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Telegram From the Embassy in Chile to the Department of State

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1767. Subj: Imminent Copper Nationalization?

1. Summary: The Chilean Copper Accord of 1967 is, as the Dept. has been made aware by our reporting, coming under ever more serious assault from all sides in Chile, right as well as left and center. I am now persuaded that the pressures for a change in the relationship between the GOC and the Anaconda and Kennecott companies because of windfall profits to Americans as result of high copper price is so great that President Frei cannot possibly resist it. I am further persuaded that within the next two weeks a major development will occur. I believe Frei will make very effort to arrive at an amicable revision for the accord rather than consider expropriation, but if confronted with implacable company positions he will move unilaterally. I am utilizing the “Nodis” priority because some of the opinions and information contained below are of such a sensitive commercial nature that they could, if circulated beyond a very restricted level, do serious damage to the legitimate interests of the US companies involved. I also believe that the probable Chilean action, which is in no rpt no way linked to the IPC case and the USG response will have direct impact on that problem as well as very significant implications for US relations with all Latin American countries. End summary.

2. The Copper Agreement or “Convenio” as it is known here was approved by Congress in late 1967 after two years of consideration by the Chilean Congress. The accord was in fulfillment of the Frei 1964 electoral promise to achieve “Chileanization” of the country’s greatest natural resource and national asset as opposed to the Marxist demand for nationalization. Anaconda which has a majority of its total raw materials in Chile went one direction while Kennecott, with less reliance on its Chilean operation, went a different route. A third US company Cerro de Pascua (now in merger talks with Standard Oil of Indiana) decided to enter Chile for the first time under the agreement. The salient points of the accord include:

A. Anaconda. It retained 100 percent ownership of its existing properties, the largest in Chile. It agreed to put in fresh expansion capital of some $109 million to raise production by end of 1971 from 780 million pounds to at least one billion. It pledged another four year investment of $38 million to start a new mine in which the GOC would have 25 percent of the equity. In return the effective tax rate on Anaconda was reduced about six percent to an average of about 54 percent (fluctuating slightly according to production) and given a 20 year guaranty against new discriminatory taxes. (Previous GOC had always hit the copper companies with taxes whenever they ran short of fiscal resources.)

B. Kennecott sold 51 percent of its sole interest to the GOC, with which it formed a new joint company (El Teniente) in which it also had an 11-year management contract. The new company is investing $230 million to increase production from 360 million pounds to at least 560 million. The tax rate was reduced from quasi-confiscatory 87 percent to an average

of about 53 percent with the same non-discriminatory tax provisons as Anaconda.

C. Cerro has a new mine under development in which the GOC has 30 percent and which will cost about 155 million to develop by end 1971. (It would not rpt not be affected by the subject treated in this cable.)

3. In all, including housing and other subsidiary works, the three companies and the GOC will expend about $760 million in the four year period pending 1971. The programs are each running at least on schedule and in the case of Kennecott about a half a year ahead of plan. The flow of investment is at its peak currently.

4. A large share of the expansion program was financed by the EX–IM Bank. Unlike the GOC negotiating team, the EX–IM tied the conditions of repayment indirectly to the price of copper and directly to the level of profits any year. For example, the joint Kennecott-GOC company received a 15-year $100,000,000 loan with repayments to begin three months after the completion of the investment program. The normal annual repayment is to be some seven and a third million dollars. But EX–IM had a rider which said that one-half of the net income of the company above an annual yield to the GOC of $51,250,000 in both taxes and profit-sharing would have to be repaid to the EX–IM in addition to the normal annual repayments.

5. The GOC's failure to protect its own interests in the same way as the EX–IM—that is, by linking the price of copper or profits to the tax rate on the US companies—has been the major motivation behind the current campaign to change the Copper Accord. When the GOC negotiated with the US companies, it based its projections on a price of copper of between 29 cents a pound and 35 cents. Copper for the last two years has averaged above 50 cents projection and the windfall profits to the companies have been very large indeed. A study done last year for CIAP by US Professor Malcom Griffin, currently at Magdalen College, Oxford, was so critical of the GOC's failure to protect Chilean interests at the 29 to 35 cent price level, that both the USG and GOC had to intervene last year to prevent circulation or publication of the report. Griffin predicted that the eventual Chilean reaction would envenom relations between our two countries. (What would he say about this year's average price so far of 58 cents?)

6. I do not have the relevant figures on US remittances and profits and they are going to be very hard to acquire since both company and government, for similar motivation, are treating them as the highest state secret since leakage would make the Frei government appear to be incredibly naive if not treacherous negotiators and would depict the US companies as callous profiteers. However, by the time I leave Santiago for Washington Sunday night, I intend to have them, one way or another.

7. What I do know is that if copper were to average 45 cents a pound, let us assume for the years 1970–73, the Kennecott-GOC joint company would have to repay the EX–IM, under the accelerated payment rider, 100 million of the $110 million loan in four instead of the contemplated 15 years. (The EX–IM rider specified that the last ten million of the loan would be repaid over the 15 year period whatever the profit of the company might be.) This one hard piece of information gives an idea of the current profits, all other conditions, of course, remaining equal.

8. The mood in Chile can be gauged from the unprecedented manner in which the Chilean Congress approved on Wednesday a minor piece of legislation directed against Anaconda (our 1729). In five minutes without debate and with unanimity, all of the very complicated Chilean legislative conditions were fulfilled and the law passed. The businessman's party, the Nacionales, have been as vociferous in their criticism of the GOC on this issue in the congressional debates as any other—and, happily, none of the politicians have even a remote approximation of the true commercial facts in the situation.

9. There are several other significant factors which are worthy of mention:

A. It was a unilateral GOC decision to base the Chilean export price on the London metal exchange price rather than the US domestic price. This decision of a few years ago meant that the selling price (and hence profits) was considerably higher for the companies—e.g. in 1968, the spread was almost 12 cents a pound, with the US price averaging 40.54 cents and the Chilean selling price 52.47.

B. The GOC in December 1965 in secret negotiations with Gov. Harriman here agreed to help the US anti-inflationary effort by selling 90,000 tons of its copper to US at 36 cents a pound even though the average price for the delivery period averaged close to four cents more per pound. Despite steadily rising world prices, Frei held to his commitment.

C. The US taxpayer is hostage to the copper companies in the form of aid guaranties which have a theoretical payoff of more than $1,500,000,000 (billions) in the event of nationalization but which in practical effect would require repayment of approximately $600,000,000 (million) because of the concurrent guaranties. The guaranties might come into play in part even if GOC changed accords unilaterally without nationalizing.

10. What has provoked the urgency of the present situation is that Frei prior to the opening of the new Chilean Congress on May 21 will present an economic program for the remainder of his term (until Nov 1970). In that program he will propose a number of belt-tightening measures which will imply sacrifices for many. (There is some talk of a wage freeze.) He wants to leave office with a low rate of inflation—below 20 percent which is a very difficult target to achieve in a country which has the most powerful Communist party in the hemisphere and an equally large Socialist party to its left, the two controlling the majority of organized labor and comprising close to one third of the voters. The suggestion that Chileans sacrifice while US companies make windfall profits would be rejected by every sector of the political spectrum including Frei's own party, particularly at a time when the high prices and other copper issues are attracting increasing focus and mounting criticism.

11. Yesterday the government party, the Christian Democrats (PDC) began a four day meeting at a Junta Nacional to determine its new platform for the 1970 Presidential elections. Frei and his Ministers are maneuvering in every possible way to avoid a copper debate, but they are fully aware, as I have been for some time and have reported, that the copper issue can no longer be swept under the rug. In all my discussions with the GOC on copper since my arrival here some 18 months ago I have taken the position that (A) relations between the copper companies and the GOC should not involve the USG; (B) that revision of the Copper Accords would undermine the reputation of Frei's and Chile's good faith; and (C) that reopening the issue would frighten off the capital that Chile needs so badly for its own development.

12. These arguments just won't wash any longer. Indeed our own official negotiating position with respect to copper price—our justification for reduction of planned US assistance because of the high level of copper prices—has only served indirectly to remind the Chileans that they are not benefitting proportionately from the astronomical price level. Their tax take (including profit participation) for 1968 when the Chilean copper selling price averaged 52.47 cents a pound was actually lower than the fiscal revenue from US copper companies in 1966 when the price averaged only 43.32 (from a review of available US official data). So on the one hand they lose fiscal revenue and on the other they are penalized US aid support. Of course, it must be emphasized that Chile's dollar reserve position has benefitted considerably from the higher price.

13. I have not talked to Frei on this subject for some months since naturally I did not welcome the topic and since he did not want to raise what is for him a very distasteful decision. He has always defended the copper agreements. In his last TV-radio national speech on the drought and related matters a month ago he emphasized that it was the huge copper expansion investment and the influx of dollars which was fueling all Chilean development. But I do not see how he can avoid the issue any longer. If, as is his custom, he calls me before my departure, and if the subject comes up, I intend to listen carefully, to reiterate that this is a matter between the GOC and the companies, that anything he does must be based

on international norms (prompt, fair, adequate payment), that there be no attempt at retroactivity, that he should avoid the emotionalism that pervades the IPC issue, that he disassociate himself from the Peruvian case, and that above all, he should demonstrate his understanding of US sensibilities. If this conversation is to occur, and if Frei were to act in a manner consistent with his past behavior, I have a feeling that whatever the problems between him and the companies here, he could indirectly aid US in the IPC case. That is, I admit, putting the best face on an unwelcome situation. But Frei's emphasis on fairness to the US investor and on non-retroactivity would pull the rug under the Peruvian position. Needless to say, lament adding still another burden in burdensome times to you in Washington, but I for one am not rpt not entirely pessimistic about this situation for reasons I can explain more appropriately during my Washington consultations.