



Silent Revolution: An Early Export from Pinochet's Chile

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Revolución silenciosa: Una exportación prematura del Chile de Pinochet
Revolução silenciosa: Uma exportação precoce do Chile de Pinochet

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This article explores the evolution of liberal economics from the Chilean perspective as it was exported to the rest of the world. From its origins as "monetarism" to the days it started to be known as "neoliberalism." The traditional belief that free-market and democracy are bound together is challenged. Application of monetarist policies in the Pinochet regime is a good example of what can happen when market enhancement ran independently – even contrary – to the expansion of democracy and social liberties.

En este artículo se explora la evolución de la economía liberal desde la perspectiva chilena, tal como se exportó al resto del mundo. Desde sus orígenes como "monetarismo" a los días en que empezó a conocerse como "neoliberalismo". Se argumenta sobre la creencia tradicional de que el mercado libre y la democracia van de la mano. La aplicación de las políticas monetarias en el régimen de Pinochet es un buen ejemplo de lo que puede ocurrir cuando la ascensión del mercado se desarrolla de forma independiente (e incluso inversa) a la expansión de la democracia y las libertades sociales.

Este artigo explora a evolução da economia liberal na perspectiva chilena tal como foi exportada para o resto do mundo. Desde as suas origens como «monetarismo» até aos dias em que começou a ser conhecida por «neoliberalismo». É posta em causa a crença tradicional de que o mercado livre e a democracia estão interligados. A aplicação de políticas monetaristas no regime de Pinochet é um bom exemplo do que pode acontecer quando o aprofundamento do mercado corre independentemente – e até em sentido inverso – da expansão da democracia e liberdades sociais.

1. Introduction

When I was a student in London, I used to have my breakfast in a little cafe in Islington. The owner of the place was a matured-aged Spanish woman who usually chat with me before charging the bill. One morning we started to talk about Chile, where I came from. When the conversation finally shifted to the economy, she told me in a confessional voice: "you are going to excuse me, but I think countries like Spain and Latin America (sic) need strong-handed leaders to prosper". As I didn't say anything, she felt embarrassed and turned back to the counter. She was talking about general Pinochet.

I admit she got me by surprise. It had been long time since someone outside Chile openly declares his or her support to the Pinochet regime. The general has been an infamous figure, constantly remembered by the crimes against humanity committed by his government. I have come across with so many people who the only thing they know about Chile is Pinochet, and the only thing they know about Pinochet is that he is an evil man.

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But when I returned to my newspaper, suddenly her confession didn't sound so odd after all. I was reading the business section.

True, the political means used by Pinochet are broadly criticized and only very few conservative politicians who might secretly look back nostalgically to past authoritarian epochs would support his methods. Economically, however, the Pinochet regime is another story. The general and his team of young economists trained in Chicago have been broadly admired and acclaimed, from most extreme right-wing think-tanks to world-class publications like the New York Times, The Economist, Time magazine, Newsweek and Financial Times.

Actually, the most radical –and to some extent, innovative– application of liberal economics was carried out during the dictatorship of Augusto Pinochet in Chile, in the early 1970s. In fact, the IMF and the World Bank use to recommend developing countries to do the very same the Pinochet regime did. Reforms such as low tariffs, privatization, and deregulation are usually portrayed as the natural path to development and prosperity, a solution-pack of blank economics for the undeveloped world. Yet a closer look to the origins of this magic formula portrays a story in which stern ideological politics play an important role.

A common belief among Western policy makers assumes that free-market and democracy are bound together. Certainly, the evidence in many countries shows that they do work well in presence of the other. But when it comes of implementing them, things get more complicated, as market structures and democratic institutional frameworks can actually work separately for a significant period of time. The Asian crisis of 1997 along with the negative outcomes of Russia's rapid transformation into a market-economy (as other former Soviet republics) proved how mistaken can turn to be the application of liberal economic policies without considering other variables, such as maturity of the political system or social development.

This miscalculation was common during the 1990s because the fall of the Soviet Union and the rapid growth of a globally integrated economy, contributed to push into hybris the belief that liberal economics will generate by its own, in an almost automatic process, a democratic system of governance. Many Western leaders and policy makers followed the business community in adhering to that belief, without noticed that such perfection and infallibility is not something defined in practical or pragmatic terms, but something more close to ideology.

Something that can be helpful to give an idea of such miscalculations, is examining the key historical events that prompted that liberal and laissez-faire doctrines became economic orthodoxy in the second half of the 20th Century, from its origins as "monetarism" to the days it started to be known as "neoliberalism".

And perhaps the two most relevant of them are the application of the model during the Pinochet regime and the following introduction of those policies in Britain by Margaret Thatcher. The first was a successful experiment that ended up convincing Mrs. Thatcher to go forward with her revolutionary programme. The second modernized Britain and actually draw the features it face has today, becoming an example for Western governments

KEY WORDS

**Pinochet,
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School, Free
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PALABRAS CLAVE

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PALAVRAS- CHAVE

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to go in the same direction. That's why scrutinizing their respective success and failures, strengths, weaknesses, what did go well and what went wrong, can help to reveal the ideological and authoritarian factors of liberal economic's putting into practice, especially in the "rare" situation of Pinochet's market liberalization married with brutal political repression.

2. A testing ground for monetarism

During the 1950s the University of Chicago School of Business was developing a radical approach to economic theory. The approach was based on the views of American economist Milton Friedman, who opposed the socially conscious economics that had dominated Western governments after the Great Depression of 1929. Friedman rejected the principles of Keynesian economics –the economic theoretical mainstream at the time– which considers the state could intervene in the market to correct negative social consequences the rough business of laissez-faire could provoke, such as unemployment, poverty and inequality. Under Keynesian-inspired policies, the state has a role in generating demand through state borrowing and spending. It is entitled to subsidize particular sectors of the industry, redistribute resources, and monopolise public services such as health and education.

Friedman, on the contrary, believed the state's role should be relegated to guarantee and protect private property in order to extend the reach and usefulness of the market and individual enterprise. His doctrine was based in the belief that economic benefit could best be optimized if the individual has the autonomy to pursue his or her own self-interest. As Friedman's ideas were focusing in the macroeconomic effects of supply of money and central banking –and that "inflation is always and everywhere a monetary phenomenon"–, his doctrine started to be known as "monetarism". One of the key issues for Friedman's theory is to keep supply and demand for money in equilibrium (according growth in productivity and demand), so the state cannot borrow or spending over its means, as it usually does in a demand-driven model such as Keynesianism.

All those ideas turned the School of Chicago the alma mater of individualistic market economy, with its economists showing faithfulness in classical and neoclassical economic beliefs, themes and concepts. Economist H. Laurence Miller wrote that more radical than the theory itself, were the economists and students who advocate it: "They emphasize the usefulness and relevance of the neo-classical economic theory, equate the actual and the ideal market, see and apply economics in to every nook and cranny of life".

At an early stage, the main challenge monetarism had to face was its application. During the 1950s and 1960s most Western democracies –the US included– were enjoying the post-WWII wave of economic growth and social wellbeing through the welfare state model. Friedman's philosophy didn't have significant influence on policy-makers. Yet his ideas started to be heard and disseminate through conservatives and right wing supporters around the world, providing new inspiration and theoretical ground for counter-revolution advocates.

In 1955 American advisers tried to persuade Chile to apply an early version of Chicago's monetarism but, as the Chilean government was encouraging domestic industrialization,

the offer was refused. Then the University of Chicago School of Business set up an academic agreement with Chile's Catholic University in which the American university sent professors to do research and accepted Chilean graduate students into their postgraduate courses. Tuition and expenses were covered by a system of scholarships provided by the US Government and the Ford Foundation.

By the early 1970s, most of the Chilean students who benefited from the scholarships were sons of the Chilean right. In their study about Chilean economy, authors Constable and Valenzuela described them as "middle and upper-class students at the Catholic University in the 1950s and 1960s, who shared a conservative religious background, a visceral rejection of socialism, and contempt for Chile's freewheeling, mass democracy". Once in the US, they rapidly adopt the Chicago School of Economics' theoretical line and became faithful advocates of Milton Friedman's economic beliefs. They were starting to be known as "Chicago boys". Back in Chile, the Chicago boys remained teaching inside the Catholic University and could not exercise major influence. Their theories weren't in tune with the consensus-and-development policy of the Christian Democrat government of Eduardo Frei Montalva.

In 1970, Chilean electorate went further to the left. Socialist candidate Salvador Allende won the presidential elections and became the first socialist to be democratically elected in the Western hemisphere.

The US government shrank its aid to Chile and pressured multilateral lending institutions such as the World Bank and the Inter-American Development Bank to do so. As a result, Chile's foreign reserves plunged from \$400 million in 1970 to \$13 million in 1972. In an effort to redistribute resources to the poorer sectors of Chilean

society, Allende increased nationalization of Chilean copper mines and foreign-owned companies, and took further the land reform started in the previous government. These actions deeply antagonized Chilean business community and conservative sections of society, and made Washington take steeper measures against Allende. The CIA and American Embassy in Santiago helped the opposition to produce social unrest, financing union strikes (the transport's strike provoke shortage of foodstuff and essential goods all along the country) and supporting local right-wing terrorist groups. A report of the US senate accounts \$7 million channelled to anti-Allende groups and 1.6 million to keep the Chilean right-wing conservative newspaper, *El Mercurio*, afloat from bankruptcy.

At the same time the Allende government was failing to control its most extreme members and Chilean society sank into violence, uncertainty and economic stagnation. Radical leftists groups and labour unions were not only taking over perfectly productive private farms and factories, but also urging a violent raise to power. This fuel further political polarization. Turmoil and chaos were increasingly taking over Chilean streets and squares. Even a group of politicians of the same Allende's government publicly denied party politics, demanding a Cuban style Revolution in inflammatory speeches during public demonstrations.

Partly sabotage, partly Allende's administration economic mistakes, inflation rose to 900% for the year 1973, the black market rate was thirty times the official rate, and government's budget deficit reached 24.7% of the GDP.

The plotting against Allende came to an end in September 1973 when general Pinochet lead a violent coup d'état and seized power. Once in office, Pinochet deci-

ded to give the economic management of the country to the Chicago Boys. For first time in economic history a group of Milton Friedman disciples had an opportunity to influence governmental policy and put their theories into practice. As they were deeply involved with the campaign against Allende, they already have a complete programme aiming to re-structure the economy and to reverse Allende's social reforms.

On April 1975 Pinochet's finance minister announced a plan of 'shock treatment' for the economy. The Chicago boys implemented drastic monetarist measures which included liberalization of international trade, deregulation of the market, privatization of state-owned companies and public services, and an almost 50% reduction in public spending.

Although the Chicago boys thought the market would automatically provide prosperity and Chileans would become entrepreneurs due to lack of social or welfare protection, the consequences of the shock treatment were dramatic. Between 1975 and 1979 the GNP decreased 13% -the greatest loss since the 1930s, purchasing power dropped to 40% of the 1970 level, unemployment peaked to 20% and industrial production decreased 28%. Many companies were exposed overnight to foreign competition and went bankrupt while a dismantled welfare state was unable to provide social benefits. Only soup kitchens run by the Catholic Church saved people from starvation.

At the beginning of Pinochet's government most Chileans were willing to accept economic difficulties, even the depravation of individual rights and liberties, in exchange of the order and social peace provided by the army. But as the repression developed, they found themselves with no other alternative than to accept those economic policies. The military regime closed the Congress,

banned political parties, prohibited labour unions and professional associations, and introduced a curfew where everybody had to remain at home after 8pm. Schools, universities and the media were intervened by the army. About 4000 civilians were killed (of which 1000 are missing until today), and many more were tortured and forced into exile. In a Gestapo-like fashion, the government security forces broke into many Chilean homes and seized thousands of men and women, many of whom are still missing. Torture practices included electricity on genitals, teeth and nails extraction, and gang rape.

Thanks to political repression over dissidence and the longing memory of Allende's days, the Chicago boys found themselves enjoying laboratory conditions for their monetarist experiment. Their policies were implemented without having to face legal opposition nor public scrutiny -let alone competition from other economic policies.

3. From Chile to the World

In March 1975, Friedman visited Santiago to support his former disciples, holding conferences along with Chicago professor Arnold Harberger and talking privately with Pinochet himself. The visit came after an intense lobby from the Chicago boys who were former students of Friedman, as he was reluctant to travel to Chile and publicly support Pinochet because of the reports of Human Rights heard in the US. Besides, Friedman, Harberger, and Von Hayek emphasized in their writings and theoretical models that economic freedom only works properly with individual (political) freedom. In an interview given to Newsweek (January 1982), Friedman praised the general for having "supported a fully free-market economy as a matter of principle"

and described what has happened in Chile as an “economic miracle”. But he remained silent about politics.

After the crisis of 1976, Chilean economy started to recover, growing at 6.8% in 1978, and rapidly gained international attention. Time magazine described the Chicago boy’s performance as ‘An Odd Free Market Success’ (14/1/1980). In June 1987, journalist Shirley Christian wrote in the New York Times a favourable article reporting the success of the Chicago boys over inflation, exports growth and foreign investment.

Friedman’s monetarist ideas also started to inspire conservatives who would become economic advisors of Margaret Thatcher, Jimmy Carter and then Ronald Reagan. The collapse of the Breton Wood system in 1972 and the oil shocks of 1973 produced a rare phenomenon of rising unemployment and inflation at the same time. Keynesian economics proved unable to explain or propose a solution to that seemingly contradictory problem, so policy makers turned their eyes to an alternative economic theory that seemed capable to cope with those issues and which popularity was raising fast: monetarism.

Some of those advisors were keen to import a similar Chilean-style monetarist revolution to their own countries. Journalist Andy Beckett reports in his book *Pinochet in Piccadilly* (Faber, 2002) how economist Alan Walters, Friedman’s friend and the mastermind behind the economics of Thatcherism, often travelled to Santiago to meet Pinochet and the Chicago boys. “It was very exciting”, Walters told Beckett, “the great experiment in liberal economics”. Alvaro Bardon, Chicago boy and president of the Chilean central bank during the Pinochet regime accounts, “after the 1970s came a new fashion of liberal economics that has increasingly become

economic rule. But we started it here much before Margaret Thatcher”.

In fact, the rare success of the Chilean experiment proved right one of the key issues of Margaret Thatcher project. She proposed a model which was new for traditional political standards: a project that it was radical but at the same time from the right. Key for this combination of radical conservatism was the belief of considering the market economy as the great vehicle for social change, the mechanism that will put back things in order. Her opportunity came up soon, as a world event put more economic strain over Western governments and their welfare systems.

The same year when Pinochet took his soldiers to the streets to take over Allende, was also the year of the Oil Crisis. As great part of the British economy of that time was based in industrial manufacturing and exporting its products, the energy shortages severely affected companies and businesses. Labour unions, which had vast political power, turned increasingly antagonistic to the extent of freezing the economy of the country. In fact, the summer of 1978 became to be known as the “Winter of Discontent”, as workers from key public and private sectors went into strike: truck-drivers, nurses, hospital, railways and gas-station workers. The crisis became unbearable when cemetery workers and garbage collectors adhere to the generalized strike: piles of coffins were accumulating in every cemetery while the streets and parks were filled up with rubbish.

A significant part of the workforce went to live on social benefits, generating a real culture of unemployment (being “on the toll”), closed factories and estates. Figures of that time showed a dramatic plunge in productivity and competitiveness, to an extent than in 1975 Great Britain –the former superpower of Capitalism and Industrial

Revolution— ended up producing 25% less than France (in comparison of 25% more that produced today) and was starting to be known as “The Sick Man of Europe”. In all those years, the Labour party Government proved to be unable to articulate the necessary changes or tackle the relevant problems, let alone to find a solution to the generalized crisis. This cost it the elections of 1979, where Labour lost against the Conservatives lead by Margaret Thatcher. On that same year, United States’ President Jimmy Carter, a democrat, appointed Paul Volker, a well known monetarist, as Federal Reserve chief.

Once in office, Thatcher carried out her planned “revolution in democracy”. Based on Friedman’s philosophy of shrinking back the state to leave space for free enterprise and individual initiative, she introduced a series of reforms that, seen in retrospective, they had the virtue of transforming the UK in a buoyant service economy and consumer-driven society. Her measures include a systematic dismantling of British manufacturing—the power source of labour unions. She cut subsidies for the national industry, forcing British companies to face international competition and the ups and downs of the global market, and dramatically reduced public spending and social benefits, taking away great part of the welfare network that keep people comfortably unemployed. At the same time, she privileged property rights, diminished taxes, and fomented competition and entrepreneurship. Britons appreciated Thatcher reforms and re-elected her for twice consecutive periods, in 1983 and 1987.

After three conservative governments leading by Thatcher, the United Kingdom became a nation of unashamed capitalism and cult for money, with young energetic brokers spending their millions they made that same day in the clubs and bars of the City. However, when in 1989 another re-

cession hit the UK and unemployment raised back, the country did not have proper public services to offer to the people and mitigate the hardships of the crisis. The conservative party started to pay in the polls the cost for its thatcherist achievement of making Great Britain a more competitive nation. The same ideological zeal that worked so well as a transforming force was unable to adapt itself to the more subtle but explosive social changes of the 1990s.

The traumas of that transformation started to bloom to the surface: counter-culture movements such Punk or The New Wave became more popular criticizing the establishment, while the BNP (the right-wing extreme nationalistic party) won adherents and racial violence and hooliganism spread mayhem in streets and stadiums.

When Labour won back the Government in 1994, his leader Tony Blair did not reverse Margaret Thatcher reforms, but aimed to resolve the social problems of the UK within the system created by Thatcher, one that worked along monetarists guidelines. Blair constantly repeated the need of governing with the market and not against it, proposing measures to improve public services such health and education, but making clear that none of them would be viable if they slow or affect economic growth.

By that time the world portrayed a complete different economic structure. Thanks to digitalization and the ICT (Information and Communication Technologies) revolution, the expansion of a real-time globally-integrated economy, Western businesses were flourishing almost everywhere. The End of the Cold War and the low growth of European social-democracies put more strains on the evidence that the Welfare-state model was a burden of the past. Monetarist ideas almost completely monopolise business community and policy makers, espe-

cially in the Anglo-Saxon world, and rapidly became the economic orthodoxy of universities and multinational lending institutions.

In fact, the most virtuous Chicago boys of the Pinochet government became world-class economic authorities. Some of them returned to their alma-mater to become professors of economy or filling posts inside monetarists universities and think-tanks, others were recruited by the World Bank and the IMF, and others have built-up a career as private consultants and economic advisors. Ex-Pinochet's finance minister Hernan Büchi along with labour minister Jose Piñera and debt negotiator Hernan Somerville, have been advising Eastern European countries on issues such as privatization, deregulation of the market and liberalization of trade. In fact, at least 25 leading economists from the former Soviet Union, reported the Financial Times, had been sought Büchi's advice on the regime's economic model.

4. Some facts of the Chilean miracle

Milton Friedman's ideas were so revolutionary and successful that the Swiss Academy granted him the Nobel Memorial Prize in Economic Sciences in 1976. He is perhaps the most influential economist and public intellectual of the second half of the 20TH Century. Yet one of the basic principles of his theories is the one that bound together economic laissez-faire with political freedom. That's why the application of monetarist policies in the Pinochet regime is a good example of what can happen when market enhancement ran independently –even contrary– to the expansion of democracy and social liberties.

Although the reasons of Pinochet were more pragmatic than Thatcher's reformist zeal, he also introduced structural changes aimed to change Chilean society by large and forever. The regime reduced the budget for the National Health Service, while private health care was encouraged and subsidized. Private pension funds replaced the state pension system. Public schools and universities dramatically lost funding –subjects like sociology or politics were banned for having 'subversive' ideas. At the same time, the government gave tax exemptions and subsidies to private universities, most of them owned by business conglomerates of the Chilean right. In 1980, Pinochet epitomized these alterations in the country's laws and institutions introducing a new Constitution.

In fact, unfortunately for most Chileans, Pinochet's liberal experiment could mean a matter of life-or-death. Even as late as 1985 to disagree with the Chicago boys' policies was risky business. When they released a new social security plan in which pensions were to be administrated by private investment companies, Tucapel Jiménez, president of Chile's public employee's union was sceptical about the scheme. The new pension fund companies offered him big-cash bonuses (a private bank even offered him a management job) in exchange of publicizing his membership. But, although Jiménez had supported Pinochet's coup, he was also committed to his role as union leader. He rejected the offers and publicly opposed the new scheme. One week later he was found dead with five shots in the head.

Joaquin Lavín, a young Chicago boy who later will be presidential candidate of the Chilean right, wrote a book praising the economic and political transformations made by the general.

The book, entitled *Chile: A Quiet Revolution*, was published by a regime's publishing house and distributed by Chilean embassies abroad. After celebrating business development throughout the country, Lavín argued in his book that children in Santiago slums were "more creative" than those in higher income zones. "Most of the time a six-year-old child from La Pincoya [a low-income district] must strive for his own food and clothing, and solve his daily needs for himself. This makes him much more creative"

Economically though, despite condescending views about Pinochet and the publicity of the Chicago boys' experiment, the performance of the regime is not as successful as it has been portrayed. Proponents of the Chilean 'economic miracle' use to focus their analysis on the stages of prosperity without taking into account the stages of depression. The strong growths of 1977-79 and 1986-89 are in fact recoveries from previous depression-like economic constrictions. "The magnitude of the 1982 decline", says Chilean economist Juan Gabriel Valdés, "was key to the strength of the ensuing recovery; moreover, economic growth rates of 7-10% between 1986 and 1989 failed to compensate fully for the plunge in GNP of 17% in 1975 and 14% in 1982."

The average growth rate for the whole period of the Pinochet regime is 2.4%, according to World Bank figures. When the general left office in 1989, real wages were less than in 1973, unemployment was at 28% and nearly half of Chilean population (40%) was under the poverty line according to the UN standards, and income inequality was at its worst since 40 years.

After Pinochet was defeated in an election of 1989, democracy was re-established and four successive governments from the centre-left coalition opposed to Pinochet have been in office until today. Ironically,

the most sustainable economic growth Chile has experienced came with democracy, where the coalition's governments reverted many of the most extreme Chicago boy's policies. One of the first measures of the new administration was a tax increase to finance 2.3 billion public spending programs. In its edition of September 1991, *The Economist* reported how new President Patricio Alwyn almost doubled the minimum wage from \$51 to \$94 per month and initiated a scheme to restore the country's worn out infrastructure -a sewage system for Santiago and improvements in roads and highways. Figures of the Chilean central bank show the economy grew by 10.4% in 1992, the largest growth rate reported in twenty-seven years. Inflation declined from 18.7% to 12.7% in 1992.

In policy terms, however, the economic legacy of the military regime is in very good shape today. Chileans are conscious that thanks to economic reforms introduced by the general -this severe version of liberal economics-, they have enjoyed economic growth and political stability for decades. It is true that Pinochet was a sort of stern father that stamped his boot in the face of the welfare state through overnight liberalization, privatization, dramatic cuts in public spending and openness of its trade to global competition. But when the general stepped down, the Concertación realized that his economic formula was in the right direction to generate wealth, so its leaders polished the edges of the model -otherwise social discontent may have become political force, as happened in Bolivia- increasing public spending and investment in infrastructure.

Things worked out well and Chile enjoyed more than a decade of economic growth and Concertación became a very successful political force, holding power since Chile recovered democracy from the hands of general Pinochet in 1989 until today. The

last decade was the most successful economic period of Chile's entire history, increasing its real gross domestic product (GDP) in 30% between 1996 and 2005, and so far the trend is set to continue. The country duplicated its GDP per capita from the US\$ 3.463 registered in 1993 by the IMF, to over US\$ 7.000 achieved in 2005.

Although the Chilean monetarist experiment didn't succeed as it has been publicized, it importantly transformed Chilean society in a similar way Thatcherism changed Britain forever. But the monetarist claims of political neutrality seem to have an ideological flavour that has been quite appealing for business conglomerates and conservative politicians around the globe.

Chilean economist Alejandro Foxley, who in the current Bachelet's administration is the Minister of Foreign Relations, observed as early as 1983 that the rules of sound economic management "are perfectly codified by the international financial community, including the IMF, large private international banks and business groups. They consist of reducing the rate of expansion in money supply, eliminating the fiscal deficit, devaluating domestic currency, deregulating prices and private sector activities, and opening up the economy to free trade. Given such an explicit codification of what constitutes sound policies, the restoration of confidence requires strictly abiding by them. In doing so, the economic policies acquire distinct orthodox flavour".

But in today's complex post 9/11 world, when tackling poverty in Africa and modernizing the Middle East are perhaps the most important and delicate global security issues, ideological mistakes from Western policy makers can be of great cost. Moreover, in a momentum when Global Warming increasingly permeates both the political and media agenda, raising more suspicion against neoliberalism and laissez-faire doctrines. Maybe it's time for liberal economics to leave ideology behind and become more practical.

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