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Intelligence Memorandum

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Nota de Archivo: *Summary: This CIA assessment of Chile's economy noted that while Allende had achieved many of his socialist goals, the nation itself faced food and other consumer goods shortages. Source: National Archives, Nixon Presidential Materials, NSC Files, Box 776, Country Files, Latin America, Chile, Vol. VI. Secret; No Foreign Dissem. Prepared in the Central Intelligence Agency in the Office of Economic Research and coordinated within the Directorate of Intelligence. Attached to an October 15 memorandum from Hewitt to Kissinger summarizing the main points of the paper. Hewitt's memorandum to Kissinger is printed in Foreign Relations, 1969–1976, vol. XXI, Chile, 1969–1973, Document 268.*

THE CHILEAN ECONOMY: A STATUS REPORT

Introduction

1. Chile's announcement on 11 October that Anaconda and Kennecott would receive no compensation confirmed the worst fears of US companies and government officials alike but came as no real surprise. Payment of adequate and timely compensation—a sine qua non of US policy if intergovernmental friction is to be avoided—never had appeared likely, and prospects for a satisfactory settlement had progressively dimmed over recent months. By mid-August, Allende—a consummate politician on all fronts—was already pointing to new US economic policies to justify any internationally unpopular decisions that Chile might "also be forced to take to defend its economy."

2. After less than one year in office, the Allende government can justifiably claim substantial progress in effecting its socialist revolution. The President has proved himself remarkably adept at keeping his seemingly unwieldy coalition together and his opposition divided. Despite its minority representation in the Congress, this political dexterity and full use of traditionally strong executive powers have permitted the Allende administration to assume pervasive economic control with only an occasional bending of constitutional law. Its policies, however, have seriously aggravated some chronic economic problems and created others that will have to be dealt with in the months to come. This memorandum chronicles economic developments in recent months and describes the status of key domestic indicators and foreign economic relations as of early October. It also comments on the factors leading to Chile's adoption of a hard line on the copper question.

Discussion

Allende's Confrontation Decision

3. President Allende—clearly the indispensable man in today's Chile—thus far has managed to stay on top of the rapid and radical changes that are transforming his country into a socialist state. Developments of the past few months, however, reflect a mixed bag of successes and failures, progress and problems. By the end of September, the two most important elements affecting Allende's thinking were:

• A perhaps exaggerated view of Chile's importance in the world and its international "respectability" resulting, among other things, from the meeting with Argentine President Lanusse, the successful tour of Peru, Colombia, and Ecuador, Chile's vocal participation in various international forums protesting the new US economic policy, and the presence of numerous visiting foreign delegations in Santiago.

• Growing worry about worsening economic problems and his ability to consolidate political power in time to deal with them.

Both elements bear heavily on Allende's policy decisions affecting the pace of "irreversible change" in Chile's domestic society and the administration's stance—confrontation or cooperation—vis-à-vis the United States regarding copper compensation and other financial obligations.

4. Food and other consumer good shortages are perhaps the most embarrassing indication that a shift away from the populist policies of the regime's first eleven months is now overdue. Somewhat less politically damaging but equally important signs are the decline in investment, production problems in copper and other industries, and the continuing drop in foreign reserves. Although Allende's speeches contain increasingly frequent allusions to "the hard times to come," his regime apparently does not yet feel ready to take the harsh actions required to bring supply and demand into equilibrium or to impose upon the populace the sacrifices inherent in a shift from "the year of consumption" to "the year of accumulation" (i.e., forced investment in basic industries).

5. The need to effect such a shift was a key factor in deciding which way Chile would go on the question of compensation for large expropriated properties. For months, the Allende regime had been weighing the relative gains and losses to be derived from taking a hard or a soft line with the US companies involved. As the mid-October deadline on copper decisions approached, both Allende and the Communist Party were visibly moving toward the more radical Socialist Party line of negligible or no compensation. Allende's final hard-line decision almost certainly was heavily influenced by his increasing conviction that, by so doing, more would be gained in terms of Chilean popular commitment to the socialist revolution than would be lost from damage to Chile's international credit rating.

6. Chile had completed nationalization of the formerly US-owned copper industries on 16 July when the "copper amendment" to the constitution took effect and President Allende signed five decrees giving the Chilean State Copper Corporation (CODELCO) possession of Kennecott's El Teniente, Cerro's Andina, and Anaconda's Chuquicamata, El Salvador, and Exotica operations. The amendment, passed unanimously by the Chilean Congress some months earlier, permitted nationalization with little or no compensation but provided the administration latitude for negotiating an acceptable settlement with the companies. The Comptroller General was given 90 days in which to determine the book value of the expropriated firms—the basis for compensation stipulated in the constitutional amendment. At the same time, CODELCO was directed to "inventory" the installations to determine the amount to be deducted from book value because of deterioration in physical plant and mismanagement of the mining properties. President Allende in effect had the responsibility for determining the final amount of compensation to be paid, having been given the right to deduct "excess profits" from the modified book value figures.

7. President Allende's announcement on 28 September that $774 million in excess profits would be deducted from compensation paid to Anaconda and Kennecott left little doubt that Chile had opted to risk a showdown with the US government. Allende's excess profits figure far exceeded the likely book value estimate of the companies' current holdings being compiled by the Comptroller General's office. At the same time, CODELCO—using methodology with no pretense of being anything but vindictive—filed a $1 billion claim against the companies for "deficient" equipment and "damage to the mines." Under these circumstances, the amount of "negative compensation" Chile would offer also canceled out existing claims by Kennecott and Anaconda for the earlier sale of 51% equity in their properties. In fact, the final

announcement issued by the Comptroller General on 11 October claims the US companies owe some $388 million that the Chilean government has no means to collect.

8. Chile's claim of "negative compensation" may be used to justify reneging at least in part on Allende's earlier promises to honor some $350–$400 million in debts to Eximbank and other third-party creditors incurred by the companies in carrying out their recent expansion programs. In an attempt to retain some respectability in international financial circles, however, Chile is likely to pursue a more generous policy regarding the repayment of the $100 million or so owed to Japanese and European financiers than it adopts toward Eximbank. For similar reasons, it has promised to pay for Cerro Corporation's equity in Andina—a newly developed mine that has not yet earned the company any profit. The amount involved, moreover, is a small enough price to pay for continued access to US equipment and technology, as assured in Cerro's agreement in late August to act as the Chilean government's purchasing agent for material needed to operate the expropriated industry.

9. Chile's failure to offer adequate compensation for expropriated copper properties will give the investment guaranty program operated by the Overseas Private Investment Corporation (OPIC) its first major test. Under this program, the US copper companies involved could file claims against the US government for as much as $368 million. Moreover, because Chile's adoption of a hard line on copper does not bode well for ongoing negotiations with International Telephone and Telegraph (ITT) for purchase of its equity in the Chilean Telephone Company (Chitelco), upcoming claims against OPIC could be even higher. ITT's current coverage on its Chitelco investments alone totals $108 million.

Domestic Economic Developments

Socialization of the Economy

10. In an early September speech outlining his party's strategy for carrying out the Chilean "revolution," Communist Party Chief Luis Corvalan justifiably counted as a major victory Chilean capitalists' acceptance of the government's economic program. The Communist Party has long recognized that Allende's socialization of the economy will make his revolution irreversible. Corvalan pointed in particular to capitalist leaders' acquiescence in the division of the economy into three sectors as an accomplishment that substantially eases the Allende government's task. This view was probably only strengthened when the Christian Democratic Party (PDC) agreed in mid-September to vote against Economic Minister Vuscovic's impeachment in exchange for an open-ended commitment by Allende to submit a draft law "soon" that would establish nationalization standards and try to define clearly the public, private, and mixed sectors of the economy. It is doubtful that the government itself has any detailed timetable for nationalization of various firms and activities still in private hands. In any event, the question is rapidly becoming largely academic in that the government already has gained or soon will have direct or indirect control over all key economic areas. Except for two branches of European banks and a couple of minor plants, all of the foreign operations thus far taken over by the state were formerly owned by US interests.

Industrial Production

11. Increased purchasing power among lower income groups has continued to nurture the mini-boom in manufacturing output, but growth is leveling off as more industries reach full capacity production levels. Industrial production increased by less than 2% in July and about 4% in August, compared with 8.5% in June. Moreover, although overall industrial output during the first eight months of this year averaged about 6%–7% higher than in the same period in 1970, performance among the various manufacturing sectors was very uneven. Consumer goods and various intermediate products showed the most dynamic growth, while construction and investment goods remained depressed. Initiation of a massive government housing program and repair of earthquake damage probably spurred demand for construction materials beginning in August, however.

Agricultural Production and Agrarian Reform

12. President Allende and other top government officials appear increasingly concerned about the expected decline in agricultural production in the next year or two. Agriculture Minister Jacques Chonchol, a key leader in agrarian reform under both the Frei and Allende administrations, contends that output will be normal and that the sharp rise in agricultural import requirements to some $250–$300 million annually is solely attributable to increased consumption among lower income groups. Other government spokesmen, however, have been more candid about the production problems on both newly expropriated farms and those still in private hands. The US Embassy in Santiago estimates that dislocations and uncertainties deriving from government policies will cause at least a 10% drop in agricultural output. If so, production would be little higher than in 1965 and, barring unpopular restraints on consumer demand, agricultural import requirements would be even larger than now planned.

13. While hoping to minimize the production costs involved, the Allende government clearly is willing to pay a substantial price for irreversible, revolutionary change in the countryside. Recent official statements point to an acceleration in the pace of land redistribution, indicating that all large farms will be expropriated by mid-1972. Moreover, various bills now being drafted or already in the Congress could lower the maximum permissible farm size from 80 basic hectares (under the 1967 agrarian reform law) to the 40 basic hectares called for in legislation sponsored by the PDC or to the 20 basic hectares advocated by the Socialist Party. The Allende government also has decided to change officially the tenancy procedures called for under the Frei law—in effect, killing the myth that peasants would eventually receive individual titles to expropriated land. A new system of agrarian reform centers—collectivized groupings of expropriated farms to be worked cooperatively by all peasants in the area—will replace the asentamientos (transitional agrarian reform settlements on individual estates). Although few if any settlers actually received land titles under the asentamiento system, the new tenancy arrangements dash any lingering hopes for eventual land ownership the peasants may have had. In an effort to reduce agricultural inefficiency, the structure and operations of the new agrarian reform centers also will give the government more complete control over planning, production, and sales.

Shortages

14. While food and other consumer good shortages have not yet reached crisis proportions, they are a source of ever-increasing political embarrassment to the government. Economic Minister Vuscovic and other officials have publicly attributed the shortages to problems inherited from earlier administrations, to earthquakes and other natural catastrophes, to a US “boycott”, to a domestic “reactionary plot”, and the like, but opposition party allegations that the full blame should be laid on the doorstep of government policy appear to be gaining more credence. Although bad weather and earthquakes in fact did aggravate food supply problems, the sharp reduction in herds following Allende’s 1970 election and subsequent price and agrarian reform policies are basically to blame for spreading shortages of beef, pork, lamb, poultry, eggs, seafood products, and various dry and canned foods. As supply dependability decreased, hoarding has further complicated the problem. Shortages of consumer durables also are increasing as industries reach full-capacity production and are understandably unwilling to invest in plant expansion. While the inability to fulfill demand for such items as household appliances and television sets will simply be reflected in longer waiting lists, government officials are more concerned about expected shortages of shoes, clothing, and other necessities in the next few months. As in the case of food, the government probably will try to cover these shortages by increasing imports, as long as foreign reserves permit.

Contained Inflation in a State Economy

15. The government’s ability to hold the rise in the consumer price index (CPI) to 12.7% through August (compared with 29.5% during the first eight months of 1970) is an important political achievement but not a very useful economic indicator. The CPI rarely has been an accurate measure of actual price increases, and current opposition charges that it

understates the real inflation rate thus far this year by something like one-half are equally applicable to periods under previous administrations. Black market activities also are not a new phenomenon, although a wider variety of goods probably now figures in this trade. The important difference from past experience is that the CPI is now even less efficient as a barometer of inflationary pressures than it was before. With more and more production in state hands—and therefore subject to government subsidies—and little official concern for private entrepreneurs' dwindling profit margins, prices less and less reflect free market demand and supply relationships.

16. The Allende government has continued its expansionary policies contrary to Central Bank recommendations some months ago that it curtail deficit spending (now running at an estimated 30% of government expenditures), raise prices charged by nationalized enterprises, allow prices particularly on luxury goods to rise, reassure private investors, and devalue the escudo to stimulate exports and reduce imports. A government intent upon building socialism is not likely to adopt such orthodox tools for dealing with economic realities. Nevertheless, because output cannot continue to rise for very long in the face of negative savings in the public sector and no investment in private industry and because prospects for increasing supplies through imports are increasingly bleak, the adoption of austerity measures in one form or another can only be a matter of time.

Foreign Economic Developments

Foreign Exchange Reserves and Policies

17. Because of rising imports, lower export earnings, and the drying up of traditional sources of short-term credit, Chile's net foreign reserves have declined from about $350 million at the end of last year to an estimated $140 million in mid-September. By the end of 1971, reserves could be as low as $100 million—the equivalent of one month's imports—if the overall balance-of-payments deficit reaches $250 million, as expected. Because of the inflationary impact of such a move, the Allende government thus far has stuck by its pledge not to devalue the escudo used for commodity trade (i.e., the bankers rate). Nevertheless, it has introduced various regulations to slow the inflow of "non-essential" imports and thereby stem the worsening balance of trade. The government also has recently moved to cut losses from tourism and other non-trade transactions by changing the brokers rate from 14 to 28 escudos to the dollar, by imposing various foreign exchange taxes, and by tightening quantitative restrictions on tourist allowances. As a result, Chile now has a full-fledged multiple exchange rate system: 12.2 escudos to the dollar for exports and approved imports, 28 escudos for foreign tourists, 38 escudos for payments to foreign creditors, and 43 escudos for funds for foreign travel by Chileans and for payment of foreign royalty or licensing fees. Speculation concerning additional changes in exchange rates reportedly has driven the black market rate substantially above the 65 escudos to the dollar averaged in recent months.

18. Private firms committed to heavy foreign payments have been hard hit by the recent escudo devaluations. The Chilean National Manufacturers' Association (SOFOFA) estimated that private firms owe about $300 million in short-term and medium-term debts abroad—largely to US banks and companies. Of this amount, about $50–$70 million is due this year, as are large royalty and licensing payments. SOFOFA has warned the government that the increased escudo burden of their foreign debts may bankrupt many firms and increase unemployment. In response to these complaints, Economic Minister Vuscovic reportedly advised the firms "not to pay and see what happens."

Foreign Debt Repayment

19. Chile's total foreign debt is estimated at $2.4 billion, not including commitments to compensate for foreign private properties nationalized by the Allende government. Heaviest repayments are scheduled to occur in 1971–73, averaging more than $300 million annually. The United States is by far Chile's most important creditor, accounting for approximately half of the scheduled capital outflow. Allende's recent speeches indicate that Chile may be preparing to impose a debt rescheduling on its creditors. In view of the understandable reluctance of US investors to put new money

into Chile, the lack of any substantial USAID commitments, and Eximbank's postponement of a decision on the Lan-Chile loan (and, by inference, other loans) until Chile's expropriation compensation policies are clarified, Allende may decide that he has little to lose from simply defaulting on payments to US creditors. He will make every effort to protect his credit rating elsewhere, however, and at worst will formally request refinancing of outstanding obligations to Western Europe and international financial organizations. If the large balance-of-payments deficits expected in 1971 and 1972 materialize, Chile's ability to pay will be seriously limited and its creditors would have little alternative but to agree to a debt rollover.

Alternative Sources of Western Capital

20. In general, the Allende government has been disappointed in its efforts to obtain loans and investment in Western Europe where most countries appear to be following a "wait-and-see" policy. An exception to this policy may be European response to efforts by CAP (Compania de Acero del Pacifico—Chile's state iron and steel complex) to obtain $100 million in foreign financing for its expansion program. In mid-September, CAP's General Manager Flavian Levine stated that he would soon be going to Europe to make final arrangements for $75 million in credits previously negotiated and to arrange for an additional $25 million reportedly available in England. Belgium, Yugoslavia, Spain, and possibly West Germany apparently are expected to participate in the project. Although details are lacking, it is probable that this financing represents suppliers' credits covering European exports of equipment for the iron and steel project. Both Western Europe and Japan have shown far more interest in this type of financial assistance as a means of increasing their share of the Chilean market than in supplying untied loans and direct investment capital. Japanese interest in the project also reflects its worldwide search for long-term supplies of raw materials. Japan recently signed a seven-year contract with CAP to purchase large amounts of Chilean iron ore, in addition to those supplies earlier arranged for with Bethlehem. Mitsubishi, CAP's sales agent in Japan, also is a major supplier of equipment for the expansion program.

Communist Aid to Allende

21. Despite continued resistance by Chilean industry and military alike to a shift to Communist area equipment and technology, Soviet and East European involvement in the country clearly has been growing. Numerous technical missions have arrived in Chile in recent months to do feasibility studies on a wide variety of projects to be undertaken with Communist assistance. Since Foreign Minister Almeyda's mission to Moscow and East European capitals in May–June, long-term credit agreements involving more than $100 million are known to have been signed, bringing to $164 million total Communist commitments to Chile. All of these credits are designed to cover purchases of material and technical expertise from the donor country. To date, no untied financial assistance has been offered. Long-term credits extended and projects thus far agreed upon are shown in the table.

22. Chile and the USSR apparently have signed a military agreement, involving an exchange of army attachés and perhaps the extension of large Soviet credits on favorable terms to cover purchases of badly needed equipment and material. Although a $50 million figure has been quoted, there is still some question about the amounts involved and the types of equipment that will be purchased. In any event, Allende appears to be gaining ground in his campaign to buy the military's loyalty with promises of modernization and to reduce its opposition to a shift away from dependence on Free World equipment. Allende also may succeed in winning Lan-Chile's concurrence in purchasing Soviet Ilyushins as the only viable alternative to the Boeing 707s and 727s that Eximbank thus far has refused to finance. The Soviet aircraft industry reportedly has offered to sell Chile on any terms as many civilian jets as it wants. Although opposition by Lan-Chile technicians to buying Ilyushins because of their incompatibility with the existing Boeing fleet caused the postponement of a Chilean mission to Moscow in early September, a Lan-Chile team is now scheduled to depart soon for discussions with their Soviet counterparts.