo*. And a few days later, on July 3, 1973, *The Times* published an article titled “Chile at a Standstill, Waiting for a Coup?” Moreover, on September 1, 1973, *The Economist* published an article entitled “Near the Road’s End” that began with the words: “Only Chile’s armed forces can halt that country’s slide into civil war.”

In early September, after negotiations between Allende and the Christian Democrats were not prospering, or simply had failed, some members of the government coalition were calling for the real proletarian revolution. And the right, for the military coup. Allende, well known and admired by his followers for his “political wrist” and his commitment for peaceful means, had lost control of the situation and of his own political coalition. Finally, on September 11, 1973,

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<sup>14</sup> Of course Friedman shared this concern of a totalitarian communist regime a la Castro. Moreover, when he recalls his public lectures entitled “The Fragility of Freedom” in Chile, he wonders whether they would have been censored during “the communist regime Allende was seeking, or Castro’s Cuba?” (Friedman and Friedman, 1998, p. 596).

<sup>15</sup> In fact, a member of the Navy wrote that this resolution was a condition that the armed forces needed for planning and executing the military coup (Huerta Díaz 1988, vol. 2, p. 80).

the three branches of Chile's armed forces (army, navy and aviation) and *Carabineros de Chile* (Chile's national police) joined to overthrow the government of Salvador Allende. "The Chilean Road to Socialism" came to an abrupt and bloody end with the symbolic bombardment of the Presidential Palace. After a tragic and emotional radio address, Allende committed suicide in his office at *La Moneda*. He used the machine gun that Fidel Castro had given to him after his visit to Chile.<sup>16</sup>

In this highly polarized atmosphere, the Christian Democrats were divided among those who supported the military coup and those who did not. But the majority welcomed the coup. For example, in an interview immediately after the coup, Patricio Aylwin - who was then leader of the Christian Democrats and would succeed Pinochet as Chilean first democratically elected President - gave some reasons, similar to those stated in the Congressional resolution, for his support of the "military intervention". He criticized the Allende government on a number of issues. First, for creating "the economic crisis, their attempt to retain power by any means, the moral chaos and destruction of the institutional framework, [which] provoked a collective despair and anguish in the majority of the Chileans that triggered the military action." According to Aylwin, "we are convinced that the so-called Chilean Road to Socialism, the flag that Unidad Popular promoted around the world, had completely failed." He also noted that "the organized militias of Unidad Popular, a parallel army that was heavily armed, had also planned a coup to get total power. We believe that the armed forces simply anticipated that risk, saving the country from falling into a civil war or a communist tyranny."<sup>17</sup>

The first months after the coup were particularly brutal and violent against communists, socialists and anyone linked to the left. Harsh political repression was established, the Constitution was abolished and Congress was closed. And the international press began reporting the abuses on human rights. Official reports, on what is a wound that still marks the Chilean republican history, account for 3,197 Chileans killed.<sup>18</sup> Some 20,000 Chileans were officially exiled and their passport was marked with an "L" and around 180,000 had to leave the country.<sup>19</sup>

During the Cold War, this situation was not unique to Chile. Several countries in Latin America already had dictatorships. For example, in South America, Bolivia, Brazil, Ecuador, Paraguay, Perú and Uruguay had military dictatorships. And Chile was neither the first country that implemented economic liberalization within a military regime that performed despicable human rights abuses.

Many Chileans who celebrated the military coup believed that it was a necessary transition or an emergency situation and that constitutional democracy would quickly return with

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<sup>16</sup> On Allende's suicide see Cavallo and Serrano ([2003] 2013, pp. 186-9) and Fermandois (2013, p. 768).

<sup>17</sup> The video of Aylwin's interview may be accessed at <https://www.youtube.com/watch?v=owtCH6XP6Qk>.

<sup>18</sup> Official figures account for 2,095 executed and 1,102 disappeared. At least 40,000 people were subject to political prison and most suffered ill-treatment or torture.

<sup>19</sup> I am indebted to José Zalaquett, a Chilean expert on human rights, for sharing these estimations. Most of the exiles went to Venezuela, Mexico, Argentina, Sweden and the RDA.

a call for elections.<sup>20</sup> But they were wrong. The military regime took control and embarked in a process of “reconstruction” that would last 17 years. And as Pinochet gained power within the military Junta, and human rights abuses persisted, the Christian Democrats became strong critics of Pinochet and the military regime.

Regardless the complexities of this period, the economic collapse left by Allende was, as Larrain and Meller conclude, “the failure of ideology” (1991, p. 212). Inflation reached 606.1% in 1973, shortages and scarcity were still a problem and the state control of the economy was not helping the fiscal accounts. Right after the coup, the military Junta did not have a clear strategy on how to tackle the severe economic situation. But after some months of uncertainty, the main objectives were to bring down inflation, remove price controls and gradually return the firms and farms confiscated by the Unidad Popular government to previous owners.

The initial liberalization process began with the support and influence of the “Chicago Boys”. They had already written the famous *El Ladrillo* (“The Brick”), a plan to liberalize the economy using free market policies.<sup>21</sup> Although their power and preeminence would reach its peak when Sergio de Castro became Finance Minister at the end of 1976,<sup>22</sup> apparently all leaders of the Armed Forces had a copy of *El Ladrillo* on their desks the day after the coup (Fontaine 1988, p. 20). Therefore, they were, since the beginning of the military regime, quite active. But not yet that influential.

In July 1974 Jorge Cauas, a well-respected Christian Democrat who had been Central Bank vice President under the government of Frei Montalva, was appointed Finance Minister.<sup>23</sup> With unusual powers, he faced an adverse situation as copper price, the main source of Chilean income, was quite low, oil prices were soaring and international creditors were concerned about the Chilean economic situation. At the internal level, unemployment was 9.1%, and though inflation was lower than the peak in 1973, it reached 369.2% in 1974. In this setting, Minister Cauas, supported by a group of young “Chicago Boys”, implemented the “National Recovery Plan” to tackle inflation and cut fiscal expenses. It would become known as the “shock treatment”. It was publicly announced on April, 24, 1975. As Friedman recalls:

“For the first year and a half, the generals did little with the proposals [*El Ladrillo*]. Instead, they put the military in charge of undoing the damage that Allende had done. Not surprisingly, the military were largely ineffective. In 1975, when inflation still raged and a world recession triggered a depression in Chile, General Pinochet turned to the “Chicago Boys” ... and appointed several of them to powerful positions in the government” (Friedman and Friedman, 1998, p. 398).

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<sup>20</sup> This, for example, appears to have been the case of former President Eduardo Frei Montalva (see Gazmuri 2000, pp. 851-71).

<sup>21</sup> *El Ladrillo*, with a foreword by Sergio de Castro, was published by *Centro de Estudios Públicos* in 1992 (see de Castro, 1992).

<sup>22</sup> De Castro, who was Finance Minister between December 31, 1976 until April 19, 1982, obtained his PhD in Economics at Chicago University in 1973 (cf. note 5).

<sup>23</sup> Jorge Cauas was a civil engineer who then graduated with a MA in Economics at Columbia University in 1961.

The “National Recovery Plan” was announced just a month after Friedman’s first visit to Chile. It marks the beginning of the economic liberalization process.

## 2.2. Milton Friedman’s 1975 visit in the press

Milton Friedman arrived to Santiago, Chile, with his wife Rose Friedman, Arnold C. Harberger and Carlos G. Langoni on Thursday, March 20, 1975.<sup>24</sup> They had been invited to Chile by *Fundación de Estudios Económicos*, a private foundation that depended from *Banco Hipotecario de Chile* (Friedman and Friedman, 1998, p. 398-9).<sup>25</sup>

The day after their arrival, on Friday, March 21, 1975, Friedman, Harberger and Langoni met with Pinochet in “a meeting that extended from 17:30 until 18:15 approximately” (*El Mercurio*, Saturday, March 22, 1975, cf. Friedman and Friedman, 1998, p. 399). *El Mercurio* also reports that on Friday and Saturday morning the three economists would meet with public and private representatives. Saturday afternoon they would travel to Viña del Mar, visiting, on their way, some newly “reformed” agribusiness in the area.<sup>26</sup> They would spend a night at the coastal resort, Viña del Mar, and on Sunday, Friedman gave his first lecture at *Universidad Técnica Federico Santa María*, returning to Santiago at night (*El Mercurio*, Saturday, March 22, 1975).<sup>27</sup>

During his visit, Friedman gave few interviews. The first came out in *El Mercurio* on Saturday, March 22, 1975. Friedman talked about the inflation problem in the US referring to the situation as a “retarded or continuous recession”. He also added that, following the status quo, inflation in the US would re-emerge. Friedman also refers to the concerns about an energetic crisis saying that there is no such a problem. He argued that it was simply a temporary crisis caused by the OPEC cartel. And he predicted that in the long run the arrangement to rise prices would play against the cartel as there was abundance of oil in the world. Friedman also referred to the international financial system, talked about growth and unemployment in the US and finally gave some ideas on the inconvenience of redistribution from rich to poor countries. But he did not say anything about Chile.

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<sup>24</sup> Carlos Geraldo Langoni was only 30 years old and had just finished his PhD in Economics at University of Chicago in 1970 (*A Study in Economic Growth: The Brazilian Case*). By then, he was sub-director of the School of postgraduate studies at *Fundación Getulio Vargas* in Brazil. Later he would become President and Chairman of Central Bank of Brazil from 1980 to 1983.

<sup>25</sup> *Banco Hipotecario de Chile* (BHC) had been founded in 1893 and in 1975 it was controlled by Javier Vial, head of the *Grupo Vial*, an important industrial and financial conglomerate that collapsed in the 1982 economic crisis.

<sup>26</sup> As during the agrarian reform nearly 10 million hectares had been confiscated, “reformed” probably refers to farms that had been already returned to their previous owners.

<sup>27</sup> According to testimonies of people who attended this lecture, he talked about inflation, monetary policy and the role of Central Banks. This lecture took place at *Escuela de Negocios de Valparaíso* in Viña del Mar, a private Business School related to *Universidad Técnica Federico Santa María*. Most possibly his relationship with Pedro Ibáñez Ojeda, member of Mont Pèlerin Society since 1969, senator of the Republic between 1961 and 1973, businessman and President of *Fundación Adolfo Ibáñez* that ran *Escuela de Negocios de Valparaíso*, influenced this trip to Viña del Mar. In fact, he was awarded an Academic Honorary Fellowship at *Escuela de Negocios de Valparaíso*.

Next interview was published on Sunday, March 23, in the front page of *El Mercurio*, with a picture of the three economists sitting together. Harberger complains about the delay of the Chilean economic to take off due to the excessive emission of money. Although the newspaper underlines that the three economists were “reticent” to speak about Chile before the seminar organized by *Fundación de Estudios Económicos* took place, Friedman finally talked about the Chilean situation. Asked by the journalist about Chile as “an ill country with an economic disease,” Friedman replies: “I can assure you that the patient is very strong. I think its disease is temporal and my diagnosis is that the patient suffers from a virus called ‘fiscal deficit’ with monetary complications”. And regarding the remedy for such illness, Friedman prescribed that “social market economy is the only medicine. Absolutely. There is no other. There is no other long term solution. No country in the world has been successful improving its economy using any other method that is not free market”. Then, when asked about its social costs, Friedman said:

”Undoubtedly there are costs. But unfortunately there is no other alternative. Anyway, I believe that the current situation is better than 18 months ago [the end of Allende’s government]. Possibly it could have improved more, but when the patient is ill, there is no easy solution. The oxygen, in this case, would worsen up the patient instead of curing him. The policy of a palliative instead of amputating the sick parts entails the danger of a final cost more critical that the one avoided. The alternative that Chile faces, in my view, is a high unemployment rate for a short or long period. When one is ill, you can only choose between a major or minor evil.”

Finally, when asked about whether the low price of copper was responsible for Chile’s economic stagnation, Friedman closes the interview with the catch phrase “Chilean problems are made in Chile” (*El Mercurio*, Sunday, March 23, 1975).<sup>28</sup>

On Monday, March 24, 1975 the seminars sponsored by *Fundación de Estudios Económicos* began. Langoni talked about reforms in Brazil on Monday,<sup>29</sup> Harberger, who had been in Chile three times during the last 9 months, gave his diagnostic about the Chilean situation on Tuesday.<sup>30</sup> On Wednesday Friedman closed the seminar with his assessment of the

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<sup>28</sup> It is worth noting that on that very same day *El Mercurio* publishes a summary of new policies and measures for the capital markets. It included the creation of a Monetary Council, the modification of the Banking Commission into a Financial Services Authority, and the promotion of transferring the property of banks to the private sector, among others. In sum, many pro-market measures were already being implemented before Friedman’s visit to Chile.

<sup>29</sup> Brazil had a military regime since 1964 and by the time of their visit, analysts would refer to the Brazilian economic miracle. Gross national product grew at 10% in 1974, and economic optimism in Brazil, where human rights were also an issue, was booming during 1975. In sum, Brazil was a model for the “Chicago Boys.”

<sup>30</sup> Harberger relationship with the Chilean economists trained in Chicago, the so-called “Chicago Boys”, was close and special. So was his relationship with Chile. He initiated and promoted the exchange between Chicago and *Pontificia Universidad Católica de Chile*, he got married to a Chilean, and he was advisor and friend of many Chileans economists trained in Chicago. As Valdés says, “he and his wife, Anita, a Chilean, opened their home to the Chilean students and bestowed on them affectionate attention” (1995, p. 155). At his 90 years he still keeps in touch with his friends in Chile.

Chilean Economy.<sup>31</sup> *El Mercurio* reported that he said that “The cause of inflation is always the quantity of money, which is the Chilean case”. He added that “the only way to finish with inflation in Chile is finishing drastically the fiscal deficit, preferably reducing public spending”. And he famously claimed that the country should choose a “shock treatment” like the one applied in Japan or Germany after the Second World War. This would imply “eliminating price and salary controls, strengthening fiscal situation to eradicate fiscal deficit, and keeping a strict limit on the quantity of money”. Friedman also called for “eliminating the 0’s from bills as a psychological measure, reducing fiscal deficit to 20 or 25%, and suppressing all restrictive measures that hamper the emergence of a strong and dynamic private sector”.

Friedman also gave interviews to two magazines (*Que Pasa* number 206, April 3, 1975 and *Ercilla* number 2070, April 4, 1975). In *Que Pasa* the cover front page is entitled “*Raquetazos en la Política Económica*” (“Tennis strikes in Economic Policy”) and Friedman appears playing tennis at the Sheraton Hotel in Santiago. The article begins stating that the “experts” had met with official members of the economic team, members of the military regime and executives of state owned companies. It is also reported that the Chilean “shock treatment” to reduce inflation was already in course as a consequence of an “internal analysis.” Moreover, it is advanced that the “shock treatment” was going to be similar, but softer than the harder one proposed by Friedman, Harberger and Langoni.

This is important. It has been generally assumed that the “shock treatment” was inspired and implemented by Friedman. If the former is true, there is no evidence for the latter. The “National Recovery Plan” had already been developed by a group of Chileans, mainly “Chicago Boys” certainly inspired by their Chicago economics education. In fact, when Friedman wrote a letter with his recommendations to Pinochet on April 21, 1975, Pinochet replies on May 16, 1975 saying:

“The valuable approaches and appraisals drawn from an analysis of the text of your letter coincide for the most part with the national Recovery Plan proposed by the Secretary of the Treasury, Mr. Jorge Cauas. The Plan is being fully applied at the present time – a plan for which we have high expectations of advancing the Chilean economy” (Friedman and Friedman, 1998, p. 594).

As already mentioned, the plan was publicly announced on April, 24, 1975, just a month after Friedman’s visit to Chile. But it had already been developed in Chile by the “Chicago Boys.”

The article at *Que Pasa* follows summarizing the three experts’ proposals. For Harberger the problem was inflation occasioned by monetary expansion due to a huge fiscal deficit. He called for an effort postponing expenses, adjusting the tax system to collect more money, cutting fiscal expenditure and increasing government income taxing certain products like oil. Friedman underlined that inflation was a problem of printing money, stressing that it was a Chilean problem that could not be solved gradually, but only through a “shock treatment”. He insisted suggesting the psychological measure of eliminating zeros from bills, liberalizing the capital

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<sup>31</sup> Friedman’s talk with the questions from the public and his answers, are published in Friedman et al. (2012, pp. 17-62).

markets, and promoting labor mobility and exports growth. Langoni appealed to the Brazilian example, a country that had already followed the “shock treatment” generating the “economic miracle”. His proposals were tax reforms, creation of capital markets and opening up to the foreign market.

*Que Pasa* also discloses some of the economic policies that had already been agreed. A column by Emilio Sanfuentes entitled “Langoni, Harberger, Friedman” follows, finishing with Milton Friedman’s interview.<sup>32</sup> In the introduction, Friedman is referred as “the father of the Chicago School” and “a staunch supporter of free markets that travels around the world propagating his ideas. Chile was no exception. As a physician that studies a serious illness, Friedman is interested in the causes of Chilean Inflation.” Friedman then declares that inflation “is a subject that has always concerned me, and I was especially curious for visiting a country where inflation goes through a really serious period”. After some questions about his differences with Galbraith and Samuelson, his “reactionary” free market position, the role of “the powerful” in the market, the Soviet Union and his opinion on the economic situation in the US, only the last two questions refer to Chile. He defines the Chilean economy as a mixed economy that should become a market economy following the example of Hong Kong, Singapore or Taiwan. Finally the journalist asked Friedman if Chile is applying his economic ideas. He finishes the interview replying:

“My impression is that the government has taken numerous measures based on the economic theory of free markets. The question is whether they are sufficient, or if they have covered what is necessary to correct the nature and graveness of the situation. I think that when one has a grave illness, deep measures are needed to heal.” (*Que Pasa* number 206, April 3, 1975)

The interview with *Ercilla* is more critical and provocative.<sup>33</sup> It is entitled “*Los Consejos del Profesor*” (“The advices of the Professor”). Friedman asserts that the two challenges for Chile are inflation control and the establishment of a social market economy. It is interesting to note that the article discloses the advices Friedman would have given to Pinochet during the controversial meeting. Supposedly they were three:

1. Just worry about the internal situation and fix the economy so international investors will find a good soil to sow.
2. Chile is like a patient with a heart disease. No matter what is the temperature of the house, the disease will remain. Copper price can go up or down, but heart disease will continue.
3. With annual inflation of 400% no capital will flow into the country. The problem must be solved rapidly. Is like cutting a tail of a dog. You cut it at once or suffering is prolonged.

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<sup>32</sup> Emilio Sanfuentes was a relevant “Chicago Boy” who directed “*Centro de Estudios Económicos y Sociales*” (Center for Social and Economic Studies) and played a crucial role in the shaping and dissemination of *El Ladrillo*. He had an MBA at Chicago, and died in an accident in 1982.

<sup>33</sup> It was done by well-known Chilean journalist María Olivia Monckeberg, who opposed the military regime.

If inflation is stopped drastically, suffering will last three months before the economy takes off.

In the interview Friedman also talks about free competition in labor market, free international exchange, the elimination of price controls and privatizations. After a final long question, Friedman rebuts “silly question”. Then the article finishes with the journalist asking whether the Chicago School is the only solution, mentioning some alternatives like Paul Samuelson and Francois Perroux (*Ercilla* number 2070, April 4, 1975).

After a week in Chile, on Thursday March 27, 1975, Friedman flew with his wife Rose to Australia (*El Mercurio* Thursday March 26, 1975).

### 2.3. Friedman’s academic lectures

Besides his main talk at *Fundación de Estudios Económicos*, Friedman gave an academic lecture on inflation and monetary policy at *Escuela de Negocios de Valparaíso* (cf. note 27). But he also gave a polemical lecture entitled “The Fragility of Freedom” at the two most important Chilean universities. *El Mercurio* very briefly reports that on Tuesday Milton Friedman lectured on “The Fragility of Freedom” at *Universidad de Chile* (*El Mercurio*, Wednesday 26, 1975). The same lecture was given at *Pontificia Universidad Católica de Chile* on Thursday, March 26. In fact, regarding the latter, *La Segunda* reported that “in one of the central parts of his exposition he referred to the condition that economic freedom imposes upon political liberty, quoting historical examples” (*La Segunda*, March 26, 1975). It was also reported that he answered questions from the public.

In *Two Lucky People*, Friedman recalls both of his talks at *Universidad de Chile* and *Pontificia Universidad Católica de Chile*, and quotes part of his personal notes after the visit:

“I departed from the main theme of all the other talks which had to do with inflation and talked on the fragility of freedom, emphasizing the rareness of free societies... and the role in the destruction of a free society that was played by the emergence of the welfare state. The general line I was taking – which was that their present difficulties were due almost entirely to the forty-year trend toward collectivism, socialism and the welfare state, that this was a course which would hurt people not help them, and that it was a course that would lead to coercion rather than freedom – was, from their reaction, obviously almost completely new to them. There was an attitude of shock that pervaded both groups of students at hearing such a talk” (Friedman and Friedman 1998, p. 400).<sup>34</sup>

The attitude of shock among students and the little attention these two lectures received from the press, is not surprising given the political context.

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<sup>34</sup> Friedman’s notes about his visit to Chile were dictated and written on his stay at Fiji Islands, on the way back from Australia (Friedman and Friedman 1998, p. 631, note 5).

In the three available reproductions of this lecture, Milton Friedman affirmed that freedom is an extraordinarily unusual situation.<sup>35</sup> But what has been generally ignored is that, in his first reproduction in *Encounter*, he used Chile as an example of this fragility:

“There was first, the Allende régime with its threat of a left-wing dictatorship; and then a counterrevolution with the military taking over and a military junta established, which also is very far indeed from a free society. It, too, is an authoritarian society which denies the liberties and freedoms of the people in the sense in which Anglo-Saxon democrats conceive them” (Friedman, 1976, p. 9).<sup>36</sup>

Friedman also compared the economic situation of Chile to what was happening in Great Britain and New York. But there is some evidence that during his talks in Chile he was politically provocative regarding the current political situation. According to some witnesses, his usual argument of economic and political freedom, emerged during the talk and the questions. The causality argument might have certainly struck, as he recalled in *Two Lucky People*, many students in Chile (Friedman and Friedman 1998, p. 400).

Milton Friedman’s commitment with democracy and political liberty is out of question. In *Capitalism and Freedom*, Friedman had already argued that “... economic freedom is also an indispensable means toward the achievement of political freedom... The kind of economic organization that provides economic freedom directly, namely, competitive capitalism, also promotes political freedom because it separates economic power from political power and in this way enables the one to offset the other” (Friedman 1962, pp. 8-9). And this testimony by Deirdre McCloskey is another practical evidence:

“When [in the early 1970s] the Shah of Iran proposed to give the University of Chicago a large amount of money for a chair in Economics and sending to Chicago good grad students, a la Chile and Brazil (which agreements were made, remember, with *democracies*) Milton Friedman killed it. I was at the meeting. The expert-believing people were behind it. Milton said, ‘we can’t make such an agreement with a despot’. End of discussion” (quoted in Schliesser 2010, p. 188).

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<sup>35</sup> Milton Friedman recalls that “later gave essentially the same lecture under the title “The Fragility of Freedom” at Brigham Young University in December 1975, and published a revised transcript as “The Line We Dare Not Cross” in *Encounter*, November 1976, pp. 8-14. An excerpt was also published as “The Path We Dare Not Take” in *Reader’s Digest*, March, 1977, pp. 110-15” (Friedman and Friedman 1998, p. 631, note 7). However, a year after his visit to Chile, Friedman also gave this lecture at the University of Cape Town in March 22, 1976 (see Friedman 1976, pp. 3-10).

<sup>36</sup> The *Reader’s Digest* condensed version is similar in this respect: “Today Chile has lost its freedom and is governed by an authoritarian regime. Its problems had their origin, in my opinion, some 50 or 60 years ago, when Chile became one of the first countries to institute welfare-state measures... Allende, clearly seeking to turn Chile into a communist state, actually introduced very little... To control the people, the Allende regime threatened a left-wing dictatorship. A counter-revolution followed, at the end of which an authoritarian junta was established by the military. In either case, Chile lost its freedom” (Friedman 1977, pp. 110-1).

This is all consistent with a letter that Harberger sent, as Chairman of the Economics Department of the University of Chicago, to Stig Ramel, President of the Nobel Foundation, just two months after the Nobel Prize award to Friedman had been announced:<sup>37</sup>

“Our visit to Chile did not and does not in any way connote approval of the present Chilean government, much less of its repression of individual liberty and its imposition of restraint on free and open discussion and debate.

Mr. Friedman also showed his position very clear at the time by turning down two offers of honorary degrees from Chilean universities,<sup>38</sup> precisely because he felt that acceptance of such honors from universities receiving government funds could be interpreted as implying political approval.

Mr. Friedman also showed his concern by delivering a lecture on “The Fragility of Freedom” at both the Catholic University of Chile and the (National) University of Chile. He characterized the present government of Chile as one which was denying and curtailing freedom in many important ways, and expressed the hope that in the near future Chileans would once again enjoy a full measure of political and intellectual liberty” (Friedman and Friedman, 1998, p. 598)

Friedman’s defense of a “free market democracy” is actually one of the reasons why he was criticized once he visited Chile (see especially Letelier, 1976). In fact, Friedman was criticized for being inconsistent with his thought. Or for not raising his voice enough. However, if his voice was not louder against the Pinochet dictatorship and human rights abuses, there is evidence that he defended his position on political liberty.

In sum, Milton Friedman was first invited by his good friend Al Harberger, the real “father” of the “Chicago Boys”. Indeed, Harberger was “the most decisive figure in the project and in the constitution of the group of Chilean students” (Valdés, 1995, p. 134).<sup>39</sup> As a world-known economist and public figure who staunchly fostered the economic liberalization reforms, Friedman gave political support to the “Chicago Boys” with his visit. But even though he was an inspiration for the “Chicago Boys,” he was not directly involved with Chilean affairs. Moreover, he provocatively lectured on the “Fragility of Freedom.” Besides, after his visit to Chile, he wrote in his *Newsweek* column about “... the destruction of personal freedom in Chile, Argentina, and now India” (*Newsweek*, November 17, 1975, p. 90).

Therefore, the outcry after his visit to Chile certainly surprised him. Regarding the whole episode, Friedman bluntly concluded, with his common frankness and humor, that: “I never could decide whether to be more amused or more annoyed by the charge that I was running the

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<sup>37</sup> This letter was published in the *Wall Street Journal*, December 10, 1976.

<sup>38</sup> Most possibly the honorary degrees were offered by *Pontificia Universidad Católica de Chile* and *Universidad de Chile* as they both received state funding.

<sup>39</sup> Elsewhere Valdés says that if Albion Patterson, Theodore W. Schultz and Julio Chaná “can rightly be called the “fathers” of the contracts... the title of “father” of the Chicago Boys must be given in all justice to Dr. Arnold Harberger” (Valdés, 1995, p. 109).

Chilean economy from my office desk in Chicago” (Friedman and Friedman, 1998, p. 400). As we will see, he was probably more annoyed.

#### **2.4. Some reactions after his visit**

During his first visit to Chile, Milton Friedman was already a very prestigious economist and an important public figure. His weekly columns for *Newsweek* magazine (1966–84) were widely read. And they were quite influential. So were his public debates on current issues with Paul Samuelson. He was also advisor to Richard Nixon and, as he would say, “a republican with a capital R”. In the peak of the Cold War, his libertarianism extended well beyond his economic ideas on monetary theory. Moreover, he was a *vox populi* candidate for the Nobel Prize.

Just five months after his visit, the *New York Times* published a very critical editorial article of what was going on in Chile. It also reported that:

“But after many months of applying Prof. Milton Friedman’s monetary theories and harsh austerity programs, unemployment hovers around 20 per cent, industrial production fell off sharply for the first half of the year, foreign investment remains at a trickle and a fantastic inflation rate has only recently shown signs of slackening. There is unquestionably a worldwide Marxist campaign to blacken the junta and exalt the chaotic Allende regime, much of it carried on by governments even more oppressive than the one headed by Pinochet” (“Two years of Pinochet”, September 22, 1975).

This final sentence, within the context of Friedman’s visit and its consequences, has been ignored. And there is truth in it. What Allende and his Unidad Popular government had represented to the left - a novel, democratic and original constitutional or institutional road to socialism - and what Friedman represented in political terms, made him a perfect and prized target. Besides, calling international attention for human rights abuses in Chile, the purpose of the campaign against Friedman was also to discredit the economic policies implemented during the Pinochet military regime, and to attack Friedman, a public economist who represented a libertarian stance and was considered a conservative and right wing economist. But all the conditions for a successful campaign against Friedman were not yet ready.

Ten days later after the editorial at the *New York Times*, Anthony Lewis wrote in the same newspaper an influential column about torture and repression in Chile, mentioning Friedman’s visit to Chile and directly linking him to the economic policies:

“[b]ut the repression may also be related to an economic policy that could not be imposed on a free society... The Chilean junta’s economic policy is based on the ideas of Milton Friedman, the conservative American economist, and his Chicago School. Friedman himself has visited Santiago and is believed to have suggested the junta’s draconian program to end inflation” (“For Which We Stand: II”, October 2, 1975).

On October 27, 1975 a letter from Friedman responding to a colleague who criticized his visit to Chile, was published by the *Wall Street Journal*. Friedman accuses a “curious double standard.” He recalls that his visits to the Soviet Union and a number of his trips to Yugoslavia to give economic advice did not generate any reaction.<sup>40</sup> They were both also totalitarian regimes, so he adds: “I approve of none of these authoritarian regimes – neither the Communist regimes of Russia and Yugoslavia nor the military juntas of Chile and Brazil”. Then he analyzes the situation with Allende, and asserts that:

“My impression is that the Allende regime offered Chile only bad choices: either communist totalitarianism or a military junta. Neither is desirable and had I been a Chilean citizen, I would if possible have opposed both... As between the two evils, there is at least one thing to be said of the military junta - there is more chance of a return to a democratic society. There is no example so far as I know of a communist totalitarianism developing into a liberal democratic society... The reason for the difference is not superior merit or demerit of the generals versus the commissars. It is rather the difference a totalitarian philosophy and society and a dictatorial one. Despicable though the latter is, it at least leaves more room for individual initiative and for a private sphere of life... to restore democracy hinges critically on the success of the regime in improving the economic situation and eliminating inflation” (Friedman and Friedman, 1998, pp. 595).

Friedman then recalls his two “talks on ‘The Fragility of Freedom’, in which I explicitly characterized the existing regime as unfree, talked about the difficulty of maintaining a free society, the role of free markets and free enterprise in doing so, and the urgency of establishing those preconditions for freedom. There was no advance or ex post censorship, the audiences were large and enthusiastic, and I received no subsequent criticism. Could I have done that in the Soviet Union? Or, more to the point, in the communist regime Allende was seeking, or Castro’s Cuba?” (ibid., pp. 595-6).

He finishes his letter arguing:

“Let me stress again. I do not approve or condone the regimes in Chile, Brazil, Yugoslavia, or Russia. I had nothing to do with their establishment. I would fervently wish their replacement by free democratic societies. I do not regard visiting any of them as an endorsement. I do not regard learning from their experience as immoral. I do not regard giving advice on economic policy as immoral if the conditions seem to me to be such that economic improvement

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<sup>40</sup> Throughout his life, Friedman continued insisting on this double standard argument. For example, after a three weeks visit to China, Friedman wrote in a column in *Newsweek*: “[y]et I predict with great confidence that Anthony Lewis will not use his column to berate me for giving economic advice to a Communist government” (entitled “A Biased Double Standard”, *Newsweek*, January 12, 1981). Then on October 27, 1988, in a Letter to *Stanford Daily*, Friedman recalls that in another recent trip to China he had a two-hour private meeting with Zhao Ziyang, the General Secretary of the Chinese Communist Party. And after comparing the Chilean and Chinese dictatorships, ironically wonders whether he should prepare “for an avalanche of protests for having been willing to give advice to so evil a government? If not, why not?” (Friedman and Friedman, 1998, pp. 601-2).

would contribute both to the well-being of the ordinary people and to the chance of movement toward a political free society” (ibid., pp. 596).

The same day of Friedman’s reply, on October 27, 1975, some students at Chicago created a “Commission of Inquiry on the Friedman/Harberger Issue” (ibid., 402). Soon after, student protests began at the University of Chicago. Though the protests included such things as picketing the apartment house where he and Rose lived, they were small and, according to the Friedmans, “... they were not very serious. However, they were the first of many during the next five years or so” (ibid., p. 402).

André Gunder Frank (1929-2005), a Marxist and revolutionary economist graduated with a PhD from Chicago in 1957, played an important role in the campaign.<sup>41</sup> Frank was a prolific, controversial and active Marxist economist married, as Harberger, to a Chilean socialist. He worked closely with Cuba and socialist Chile, and supported the Cuban revolution (Frank, 1969). Frank endorsed and promoted a radical Marxist dependency theory, favoring a revolution against capitalism to surmount underdevelopment in Latin America. His thesis of the “underdevelopment of development” was quite influential in the left during the late 1960s and early 1970s, but his revolutionary ideas were severely criticized from the political and intellectual left.<sup>42</sup>

Before Friedman’s visit, in August 1974, Frank had already written his first long open letter criticizing Harberger’s involvement with Chile (Frank 1974). He remembers the human rights abuses and crimes and finishes his open letter with the revolutionary slogan “Venceremos” (that is, the classical revolutionary call “We will win”, ibid., p. 75). In April 1976, Frank wrote his second open letter, but this time it was mainly directed against Friedman. He claimed that “the new policies were implemented by Pinochet as equilibrium on the point of a bayonet”, and that “Pinochet gave the Chicago Boys free reign over economic policy”.<sup>43</sup> Through his connections, Frank was an active promoter of the campaign against Friedman.

As protests and manifestations against Friedman somehow dwindled, on September 21, 1976, 44 years old Orlando Letelier was brutally assassinated in Washington DC. Letelier had been Allende’s ambassador in the US and held three different ministries during the last four months of Allende’s government. His car had a bomb and exploded at Sheridan circle, quite near to the Chilean Embassy. In the explosion, his colleague at the *Institute for Policy Studies*,<sup>44</sup> the American citizen Ronni Moffitt, also died. And her husband, Michael Moffitt, was seriously

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<sup>41</sup> He appears as graduated with a PhD from Chicago in 1957 (*Growth and Productivity in Ukrainian Agriculture and Industry from 1928 to 1955*), but the thesis is lost from Chicago Library. However, it was published at *Journal of Political Economy* in 1958. Most probably, Professor D. Gale Johnson, who is acknowledged in the opening footnote of his 1958 JPE paper, was Frank’s PhD supervisor at the Department of Economics at University of Chicago.

<sup>42</sup> For Frank’s personal account of his intellectual legacy, see Arestis and Sawyer (2000 [1992], pp. 186-195) and for an influential intellectual criticism of his ideas from the Marxist left, see Palma (1978, pp. 899-905).

<sup>43</sup> In 1976 Frank published *Economic Genocide in Chile: Equilibrium on the Point of a Bayonet* (Nottingham: Spokesman Books), which contains the open letters.

<sup>44</sup> Orlando Letelier was Head of the *Transnational Institute*, created in 1974 as a sister organization of the *Institute for Policy Studies*. Both think tanks were closely linked to socialism and the left.

injured. This crime attracted worldwide attention and censure, especially as the involvement of DINA, Pinochet's secret police, was suspected.<sup>45</sup>

Only three weeks before Letelier was killed, he had published, on August 28, 1976, an essay in *The Nation*, entitled "The 'Chicago Boys' in Chile: Economics 'Freedom's' Awful Toll" (Letelier, 1976).<sup>46</sup> This essay was widely reproduced and talked about after the brutal crime. It contained a severe criticism of Friedman and the "Chicago Boys" economic policies, labeling Friedman as "the intellectual architect and unofficial adviser for the team of economists now running the Chilean economy" (ibid., p. 137). Although Letelier, who was a socialist loyal to Allende, attempts to defend the economic legacy of the Unidad Popular government, his aim is Friedman, who is portrayed as the promotor of the "shock treatment" (ibid., 138). Moreover, Letelier cunningly refers to "the last known visit of Messrs. Friedman and Harberger to Chile" (ibid., 140).<sup>47</sup> And he also mentions and quotes André Gunder Frank "Second Open Letter to Milton Friedman and Arnold Harberger" (ibid. p. 142).

Then, on October 14, 1976, only three weeks after Letelier's assassination, it was announced that Friedman would receive the 1976 Nobel Prize "for his achievements in the fields of consumption analysis, monetary history and theory and for his demonstration of the complexity of stabilization policy".<sup>48</sup>

Within days of the announcement, the *New York Times* published a letter from two Nobel laureates, George Wald (medicine) and Linus Pauling (chemistry and peace), criticizing the award committee for a "deplorable exhibition of insensitivity" in giving him the prize. On the same day they published another letter, this one signed by laureates David Baltimore and Salvador Edward Luria (both in medicine), calling the award committee's decision "disturbing" and "an insult to the people of Chile" who were "burdened by the reactionary economic measures sponsored by Professor Friedman" (ibid., pp. 596-97).<sup>49</sup>

When Friedman went to Sweden to receive the prize in December 1976, there were multiple demonstrations, some rather large. He and his wife had police protection during their stay in Stockholm. After the military coup, many Chilean exiles were received in Sweden, so the Chilean contingent was prepared.<sup>50</sup> During the ceremony itself a protester dressed in black tie stood up and shouted "Down with capitalism, freedom for Chile" while Friedman was receiving the award. Vocal protests at his speaking appearances would recur over the next few years.

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<sup>45</sup> After a long and much followed investigation, DINA's involvement was finally confirmed almost two years later.

<sup>46</sup> *The Nation* was regarded as the flagship of the left.

<sup>47</sup> To my knowledge, only Hammond (2003, p. 142) has perceived this small but not inimical detail.

<sup>48</sup> Friedman received the Nobel Prize two years after Friedrich Hayek, with whom he shared an ideological and political position. In fact, Friedman attended the first meeting of the first Mont Pèlerin Society in 1947, becoming a founding and active member of the Society (on his role in MPS see Burgin, 2012). And most probably they talked about Chile in June 1977, when they both met in at the Hoover Institution just before Hayek's trip to Chile in November 1977.

<sup>49</sup> Although the letters were published on October 24, 1976, both were dated October 14, 1976, the same day Friedman's Nobel Prize was announced.

<sup>50</sup> According to private correspondence with José Zalaquett, an eminence in human rights in Chile, Sweden received some 30,000 Chilean exiles.

On December 14, 1976, only four days after the awards ceremony, Gunnar Myrdal published a controversial piece in the Swedish newspaper *Dagens Nyheter*, an English translation of which soon appeared in the American popular economics magazine *Challenge* (volume March-April 1977).<sup>51</sup> He began saying that Friedman's recent receipt of the Nobel Prize "has given cause for very unpleasant comments in many parts of the world and even in Sweden" (Myrdal 1977, p. 50). Immediately Myrdal criticized the Swedish Academy of Science for its secretive practices in choosing the recipient, a process that makes it difficult for any opposition to form prior to their recommendation. He also argued that, because economics is at best a "soft" science, the awarding of the prize had become a political act that should be discontinued. Myrdal then claimed that he avoided "saying anything about what I think about Milton Friedman as Nobel Laureate in economic science" (ibid.). But he also criticized Friedman's work from a methodological perspective, underlining that his theories "have had great political importance" so the Prize "becomes a political prize" (ibid., p. 51).<sup>52</sup> Myrdal ended the essay expressing regret that in 1974 he had accepted the award together with Hayek, as it was another political act. His excuse was that "I should have declined to receive it, particularly as I did not need the money but gave it away... But I had not then thought the problem through. I was merely disgusted. Also, the message reached me very early one morning in New York, when I was totally off my guard" (ibid., p. 52).

The issue became a public one. For example, on May 31, 1977 the *New York Times* published an article by Leonard Silk entitled "Nobel Award in Economics: Should Prize Be Abolished?" It begins summarizing the whole situation:

"The award of the Nobel Memorial Prize in Economic Science to Prof. Milton Friedman of the University of Chicago last October provoked a storm of criticism over Professor Friedman's right-wing politics, focused particularly on his willingness to give advice to the central bank and the post-Allende Government in Chile. This storm has been followed by a blast from an earlier Nobel Laureate, Prof. Gunnar Myrdal."

To sum up, the initial uproar against Friedman visit to Chile was further exacerbated by the brutal assassination of Allende's Minister and US Ambassador, Orlando Letelier, who had just written an essay criticizing Friedman's involvement with Chile. This was almost immediately followed by the announcement of Friedman's Nobel Prize in October 1976. These events intensified the many manifestation and reactions against Friedman. In this scenery, the campaign against the promoter of free markets gained momentum and would last almost all of his life. No wonder after more than twenty years after his visit to Chile, Friedman spent great care recalling all facts and details of the episode in *Two Lucky People* (Friedman and Friedman, 1998, Chapter 24 entitled "Chile", pp. 397-408, and Appendix A, with Documents on Chile, in pp. 591-602).

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<sup>51</sup> Friedman knew of the Myrdal piece soon after it was published in Swedish because Ole-Jacob Hoff sent him a letter summarizing its contents. Hoff's letter may be found in the Hayek collection, box 147.

<sup>52</sup> Myrdal was methodologically against the emphasis on "closed" models, regularity and causation that ignores "the role of values" (ibid., p. 51).

Regarding his first visit in 1975, the Chilean context has been either neglected or simply ignored. The focus has been mainly on the brutal figure of Pinochet, the unjustifiable crimes, the human rights abuses, and the “Chicago Boys” experiment. But all other factors seem to have been overshadowed. Chile was perceived, by the left and the right, the US and the communist regimes, as a kind of symbolic laboratory or simply as a political trophy during the Cold War. And Friedman certainly engaged in this ideological and political battle.

Friedman’s 1975 visit to Chile became an intense and cumbersome unintended episode in his public life. Even the joy of receiving the Nobel Prize was overshadowed.<sup>53</sup> However, almost nothing has been said about his second visit to Chile in November, 1981.

### **3. Friedman’s 1981 visit**

#### **3.1. Chile before Friedman’s visit**

After the 1975 implementation of the “National Recovery Plan,” dubbed as the “shock treatment,” inflation was slowly brought under control, but unemployment remained high (18% in 1975, 21.9% in 1976 and 18.1% in 1977). At the end of 1976, Finance Minister Jorge Cauas resigned and Sergio de Castro, the most prominent and emblematic Chicago Boy, assumed this important and powerful position. With his appointment, the influence and control of the “Chicago Boys” consolidated, extending their influence to the main government institutions. Almost immediately de Castro withdrew Chile from the Andean Pact – a trade agreement with Colombia, Peru, Bolivia, Venezuela, and Ecuador – and drastically reduced its high tariffs on foreign goods to a uniform 10%.<sup>54</sup> This simple and bold measure of opening up the Chilean market, triggered competition and promoted exports. In the long term, it had a significant impact on the efficiency and productivity of Chilean firms and a culture of free commerce.<sup>55</sup>

Privatizations had already begun during the first five years of the military regime. By 1978 all but one bank had been privatized. Moreover, in 1978 *Corporación de Fomento de la Producción* (Corfo), the state holding company that controlled 488 firms and 19 banks in 1973, had only 23 firms, of which 11 were in the process of being sold to the private sector (Edwards and Cox, [1987] 1991, pp. 95-98).<sup>56</sup> The opening up of the economy, the privatizations and the implementation of additional market-oriented reforms, finally led to clear signs of economic

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<sup>53</sup> It has even been argued that his Nobel lecture “can best understood in the context of the furore over Friedman’s association with the Chicago Boys’ activity in Pinochet’s Chile” (Schliesser 2010, p. 184).

<sup>54</sup> During Allende’s government “the average nominal import tariff was 105% with tariffs ranging from nil for some inputs and ‘essential’ consumer goods to 750% for goods considered as ‘luxuries’” (Corbo, 1993, p. 2) and “[at] the end of 1973 the average import tariff in Chile was 94%. In June 1979 it was 10% and covered all imported items, except cars” (Foxley 1980, p. 23).

<sup>55</sup> For example, in 2003, under socialist President Ricardo Lagos, Chile was the first Latin American country that signed a free trade agreement with the US.

<sup>56</sup> Codelco, the Chilean copper holding corporation, remained state-owned for “strategic” reasons (for more on the discussion of this issue within the Junta Militar, see Barros 2002, pp. 105-7, and Barros 2005, pp. 135-8). To avoid the international embargo on Chilean copper, at the end of 1974 the Chilean state had to pay a \$142.7 million compensation to the expropriated American firms.

recovery.<sup>57</sup> For example, between 1975 and 1981 the average annual growth rate was 7.3%. Chile was considered an example of the success of market oriented public policies. In addition, in September 1980 a new Constitution had been enacted. It included an article that called for a referendum in 1988. So a slow and gradual political transition towards a constitutional democracy appeared to have begun.

In 1981, the economic and political conditions in Chile were different compared to those of his 1975 visit. Also in the world. Margaret Thatcher became prime minister of the UK in May 1979. And Ronald Reagan, President of the United States in January 1981. As those countries could follow some of the economic policies already pioneered in Chile, this turn towards neoliberalism fostered the “Chicago Boys” *animal spirits*. But regardless the good spirits, the 1982 recession came as a shock.

### 3.2 Friedman’s visit to Chile in the press

Already in October 27, 1981, *El Mercurio* confirmed that Milton Friedman would attend the 1981 Regional Meeting of the Mont Pèlerin Society to be held in November 15-19, at coastal resort Viña del Mar.<sup>58</sup> Once again Friedman arrived in Chile, accompanied by his wife, Rose, on Sunday November 15, 1981 for another six days visit. Upon his arrival, Friedman declared that “there is no recession in the world,” making headlines. Although he explained there were different conditions in different countries, and therefore a worldwide concept of recession was not significant, the phrase got the front page of *El Mercurio* (Monday 16, 1981). On Tuesday, when asked about the Chilean economy, Friedman apologized as he “did not know enough about the Chilean economic situation” (*La Tercera*, Wednesday 18, 1981). But the day after, he gave a press conference and talked about Chile.<sup>59</sup> However, he began saying:

“I would like you to understand why I am in Chile. I am here to attend the Regional Meeting of the Mont Pèlerin Society, of which I have been founding member for 34 years. I am not here to give advice, neither to analyze the Chilean policies. I believe this country has been notably successful during the last years without my advice and I believe it will continue being successful” (*Ercilla*, November 25, 1981, p. 21)

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<sup>57</sup> Perhaps the most famous and emblematic of these reforms was the pioneering social security reform designed by Minister of Labor and Social Security José Piñera, which was enacted in 1980 and replaced a virtually bankrupt pay-as-you-go system with individual retirement accounts.

<sup>58</sup> Around 250 people attended the meeting. James Buchanan, Gordon Tullock, Arnold Harberger, Arthur Shenfield, Rose Friedman, Larry Sjaastad and Gottfried Dietze, among others, presented papers. The Meeting was promoted by Pedro Ibáñez Ojeda who was member of Mont Pèlerin Society since 1969 (for more details, see Caldwell and Montes forthcoming, pp. \*\*). The main papers of the Mont Pèlerin Society Meeting, including Friedman’s, were translated into Spanish and published in *Revista de Estudios Públicos*, volume 6, 1982.

<sup>59</sup> The press conference, that triggered questions from journalists and replies from Friedman for almost an hour, was fully published by *Ercilla* (November 25, 1981, pp. 21-7).

Even if he initially tried to disassociate himself from the Chilean situation, he ended up talking about Chile. The first question was about the relationship between a market economy and political democracy. Friedman replied:

“I believe that a free economy is a necessary condition for a politically free society; unfortunately it is not a sufficient condition. However, I think that a free economy will be difficult to maintain in the long term, unless it is accompanied by a politically free society” (ibid.)

This reference to Friedman’s causality argument between economic and political liberty could be interpreted as an endorsement of the transition that was included in the 1980 Constitution. But it can also be read as an extension of the causality condition between economic and political freedom, as will be argued in the next section.

Then, when he is asked about the fixed exchange rate in Chile, he explains the policy undertaken, the peg of the Chilean peso to the dollar, contrasting it with a free exchange policy that would demand a strict control of the quantity of money. When asked about state financial intervention – something that had recently happened in Chile – Friedman justifies it only to protect small deposits, but not shareholders.<sup>60</sup> He praised the American insurance system for small depositors and opposed to socialize the losses of owners. When asked about salaries – Chile had partial fixed public salaries – he replied that he endorsed free market for salaries. When asked about protection and subsidies for agriculture, he replied that they should be treated as any other activity, without special treatment. Friedman clarified that the US was in recession. And praised, with some caution, the Chilean fixed exchange rate (*Ercilla*, November 25, 1981, p. 21, see also *La Segunda*, Wednesday 18 and *El Mercurio*, Thursday 19, 1981).

The Mont Pèlerin Society Meeting opened with a reception and dinner on Sunday, November 15, the same day the Friedmans arrived to Chile. During the last day of the meeting, on Thursday November 19, one presenter celebrated the condition of an authoritarian government in Chile that permitted the implementation of a free market economy. *La Segunda* reported that Friedman emphatically intervened during this presentation arguing that the same reforms could be implemented under a constitutional or parliamentary democracy. It is also reported that he received an applause and ovation from the public (*La Segunda* Thursday 19, 1981 and see also *Hoy*, November 25, 1981, p. 27).<sup>61</sup>

Friedman’s paper was entitled “Monetary system for a Free Society” (Friedman, 1982, pp. 165-78).<sup>62</sup> But during his presentation Friedman did not talk about his paper. Instead, he

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<sup>60</sup> Recently two big banks (*Banco de Talca* and *Banco Español Chile*), four financial institutions (*Compañía General Financiera*, *Financiera de Capitales*, *Financiera Sur* and *Financiera Cash*) and two small banks (*Banco de Linares* and *Banco de Fomento de Valparaíso*) had been intervened on November 2, 1981 for taking “excessive risks.”

<sup>61</sup> The previous session, the first on Thursday morning, was chaired by Donald Kemmerer, and participants were Rose Friedman, Wolfgang Frickhoffer and Carlos Cáceres, who was dean of the Valparaíso School of Business. Probably Cáceres, who would become Central Bank President in September 1982, Finance Minister in February 1983 and Interior Minister of Pinochet in October 1988, made that remark.

<sup>62</sup> The English version was later published in Hoover (\*\*\*)

divided his intervention in three parts: the exchange rate issue in Chile, free markets and democracy and the difficult economic situation.

On Friday 20, 1981 *La Segunda* partially reproduced Friedman's intervention, skipping the political issue.<sup>63</sup> In his intervention we know that Friedman insisted that it was dangerous to affirm that an open and free market economy needed an authoritarian government, as it was also possible in a democracy (*La Tercera*, Friday 20, 1981). However, it is also interesting to understand Friedman's position on the fixed exchange rate and his opinion about the "difficult times ahead." He begins explaining the difference between "unifright" (sic.) or a pegged currency that fixes its currency with that of an important commercial partner. Friedman explains that it is the same as the gold standard or what Panama had done with the dollar pegged to its currency. He goes on claiming that Chile had found an "ambiguous solution" through its fixed exchange rate with the US dollar. He endorses the pegging, claiming that discretionary "pack exchange rate" (sic.) a la Bretton Woods "would lead to a softening of small problems at the cost of accumulating major problems". Instead, the pegged currency "would lead to more small problems, giving less opportunity for the emergence of bigger problems."

After skipping the second part of free markets and politics, the report jumps into "the difficult times ahead." Friedman claims that if the US monetary policy was bad, the one of smaller countries had been worse. He recalls that in Australia he recommend to peg the Australian dollar to the yen, not to the US dollar, first because Japan was Australia's most important commercial partner, and second, because Japan's monetary policy during the last 8 years had been better than that of the United States. For Chile he considers that pegging the Chilean peso to the dollar, as the US is the most important commercial partner, is the solution only if the monetary discipline is also accepted.

Friedman then asserts that the peg of the dollar at \$39 has been the decision adopted in Chile, and that he avoids "a judgment on whether it was the right policy or not." The main disadvantage, he argues, is that the local currency has significantly devalued and the economy rests on the monetary fluctuations of the US. So, he continues, one has to choose between the two alternatives: really fixed or temporally fixed. He considers a bad idea a pegged currency open to change, and endorses a fixed exchange that reflects credibility to the world. Chile, he says, "has lived three or four years of extraordinary economic success, but could lose credibility." Even if speculation against the Chilean peso might be strong, Friedman argues, he endorses discipline and external credibility. Friedman concludes that "there are difficult times ahead in order to adjust an overvalued currency, but that these difficulties can be temporary giving room to easier times." In sum, although he was more reluctant in the beginning, Friedman ends up clearly supporting the "Chicago Boys" policy of the Chilean peso pegged to the dollar.<sup>64</sup>

On Sunday November 22 *El Mercurio* presents some interesting interviews to William Hutt, Richard Hartwell, Anthony Fisher and Pascal Salin.<sup>65</sup> When Hutt declares that "we all have

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<sup>63</sup> As reported in the article of the newspaper, Friedman himself shared his presentation with *La Segunda* and authorized its publication.

<sup>64</sup> For an analysis of this policy, see Edwards (1984) and Edwards and Cox ([1987] 1991, pp.53-92 and 195-227).

<sup>65</sup> The interviews were done by prestigious historian Lucía Santa Cruz jointly with Pilar Molina.

a great concern for human rights, freedom of expression, of thinking and writing”, the journalists immediately and succinctly add: “[t]his was corroborated, besides, by the declarations made by Friedman and Buchanan in this direction” (*El Mercurio*, Sunday November 22, 1981). Given the political atmosphere, the latter was a brave and bold remark. And it also reflects Friedman’s and Buchanan’s position on Pinochet’s dictatorship and human rights.<sup>66</sup>

Finally, the Chilean magazine *Hoy*, that promoted open opposition to the military regime, shows Friedman leaning out a door advertising “Friedman in Viña del Mar: The neo-liberal coven.” It carries an interesting article entitled “The coven at Viña del Mar” (*El aquelarre de Viña del Mar*, *Hoy*, November 25, pp. 26-30) that confirms many of the points already discussed.<sup>67</sup>

After a week in Chile, Milton Friedman with his wife Rose left the country on Sunday November 22, 1981. It was their second and last visit to Chile.

As a final detail, it is interesting to note that while Friedman was involved in organizing General Meeting of the Mont Pèlerin Society at the Hoover Institution, at Stanford University in Palo Alto, California in 1980, he wrote a letter to Manuel Ayau, then President of the Mont Pèlerin Society. We don’t know the content of this letter, but there is a letter from Manuel Ayau to Pedro Ibáñez dated April 28, 1980 in which Ayau notes a “problem” regarding the upcoming meeting in Palo Alto.<sup>68</sup> In the letter he explains to Ibáñez that though Sergio de Castro had been invited to participate as a guest, the organizing Committee had decided to “disinvite” him. Although invitations would still be sent to other people whom Ibáñez had recommended, including Jorge Cauas, Pablo Barahona and Carlos Cáceres, Ayau explained to Ibáñez that he “had agreed with Milton Friedman not to invite people currently in government positions”, which would exclude Sergio de Castro, who was Finance Minister by then. The leadership of the Mont Pèlerin Society, in particular Milton Friedman, wanted to avoid any pretext for demonstrations when the Society’s meetings were held at the Hoover Institution and/or make it clear that the Society did not support the Pinochet regime.

### 3.3. Friedman on economic and political freedom

In his first interview in Chile Friedman expanded his causality argument of economic and political freedom adding that “I think that a free economy will be difficult to maintain in the long term, unless it is accompanied by a politically free society” (*Ercilla*, November 25, 1981, p. 21). In *Capitalism and Freedom* (1962) Friedman had already expressed the causality argument

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<sup>66</sup> **Lucía Santa Cruz attended the Mont Pèlerin Society Meeting...**

<sup>67</sup> It also reports that during Milton Friedman’s previous visit to Peru, he was confronted by Mario Vargas Llosa, an influential liberal who was awarded the Nobel Laureate in Literature in 2010. Vargas Llosa asked him whether he had any moral doubt witnessing that his theories were generally applied in countries with authoritarian regimes. According to the report, Friedman replied “No. I don’t like military government, but I seek the less evil” (*Hoy*, November 25, p. 27).

<sup>68</sup> The letter is in the files of Pedro Ibáñez’s correspondence. I am grateful to Adolfo Ibáñez Santa-María for facilitating access to the Pedro Ibáñez archives.

clarifying that it was not a sufficient condition, as there can also be economic freedom without political freedom:

“History suggest only that capitalism is a necessary condition form political freedom. Clearly it is not a sufficient condition. Fascist Italy and Fascist Spain, Germany at various times in the last seventy years, Japan before World War I and II, tzarist Russia in the decades before World War I are all societies that cannot conceivably be described as politically free. Yet, in each, private enterprise was the dominant form of economic organization. It is therefore clearly possible to have economic arrangements that are fundamentally capitalist and political arrangements that are not free.” (Friedman, 1962, p. 10)

As history showed there could be an authoritarian regime and economic freedom, Friedman only argued that necessarily free markets would lead to democracy. Certainly Chile was another example of an authoritarian regime that promoted economic freedom, but not political freedom. Therefore, in his press conference, Friedman makes the case that “a free economy will be difficult to maintain in the long term, unless it is accompanied by a politically free society.”

José Rodríguez Elizondo, a communist during the Allende regime, interviewed Friedman right after his visit to Chile, in Perú (*Caretas* 673, November 16, 1981).<sup>69</sup> But after the interview, Rodríguez Elizondo maintained some interesting correspondence with Friedman. When he sent a copy of the magazine issue with his interview, Friedman replied. And after thanking Rodríguez Elizondo for his letter, Friedman added:

“I write, however, not merely to say that, but also to pass on some views about the situation as I found it in Chile. On the basis of what I found there I felt impelled to say while I was in Chile, in a press conference with the news media, that Chile would not retain its present economic freedom unless it ended the military form of government and did establish a more democratic government. That, as you will realize, did not take a great deal of courage in the present situation in Chile since the military government has announced its intention to terminate its hold and to return the country to a more democratic form of government, and hence I was able to precede my remarks by saying that I applaud the government for announcing that intention and I trust very much that that will in fact be carried out because otherwise the economic freedom could not be retained. I also on the way back on the plane wrote a *Newsweek* column [“Free Markets and the Generals”, *Newsweek*, January 25, 1982] along that theme that I plan to complete and publish sometime in the not too distant future... the kind of economic freedom that Chile enjoys goes fundamentally against the basic instincts of a military government. The military is organized from the top down in a hierarchical fashion; a free economy is organized from the bottom up with no lasting hierarchy. I know of no

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<sup>69</sup> The interview appeared in the Peruvian magazine *Caretas*. A year before, Rodríguez Elizondo had interviewed Paul Samuelson (*Caretas* 611, August 18, 1980), who was quite critical of Friedman. Samuelson referred to Chile as a kind of “fascist capitalism.” During his interview with Friedman, Rodríguez Elizondo showed Samuelson’s remark, and he replied “Really?”

other military government which has supported over any long period a free economy. I suspect this one will not either if it stays in power, and sooner or later it will revert to type”<sup>70</sup>

This letter is interesting, first because he refers to the word “courage,” as if his 1975 visit to Chile were in the background, and secondly, because he insists on his extension of the causality argument between economic and political freedom applied to the Chilean situation. In fact, Friedman finally wrote his column about Chile in *Newsweek* (“Free Markets and the Generals”, *Newsweek*, January 25, 1982, p. 59) on the same lines advanced to Rodríguez Elizondo. And it closes stating that:

“I have long argued that economic freedom is a necessary but not sufficient condition for political freedom. I have become persuaded that this generalization, while true, is misleading unless accompanied by the proposition that political freedom in turn is a necessary condition for the long-term maintenance of economic freedom” (ibid.)

Although Friedman had already given this argument during his press conference, this long-term extension of his argument was most probably motivated by his experience with Chile. But in the column, there is also a political message. As the economic and political crisis in Chile was escalating, and Sergio de Castro was still Finance Minister and his position was unstable as publicly the “Chicago Boys” were blamed for the economic situation, Milton Friedman’s column can also be interpreted as supporting the “Chicago Boys”, the economic liberalization process undertaken in Chile and the controversial peg of the Chilean peso to the US dollar. He opens up praising the military junta for promoting bottom up free-market economy which is contrary to their top down culture and he mentions the intention of the military regime to call for elections. In sum, Friedman’s column in *Newsweek* can also be read as an endorsement of the “Chicago Boys” policies and a message for the military Junta, and Chilean elite. Besides, it appears that Friedman was reasonably informed about the Chilean situation. For example he knew about the promised transition, but he did not know that public salaries were still partially fixed.

Finally, regarding the last point, it is worth recalling an interview that Hayek gave to *Ercilla* magazine in November 1977. Referring to the three main prices in the economy – interest rates, salaries and the exchange rate – the interviewer asked Hayek whether one could talk of a market economy in Chile if only interest rates are free. Hayek replied, “Really? I thought the exchange rate was free. Well, I believe that that is not too damaging. The real problem is fixed salaries. The economy cannot work unless relative salaries are in equilibrium... Inflexible salaries are a major obstacle for the market to function well” (*Ercilla*, November 23, 1977). Although the pegging of the Chilean peso to the US dollar was implemented in June 1979, the problem with salaries was an issue that Hayek forewarned.

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<sup>70</sup> Letter Friedman to Rodríguez Elizondo, December 18, 1981 (this letter and its publication has been facilitated by José Rodríguez Elizondo).

### 3.4. Chile after Friedman's visit

The strong economic recovery led by the “Chicago Boys” came to an abrupt end with the world recession of 1982. The Chilean situation was further aggravated because the peso had been pegged to the dollar in June 1979. Triggered by skyrocketing international interest rates, the recession resulted in a significant fall in the exchange rate, lower prices for Chilean exports (especially copper, which reached its lowest price in 50 years), a rapid accumulation of private foreign debt, and a virtual halt to capital inflows from abroad. Besides, the recently privatized banking system lacked sufficient regulation. Already in November 2, 1981, two weeks before Friedman's second visit, the government had intervened eight banks and financial institutions to prevent their failure (cf. note 60). Some industrial conglomerates closely connected to the banks - the *grupos* - became heavily indebted in dollars using their banks. They finally went bankrupt, forcing the state to intervene.<sup>71</sup> Ironically, in January 1983 the state had to intervene the economy to rescue the financial system. To give an idea of the magnitude of this crisis, in 1982 real unemployment reached almost 25% and the real rate of growth of GDP plummeted -14.1%. For Chile, the consequences of the 1982 recession were devastating.

Suddenly it seemed that the economic liberalization policies of the “Chicago Boys” had failed. Sergio de Castro left as Minister of Hacienda on April 19, 1982.<sup>72</sup> And the controversial fixed exchange rate, staunchly defended until the end by Sergio de Castro and the “Chicago Boys”, was finally abandoned in June 1982. A period of acute economic depression, political uncertainty, and intense social and civil unrest, followed. After Sergio de Castro's resignation, Chile had five Finance Ministers in the following three years. In this scenario of uncertainty, the military Junta was ambivalent and ambiguous with the future of the economy. The market oriented reforms were at risk. So was the promised transition.

Finally, Hernán Buchi, who had previously worked in government, assumed the position of Finance Minister in February 1985. Buchi was conveniently not from Chicago. He had a MBA from Columbia (1975), but carried on liberalizing the economy. If the “Chicago Boys” influence can explain why the military regime embraced with enthusiasm an open economy and a free market oriented approach, it is harder to explain their perseverance with those programs after the severe crisis of 1982.<sup>73</sup> Moreover, it could be argued that the economic recovery contributed to the Chilean exemplar transition to democracy.

Under Buchi's market oriented and pragmatic macroeconomic management, the Chilean economy would take off again. By 1988 economic growth was at 7.3% and unemployment fell to 9.9%. In that year, the Constitution called for a plebiscite. Approximately 55% of the Chileans voted against the continuity of Pinochet for another 8 years, so, according to the 1980

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<sup>71</sup> Until 1980 the rapid growth of the economy overshadowed most of the problems caused by the lack of prudential regulation, allowing the *grupos* to finance with their own banks (see de la Cuadra and Valdes 1992).

<sup>72</sup> For Sergio de Castro's testimony, see Arancibia et al. (2007, pp. 380-6).

<sup>73</sup> See the interesting article “Pinochet sends the Chicago Boys back to School” (*The Economist*, issue 7406, August 10, 1985).

Constitution, presidential and parliamentary elections followed in December 1989. Patricio Aylwin, a Christian Democrat leading a political coalition of center and center left parties, called *Concertación*, was elected with 56% of the votes. During 1989, the last complete year of Pinochet as President, real GDP growth reached 10.5% and unemployment hit a low of 7.9%.

In November 1989, the Berlin Wall had fallen. And finally, on March 11, 1990, in a ceremony at the new Congressional building in Valparaíso, Pinochet handed over power to democratically elected President Patricio Aylwin. A successful transition would follow. Since then, Chile has experienced sustained economic growth, democracy and political stability. During the so-called golden period of the Chilean economy (1985-97), GDP grew at an average annual rate of 7.1% and GDP per capita doubled (De Gregorio 2005, p. 23). Nowadays Chile has the highest GDP per capita in Latin America. If at the end of Allende's government in 1973 and at the bottom of the 1982 recession Chilean GDP per capita only reached almost 20% of the US GDP per capita, currently is almost 45%.

#### **4. Conclusions**

The accounts over Friedman's 1975 visit are mostly rational reconstructions that tend to ignore the political context of the Cold War and the peculiar situation of Chile, focusing mainly on the on the brutal figure of Pinochet, the unjustifiable crimes, the human rights abuses, Friedman's meeting with Pinochet and the "Chicago Boys" experiment. But little attention is placed on Chile, a country that embodied a closely watched laboratory or trophy of the Cold War. Indeed, this small country was at the center of the political struggle between capitalism and socialism. And Friedman was a public and staunch supporter of the former.

It has been traditionally argued that Friedman was influential in Chile, but his influence was indirect. Milton Friedman, a public figure and a strong influence in the Department of Economics at Chicago University, was naturally an inspiration for the "Chicago Boys." But he was not involved in the shaping and implementation of the liberalization process that had already been developed by the Chilean "Chicago Boys." Moreover if we ask about "... the involvement of Arnold Harberger and Milton Friedman in the economic policy decisions of the Pinochet regime in 1975" (Valdés, 1995, p. 151), for several reasons certainly Harberger was very much involved and directly engaged with Chile. But not Friedman, a world public figure that would become Nobel Prize winner in 1976.

The first reactions against Friedman first visit to Chile were intensified by the brutal assassination of Allende's Minister and US Ambassador, Orlando Letelier. He had just written an essay criticizing Friedman's involvement with Chile and the killing of Letelier was immediately followed by the announcement of Friedman's Nobel Prize in October 1976. After these events, if we take into account the political and historical context of this period and what Milton Friedman represented, the ground was ready for the political forces that fought against capitalism, free markets or simply neoliberalism. Friedman became the target of a political campaign.

Friedman's second visit, to attend the Mont Pèlerin Society to be held in November 15-19, 1981, at coastal resort Viña del Mar, took place during the peak, and the twilight, of a booming and optimistic economic moment. Chile was perceived as an example of economic success. But some internal signals about financial instability were already present. Besides, the world recession of 1982 would hit particularly hard the Chilean economy that had its currency pegged to the US dollar. During his visit Friedman supported the policies of the "Chicago Boys," especially the peg of the Chilean peso to the US dollar. As public opinion would blame the "Chicago Boys" policies for the devastating consequences of the 1982 economic crisis, Friedman continued supporting the "Chicago Boys" ("Free Markets and the Generals", *Newsweek*, January 25, 1982, p. 59). In fact, his involvement in Chilean affairs was open and explicit in his 1981 visit.

If Hayek's thought is more complex in terms of authoritarian regimes and economic freedom (see Caldwell and Montes, forthcoming), Friedman's is simpler: necessarily economic freedom would lead to political freedom. But it was not complete from the perspective of a sufficient condition. If Milton Friedman strongly believed in the preeminence or priority of free markets, during his last visit in Chile in November 1981, he insisted with the need of political freedom for the persistence of long-term economic freedom. This improvement was most probably influenced by the Chilean experience.

Finally, Chile has received much attention due to Pinochet and the human rights abuses, but less attention for its recent successful history. We tend to forget that during the cold war Latin America was predominantly run by military dictatorships. In 1975 only three countries in South America did not have a military dictatorships.<sup>74</sup> And as Jeffrey Puryear remarks, since 1980 "fifteen military regimes have yielded power to elected civilian governments, and today Cuba is the lone remaining Latin American dictatorship" (1994, pp. ix-x). With the exception of Cuban socialist dictatorship, this represents the triumph of capitalism and democracy.

Indeed, with the benefit of hindsight it could be argued that after 40 years of Friedman's visit, he did not fail predicting the broader picture. On October 27, 1975, he wrote: "[a]s between the two evils [communist totalitarianism or a military junta], there is at least one thing to be said of the military junta - there is more chance of a return to a democratic society" (Friedman and Friedman, 1998, pp. 595). He was right. Chile underwent a successful transition maintaining economic freedom. Moreover, perhaps the Chilean successful political and economic experience after the transition to democracy, with all its complexities, lights and shadows, might owe more than has been traditionally acknowledged to Friedman's economic and political ideas.

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<sup>74</sup> They were Argentina, Colombia and Venezuela. And in 1981, the number remained, but the countries without dictatorships were now Colombia, Ecuador and Peru.

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