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Chile: Prospects for the Aylwin Government



An Intelligence Assessment

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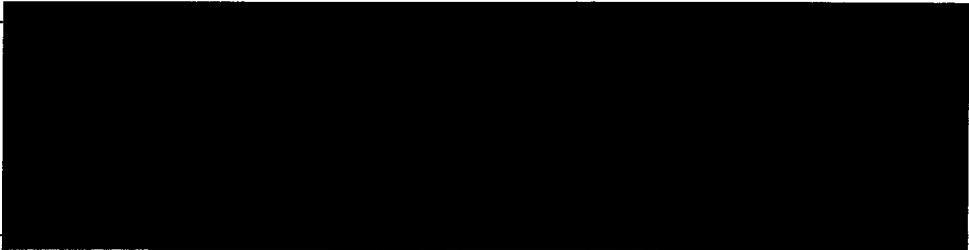
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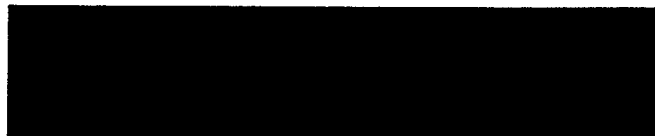


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Chile: Prospects for the Aylwin Government [Redacted]

An Intelligence Assessment



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September 1990

Chile: Prospects for the Aylwin Government

Key Judgments

*Information available
as of 3 July 1990
was used in this report.*

The inauguration on 11 March of Christian Democrat Patricio Aylwin as Chile's first popularly elected President in 20 years capped a generally orderly transition set in motion by a plebiscite in October 1988. The departure of former President Augusto Pinochet and the return to an open political system fulfill a key objective of US policy toward Chile. Despite their landslide win at the polls, however, Aylwin and his 17-party coalition face major challenges in the near term as they reassert civilian control over the government. These include:


- Easing civil-military strains, dismantling restrictive constitutional and legislative measures, and addressing the emotionally charged issue of human rights grievances associated with the Pinochet regime.
- Expanding social programs and revising Pinochet's restrictive labor code without impairing the strong performance of Chile's free market economy.
- Overcoming the skepticism of the far right and the armed forces—egged on by Pinochet in his current capacity as Army Commander—about the ability of "politicians" to govern, while persuading the far left to work within the political system.


The new government has made a promising start. Aylwin's Cabinet appointees have won widespread public approval, and the coalition has a team of savvy, pragmatic floor managers in the new legislature who already have successfully steered some key bills through an extraordinary session. These managers, along with key Cabinet members, will play a pivotal role in reaching understandings with the sizable moderate-rightist bloc in order to pass legislation in the coming months to revise constitutional obstructions and eleventh-hour measures by the Pinochet regime that limit the civilian government's options.


The economic course set by the new administration also augurs well. The government's commitment to continue the free market policies that have made the Chilean economy a standout in the region has soothed concerns in the business community about a possible shift toward more statist programs. Moves to cool the overheated economy, however, are reducing government revenues—potentially complicating Santiago's efforts to fund modest new social programs without deficit financing.


The Aylwin government's tentative first steps on the human rights front already are provoking controversy. The President's early pardon of some prisoners accused by the Pinochet regime of political "crimes" and his



establishment of a human rights investigatory committee risk provoking the political right and the military without satisfying some critics in his own coalition and the left. Likewise, Aylwin's public support for legalizing the Chilean Communist Party—at a time when associated far-left terrorists are openly threatening to kill several officers accused of human rights abuses during the Pinochet era—has contributed to misgivings on the part of senior officers about his commitment to preserve the military's institutional interests. 

On balance, we judge that Aylwin will turn in a generally successful performance over the next year or so and effectively reestablish civilian control over the government. We expect him to score early gains in liberalizing the Constitution, managing the economy, adopting moderate labor code reforms, and lowering barriers to constructive civil-military relations. Factors working in his favor include his proven political skills and solid electoral mandate, the strong position of his coalition in the new Congress, broad public support for his legislative agenda, and a firm intention to avoid confrontation with the military. In our view, the new government probably will also be able to parry continuing obstructionist efforts by Pinochet and his dwindling group of hardline military supporters. 

Despite our optimism, Aylwin's prospects for success could be reduced by unexpected developments, such as a sudden breakup of his coalition, a surge in political and labor agitation, escalating far-left terrorism, or failure of the new government to deal effectively with the Congress, the military, and Pinochet. Even if faced with a combination of such developments, however, Aylwin would still probably muddle through his first year or so in office. Although intensifying harassment by Pinochet might paralyze the Aylwin government—generating sufficient political unrest to spark military coup plotting—we give this scenario a fairly low probability. 

US-Chilean relations are now on a sounder footing than in many years, although a handful of potentially troublesome issues persist. The Aylwin team hopes to resolve the Letelier case—the most important impediment to full normalization of ties—within the constraints of Chilean law and of military concerns about exposing Pinochet. Several more minor bilateral issues, meanwhile, are emerging as benchmarks of US good will toward the Aylwin government, especially the prompt restoration of trading benefits under the Generalized System of Preferences (GSP) and investment guarantee privileges by the Overseas Private Investment Corporation (OPIC) that were suspended during the Pinochet era; some US assistance for health, education, and housing projects; and US support for a debt restructuring package next year. 


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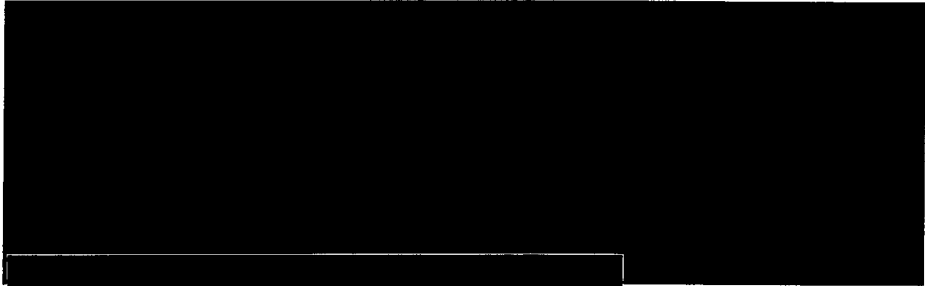
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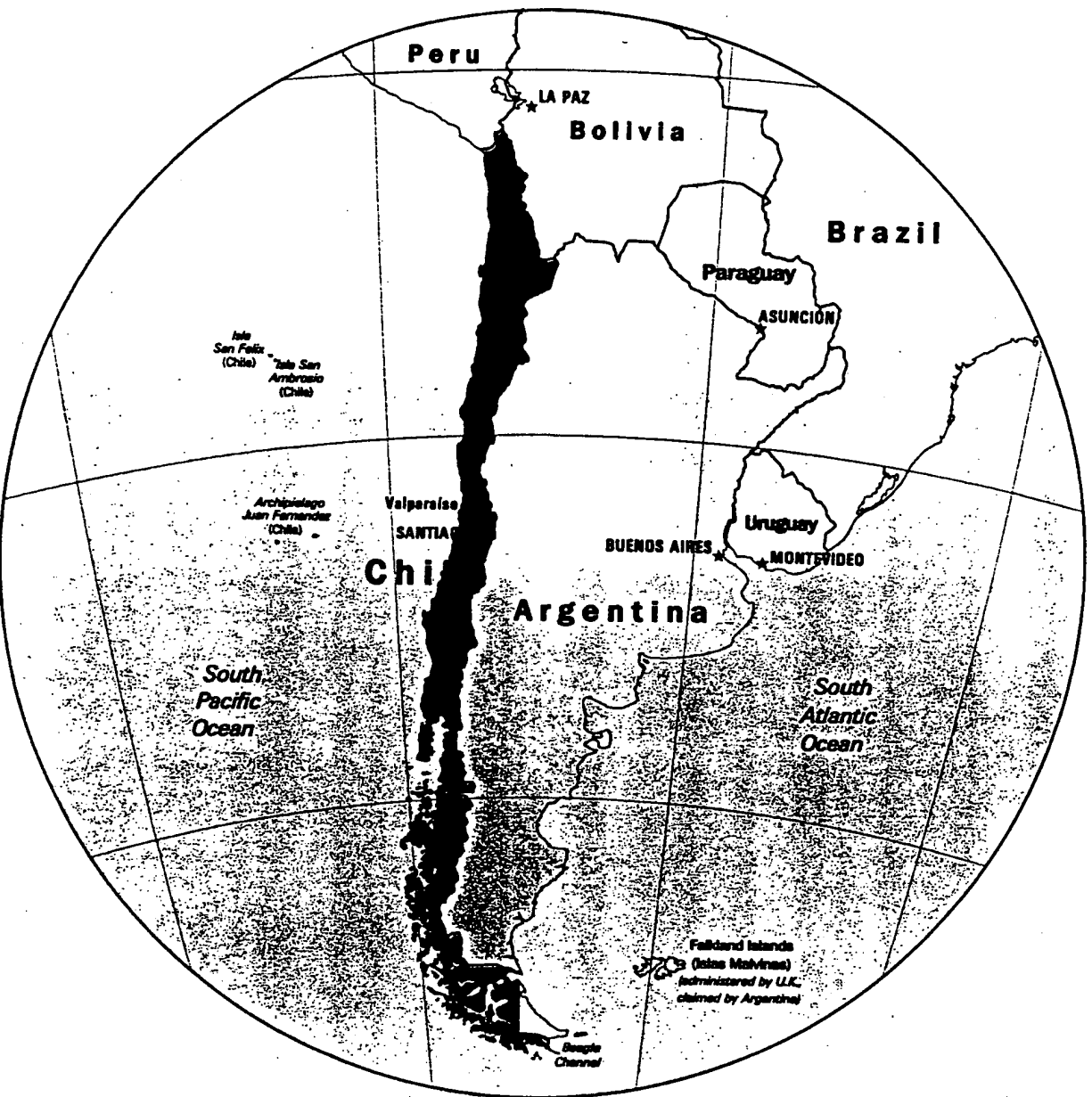


Scope Note

This paper assesses the likely performance of the government of President Patricio Aylwin over the near term, weighs its prospects of consolidating democratic rule, and examines the impact on US interests. The paper also looks at the evolving roles and influence of key institutions and groups, such as Congress and the political right, former President Pinochet and the military, and the Communists and their far-left allies. 



 **DI Intelligence Assessment**
 **April 1987, Chile: Pinochet and the Military.** 



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Chile: Prospects for the Aylwin Government

Introduction

The inauguration of a popularly elected President and National Congress on 11 March marked the end of over 16 years of rule by Army Gen. Augusto Pinochet, the last of South America's once numerous military dictators to relinquish power. This development was the product of almost three years of sustained effort by a formerly divided, ideologically diverse, and ineffectively led group of political parties to devise a coherent, unified strategy to unseat the once all-powerful Pinochet using his own, restrictive electoral rules. The relative ease of the opposition's successive political victories against Pinochet was as surprising to its new leadership and much of the electorate as it was shocking to Pinochet and hardline elements in the military, who had deluded themselves into believing that he enjoyed widespread popularity and was invincible at the polls. While the switch from military to civilian rule evoked widespread euphoria, its suddenness made many Chileans anxious about prospects for near-term political stability and continued economic growth. Moreover, many observers expect political and economic flux in Chile over the next few years, marked by rumblings within the armed forces, increased political agitation, and doubts among key groups about the efficacy of civilian rule.

Setting the Stage for the New Government

Background

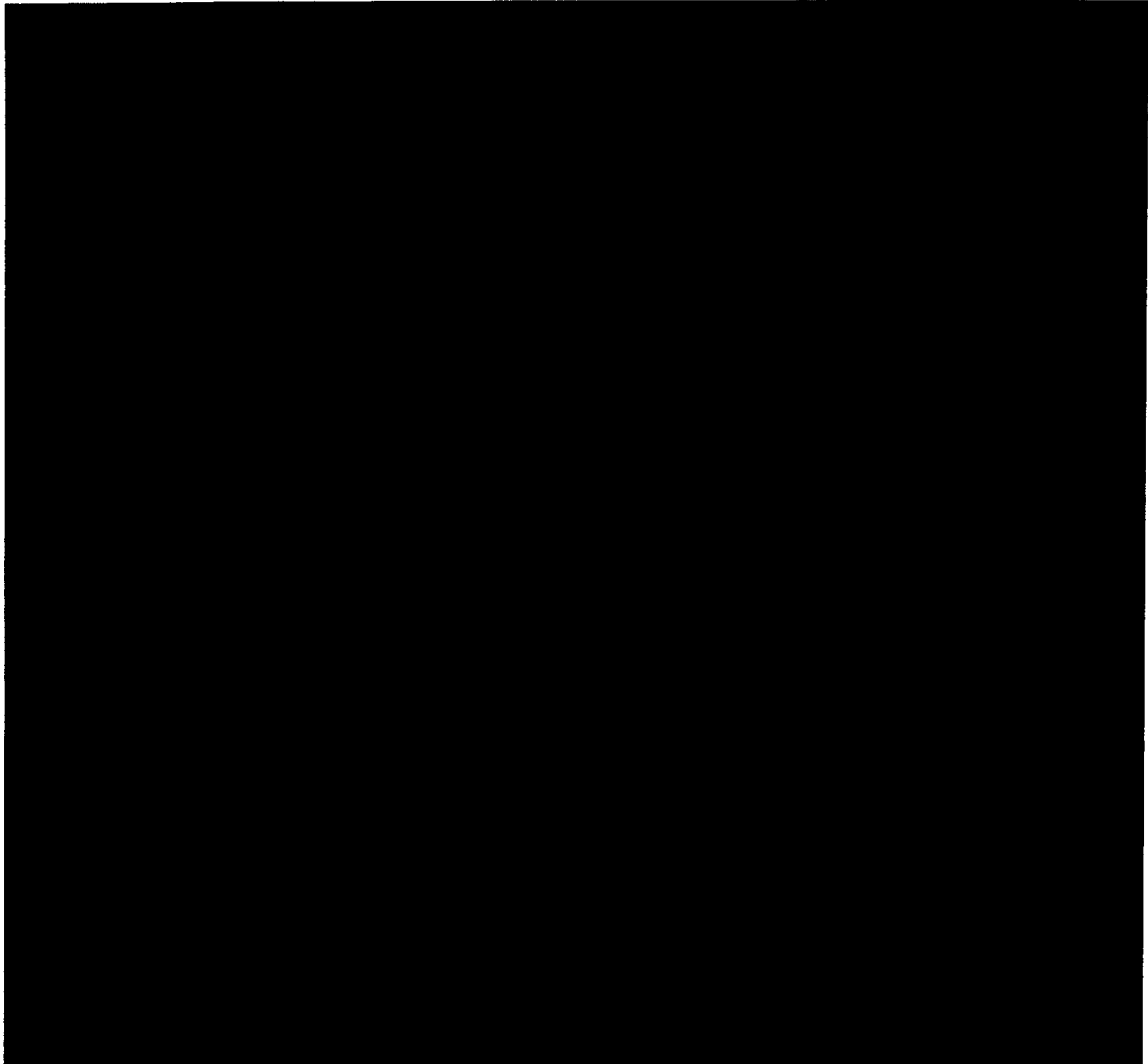
Chilean political life has undergone a transformation since the watershed plebiscite of October 1988 in which the moderate opposition—led by Christian Democrat Patricio Aylwin—soundly defeated Pinochet's bid for another eight-year term. Although reluctant at first to accept the outcome, Pinochet eventually decided—fulfilling a requirement of the Constitution of 1980—to set 14 December 1989 as the date for direct

presidential and congressional elections. Under pressure from senior military officers and key moderate Cabinet members, Pinochet also agreed to an earlier popular referendum on amendments to the Constitution that would meet opposition demands to ease some restrictive campaign rules and shorten the term of the next President from eight to four years. Although the overwhelming vote for these changes in July 1989 was widely viewed as a victory for the opposition, it left untouched several provisions favoring the political right in the congressional contest, as well as the regime's authority to designate nine of the 47 members of the future Senate.

The runup to the national elections confirmed the erosion in Pinochet's standing as Chile's principal political actor and the corresponding increase in importance of the moderate opposition led by Aylwin. The 17-member Concertation of Parties for Democracy (COPODE) harmoniously endorsed Aylwin as a consensus presidential nominee, devised a unified campaign strategy, selected congressional candidates from virtually all COPODE parties, and formulated a sophisticated, politically balanced program for governing.

Aylwin's first-round victory against two rightist candidates in balloting that drew about 95 percent of the registered electorate gave him an overwhelming mandate—he won 55.2 percent of the valid votes, nearly twice his nearest rival's total. The COPODE slate won 69 of the 120 seats in the Chamber of Deputies and 22 of the 38 directly elected senatorial slots. Nevertheless, largely because of nonproportional electoral rules, in about 18 districts rightist candidates

¹ Aylwin launched his bid for his party's and COPODE's nomination in early 1989—following a drawn-out, divisive Christian Democratic Party (PDC) leadership reelection struggle—and only then began forming a personal campaign staff. He was never before viewed as presidential timber, despite having served three times as PDC president and as a senator until 1973.

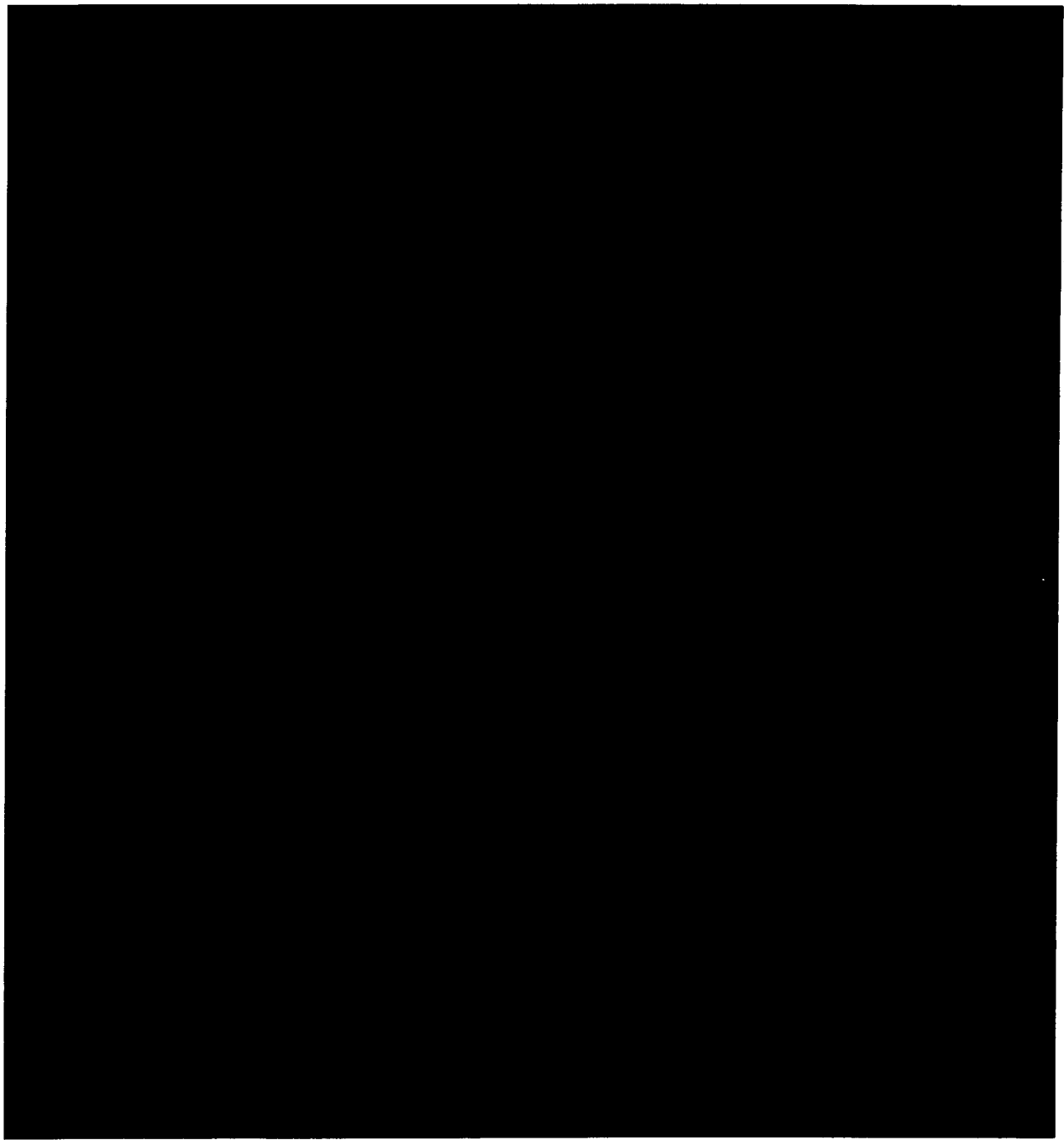


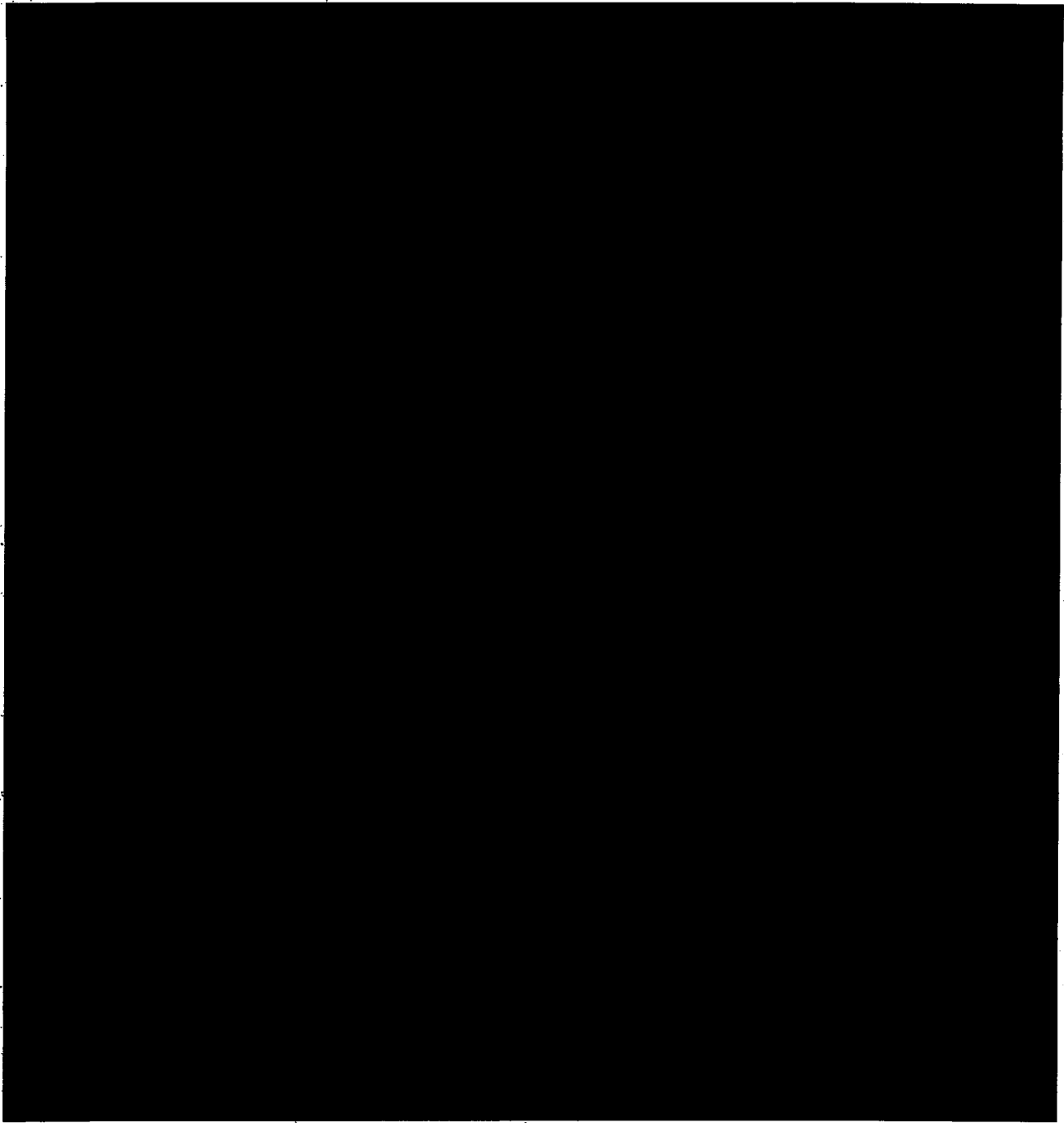
were elected with fewer votes than second-place vote-getters on the COPODE ticket. [REDACTED]

Preparing To Assume Office

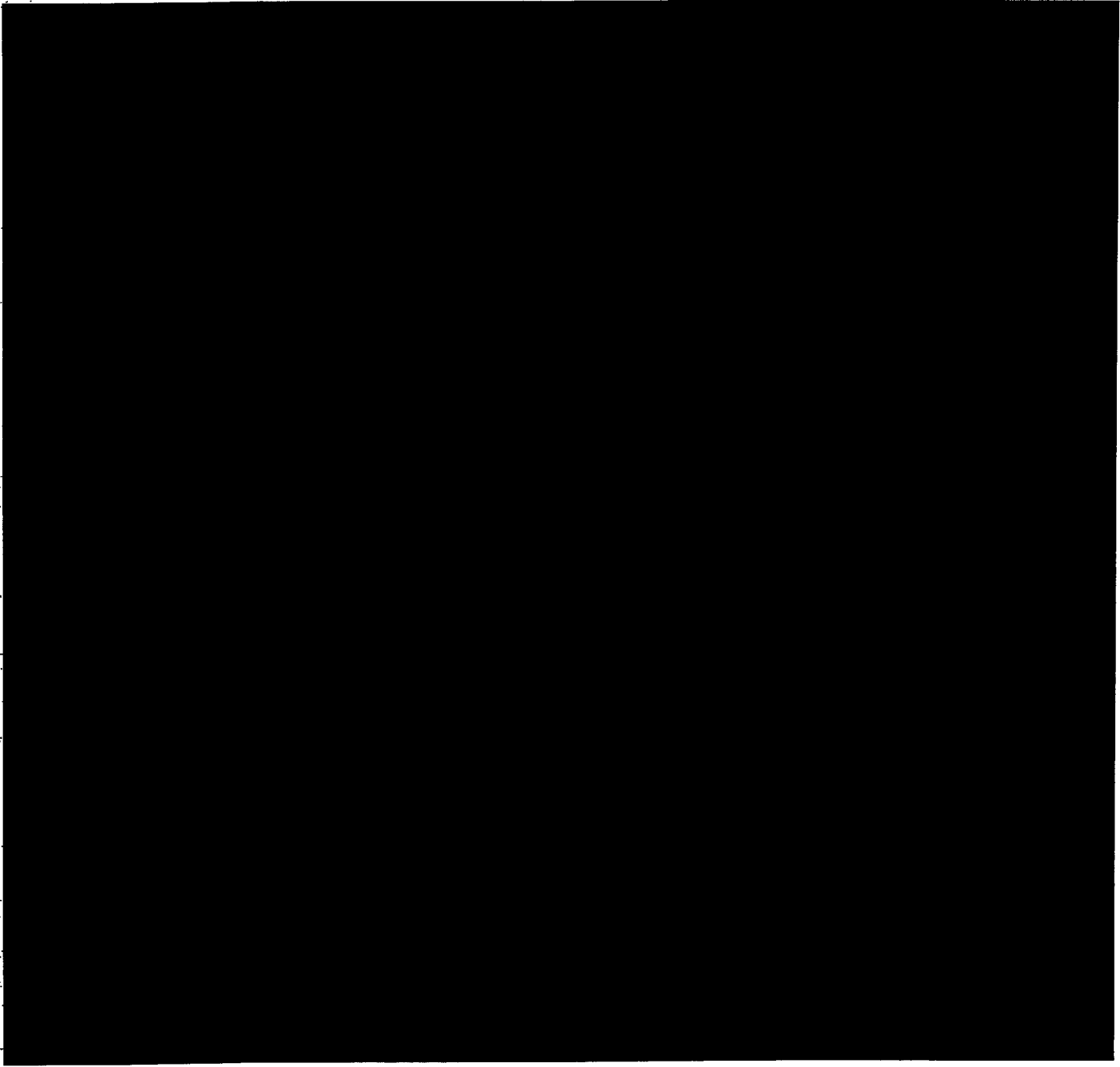
As Aylwin prepared to take office, he faced several daunting new tasks as Chile's first elected President in 20 years, including:

- Making COPODE work as a governing coalition.
- Reestablishing a viable relationship between the executive and legislative branches after the lengthy hiatus of military rule.
- Reasserting civilian control over government at all levels by replacing officials appointed by Pinochet and by restoring local elections.
- Reforming the judiciary, discredited by years of interference from Pinochet and the military.
- Implementing sound programs—particularly with regard to the economy—in the face of lingering skepticism in the military and among conservatives over the ability of “politicians” to rule.





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- Expanding social services and improving living standards for the working classes.
- Responding to the pent-up desire for increased labor freedoms without unleashing destructive strike activity and excessive demands or antagonizing management.
- Facilitating the resurrection of the moderate right as an independent political force.
- Restoring legitimacy as political actors to far-left parties, such as the Communists, while avoiding a resurgence of terrorist activity from either the extreme left or far right.
- Countering the machinations of Pinochet from his powerful position as Army Commander after 11 March and effecting a constructive relationship with the armed forces. [REDACTED]

In January—even before Aylwin took office—he named his choices for Cabinet members, subsecretaries, and the directors of the key state-run corporations from among the responsible and experienced politicians and economists from the main parties in COPODE. His key ministers are drawn from the inner circle of advisers on whom he has relied since he became the head of the opposition coalition during the campaign for the 1988 plebiscite. Most observers believe his 20-member Cabinet—which includes nine portfolios held by Christian Democratic Party (PDC) stalwarts, five by the recently reunited Socialist Party of Chile (PSCh), two from the Radical Party (PR), and the remainder from smaller groups in COPODE—is a strong, credible, team-oriented group. Individual members of the Cabinet, in our view, have greater status and influence than their predecessors under Pinochet's highly centralized decisionmaking system. [REDACTED]

Aylwin has also balanced coalition political forces within ministries, where a minister belonging to one party is often matched with a subsecretary from another. The party distribution of under-secretaryships and of senior regional, provincial, and major municipal appointments roughly mirrors that of the Cabinet, with the PDC receiving about half followed by the other COPODE parties. [REDACTED]

With COPODE holding a clear majority in the lower house of Congress but two seats shy of controlling the Senate, the Aylwin government also skillfully avoided

controversy with other parties concerning the distribution of legislative leadership posts. The coalition reached agreement in February with one of the two moderate-rightist parties on dividing up the congressional leadership slots, including the top positions in the Senate and Chamber of Deputies and the chairmanships of 33 congressional committees. The Aylwin team's emphasis on securing at the outset an effective congressional leadership as the key to an orderly legislative process was driven partly by the perceived need to compensate for the fact that many legislators have no prior experience in the Congress, which has not met since 1973, and also by the fact that Pinochet relocated Congress from Santiago to the port city of Valparaiso.² Finally, the team succeeded in having Christian Democrat Gabriel Valdes elected Senate president, a vital position that permits him, as one of the four civilians on the National Security Council, to serve as a potential counterpoint to Pinochet and the three other service commanders in debates over whether government actions contravene the restrictive, promilitary national security provisions inserted by Pinochet in the 1980 Constitution. [REDACTED]

The Aylwin team's efforts to draw closer to labor, a key constituency with high expectations of the new government, have borne fruit early. Labor Minister Rene Cortazar's first action upon taking office was to reassure leaders of the Unified Workers Central (CUT)—the main organized labor group—that the new government is committed to liberalizing Pinochet's restrictive labor code, [REDACTED].³ Senior officials also reassured concerned rightist groups that the changes would threaten neither the business community nor free market economic policies. [REDACTED]

² Many observers believe Pinochet hoped to impede cooperation between the legislative and executive branches by moving Congress out of the capital. The new congressional building will not be completed for at least another year, however. [REDACTED]

³ Under the dictatorship, organized labor comprised only about 10 percent of Chile's nearly 4 million workers. About 55 percent of the country's unions are affiliated with the CUT. [REDACTED]

In an agreement reached in January 1990, the CUT and the Confederation of Production and Commerce (CPC)—the most important businessmen's association—concurred that proposed revisions to the code must safeguard orderly economic growth, expand export markets, and foster domestic and foreign investment, while also ensuring higher employment, salaries, living standards, and a more equitable distribution of wealth. They created joint commissions to formulate proposed code modifications that would provide for industrywide collective bargaining, expanded strike rights, elimination of management's ability to fire workers for political reasons, higher minimum wages and retirement benefits, and mandatory union dues. The accord was followed by extended negotiations between labor groups, business organizations, and government representatives on the terms of revisions to the labor code sent to Congress in July, which [redacted] are expected to receive legislative approval. [redacted]

Looming Challenges

Aylwin and his ministers face difficult choices in setting priorities for their first year in office. Some sensitive political issues, such as addressing earlier human rights abuses and finding a way to shorten Pinochet's stay as Army Commander, are charged with emotion and high expectations for members of COPODE and the left in general. Others, such as the economic team's ability to maintain a strong economy while expanding social services and improving living standards for the poor, as well as how the new President goes about upgrading civil-military relations, will be important tests for civilian rule. [redacted]

In our view, however, the new government has already bogged down partially in trying to revise the legislative and administrative restraints rushed through the junta during Pinochet's last months in office, and it will have to move skillfully if it is to implement key parts of the COPODE program in the coming months. Indeed, [redacted] the new administration and Congress could be tied up some time trying to revise these laws and could squander additional time investigating publicly exposed improprieties by the former regime, such as sales of state

Stumblingblocks Left by the Pinochet Regime

During the interregnum between the election and the inauguration, Aylwin and his advisers sought—with mixed results—to counter numerous legislative and administrative measures introduced by the lame-duck Pinochet regime in the apparent hope of limiting the new government's options. The most far reaching of these measures was the Organic Law for the Armed Forces limiting the new President's authority over military matters—including the budget, promotions, and retirements—subordinating the service chiefs to the President only in time of war, and creating an autonomous board of commanders headed by Pinochet as Army Commander. In January, Pinochet—under pressure from the Concertation of Parties for Democracy (COPODE) and the main moderate-rightist party, and at the urging of his military and civilian advisers—agreed to modify the most controversial features of the bill and to accept language placing the military under civilian authority. [redacted]

Nevertheless, the version Pinochet promulgated left the new President's authority unclear regarding the military. The regime also pressed ahead unilaterally with other legislation regulating the Congress, the State Bank, the Supreme Court, the judiciary, the bureaucracy, and the educational system. [redacted]

These moves heightened the distrust between the incoming administration and the regime and prompted promises from the Aylwin camp to seek early congressional reform of the most objectionable bills; under one of these, the new government could not remove career government employees or appoint senior officials below under secretary rank in most agencies. COPODE leaders also stepped up consultations with rightist parties on a joint legislative agenda to ensure rapid passage of the reforms through Congress. [redacted]

resources to Pinochet cronies and transfers of valuable state properties to the Army. Nonetheless, Aylwin sees congressional overhaul of the most restrictive laws as a top priority and convoked the Congress into extraordinary session in March—two months early—to consider a package of judicial reforms and proposed tax increases to cover social spending.⁴ [REDACTED]

The new administration's commitment to reforming basic features of the inherited political system means it must tackle constitutional and other key statutes that rigidly regulate most basic political functions, including electoral registration and voting, legalization and organization of political parties, Congress's prerogatives, the structure and functioning of municipal and regional government, and, specifically, the relationship between the armed forces and the central government. The rules governing congressional modification of these diverse measures are complicated, however, reflecting Pinochet's efforts to safeguard his authoritarian system from meddling by a civilian successor. For example, certain constitutional amendments would require a two-thirds majority of both houses—considerably more votes than COPODE alone can muster. [REDACTED]

In addition to moving more expeditiously on the legislative front, the Aylwin government realizes it needs to demonstrate a "take charge" attitude on key issues or risk being seen as indecisive. Many in the military, as well as civilian conservatives, are skeptical about the ability of politicians long in opposition to the Pinochet regime to manage the government effectively. [REDACTED] many Chileans wonder how the Aylwin government will fulfill its promises both to sustain Chile's free market economic policies and to improve living standards for the poor. Aylwin has acknowledged this skepticism and the difficulty of implementing COPODE's broad gauged program and has pleaded for patience and cooperation from his followers. [REDACTED]

Human Rights

One lightning rod for the new government is how it addresses the controversial issue of human rights abuses by the military and the intelligence services

⁴ The tax increase legislation took effect on 1 July. [REDACTED]

The Pinochet Era and Human Rights: The Numerical Record

Compilations of human rights abuses committed since 1973 vary widely, but, in our view, the most credible are the following:

- *Almost 1,000 people were executed in the weeks immediately following the turmoil of the military coup.*
- *About 750 others were picked up by the security services and "disappeared" between 1974 and 1978.*
- *Over the past decade, several hundred have been killed by security forces, many of them during antiregime protests in 1983-84, or by death squads widely suspected of receiving support from the Pinochet regime.*
- *Several thousand were arbitrarily detained and interrogated—and often tortured—throughout the post-1973 period.* [REDACTED]

during the Pinochet era, recently highlighted by the discovery of mass graves of persons seized immediately after the military coup in 1973. On one side of the issue are the far left, a few human rights groups, some in the legal community, and many relatives of the "disappeared," who advocate airing all human rights questions completely and prosecuting military and other personnel responsible for abuses dating back to 1973. The Communists and even some leftists in COPODE have called for investigating Pinochet and for wholesale indictments of military officers, [REDACTED] In opposition to this view are most Army officers, many in the other services, Pinochet and other hardliners—including still influential retired senior intelligence service personnel—and many conservatives, who adamantly oppose any investigation or formal charges against more than a handful of officers. [REDACTED]

Aylwin has promised publicly and privately to support a full investigation of human rights abuses under the Pinochet regime, but he has emphasized that only individuals, and not the armed forces as a whole, will be held accountable and that witch hunts must be avoided. In April, he established a commission composed of eminent politicians and jurists and empowered them to document Pinochet-era abuses and to recommend appropriate compensation for the families of victims; the commission, however, was not authorized to recommend prosecution of human rights offenders. Aylwin also announced that, once the investigation is completed, he will consider pardons. While most Chileans applauded Aylwin's prudence, [redacted] rightist politicians are warning that his approach could trigger conflict with the military. The main rightist party, National Renovation (RN), has argued that the commission's investigation should be broadened to include political violence before the Pinochet era. In our view, the RN is trying to capitalize on the controversy to press the government for compromises on legislative matters. [redacted]

Aylwin also faces pressure to resolve the status of the approximately 400 political prisoners still in prison or awaiting trial and to find a legal way to reduce the severe sentences handed down for political offenses under the Pinochet regime. The new President is committed to ending the death penalty, eliminating military court jurisdiction over civilians, and pardoning those held or convicted for nonviolent political activities. Accordingly, he has freed about 40 political prisoners and promised to pardon others awaiting trial—some for years—as soon as the legislature lifts restrictions on presidential authority to do so. Once again, however, [redacted] the RN is holding off on supporting this legislation as it tries to cut a political deal with the government. [redacted]

Despite some advances, Aylwin still has not devised a plan for at least progressively reducing tensions on the human rights issue, even if he realistically does not expect to resolve it completely any time soon. Unless he tackles this and related questions, such as the need to rebuild an independent judiciary, key political groups may conclude that the President lacks decisiveness. Even Aylwin team members admit, [redacted]

[redacted] taking human rights cases out of military courts and reforming antiterrorist legislation probably is only the first step, because the civilian court system itself—especially the current crop of judges up to and including those on the Supreme Court—needs to be overhauled. In our view, however, the new government has not yet decided how to promote a better judicial system. [redacted]

Dealing With the Communists

Another difficult decision for the new administration is when and how the Chilean Communist Party (PCCh) should be legalized. The PCCh already has secured consent from the National Electoral Service (SEN) to gather the required signatures of about 34,000 party members—the first step in the drawn-out legalization process—but legislation still on the books apparently precludes legalization of the PCCh and other far-left parties. President Aylwin, and his Interior Minister who has ultimate authority over the SEN, must decide whether to ignore this legislation—setting a dangerous precedent in legalistic Chile—or to seek its repeal by Congress. [redacted]

The Aylwin team has devoted much attention in recent months to preventing the PCCh from playing a disruptive role, [redacted]



[redacted] The President appears convinced that a legal PCCh—part of Chile's political tradition—would be less of a threat to the consolidation of democracy than would a clandestine party, which might not be disposed to restrain affiliated terrorist groups. [redacted]



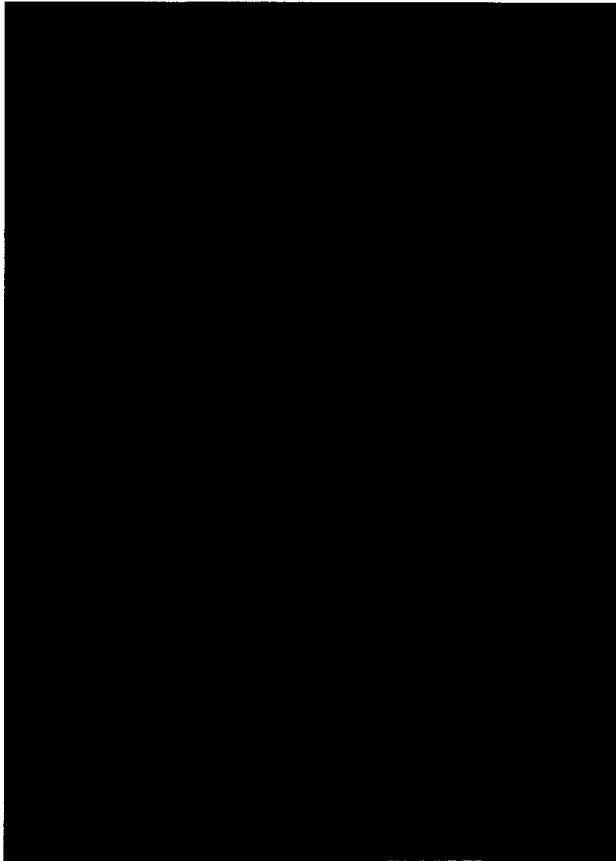
Nevertheless, we believe that unless the PCCh formally forswears violent tactics,¹ Aylwin and his advisers may decide not to confront the right, the military, and diehard Pinochet loyalists by continuing to mollify the PCCh. On the other hand, failing to press for PCCh legalization could have costs as well, and Aylwin's standing with the left and within his own coalition could slip. Moreover, his indecision could provide a pretext for increased far-left terrorist activity, such as the two dramatic assassination attempts against former regime officials that have taken place since Aylwin took office. The dissident faction of the Manuel Rodriguez Patriotic Front (FPMR/D), formerly closely associated with the PCCh, claimed responsibility for these attempts and has promised more such "executions," and other, smaller terrorist groups have also recently stepped up their activities.


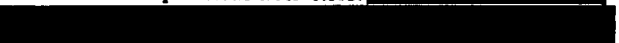

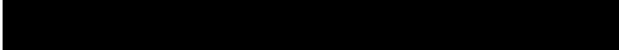


The Pinochet Factor

We believe the thorniest problem faced by Aylwin and his advisers has been how to deal with the "Pinochet problem" without damaging overall civil-military relations. Pinochet's reluctance to forgo a role as power broker even as he stepped down from the presidency implicitly threatens Aylwin's authority.  The President's task on this score is once again complicated by laws and decrees on military matters left in place by Pinochet; two particularly troublesome statutes guarantee that the military's share of the national budget will not be cut, and limit the right of Congress to investigate military abuses. 

Nevertheless, in our view, Aylwin has demonstrated both firmness and astuteness in his efforts to improve overall civil-military relations, specifically in reacting



to Pinochet's political activities. 




Moreover, to subordinate all armed forces commanders to his authority, Aylwin named a senior member of his party as Defense Minister and—breaking with tradition—appointed civilian defense subsecretaries for each branch of the military. He was careful, however, to select political moderates who had not previously been antagonistic toward the military; he even replaced his first choice for Army subsecretary after Pinochet objected to him. He also asked Generals Fernando Matthei and Rodolfo Stange—the commanders, respectively, of the Air Force and Carabineros, the paramilitary national police—to stay on. Matthei and Stange, in turn, have declared publicly

that they would respect the new President's authority and would work to strengthen civil-military relations.

Still, [redacted] Aylwin and his advisers recognize they must proceed with care in containing Pinochet. Senior officers will be prepared to protest over any signs of disrespect for the former President—who is still admired throughout the services—or over any apparent effort to ignore the interests of the armed forces on major national policy issues. Military officers almost certainly would reject any move by the Aylwin team to hold Pinochet accountable for human rights violations or to abrogate the amnesty law he authored in 1978, which provides a blanket pardon for such offenses by regime officials committed before that date. While Aylwin and his advisers appear ready to respect these taboos, they realize they cannot afford to overlook any attempt by Pinochet to use his Army command as a power base to undermine Aylwin—and perhaps even create a shadow government. [redacted]

[redacted]

[redacted]

[redacted]

Fine-Tuning the Economy

One of the Aylwin government's greatest assets is that it has inherited an economy that is running efficiently and riding the crest of an expansion unparalleled in South America in recent years. In contrast to new leaders elsewhere in the region, Aylwin faces neither the need to adopt drastic economic stabilization measures nor the threat of major social unrest. [redacted]

The Chilean economy is now in its seventh consecutive year of growth, averaging 6 percent annually and even approaching 10 percent in 1989. Since 1985, it has benefited from policies that have fostered growth in traditional exports—copper, wood products, agriculture, and fish products—thereby contributing to a 7.4-percent increase in industrial-sector production in 1989 alone. Household income has grown steadily for several years. Real wages started to rise in 1987, increasing by about 7 percent in the past two years,

[redacted] and some nonmonetary indicators of social well-being also improved. Unemployment, which surged to more than 25 percent in the early 1980s, is currently at about 6 percent, although the minimum wage still lags below 1981 levels. Nevertheless, high levels of consumer purchases and business investment spending pushed inflation up from 12.7 to 21.4 percent last year; it was running at an annual rate of over 23 percent at the time of the inauguration. Moreover, concern that the economy was overheating led the Pinochet regime to tighten monetary policies during its last few months, the full effects of which have yet to be felt in key economic sectors. [redacted]

Members of the Aylwin government's economic team recognized that difficult choices awaited them, particularly in maintaining favorable macroeconomic trends while also honoring COPODE's commitment to expand social services. These officials have announced that GDP growth must be slowed to a sustainable pace—the target for 1990 is 5 percent. They note that

Developing A Sound Economy

Chile's vigorous, growing economy reflects its reliance on the market system, private enterprise, and foreign trade. Its hospitable climate for the private sector and favorable regulatory environment have attracted significant domestic and foreign investment. Although it still owes foreign lenders about \$16 billion, Chile has been a model debtor, remaining current on principal and interest payments and reducing its foreign debt by about \$3 billion between 1985 and 1989. Santiago has also maintained compliance with a series of IMF programs and has drawn substantial World Bank support for development projects. [REDACTED]

Shortly after the 1973 coup, President Pinochet adopted free market policies to turn around the ailing economy—hamstrung by Marxist principles and registering a 1,000-percent inflation rate. He turned for help to a group of young economists, largely educated at the University of Chicago and later dubbed the "Chicago Boys," who drew up a plan based on free enterprise and a reduced government role in the economy. Pinochet applied it gingerly at first, and vigorously after 1975, generating sharp reductions in inflation and the highest per capita growth in Latin America during the late 1970s. [REDACTED]

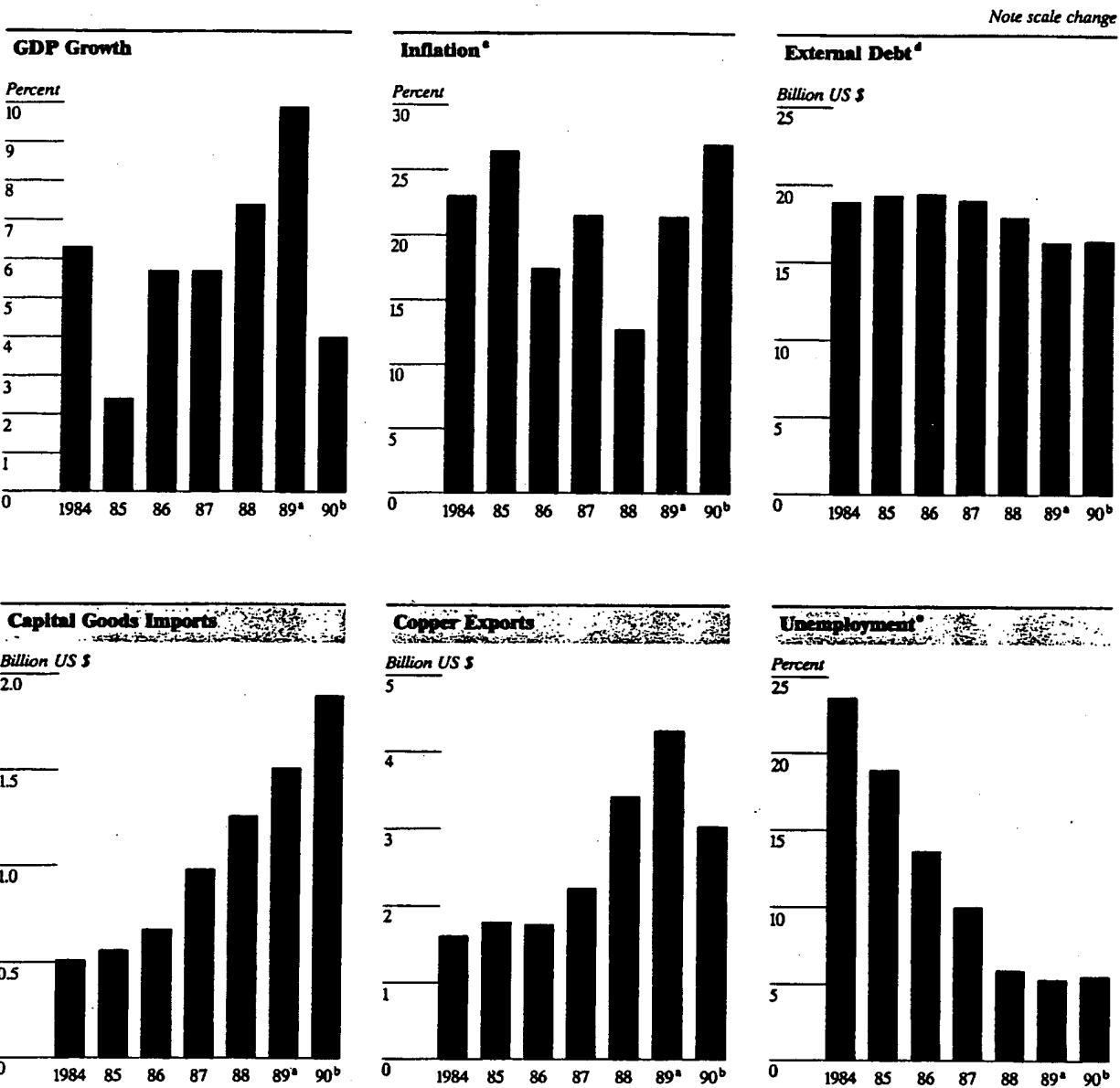
The convergence of external shocks and rigidity in economic policies brought the growth boom to an abrupt end in 1982. Between 1980 and 1982, the value of Chile's exports fell sharply, rapid increases in international interest rates pushed up debt payments, and foreign borrowing, which had been fostering domestic growth, dried up in the wake of the Mexican debt crisis. GDP fell by about 15 percent during 1982-83, and the number unemployed or in emergency jobs programs surged to a quarter of the work force. [REDACTED]

Stimulative policies did not generate a sustained recovery until Hernan Buchi, installed as Finance Minister in early 1985, capitalized on earlier free market reforms with an export expansion scheme based on the private sector. He began by emphasizing Chile's comparative advantage in its traditional exports: minerals, forestry, and agricultural and fishing products. The expansion has since spilled over into other sectors, generating continuous growth above 5 percent annually beginning in 1986. The programs were implemented without generating large fiscal deficits, helping inflation to fall to 12.7 percent by 1988. [REDACTED]

International financial support for these programs was available largely because of Chile's good record as a debtor and its favorable climate for domestic and foreign investment. Commercial creditors re-scheduled about \$6 billion in payments due during 1985-87 and granted new loans of more than \$1 billion, leaving Santiago with sufficient funds to pursue export promotion policies. A series of IMF loan programs, beginning in 1983, has also contributed to continued financing for economic programs, and the World Bank provided three \$250 million Structural Adjustment Loans (1985-87) in addition to extensive project lending. [REDACTED]

Chile's favorable business climate increased private investment sharply and enticed Chileans to bring back and invest more than \$1 billion held abroad. Equitable treatment of foreign investors has yielded a heavy influx of foreign funds. During 1989 alone, nearly \$3 billion in foreign investment projects were approved. [REDACTED]

Figure 1
Chile: Selected Economic Indicators, 1984-90



^a Estimated.
^b Projected.
^c December/December.
^d Yearend values.
^e Yearend values, includes those in government work programs.

the growth of export earnings probably will slow in any case if world copper prices drop from recent high levels.⁶ They also acknowledge that tax revenues may decline; moreover, their decision to halt privatization of state enterprises, at least temporarily—to decide on pricing and legal requirements—is further limiting government revenues. [REDACTED]

At the same time, Aylwin and his advisers have promised to improve the lot of those who have not shared in the economic growth of recent years—the 40 percent of Chileans they claim live in poverty. The administration has targeted underemployment—particularly among urban youth—a severe housing shortage, declining health services, and an inadequate educational system for corrective action; it has already obtained congressional approval for raising the minimum wage. [REDACTED]

To make inroads in these areas without incurring a fiscal deficit, Aylwin has stated that increases in social spending will be limited to about 4 percent of GDP over the next few years, which he proposes to finance through higher taxes on business, increases in aid from abroad, and funds made available by renegotiating the foreign debt. [REDACTED]

because efforts to slow the overheated economy are likely to reduce government revenues, avoiding a fiscal deficit while expanding social spending may prove difficult. It is unclear how much of a problem this will be, but, in our view, President Aylwin and his advisers will need to clarify their social programs soon or face criticism from within the coalition that the government is moving too slowly. In any case, the administration may have to parry efforts by groups outside the coalition, such as the Communists, to embarrass the government with demands for immediate major spending hikes. [REDACTED]

Reformulating Foreign Policy

The Aylwin team, on record as intending to reorient fundamentally Chile's foreign relations, has already

⁶ Despite the significant gains in diversifying exports in recent years, about 40 percent of foreign exchange receipts are still derived from copper exports. [REDACTED] production problems at the State Copper Corporation (CODELCO) and the expected drop in prices are likely to lower significantly CODELCO's contribution to the national treasury during Aylwin's term. [REDACTED]

begun to repair the damage to the country's reputation resulting from the legacy of the Pinochet era.⁷ Its first step was to restore relations with as many countries as possible during the early months of the new government. On inauguration day, Santiago signed protocols reopening relations with the Soviet Union and four East European countries. Spokesmen for the new government announced that they expected to strengthen relations with other Latin American states and to join or rejoin regional organizations. The presence of Nicaragua's Daniel Ortega at the inauguration signaled the resumption of bilateral ties, which had been suspended for several years. Soon afterward, Mexico restored relations broken in 1974, while Santiago announced the reopening of Chilean diplomatic missions in Trinidad and Tobago, Suriname, Guyana, and Jamaica. [REDACTED]

Two countries have been exempted from this warming trend in Chile's global diplomatic ties—Cuba, with which [REDACTED] has said relations would be rebuilt only gradually, and South Africa, with which ties are being downgraded. [REDACTED]

A second foreign policy priority for the new government has been to maintain the good relations with the international economic community inherited from the Pinochet regime, because the Aylwin government

⁷ Following the 1973 coup, the Soviet Union, Cuba, most East European countries, and Mexico broke relations with Santiago, while the Scandinavian countries, France, Spain, Italy, and West Germany were cool to Chile for extended periods. Except for a papal tour in 1987, the last visit by a head of state was that of Brazil's military President in 1982. Pinochet received few invitations to travel abroad; he was discouraged by UN officials from attending UN General Assembly (UNGA) sessions and in 1980 was disinclined by President Ferdinand Marcos from visiting Manila while already en route. For years, the UN Human Rights Committee and the UNGA singled out Chile's human rights record for criticism. [REDACTED]

Chronology of the Letelier Affair

21 September 1976

Former Foreign Minister and Ambassador to the United States Orlando Letelier and his American coworker Ronnie Moffit are murdered by a bomb explosion in Letelier's car on Sheridan Circle in Washington, DC.

28 March 1978

US attorneys issue a warrant for the arrest of the prime suspect in the case, Michael Townley, a US citizen working for Chilean intelligence, whom US officials have located residing in Chile.

9 April 1978

Chilean authorities expel Michael Townley and hand him over to FBI special agents in Santiago, who escort him to Washington where he is arraigned in a US district court.

16 April 1978

Michael Townley and US attorneys sign a plea bargaining agreement, and Townley begins his testimony.

1 August 1978

The US attorney in Washington, DC, announces a grand jury indictment of Chilean national intelligence officials, Manuel Contreras, Pedro Espinoza, and Armando Fernandez Larios, as well as three Cuban-Americans, for the murders of Letelier and Moffit.

20 September 1978

US Ambassador to Chile delivers the request for the extradition of Contreras, Espinoza, and Fernandez Larios to the Chilean Foreign Minister.

1 October 1979

The Chilean Supreme Court formally denies the US request for the extradition of the three suspects and declares that there is insufficient evidence to warrant an investigation of the Letelier murder in Chile.

4 February 1987

Maj. Fernandez Larios, who fled Chile to seek a plea bargaining arrangement with US authorities, is arraigned in US District Court in Washington, DC.

11 May 1987

The US Government asks that the Pinochet regime expel Contreras and Espinoza and place them at the disposition of US authorities.

17 June 1987

The Pinochet government rejects the US request for expulsion of Contreras and Espinoza.

January 1989

The US Government invokes a 1914 treaty with Chile, providing for international arbitration of bilateral disputes; Chile has yet to accept the full applicability of this treaty to the Letelier case.

needs foreign credits and access to export markets. An early achievement in this area was the four-year, \$2 billion economic cooperation agreement signed with Spain at the inauguration. [REDACTED] smaller aid packages from several other West European countries are also in the offing. The Aylwin government apparently hopes economic ties to Europe will help ensure access for Chilean exports after the European Community integrated market system takes effect in 1992. [REDACTED]

The final but key foreign policy priority has been to reestablish a cooperative relationship with Washington across the board. [REDACTED] Aylwin and his team keenly appreciate Washington's role in the restoration of civilian rule to Chile and regard closer bilateral ties as vital to consolidating democracy. They thus recognize the need to manage deftly the handful of bilateral problems inherited from Pinochet. [REDACTED]

The most important of these issues is bringing to justice those responsible for the Letelier murder, which must be done before US Congressional restrictions on military sales, training, and other assistance to the Chilean armed forces—as mandated by the Kennedy-Harkin amendment—can be lifted.¹ Aylwin and several close advisers have publicly acknowledged their determination to find a solution acceptable to the United States that is within the constraints of Chilean law. [REDACTED]

In our view, however, the government will have a difficult time satisfying the various parties in Chile with a stake in the Letelier case, [REDACTED]

[REDACTED] Continued delay could foster a perception that Aylwin is indecisive, or even unwilling to tackle overall human rights issues, and, no matter how the case is addressed in the next few months, it has the potential to sour relations between the government and the military. [REDACTED]

The Aylwin government, in our judgment, also sees several more minor, bilateral issues as benchmarks of US good will. One has been Washington's willingness to restore trading benefits under the Generalized System of Preferences (GSP) and investment guarantee privileges under the Overseas Private Investment Corporation (OPIC) that were removed two years ago because of the Pinochet regime's restrictive labor policies and poor human rights record. [REDACTED]

In addition, although President Aylwin accepts that major US aid is unlikely, he probably expects more than rhetorical support, [REDACTED]

[REDACTED] European offers of assistance may be fueling hopes

¹ See inset, page 14, for a chronology of how the dispute evolved following the assassination of former Chilean Foreign Minister Orlando Letelier and an American coworker in Washington in September 1976. [REDACTED]

in the new administration that, at a minimum, Washington will contribute to health, education, and housing projects in line with COPODE's program. Moreover, as the Aylwin government negotiates a commercial debt restructuring package during the next few months, it undoubtedly will compare the US response to Santiago's request for backing with Washington's support for debt relief and new loans for the Pinochet government on several occasions during the late 1980s. [REDACTED]

Finally, in line with its plans to resume diplomatic relations with numerous countries, Santiago may move too quickly for Washington's taste to restore ties to Cuba. It could also seek relations with such pariah states as Libya or accept PLO diplomatic representation in Chile. [REDACTED]

Outlook

We believe Aylwin will turn in a generally effective performance as President over the next year or so. In particular, we expect him to make major progress toward removing obstructive legislation left by Pinochet and reforming the Constitution, to manage the economy well, and to place civil-military relations on a sounder footing. In our view, these key factors will work in his favor:

- Aylwin's solid electoral mandate and his proven political skills. Aylwin shows clear signs of being a strong executive with the power and skill necessary to implement his policies within the established constitutional structure. He is likely to continue his practice of consulting a wide spectrum of political supporters and carefully gathering authority, then making a decisive move.
- A competent team of advisers and Cabinet members who have already demonstrated their grasp of what constitutes a sound program of government. Key advisers have skillfully handled difficult political negotiations since the election, and the Aylwin team shows strong cohesiveness and discipline.

- COPODE's solid position in Congress and steady movement toward legislative accommodation with moderate rightists. At the opening of the emergency session of Congress, the major parties agreed to cooperate in enacting several of the executive's initial proposals, and we believe it is only a matter of time before the main rightist party, RN, reaches an accommodation with COPODE; already it has supported Aylwin's fiscal reform proposal [REDACTED]

- Continued unity within COPODE, whose key member parties clearly still concur that making the new government work should override partisan interests.

- The determination of the Aylwin team to reach an understanding with the military on its institutional role under civilian government. Aylwin's strategy has been to avoid confrontation and to co-opt key sectors of the high command. His decision to ask Generals Matthei and Stange to stay on, for example, has made them more his men than Pinochet's, in our judgment. We share the [REDACTED] view that his assertion of full control over the Army and Navy will be more gradual, but eventually successful.

- The likelihood that Pinochet's options for manipulating the political process will continue to narrow over time. We believe that Pinochet will eventually choose to step down as head of the Army—perhaps even during Aylwin's first year in office; his departure would help consolidate Aylwin's authority over the military.

- Widespread public sentiment—echoed by leaders of most parties and in business, banking, and professional circles—that Chile needs a long period of stability to heal its political wounds. This perception should help provide a lengthy honeymoon to Aylwin, [REDACTED]

Alternative Scenarios

Despite the favorable signs, Aylwin's prospects could be set back by unexpected developments on any of several fronts. These include:

- Failure of the new team to take hold of the government as effectively as generally expected. One negative indicator might be a decision by the

administration to give priority to investigations or pretransition irregularities—for instance, Pinochet's last-minute illegal transfers of government facilities to the Army—at the expense of more immediate practical matters, such as streamlining the government bureaucracy and adopting legislation in time to hold municipal elections by late 1991.

- A sudden breakup of COPODE, perhaps over differences among centrist and leftist member parties on how to address the human rights issue. In addition, some member parties might defect in order to present independent slates for municipal elections likely to be scheduled for late 1991.

- Failure of the government to secure a working alliance with rightist parties in support of its legislative agenda.

- A sharp decline in economic activity or a rapid increase in inflation, caused by rash policy shifts or world market conditions.⁹

- A surge in disruptive political and labor agitation, which might be occasioned by a wave of strikes even before a new labor code is adopted.

- An escalation of far-left terrorism, such as by the dissident faction of the Manuel Rodriguez Patriotic Front (FPMR/D).

- Inability to come to terms with the military on a broad range of civil-military matters and to contain Pinochet. Aylwin's standing with the military could deteriorate sharply if, for example, the administration moved suddenly to abrogate the 1978 amnesty decree; to prosecute a large number of military officers, including Pinochet, for past human rights abuses; or to cut the budget for the armed forces.¹⁰ [REDACTED]

⁹ See appendix A for an examination of constraints on economic policy inherited from the Pinochet regime. [REDACTED]

¹⁰ Ironically, most Army officers probably would accept prosecution of retired General Contreras under the Letelier case because of the damage to the Army's reputation caused by his many unsavory actions while serving as head of national intelligence in the mid-1970s. [REDACTED]

We judge, however, that, even if faced with a combination of such negative developments, Aylwin would muddle through the next 12 to 18 months and would not lose control over essential aspects of government, or abandon free market economic policies or his legislative agenda. Even if there is an upsurge in far-left violence, labor unrest, and agitation by other groups, we judge that the mood of the country would remain sufficiently supportive of the democratic transition to preclude major political instability. Moreover, even if the military has reservations in coming months about perceived moves against it, the officer corps is unlikely to try to destabilize the government.

Finally, we believe there is only a 1-in-5 possibility that harassment by Pinochet might intensify enough to paralyze the Aylwin government and generate sufficient political uncertainty over time to spark coup plotting within the military. It could unfold, in our view, only if President Aylwin demonstrates near total incompetence in setting policy, managing his ministries, and dealing with Congress. Pinochet would also have to dramatically broaden his base of support within the Army, as well as in the other services, and public attitudes would have to shift overwhelmingly in favor of a return to military government. Even under these circumstances, a move by Pinochet to resume power by force—as distinct from a presidential bid in 1993, when he is eligible to run again—would almost certainly split the military and spark massive popular unrest.

Implications for the United States

In our view, the implications for the United States flowing from developments in Chile since late 1988 have been overwhelmingly positive. The orderly transfer of power from the Pinochet regime to a new, freely elected civilian government, headed by responsible, pro-US and prodemocratic leaders, fulfills a longtime US goal for Chile. Moreover, if our judgment about the near-term prospects of the Aylwin government is correct, basic United States interests vis-a-vis Chile will continue to be served.

The handful of potentially troublesome bilateral issues, in our view, do not pose major risks to the United States. The one area where tension is likely to

prevail for some time—and possibly intensify—is that of military-to-military ties. Even if Aylwin cannot find a formula to resolve the Letelier case and Washington, therefore, is unable to lift restraints on military ties, Santiago will remain cordial toward the United States, in our judgment. At worst, the Aylwin government might sour somewhat on the bilateral relationship if the United States fails to meet Santiago's expectations for the prompt restoration of GSP benefits and for US assistance in persuading Chile's creditors to write off its foreign debt, perhaps under the Brady plan.

The only major development that would alter our generally favorable forecast would be if, against strong odds, Pinochet and his hardline supporters—or others in the armed forces—staged a successful coup and restored a military dictatorship. If conditions for a coup appeared to be ripening over the next year or so, however, we believe Washington—along with West European and other Latin American governments—might be able to turn aside such an attempt by forewarning Pinochet and the military of the adverse consequences of such action.

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Appendix A

Institutionalizing Economic Reform

The successful growth record, employment generation, and foreign exchange earnings of Pinochet's laissez faire economic program have won plaudits from members of the incoming Aylwin administration—who pledged not to tamper with the macroeconomic policies they inherited. Nevertheless, Pinochet's economic team worked hard during its final months in office to consolidate the institutional changes it had made in order to impede any future government's attempts to return to a statist economic structure or to damage carefully cultivated relations with international creditors. [REDACTED]

A key aim of Finance Minister Hernan Buchi's policies under Pinochet was to broaden the private ownership of firms and establish supporting financial markets. Accordingly, during its final months the Pinochet regime increased the pace of privatization—despite mounting objections by officials of the incoming government who were not consulted. One mechanism used by the government for privatization was to hold blocks of stock both for the general public and for employees of the firms in question, with financing available for both groups. Pinochet regime officials apparently believed that wide holdings of stock would make it more difficult to renationalize firms. They also hoped to deflect charges of sweetheart deals to sell enterprises below market value; nevertheless, [REDACTED] several improper sales of state resources to Pinochet cronies apparently occurred during the postelection transition. In addition, private pension funds, one of the largest single sources of Chilean capital, were permitted to invest in a greater range of private firms, widening the capital market and spurring public interest in the financial health of private enterprises. [REDACTED]

Beginning in 1985, the Pinochet administration also manipulated the size and composition of its external debt to facilitate servicing and to encourage future governments to maintain a good credit rating. During the last five years of Pinochet's rule, Chile eliminated nearly \$9 billion of debt owed to foreign commercial

banks using debt-equity swaps and buying back its own debt on the secondary market. The consequent reduction in interest due by as much as \$800 million annually has lessened the debt service burden on the new government—although it faces a sharp rise in amortization in 1991—and increased its ability to maintain good relations with creditors. Total foreign debt fell only by about \$3 billion, however, because Pinochet continued to borrow to meet Chile's external financing needs, turning increasingly to multilateral development banks. Debt to multilateral institutions, although it generally involves lower interest rates, cannot be rescheduled; the severe penalties for non-payment to the IMF and World Bank will increase pressure on Santiago to keep future payments current. [REDACTED]

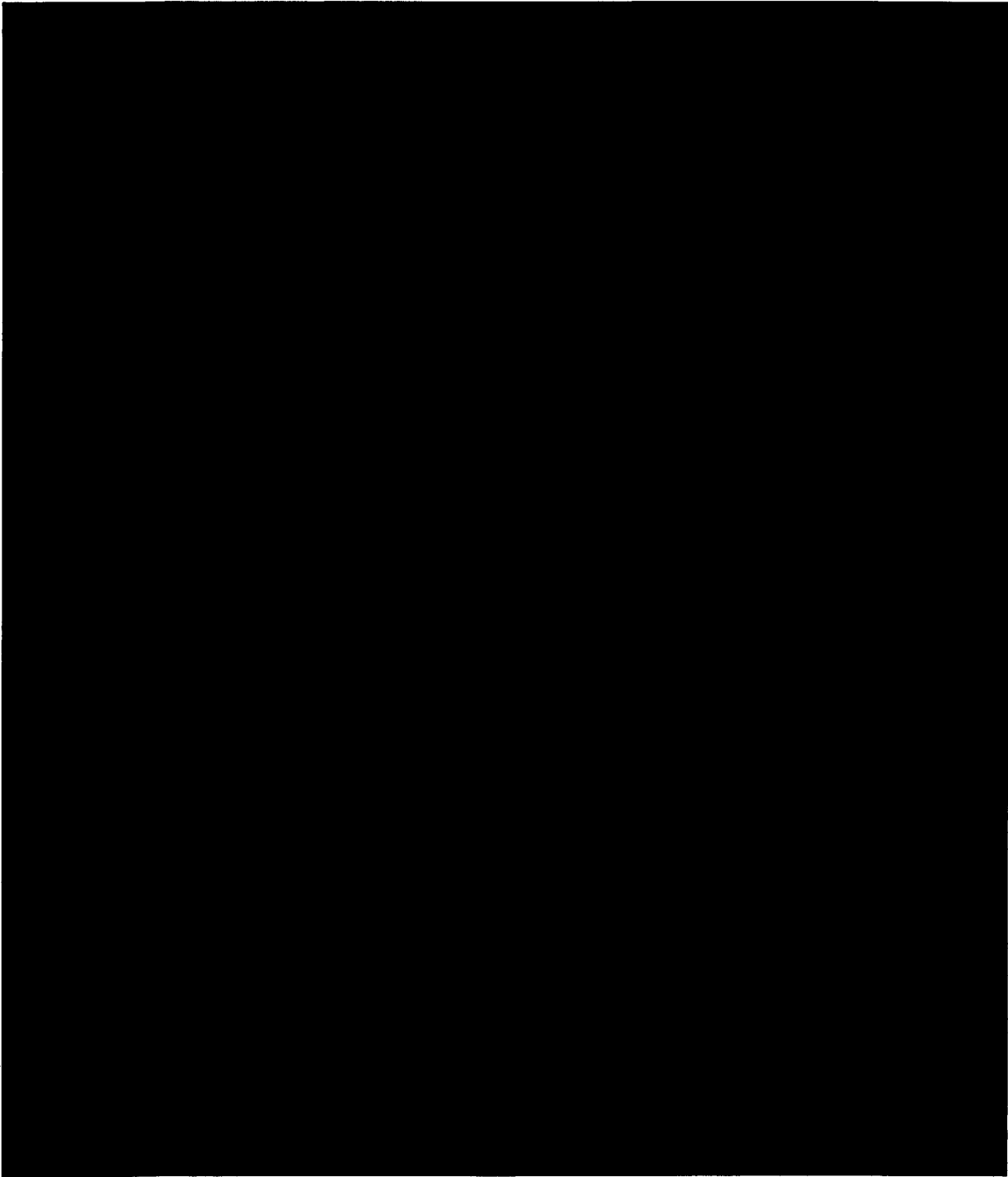
To assuage their fears that future administrations might use the printing of money to support overspending, the outgoing economic team also pushed through legislation to make the Central Bank more independent, along the lines of the US Federal Reserve System. The Aylwin team objected strenuously to this bill; even prominent rightists expressed reservations about Pinochet's motives—noting that the proposed law would preclude lending by the Central Bank to the treasury to cover future deficit spending. [REDACTED] In response to the criticism, the government worked out a compromise, shortly before the election, with key Aylwin advisers whereby they jointly selected the new bank governing board, consisting of two directors from the Concertation of Parties for Democracy (COPODE), two chosen by Pinochet, and a new, nonpolitical chairman. The chairman is a consensus choice who will serve for only two years, allowing Aylwin to appoint the next chairman for a regular 10-year term. Nonetheless, the powers of the bank's directorate made Pinochet regime officials confident that it would be able to withstand any pressure by a future government to distort monetary policy or provide loans to cover excessive spending. [REDACTED]

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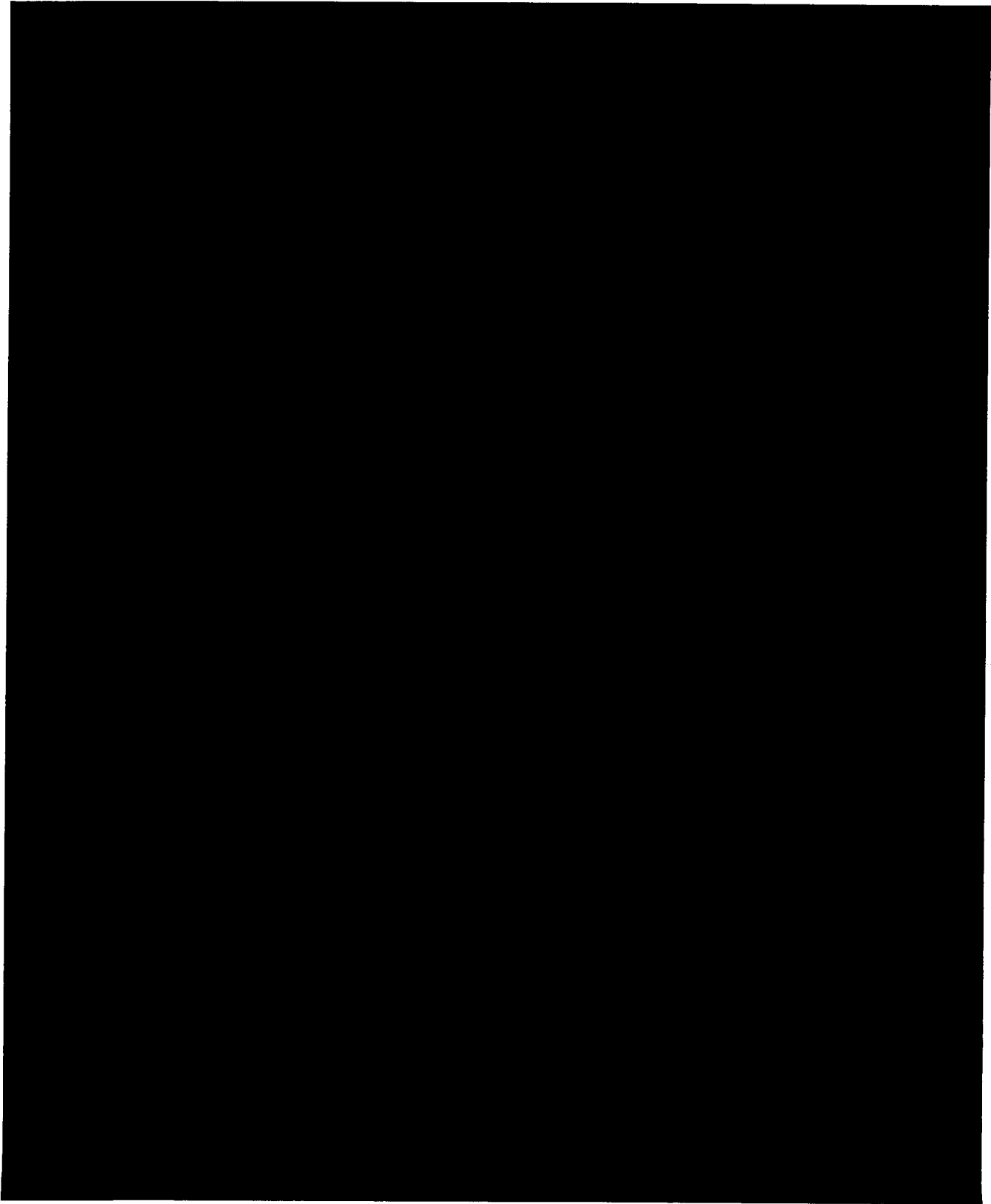
In addition, Pinochet's 1990 budget—Chile's fiscal year coincides with the calendar year—will constrain spending by the Aylwin administration for the remainder of the year. Budget calculations for this year were based on conservative figures of 4.5-percent GDP growth and an average copper price of only \$0.83 per pound; the assumption of a 12-percent rate of inflation—half the current rate—has resulted in reduced spending allocations from 1989 for some ministries. While higher inflation will also boost tax revenues, the increase is likely to lag behind spending and throw the budget out of balance. [REDACTED]

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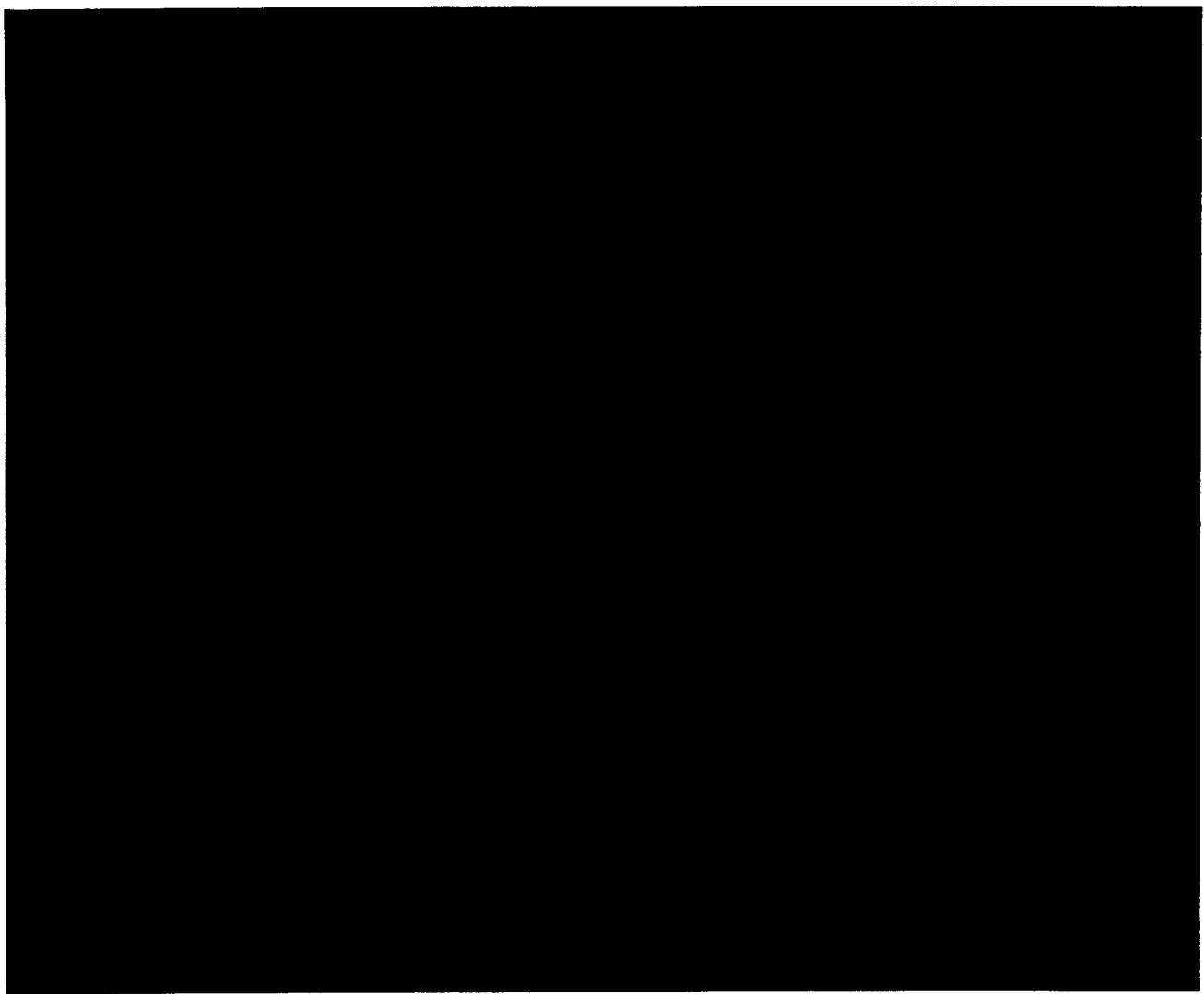
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