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ECONOMIC ASPECTS OF STATE SOCIALISM IN CHILE

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ECONOMIC ASPECTS OF STATE SOCIALISM IN CHILE

The heavy cost of Chile's inefficient state enterprises is one of the country's serious economic problems. The financial drain has been a factor in recurring budget deficits and in inflation which has risen more than 40 percent in each of the past two years. The prospects for reducing the deficit and the inflationary spiral would improve if the net loss from the operations of state enterprises were cut substantially. However, in an election year with a pro-Communist candidate as a strong contender, the government is not likely to consider--much less implement--any required long-range corrective measures. These would include more efficient management of state enterprises free from political pressures, elimination of surplus employees, closer control of the allocation of investment funds, and a realistic rate policy for goods and services provided by state agencies. In some instances, a radical reduction or liquidation of unprofitable operations might be essential.

The Growth of State Enterprises

The government's involvement in large-scale economic activities dates back to 1939, when the Corporation for the Development of Production (CORFO) was established as the central agency for economic planning and development. It still substantially controls the administration and investment programs of most of the so-called autonomous agencies relating to fuels, power, transportation, and manufacturing.

The long-range trend has been toward the gradual expansion and increasing diversity of state economic activity. Excluding the copper and nitrate industries, 8 of the 12 largest enterprises in Chile are government owned and operated. In addition the government now either operates or has substantial money invested in a number of "mixed" (government and private) enterprises. These include investment banking, oil and electric power production, air, rail and maritime transport, port services, international and domestic marketing, mineral refining and several manufacturing fields, such as the production of steel, chemicals, and fertilizers, and sugar refining.

Political Views of Statism

In Chile, as in many of the larger Latin American countries, prevailing economic theory and political sentiment favor a

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SELECTED STATE ECONOMIC ENTERPRISES IN CHILE

GOVERNMENT-OWNED ENTERPRISES*	ACTIVITIES	EXTENT OF CONTROL	COMMENTS ON PERFORMANCE
Corporation for the Development of Production (CORFO)	Planning, financing of economic development; investment banking; management; est. 1939.	Chile's leading economic development agency; has extensive control over licensing of new Industries and industrial expansion; exercises general supervision or direct control over a number of government and "mixed" enterprises.	CORFO receives annual government subsidies; has generally favorable reputation; many of the industries it has financed or controls have a protected and otherwise privileged position in the economy; data not available to estimate the size of the deficit of CORFO's extensive financing and management operations.
National Electricity Enterprise, Inc. (ENDESA)	Public utility electric power production and distribution; est. 1944.	Now accounts for over 70% of public utility electric power generation, compared with 48% in 1953; government rate policy has prevented new investment in the private sector.	Has received extensive loans for expansion projects from IBRD and Export-Import Bank; management considered competent; does not receive (at least overtly) any operating subsidy.
National Petroleum Enterprise (ENAP)	Oil exploration, production and refining; est. 1950.	Monopoly (except for one small private refiner)	Only major state economic enterprise to generate investment funds largely from profitable operations; reduced Chile's oil deficiency from 93% to about 40% between 1950 and 1962.
State Rail Enterprise (EFE)	Rail transport	Operates about 80% of total track mileage in Chile and all of public carrier mileage.	Receives largest subsidy of all state economic enterprises to cover heavy operating deficits; personnel costs account for about 55% of all costs; revenues cover only about 50%; has obtained sizable foreign credits; much of its investment program has been directed toward maintaining uneconomic operations.
State Transport Enterprises (ETCE)	Municipal bus services.	Private bus lines operate in a number of cities.	Heavy operating deficits subsidized by government; private bus companies also have received subsidies since 1962.
National Airline (LAN)	Air transport, est. 1932	Monopoly of domestic routes until 1949; subsequently, 3 small private carriers lincensed for non-competitive routes.	Heavy operating deficit subsidized by government; has received direct appropriations and tax and fee exemptions; a drain on government resources likely to increase as LAN replaces obsolescent equipment; good safety record.
State Maritime Enterprise (EME)	Maritime transport	Competes with private shipping lines.	Heavily subsidized inefficient operations; as of 1956, its oceangoing vessels were obsolete, pre-1930 vintage; fleet has subsequently been modernized.
Chilean Port Enterprise (EPCh)	Docking, warehousing and related port services.		Considered a costly and inefficient operation; subsidized by government.
National Mining Enterprise (ENAMI)	Copper refining for small producers.	Processes only a small fraction of Chilean copper production.	Operating deficit subsidized by government.
Steel Company of the Pacific (CAP)	Iron and steel; steel fabrication; established 1946.	Accounts for over 90% of domestic production.	Export-Import Bank has granted extensive credits; successful for import substitution; rising costs and location have largely eliminated CAP as an exporter except under barter arrangements; Company has domestic protected monopoly; actual financial and other costs to government cannot be determined.
National Institute of Trade (INACO)	International trade; also warehousing and refrigeration.	Has extensive control on international trade and a monopoly of imports on some commodities.	No information available on financial performance.
National Sugar Industry (INASA)	Sugar refining	3 refineries supply about one-third of national requirements.	No information available on financial performance.
Nitrate and Iodine Sales Corp (COVENSA)	Export sales for nitrate and iodine.	Government monopoly.	Privately owned nitrate industry receives government subsidies.

* All are fully government-owned except the CAP, in which the government holds less than half the equity capital.

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substantial measure of government participation in business. Nationalistic feelings and the traditional paternalism of government tend to reinforce statism, particularly where private foreign capital and natural resources are involved. Moreover, private business managers--with but few exceptions--have been reluctant to exercise initiative and risk investment funds, thus leaving a vacuum which the government has filled by default or by unchallenged pre-emption.

Enterprise Performance

Most state enterprises require subsidies to cover both operating deficits and investments. The performance of these agencies in managing their finances varies considerably.

ENAP, the state oil monopoly, has one of the best records from the standpoint of management and the conduct of its business. With the exception of two years since it was established in 1950, ENAP reportedly has operated profitably, generating a surplus to finance most of its expansion. Indeed, crude oil production has outdistanced the growth in domestic consumption of petroleum. ENAP's good performance, however, is traceable in part to its exemption from taxes and from import duties on supplies and equipment.

ENDESA, the state electric utility corporation, also has a reputation for competent management, presumably operates without subsidy, and has demonstrated its capability for planning and implementing extensive expansion programs.

At the other extreme, the National Railway System (EFE) is the principal single drain on the government's limited resources. According to the International Monetary Fund, EFE received an operating subsidy of about $42 million in 1961, a substantial portion of the total government deficit. An extensive effort, however, is being made to modernize and maintain the system, including those segments which are no longer competitive with road transportation. In 1962, the International Bank estimated that about $88 million would be required to cover the railroad's operating losses and finance new investment.

The obstacles to EFE's approaching a break-even point are at best, formidable. Rail equipment is obsolete, roadbeds require extensive maintenance, and the system is burdened with a surplus work force. Built-in bureaucratic resistance and public sentiment favoring the rail system also block reform.

Other state transportation systems--the national airline and the bus lines--as well as the state mining enterprises and CORFO, consistently compile operating deficits, but the combined losses are usually less than that of the railroads. The government's experience with other enterprises, such as the

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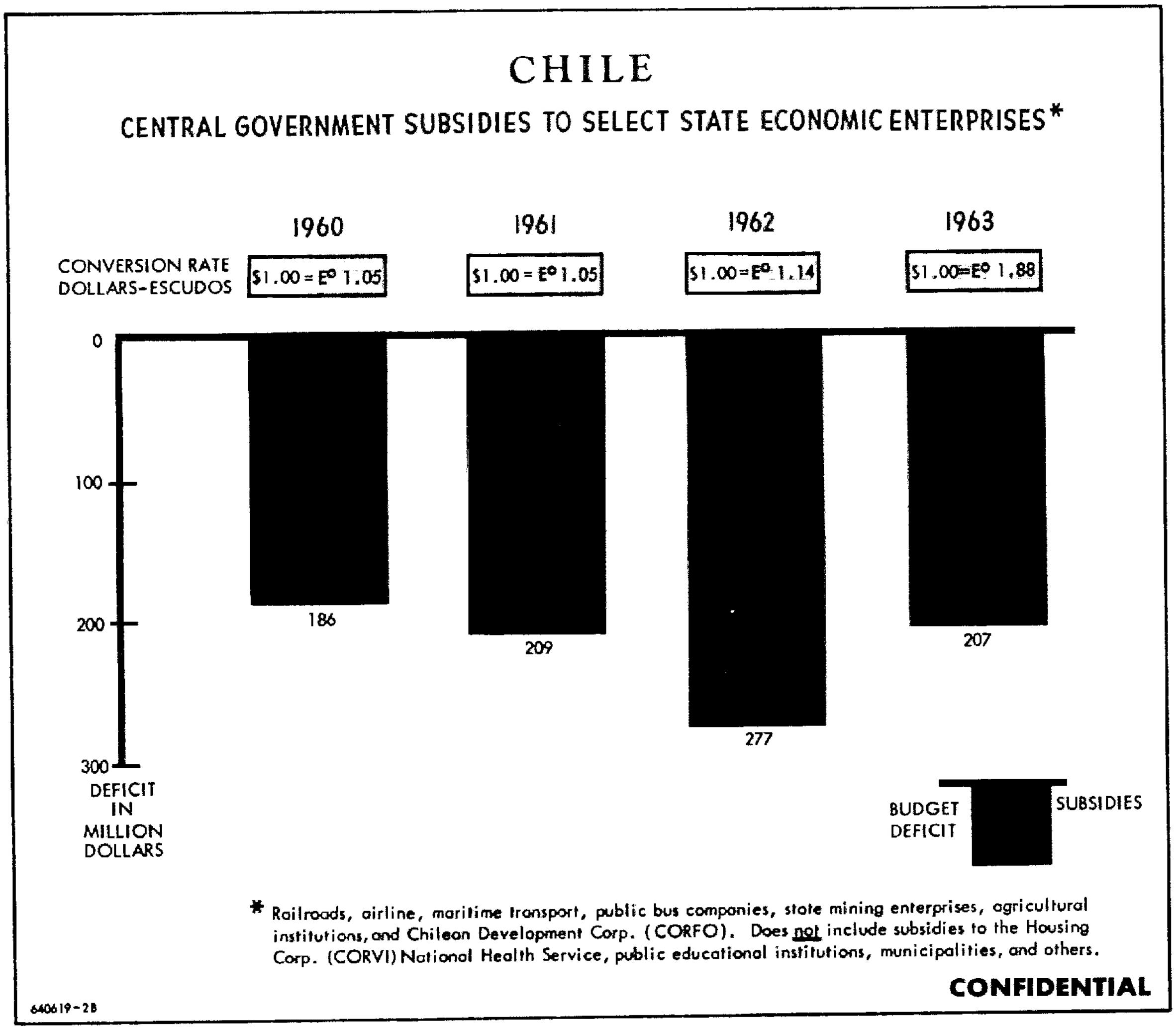

Steel Mill of the Pacific, the National Sugar Industry, and the Nitrate and Iodine Sales Corporation, cannot be determined by a review of the central government budget. CORFO may partly cover the deficits incurred by these industries. In fact, CORFO's budget provides for financing subsidy and investment programs which involve most state and "mixed" agencies.

Some Direct Costs of Statism

Subsidies to state enterprises have amounted to about 30 percent of the government's total deficit in recent years (see table). The subsidies do not constitute the entire cost to the government, since it also contributes heavily to the investment programs of these agencies and apparently covers all or part

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of the amortization of their debts.

In addition, most of the state businesses are exempt from taxes, fees, and import duties levied on private enterprise--privileges which reduce the central government's revenues. Moreover, the autonomous enterprises do not appear to apply uniform budget and accounting procedures. For political reasons, they probably present operational results in the best possible light, for example, by making minimum or less than adequate provision for depreciation and depletion.

Indirect Efforts

The indirect costs of state enterprises are probably of even greater magnitude, but cannot be fully evaluated. For example, statism has been an ingredient of inflation, which in turn is a major cause of stagnation in the private sector, of the flight of capital, and of the general loss of business confidence. Public investment, now over 50 percent of the total new investment, has taken up some of the slack, but has served to stimulate further inflation.

State sovereignty has also eliminated private capital investment in some spheres, frozen it to the status quo in others and, in some cases, blocked potential private investment. Proposals to permit private firms to explore Chile's northern provinces for oil a few years ago were blocked because the oil industry is a government monopoly. In this case, several million dollars of potential private foreign investment never entered Chile.

Another example is the electric power industry which was pioneered by private foreign capital. Further private expansion is no longer attractive because of the government's discriminatory and low-rate policies. The state electric enterprise (ENDESA) now has become the predominant producer of electric power in recent years.

Government Rate Policies

The deficits in key state enterprises cannot be attributed solely to poor management, waste, misuse of investment funds, and surplus work forces. Government pricing policy on the services and goods of these organizations, often formulated to avoid adverse political reactions, has increased their losses. State enterprises, with rising production costs compounded by inflation, have been tied to unrealistic rates for their own goods and services. By the time adjustments are granted, inflation has generally outrun and devoured the differential. At the same time, these low rates and the privileged position of state enterprises have reduced profit margins for competing private enterprise, thus tending to discourage investment by this sector of the economy. (CONFIDENTIAL)

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