

THE NEW DOCTOR SHOCK

ECONOMIC WARFARE REPLACES DICTATORSHIP

Bolivia's situation could well be compared with the case of a person who has cancer. He knows he faces that most dangerous and painful operation which monetary stabilization and a number of other measures will undoubtedly be. Yet he has no alternative.

—Cornelius Zondag, U.S. economic adviser to Bolivia, 1956.¹

The use of cancer in political discourse encourages fatalism and justifies "severe" measures—as well as strongly reinforcing the widespread notion that the disease is necessarily fatal. The concept of disease is never innocent. But it could be argued that the cancer metaphors are in themselves implicitly genocidal.

—Susan Sontag, *Illness as Metaphor*, 1977²

In 1985, Bolivia was part of the democratic wave sweeping the developing world. For eighteen of the previous twenty-one years, Bolivians had been living under some form of dictatorship. Now they were getting the chance to choose their president in national elections.

Winning control over Bolivia's economy at this particular juncture looked less like a prize than a punishment, however: its debt was so high that the amount Bolivia owed in interest surpassed its entire national budget. A year earlier, in 1984, Ronald Reagan's administration pushed the country over the edge by funding an unprecedented attack on its coca farmers, who grow the green leaf that can be refined into cocaine. The siege, which turned a large section of Bolivia into a military zone, didn't just choke the

coca trade, but cut off the source of roughly half of the country's export revenues, triggering an economic meltdown. As *The New York Times* reported, "When the army marched into the Chapare in August, closing the narcodollar pipeline part way, the shock wave immediately hit the thriving black market in dollars . . . less than a week after the Chapare occupation, the Government was forced to drop the peso's official value by more than half." A few months later, inflation had increased tenfold, and thousands were leaving the country in search of jobs in Argentina, Brazil, Spain and the United States.³

It was in those volatile circumstances, with inflation up to 14,000 percent, that Bolivia entered its historic 1985 national elections. The election was a race between two familiar figures for Bolivians—their former dictator, Hugo Banzer, and their former elected president, Víctor Paz Estenssoro. The vote was very close, and the final decision would be left to Bolivia's Congress, but Banzer's team was sure it had won. Before the results were announced, the party enlisted the help of a little-known thirty-year-old economist named Jeffrey Sachs to help develop an anti-inflation economic plan. Sachs was the rising star of Harvard's economics department, raking in academic awards and becoming one of the university's youngest tenured professors. A few months earlier, a delegation of Bolivian politicians had visited Harvard and seen Sachs in action; they had been impressed by his bravado—he had told them that he could turn around their inflationary crisis in a day. Sachs had no experience in development economics, but, by his own admission, "I thought that I knew just about everything that needed to be known" about inflation.⁴

Sachs had been heavily influenced by Keynes's writings on the connection between hyperinflation and the spread of fascism in Germany after the First World War. The peace agreement imposed on Germany had sent it into severe economic crisis—including a hyperinflation rate of 3.25 million percent in 1923—which was then compounded by the Great Depression a few years later. With an unemployment rate of 30 percent and generalized rage at what seemed a global conspiracy, the country was fertile ground for Nazism.

Sachs liked to quote Keynes's warning that "there is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction."⁵ He shared Keynes's view that it was the sacred duty of economists to suppress those forces of destruction at all costs. "The thing I got from Keynes," Sachs says, "was this deep sadness and sense of risk that things

can go completely awry. And how incredibly stupid it was of us to leave Germany in a state of disrepair.”⁶ Sachs also told journalists that he regarded Keynes’s lifestyle as a politically engaged, globe-trotting economist as a model for his own career.

Although Sachs shared Keynes’s belief in the power of economics to fight poverty, he was also a product of Reagan’s America, which was, in 1985, in the midst of a Friedman-inspired backlash against all that Keynes represented. Chicago School precepts about the supremacy of the free market had rapidly become the unquestioned orthodoxy in Ivy League economics departments, including Harvard’s, and Sachs was definitely not immune. He admired Friedman’s “faith in markets, his constant insistence on proper monetary management,” calling it “far more accurate than fuzzy structuralist or pseudo-Keynesian arguments one hears a lot in the developing world.”⁷

Those “fuzzy” arguments were the same ones that in Latin America had been suppressed by violence a decade earlier—the conviction that in order to escape poverty, the continent needed to break the colonial ownership structures with such interventionist policies as land reform, trade protections and subsidies, nationalization of natural resources, and cooperatively run workplaces. Sachs had little time for such structural changes. So although he knew next to nothing about Bolivia and its long history of colonial exploitation, the suppression of its indigenous inhabitants and the hard-won gains of its 1952 revolution, he was convinced that in addition to hyperinflation, Bolivia suffered from “socialist romanticism”—the same delusion of developmentalism that an earlier generation of U.S.-trained economists had tried to stamp out in the Southern Cone.⁸

Where Sachs parted ways with Chicago School orthodoxy was that he believed free-market policies needed to be supported by debt relief and generous aid—for the young Harvard economist, the invisible hand was not enough. This discrepancy eventually led Sachs to part ways from his more laissez-faire colleagues and devote his efforts exclusively to aid. But that split was years away. In Bolivia, Sachs’s hybrid ideology merely made for some strange contradictions. For instance, when he got off the plane in La Paz, breathing the thin Andean air for the first time, he imagined himself as a latter-day Keynes arriving to save the Bolivian people from the “chaos and disorder” of hyperinflation. * Although the core tenet of Keynesianism is that

* Beating hyperinflation had not saved Germany from depression and then fascism, a contradiction Sachs has never addressed in his persistent use of this analogy.

countries in severe economic recession should spend money to stimulate the economy, Sachs took the opposite approach, advocating government austerity and price increases in the midst of the crisis—the same recipe for contraction that *BusinessWeek* had described in Chile as a “Dr. Strangelove world of deliberately induced depression.”⁹

Sachs’s advice to Banzer was straightforward: only sudden shock therapy would cure Bolivia’s hyperinflation crisis. He proposed raising the price of oil tenfold and a range of other price deregulations and budget cuts. In a speech to the Bolivian-American Chamber of Commerce, Sachs again predicted that hyperinflation could be ended in a day, reporting that “the crowd was startled, and delighted, at the prospect.”¹⁰ Like Friedman, Sachs was a firm believer that, with a sudden policy jolt, “an economy can be reoriented from a dead end, a dead end of socialism or a dead end of mass corruption or a dead end of central planning, to a normal market economy.”¹¹

At the time Sachs made these bold promises, the results of Bolivia’s elections were still up in the air. The former dictator Hugo Banzer was acting as if he had won, but his rival in the race, Victor Paz Estenssoro, hadn’t yet given up. During the campaign, Paz Estenssoro had provided few concrete details about how he planned to deal with inflation. But he had served three times before as Bolivia’s elected president, most recently in 1964, before he was overthrown in a coup. It was Paz who had been the face of Bolivia’s developmentalist transformation, nationalizing the large tin mines, beginning to distribute land to indigenous peasants, defending the right of all Bolivians to vote. Like Argentina’s Juan Perón, Paz was a complicated, omnipresent fixture on the political landscape, often switching allegiances abruptly in order to hold on to power or make a comeback. During the 1985 campaign, an aging Paz pledged allegiance to his “nationalist revolutionary” past and made vague statements about fiscal responsibility. He was not a socialist, but he was no Chicago School neoliberal—or so Bolivians believed.¹²

Since the final decision about who would be named president was up to Congress, this was a period of high-stakes backroom negotiations and horse-trading between the parties, the Congress and the Senate. One newly elected senator ended up playing a pivotal role: Gonzalo Sánchez de Lozada (known in Bolivia as Goni). He had lived in the United States for so long that he spoke Spanish with a heavy American accent and had returned to Bolivia to become one of the country’s wealthiest businessmen. He owned Comsur, the second-largest private mine in the country, soon to be the largest. As a young man, Goni had studied at the University of Chicago, and

though he was not an economist, he was strongly influenced by Friedman's ideas and recognized that they held tremendously profitable implications in the mining sector, which in Bolivia was still largely controlled by the state. When Sachs laid out his shock plans to Banzer's team, Goni was impressed.

The details of the backroom negotiations have never been disclosed, but the results are clear enough. On August 6, 1985, it was Paz who was sworn in as president of Bolivia. Only four days later, Paz appointed Goni to head up a top-secret bipartisan emergency economic team charged with radically restructuring the economy. The group's starting point was Sachs's shock therapy, but it would go much further than anything he had suggested. In fact, it would propose dismantling the entire state-centered economic model that Paz himself had constructed decades earlier. At this point Sachs was back at Harvard, but he says he "was happy to hear that the ADN [Banzer's party] had shared a copy of our stabilization plan with the new president and his team."¹³

Paz's party had no idea that their leader had struck this backroom deal. With the exception of the minister of finance and the minister of planning, who were part of the secret group, Paz did not even tell his newly elected cabinet about the existence of the emergency economic team.¹⁴

For seventeen days straight, the emergency team met in the living room of Goni's palatial home. "We holed ourselves up there in a cautious and almost clandestine way," recalled the planning minister, Guillermo Bedregal, in an interview given in 2005, revealing these details for the first time.¹⁵ What they were contemplating was a radical overhaul of a national economy so sweeping that nothing like it had ever been attempted in a democracy. President Paz was convinced that his only hope was to move as fast and suddenly as possible. That way, Bolivia's notoriously militant trade unions and peasant groups would be caught off guard and wouldn't have a chance to organize a response, or so he hoped. As Goni recalled, Paz "kept saying, 'If you are going to do it, do it now. I can't operate twice.'¹⁶ The reason for Paz's post-election about-face remains something of a mystery. He died in 2001 and never did explain whether he had agreed to adopt Banzer's shock therapy program in exchange for being awarded the presidency, or whether he had

* For two decades, Bolivians did not know how their shock therapy program had been devised. In August 2005, twenty years after the drafting of the original decree, the Bolivian journalist Susan Velasco Portillo interviewed the original members of the emergency economic team, and several of them shared information about the clandestine operation. This account is primarily based on those memories.

undergone a heartfelt ideological conversion. Some insight was provided to me by Edwin Corr, the U.S. ambassador to Bolivia at the time. He recalled that he had met with all the political parties and made it clear that U.S. aid would flow if they went the shock route.

After seventeen days, Bedregal, the planning minister, had the draft of a textbook shock therapy program. It called for the elimination of food subsidies, the canceling of almost all price controls and a 300 percent hike in the price of oil.¹⁷ Despite the fact that life was about to get a lot more expensive in an already desperately poor country, the plan froze government wages at their already low levels for a year. It also called for deep cuts to government spending, flung open Bolivia's borders to unrestricted imports and called for a downsizing of state companies, the precursor to privatization. Bolivia had missed the neoliberal revolution imposed on the rest of the Southern Cone in the seventies; now it was going to make up for lost time.

When the members of the emergency team had finished drafting the new laws, they still weren't ready to share them with Bolivia's elected representatives, let alone its voters, who had never cast their ballots for such a plan. They had one more task to complete. As a group, they drove over to the office of the International Monetary Fund's representative in Bolivia and told him what they were planning to do. His response was at once encouraging and harrowing: "This is what every official at the IMF has dreamed about. But if it doesn't work, luckily I have diplomatic immunity and I can catch a plane and flee."¹⁸

The Bolivians proposing the plan had no such escape hatch, and several were terrified of how the public was going to react. "They are going to kill us," predicted Fernando Prado, the youngest member of the group. Bedregal, the plan's main author, attempted to stiffen spines by comparing the team to fighter pilots attacking an enemy. "We have to be like the pilot of Hiroshima. When he dropped the atomic bomb he didn't know what he was doing, but when he saw the smoke he said: 'Oops, sorry!' And that's exactly what we have to do, launch the measures and then: Oops, sorry!"¹⁹

The idea that policy change should be like launching a surprise military attack is a recurring theme for economic shock therapists. In *Shock and Awe: Achieving Rapid Dominance*, the U.S. military doctrine published in 1996 that eventually formed the basis of the 2003 invasion of Iraq, the authors state that the invading force should "seize control of the environment and paralyze or so overload an adversary's perceptions and understanding of events so that the enemy would be incapable of resistance."²⁰ Economic

shock works according to a similar theory: the premise is that people can develop responses to gradual change—a slashed health program here, a trade deal there—but if dozens of changes come from all directions at once, a feeling of futility sets in, and populations go limp.

Hoping to induce that sense of hopelessness, the Bolivian planners required all of their radical measures to be adopted at the same time, and all within the first hundred days of the new government. Rather than presenting each section of the plan as its own individual law (the new tax code, the new pricing law and so on), Paz's team insisted on bundling the entire revolution into a single executive decree, D.S. 21060. It contained 220 separate laws and covered every aspect of economic life in the country, making it the equivalent, in scope and ambition, to "The Brick," the hefty blueprint written by the Chicago Boys in preparation for Pinochet's coup. According to its authors, the entire program had to be accepted or rejected; it couldn't be amended. It was the economic equivalent of Shock and Awe.

When the document was complete, the team made five copies: one for Paz, one for Goni and one for the treasury minister. The destination of the other two copies revealed how certain Paz and his team were that many Bolivians would regard the plan as an act of war: one was for the head of the army and the other was for the chief of police. Paz's cabinet, however, was still in the dark. They continued to be under the mistaken impression that they were working for the same man who had nationalized the mines and redistributed land all those years ago.

Three weeks after being sworn in as president, Paz finally called his cabinet together to let them in on the surprise he had in store. He ordered the doors closed to the governing chambers and "instructed the secretaries to hold all of the ministers' telephone calls." Bedregal read the full sixty pages to the stunned audience. He was so nervous, he confessed, that he "even got a nosebleed only minutes later." Paz informed his cabinet members that the decree was not up for debate; in yet another backroom deal, he had already secured support from Banzer's right-wing opposition party. If they disagreed, he said, they could resign.

"I don't agree," announced the minister of industry.

"Please leave," Paz replied. The minister stayed. With inflation still soaring and strong hints that a shock therapy approach would be rewarded with significant financial aid from Washington, no one dared leave. Two days later, in a televised presidential address titled "Bolivia Is Dying," Paz dropped Bolivia's "Brick" on a completely unsuspecting public.

Sachs was correct in predicting that price increases would end hyperinflation. Within two years, inflation was down to 10 percent, impressive by any standard.²¹ The broader legacy of Bolivia's neoliberal revolution is far more contentious. All economists agree that rapid inflation is enormously damaging, unsustainable and must be controlled—a process that imposes significant pain during the adjustment. The debate is over how a credible program can be achieved, as well as who, in any given society, is forced to bear the brunt of that pain. Ricardo Grinspun, a professor of economics specializing in Latin America at York University, explains that an approach in the Keynesian or developmentalist tradition seeks to mobilize support and share the burden through "a negotiated process involving key stakeholders—government, employers, farmers, unions and so on. In this way, the parties come to agreements over income policies, like wages and prices, at the same time that stabilization measures are implemented." In sharp contrast, says Grinspun, "the orthodox approach is to shift all the social cost onto the poor through shock therapy." That, he told me, is precisely what happened in Bolivia.

Just as Friedman had promised in Chile, freer trade was supposed to create jobs for the newly jobless. It didn't, and the unemployment rate increased from 20 percent at the time of the elections to between 25 and 30 percent two years later.²² The state mining corporation alone—the same one that Paz had nationalized in the 1950s—was downsized from twenty-eight thousand employees to just six thousand.²³

The minimum wage never recovered its value, and two years into the program, real wages were down 40 percent; at one point they would drop 70 percent.²⁴ In 1985, the year of shock therapy, the per capita average income in Bolivia was \$845; two years later it had fallen to \$789. This is the measure used by Sachs and the government, and despite the lack of progress it conveys, it does not begin to capture the degradation of daily life for many Bolivians. Average income is derived by adding up the country's total income and dividing by the number of people in the country; it glosses over the fact that shock therapy in Bolivia had the same effects that it had in the rest of the region: a small elite grew far wealthier while large portions of what had been the working class were discarded from the economy altogether and turned into surplus people. In 1987, Bolivian peasants, known as campesinos, were earning, on average, just \$140 a year, less than one-fifth of the "average income."²⁵ That is the problem with measuring only the "average": it effectively erases these sharp divisions.

A leader of the peasants' union explained that "the government's statistics

don't reflect the growing number of families forced to live in tents; the thousands of malnourished kids who get only a piece of bread and a cup of tea a day; the hundreds of campesinos who have come to the capital in search of work and end up begging on the streets."²⁶ That was the hidden story of Bolivia's shock therapy: hundreds of thousands of full-time jobs with pensions were eliminated, replaced with precarious ones with no protections at all. Between 1983 and 1988, the number of Bolivians eligible for social security dropped by 61 percent.²⁷

Sachs, who returned to Bolivia as an adviser in the midst of the transition, opposed raising salaries to keep up with the price of food and gasoline and instead favored an emergency fund to help the hardest hit—a Band-Aid on what had become a gaping wound. Sachs returned to Bolivia at Paz Estenssoro's request and was working directly for the president. He is remembered as an unyielding presence. According to Goni (who would later become president of Bolivia), Sachs helped to stiffen the resolve of policy makers when public pressure was building against the human cost of shock therapy. "In his visits [Sachs] said, 'Look, all this gradualist stuff, it just doesn't work. When it really gets out of control you've got to stop it, like a medicine. You've got to take some radical steps; otherwise your patient is going to die.'"²⁸

One immediate result of this resolve was that many of Bolivia's desperately poor were pushed to become coca growers, because it paid roughly ten times as much as other crops (somewhat of an irony since the original economic crisis was set off by the U.S.-funded siege on the coca farmers.)²⁹ By 1989, an estimated one in ten workers was turning to work in some aspect of the coca or cocaine industries.³⁰ These workers would include the family of Evo Morales, future president of Bolivia and a former leader of the militant coca growers' union.

The coca industry played a significant role in resuscitating Bolivia's economy and beating inflation (a fact now recognized by historians but never mentioned by Sachs in explanations of how his reforms triumphed over inflation).³¹ Just two years after the "atomic bomb," illegal drug exports were generating more income for Bolivia than all its legal exports combined, and an estimated 350,000 people were earning a living in some facet of the drug trade. "For now," a foreign banker observed, "the Bolivian economy is hooked on cocaine."³²

In the immediate aftermath of shock therapy, few outside Bolivia were talking about such complex repercussions. They were telling a far simpler story:

about a bold, boyish professor from Harvard who had, virtually single-handedly, "salvaged the inflation-wracked economy of Bolivia," according to *Boston Magazine*.³³ The victory over inflation that Sachs had helped engineer was enough to qualify Bolivia as a stunning free-market success story, "the most remarkable of modern times," as *The Economist* described it.³⁴ "Bolivia's Miracle" gave Sachs immediate star status in powerful financial circles and launched his career as the leading expert on crisis-struck economies, sending him on to Argentina, Peru, Brazil, Ecuador and Venezuela in the coming years.

The praise heaped on Sachs was not just about beating inflation in a poor country. It was that he had achieved what so many had claimed was impossible: he had helped stage a radical neoliberal transformation within the confines of a democracy and without a war, a change far more sweeping than those attempted by either Thatcher or Reagan. Sachs was fully aware of the historical significance of what he had accomplished. "Bolivia was really the first, in my view, combination of democratic reform combined with economic institutional change," he said years later. "And Bolivia much more than Chile showed that you could combine political liberalization and democracy with economic liberalization. That's an extremely important lesson, to have both of those working in parallel and each one reinforcing the other."³⁵

The comparison with Chile was not incidental. Thanks to Sachs—"evangelist for democratic capitalism," as *The New York Times* described him—shock therapy had finally shaken off the stench of dictatorships and death camps that had been clinging to it ever since Friedman made his fateful trip to Santiago a decade earlier.³⁶ Sachs had proven, contrary to what the critics claimed, that the free-market crusade could not only survive but ride the democratic wave now sweeping the world. And Sachs, with his praise for Keynes and his unabashedly idealistic commitment to improving the lot of the developing world, was the perfect man to steer the crusade into this kinder, more peaceful era.

The Bolivian left had taken to calling Paz's decree *pinochetismo económico*—economic Pinochetism.³⁷ As far as the business community was concerned, both inside and outside Bolivia, that was the whole point: Bolivia had brought in Pinochet-style shock therapy, without a Pinochet—and under a center-left government, no less. As one Bolivian banker put it with admiration, "The things Pinochet did with a bayonet, Paz has done within a democratic system."³⁸

The story of the Bolivian miracle has been told and retold, in newspaper and magazine articles, in profiles of Sachs, in Sachs's own best-selling book, and in documentary productions such as PBS's three-part series *Commanding Heights: The Battle for the World Economy*. There is one major problem: it isn't true. Bolivia did show that shock therapy could be imposed in a country that had just had elections, but it did not show that it could be imposed democratically or without repression—in fact, it proved, once again, that the opposite was still the case.

First, there was the obvious problem that President Paz had no mandate from Bolivian voters to remake the entire economic architecture of the country. He had run on a nationalist platform, which he abruptly abandoned in a backroom deal. Some years later, the influential free-market economist John Williamson coined a term for what Paz did: he called it “voodoo politics”; most people simply call it lying.³⁹ That was by no means the only problem with the democracy narrative.

Predictably, many of the voters who elected Paz were furious at his betrayal, and as soon as the decree was handed down, tens of thousands took to the streets to try to block a plan that would mean layoffs and deepening hunger. The major opposition came from the country's main labor federation, which called a general strike that brought industry to a halt. Paz's response made Thatcher's treatment of the miners seem tame. He immediately declared a “state of siege,” and army tanks rolled through the streets of the capital, which was placed under a strict curfew. To travel through their own country, Bolivian citizens now needed special passes. Riot police raided union halls, a university and a radio station, as well as several factories. Political assemblies and marches were forbidden, and state permission was required to hold meetings.⁴⁰ Oppositional politics was effectively banned—just as it had been during the Banzer dictatorship.

To clear the streets, police arrested fifteen hundred demonstrators, dispersed crowds with tear gas and fired on strikers who they said had attacked their officers.⁴¹ Paz also took further measures to make sure that the protests stopped for good. With the leaders of the labor federation on a hunger strike, Paz directed the police and military to round up the country's top two hundred union leaders, load them on planes and fly them to remote jails in the Amazon.⁴² According to Reuters, the detainees included “the leadership of the Bolivian Labor Federation and other senior trade union officials,” and they were taken “to isolated villages in the Amazon basin in northern Bolivia, where their movements [were] restricted.”⁴³ It was a mass kidnapping, complete

with a ransom demand: the prisoners would be released only if the unions called off their protests, which they eventually agreed to do. Filemon Escobar was a miner and labor activist on the streets in those years. In a recent telephone interview from Bolivia, he recalled that “they plucked the labor leaders from the streets and took them to the jungle to be eaten alive by the bugs. When they were released, the new economic plan was in place.” According to Escobar, “The government didn't take people to the jungle to be tortured or killed, but so that they could go ahead with their economic plan.”

This extraordinary state of siege stayed in place for three months, and since the plan was pushed through in one hundred days, that meant the country was under lockdown during the decisive shock therapy period. One year later, when the Paz government moved ahead with mass layoffs in the tin mines, the unions once again took to the streets, and the same series of dramatic events unfolded: a state of siege was declared, and two Bolivian Air Force planes carried one hundred of the country's top labor leaders to internment camps in Bolivia's tropical flatlands. This time, the kidnapped leaders included two former labor ministers and a former senator—recalling Pinochet's “VIP prison” in Southern Chile where Orlando Letelier had been taken. The leaders were held in the camps for two and half weeks until, once again, the unions agreed to call off their protests and hunger strike.⁴⁴

It was a kind of junta lite. In order for the regime to impose economic shock therapy, certain people needed to disappear—if only temporarily. Though certainly less brutal, these disappearances served the same purpose as they had in the seventies. Interning Bolivia's trade unionists so that they could not resist the reforms cleared the path for the economic erasure of whole sectors of workers; their jobs were soon lost, and they ended up warehoused in the shantytowns and slums surrounding La Paz.

Sachs had gone to Bolivia quoting Keynes's warning about economic collapse breeding fascism, but he had proceeded to prescribe measures so painful that quasi-fascist measures were required for their enforcement.

The Paz government's crackdown was covered in the international press at the time, but only as a one- or two-day news story about generic riots in Latin America. When it came time to tell the tale of the triumph of “free-market reforms” in Bolivia, however, the events did not make it into the narrative (much as the symbiosis of Pinochet's violence and Chile's “economic miracle” is so often omitted). Jeffrey Sachs, of course, is not the one who called in the riot police or declared the state of siege, but he does devote a chapter of his book *The End of Poverty* to Bolivia's victory over inflation, and while he