

PART 2

THE FIRST TEST

BIRTH PANGS

The theories of Milton Friedman gave him the Nobel Prize; they gave Chile General Pinochet.

—Eduardo Galeano, *Days and Nights of Love and War*, 1983

I don't think I was ever regarded as "evil."

—Milton Friedman, quoted in *The Wall Street Journal*, July 22, 2006

STATES OF SHOCK

THE BLOODY BIRTH OF THE COUNTERREVOLUTION

For injuries ought to be done all at one time, so that, being tasted less, they offend less.

—Niccolò Machiavelli, *The Prince*, 1513¹

If this shock approach were adopted, I believe that it should be announced publicly in great detail, to take effect at a very close date. The more fully the public is informed, the more will its reactions facilitate the adjustment.

—Milton Friedman in a letter to General Augusto Pinochet, April 21, 1975²

General Augusto Pinochet and his supporters consistently referred to the events of September 11, 1973, not as a coup d'état but as “a war.” Santiago certainly looked like a war zone: tanks fired as they rolled down the boulevards, and government buildings were under air assault by fighter jets. But there was something strange about this war. It had only one side.

From the start, Pinochet had complete control of the army, navy, marines and police. Meanwhile, President Salvador Allende had refused to organize his supporters into armed defense leagues, so he had no army of his own. The only resistance came from the presidential palace, La Moneda, and the rooftops around it, where Allende and his inner circle made a valiant effort to defend the seat of democracy. It was hardly a fair fight: though there were just thirty-six Allende supporters inside, the military launched twenty-four rockets into the palace.³

Pinochet, the operation's vain and volatile commander (built like one of the tanks he rode in on), clearly wanted the event to be as dramatic and traumatic as possible. Even if the coup was not a war, it was designed to feel like one—a Chilean precursor to Shock and Awe. It could scarcely have been more shocking. Unlike neighboring Argentina, which had been ruled by six military governments in the previous four decades, Chile had no experience with this kind of violence; it had enjoyed 160 years of peaceful democratic rule, the past 41 uninterrupted.

Now the presidential palace was in flames, the president's shrouded body was being carried out on a stretcher, and his closest colleagues were lying facedown in the street at rifle point.* A few minutes' drive from the presidential palace, Orlando Letelier, recently returned from Washington to take up a new post as Chile's defense minister, had gone to his office that morning in the ministry. As soon as he walked through the front door, he was ambushed by twelve soldiers in combat uniform, all pointing their submachine guns at him.†

In the years leading up to the coup, U.S. trainers, many from the CIA, had whipped the Chilean military into an anti-Communist frenzy, persuading them that socialists were de facto Russian spies, a force alien to Chilean society—a homegrown “enemy within.” In fact, it was the military that had become the true domestic enemy, ready to turn its weapons on the population it was sworn to protect.

With Allende dead, his cabinet in captivity and no mass resistance in evidence, the junta's grand battle was over by mid-afternoon. Letelier and the other “VIP” prisoners were eventually taken to freezing Dawson Island in the southern Strait of Magellan, Pinochet's approximation of a Siberian work camp. Killing and locking up the government was not enough for Chile's new junta government, however. The generals knew that their hold on power depended on Chileans being truly terrified, as the people had been in Indonesia. In the days that followed, roughly 13,500 civilians were arrested, loaded onto trucks and imprisoned, according to a declassified CIA report.⁵ Thousands ended up in the two main football stadiums in Santiago, the Chile Stadium and the huge National Stadium. Inside the National Stadium, death replaced football as the public spectacle. Soldiers prowled the

* Allende was found with his head blown apart. Debates continue over whether he was shot by one of the bullets fired into La Moneda or he shot himself rather than give Chileans the lasting image of their elected president surrendering to an insurrectionary army. The second theory is the more credible.

bleachers with hooded collaborators who pointed out “subversives”; the ones who were selected were hauled off to locker rooms and skyboxes transformed into makeshift torture chambers. Hundreds were executed. Lifeless bodies started showing up on the side of major highways or floating in murky urban canals.

To make sure that the terror extended beyond the capital city, Pinochet sent his most ruthless commander, General Sergio Arellano Stark, on a helicopter mission to the northern provinces to visit a string of prisons where “subversives” were being held. At each city and town, Stark and his roving death squad singled out the highest-profile prisoners, as many as twenty-six at a time, who were subsequently executed. The trail of blood left behind over those four days came to be known as the Caravan of Death.⁶ In short order, the entire country had gotten the message: resistance is deadly.

Even though Pinochet's battle was one-sided, its effects were as real as any civil war or foreign invasion: in all, more than 3,200 people were disappeared or executed, at least 80,000 were imprisoned, and 200,000 fled the country for political reasons.⁷

The Economic Front

For the Chicago Boys, September 11 was a day of giddy anticipation and deadline adrenalin. Sergio de Castro had been working down to the wire with his contact in the navy, getting the final sections of “The Brick” approved page by page. Now, on the day of the coup, several Chicago Boys were camped out at the printing presses of the right-wing *El Mercurio* newspaper. As shots were being fired in the streets outside, they frantically tried to get the document printed in time for the junta's first day on the job. Arturo Fontaine, one of the newspaper's editors, recalled that the machines “worked non-stop to duplicate copies of this long document.” And they made it—just barely. “Before midday on Wednesday, September 12, 1973, the General Officers of the Armed Forces who performed government duties had the Plan on their desks.”⁸

The proposals in the final document bore a striking resemblance to those found in Milton Friedman's *Capitalism and Freedom*: privatization, deregulation and cuts to social spending—the free-market trinity. Chile's U.S.-trained economists had tried to introduce these ideas peacefully, within the confines of a democratic debate, but they had been overwhelmingly rejected. Now the Chicago Boys and their plans were back, in a climate distinctly

more conducive to their radical vision. In this new era, no one besides a handful of men in uniform needed to agree with them. Their staunchest political opponents were either in jail, dead or fleeing for cover; the spectacle of fighter jets and caravans of death was keeping everyone else in line.

"To us, it was a revolution," said Cristián Larroulet, one of Pinochet's economic aides.⁹ It was a fair description. September 11, 1973, was far more than the violent end of Allende's peaceful socialist revolution; it was the beginning of what *The Economist* would later describe as a "counterrevolution"—the first concrete victory in the Chicago School campaign to seize back the gains that had been won under developmentalism and Keynesianism.¹⁰ Unlike Allende's partial revolution, tempered and compromised by the push and pull of democracy, this revolt, imposed through brute force, was free to go all the way. In the coming years, the same policies laid out in "The Brick" would be imposed in dozens of other countries under cover of a wide range of crises. But Chile was the counterrevolution's genesis—a genesis of terror.

José Piñera, an alumnus of the economics department at the Catholic University and a self-described Chicago Boy, was doing graduate work at Harvard at the time of the coup. On hearing the good news, he returned home "to help found a new country, dedicated to liberty, from the ashes of the old one." According to Piñera, who would eventually become Pinochet's minister of labor and mining, this was "the real revolution . . . a radical, comprehensive, and sustained move toward free markets."¹¹

Before the coup, Augusto Pinochet had a reputation for deference that bordered on the obsequious, forever flattering and agreeing with his civilian commanders. As a dictator, Pinochet found new facets of his character. He took to power with unseemly relish, adopting the airs of a monarch and claiming that "destiny" had given him the job. In short order, he staged a coup within a coup to unseat the other three military leaders with whom he had agreed to share power and named himself Supreme Chief of the Nation as well as president. He basked in pomp and ceremony, proof of his right to rule, never missing an opportunity to put on his Prussian dress uniform, complete with cape. To get around Santiago, he chose a caravan of gold bulletproof Mercedes-Benzes.¹²

Pinochet had a knack for authoritarian rule, but, like Suharto, he knew next to nothing about economics. That was a problem because the campaign of corporate sabotage spearheaded by ITT had done an effective job of sending the economy into a tailspin, and Pinochet had a full-fledged crisis

on his hands. From the start, there was a power struggle within the junta between those who simply wanted to reinstate the pre-Allende status quo and return quickly to democracy, and the Chicago Boys, who were pushing for a head-to-toe free-market makeover that would take years to impose. Pinochet, enjoying his new powers, intensely disliked the idea that his destiny was a mere cleanup operation—there to "restore order" and then get out. "We are not a vacuum cleaner that swept out Marxism to give back power to those Mr. Politicians," he would say.¹³ It was the Chicago Boys' vision of a total country overhaul that appealed to his newly unleashed ambition, and, like Suharto with his Berkeley Mafia, he immediately named several Chicago grads as senior economic advisers, including Sergio de Castro, the movement's de facto leader and the main author of "The Brick." He called them the *technos*—the technicians—which appealed to the Chicago pretension that fixing an economy was a matter of science, not of subjective human choices.

Even if Pinochet understood little about inflation and interest rates, the *technos* spoke a language he did understand. Economics for them meant forces of nature that needed to be respected and obeyed because "to act against nature is counter-productive and self-deceiving," as Piñera explained.¹⁴ Pinochet agreed: people, he once wrote, must submit to structure because "nature shows us basic order and hierarchy are necessary."¹⁵ This mutual claim to be taking orders from higher natural laws formed the basis of the Pinochet-Chicago alliance.

For the first year and a half, Pinochet faithfully followed the Chicago rules: he privatized some, though not all, state-owned companies (including several banks); he allowed cutting-edge new forms of speculative finance; he flung open the borders to foreign imports, tearing down the barriers that had long protected Chilean manufacturers; and he cut government spending by 10 percent—except the military, which received a significant increase.¹⁶ He also eliminated price controls—a radical move in a country that had been regulating the cost of necessities such as bread and cooking oil for decades.

The Chicago Boys had confidently assured Pinochet that if he suddenly withdrew government involvement from these areas all at once, the "natural" laws of economics would rediscover their equilibrium, and inflation—which they viewed as a kind of economic fever indicating the presence of unhealthy organisms in the market—would magically go down. They were mistaken. In 1974, inflation reached 375 percent—the highest rate in the world and almost twice the top level under Allende.¹⁷ The cost of basics such as

bread went through the roof. At the same time, Chileans were being thrown out of work because Pinochet's experiment with "free trade" was flooding the country with cheap imports. Local businesses were closing, unable to compete, unemployment hit record levels and hunger became rampant. The Chicago School's first laboratory was a debacle.

Sergio de Castro and the other Chicago Boys argued (in true Chicago fashion) that the problem didn't lie with their theory but with the fact that it wasn't being applied with sufficient strictness. The economy had failed to correct itself and return to harmonious balance because there were still "distortions" left over from nearly half a century of government interference. For the experiment to work, Pinochet had to strip these distortions away—more cuts, more privatization, more speed.

In that year and a half, many of the country's business elite had had their fill of the Chicago Boys' adventures in extreme capitalism. The only people benefiting were foreign companies and a small clique of financiers known as the "piranhas," who were making a killing on speculation. The nuts-and-bolts manufacturers who had strongly supported the coup were getting wiped out. Orlando Sáenz—the president of the National Association of Manufacturers, who had brought the Chicago Boys into the coup plot in the first place—declared the results of the experiment "one of the greatest failures of our economic history."¹⁸ The manufacturers hadn't wanted Allende's socialism but had liked a managed economy just fine. "It is not possible to continue with the financial chaos that dominates in Chile," Sáenz said. "It is necessary to channel into productive investments the millions and millions of financial resources that are now being used in wild-cat speculative operations before the very eyes of those who don't even have a job."¹⁹

Their agenda now in grave danger, the Chicago Boys and the piranhas (and there was a great deal of overlap between the two) decided it was time to call in the big guns. In March 1975, Milton Friedman and Arnold Harberger flew to Santiago at the invitation of a major bank to help save the experiment.

Friedman was greeted by the junta-controlled press as something of a rock star, the guru of the new order. Each of his pronouncements made headlines, his academic lectures were broadcast on national television and he had the most important audience of all: a private meeting with General Pinochet.

Throughout his stay, Friedman hammered at a single theme: the junta was off to a good start, but it needed to embrace the free market with greater

abandon. In speeches and interviews, he used a term that had never before been publicly applied to a real-world economic crisis: he called for "shock treatment." He said it was "the only medicine. Absolutely. There is no other. There is no other long-term solution."²⁰ When a Chilean reporter pointed out that even Richard Nixon, then president of the U.S., imposed controls to temper the free market, Friedman snapped, "I don't approve of them. I believe we should not apply them. I am against economic intervention by the government, in my own country, as well as in Chile."²¹

After his meeting with Pinochet, Friedman made some personal notes about the encounter, which he reproduced decades later in his memoirs. He observed that the general "was sympathetically attracted to the idea of a shock treatment but was clearly distressed at the possible temporary unemployment that might be caused."²² At this point, Pinochet was already notorious the world over for ordering massacres in football stadiums; that the dictator was "distressed" by the human cost of shock therapy might have given Friedman pause. Instead, he pressed the point in a follow-up letter in which he praised the general's "extremely wise" decisions but urged Pinochet to cut government spending much further, "by 25 per cent within six months . . . across-the-board," while simultaneously adopting a package of pro-business policies moving toward "complete free trade." Friedman predicted that the hundreds of thousands of people who would be fired from the public sector would quickly get new jobs in the private sector, soon to be booming thanks to Pinochet's removal of "as many obstacles as possible that now hinder the private market."²³

Friedman assured the general that if he followed this advice, he would be able to take credit for an "economic miracle"; he "could end inflation in months" while the unemployment problem would be equally "brief—measured in months—and that subsequent recovery would be rapid." Pinochet would need to act fast and decisively; Friedman emphasized the importance of "shock" repeatedly, using the word three times and underlining that "gradualism is not feasible."²⁴

Pinochet was converted. In his letter of response, Chile's supreme chief expressed "my highest and most respectful regard for you," assuring Friedman that "the Plan is being fully applied at the present time."²⁵ Immediately after Friedman's visit, Pinochet fired his economic minister and handed the job to Sergio de Castro, whom he later promoted to finance minister. De Castro stacked the government with his fellow Chicago Boys, appointing one of them to head the central bank. Orlando Sáenz, who had objected to

the mass layoffs and plant closures, was replaced as head of the Association of Manufacturers by someone with a more shock-friendly attitude. "If there are industrialists who complain because of this, let them 'go to hell.' I won't defend them," the new director announced.²⁶

Freed of the naysayers, Pinochet and de Castro got to work stripping away the welfare state to arrive at their pure capitalist utopia. In 1975, they cut public spending by 27 percent in one blow—and they kept cutting until, by 1980, it was half of what it had been under Allende.²⁷ Health and education took the heaviest hits. Even *The Economist*, a free-market cheerleader, called it "an orgy of self-mutilation."²⁸ De Castro privatized almost five hundred state-owned companies and banks, practically giving many of them away, since the point was to get them as quickly as possible into their rightful place in the economic order.²⁹ He took no pity on local companies and removed even more trade barriers; the result was the loss of 177,000 industrial jobs between 1973 and 1983.³⁰ By the mid-eighties, manufacturing as a percentage of the economy dropped to levels last seen during the Second World War.³¹

Shock treatment was an apt description for what Friedman had prescribed. Pinochet had deliberately sent his country into a deep recession, based on the untested theory that the sudden contraction would jolt the economy into health. In its logic, it was strikingly similar to that of the psychiatrists who started mass-prescribing ECT in the 1940s and 1950s, convinced that deliberately induced grand mal seizures would magically reboot their patients' brains.

The theory of economic shock therapy relies in part on the role of expectations in feeding an inflationary process. Reining in inflation requires not only changing monetary policy but also changing the behavior of consumers, employers and workers. The role of a sudden, jarring policy shift is that it quickly alters expectations, signaling to the public that the rules of the game have changed dramatically—prices will not keep rising, nor will wages. According to this theory, the faster expectations of inflation are driven down, the shorter the painful period of recession and high unemployment will be. However, particularly in countries where the political class has lost its credibility with the public, only a major, decisive policy shock is said to have the power to "teach" the public these harsh lessons.*

* Some Chicago School economists claim that the first experiment in shock therapy took place in West Germany on June 20, 1948. That's when Finance Minister Ludwig Erhard eliminated

Causing a recession or a depression is a brutal idea, since it necessarily creates mass poverty, which is why no political leader had until this point been willing to test the theory. Who wants to be responsible for what *Business-Week* described as a "Dr. Strangelove world of deliberately induced depression"?³²

Pinochet did. In the first year of Friedman-prescribed shock therapy, Chile's economy contracted by 15 percent, and unemployment—only 3 percent under Allende—reached 20 percent, a rate unheard of in Chile at the time.³³ The country was certainly convulsing under its "treatments." And contrary to Friedman's sunny predictions, the unemployment crisis lasted for years, not months.³⁴ The junta, which had instantly taken to Friedman's illness metaphors, was unapologetic, explaining that "this path was chosen because it is the only one that goes directly to the sickness."³⁵ Friedman concurred. When asked by a reporter "whether the social cost of his policies would be excessive," he responded, "Silly question."³⁶ To another reporter he said, "My only concern is that they push it long enough and hard enough."³⁷

Interestingly, the most powerful criticism of shock therapy came from one of Friedman's own former students, André Gunder Frank. During his time at the University of Chicago in the fifties, Gunder Frank—originally from Germany—had heard so much about Chile that when he graduated with a PhD in economics, he decided to go see for himself the country his professors had portrayed as a mismanaged developmentalist dystopia. He liked what he saw and ended up teaching at the University of Chile, then serving as an economic adviser to the government of Salvador Allende, for whom he developed a great respect. As a Chicago Boy in Chile who had defected from the school's free-market orthodoxy, Gunder Frank had a unique perspective on the country's economic adventure. One year after Friedman prescribed

most price controls and introduced a new currency. The moves were sudden and without warning, a tremendous shock to the German economy, leading to widespread unemployment. But that is where the parallels end: Erhard's reforms were restricted to price and monetary policy, they were not accompanied by cuts to social programs or by rapid introduction of free trade, and many measures were taken to protect citizens from these shocks, including increasing wages. Even post-shock, West Germany easily met Friedman's definition of a quasi-socialist welfare state: it provided subsidized housing, government pensions, public health care and a state-run education system, while the government ran, and subsidized, everything from the phone company to aluminum plants. Crediting Erhard with inventing shock therapy makes for a palatable narrative, since his experiment took place after West Germany was liberated from tyranny. Erhard's shock, however, bears little resemblance to the sweeping transformations currently understood as economic shock therapy—that method was pioneered by Friedman and Pinochet, in a country that had just lost its liberty.

maximum shock, he wrote a rage-fueled “Open Letter to Arnold Harberger and Milton Friedman” in which he used his Chicago School education “to examine how the Chilean patient has responded to your treatment.”³⁸

He calculated what it meant for a Chilean family to try to survive on what Pinochet claimed was a “living wage.” Roughly 74 percent of its income went simply to buying bread, forcing the family to cut out such “luxury items” as milk and bus fare to get to work. By comparison, under Allende, bread, milk and bus fare took up 17 percent of a public employee’s salary.³⁹ Many children weren’t getting milk at school either, since one of the junta’s first moves had been to eliminate the school milk program. As a result of this cut compounding the desperation at home, more and more students were fainting in class, and many stopped going altogether.⁴⁰ Gunder Frank saw a direct connection between the brutal economic policies imposed by his former classmates and the violence Pinochet had unleashed on the country. Friedman’s prescriptions were so wrenching, the disaffected Chicago Boy wrote, that they could not “be imposed or carried out without the twin elements that underlie them all: military force and political terror.”⁴¹

Undeterred, Pinochet’s economic team went into more experimental territory, introducing Friedman’s most vanguard policies: the public school system was replaced by vouchers and charter schools, health care became pay-as-you-go, and kindergartens and cemeteries were privatized. Most radical of all, they privatized Chile’s social security system. José Piñera, who brought in the program, said that he got the idea from reading *Capitalism and Freedom*.⁴² George W. Bush’s administration is usually credited with pioneering “the ownership society,” but in fact it was Pinochet’s government, thirty years earlier, that first introduced the idea of “a nation of owners.”

Chile was now in bold new territory, and free-market fans the world over, accustomed to debating the merits of such policies in purely academic settings, were paying close attention. “Economics textbooks say that’s the way the world should work, but where else do they practice it?” marveled the U.S. business magazine *Barron’s*.⁴³ In an article headlined “Chile, Lab Test for a Theorist,” *The New York Times* noted that “it is not often that a leading economist with strong views is given a chance to test specific prescriptions for a very sick economy. It is even more unusual when the economist’s client happens to be a country other than his own.”⁴⁴ Many came for an up-close look at the Chilean laboratory, including Friedrich Hayek himself, who traveled to Pinochet’s Chile several times and in 1981 selected Viña del Mar

(the city where the coup had been plotted) to hold the regional meeting of the Mont Pelerin Society, the brain trust of the counterrevolution.

The Myth of the Chilean Miracle

Even three decades later, Chile is still held up by free-market enthusiasts as proof that Friedmanism works. When Pinochet died in December 2006 (one month after Friedman), *The New York Times* praised him for “transforming a bankrupt economy into the most prosperous in Latin America,” while a *Washington Post* editorial said he had “introduced the free-market policies that produced the Chilean economic miracle.”⁴⁵ The facts behind the “Chilean miracle” remain a matter of intense debate.

Pinochet held power for seventeen years, and during that time he changed political direction several times. The country’s period of steady growth that is held up as proof of its miraculous success did not begin until the mid-eighties—a full decade after the Chicago Boys implemented shock therapy and well after Pinochet was forced to make a radical course correction. That’s because in 1982, despite its strict adherence to Chicago doctrine, Chile’s economy crashed: its debt exploded, it faced hyperinflation once again and unemployment hit 30 percent—ten times higher than it was under Allende.⁴⁶ The main cause was that the piranhas, the Enron-style financial houses that the Chicago Boys had freed from all regulation, had bought up the country’s assets on borrowed money and run up an enormous debt of \$14 billion.⁴⁷

The situation was so unstable that Pinochet was forced to do exactly what Allende had done: he nationalized many of these companies.⁴⁸ In the face of the debacle, almost all the Chicago Boys lost their influential government posts, including Sergio de Castro. Several other Chicago graduates held prominent posts with the piranhas and came under investigation for fraud, stripping away the carefully cultivated facade of scientific neutrality so central to the Chicago Boy identity.

The only thing that protected Chile from complete economic collapse in the early eighties was that Pinochet had never privatized Codelco, the state copper mine company nationalized by Allende. That one company generated 85 percent of Chile’s export revenues, which meant that when the financial bubble burst, the state still had a steady source of funds.⁴⁹

It’s clear that Chile never was the laboratory of “pure” free markets that its cheerleaders claimed. Instead, it was a country where a small elite leapt from

wealthy to super-rich in extremely short order—a highly profitable formula bankrolled by debt and heavily subsidized (then bailed out) with public funds. When the hype and salesmanship behind the miracle are stripped away, Chile under Pinochet and the Chicago Boys was not a capitalist state featuring a liberated market but a corporatist one. Corporatism, or “corporativism,” originally referred to Mussolini’s model of a police state run as an alliance of the three major power sources in society—government, businesses and trade unions—all collaborating to guarantee order in the name of nationalism. What Chile pioneered under Pinochet was an evolution of corporatism: a mutually supporting alliance between a police state and large corporations, joining forces to wage all-out war on the third power sector—the workers—thereby drastically increasing the alliance’s share of the national wealth.

That war—what many Chileans understandably see as a war of the rich against the poor and middle class—is the real story of Chile’s economic “miracle.” By 1988, when the economy had stabilized and was growing rapidly, 45 percent of the population had fallen below the poverty line.⁵⁰ The richest 10 percent of Chileans, however, had seen their incomes increase by 83 percent.⁵¹ Even in 2007, Chile remained one of the most unequal societies in the world—out of 123 countries in which the United Nations tracks inequality, Chile ranked 116th, making it the 8th most unequal country on the list.⁵²

If that track record qualifies Chile as a miracle for Chicago school economists, perhaps shock treatment was never really about jolting the economy into health. Perhaps it was meant to do exactly what it did—hoover wealth up to the top and shock much of the middle class out of existence.

That was the way Orlando Letelier, Allende’s former defense minister, saw it. After spending a year in Pinochet’s prisons, Letelier managed to escape Chile, thanks to an intensive international lobbying campaign. Watching from exile the rapid impoverishment of his country, Letelier wrote in 1976 that “during the last three years several billions of dollars were taken from the pockets of wage earners and placed in those of capitalists and landowners . . . concentration of wealth is no accident, but a rule; it is not the marginal outcome of a difficult situation—as the junta would like the world to believe—but the base for a social project; it is not an economic liability but a temporary political success.”⁵³

What Letelier could not know at the time was that Chile under Chicago School rule was offering a glimpse of the future of the global economy, a

pattern that would repeat again and again, from Russia to South Africa to Argentina: an urban bubble of frenetic speculation and dubious accounting fueling superprofits and frantic consumerism, ringed by the ghostly factories and rotting infrastructure of a development past; roughly half the population excluded from the economy altogether; out-of-control corruption and cronyism; decimation of nationally owned small and medium-sized businesses; a huge transfer of wealth from public to private hands, followed by a huge transfer of private debts into public hands. In Chile, if you were outside the wealth bubble, the miracle looked like the Great Depression, but inside its airtight cocoon the profits flowed so free and fast that the easy wealth made possible by shock therapy-style “reforms” have been the crack cocaine of financial markets ever since. And that is why the financial world did not respond to the obvious contradictions of the Chile experiment by reassessing the basic assumptions of *laissez-faire*. Instead, it reacted with the junkie’s logic: Where is the next fix?

The Revolution Spreads, the People Vanish

For a time, the next fix came from other countries in Latin America’s Southern Cone, where the Chicago School counterrevolution quickly spread. Brazil was already under the control of a U.S.-supported junta, and several of Friedman’s Brazilian students held key positions. Friedman traveled to Brazil in 1973, at the height of the regime’s brutality, and declared the economic experiment “a miracle.”⁵⁴ In Uruguay the military had staged a coup in 1973 and the following year decided to go the Chicago route. Lacking sufficient numbers of Uruguayans who had graduated from the University of Chicago, the generals invited “Arnold Harberger and [economics professor] Larry Sjaastad from the University of Chicago and their team, which included former Chicago students from Argentina, Chile, and Brazil, to reform Uruguay’s tax system and commercial policy.”⁵⁵ The effects on Uruguay’s previously egalitarian society were immediate: real wages dropped by 28 percent, and hordes of scavengers appeared on the streets of Montevideo for the first time.⁵⁶

Next to join the experiment was Argentina in 1976, when a junta seized power from Isabel Perón. That meant that Argentina, Chile, Uruguay and Brazil—the countries that had been showcases of developmentalism—were now all run by U.S.-backed military governments and were living laboratories of Chicago School economics.

According to declassified Brazilian documents just released in March 2007, weeks before the Argentine generals seized power, they contacted Pinochet and the Brazilian junta and “outlined the main steps to be taken by the future regime.”⁵⁷

Despite this close collaboration, Argentina’s military government did not go quite as far into neoliberal experimentation as Pinochet had; it did not privatize the country’s oil reserves or social security, for instance (that would come later). However, when it came to attacking the policies and institutions that had lifted Argentina’s poor into the middle class, the junta faithfully followed Pinochet, thanks in part to the abundance of Argentine economists who had gone through the Chicago program.

Argentina’s newly minted Chicago Boys landed key economic posts in the junta government—as secretary of finance, president of the central bank and research director for the Treasury Department of the Finance Ministry, as well as several other lower-level economic posts.⁵⁸ But while the Argentine Chicago Boys were enthusiastic participants in the military government, the top economic job went not to one of them but to José Alfredo Martínez de Hoz. He was part of the landed gentry that belonged to the Sociedad Rural, the cattle-ranchers’ association that had long controlled the country’s export economy. These families, the closest thing to an aristocracy that Argentina possessed, had liked the feudal economic order just fine—a time when they didn’t have to worry about their land being redistributed to peasants or the price of meat being lowered to make sure everyone could eat.

Martínez de Hoz had been president of the Sociedad Rural, as had his father and grandfather before him; he also sat on the boards of several multinational corporations, including Pan American Airways and ITT. When he took up his post in the junta government, there was no mistaking the fact that the coup represented a revolt of the elites, a counterrevolution against forty years of gains by Argentina’s workers.

Martínez de Hoz’s first act as minister of the economy was to ban strikes and allow employers to fire workers at will. He lifted price controls, sending the cost of food soaring. He was also determined to make Argentina once again a hospitable place for foreign multinationals. He lifted restrictions on foreign ownership and in the first few years sold off hundreds of state companies.⁵⁹ These measures earned him powerful fans in Washington. Declassified documents show William Rogers, assistant secretary of state for Latin America, telling his boss, Henry Kissinger, shortly after the coup that “Martínez de Hoz is a good man. We have been in close consultations

throughout.” Kissinger was so impressed that he arranged to have a high-profile meeting with Martínez de Hoz when he visited Washington “as a symbolic gesture.” He also offered to make a couple of calls to help along Argentina’s economic efforts: “I will call David Rockefeller,” Kissinger told the junta’s foreign minister, a reference to the president of Chase Manhattan Bank. “And I will call his brother, the Vice President [of the United States, Nelson Rockefeller].”⁶⁰

To attract investment, Argentina took out a thirty-one-page advertising supplement in *BusinessWeek*, produced by the PR giant Burson-Marsteller, declaring that “few governments in history have been as encouraging to private investment. . . . We are in a true social revolution, and we seek partners. We are unburdening ourselves of statism, and believe firmly in the all-important role of the private sector.”⁶¹

Once again, the human impact was unmistakable: within a year, wages lost 40 percent of their value, factories closed, poverty spiraled. Before the junta took power, Argentina had fewer people living in poverty than France or the U.S.—just 9 percent—and an unemployment rate of only 4.2 percent.⁶² Now the country began to display signs of the underdevelopment thought to have been left behind. Poor neighborhoods were without water, and preventable diseases ran rampant.

In Chile, Pinochet had a free hand to use economic policy to eviscerate the middle class, thanks to the shocking and terrifying way in which he had seized power. Although his fighter jets and firing squads had been enormously effective at spreading terror, they had turned out to be a public relations disaster. Press reports about Pinochet’s massacres sparked a worldwide outcry, and activists in Europe and North America aggressively lobbied their governments not to trade with Chile—a distinctly unfavorable outcome for a regime whose reason for existence was to keep the country open for business.

The newly declassified documents from Brazil show that when Argentina’s generals were preparing their 1976 coup, they wanted “to avoid suffering an international campaign like the one that has been unleashed against Chile.”⁶³ To achieve that goal, less sensational repression tactics were needed—lower-profile ones capable of spreading terror but not so visible to the prying international press. In Chile, Pinochet soon settled on disappearances.

* The junta was so eager to auction off the country to investors that it advertised “a 10 percent discount on the price of land for ground-breaking within 60 days.”

Rather than openly killing or even arresting their prey, soldiers would snatch them, take them to clandestine camps, torture and often kill them, then deny any knowledge. Bodies were thrown into mass graves. According to Chile's truth commission, established in May 1990, the secret police would dispose of some victims by dropping them into the ocean from helicopters "after first cutting their stomach open with a knife to keep the bodies from floating."⁶⁴ In addition to their lower profile, disappearances turned out to be an even more effective means of spreading terror than open massacres, so destabilizing was the idea that the apparatus of the state could be used to make people vanish into thin air.

By the mid-seventies, disappearances had become the primary enforcement tool of the Chicago School juntas throughout the Southern Cone—and none embraced the practice more zealously than the generals occupying Argentina's presidential palace. By the end of their reign, an estimated thirty thousand people had been disappeared.⁶⁵ Many of them, like their Chilean counterparts, were thrown from planes into the muddy waters of the Rio de la Plata.

The Argentine junta excelled at striking just the right balance between public and private horror, carrying out enough of its terror in the open that everyone knew what was going on, but simultaneously keeping enough secret that it could always be denied. In its first days in power, the junta made a single dramatic demonstration of its willingness to use lethal force: a man was pushed out of a Ford Falcon (a vehicle notorious for its use by the secret police), tied to Buenos Aires's most prominent monument, the 67.5-meter-high white Obelisk, and machine-gunned in plain view.

After that, the junta's killings went underground, but they were always present. Disappearances, officially denied, were very public spectacles enlisting the silent complicity of entire neighborhoods. When someone was targeted to be eliminated, a fleet of military vehicles showed up at that person's home or workplace and cordoned off the block, often with a helicopter buzzing overhead. In broad daylight and in full view of the neighbors, police or soldiers battered down the door and dragged out the victim, who often shouted his or her name before disappearing into a waiting Ford Falcon, in the hope that news of the event would reach the family. Some "covert" operations were even more brazen: police were known to board crowded city buses and drag passengers off by their hair; in the city of Santa Fe, a couple was kidnapped right at the altar on their wedding day in front of a church filled with people.⁶⁶

The public character of terror did not stop with the initial capture. Once in

custody, prisoners in Argentina were taken to one of more than three hundred torture camps across the country.⁶⁷ Many of them were located in densely populated residential areas; one of the most notorious was in a former athletic club on a busy street in Buenos Aires, another in a schoolhouse in central Bahía Blanca and yet another in a wing of a working hospital. At these torture centers, military vehicles sped in and out at odd hours, screams could be heard through the badly insulated walls and strange, body-shaped parcels were spotted being carried in and out, all silently registered by the nearby residents.

The regime in Uruguay was similarly brazen: one of its main torture centers was a navy barracks abutting Montevideo's boardwalk, an area once favored by families for ocean-side strolls and picnics. During the dictatorship, the beautiful spot was empty, as the city's residents studiously avoided hearing the screams.⁶⁸

The Argentine junta was particularly sloppy about disposing of its victims. A country walk could end in horror because mass graves were barely concealed. Bodies would show up in public garbage bins, missing fingers and teeth (much as they do today in Iraq), or they would wash ashore on the banks of the Rio de la Plata, sometimes half a dozen at a time, after one of the junta's "death flights." On occasion, they even rained down from helicopters into farmers' fields.⁶⁹

All Argentines were in some way enlisted as witnesses to the erasure of their fellow citizens, yet most people claimed not to know what was going on. There is a phrase Argentines use to describe the paradox of wide-eyed knowing and eyes-closed terror that was the dominant state of mind in those years: "We did not know what nobody could deny."

Since those wanted by the various juntas often took refuge in neighboring countries, the regional governments collaborated with each other in the notorious Operation Condor. Under Condor, the intelligence agencies of the Southern Cone shared information about "subversives"—aided by a state-of-the-art computer system provided by Washington—and then gave each other's agents safe passage to carry out cross-border kidnappings and torture, a system eerily resembling the CIA's "extraordinary rendition" network today.*⁷⁰

The juntas also swapped information about the most effective means

* The Latin American operation was modeled on Hitler's "Night and Fog." In 1941, Hitler decreed that resistance fighters in Nazi-occupied countries would be brought to Germany to "vanish in the night and fog." Several high-profile Nazis took refuge in Chile and Argentina, and there is some speculation that they may have trained the Southern Cone intelligence agencies in these tactics.

each had found to extract information from their prisoners. Several Chileans who had been tortured at Chile Stadium in the days after the coup remarked on the unexpected detail that there were Brazilian soldiers in the room offering advice on the most scientific uses of pain.⁷¹

There were countless opportunities for such exchanges in this period, many of them running through the United States and involving the CIA. A 1975 U.S. Senate investigation into U.S. intervention in Chile found that the CIA had provided training to Pinochet's military in methods for "controlling subversion."⁷² And U.S. training of Brazilian and Uruguayan police in interrogation techniques has been heavily documented. According to court testimony quoted in the country's truth commission report, *Brazil: Never Again*, published in 1985, military officers attended formal "torture classes" at army police units where they watched slides depicting various excruciating methods. During these sessions, prisoners were brought in for "practical demonstrations"—brutally tortured while as many as a hundred army sergeants looked on and learned. The report states that "one of the first people to introduce this practice into Brazil was Dan Mitrione, an American police officer. As a police instructor in Belo Horizonte during the early years of the Brazilian military regime, Mitrione took beggars off the streets and tortured them in classrooms so that the local police would learn the various ways of creating, in the prisoner, the supreme contradiction between the body and the mind."⁷³ Mitrione then moved on to conduct police training in Uruguay, where, in 1970, he was kidnapped and killed by the Tupamaro guerrillas—the group of leftist revolutionaries had planned the operation in order to expose Mitrione's involvement in torture training.* According to one of his former students, he insisted, like the authors of the CIA manual, that effective torture was not sadism but science. "The precise pain in the precise place, in the precise amount" was his motto.⁷⁴

The results of this training are unmistakable in all the human rights reports from the Southern Cone in this sinister period. Again and again they testify to the trademark methods codified in the *Kubark* manual: early morning arrests, hooding, intense isolation, drugging, forced nudity, electroshock. And everywhere, the terrible legacy of the McGill experiments in deliberately induced regression.

Prisoners released from Chile's National Stadium said that bright floodlights were kept on twenty-four hours a day, and the order of meals seemed

deliberately out of sequence.⁷⁵ Soldiers forced many prisoners to wear blankets over their heads so they could neither see nor hear properly, a baffling practice since all the prisoners knew they were in the stadium. The effect of the manipulations, prisoners reported, was that they lost their sense of night and day, and the shock and panic triggered by the coup and their subsequent arrests were greatly intensified. It was almost as if the stadium had been turned into a giant laboratory, and they were the test subjects in some strange experiment in sensory manipulation.

A more faithful copy of the CIA experiments could be seen in Chile's Villa Grimaldi prison, which "was known for its 'Chile rooms'—wooden isolation compartments so small that prisoners could not kneel" or lie down.⁷⁶ Prisoners in Uruguay's Libertad prison were sent to *la isla*, the island: tiny windowless cells in which one bare bulb was illuminated at all times. High-value prisoners were kept in absolute isolation for more than a decade. "We were beginning to think we were dead, that our cells weren't cells but rather graves, that the outside world didn't exist, that the sun was a myth," one of these prisoners, Mauricio Rosencof, recalled. He saw the sun for a total of eight hours over eleven and a half years. So deprived were his senses during this time that he "forgot colors—there were no colors."⁷⁷

In one of Argentina's largest torture centers, the Navy School of Mechanics in Buenos Aires, the isolation chamber was called the *capucha*, the hood. Juan Miranda, who spent three months in the *capucha*, told me about that dark place. "They keep you in a blindfold and a hood with your hands and legs in chains, lying down on a foam mattress all day long, in the attic of the prison. I could not see the other prisoners—I was separated from them with plywood. When the guards would bring food, they made me face the wall, then they would pull up the hood so I could eat. It was the only time we were allowed to sit up; otherwise, we had to lie down all the time." Other Argentine prisoners had their senses starved in cells the size of coffins, called *tubos*.

The only reprieve from isolation was the worse fate of the interrogation room. The most ubiquitous technique, used in the torture chambers of all the region's military regimes, was electroshock. There were dozens of variations on how electrical currents were sent coursing through prisoners' bodies: with live wires, with army field telephones, with needles under fingernails, clamped

* The prison administration at Libertad worked closely with behavioral psychologists to design torture techniques tailored to each individual's psychological profile—a method now used at Guantánamo Bay.

* The episode was the basis for Costa-Gavras's superb 1972 film, *State of Siege*.

with clothespins on gums, nipples, genitals, ears, mouths, in open wounds, attached to bodies doused in water to intensify the charge; on bodies strapped to tables or to Brazil's iron "dragon chair." Argentina's cattle-owning junta was proud of its distinctive contribution—prisoners were shocked on a metal bed, called the *parilla* (the barbecue), where they were subject to the *picana* (cattle prod).

The exact number of people who went through the Southern Cone's torture machinery is impossible to calculate, but it is probably somewhere between 100,000 and 150,000, tens of thousands of them killed.⁷⁸

A Witness in Difficult Times

To be a leftist in those years was to be hunted. Those who did not escape to exile were in a minute-by-minute struggle to stay one step ahead of the secret police—an existence of safe houses, phone codes and false identities. One of the people living that life in Argentina was the country's legendary investigative journalist Rodolfo Walsh. A gregarious Renaissance man, a writer of crime fiction and award-winning short stories, Walsh was also a super sleuth able to crack military codes and spy on the spies. His greatest investigative triumph took place when he was working as a journalist in Cuba, where he managed to intercept and decode a CIA telex that blew the cover of the Bay of Pigs invasion. That information is what allowed Castro to prepare for and defend against the invasion.

When Argentina's previous military junta had banned Peronism and strangled democracy, Walsh decided to join the armed Montonero movement as their intelligence expert.* That put him at the very top of the generals' Most Wanted list, with every new disappearance bringing fresh fears that information extracted by the *picana* would lead the police to the safe house he had secured with his partner, Lilia Ferreyra, in a small village outside Buenos Aires.

From his vast network of sources, Walsh had been trying to track the junta's many crimes. He compiled lists of the dead and disappeared, the locations of

* The Montoneros were formed as a response to the previous dictatorship. Peronism was banned, and Juan Perón, from exile, called on his young supporters to arm themselves and fight for a return to democracy. They did, and the Montoneros—though they engaged in armed attacks and kidnappings—played a significant part in forcing democratic elections with a Peronist candidate in 1973. But when Perón returned to power, he was threatened by the Montoneros' popular support and encouraged right-wing death squads to go after them, which is why the group—the subject of much controversy—was already significantly weakened by the time of the 1976 coup.

mass graves and of secret torture centers. He prided himself on his knowledge of the enemy, but in 1977 even he was stunned by the furious brutality that the Argentine junta had unleashed on its own people. In the first year of military rule, dozens of his close friends and colleagues had disappeared in the death camps, and his twenty-six-year-old daughter, Vicki, was also dead, driving Walsh mad with grief.

But with Ford Falcons circling, a life of quiet mourning was not available to him. Knowing his time was limited, Walsh made a decision about how he would mark the upcoming one-year anniversary of junta rule: with the official papers lavishing praise on the generals for having saved the country, he would write his own, uncensored, version of the depravity into which his country had descended. It would be titled "An Open Letter from a Writer to the Military Junta," and it was composed, Walsh wrote, "without hope of being listened to, with the certainty of being persecuted, true to the commitment I took up a long time ago, to bear witness in difficult times."⁷⁹

The letter would be the decisive condemnation of both the methods of state terror and the economic system they served. Walsh planned to circulate his "Open Letter" the way he had distributed previous communiqués from the underground: by making ten copies, then posting them from different mailboxes to select contacts who would distribute them further. "I want to let those fuckers know that I'm still here, still alive and still writing," he told Lilia as he sat down at his Olympia typewriter.⁸⁰

The letter begins with an account of the generals' terror campaign, its use of "maximum torture, unending and metaphysical," as well as the involvement of the CIA in training the Argentine police. After listing the methods and grave sites in excruciating detail, Walsh abruptly switches gears: "These events, which stir the conscience of the civilized world, are not, however, the greatest suffering inflicted on the Argentinean people, nor the worst violation for human rights which you have committed. It is in the economic policy of this government where one discovers not only the explanation for the crimes, but a greater atrocity which punishes millions of human beings through planned misery. . . . You only have to walk around greater Buenos Aires for a few hours to check the speed with which such a policy transforms the city into a 'shantytown' of ten million people."⁸¹

The system Walsh was describing was Chicago School neoliberalism, the economic model that would sweep the world. As it took deeper root in Argentina in the decades to come, it would eventually push more than half the

population below the poverty line. Walsh saw it not as an accident but the careful execution of a plan—“planned misery.”

He signed the letter on March 24, 1977, exactly one year after the coup. The next morning, Walsh and Lilia Ferreyra traveled to Buenos Aires. They split the bundle of letters between them and dropped them into mailboxes around the city. A few hours later, Walsh went to a meeting he had arranged with the family of a disappeared colleague. It was a trap: someone had talked under torture, and ten armed men were waiting outside the house in ambush, with orders to capture Walsh. “Bring that fucking bastard back alive, he’s mine,” Admiral Massera, one of the three junta leaders, had reportedly directed the soldiers. Walsh, whose motto was “It isn’t a crime to talk; getting arrested is the crime,” immediately pulled out his gun and began firing. He injured one of the soldiers and drew their fire; he was dead by the time the car arrived at the Navy School of Mechanics. Walsh’s body was burned and dumped in a river.⁸²

The “War on Terror” Cover Story

The juntas of the Southern Cone made no secret of their revolutionary ambitions to remake their respective societies, but they were savvy enough to publicly deny what Walsh was accusing them of: using massive violence in order to achieve those economic goals, goals that, in the absence of a system of terrorizing the public and eliminating obstacles, would have certainly provoked popular revolt.

To the extent that killings by the state were acknowledged, they were justified by the juntas on the grounds that they were fighting a war against dangerous Marxist terrorists, funded and controlled by the KGB. If the juntas used “dirty” tactics, it was because their enemy was monstrous. Using language that sounds eerily familiar today, Admiral Massera called it “a war for freedom and against tyranny . . . a war against those who favor death and by those of us who favor life. . . . We are fighting against nihilists, against agents of destruction whose only objective is destruction itself, although they disguise this with social crusades.”⁸³

In the run-up to Chile’s coup, the CIA bankrolled a massive propaganda campaign to paint Salvador Allende as a dictator in disguise, a Machiavelian schemer who had used constitutional democracy to gain power but was on the verge of imposing a Soviet-style police state from which Chileans would never escape. In Argentina and Uruguay, the largest left-wing guerrilla groups—the Montoneros and the Tupamaros—were presented as such

perilous threats to national security that the generals had no other choice but to suspend democracy, seize the state for themselves and use whatever means were necessary to crush them.

In every case, the threat was either wildly exaggerated or completely manufactured by the juntas. Among its many other revelations, the 1975 Senate investigation disclosed that the U.S. government’s own intelligence reports showed that Allende posed no threat to democracy.⁸⁴ As for Argentina’s Montoneros and Uruguay’s Tupamaros, they were armed groups with significant popular support, able to pull off daredevil attacks on military and corporate targets. But Uruguay’s Tupamaros were completely dismantled by the time the military seized absolute power, and Argentina’s Montoneros were finished within the first six months of a dictatorship that stretched on for seven years (which was why Walsh was in hiding). Declassified State Department documents have proven that César Augusto Guzzetti, the Argentine junta’s foreign minister, told Henry Kissinger on October 7, 1976, that “the terrorist organizations have been dismantled”—yet the junta would go on to disappear tens of thousands of citizens after that date.⁸⁵

For many years, the U.S. State Department also presented the “dirty wars” in the Southern Cone as pitched battles between the military and dangerous guerrillas, struggles that at times got out of hand but were still deserving of economic and military aid. There is mounting evidence that in Argentina as well as in Chile, Washington knew it was supporting a very different kind of military operation.

In March 2006, the National Security Archive in Washington released the newly declassified minutes from a State Department meeting that took place just two days after the Argentine junta staged its 1976 coup. At the meeting, William Rogers, assistant secretary of state for Latin America, tells Kissinger that “we’ve got to expect a fair amount of repression, probably a good deal of blood, in Argentina before too long. I think they’re going to have to come down very hard not only on the terrorists but on the dissidents of trade unions and their parties.”⁸⁶

Indeed they did. The vast majority of the victims of the Southern Cone’s terror apparatus were not members of armed groups but non-violent activists working in factories, farms, shantytowns and universities. They were economists, artists, psychologists and left-wing party loyalists. They were killed not because of their weapons (which most did not have) but because of their beliefs. In the Southern Cone, where contemporary capitalism was born, the “War on Terror” was a war against all obstacles to the new order.