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5 December 1973

[Redacted]

MEMORANDUM FOR:

ATTENTION :

SUBJECT : Chile's Current Economic Situation
and Investment Climate

[Redacted]

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Attached is the material in response to your request
of 28 November for support of source maintenance. If

STAT we can be of further assistance, please contact

[Redacted]

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[Redacted]

[Redacted]

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Chief,
Latin America Branch, OER

Attachment:
As stated

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Chile's Current Economic Situation and
Investment Climate

1. The ruling junta in Chile is moving aggressively to rebuild the economy by adopting a harsh austerity program and instituting policies designed to return Chile to a market economy.

2. Santiago moved quickly after the coup to remove price controls on all but 30 basic commodities, while the Central Bank effectively devalued the escudo by some 60% in an effort to curb import demand and ease pressures on Santiago's meager foreign exchange reserves. As a result, Chile's cost of living jumped 88% in October, bringing inflation to nearly 450% for the first ten months of the year. Anticipated price rises during the rest of 1973 is expected to push inflation to some 750% for the year.

3. The elimination of price controls and adjustment of exchange rates has practically eliminated the once flourishing black markets in commodities and foreign exchange. While exchange rates changed and prices rose, the growth in the money supply has been sharply curtailed, causing a relative scarcity of local currency and a liquidity crunch for businessmen.

The Austerity Pinch

4. The burden on consumers has been heavy. Despite a healthy increase in the minimum wage, working class

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consumers are finding it increasingly difficult to afford the barest necessities. Austerity has been exacerbated in many cases by dismissals of relatively unproductive and politically suspect employees hired under the Allende regime. An unemployment compensation program has been announced and an extensive public works program is under consideration.

5. The junta is attempting to enlist public support for the austerity program and business is showing renewed confidence. Consumers and labor, however, are taking a wait-and-see attitude. No organized resistance to the junta or its programs has materialized, even though some political factions are grumbling and predicting failure for the junta.

External Economic Relations

6. Chile still faces large balance-of-payments deficits in both 1973 and 1974 even if debt repayments are rescheduled in both years. With a massive \$4 billion foreign debt hanging over Santiago's head, it will at least be several years before Chile's balance-of-payments position improves significantly.

7. However, copper production has already increased more than 50% above last year's level as a result of a 9% lengthening of the work week and improved mine management. Production will probably reach a record 750,000 tons next year despite continuing shortages of spare parts and serviceable vehicles.

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8. Agricultural imports continue to be the largest drain on foreign exchange and the recovery of domestic production is a priority objective of the junta. Farm output, however, is not expected to fully recover until the 1974/75 harvest since most crops already are planted and are well into their growing seasons. Thus, Chile will continue to import grain in large quantities during 1974.

9. Although the problems of adequate short run supplies of raw materials and spare parts must be solved to boost production quickly, long run growth will depend heavily on Chile's ability to attract adequate foreign investment. Attraction of substantial new investment will depend on the junta's ability to demonstrate good faith in the treatment of foreign equity as well as their ability to instill confidence in Chile's prospects for stable recovery and growth. A critical first step is timely settlement of outstanding compensation claims emanating from the Allende nationalizations. The junta has stated that it will either return intervened firms to the private sector or, as in the case of the large copper mines, adequately compensate the previous owners. Some 90 firms are already in the process of reversion.

10. Thus far the junta has succeeded in lining up sufficient foreign credits to enable it to purchase essential capital goods and finance the current payments gap. In addition,

there are strong indications of renewed investor confidence, and private foreign investment in Chile is expected to grow dramatically during the next 12 months.

Prospects

11. The economic outlook for Chile is cautiously optimistic as the junta takes steps to correct the excesses of nearly three years of decapitalization under state socialism. The programs, though austere, are economically sound and offer a firm foundation for recovery and growth of the Chilean economy. The major policy conflicts within the government appear to be over the degree and timing of specific measures rather than problems of basic policy orientation.

12. The emerging dominance of Raul Saez as senior economic advisor is probably for the best since the junta's austerity program must be tempered if political as well as economic recovery and stability is to be achieved. Meanwhile, Chile is preparing to settle outstanding compensation issues and complete bilateral negotiations on 1971/72 debt service in accord with the 1972 Paris Club agreements. Timely resolution of these issues will go far in improving investor and creditor confidence in Chile.

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4 December 1973