
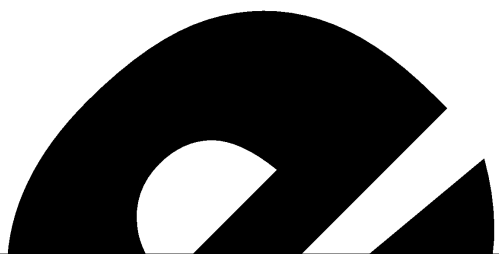


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**DIRECTORATE OF
INTELLIGENCE**

Intelligence Memorandum

Chile: Allende's Economic Record

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**CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
April 1972**

INTELLIGENCE MEMORANDUM

CHILE: ALLENDE'S ECONOMIC RECORD

Introduction

1. In its first year and a half in power, the Allende government successfully pursued its basic goals of rejuvenating a sluggish economy and reducing the economic power of its opposition. But, its policies already have entailed heavy costs in terms of economic dislocation and political polarization. Postponing their full consequences until after the congressional elections, scheduled for March 1973, will test even Allende's talents for political maneuver and economic sleight-of-hand. This memorandum presents an overview of Allende's economic record to date and chronicles recent developments affecting the expansion of state control over the economy. It also comments on Chile's current relations with its major foreign creditors, both Communist and non-Communist.

Discussion

Overview

2. At the end of 1971, Allende claimed success in his management of the economy by pointing to an 8.5% jump in real gross domestic product (GDP), a lower inflation rate than under the previous administration, and the lowest unemployment rate in a decade (see Table 1). Reactivation of the economy resulted largely from Allende's early bid for popular support by sharply boosting the real wages of Chile's lower classes. Because of the consumer buying spree that followed, manufacturing output increased by about 12% in 1971. Increased government outlays for housing also brought a 12% jump in construction activity. Both industries had ample unused capacity on which to draw, and their increased production activity brought about a decline in the unemployment rate in the Santiago area from 8.3% to 3.8%.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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Table 1
Chile: Selected Economic Indicators

	<u>Percent Increase</u>		<u>Unemployment in Santiago (Percent of Labor Force at End of Year)</u>
	<u>Real Gross Domestic Product</u>	<u>Official Consumer Price Index</u>	
1965	5.0	25.9	4.8
1966	7.0	17.0	5.4
1967	2.3	21.9	6.4
1968	2.9	27.9	5.4
1969	3.3	29.3	5.4
1970	3.1	34.9	8.3
1971	8.5	22.1	3.8

3. Important primary industries, however, did not fare so well. Despite unusually favorable weather during the main growing season, agricultural output increased only slightly in 1971, and early indications point to a drop of at least 10% this year. Moreover, total mining output rose by about 6%, in contrast with the large increases expected as a result of the copper expansion program. Copper output in fact declined at the three large mines formerly operated by Anaconda and Kennecott (see Table 2).

Table 2
Large Chilean Mines: Copper Production

<u>Mine</u>	<u>1971</u>				
	<u>1970 Actual</u>	<u>Actual</u>	<u>Goal</u>	<u>Change in Production</u>	<u>Shortfall in Meeting Goal</u>
	<u>Million Pounds</u>			<u>Percent</u>	
Chuquicamata	580	551	740	-5.0	-25.5
El Teniente	390	325	560	-16.7	-42.0
El Salvador	205	187	220	-8.8	-15.0
Andina	13	118	134	New mine	-11.9
Exotica	4	78	204	New mine	-61.8
<i>Total</i>	<i>1,192</i>	<i>1,259</i>	<i>1,858</i>	<i>5.6</i>	<i>-32.2</i>

4. Although personal and government consumption grew 12% in real terms in 1971, gross domestic investment fell at least 16%. An increase in public investment only partly offset a drop by nearly 60% in private investment outlays. The impact of this investment slump is even greater than the statistics imply, because a substantial portion of increased public outlays went into "social infrastructure projects" that at best would have a beneficial effect on production capabilities only in the long term. Threatened with imminent nationalization, businessmen refrained from expanding their facilities even in those industries operating at or near full capacity. By year's end, the combination of consumer boom and investment slump was being reflected in increasingly widespread shortages in supply.

5. Allende's ability to cover domestic supply shortages through imports came under increasing constraints as the year wore on. Net foreign reserves, which stood at a record \$378 million when he was elected, plummeted to about \$40 million by the end of 1971. Chile's foreign exchange crunch derived both from inflated imports to meet spiraling demand for food and other consumer goods and from a nearly 20% drop in copper export earnings in 1971 due to lower world prices and production difficulties in the nationalized mines. Moreover, because of the worsening political and economic atmosphere, capital flows shifted from a large net surplus in 1970 to a \$100 million deficit in 1971. In the early months of 1972, foreign reserves probably declined further despite the continued unilateral moratorium on debt service payments, which since its inception last November has saved Chile about \$150 million, and despite the receipt of at least \$50 million in hard currency credits from the USSR.

6. The Allende government's highly inflationary policies throughout its administration are now compounding Chile's economic problems. Public sector wages were increased by more than 50% in 1971 and, as was to be expected, average wages in private enterprise rose considerably more. The steep acceleration in government spending, moreover, brought a record budget deficit, and one-fourth of total public sector expenditures was financed through inflationary borrowing from the domestic banking system - in effect, by printing money. As a result, the money supply more than doubled and rose from 13% to 20% as a share of GDP at current prices. Despite these formidable pressures, the government was fairly successful in holding the line on prices until October 1971, mainly because many people apparently were willing to hold larger cash balances as long as the supply of goods seemed adequate. In the latter part of the year, however, shortages of food, durable consumer goods, and industrial materials became increasingly evident, and the pace of inflation accelerated markedly, as shown in the following increases in the official consumer price index:

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	<u>Percent</u>
January-October 1971 (monthly average)	1.5
November 1971	2.7
December 1971	2.8
January 1972	3.7
February 1972	6.5

Moreover, with a growing number of products available only in the black market or not at all, the official price index was even less representative of actual inflation rates than it had been previously.

7. The task of controlling price rises is far more complicated now than when Allende took office. Supplies are limited by declining agricultural production, a leveling off in manufacturing output as capacity limits are reached, and inadequate import capabilities. It is politically difficult, however, to restrain demand through restrictions on wage increases and government spending or through rationing. The administration's proposed public wage increase for 1972 averages 35%, and labor unions in the private sector again are using this hike as a floor for their wage bargaining. Although Allende at least once has publicly stated that he will use a firm hand in rationing consumer goods if need be, he indicated in a recent speech that "Chile is not ready for that yet."

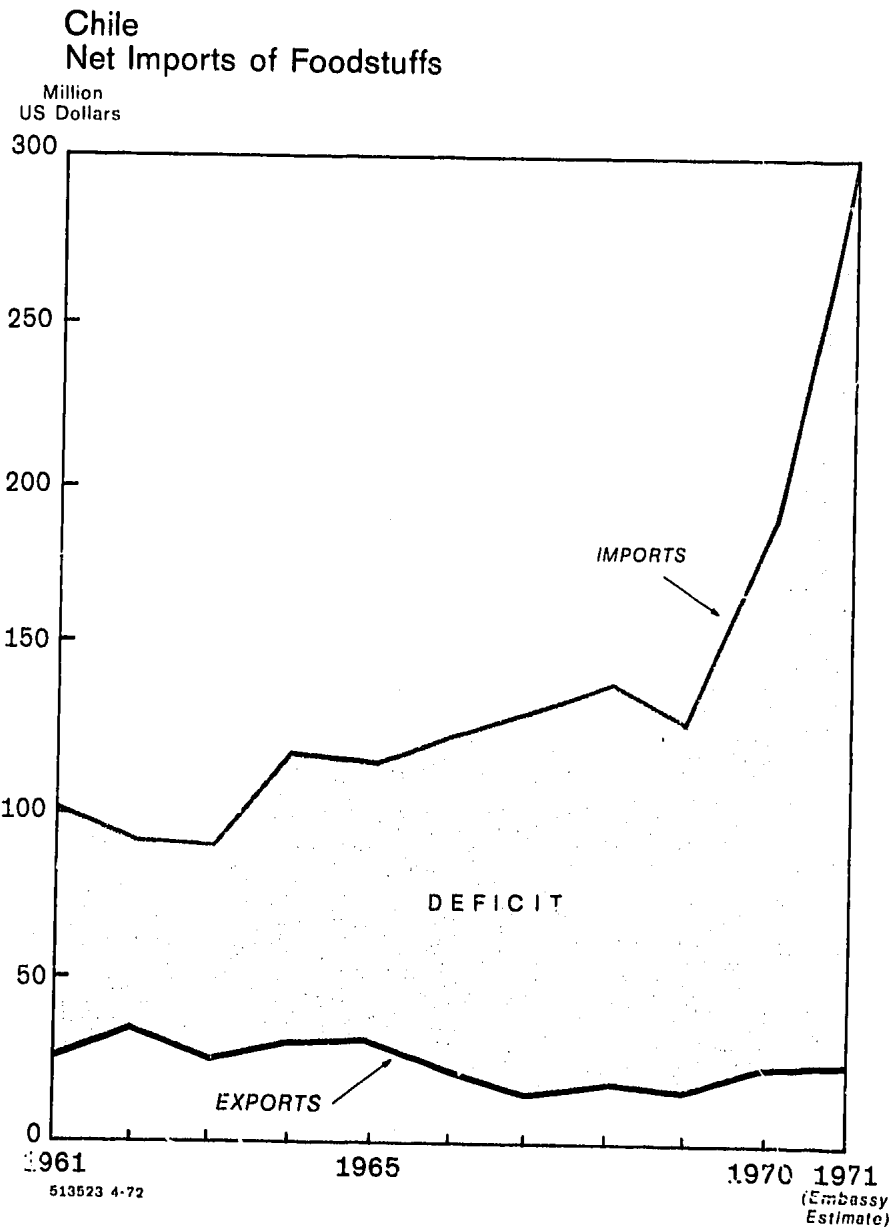
8. Under these circumstances, rapid inflation - which in effect would restrict consumption by eroding nominal wage gains - may be the most palatable option open. The government already has officially raised prices of various basic foodstuffs this year by an average of 30% and is in the process of upping rates on public services by a similar amount. Because it is increasingly difficult for private enterprises to absorb additional labor cost increases through productivity gains and a further profits squeeze, the government is expected to permit price rises for some of their products as well.

9. In an effort to avoid the most politically embarrassing kinds of shortages, the government is sharply increasing food imports to offset the marked deterioration already apparent in this year's agricultural production. Wheat imports, which in 1971 represented almost 30% of total consumption, are expected to rise by 40% to 700,000 metric tons this year. Because of increasing agitation in the countryside associated with the government agrarian reform effort and illegal land seizures, total wheat output in 1972 is now estimated at some 27% below last year's. Corn imports are likely to jump almost 70% to 500,000 tons, and increased imports of rye, barley, oats, and potatoes also are expected. In dealing with the continuing beef

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shortage, the government has increased the number of "beefless days" to more than 200 in 1972, but imports will still be required to fill the remaining supply gap. As a result, net foreign exchange expenditures for foodstuffs are expected to rise significantly above the all-time record of \$276 million set in 1971 (see the chart). Because shortages of cloth, drugs and medicines, and other consumer goods are becoming increasingly apparent, supplementary imports of this type may further burden foreign exchange capabilities.



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10. Even though Santiago achieved most of its rescheduling goals at the debt renegotiations completed in Paris on 19 April, the Allende government still faces serious balance-of-payments problems over the next year or so.* It almost certainly will not be able to fulfill import requirements for both consumer and industrial goods, and shortfalls of either type carry political costs. With the congressional elections less than a year away, Allende can be expected to continue to opt for appeasing the consumer at the expense of needed investment, but he will also have to allot foreign exchange for the imports of machinery and raw material required to avoid a serious deterioration in output and employment levels. New foreign credit offers, which so far the Allende government has found disappointing, will be an important factor determining Chile's import capacity and thus its ability to offset domestic supply shortfalls and contain inflationary pressures.

Socialization of the Economy

11. As of September 1971, the state had ownership or control of 187 enterprises, of which 79 had been taken over by the Allende government during its first year in office (see Tables 3 and 4). Since September, it has expropriated, requisitioned, or intervened an additional 20-25 enterprises. The government also has drawn up a list of all corporations whose capital plus reserves exceed \$500,000; by the government's own estimate, these 189 corporations account for 82% of the capital holdings of the 1,987 companies incorporated in Chile. Many of them already are government-owned, and those still in private hands are earmarked for nationalization with few if any exceptions.

12. In a belated move to block Allende's efforts to place the state in absolute control of Chile's economy, the opposition-controlled Congress on 19 February approved a constitutional amendment sponsored by the Christian Democratic Party (PDC), defining the economic areas subject to government ownership. The congressional bill broadly defines the activities that the state can control directly, those that it can operate in partnership with private enterprise, and those that the state cannot touch. Ten basic industries or groups of industries are included in the first category: large-scale copper mining; insurance; railways; air and water transport; mail and telegraph services; power generation; production and distribution of natural gas; extraction of petroleum, coal, and nitrates; the making of weapons and armaments; and the production of steel, cement, iodine, and heavy chemicals. Expropriation of enterprises in all other sectors would

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Table 3
Chile: Government-Owned and Controlled Enterprises
as of September 1971

Sector	Wholly Government- Owned	Mixed		Government Intervened	Total
		Majority Government- Owned	Minority Government- Owned		
Productive sector	41	19	20	38	118
Agricultural	7	1	5	--	13
Copper	5	--	--	--	5
Other mining	6	2	7	--	15
Forestry	3	5	4	6	18
Industrial	20	11	4	32	67
Infrastructure and service sector	33	6	2	--	41
Energy	7	3	--	--	10
Communications	2	2	1	--	5
Transport	10	1	1	--	12
Housing	4	--	--	--	4
Commerce	8	--	--	--	8
Tourism	2	--	--	--	2
Financial sector	7	11	7	3	28
Banks	2	10	4	3	19
Real estate	--	--	3	--	3
Insurance	5	1	--	--	6
<i>Total</i>	81	36	29	41	187

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Table 4

Chile: Firms Coming Under Government
Ownership or Control During the First Year
of the Allende Administration
as of September 1971

<u>Sector</u>	<u>Government- Owned or Mixed</u>	<u>Government Intervened</u>	<u>Total</u>
Productive sector	23	38	61
Agriculture	--	--	--
Mining	4	--	4
Copper	5	--	5
Industrial	14	38	52
Infrastructure and service sector	5	--	5
Energy	2	--	2
Communications	1	--	1
Transport	2	--	2
Financial sector	10	3	13
Banks	10	3	13
<i>Total</i>	38	41	79

require congressional approval. A retroactive feature of the bill ma' i
government takeovers since October 1971 subject to such approval.

13. After weeks of secret negotiations with the PDC, seeking a way
to avoid a direct confrontation with Congress, Allende in early April vetoed
the key portions of the PDC constitutional amendment and added clauses
that would significantly ease government takeover of the economy.
Administration forces contend that a two-thirds majority of Congress is

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needed to override a presidential veto in this case, whereas opposition jurists claim that only a simple majority is required. Allende wants to submit the question to a five-member constitutional tribunal, which has supported the government's position in its four decisions to date, while opposition politicians maintain that a plebescite is the proper means of resolving the issue.

14. Although Congress has unlimited time to deal with the veto problem, any delay will benefit the Allende administration because it can proceed freely with its expropriation plans in the interim. To counter further government moves during this legislative impasse, business leaders are attempting to persuade workers in firms marked for expropriation to seize the property, thereby pre-empting government takeover or at the least making such action politically difficult. Private sector leaders are also trying to arouse rural workers by pointing out that the large farms expropriated under the government's agrarian reform program are being turned into state farms rather than divided into smaller tracts for peasant ownership. They are attempting to instigate widespread seizures by agricultural workers of government agrarian reform centers in southern Chile and, to this end, have been collecting food, vehicles, and weapons. Serious organizational difficulties apparently have delayed these actions, which had been scheduled to begin shortly before the third UN Conference on Trade and Development (UNCTAD) opened in Santiago on 13 April.

15. In the meantime, the Central Bank is considering a new credit control measure that would substantially increase the government's control over the economy. The proposal would limit most private firms to only one account in one bank and require a quarterly financial report. The government wants to liquidate outstanding non-banking credit instruments that are not subject to its control, claiming that the measure is necessary to "rationalize and make more democratic the credit system." By year's end, the government controlled about 85% of all bank credit and 83% of bank deposits. The government also has stiffened its control over foreign travel through a new regulation requiring all ticket purchases for foreign air travel to be made through state-controlled banks. In addition to adding another bureaucratic link to the already complicated process of leaving the country, the measures will have the effect of eliminating direct ticket sales and credit extensions by travel agents and airlines.

Communist Assistance

16. Soviet, East European, and Chinese assistance clearly has been growing and seems headed for further expansion, despite continued resistance against a shift to Communist equipment and technology by both Chilean industry and the military. In late January 1972, an 11-man Soviet economic delegation began a month-long stay in Chile "to firm up bilateral

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agreements." The composition of the mission -- specialists in planning, finance, and balance of payments -- and the length of its stay suggest the possibility of an in-depth examination of Chile's acute economic problems, perhaps accompanied by discussions of Soviet commitments in addition to the \$89 million in long-term project loans already extended. Thus far, the Soviets have been cautious in offering the kinds of aid Allende wants and needs most; known hard currency credits to Chile now total only \$50 million and the Soviets have made no offer as yet to help Chile meet its current consumption requirements for food, other consumer goods, petroleum, and the like. The USSR probably wants to tie any larger aid commitment to assurances that Allende can put the Chilean economy in order.

17. In late January 1972, Chile announced that China had offered a \$65 million credit, \$13 million of which would be used to finance imports of food and medicines this year and the remainder for small- and medium-sized development projects. The credit is repayable in ten equal annual installments beginning in 1981, and no interest will be charged. A Chilean commercial mission left for China in late March to work out final details on this loan.

18. Known long-term Communist economic assistance to Chile now totals \$256 million, of which nearly \$200 million has been extended since 1 June 1971 (see Table 5). Except for the \$13 million in Chinese food and medical assistance, a \$2.5 million earthquake relief grant from China, and a reported Soviet offer to donate a \$2.5 million prefabricated housing plant, all of this assistance has been in the form of long-term project loans to cover purchases of equipment and technical expertise from the donor country. Until recently, virtually nothing had been drawn on these credits, but the sale of 5,000 Soviet tractors now being delivered to Chile was financed under the 1967 loan. Chile, however, probably is making full use of the \$50 million in short-term, hard currency credits thus far extended by the USSR.

New Western Credits

19. The Allende government's credit rating has been badly damaged by its temporary default on most of its foreign debt repayments, but Chile is still obtaining a small amount of new Western financing. Santiago is currently negotiating a rescheduling of a substantial part of its existing foreign debt and simultaneously trying to arrange new loans. The largest thus far obtained is an \$18 million export credit from Brazil to finance the sale of 1,000 locally built Mercedes Benz buses. The Bank of Montreal has offered a \$10 million export credit line to the Chilean Nitrate Sales Corporation in an attempt to attract the company's deposits that were

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Table 5
Chile: Known Long-Term Credits from Communist Countries

Source	Date	Million US \$	Type
USSR	January 1967	42	Industrial plants (port improvement, lubricants plant, housing project, chemical plants, agricultural assistance, technical aid to copper facilities)
USSR	July 1971	46.8 ^{a/}	Machinery and equipment (\$5 million earmarked for road-building equipment)
Bulgaria	June 1971	20	Mining equipment, health supplies, possibly cargo crane plant
Czechoslovakia	April 1968	5	Industrial plants (plants for the manufacture of compressors, motorcycle engines, and power tools)
Hungary	June 1971	5	Machinery and equipment
Hungary	September 1971	15	Pharmaceuticals plant, copper mining and transport equipment
Romania	July 1971	20	Sulphuric acid plant, agricultural machinery and transport equipment, possibly copper manufactures plant
Poland	November 1971	25	Technical projects, particularly in the mining, fishing, and metallurgical sectors
Poland	November 1971	10	Machinery and equipment
China	July 1971	2.5	Earthquake relief (grant)
China	January 1972	52	Small and medium-sized projects over the next four years
China	January 1972	13	Finance imports of food and pharmaceutical products
<i>Total</i>		256.3	

a. Expansion of \$12.8 million credit extended in 1967. The amount has been adjusted for downpayments.

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transferred to Canada from New York banks in February to avoid attachment by US courts. To protect its long-term market position in Chile, the Gulf Oil Company is considering extending a \$5 million line of credit, repayable over five years. Various other small Western loans totaling some \$20 million to \$25 million have been arranged in recent weeks, including a \$6 million credit from a Swedish heavy machinery firm and several other credits from European, US, and South American private banks and firms.

Foreign Debt Renegotiation

20. In early February, Chilean officials signed an agreement with 36 US commercial banks, rescheduling about \$245 million in debt, including interest. The agreement provides for repayment of 5% of the principal in 1972 and 1973, 10% in 1974, 15% in 1975, 10% in June 1976, and 55% in December 1976. If Chile is unable to meet this last "balloon" payment, the proposal permits a substantial extension involving a 10% payment in December 1976 and 15% annually for the next three years. The agreement requires Chile to pay less than half of the debts due to these banks during the remainder of Allende's presidential term, scheduled to end in November 1976. The settlement probably reflects the banks' belief that a fairly generous compromise was necessary in view of Chile's evident insolvency and that the compromise was preferable to default.

21. In its presentation to the first Paris Club meeting during 2-4 February, Chile requested its major creditors to allow a moratorium on \$998 million in long-term debt service payments due between 9 November 1971 and 31 December 1974, followed by a ten-year deferred payment schedule. Chile's request to exclude from renegotiation debts contracted after Allende's inauguration and those owed to other Latin American countries was generally opposed because such exclusion would involve discriminatory treatment of creditors. Representatives of the United States, Canada, Japan, Belgium, the United Kingdom, West Germany, Italy, the Netherlands, Denmark, Spain, and Switzerland generally supported the French suggestion that a moratorium of only one year be granted because of the lack of longer range forecasts of Chile's balance of payments. US attempts to link the copper compensation issue with debt renegotiation received support from West Germany, Canada, and the Netherlands but were opposed by France and Spain.

22. The second round of meetings during 16-17 February was disappointing to the Chileans because of the relatively united stand by the creditor nations in offering somewhat harder terms than anticipated. In addition to cutting the requested moratorium period from three years to one and the exemption of interest payments and a minor share of the principal from rescheduling, the creditors also insisted on an International Monetary Fund standby, which Chile rejected "for domestic and policy

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reasons." In lieu of an IMF standby agreement, Chile circulated in March an alternative plan that in essence would be self-policing.

23. The third round of talks held during 29-30 March also was inconclusive, despite strenuous Chilean efforts to obtain a favorable decision. Chile was strongly backed by France, and to a lesser extent by Italy and Spain, whereas US proposals were actively supported by the United Kingdom, West Germany, Canada, and Denmark. The US proposal that a "debt clause" be a precondition for rescheduling was generally upheld by other creditors; such a clause would preclude discriminatory treatment of any outstanding debts, including those deriving from copper nationalization. During the meeting, the creditors softened their financial demands somewhat, extending the moratorium to two years' duration. Although the Paris Club members formally insisted on Chile's strengthening its alternative plan if it is to replace an IMF standby program, most creditors appeared willing to compromise on this issue. Despite vigorous Chilean objections, final decisions on these and related matters were postponed until 17-19 April - after the opening of UNCTAD III.

24. A compromise agreement was finally reached by Chile and the Paris Club on 19 April. It grants Chile two years' grace followed by a six-year repayment period on 70% of principal and interest falling due during the 14-month period from 1 November 1971 through 1972. Inclusion of interest payments in the rescheduling process represents a concession to Chile and significantly increases the debt relief involved during this period. The creditors' decision not to reschedule at this time payments on debt maturing after 1972 was a disappointment to Chile and was influenced by the Allende government's refusal to arrange a standby agreement with the IMF. Rescheduling of debt payments falling due in 1973 will be considered late this year, at which time creditors will reassess the economic and financial policies being pursued by Santiago. The creditors' position at that time - and particularly that of the United States - will also be influenced by Chile's scorecard on adhering to its formal acceptance of obligation to repay its foreign debts on a non-discriminatory basis and its promise to compensate adequately for expropriated foreign properties, both of which were integral parts of the Paris agreement.

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