

# GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

BOP/R/14

31 October 1967

Limited Distribution

---

## Committee on Balance-of-Payments Restrictions

### REPORT OF THE CONSULTATION UNDER ARTICLE XVIII:12(b) WITH CHILE

1. In accordance with its terms of reference, the Committee has conducted the consultation with Chile under Article XVIII:12(b). The Committee had before it a basic document for the consultation (BOP/72), a Decision of the Executive Board of the International Monetary Fund dated 17 March 1967, (see Annex II) and two background documents supplied by the Fund dated 17 February and 3 October 1967.
2. In conducting the consultation, the Committee followed the plan for consultations under Article XVIII:12(b) recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 18 October 1967. The present report summarizes the main points of the discussion.

#### Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with the consultation with Chile. In accordance with the agreed procedure, the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Chile. The statement was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of March 17, 1967 taken at the conclusion of its most recent Article XIV consultation with Chile."

"The Fund notes that Chile's balance of payments, affected by a decline in copper prices, by an adverse movement of about \$95 million in net foreign borrowing of the Government, and by a continued increase in imports, is expected to result in a deficit of about \$20 million in 1967 as compared with the surplus of about \$140 million in 1966. The Fund notes with appreciation that Chile, despite adverse developments, has maintained (and even, in some respects, improved upon) the considerable liberalization of payments and trade restrictions, the flexible exchange rate policy, and the unification of the exchange rates in the banking market, that were achieved in 1966."

"At the present time the general level of restrictions of Chile which are under reference does not go beyond the extent necessary to stop a serious decline in its monetary reserves."

Opening statement by the representative of Chile

4. In his opening statement, the full text of which is contained in Annex I to this report, the representative of Chile explained that his Government's aims in the field of economic development were three-fold: a high rate of growth, a reasonable stability and a just distribution of national income. Within Chile's global policy to attain these objectives the external sector played a determinant rôle. In so far as exports were concerned it was the intention of his Government to double the production of copper and to diversify the composition of exports putting special emphasis on manufactured goods. A series of measures had been taken to implement these objectives, amongst which special mention should be made of the fact that the exchange rate had been maintained at a realistic level, and a law on development of exports had been enacted. On the import side, available foreign exchange was utilized following a strict priority criteria and in general there had been a simplification of import regulation, such as the adoption of the Brussels Tariff Nomenclature, the issuance of a new list of permitted imports grouped by BTN headings, the elimination for certain goods of the prior deposit requirement and the reduction in the level of the deposits; the reduction of import duties on a series of goods and of the obligatory deferment period, to sixty days. Furthermore, since the beginning of 1966, the faculty to reject import applications in accordance with Law 16.101, had not been utilized. At present, within the framework of the list of permitted imports, products entering Chile were subject only to the duties established in the tariff and to the prior deposits requirements. As a result of all these measures, the volume of imports which was of \$625 million in 1965, is expected to reach \$900 million this year. Nonetheless it should be stated that this favourable situation was due mainly to greater exchange availability resulting from higher prices for copper in the international market. This dependence on a single export product made it necessary to maintain still a series of regulations permitting the Government of Chile to adapt imports to existing exchange availability. The representative of Chile added further that all the measures he had referred to, were part of a global strategy of his Government to change the economic and social structure of his country. Some of these structural changes, such as an important redistribution of wealth in favour of the low income sectors of the country, created additional pressure on the balance of payments because of a greater internal demand which it generated. It was thus necessary to review the economic development of Chile, and its problems in the light of the changes in structure which his Government had undertaken.

Balance-of-payments position and prospects

5. Members of the Committee expressed sympathy for Chile's efforts in the field of economic development and congratulated the representative of Chile for the measures his Government had taken to achieve a deceleration of inflation. Special reference was made to the fact that the short-run outlook for Chile's foreign exchange reserves had improved markedly in the past two years and that an important factor in this improvement was the flexible exchange rate policy being pursued by the authorities. It was suggested that the Government of Chile should be encouraged to continue its policy of flexible exchange rates. In answer to a question the representative of Chile said that it was difficult to anticipate what the long-run outlook for copper prices would be. This was a question directly linked with the level of industrial activity in the developed countries and with changes in the demand pattern of the product. He stressed that his country was embarking on an effort of export diversification in order to reduce the heavy reliance on copper proceeds as a source of foreign exchange. In this context new investments had been made in the forest industry, copper manufactures, the petro-chemical and automotive sectors and also in the field of electronics and steel.

6. In reply to a question the representative of Chile acknowledged that there had been a certain stagnation in certain exports of the non-mining sector. In fact exports of fish meal had diminished as a result of a shift in the location of the raw material. There had also been a reduction of exports of copper manufactures. Exports of some agricultural products had also slowed down. This was due to the fact that internal demand had increased sharply and that local production had been unable to cope with it. The critical situation of agriculture in Chile had been inherited from the past, a considerable proportion of agricultural land was divided into a small number of very large farms. The lax tax régime and inadequate investment for decades past had produced a certain type of entrepreneur more preoccupied with consumption than production. In reply to a further question he explained that the Chilean land reform did not seek a reduction in the size of Farming Units per se. It was based on the idea of establishing technically optimum units, which could either represent an increase or a reduction in holdings with respect to the actual situation before the reform began to be implemented. Up to now one million hectares had been expropriated and even though a drop in production of the fields expropriated might have been expected, the results had been quite the contrary. This was due to special technical assistance facilities put at the disposal of the new owners, together with exceptional tax and credit benefits afforded them. The representative of Chile stressed that the land reform was not based on a quest for self-sufficiency in the whole range of agricultural production, but rather on the idea that Chile should specialize in the production of those items for which it had natural facilities.

7. In reply to several questions the representative of Chile explained that ODEPLAN (Oficina de planificación nacional) was an advisory body to the President of the Republic in charge of establishing the fundamental guidelines of the process of economic and social planning, function consisting basically in the formulation of a national development plan whose implementation was the responsibility of the corresponding executive bodies of the Administration. With respect to CORFO (Corporación de Fomento de la producción) he informed the Committee that its main rôle was to promote and finance the development of certain activities either by the private sector alone or by the public and the private sector together, within the framework of the development plan. In this connexion it was noted that in the early part of 1967 the expansion of credit had continued in the government sector but seemed to have levelled off in the private sector, and a question was asked as to whether the present relative proportions in public and private investment were likely to continue. In reply the representative of Chile said that within the plans envisaged by his Government to modify the economic structure of his country, the private sector had an important rôle to play and a certain level of investment was expected of it. The problem though was that within Chile's framework of rapidly changing structures, certain internal sectors had adopted a kind of "wait and see" attitude which had negatively influenced the volume of private investment. This tendency had been further strengthened by the fact that there had been an increase in credits to the agricultural sector which had resulted in a diversion of credit resources previously allocated to other sectors of the economy. Nonetheless it was noticeable that private investment was increasing again.

8. The representative of Chile replying to a question said that the "Chileanization" of the copper mines would not result in a decrease in the volume of foreign investment in that sector, since the "Chileanization", which in fact meant association between the foreign enterprises and the Chilean Government, had been done by mutual agreement. As a result in the period 1967-1970, \$500 million would be invested in copper mining and a large proportion of this sum would be allocated to the acquisition of locally produced goods. It could not be said either that the "Chileanization" of copper mines had affected foreign investments in other sectors of the economy, since large investments were being made in the chemical, automotive and other sectors.

9. It was stated that on the current account of Chile's balance of payments there was a considerable negative figure for investment income which had been growing in the last years. Since the increase in this outflow seemed to be due to increased profitability in the copper industry, it was asked of the representative of Chile if the reduction of the share of foreign capital in the copper industry would produce a corresponding reduction in the proportion of profits going out of Chile and in consequence improve the balance-of-payments situation. The representative of Chile replied that outflow of investment income would continue to increase in the future, as foreign capital continued to invest in the copper industry, but that in any case this higher volume would represent a smaller percentage, in relation to total investment in the industry, and also in relation to total foreign exchange availability from copper exports than before the "Chileanization" of the copper mines.

10. In explaining his country's policy in respect of the external debt the representative of Chile said that his Government was maintaining a strict control over credit operations and in fact was applying a series of measures to limit borrowing abroad. Only credit operations to be repaid in a term of more than eight years could be effected freely. He noted that the level of additional debts contracted yearly had gone down to \$100 million in the period 1965-67, from a level of \$250 million in previous years.

## II. Alternative measures to restore equilibrium

11. Some representatives referred to the fact that the big underlying difficulty facing Chile appeared to be that internal inflation had become a permanent feature of Chile's economic development. It was suggested that the problems could be tackled by acting on three inter-related components, namely: the policy of annual wage increases, the improvement of price incentives and finally the question of public sector expenditures. It was felt that constructive action with respect to these three elements could and should be regarded as alternative measures to quantitative import restrictions as a means of moving closer to balance-of-payments equilibrium. In this connexion the representative of Chile was asked what progress could be expected in this field in the foreseeable future. The representative of Chile said that, unfortunately, to some extent inflation had become a way of life in Chile and that people had grown accustomed to it. His Government was implementing an austerity programme by which inflation would be maintained within certain pre-determined bounds, with a view to reducing its rate to a minimum level over the next years. It was the intention of his Government to apply as of next year a stricter policy in respect of wages increases, but this was always a difficult decision to take because of political considerations; it had not been done, up to now, because his country was pursuing other objectives in connexion with the level of wages. In so far as public expenditure was concerned he was optimistic. In the present year the Chilean Government had limited current expenditures very strongly and the budget deficit was minimal.

### III. System and method of the restrictions

12. Members of the Committee referred to the extreme complexity of Chile's import regulations and noted that part of the explanation could be that they attempted to serve a variety of purposes: Chile's exchange or quantitative restrictions appeared to be designed not only to safeguard the balance of payments and monetary reserves but also to protect domestic industry and to raise fiscal revenues. It was comprehensible that such a multi-purpose instrument designed to serve so many functions would have to be exceedingly complex. Members of the Committee welcomed the steps taken by the Government of Chile since the last balance-of-payments consultation in reducing the restrictiveness of the import system. However there were still many elements which continued to be of concern. In this respect it was asked whether the Government of Chile had a time-table for elimination of prior deposits some of which ran as high as 10,000 per cent, and also inquired why prior deposits were applied in a discriminatory manner, in that they were not required for Latin American Free Trade Association imports. In reply the representative of Chile agreed that his country's import regulations were complex; that was the reason why a series of liberalizing measures had been taken since the last consultation. As things stood now, within the scope of the list of permitted imports, the tariff was in practice the basic element which regulated the flow of imports into Chile. With respect to the prior deposit system he recalled that it had been simplified extensively in the last years so that today, in practice, the highest rate was 200 per cent of the value of the import. There were only some very exceptional cases in which prior deposits ran as high as 10,000 per cent. Furthermore, to weigh the real importance of this mechanism it had to be taken into account that in 1966 only 20 per cent of total imports were subject to prior deposit requirements. The representative of Chile said that his Government did not at this moment intend to eliminate the prior deposit system and in consequence no time-table for its progressive disappearance had been prepared. These deposits were not required for imports of products originating in LAFTA included in Chile's "national list", which contains the concessions granted by Chile to other LAFTA members, because they were considered to be charges of equivalent effect to import duties and in consequence had to be eliminated in the process of reaching free trade within LAFTA. This situation was referred to during the discussion of the Treaty of Montevideo pursuant to Article XXIV, paragraph 7 of the General Agreement and it was thus known to contracting parties at that time that prior deposits would be eliminated for LAFTA countries. Some members of the Committee expressed reservations on the discrimination resulting from the elimination of prior deposits solely for LAFTA countries and stated further that in their view there was an inconsistency between the non-application of prior deposits to LAFTA and their original justification on balance-of-payments grounds.

13. Some members of the Committee recalled that in 1959 Chile had obtained a waiver, periodically renewed since, permitting it to apply temporary surcharges because of balance-of-payments problems. Regret was expressed that these surcharges had not been incorporated into Chile's tariff. This appeared to make virtually permanent these measures which were presumably designed for temporary balance-of-payments relief. Furthermore these charges were not, in the past, levied against LAFTA countries; their incorporation into the tariff had maintained and frozen the discriminatory element against non-LAFTA countries since the resultant higher tariff levels are not applied to goods on Chile's "national list". This can have the effect of diverting imports from non-LAFTA exporters to those within the regional group. Some members of the Committee reiterated in this connexion that discrimination in favour of members of regional arrangements is not acceptable in the application of measures maintained for balance-of-payments problems in the absence of a common currency. The representative of Chile declared that the surcharges were applied to other countries of LAFTA, except for products on which they had been negotiated, and added further that in any case, preferential treatments resulting from a process of economic integration were normal. One member of the Committee reaffirmed his country's position in favour of economic integration in the developing countries as well as in the developed countries and of all measures necessary to achieve a free movement of goods among countries participating in the arrangement.

14. In reply to a question the representative of Chile said that it was the intention of his Government not to utilize its option of rejecting import applications so long as the balance-of-payments situation permitted. In answer to a further question he said that not all paper and forestry products had been eliminated from the list of permitted imports. Chile imports from \$2 million worth of paper for different uses and cellulose for the manufacture of rayon. Reference was made to the fact that goods not included in the list of permitted imports could nonetheless be imported when they had been negotiated within LAFTA and it was asked how many products were covered by this situation. The representative of Chile replied that twenty-three products not on the permitted list had been incorporated into Chile's "national list".

15. The representative of Chile said, in reply to a question, that goods not included in the list of permitted imports were normally of a kind which his country could do without. The fact of prohibiting these imports was intended to permit the optimum utilization of Chile's foreign exchange availabilities.

16. In reply to a question concerning the principles followed in including or eliminating a product from the list of permitted imports, the representative of Chile said that as the balance-of-payments situation permitted his country wished to incorporate more products into the permitted list in order ultimately not to have any prohibited imports. While balance-of-payments problems persist, many products had to be kept off the list, and to this effect there was a committee in the Central Bank which decided upon the inclusion or elimination of a product from the list. This was done on the basis of a strict analysis of what were the import requirements of the country.

17. In reply to a question the representative of Chile said that it was his Government's intention to proceed to a progressive elimination of the specific duties in the tariff. When the new tariff was being prepared the possibility of eliminating the specific column outright was considered, but, due to difficulties in valuing imports it was finally retained.

#### IV. Effects of the restrictions

18. Some members of the Committee commented on the protective effect created for domestic industry by such severe import regulations and referred to the fact that goods produced in Chile in sufficient quantity to meet the needs of the domestic market were either unconditionally prohibited or subject to charges so high as to bar their entry effectively. Industries located in the free port zone, especially in Arica, were important recipients of such protective benefits. The unconditional prohibition of the importation of automobiles into Chile, while their components and parts were permitted entry into Arica, had resulted in the establishment of a high cost, inefficient automobile assembly industry almost a thousand miles distant from its major market. Imports of goods which were produced in Chile in insufficient quantities to meet domestic demand were also generally subject to heavily restrictive charges. It was stated that restrictions even extended to products not manufactured in Chile for which some form of local quasi-substitute was available and to products considered unessential. A question was asked as to the steps that the Government of Chile might be contemplating which would tend to minimize the incidental protective effect of its complex system of quantitative restrictions. The representative of Chile acknowledged that his country had certain areas of domestic production under protection. His Government was conscious of the problems it entailed and of the high costs sometimes resulting from lack of competition. Measures were being taken to remedy some of these situations; for example the automotive industry was now being installed near the centres of consumption and being drawn away from Arica in the extreme north of the country. The reservations manifested by some members of the Committee were shared by the Government of Chile. That was a problem linked with the process of development and a certain degree of protectionism was necessary in developing countries, as it had been necessary in the first stages of development of industrialized countries.

19. The Committee thanked the representative of Chile for the information he had supplied and he in turn assured the members of the Committee that the views expressed by them would be brought to the attention of his Government.

