

seems happy to take a share of the credit, he makes no mention of the repression required to carry out the plan. The closest he comes is an oblique reference to “tense moments in the early months of the stabilization program.”<sup>45</sup>

In other accounts, even that admission is erased. Goni went so far as to claim that “stabilization had been achieved in a democracy without going against people’s human liberties, letting people express themselves.”<sup>46</sup> A less idealized assessment came from a minister in the Paz government, who said that they “behaved like authoritarian pigs.”<sup>47</sup>

That dissonance may be the most lasting legacy of Bolivia’s shock therapy experiment. Bolivia had shown that wrenching shock therapy still needed to be accompanied by shocking attacks on inconvenient social groups and on democratic institutions. It also showed that the corporatist crusade could advance by these baldly authoritarian means and still be applauded as democratic because elections had taken place, regardless of how completely civil liberties were suppressed in the aftermath or how fully democratic wishes were ignored. (It was a lesson that would prove particularly handy for Russia’s Boris Yeltsin, among other leaders, in the years to come.) In this way, Bolivia provided a blueprint for a new, more palatable kind of authoritarianism, a civilian coup d’état, one carried out by politicians and economists in business suits rather than soldiers in military uniforms—all unfolding within the official shell of a democratic regime.

## CRISIS WORKS

### THE PACKAGING OF SHOCK THERAPY

**Well, what is the sense of ruining my head and erasing my memory, which is my capital, and putting me out of business? It was a brilliant cure but we lost the patient.**

—Ernest Hemingway on his electroshock therapy, shortly before committing suicide, 1961<sup>1</sup>

For Jeffrey Sachs, the lesson of his first international adventure was that hyperinflation could indeed be stopped in its tracks, with the right tough and drastic measures. He had gone to Bolivia to slay inflation and he had done it. Case closed.

John Williamson, one of the most influential right-wing economists in Washington and a key adviser to the IMF and the World Bank, was watching Sachs’s experiment closely, and he saw something of far greater significance in Bolivia. He described the shock therapy program as “the big bang” moment—a breakthrough in the campaign to bring the Chicago School doctrine to the entire globe.<sup>2</sup> The reason had little to do with economics and everything to do with tactics.

It may not have been his intention, but in quite spectacular fashion Sachs had proven that Friedman’s theory about crisis was absolutely correct. Bolivia’s hyperinflation meltdown was the excuse that was needed to push through a program that would have been politically impossible under normal circumstances. Here was a country with a strong, militant labor movement and a powerful left tradition, site of Che Guevara’s last stand. Yet it had

been forced to accept draconian shock therapy in the name of stabilizing its out-of-control currency.

By the mid-eighties, several economists had observed that a true hyperinflation crisis simulates the effects of a military war—spreading fear and confusion, creating refugees and causing large loss of life.<sup>3</sup> It was strikingly clear that in Bolivia, hyperinflation had played the same role as had Pinochet's "war" in Chile and the Falklands War for Margaret Thatcher—it had created the context for emergency measures, a state of exception during which the rules of democracy could be suspended and economic control could be temporarily handed over to the team of experts in Goni's living room. For hard-core Chicago School ideologues like Williamson, that meant that hyperinflation was not a problem to be solved, as Sachs believed, but a golden opportunity to be seized.

There was no shortage of such opportunities in the eighties. In fact, much of the developing world, but particularly Latin America, was at that very moment spiraling into hyperinflation. The crisis was the result of two main factors, both with roots in Washington financial institutions. The first was their insistence on passing on illegitimate debts accumulated under dictatorships to new democracies. The second was the Friedman-inspired decision at the U.S. Federal Reserve to allow interest rates to soar, which massively increased the size of those debts overnight.

### Passing on Odious Debts

Argentina was a textbook case. In 1983, when the junta collapsed after the Falklands War, Argentines elected Raúl Alfonsín as their new president. The newly liberated country was rigged to detonate, thanks to the planting of a so-called debt bomb. As part of what the outgoing junta had termed a "dignified transition" to democracy, Washington insisted that the new government agree to pay off the debts amassed by the generals. During junta rule, Argentina's external debt had ballooned from \$7.9 billion the year before the coup to \$45 billion at the time of the handover—debts owed to the International Monetary Fund, the World Bank, the U.S. Export-Import Bank and private banks based in the U.S. It was much the same across the region. In Uruguay, the junta took a debt of half a billion dollars when it seized power and expanded it to \$5 billion, a huge load in a country of only 3 million people. In Brazil, the most dramatic case, the generals, who came to power in 1964 promising financial order, managed to take the debt from \$3 billion to \$103 billion in 1985.<sup>4</sup>

At the time of the transitions to democracy, powerful arguments were made, both moral and legal, that these debts were "odious" and that newly liberated people should not be forced to pay the bills of their oppressors and tormentors. The case was especially strong in the Southern Cone because so much of the foreign credit had gone straight to the military and police during the dictatorship years—to pay for guns, water cannons and state-of-the-art torture camps. In Chile, for instance, the loans bankrolled a tripling in military spending, enlarging Chile's army from forty-seven thousand in 1973 to eighty-five thousand in 1980. In Argentina, the World Bank estimates that roughly \$10 billion of the money borrowed by the generals went to military purchases.<sup>5</sup>

Much of what wasn't spent on weapons simply vanished. A culture of corruption permeated junta rule—a glimpse of the debauched future to come when the same free-wheeling economic policies spread to Russia, China and the "free fraud zone" of occupied Iraq (to borrow a phrase from a disaffected U.S. adviser).<sup>6</sup> According to a 2005 U.S. Senate report, Pinochet maintained a byzantine web of at least 125 secret foreign bank accounts listed under the names of various family members and combinations of his own name. The accounts, the most notorious of which were at the Washington, D.C.-based Riggs Bank, hid an estimated \$27 million.<sup>7</sup>

In Argentina, the junta has been accused of being even more acquisitive. In 1984, José Martínez de Hoz, architect of the economic program, was arrested on fraud charges relating to a massive state subsidy to one of the companies he used to head (the case was later dismissed).<sup>8</sup> The World Bank, meanwhile, later tracked what happened to \$35 billion in foreign loans borrowed by the junta and found that \$19 billion—46 percent of the total—was moved offshore. Swiss officials have confirmed that much of it ended up in numbered accounts.<sup>9</sup> The U.S. Federal Reserve observed that in 1980 alone, Argentina's debt expanded by \$9 billion; in that same year, the amount of money deposited abroad by Argentine citizens increased by \$6.7 billion.<sup>10</sup> Larry Sjaastad, a famed University of Chicago professor who personally trained many of Argentina's Chicago Boys, has described these missing billions (stolen under the noses of his students) as "the greatest fraud of the twentieth century."<sup>11</sup>

The junta embezzlers even enlisted their victims in these crimes. At the

\* It may well have been at the time, but the century was not over—Russia's Chicago School experiment was to come.

ESMA torture center in Buenos Aires, prisoners with strong language skills or university educations were regularly pulled out of their cells to perform clerical tasks for their captors. One survivor, Graciela Daleo, was instructed to type a document advising officers on offshore tax havens for the money they were embezzling.<sup>12</sup>

The remainder of the national debt was mostly spent on interest payments, as well as shady bailouts for private firms. In 1982, just before Argentina's dictatorship collapsed, the junta did one last favor for the corporate sector. Domingo Cavallo, president of Argentina's central bank, announced that the state would absorb the debts of large multinational and domestic firms that had, like Chile's piranhas, borrowed themselves to the verge of bankruptcy. The tidy arrangement meant that these companies continued to own their assets and profits, but the public had to pay off between \$15 and \$20 billion of their debts; among the companies to receive this generous treatment were Ford Motor Argentina, Chase Manhattan, Citibank, IBM and Mercedes-Benz.<sup>13</sup>

Those who favored defaulting on these illegitimately accumulated debts argued that the lenders knew, or ought to have known, that the money was being spent on repression and corruption. This case was bolstered recently when the State Department declassified the transcript of a meeting held on October 7, 1976, between Henry Kissinger, then secretary of state, and Argentina's foreign minister under the military dictatorship, the admiral César Augusto Guzzetti. After discussing the international human rights outcry following the coup, Kissinger said, "Look, our basic attitude is that we would like you to succeed. I have an old-fashioned view that friends ought to be supported. . . . The quicker you succeed, the better." Kissinger then moved on to the topic of loans, encouraging Guzzetti to apply for as much foreign assistance as possible and fast, before Argentina's "human rights problem" tied the hands of the U.S. administration. "There are two loans in the bank," Kissinger said, referring to the Inter-American Development Bank. "We have no intention of voting against them." He also instructed the minister, "Proceed with your Export-Import Bank requests. We would like your economic program to succeed and we will do our best to help you."<sup>14</sup>

The transcript proves that the U.S. government approved loans to the junta knowing they were being used in the midst of a campaign of terror. In the early eighties, it was these odious debts that Washington insisted Argentina's new democratic government had to repay.

### The Debt Shock

On their own, the debts would have been an enormous burden on the new democracies, but that burden was about to get much heavier. A new kind of shock was in the news: the Volcker Shock. Economists used this term to describe the impact of the decision made by Federal Reserve chairman Paul Volcker when he dramatically increased interest rates in the United States, letting them rise as high as 21 percent, reaching a peak in 1981 and lasting through the mid-eighties.<sup>15</sup> In the U.S., rising interest rates led to a wave of bankruptcies, and in 1983 the number of people who defaulted on their mortgages tripled.<sup>16</sup>

The deepest pain, however, was felt outside the U.S. In developing countries carrying heavy debt loads, the Volcker Shock—also known as the "debt shock" or the "debt crisis"—was like a giant Taser gun fired from Washington, sending the developing world into convulsions. Soaring interest rates meant higher interest payments on foreign debts, and often the higher payments could only be met by taking on more loans. The debt spiral was born. In Argentina, the already huge debt of \$45 billion passed on by the junta grew rapidly until it reached \$65 billion in 1989, a situation reproduced in poor countries around the world.<sup>17</sup> It was after the Volcker Shock that Brazil's debt exploded, doubling from \$50 billion to \$100 billion in six years. Many African countries, having borrowed heavily in the seventies, found themselves in similar straits: Nigeria's debt in the same short time period went from \$9 billion to \$29 billion.<sup>18</sup>

These were not the only economic shocks zapping the developing world in the eighties. A "price shock" occurs every time the price of an export commodity like coffee or tin drops by 10 percent or more. According to the IMF, developing countries experienced 25 such shocks between 1981 and 1983; between 1984 and 1987, the height of the debt crisis, they experienced 140 such shocks, pushing them deeper into debt.<sup>19</sup> One hit Bolivia in 1986, the year after it had swallowed Jeffrey Sachs's bitter medicine and submitted to a capitalist makeover. The price of tin, Bolivia's major export other than coca, dropped by 55 percent, devastating the country's economy through no fault of its own. (This was precisely the kind of dependence on raw resource exports that developmentalist economics had been trying to transcend in the fifties and sixties—an idea dismissed as "fuzzy" by the Northern economic establishment.)

This is where Friedman's crisis theory became self-reinforcing. The more

the global economy followed his prescriptions, with floating interest rates, deregulated prices and export-oriented economies, the more crisis-prone the system became, producing more and more of precisely the type of melt-downs he had identified as the only circumstances under which governments would take more of his radical advice.

In this way, crisis is built into the Chicago School model. When limitless sums of money are free to travel the globe at great speed, and speculators are able to bet on the value of everything from cocoa to currencies, the result is enormous volatility. And, since free-trade policies encourage poor countries to continue to rely on the export of raw resources such as coffee, copper, oil or wheat, they are particularly vulnerable to getting trapped in a vicious circle of continuing crisis. A sudden drop in the price of coffee sends entire economies into depression, which is then deepened by currency traders who, seeing a country's financial downturn, respond by betting against its currency, causing its value to plummet. When soaring interest rates are added, and national debts balloon overnight, you have a recipe for potential economic mayhem.

Chicago School believers tend to portray the mid-eighties onward as a smooth and triumphant victory march for their ideology: at the same time that countries were joining the democratic wave, they had the collective epiphany that free people and unfettered free markets go hand in hand. That epiphany was always fictional. What actually happened is that just as citizens were finally winning their long-denied freedoms, escaping the shock of the torture chambers under the likes of the Philippines' Ferdinand Marcos and Uruguay's Juan María Bordaberry, they were hit with a perfect storm of financial shocks—debt shocks, price shocks and currency shocks—created by the increasingly volatile, deregulated global economy.

Argentina's experience of how the debt crisis was compounded by these other shocks was, unfortunately, typical. Raúl Alfonsín took office in 1983, in the midst of the Volcker Shock, which placed the new government in crisis mode from day one. In 1985, inflation was so bad that Alfonsín was forced to unveil a brand-new currency, the austral, gambling that a fresh start would allow him to regain control. Within four years, prices had soared so high that massive food riots broke out, and Argentine restaurants were using the currency as wallpaper because it was cheaper than paper. In June 1989, with inflation up 203 percent that month alone, and five months before his term was set to expire, Alfonsín gave up: he resigned and called early elections.<sup>21</sup>

Other options were available to politicians in Alfonsín's position. He could have defaulted on Argentina's huge debts. He could have joined with neighboring governments in the same crisis and formed a debtors' cartel. These governments could have created a common market based on developmentalist principles, a process that had begun when the region was torn apart by sadistic military regimes. But part of the challenge at the time had to do with the legacy of state terror faced by new democracies. In the eighties and nineties, much of the developing world was in the grip of a kind of terror hangover, free on paper but still cautious and wary. Having finally escaped the darkness of dictatorship, few elected politicians were willing to risk inviting another round of U.S.-supported coups d'état by pushing the very policies that had provoked the coups of the seventies—especially when the military officials who had staged them were, for the most part, not in prison but, having negotiated immunity, in their barracks, watching.

Understandably unwilling to go to war with the Washington institutions that owned their debts, crisis-struck new democracies had little choice but to play by Washington's rules. And then, in the early eighties, Washington's rules got a great deal stricter. That's because the debt shock coincided precisely, and not coincidentally, with a new era in North-South relations, one that would make military dictatorships largely unnecessary. It was the dawn of the era of "structural adjustment"—otherwise known as the dictatorship of debt.

Philosophically, Milton Friedman did not believe in the IMF or the World Bank: they were classic examples of big government interfering with the delicate signals of the free market. So it was ironic that there was a virtual conveyor belt delivering Chicago Boys to the two institutions' hulking headquarters on Nineteenth Street in Washington, D.C., where they took up many of the top positions.

Arnold Harberger, who headed the University of Chicago's Latin America program, often brags about how many of his graduates landed powerful jobs at the World Bank and the IMF. "There was one moment in time when four regional chief economists at the World Bank had been my students in Chicago. One of them, Marcelo Selowsky, went off to be the chief economist for the newly minted ex-Soviet empire area, which is the biggest such job in the whole Bank. And guess what? He was replaced by yet another former student, Sebastian Edwards. So it's very nice to see these people moving up, and I'm proud to have played a part in their development as economists."<sup>21</sup>

Another star was Claudio Loser, an Argentine who graduated from the University of Chicago in 1971 and went on to become director of the Western Hemisphere Department of the IMF, the most senior post dealing with Latin America.\* Chicagoans occupied many other senior IMF posts as well, including the second-highest position, first deputy managing director, as well as chief economist, director of research and senior economist of the African Department.<sup>22</sup>

Friedman may have opposed the institutions on philosophical grounds, but practically, there were no institutions better positioned to implement his crisis theory. When countries were sent spiraling into crisis in the eighties, they had nowhere else to turn but the World Bank and the IMF. When they did, they hit a wall of orthodox Chicago Boys, trained to see their economic catastrophes not as problems to solve but as precious opportunities to leverage in order to secure a new free-market frontier. Crisis opportunism was now the guiding logic of the world's most powerful financial institutions. It was also a fundamental betrayal of their founding principles.

Like the UN, the World Bank and the IMF were created in direct response to the horror of the Second World War. With the goal of never again repeating the mistakes that had allowed fascism to rise in the heart of Europe, the world powers came together in 1944 in Bretton Woods, New Hampshire, to create a new economic architecture. The World Bank and the IMF, financed through contributions by their initial forty-three member countries, were given the explicit mandate to prevent future economic shocks and crashes like the ones that had so destabilized Weimar Germany. The World Bank would make long-term investments in development to pull countries out of poverty, while the IMF would act as a kind of global shock absorber, promoting economic policies that reduced financial speculation and market volatility. When a country looked as though it was falling into crisis, the IMF would leap in with stabilizing grants and loans, thereby preventing crises before they occurred.<sup>23</sup> The two institutions, located across the street from each other in Washington, would coordinate their responses.

John Maynard Keynes, who headed the U.K. delegation, was convinced that the world had finally recognized the political perils of leaving the mar-

ket to regulate itself. "Few believed it possible," Keynes said at the conference's end. But if the institutions stayed true to their founding principles, "the brotherhood of man will have become more than a phrase."<sup>24</sup>

The IMF and the World Bank did not live up to that universal vision; from the start they allocated power not on the basis of "one country, one vote," like the UN General Assembly, but rather on the size of each country's economy—an arrangement that gives the United States an effective veto over all major decisions, with Europe and Japan controlling most of the rest. That meant that when Reagan and Thatcher came to power in the eighties, their highly ideological administrations were essentially able to harness the two institutions for their own ends, rapidly increasing their power and turning them into the primary vehicles for the advancement of the corporatist crusade.

The colonization of the World Bank and the IMF by the Chicago School was a largely unspoken process, but it became official in 1989 when John Williamson unveiled what he called "the Washington Consensus." It was a list of economic policies that he said both institutions now considered the bare minimum for economic health—"the common core of wisdom embraced by all serious economists."<sup>25</sup> These policies, masquerading as technical and uncontentious, included such bald ideological claims as all "state enterprises should be privatized" and "barriers impeding the entry of foreign firms should be abolished."<sup>26</sup> When the list was complete, it made up nothing less than Friedman's neoliberal triumvirate of privatization, deregulation/free trade and drastic cuts to government spending. These were the policies, Williamson said, "that were being urged on Latin America by the powers-that-be in Washington."<sup>27</sup> Joseph Stiglitz, former chief economist of the World Bank and one of the last holdouts against the new orthodoxy, wrote that "Keynes would be rolling over in his grave were he to see what has happened to his child."<sup>28</sup>

Officials with the World Bank and the IMF had always made policy recommendations when they handed out loans, but in the early eighties, emboldened by the desperation of developing countries, those recommendations morphed into radical free-market demands. When crisis-struck countries came to the IMF seeking debt relief and emergency loans, the fund responded with sweeping shock therapy programs, equivalent in scope to "The Brick" drafted by the Chicago Boys for Pinochet and the 220-law decree cooked up in Goni's living room in Bolivia.

The IMF issued its first full-fledged "structural adjustment" program in

\* Loser was fired after Argentina's 2001 collapse. The consensus was that the IMF under his watch was so enamored of free-market policies that, as long as countries kept cutting spending and privatizing their economies, it continued to lavish loans on them, overlooking glaring weaknesses in their economies, such as mass unemployment and rampant corruption—not to mention unsustainable debt to the IMF.

1983. For the next two decades, every country that came to the fund for a major loan was informed that it needed to revamp its economy from top to bottom. Davison Budhoo, an IMF senior economist who designed structural adjustment programs in Latin America and Africa throughout the eighties, admitted later that “everything we did from 1983 onward was based on our new sense of mission to have the south ‘privatised’ or die; towards this end we ignominiously created economic bedlam in Latin America and Africa in 1983–88.”<sup>29</sup>

Despite this radical (and highly profitable) new mission, the IMF and the bank always claimed that everything they did was in the interest of stabilization. The fund’s official mandate was still crisis prevention—not social engineering or ideological transformation—so stabilization needed to be the official rationale. The reality was that in country after country, the international debt crisis was being methodically leveraged to advance the Chicago School agenda, based on a ruthless application of Friedman’s shock doctrine.

Economists at the World Bank and the IMF admitted this at the time, although the admissions were generally made in coded economic language and restricted to specialized forums and publications for fellow “technocrats.” Dani Rodrik, a renowned Harvard economist who worked extensively with the World Bank, described the entire construct of “structural adjustment” as an ingenious marketing strategy. “The World Bank must be given credit,” Rodrik wrote in 1994, “for having invented and successfully marketed the concept of ‘structural adjustment,’ a concept that *packaged together* microeconomic and macroeconomic reforms. *Structural adjustment was sold as the process that countries needed to undergo in order to save their economies from the crisis.* For governments that bought into the package, the distinction between sound macroeconomic policies that maintain external balance and stable prices, on the one hand, and policies that determine openness [like free trade], on the other, *was obfuscated.*”<sup>30</sup>

The principle was simple: countries in crisis desperately need emergency aid to stabilize their currencies. When privatization and free-trade policies are packaged together with a financial bailout, countries have little choice but to accept the whole package. The really clever part was that the economists themselves knew that free trade had nothing to do with ending a crisis, but that information was expertly “obfuscated.” Rodrik meant his comment as a compliment. Not only did this bundling work in getting poor countries to accept the policies selected for them by Washington, but it was the only

thing that worked—and Rodrik had the numbers to back up his claim. He had studied all the countries that adopted radical free-trade policies in the eighties and found that “no significant case of trade reform in a developing country in the 1980s took place outside the context of a serious economic crisis.”<sup>31</sup>

It was a staggering admission. At this point in history, the bank and the fund were publicly insisting that governments the world over had seen the light and realized that the Washington Consensus policies were the only recipe for stability, and therefore democracy. Yet here was an acknowledgment, made inside the Washington establishment, that developing countries were submitting to them only through a combination of false pretenses and bald extortion: Want to save your country? Sell it off. Rodrik even conceded that privatization and free trade—two central pieces of the structural adjustment package—had no direct link with creating stability. To argue otherwise, according to Rodrik, was “bad economics.”<sup>32</sup>

Argentina—the “model student” of the IMF in this period—once again offers a clear window into the mechanics of the new order. After the hyperinflation crisis forced President Alfonsín to resign, he was replaced by Carlos Menem, a Peronist governor from a small province who wore leather jackets, had muttonchop sideburns and seemed tough enough to stand up to both the still-ominous military and the creditors. After all the violent attempts that had been made to erase the Peronist party and the trade union movement, Argentina now had a president who had run a pro-union campaign promising to revive Juan Perón’s nationalist economic policies. It was a moment with many of the same emotional echoes as Paz’s inauguration in Bolivia.

Too many, as it turned out. After a year in office, and under intense pressure from the IMF, Menem embarked on a defiant course of “voodoo politics.” Elected as the symbol of the party that had opposed the dictatorship, Menem appointed Domingo Cavallo as his economy minister, bringing back to power the junta-era official responsible for bailing out the debts of the corporate sector—the dictatorship’s parting gift.<sup>33</sup> His appointment was what economists call “a signal”—an unmistakable indication, in this case, that the new government would pick up and continue the corporatist experiment started by the junta. The Buenos Aires stock market responded with the equivalent of a standing ovation: a 30 percent spike in trading on the day Cavallo’s name was announced.<sup>34</sup>

Cavallo immediately called for ideological reinforcements, stacking the government with former students of Milton Friedman and Arnold Harberger.

Virtually all the country's top economic posts were filled by Chicago Boys: president of the central bank was Roque Fernández, who had worked at both the IMF and the World Bank; vice president of the central bank was Pedro Pou, a Chicago Boy who had worked for the dictatorship; the chief central bank adviser was the Pablo Guidotti, who came directly from his job working at the IMF under another former University of Chicago professor, Michael Mussa.

Argentina was not unique in this regard. By 1999, the Chicago School international alumni included more than twenty-five government ministers and more than a dozen central bank presidents from Israel to Costa Rica, an extraordinary level of influence for one university department.<sup>35</sup> In Argentina, as in so many other countries, the Chicago Boys formed a kind of ideological pincer around the elected government, one group squeezing from within, another exerting its pressure from Washington. For instance, the IMF delegations to Buenos Aires were often led by Claudio Loser, the Argentine Chicago Boy, which meant that when he met with the finance ministry and the central bank, the meetings were not adversarial negotiations but collegial discussions among friends, former classmates at the University of Chicago and recent coworkers on Nineteenth Street. A book published in Argentina about the effect of this global economic fraternity is aptly titled *Buenos Muchachos*, a reference to Martin Scorsese's mafia classic, *Goodfellas*.<sup>36</sup>

The members of this fraternity were in enthusiastic agreement about what needed to be done with Argentina's economy—and how to pull it off. The Cavallo Plan, as it came to be called, was based on the clever packaging trick that both the World Bank and the IMF had perfected: harnessing the chaos and desperation of a hyperinflation crisis to pass privatization off as an integral part of the rescue mission. So, to stabilize the money system, Cavallo quickly made massive cuts to public spending and launched another new currency, the Argentine peso, pegged to the U.S. dollar. Within a year, inflation was down to 17.5 percent and was virtually eliminated a few years later.<sup>37</sup> This dealt with the runaway currency but “obfuscated” the other half of the program.

Argentina's dictatorship, for all its commitment to pleasing foreign investors, had left large and desirable pieces of the economy in state hands, from the national airline to Patagonia's impressive oil reserves. As far as Cavallo and his Chicago Boys were concerned, the revolution was only half finished, and they were determined to use the economic crisis to complete their work.

In the early nineties, the Argentine state sold off the riches of the country so rapidly and so completely that the project far surpassed what had taken place in Chile a decade earlier. By 1994, 90 percent of all state enterprises had been sold to private companies, including Citibank, Bank Boston, France's Suez and Vivendi, Spain's Repsol and Telefónica. Before making the sales, Menem and Cavallo had generously performed a valuable service for the new owners: they had fired roughly 700,000 of their workers, according to Cavallo's own estimates; some put the number much higher. The oil company alone lost 27,000 workers during the Menem years. An admirer of Jeffrey Sachs, Cavallo called this process “shock therapy.” Menem had an even more brutal phrase for it: in a country still traumatized by mass torture, he called it “major surgery without anesthetic.”<sup>38</sup>

In the midst of the transformation, *Time* magazine put Menem on its cover, his face grinning out of the middle of a sunflower, under the headline “Menem's Miracle.”<sup>39</sup> And it was a miracle—Menem and Cavallo had pulled off a radical and painful privatization program without sparking a national revolt. How had they done it?

Years later, Cavallo explained. “At the time of hyperinflation it's terrible for the people, particularly for low-income people and small savers, because they see that in a few hours or in a few days they are being told their salaries got destroyed by the price increases, which take place at an incredible speed. That is why the people ask the government, ‘Please do something.’ And if the government comes with a good stabilization plan, that is the opportunity to also accompany that plan with other reforms . . . the most important reforms were related to the opening up of the economy and to the deregulation and the privatization process. But the only way to implement all those reforms was, at that time, to take advantage of the situation created by hyperinflation, because the population was ready to accept drastic changes in order to eliminate hyperinflation and to go back to normality.”<sup>40</sup>

\* In January 2006, long after Cavallo and Menem were out of office, Argentines received some surprising news. It turned out that the Cavallo Plan wasn't Cavallo's at all, nor was it the IMF's: Argentina's entire early-nineties shock therapy program was written in secret by JP Morgan and Citibank, two of Argentina's largest private creditors. In the course of a lawsuit against the Argentine government, the noted historian Alejandro Olmos Gaona uncovered a jaw-dropping 1,400-page document written by the two U.S. banks for Cavallo in which “the policies carried out by the government from '92 on are drawn up . . . the privatization of utilities, the labour law reform, the privatization of the pension system. It is all laid out with great attention to detail. . . . Everyone believes that the economic plan pursued since 1992 was Domingo Cavallo's creation, but that's not the way it is.”

In the long term, Cavallo's program in its entirety would prove disastrous for Argentina. His method of stabilizing the currency—pegging the peso to the U.S. dollar—made it so expensive to produce goods inside the country that local factories could not compete with the cheap imports flooding the country. So many jobs were lost that well over half the country would eventually be pushed below the poverty line. In the short term, however, the plan worked brilliantly: Cavallo and Menem had smuggled privatization in while the country was in shock from hyperinflation. Crisis had done its job.

What Argentina's leaders pulled off in this period was a psychological more than an economic technique. As Cavallo, a junta veteran, well understood, in moments of crisis, people are willing to hand over a great deal of power to anyone who claims to have a magic cure—whether the crisis is a financial meltdown or, as the Bush administration would later show, a terrorist attack.

And that is how the crusade that Friedman began managed to survive the dreaded transition to democracy—not by its proponents persuading electorates of the wisdom of their worldview, but by moving deftly from crisis to crisis, expertly exploiting the desperation of economic emergencies to push through policies that would tie the hands of fragile new democracies. Once the tactic was perfected, opportunities just seemed to multiply. The Volcker Shock would be followed by the Mexican Tequila Crisis in 1994, the Asian Contagion in 1997 and the Russian Collapse in 1998, which was followed shortly afterward by one in Brazil. When these shocks and crises started to lose their power, even more cataclysmic ones would appear: tsunamis, hurricanes, wars and terrorist attacks. Disaster capitalism was taking shape.

## PART 4

## LOST IN TRANSITION

WHILE WE WEPT, WHILE WE  
TREMBLED, WHILE WE DANCED

**These worst of times give rise to the best of opportunities for those who understand the need for fundamental economic reform.**

—Stephan Haggard and John Williamson, *The Political Economy of Policy Reform*, 1994