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Telegram From the Embassy in Chile to the Department of State

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Nota de Archivo: *Summary: Korry reported on his conversation on economic policy with President Frei. Source: National Archives, RG 59, Central Files 1967–69, POL 1 CHILE–US. Confidential; Limdis. Reference telegrams 1160 and 1161 from Santiago, March 25, Nos. 1 and 2 in this series of telegrams, are Documents 4 and 5 in Foreign Relations, 1969–1976, vol. XXI, Chile, 1969–1973.*

1168. Subj: Conversation With Frei (#3—Economic Policy). Refs: Santiago 1160; Santiago 1161.

1. I told Frei I wanted to understand political factors before discussions economic policies since one was largely hitched to the other. I assumed that GOC policy for its remaining 20 months (inauguration new President November 1970) would be tailored in significant degree to fit the style of the voters it wanted to impress most. Economics in the abstract was of academic interest; for a politician it had to be possible above all else.

2. Frei agreed. He said inflation was the decisive element and the government had to control its expenses above all. (I suspect that while he was sincere, this opening gambit was in anticipation of what he expected me to say. It is worth noting that in the earlier political discussion he had recalled telling Tomic that the single greatest [garble] was not inflation but the disunity of the PDC to which Tomic had made very notable contributions by continuing his earlier intra-party fight against Frei even after he had lost the PDC nod. Without such divisions between party and government, the PDC would easily have had three to four percent more of the vote and then everyone would have hailed the triumph of the PDC. This in turn, said Frei, would have provided Tomic with the momentum to be victor in the presidential elections. Tomic was the victim of his own egocentricity.) Frei said very passionately that if the US did not help Chile now with the pending loans, all the GOC programs would have to be changed. What he would do about inflation and the drought would have to be recalculated. But it was imperative that he know our response soon. He simply could not delay much longer.

3. I said I assumed that Frei would adhere to a stabilization policy since the lack of unity on this issue within his own government and between the government, and party had undermined his own policies. I also recognized that politics are not controllable in a democracy be it his or ours; yet I wondered if coherence within a government was equally unattainable. In any event I was there, on the assumption that my government would act positively soon, to offer some suggestions.

A. I repeated the arguments I have made to him and to anyone else who has listened for the past 15 months about the need to liberate the economy from the deadweight of unmanageable price control. Admittedly it would take a few years but some effective instruments are available. A unique organization, UNICOOP, had had very impressive success with supermarkets in Santiago; its social conscience and its excellent private enterprise management had combined to produce profits being reinvested in low as well as higher income neighborhoods. They had enjoyed a considerable psychological success in low income areas; it was a high priority desire of Pobladores to have one in their neighborhood. UNICOOP had

recently signed the first multi-year labor contract in Chile (three years); it offered profit sharing to its employees. It provided a viable, efficient alternative to the robbery of the poor by merchants who cheated on quality, on weight and on usurious interest. Since the majority of Chileans were urbanized, a third of them packed in Santiago, the politicians would always cater to the city-dweller. By controlling urban prices it was difficult to stimulate agriculture even with the kinds of reforms, incentives and benefits offered by the Frei government. Moreover the heavy hand of a bureaucracy seeking to control 6000 products was felt everywhere. And Christian Democrats had a particularly abrasive bureaucratic quality that in more cases than not was distasteful to the public. A major effort to speed the expansion of UNICOOP together with government internal decisions to ease some of the burdens on UNICOOP could be a healthy incentive for more producer-retailer links which would be emulated by others and which would eliminate the ruinous high-cost middleman bottlenecks which drove up food prices and made a hash of rational distribution in the country. I had been the principal exponent of this philosophy and its advantages with both the BID from Herrera down and with the World Bank, starting with McNamara. Both organizations had flashed a green light of assent. But after considerable effort, I discovered that the GOC had just shoved a request for a CORA land reform loan ahead of the pending UNICOOP (2.4 million) BID loan thus delaying this project a few more months. Since the BID experts had assured me that within a year of approval of the present loan they would be prepared to consider another for double the amount, this unjustified delay would be interpreted by BID as a deliberate reordering of priorities. Yet the UNICOOP potential, which could and would serve as a model for other chains in Santiago and in other urban areas, could do more to free agriculture from traditional restraints so as to provide incentives for production, then BIDs CORA loan. Moreover since the GOC had to announce its 1969 pricing policy for agriculture next week (a point I emphasized later) it should couple such a harbinger of higher prices with a sweetener for the housewife. A government program of support for the rapid expansion of supermarkets would be one such popular reassurance—and one which would also reassure the private sector, particularly the Chilean private sector since UNICOOP was 100 percent Chilean. Finally, since funds were available from international institutions and expertise from them or from us, it would not cost the GOC. Indeed, the end purpose was to reduce the bureaucratic monstrosity that was spread all over the landscape. Frei, who likes this idea, asked if he could not reverse the order of priority for BID consideration of the loans. I replied that I believed it was too late, but would seek to learn. (Washington action).

B. I emphasized the need to get approval of his social security reform bill designed to reduce the high administrative overhead and to avoid certain future bankruptcy of the system. I suggested that this bill, plus his constitutional reform bill, plus his soon to be submitted indirect taxation reform measure, could be helped by the Nacionales. According to the pressure required, I suggested that he consider influencing the Nacionales with the leftist threat of reducing the voting age to 18. The Marxists, Radicals and probably the PDC would back the 18-year measure so as to reduce the Alessandri probabilities in 1970. If the President were to trade a veto of this measure in return for his bills, and if he thought this was practical, it would in my view be an excellent deal. Frei was much intrigued (and I have since put it to Zaldivar who shared the interest).

C. I said a greater effort should be made to eliminate the deficits in such government enterprises as the various transportation entities. Also I suggested separating the pending education bill into two parts, one dealing with the controversial planning aspects and the other with the indispensable self-financing of university level students. I suggested again the possibility of savings accounts with readjustable interest rates in private banks (not alone for the Banco del Estado as today) to incite more savings. No reaction.

D. I proposed that he consider changing the Ley de Inamovilidad since its freezing of workers in plants impels managers with large numbers of workers to invest in labor-intensive uneconomic technology while provoking new plants to invest in capital intensive equipment so as to avoid a permanent albatross of working force. Since it was probably impossible to alter the situation in extant plants why not create a new incentive for new plants and at the same demonstrate the government’s interest in creating jobs by suspending the Ley for them. Frei was delighted with “a really good idea I had

never heard before."

4. Frei said he had appointed a committee to define his government's socio-economic policies for the remainder of its term. It was led by Zaldiver and included the President and Vice President of the Central Bank (Carlos Massad and Jorge Caus), Senators Reyes and Musalem, Deputy Luis Pareto, and his Presidential Advisor Marfan (a totally officialista group, of course). One idea under study was executing more projects in urban centers to have a psychological impact which was lacking when efforts were concentrated on the peripheries of cities; this would involve some slight changes in plans.

5. He said the problem of Chilean private enterprise was the change the past three years from a position of unused available capacity to full employment of extant plant. He doubted that the market offered sufficient attractions for significant local private investments. Only with formation of Andean Group or LAFTA or marked changes in commerce with neighbors would there be much stimuli unless fresh major investment in basic industries (petro chemicals, minerals) was made by foreigners together with GOC. Chilean private industry knew that the current high level of activity was largely due to the flow of copper investment from abroad. Unless they saw equivalent amounts in the offing, it would be difficult to persuade them to invest; hence the rationale for a private investment development bank had passed. I disagreed.