

## **LAN Chile: A Symbol of National Pride**

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LAN Chile serves as a compelling example of an enterprise whose growth and prominence is deeply intertwined with nationalized-turned-privatized Chilean economic policies. Like the vast majority of Chilean firms established in the 1930s, LAN Chile began as a state-owned enterprise (SOE), a project of the military to carry passengers and cargo throughout Chile and neighboring countries. Growing political and economic pressures resulted in state divesture in the carrier and the sale of stocks to foreign and domestic investors. As Chile's economy diversified and modernized, a thriving LAN Chile—once just a regional powerhouse—emerged as a leading global carrier. The economic impact of LAN Chile is indicative of a defining characteristic of modern Chile, the bold effort to modernize, advance and enter the global economy.

I argue that LAN Chile is both persuasive and symbolic in its significance as one of the last SOEs to be privatized during the economic liberalization policies of the 1970s and 1980s. To address this theory, I will first provide theoretical context for how and why the military regime enacted vigorous and expansive economic liberalization policies. I make two claims, one that the theoretical benefits of privatization are both ideological and pragmatic, and two, that comprehensive policies are rooted in the belief that private sector growth is the driving force to modernizing Chile's economy.

After establishing theoretical framework for the beneficial outcomes of privatization, I will briefly describe the application of the military regime's policies in the 1970s and 1980s. In the main part of my essay, I discuss my central argument that LAN Chile's history is a compelling example that weaves theoretical benefits and pragmatic applications of policies into a

story that exemplifies most—if not all—of the intended outcomes of privatization policies. The privatization of LAN Chile gave rise to more than just its status as a prestigious flag carrier: LAN Chile is the flying symbol of a modern economy.

### **The Regional Trend of Nationalized Economic Policies**

Like many Latin American countries with developing economies in the 1930s and 1940s, Chile followed the regional trend of increased state intervention and import substitution implementation, a product of Leftist governments seeking economic independence. The Chilean government established the Chilean State Development Corporation (CORFO) in 1939 to increase the state's role in investment, production and economic growth. According to Fischer et al., "CORFO established firms that were deemed essential for Chile's development," including industrial production, telecommunications and utilities. Among the first state enterprises established was Línea Aeropostal Santiago-Arica, the predecessor to LAN Chile, created in 1929 as a venture of the Chilean Air Force to fly passengers and cargo between Santiago and the Peruvian border towns. By 1970, 65 Chilean firms were state-owned (Fischer et al., 2005, p. 205). The rate of state intervention surged under the Allende administration, peaking in September 1973 with the government control of 441 firms and 15 banks, representing 40 percent of GDP (p. 206). The Chilean government was highly integrated in the economy with the clear nationalistic policy belief that state control was necessary for economic growth.

### **The Theoretical Framework for Privatization Policies**

The theoretical framework for privatization is characterized by the belief that privatization maximizes societal benefit. Jones, Tandon, and Vogelsang (1990) argue that

privatization is justified if the social value of an enterprise under private control outweighs the social value of the enterprise under state control (p. 2). Chong and Lopez-de-Silanes (2005) describe privatization as a policy that can produce added economic efficiencies and increased social welfare (p. 39). This coincides with tandem theories that a net gain in societal benefit is inevitable, provided coherent policies are properly enacted (source?). Although political motives are clearly interlaced in economic policy, the privatization goals focus more on the value-added economic benefits. Pinochet's core belief of privatization reforms was rooted in the belief that the transition from state ownership to private ownership would yield sustained economic growth and prosperity—it was not about maximizing equity, it was about maximizing efficiency. An underlying assumption of the privatization theory is that free enterprise generates not just effective, but also *efficient* allocation and production (Sanchez & Corona, 1993).

The theoretical framework for privatization establishes core ideology that then yields policy directives to achieve the desired outcome of modernizing and strengthening an economy. Manzetti (1999) divides the transition to privatization into two stages: the decision to privatize and the implementation of privatization policies. The core belief in the superiority of free-market economics must guide political leaders to build national momentum and embrace the decision to sanction drastic policy shifts. In the case of Chile, the decision was heavily influenced by the role of the “Chicago boys,” a team of economists from the University of Chicago. Their belief argued that Chile's poor economic performance resulted from a protectionist government and excessive state control of firms. As discussed by Lederman (2005), liberalization policies that followed their model of reforms to curtail inflation rates, restore macroeconomic stability and trim fiscal expenditures are complementary to privatization policies (p. 93). International economists argued that to successfully implement privatization policies, corresponding policy objectives are

necessary to foster a favorable economic climate. This illustrates the expansive nature of privatization policies in the 1970s and 1980s with the broad intention not only to make enterprises profitable, but also to create economic stability.

### **The Ideological and Pragmatic Approaches to Privatization**

According to Manzetti (1999), “Willingness to privatize comes from a mixed bag of motives, which are ideological and pragmatic in nature” (p. 12). The decision to privatize Chile’s economy illustrates Manzetti’s theory: the economic policy transition was ideological in values but equally pragmatic in that it produced tangible approaches to policy enactments. International influence and favorable political conditions were undoubtedly contributing factors to embracing privatization policies on both a micro- and macro-level scale. Yet as Manzetti (1999) argues, ideological considerations play a “secondary role” to pragmatism as the driving force behind privatization policies (p. 16). Following his argument, the pragmatic—rather than purely ideological—factors are essential to understanding the theoretical *benefits* of enacting privatization programs. Privatization policies, supported by ideological values, produce net societal gain.

The broad and encompassing goal of the Pinochet regime was to modernize Chile’s economy by embracing credible alternatives to nationalization policies. The theoretical benefits, that is, what privatization policies were *supposed* to produce, are loosely categorized under the two umbrella goals of efficiency and competition, both married to the assumption that the private sector is the engine of economic growth. By privatizing enterprises, the state is embracing economic efficiency: regulations are streamlined, intervention is limited, and state-control is diminished. Macroeconomic stability is a necessity, meaning the state’s economic actions focus

on fiscal and monetary policies to sustain a business-friendly climate rather than direct control of firms. The second overarching theoretical benefit centers on bolstering competition. The benefits of international competition and competitive industries are justified as incentives for private enterprises to innovate, grow and adapt to changing markets. Access to capital, both foreign and domestic, fuels competitive forces and enables firms to survive in a competitive environment. On a macro-level analysis, the economic policies under the Pinochet regime produced the desired outcome, full integration into the global economy, modernized companies, and sustained economic growth during the privatization period (Vanden & Prevost, Gary, 2012).

The collapse of the Allende government gave rise to one of the most aggressive and determined regimes in Chile's history. Economic chaos and political turmoil in the early 1970s served as clear reminders to the new military regime: enact sensible economic policies to stabilize and grow the Chilean economy. The military junta inherited a chaotic and collapsing economy fueled by extravagant fiscal deficits, hyperinflation and lack of capital (Vanden & Prevost, Gary, 2012, p. 465). The new administration was steadfastly committed to rapid and expansive privatization policies, beginning with the privatization of SOEs seized under the Allende administration. The initial privatization efforts continued for over a decade, ultimately divesting the majority of the last remaining state ventures. As noted in the research of Sanchez and Corona (1993), "Privatization fostered the expansion of private ownership, thus bolstering the market economy and stimulating the development of the capital market" (p. 45). Failed economic policies of the previous administration produced a climate of uncertainty that made radical changes increasingly attractive. Embracing the theory that free markets generate societal benefits, the Pinochet administration enacted privatization policies that grew and strengthened Chile's modern economy.

### **The First Phase of Privatization: 1974-1983**

After seizing power in 1973, the new military junta, led by General Augusto Pinochet, embarked on an aggressive path to privatize state-owned enterprises (SOEs) and other firms seized under the socialist Allende administration. The coordinated process of transitioning to a privatized economy produced both a shift in policy direction and an emergence of new political-economic leadership—a clear reversal of socialist policies in the previous decades. The full-fledged privatization process began in 1974, beginning with the first phase of privatization. As the new regime gained political traction, policies “fostered free competition from the outset, eliminating market distortions and applying a policy of openness to international trade and capital” (Sanchez & Corona, 1993, p. 20). As noted in the research of Fischer et al. (2005), in the two years between 1975-77, the state privatized 70 SOEs and liquidated an additional 28 firms, followed by a sale of the remaining assets (p. 206). The period between 1975-79 was marked by rapid privatization policies. Despite the accelerated rate of privatization, the military regime opted to retain control of a portion of firms created by CORFO, including most firms in the transportation industry: railways, freight companies and airlines, including LAN Chile.

In the first decade under military rule, “259 firms that were expropriated or illegally taken during the Allende administration were restored to their original owners” (Fischer et al., 2005, p. 198). As noted in the research of Schamis (2002), many of the private firms were seized by the Allende administration but were never formally nationalized (p. 41). CORFO, with the creation of a new division, The Department of Business, “focused entirely on the divestiture process,” signaling a complete reversal of the state agency’s former role (Schamis, 2002, p. 41). The reversal of Allende administration’s policies intentionally enacted a new wave of economic

policies to restore macroeconomic stability and modernize, diversify and strengthen the Chilean economy. Private sector growth quickly became the mainstay of the Chilean economy, keeping the policies in tandem with the theoretical objectives.

### **The Second Phase of Privatization: Mechanisms in Action**

The compelling research of Fischer, Gutiérrez, and Serra (2005) concludes, “One of the chief characteristics of the Chilean privatization process is that it has been all-encompassing” (p. 197). Following the brief interruption of privatization policies by the debt crisis in 1982, the Chilean government refocused its policies on the principle of free enterprise as the means to generate development and the diversification of ownership to enable more people to become stakeholders of privatized firms (Sanchez & Corona, 1993, p. 58). The precision in incorporating the theoretical benefits of privatization created a “second wave” of liberalization in the 1980s. A series of four privatization mechanisms were enacted between 1985-89, focusing on the sale of shares in open international markets and in the stock market, free market competition, diversity of ownership, and reduced government regulation. The mechanisms followed the recommendations of policy-makers and embraced the theoretical practices of beneficial policies. The approach of “popular capitalism” facilitated the direct sale of shares to small investors, often employees of privatized firms (Fischer et al., 2005, p. 211). *Capitalismo Popular* and *Capitalismo Laboral* distributed shares to employees and allowed employees to directly partake in the privatization process (Schamis, 2002, p. 61). Strategic policy to create capitalism in the “hands of the people” diffused and diversified ownership of firms previously characterized as conglomerates—a principal characteristic of privatization goals. According to Sánchez and Corona (1993), the effects of popular capitalism were significant: 39,000 individuals and

corporate entities were stockholders in the privatized financial firms (p. 61). Economic practices like the sale of shares to small investors are synonymous with the theoretical notions behind economic policies, signifying sound, pragmatic approaches to policy in the second wave of privatization.

### **A Historical Context for the Modern LAN Chile**

The economic policy transitions enacted under the Pinochet regime allowed the Chilean government to divest ownership in financially burdened enterprises ridden with excessive debt. Empirical data on outcomes of privatization policies examine microeconomic factors to describe the effects of privatization on Chilean firms. The research and numbers are as diverse as the specific firms analyzed; in short, there is not one central conclusion that summates the overall effect of privatization policies on the economy. The analysis of specific (micro) indicators of successful versus failed economic policies is useful in studying effects of industries (e.g. telecommunications) as a combined entity, but the analysis of LAN Chile is better represented by examining the success of the principal goal of privatization policies in Chile: to create a modern and diverse economy.

LAN Chile, the Chilean flag carrier that flies more than four million passengers around the globe each year, started as government-funded enterprise of the National Air Force in 1929. The airline carried 762 passengers in its first year of operation, with the primary mission of establishing mail and cargo routes with neighboring countries and international ventures. The airline separated from the National Air Force in 1932 and began its long—and tumultuous—journey as the national airline of Chile. LAN received exclusive operating rights in Chile, allowing the carrier to grow with minimal concern for domestic competition. As with many

SOEs, the nationalized firm operated in a protectionist and regulated framework that shielded the firm from free market forces.

As the carrier grew, LAN adopted the name “LAN Chile,” a brand identity that embodied the nationalistic role of “Chile’s airline.” The addition of Boeing 707 aircraft allowed LAN Chile to serve New York, Madrid, Paris and Frankfurt, a symbolic achievement in the post-war, glamorized air travel era of the 1950s (FundingUniverse). Despite its achievements, LAN Chile was hardly profitable. Yet as one of many SOEs deemed “strategic” to the Chilean economy, excessive debt never crippled the airline in operational terms, a defining characteristic of SOEs that were kept afloat by government-backed cash infusions. The political-economic rationale to essentially subsidize Chile’s airline was not misguided or irresponsible—the argument for establishing international connections is compelling for any developing nation. The problem, of course, was that the same argument was used for hundreds of state-controlled firms ranging from utilities to telecommunications. LAN Chile was merely one of many cases defined by inefficient allocation of resources, overregulation and unsustainable fiscal government backing.

### **The Privatization of LAN Chile**

Following the collapse of the Allende administration, preferential treatment once given to LAN Chile ended abruptly; new, albeit small, regional passenger and mail carriers entered the market and directly competed with LAN Chile. The new “open skies” policy enacted in 1979—aimed to reduce regulation and increase competition—paved the road for competing carriers like LADECO to rapidly gain market share in the previously regulated industry (FundingUniverse). Although the carrier was still a state-owned entity, LAN Chile continued to accumulate insurmountable debt, and eventually folded in 1984 with \$60 million in debt (FundingUniverse).

After draconian cuts and massive layoffs, a restructured LAN Chile reentered the market, still wholly controlled by the Chilean government. Elements of the growing free market economy penetrated the airline industry's "bubble," with competition that led to the bankruptcy of LADECO, LAN's principal competitor. The collapse and resulting open-market sale of LADECO's remaining assets was historic—the core elements of privatization benefits entered one the most protected industries. LADECO's bankruptcy was pivotal to the complete privatization of the airline industry, one of the last remnants of nationalization. In 1989, LAN Chile was fully privatized.

LAN Chile's privatization incorporated the mechanism of "popular capitalism" with the sale of 16 percent of LAN Chile's shares to employees at enticing rates. Ownership continued to diversify with the purchase of majority-control by a private Chilean investment group. Pinochet's economic goal of attracting foreign investment similarly diversified investment in the privatized LAN Chile. Following failed attempts to purchase Aerolíneas Argentinas, Scandinavian Air System (SAS)—a leading global airline group—became a major stakeholder of LAN Chile (LAN Chile Investor Relations). The diversely owned airline, once on the verge of total collapse, vigorously grew with a clear mission to leverage private capital, expand internationally and emerge as a profitable enterprise. The sale of LAN Chile to private investors, both domestic and foreign, followed the privatization strategy of diversifying ownership and eliminating barriers to foreign investment.

### **LAN Chile: A Success Story of Privatization Policies**

In the context of Chile's privatization policies, LAN Chile is an exemplar of successful private ownership. LAN Chile's history was synonymous with hundreds of other SOEs: the state

established and grew “strategic” industries, shielded them from free-market forces and subsidized their losses. Despite the relative initial success of many SOEs, their long-term prospects for growth were unfeasible. A favorable political climate in the early 1970s allowed the military regime to enact an expansive privatization program that vastly transformed the Chilean economy. The unwavering conviction that the private sector was the engine of economic growth led to the privatization of hundreds of nationalized firms. Symbolically, the privatization of the “strategic” SOEs that survived the first decade of privatization solidified the strength of privatization policies—in practical terms, the policies “worked” in nearly every industry. In its first year as a private airline, LAN Chile’s revenues rose from \$7 million in 1988 to \$75 million in 1989 (Fischer, Gutiérrez, & Serra, 2005, p. 210). LAN Chile serves as a compelling case to both justify the enactment of privatization policies and validate its theoretical benefits.

The complexities of the Chilean economy and the policies themselves make drawing a simple conclusion about the effectiveness of privatization policies nearly impossible. Yet as a case within the larger framework of one of hundreds of former SOEs, LAN Chile is *the* symbol of success. The privatization of the unprofitable nationalized carrier embodied nearly every theoretical benefit of privatization policies, both ideological and pragmatic. Global competition, access to private capital and decreased regulation proved to be instrumental in the “rebirth” of Latin America’s leading airline. The rapid modernization of the LAN fleet and the financial ability to responsibly carry the risk of expanding globally are feats unimaginable under state control. The airline industry is fiercely competitive; expanding globally is a financial risk that is fully susceptible to the true forces of a free market economy.

One of the defining characteristics of the Chilean privatization era was the undeniable risk the government took in enacting policies that were never guaranteed to succeed. As noted by

Williamson (1994), “The most difficult part of a reform program is not introducing the reforms, but sustaining them until they have a chance to bear fruit.” Eighty years later, LAN Chile is the first Latin American carrier to fly Boeing 787 aircraft, a defining moment that joins LAN with a team of elite worldwide carriers that connect our global economy. The tails of LAN’s growing fleet carry the symbol of Chile around the world, a shining example of the departure of its past as an SOE and the arrival of a thriving enterprise in a modern economy.

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