

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION UNDER ARTICLE XII:(b) (UNREVISED) WITH CHILE

1. The Committee has conducted the consultation with Chile initiated by the CONTRACTING PARTIES at the fifteenth session under the provisions of paragraph 4(b) of Article XII (unrevised). This consultation was started at the time of the seventeenth session in November 1960 with a statement by the Chilean delegation which has been circulated as document L/1365. In addition to that statement the Committee had before it a "basic document" prepared by the secretariat on the basis of available data (MGT(61)7) and documents provided by the International Monetary Fund. In conducting the consultation the Committee followed the "Plan" for such consultations recommended by the CONTRACTING PARTIES. The consultation was completed on 20 April 1961. The present report summarizes the main points of discussion during the consultation.

Consultation with the International Monetary Fund

2. 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 this 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 made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision relating to the last consultation with Chile under Article XIV of the Fund Agreement and the background material prepared in connection with that consultation. The Fund has also provided a supplementary paper, dated April 11, 1961, to supply background information on recent developments.

"With respect to Parts I and III of the Plan for Consultations, as contracting parties are aware, Chile maintains a system of advance deposit requirements which were considered by the CONTRACTING PARTIES when they took their decision of May 27, 1959. The advance deposits still collected by the Government of Chile have the dual effect of dampening import demand and providing a source of financing for the Government. The Fund continues to hold the view, conveyed to the CONTRACTING PARTIES at their seventeenth session, that the future stability of the balance of payments depends on the maintenance of an

adequate stabilization programme. This, in turn, depends on continued efforts to achieve budgetary equilibrium. The Fund considers that the direct and indirect effects on imports of measures maintained by Chile, including the requirement of advance deposits, do not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves.

"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, the Fund draws attention to the decision taken at the conclusion of its last consultation with Chile. The Fund has no additional alternative measures to suggest at this time."

Balance-of-payments position and prospects

3. The representative of Chile, in opening the discussion, referred to the statement made by his delegation in November 1960 (L/1365) which described the various measures taken by the Chilean Government for the purposes of providing a solid basis for the economic organization of the country, stabilizing the rate of exchange, eliminating import restrictions, ensuring the equilibrium in the balance of payments and raising the level of the monetary reserves. It also described the very encouraging results achieved by the early months of 1960, the obstacles which remained to be surmounted and the reasons for which the Chilean Government could look forward to the future with confidence. The representative of Chile noted that, while this general picture had not changed in its main outlines, the consequences of the earthquake in May 1960 and the consequent growing budgetary deficit had somewhat diminished the stability which had been gradually attained. Prices, which after a long period of inflation had been virtually stabilized during the half year previous to May 1960, had again been rising, albeit only slightly as compared to the rises in previous years. However, the Government has succeeded in containing this new inflationary tendency so that for the year 1960 as a whole the cost-of-living index had risen by only 5.4 per cent, compared to the rise of 33.3 per cent in 1959. The budgetary deficit had also increased in 1960, partly owing to a decline in revenue and partly due to the increased expenditure and loss of fiscal receipts resulting from the catastrophe.

4. As regards the balance of payments, the improved situation in 1959, in which a favourable balance was seen for the first time in many years, had not been maintained in 1960. Principally owing to the measures of liberalization, including the elimination or reduction of the prior deposits, imports had increased significantly and had brought about a payments deficit of 47 million escudos; most of this deficit was incurred in the second half of the year, thus reflecting the direct and indirect consequences of the catastrophe in May. As a result, the net international reserves of the Central Bank and commercial banks fell from \$8.6 million at the end of 1959 to a negative balance of \$38.7 million at the end of 1960. This negative balance increased by a further \$25 million between the end of 1960 and 17 March 1961.

5. The Chilean representative stressed that his Government was resolved to continue its efforts to achieve monetary stability and to encourage economic and social development of the country. The deficit on the 1961 budget would be made good by resort to internal taxes and external loans. The prior deposits would be gradually removed. The new customs tariff would be put into force as soon as it received approval by Parliament.¹ (Cf. also paragraph 24 below.)
6. Members of the Committee expressed sympathy with the Chilean Government and people for the difficulties which they had experienced. They felt, however, that the Chilean economy was basically sound and that it was most encouraging to see that various measures had been and were being taken to maintain stability and equilibrium. It was hoped that the disequilibrium would be soon redressed and further progress would be made in the dismantling of the remaining restrictions.
7. The Committee discussed with the Chilean representative various questions relating to the prospects for Chile's principal exports, the development of export production and the diversification of the economy. A member of the Committee enquired about the prospects for the copper market, noting that there had recently been signs of a recovery in the market. If this occurred Chile, which relied heavily on the export of this product, would derive considerable benefit. The representative of Chile noted that, as he had forecast in November last year, the price of copper had fallen, but that this had partly been compensated by an increased volume of exports. However Chile could not always adopt the solution of compensating a fall in prices by an increase in production owing to the problem which this entailed with regard to the costs of production and the fall in income. As regards future prices, although the prospects appeared to be encouraging at the moment, this could not be relied upon as a basis for estimating future foreign exchange earnings. The price of 30 cents per pound had been used for the preparation of the 1961 budget but this price had not been realized, the present average level being 28 cents only. The difficulties of predicting the copper market should be generally known. The fall in copper prices in 1956 and 1957, as might be recalled, had been such as to exceed the most conservative estimates that could have been made. In the light of this experience the Chilean Government now preferred not to base its estimates of copper export earnings on higher prices.
8. As regards other exports, the representative of Chile stated that increases in the export of iron ore were possible but it would never reach significant proportions. Chile would like to develop the export of processed products based on the country's resources in ores but had found it difficult partly because of the tariff structure of importing countries. In the view of the Chilean Government the industrially more advanced countries should examine the possibility of opening up their markets for processed products so as to facilitate the economic development of primary producing countries such as Chile and to help ease their balance-of-payments problem. Chile was also endeavouring to develop other production based on mineral extraction, e.g. the production of potassium nitrate from the same raw material which had

¹For the complete text of the statement, see Annex I.

hitherto been used primarily for the production of sodium nitrate. On the basis of a detailed study made by the FAO, which showed that Chile had suitable and adequate forestry resources for the production of cellulose products, Chile had already developed certain products including certain types of paper. The production of paper had already been enough to meet almost all domestic demand and Chile had already started to export the product. Agriculture was being actively developed in accordance with a programme of modernization, rationalization and diversification. Increased production might be relied upon in the future to cover a substantial part of domestic requirements, thus reducing the demand for imports of these products and releasing foreign exchange for other use. Chile would be able to increase its vegetable production for export on a competitive basis, but as statements made in discussions in Committee II had shown, there were difficulties in increasing the export of agricultural products on account of the protectionist measures applied in some countries. Efforts at economic development, particularly the rationalization and the diversification of agriculture, had been slowed down as a consequence of the earthquake disaster of last year.

9. Members of the Committee noted from the statistical data supplied by the IMF that Chile's outstanding external debts which stood at \$608.3 million at the end of September 1960, were expected to be reduced to \$395.3 million by 1964, and asked whether this apparent intention of substantially reducing external debts could indeed be achieved in present circumstances and whether the Chilean Government did not expect new debts to be incurred in connexion with industrialization projects. The representative of Chile agreed that the efforts at reconstruction and development would require the continued inflow of foreign capital but it had been decided to keep this inflow within the limit of the country's payment capacity. Debt servicing and repayment would constitute a decreasing burden on the balance of payments but the substantial amount of £114.8 million to be paid on this account in 1961 would be an important debit item for this year. However, payment on this account would be greatly reduced from 1962. In this connexion, the representative of Chile agreed with members of the Committee that a country, such as Chile, in urgent need of investment capital should take measures to encourage the inflow of long-term capital so as to avoid reliance on short-term capital as much as possible. Members of the Committee noted that the inflow of private short-term capital in 1959 largely represented a return of Chilean funds from abroad as confidence in the stability of the currency increased and that the out-flow in 1960 appeared to reflect the release of prior deposits in dollars together with the increasing liquidity of the private sector as a result of the resumption of monetary expansion. Requested to comment on the prospects for 1961 in this field, the Chilean representative referred to the erratic nature of private capital movements and the difficulty of forecasting them. The relaxation of restrictions in the form of elimination or reduction of prior deposits was indeed a factor contributing to the increased outflow of short-term capital in 1960.

10. Members of the Committee noted that, in assessing Chile's balance-of-payments prospects for 1961, undue weight should not be given to the rather sharp loss of reserves in January 1961. This loss had largely been due to foreign debt repayment and there should be a more favourable trend in the remaining months of the year. The present level of net reserves, while lower than in 1959, was still higher than in preceding years. Taking account of external assistance and possible improvements in export earnings, the balance-of-payments and monetary reserve position of Chile in 1961 might well prove better than appeared likely at the beginning of the year. The representative of Chile stated that his Government was grateful for the aid which the country had been receiving from many countries but that these loans and grants had generally been reserved for immediate assistance to victims and notably for reconstruction. Consequently, a part had already been utilized for the financing of the sector of the budget covering the expenditure on reconstruction work and the economic development of the devastated regions. Despite such external assistance, reconstruction work would still entail a substantial budgetary deficit this year. The Government of Chile would, however, continue its efforts to improve the basic economic situation of the country and to redress the disequilibrium.

Alternative measures to restore equilibrium

11. The representative of Chile recalled the various measures taken by his Government in restoring internal and external equilibrium which had been briefly described in the statement in L/1365. As a result of these measures, the Chilean economy had, by the early months of 1960, attained a substantial degree of stability. In this connexion, the representative of the International Monetary Fund observed that between 1952 and 1960 the cost-of-living index in Chile rose by fourteen times and the exchange rate by over eight times, and that against this background the relative stability which had been maintained since the beginning of 1960 must be regarded as remarkable. While the budget deficit remained a problem, of which the Chilean authorities were acutely aware, the exchange rate was stable, restrictions had been greatly reduced, and prices had increased only moderately. Stability of this kind could lay the basis for the shift toward longer term borrowing which had been referred to. The progress that had been made would seem to warrant a "cautious optimism" regarding the future of the Chilean economy.

12. Members of the Committee welcomed the Chilean Government's efforts to contain inflationary pressures by pursuing appropriate fiscal and monetary policies and urged that these efforts be continued. One member noted that the Chilean Government had taken steps in this field, including steps the Fund had recommended, and that had it not been for the natural disaster in 1960 Chile might by now have been free of the kind of problems which required the attention of this Committee.

13. A member of the Committee noted that, according to the IMF documents, the principal cause of the deterioration in the balance of payments in 1960 had been the rise in import payments which might be attributed principally to the effects of the accelerated pace of monetary expansion. This being the case,

the most important policy aim of the Government would seem to be the avoidance of further inflation. However, new legislation had been enacted providing for a general wage increase in 1961 of 15 per cent above the level of wages prevailing in 1959. While social pressures for wage increases might, in certain circumstances, be difficult to resist, it was to be hoped that intensified efforts would be made to ensure a closer relationship between wages and productivity. The representative of Chile stated that the problem of rising prices and wages was one which constantly received primary attention from his Government. The present Government came into power after a long period of inflation and its principal aim had been to prevent the pari passu increase of wages with the cost of living. The recommended increase of 15 per cent for 1960 and 1961 represented a compromise reached between the Government and the labour unions following prolonged negotiations, strikes and even social unrest. Whilst these increases had been inevitable, the Government had approved new taxes which would have the effect of counteracting those increases which impaired the national budget and of limiting their repercussions on the price index. The low rate of rise in productivity was a common feature in a region such as Latin America and this, together with the low standards of living, was at the core of all the economic problems. The present degree of stability in wages and prices, while not absolute, contrasted most strikingly with the average increase of 30 per cent per year seen in previous years.

14. A member of the Committee noted from the statement in L/1365 that under the Chilean monetary system an excess inflow of foreign exchange might, through enlarging the reserves of the issuing bank, cause an expansion of currency and credit. Insofar as additional liquidity and purchasing power were created, it might well be in the interest of stable prices for the Chilean Government to admit imports as freely as possible so as to avoid shortage-generated rises in prices. The representative of Chile commented that excess inflow of foreign funds threatening monetary stability was a phenomenon of the past. As for imports, it was the consistent policy of the Chilean Government to reduce the remaining restrictions as soon and as far as the circumstances permitted, and eventually to abolish them upon the entry into force of the new customs tariff.

Methods of the restrictions

15. The Committee discussed with the Chilean representative various aspects of the present restrictive system of Chile. Some members of the Committee noted that, from the data given in the documents before the Committee, it would appear that the system involved discrimination in three ways:

- (a) imports of goods subject to a deposit of 1,000 per cent or less are exempted from the deposit requirement when coming from countries with which Chile has bilateral payments or compensation agreements (Bolivia, Brazil, Ecuador and Yugoslavia).

- (b) the prior deposits do not apply to purchases made by the Chilean Nitrate and Iodine Corporation (COVENSA) from specified countries (Denmark, the Netherlands, Portugal, Sweden, Yugoslavia and UAR (Egypt)).
- (c) imports made under loans or credit from IBRD or the US Export-Import Bank, or under US Public Law 480, are exempt from the deposit requirement.

16. Regarding (a) the differential treatment for imports from bilateral payments partner countries, the Chilean representative explained that such bilateral arrangements were a legacy of the past and were being gradually terminated. Chile had in fact notified Bolivia and Ecuador of its intention to terminate the bilateral arrangements with them and the agreement with Argentina had been terminated in February 1961. At any rate once the new customs tariff of Chile came into force, all the prior deposits would be abolished. The question of discrimination would then no longer arise.

17. As regards (b) purchases of the COVENSA, the Chilean representative explained that this Corporation was again a relic of past trading arrangements, having been established a long while ago for the purpose of selling nitrates and saltpetre on the world market. The privilege of exemption from prior deposit applied only to imports from countries purchasing those products from the Corporation, and would likewise disappear with the termination of the prior deposit system itself.

18. Commenting on the special treatment mentioned in sub-paragraph (c), members of the Committee questioned both the rationale and the wisdom of granting special privileges to certain, but not other, sources of long-term credit. The Chilean representative indicated that the Chilean Government would be prepared to consider the extension of this treatment in connexion with any new offers of long-term loans or credit on similar conditions from other sources.

19. In regard to all these differential treatments, the Chilean representative emphasized their transitional nature and the certainty of their disappearance upon the introduction of the new customs tariff. It was the opinion of the Chilean Government that these measures were permitted under the terms of Article XIV of the General Agreement, the maintenance of the prior deposit requirement itself being covered by the provision of Article XII of the Agreement. Some members of the Committee did not accept that the discriminatory application of the restrictions by Chile was necessarily consistent with the provisions of Article XIV although the restrictions themselves were covered by Article XII.

20. An exchange of views took place at the Committee on the relative merits and demerits of prior deposits and other types of restrictions for purposes such as those envisaged in Article XII of the Agreement. The Chilean representative recalled that the present system of prior deposits and surcharges had been adopted to replace the previous system of direct quantitative licensing controls; the present system was chosen because it

was found to be the most suitable system in the present circumstances of Chile and because according to authoritative opinion, it represented a minimum restriction. In this connexion the Committee noted a statement by the representative of the IMF to the effect that restrictive measures such as the advance deposit requirements, in as much as they, on the one hand, might involve foreign exchange arrangements and, on the other hand, directly affect the importation of specific commodities, could in certain cases be regarded as embodying both an element of exchange control and an element of quantitative restriction. Consequently, in these cases, they would belong to the conjoint jurisdiction of the IMF and the GATT.

21. In answer to a question concerning his statement quoted in paragraph 2 above, the representative of the Fund stated the Fund's judgment on the need for achieving budgetary equilibrium should be considered to be neutral on the question of the appropriate source of budgetary revenue.

22. The Committee noted the statement in the secretariat document that available information had not been adequate to enable it to draw up a complete and up-to-date list of the products subject to the prior deposits and surcharges at the various rates. The Committee therefore requested that the Chilean authorities supply such a list, which should reflect the latest situation, to the secretariat for circulation to all contracting parties. The Chilean representative undertook to convey this request to the attention of his Government.

23. The Chilean representative confirmed the information given in the secretariat document that imports of wheat and frozen meat were the privilege of the "Instituto Nacional de Comercio" and were exempt from the prior deposit requirement.

24. The Chilean representative, in response to questions, confirmed that it was the intention of the Chilean Government to introduce the new customs tariff as soon as it was approved by Parliament not later than 1 January 1962 and to renegotiate in accordance with Article XXVIII any increases beyond bound rates before the new tariff entered into force. Whereas the present surtaxes might be either incorporated in the new customs tariff rates or might simply be abolished, it was the intention of the Chilean Government to discontinue the prior deposit requirements immediately upon the entry into force of the new tariff.

General

25. Members of the Committee expressed satisfaction at the considerable progress made by Chile in its stabilization programme in 1959 and the first months of 1960 and at its determination to continue with the programme despite the new burden arising from the earthquake in May 1960. Members of the Committee stressed the importance of the vigorous implementation of the stabilization programme. They welcomed the progress that had so far been made in the reduction and removal of the prior deposit requirements and expressed the hope that further improvements in the balance of payments would make it possible for Chile to dispense with the restrictive measures

in the near future. The Committee noted that it was the firm intention of the Chilean Government to abolish all import restrictions and to rely on the sole protection of the customs tariff, and that it intended to carry out the necessary renegotiations under Article XXVIII in order to apply the new customs tariff as soon as it was approved by Parliament and not later than 1 January 1962. Members of the Committee specifically urged that this process be completed as soon as possible.

26. The representative of Chile stated that he had taken note of all the views expressed at the consultation and would convey them to the attention of his Government.

Annex I : Statement by the representative
of Chile.

Annex II: IMF Board Decision of 20 July 1960
at the conclusion of consultation
between IMF and Chile.

ANNEX I

Statement by the representative of Chile

At its last meeting in 1960 the Committee decided to begin consultations with Chile, with a statement by the Chilean delegation which was circulated to the contracting parties on 17 November 1960 (document L/1365).

In this document I described the long series of measures taken by my Government in order to provide a solid basis for the economic organization of the country, to stabilize the rate of exchange, to eliminate import restrictions, to ensure the equilibrium of the balance of payments and to raise the level of our monetary reserves.

I also described the very encouraging results achieved, the obstacles which remained to be surmounted and the reasons for which we look forward to the future with confidence. Lastly, I stated that these prospects had deteriorated since the earthquake which had ravaged the southern part of the country in May.

This general picture has not changed in its main outlines, but the consequences of the catastrophe I have just mentioned and the budgetary deficit, which I predicted would increase, have introduced certain negative elements to to which I should like to refer briefly.

As I have already said, I drew attention in my statement last November to the stability which my Government's efforts had succeeded in giving to the Chilean economy. I now have to inform you that this stability has been diminished, particularly owing to the disaster of May 1960, the effects of which are still being felt and which are greatly complicating the task of the Chilean authorities.

Prices, which after a long period of inflation had been virtually stabilized during the six or seven months previous to May 1960, underwent an increase of about 5 per cent in the three months which followed the catastrophe. Nevertheless the Government has succeeded in slowing down this new inflationary outburst, and at the end of 1960 the consumers' price index had increased by only 5.4 per cent for the whole year. The full significance of this will be realized if it is compared with the increase of 33.3 per cent in 1959.

I also indicated last November that the budgetary deficit inherited by the present Government as a consequence of a long period of inflation continued to present a very serious problem. At the end of 1960 the deficit had increased, as I had anticipated, partly owing to the decline in revenue, which proved lower than the budgetary estimates, and partly owing to the increased expenditure and reduced fiscal receipts resulting from the catastrophe in the south. Over three fifths of the deficit occurred in the last four months of the year.

In spite of Parliament's approval of a first instalment of new taxes amounting to 23 million escudos for the reconstruction of the devastated areas, the consequences of the catastrophe were reflected in a net loss of over 50 million escudos in budgetary revenue.

In my statement last November I said that the balance of payments, which for years had shown a deficit, had in 1959 shown a favourable balance of 27 million escudos. This better situation has not been maintained, - as indeed had been anticipated by the Chilean authorities - and the 1960 balance showed a deficit of 47 million, due principally to the increase in imports which rose from 329.3 million in 1959 to 421.1 in 1960. This increase is chiefly explained by the measures of liberalization adopted by the Government during the year, among which mention should be made of the elimination or decrease of prior deposits. Of the total deficit of 47 million, 13 belonged to the first half of the year and 34 to the second, which also in my opinion reflects the direct and indirect consequences of the catastrophe in May.

The internal and external financial situation had a strong influence on the level of our monetary reserves which, according to the documents at my disposal and those of the Monetary Fund, showed a negative balance of 38.7 million escudos at the end of 1960. This negative balance increased by 25 million escudos between 11 January and 17 March 1961.

Nevertheless, the Government is resolved to continue its efforts for the monetary stability and the economic and social development of the country. The deficit on the 1961 budget will be made good by resort to internal taxes and external loans. The elimination of prior deposits which, as I pointed out in my November statement, already applies to three-fifths of imports, will be gradually extended. The new customs tariff will be put into force as soon as it has been approved by Parliament, and production will thus be protected solely by means of the customs tariff, in conformity with the philosophy which inspired the authors of the General Agreement.

ANNEX II

IMF Executive Board Decision at Conclusion
of IMF-Chile Consultation on 20 July 1960

1. The Government of Chile has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.
2. The Chilean Government has made considerable progress in its stabilization program in 1959 and the first months of 1960. The cost of living has been stable since September 1959, production has increased, gold and exchange reserves have risen to record levels, and the exchange rate has been stabilized. The budget deficit, while it has continued large, has been financed without direct recourse to the Central Bank.
3. In May 1960 Chile suffered one of the most devastating earthquakes in its history. But the Chilean Government is determined to continue with its stabilization program despite the new burden arising from the earthquake damage. Measures have been taken, including proposals for substantial increases in taxes, to insure that the Treasury will have no recourse to Central Bank financing. Strict limitations on bank credit to the private sector will be continued through the virtual elimination of normal rediscounts and the maintenance of high marginal reserve requirements. Through firm government action on wage rates, the wage increase in 1960 is expected to be compatible with continued price stability. Consequently, the authorities expect the continuance of stability in the exchange market together with some reduction in the advance import deposit requirements.
4. The Fund notes the substantial progress made by Chile since the last consultations in establishing stability, and welcomes the determination of the authorities to continue its stabilization program. The success of the program depends upon progress in reducing substantially the budget deficit, in addition to the maintenance of firm monetary and wage policies.
5. The Fund welcomes the further elimination of restrictions and the assurances of the Chilean Government that it plans to terminate its bilateral payments arrangements and urges early action on these plans.
6. In concluding the 1960 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Chile.