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*Chapter 4*

# Supporting Policies for Exchange Control Regimes

In the years since 1931, Chile has utilized a large number of policy tools to support the exchange-rate systems presented in the previous chapter. In this chapter, the evolution of those policies is described. An awareness of such developments is important because the levels of EERs, EER(PI)s, and EPRs depend upon how the NERs are adjusted for the impact of such policies.

## 4.1 IMPORT POLICIES

Some general characteristics of these policies must first be noted.

i. A wide range of import policies has been used in Chile because the administration was attempting to restrain imports in a disequilibrium system at the same time that it was pursuing a number of objectives not connected with the balance of payments.

ii. Owing to the attempt to maintain a disequilibrium system with an overvalued exchange rate, cyclical fluctuations have occurred in the extent of restrictiveness of the import control system and the degree of its complexity. When favorable external conditions have prevailed and the exchange rate has not been too far below the long-run equilibrium level, the import control system has been relatively simple. Once external conditions have deteriorated and the PLD-NER has declined under pressure of inflation combined with a fixed NER, the system has been made much more complex and restrictive in response to ex ante balance-of-payments deficits.

iii. Because of this pattern, a number of policy tools that initially were introduced to liberalize and rationalize the system subsequently were altered in their basic character and used to make the system more restrictive and specific. The prior-deposit system on imports, for example, was initiated in 1956 with liberalizing and rationalizing intents. As the liberalization attempt faltered in 1957 and 1958, however, prior-deposit requirements were raised in order to limit imports and were made more varied in order to discriminate more among different imports. Therefore, in the next liberalization attempt, the additional tax was imposed to replace the prior-deposit system. When that liberalization attempt failed, prior deposits were reinstituted and the additional tax was maintained. Next, the added additional tax was introduced with the same intent, but eventually prior deposits, the additional tax, and the added additional tax were all three in effect.

iv. Some major policy changes have been associated with the switches from phase to phase which are delineated in section 1.4 above.

v. Most policy changes have been small, ad hoc adjustments made in response to specific problems that have arisen in the disequilibrium system or to concerns other than those related to the balance of payments. Those changes often have been very specific in their impact, which probably has increased distortions. Overriding general motives for the increased restrictiveness have included export pessimism and the desire for greater national control over the Chilean destiny, both of which have strong roots in the catastrophic experience of the Great Depression (see section 1.3). The motivation for many of the detailed policy alterations, however, has been the desire to limit short-run inflationary effects and to alter income distribution or to favor a particular interest group.

vi. Taxes have always been an important part of the foreign-sector regime. Because of accumulative effects they have often been quite high. They have not been very flexible, however, in response to changing conditions. They also have not been used to absorbing the entire import premium (see subsection 5.1.1). In fact, some taxes have been fixed in domestic currency, with the result that they have absorbed less of the premium as inflation has occurred. For example, Leftwich [1966:405] estimates that the ad valorem equivalent of the average specific tariff rate was 70 per cent in 1935, but declined to approximately 30 per cent by the late 1930s because of inflation. Also the tax of 0.015 escudos on foreign-exchange transactions was equivalent to more than 9 per cent when it was first applied, in 1954, but declined to the equivalent of less than 2 per cent by the time it was abandoned, in 1957.

vii. Quotas have been utilized with varying degrees of intensity since 1931. Nonprohibitive quotas, however, have not generally been an integral part of the regimes since 1955, except in 1965. The system utilized in that year was abandoned relatively quickly because of the perceived negative effects (e.g., penalizing rapidly growing industries and encouraging collusion). When nonprohibitive quotas have been in effect, the recipients of premiums generally have been the traditional traders, since allocations have been made on the basis of past import patterns. Complete prohibition has been used to provide protection to a changing group of industries.

viii. Delays and time constraints have been widely utilized to regulate short-run foreign-exchange disbursements, especially at times of foreign-exchange crises.

ix. Prior deposits on imports have been the major policy tool since they were introduced in 1956. At times of foreign-exchange shortages, such deposits have been raised to prohibitive levels on many items and the whole structure has been altered to favor specific mass-consumption necessities. During the more liberalized phases (i.e., 1959–61 and 1965–70), the prior-deposit system was gradually eliminated, only to be reintroduced abruptly with the abandonment of the liberalization attempt.

x. A large number of exceptions to the general regime have always been in force: special regimes, bilateral trading and compensation arrangements, exemptions for government agencies, and regional accords. These exceptions have tended to become more important during less-liberalized phases (although many of the special regimes were established during the Phase III and Phase IV years of 1956–61). Such exceptions have been quite important at times in terms of the proportions of total imports covered. They have caused considerable distortions and have substantially weakened the capability of the Central Bank (and related agencies) to operate a consistent exchange-control system.

### 4.1.1 Tariffs and Related Indirect Taxes.

Law 4321 of 1928 established the legal basis for specific import tariffs for the next four decades. Before the institution of exchange control, in mid-1931, the President had used the power delegated to him by this law to raise the rates significantly (i.e., by the end of 1930, increases averaging 71 per cent on the 73 per cent of imports affected—and further increases were made in March 1931). Subsequent modifications in the early 1930s included, in 1932, a rise of 10 per cent in the rates for luxuries (primarily as a revenue measure); in 1933, a 50 per cent increase in all duties to counterbalance devaluation; in 1934, a 100 per cent gold surcharge to replace the 50 per cent increase of 1933; and in 1935, an increase in the gold surcharge to 300 per cent because of further devaluation.

Ad valorem duties on the landed price, i.e., c.i.f. price plus all other duties and costs of clearing goods into the country, were added in 1936, 1941, and

1942. In 1943, Law 5786 created a structure which was maintained until 1967: 3 per cent on prime necessities, 30 per cent on ordinary consumption goods, and 62 per cent on luxuries.

By the early 1940s the system had become somewhat complex, and the sum of customs and landing charges had become quite large. Ellsworth [1945:50] provides an example for an automobile tire with c.i.f. value of 0.605 escudos (1 escudo = 1,000 pesos) in early 1942:

| | |
|---|---|
| Basic duty | 0.300 |
| Warehouse charge (4 months) | 0.018 |
| Embarkation and disembarkation charges (Law 3852) | 0.002 |
| Statistical duty | 0.0212 |
| Additional duty (Law 4851) | 0.030 |
| Port fiscal duties | 0.005 |
| Total | 0.3744 |
| 300 per cent gold surcharge | 1.1232 |
| | 1.4976 |
| Ad valorem tax (Law 5786) | 0.1959 |
| Total | 1.6935 |

It is evident that the nominal protection in this case is very high because of the multitude of charges and the accumulative effects of the surcharge and that the ad valorem tariff adds significantly to the final price.

No other major revisions of import tariffs were made before 1959. The piecemeal modifications which were introduced, however, generally tended to increase the explicit tariff-equivalent, for example: (i) As mentioned earlier, from 1954 through 1957 a tax of 0.015 escudos per dollar (equivalent to 9.4 per cent initially) was collected on all exchange transactions classified as not for necessities. (ii) At the end of 1955 the exchange-rate base used to calculate customs costs in domestic currency was switched from that of the previous half-year to that of the previous quarter. (iii) In 1956, a tax of 1 per cent was introduced on all sales of foreign exchange. After being increased to 5 per cent, reduced to 1 per cent, and increased to 2 per cent, this charge was abolished in 1959. (iv) In 1957, special import taxes on vehicles were established.

In 1959, Law 13305 altered the tariff structure in a major way by imposing an additional tax (*impuesto adicional*) of from 5.0 to 200.0 per cent of the c.i.f. value for six import categories, payable in United States dollars. This tax was intended gradually to replace the prior-deposit system (see subsection 4.1.4, below) so as to rationalize the regime. At least until May 2, 1960, an amount equal to the additional tax had to be placed on deposit with the

Central Bank (and transferred to the Treasury) at the time when the import was registered with the Foreign Exchange Commission. When the import arrived, the deposit was applied against payment of the additional tax.

During the Phase IV period of 1959–61 the list of imports for which additional taxes were due in lieu of prior deposits was steadily expanded. The maximum additional-tax rate remained at 200.0 per cent, although the minimum was lowered to 0.1 per cent, and new categories were established. In May 1960, a small number of goods was shifted to lower additional-tax categories.

After the reversal to a Phase II regime, in 1962, the additional-tax rates were increased substantially in each category: in the formerly tax-free category, rates were imposed of from 5 to 30 per cent; rates of 10 to 30 per cent were raised to 100 per cent; rates of 50 per cent, to 100 per cent; and rates of 75–100 per cent, to 200 per cent. The maximum limit also was raised from 200 to 400 per cent in November 1962. In February 1963, many of these increases were reversed by the Ministry of Finance, apparently in an attempt to offset partially the inflationary impact of the devaluation of late 1962.

In November 1964, one of the first acts of the new Frei government was to institute an added additional tax (*impuesto adicional agregado*) ranging up to 300 per cent of the c.i.f. value. The government then eliminated the previous legal link between increases in additional and added additional taxes and reductions in prior deposits. Consequently, the former taxes could be changed independently of prior-deposit requirements. Subsequently, the Ministry of Finance modified these tax rates for many commodities. The most important modification, in June 1966, was a reduction of the additional and added additional taxes on machinery imports: declines from about 90 per cent to 1–10, 20–30, or 50 per cent for industrial machinery; from 90–100 per cent to 20 per cent for agricultural machinery; and from 6 per cent to 1 per cent for mining machinery.

In January 1967 Law 16464 replaced Law 4321 of 1928 as the basic Chilean tariff legislation and instituted a major rationalization. In the new law, the simpler Brussels nomenclature was adopted, a 5 per cent charge was established on items previously exempted from tariffs, and the multitude of previously existing taxes [1] was consolidated into specific taxes defined in terms of 0.183057 grams of gold-equivalent per unit and ad valorem taxes on the c.i.f. value.

Some changes were made after January 1967 which were directed toward further rationalization. The most important one, made in August 1969, was that tariff charges generally were increased by 5, 10, 20, or 35 per cent to replace prior deposits of 15, 40, 90, or 180 per cent. However, most subsequent changes were of a much more ad hoc nature, as the following four cases illustrate: (i) The registration tax on the c.i.f. value of all imports (which had been established at 1.0 per cent in 1969) was increased to 2.0 per cent in 1967 and to 3.0 per cent in 1969. (ii) In July 1967, the percentage of ad valorem customs charges on capital goods paid out of the proceeds of foreign loans was reduced by twenty points for goods imported before the end of the year. (iii) In January 1968, ad valorem duties on all private imports (including those previously exempt, except for specified foodstuffs and specified commodities covered by international agreements) were raised by five percentage points. (iv) In September 1968, ad valorem duties on capital goods were reduced in proportion to the length of the repayment period for foreign credit obtained by the importer.

### 4.1.2 Quotas, Licenses, Foreign-Exchange Budgets, and Permitted Lists.

Integral to the attempt to partition the foreign-exchange market were explicit quantitative restrictions limiting access to import subdivisions of that market. Decree Law 138 of July 1932 (superseded by Law 5202 in July 1933) inaugurated the system of import quotas and licenses. The initial purpose of this system was to conserve foreign exchange by rationing and other means. Soon it was also used for other ends: to bring pressure on other countries with exchange control systems in hopes of promoting Chilean exports (e.g., to force Peru to buy Chilean exports; import quotas on Peruvian sugar were limited); to redistribute income by subsidizing "necessities" and prohibiting "luxuries"; and to provide additional protection (e.g., in the 1930s for flat glass, light bulbs, calcium carbide, jute bags). The Import License Commission (established in October 1933) determined the allocations of quotas and licenses primarily on the basis of past patterns, with some modifications in response to political influence. The Exchange Control Commission administered the system. The recipients were largely traders.

At times quotas exceeded available foreign exchange; as a result, by 1939 large quantities of goods were being held in customs because no foreign exchange was available. Therefore, the requirement was added that imports receive an additional permit before the goods were shipped to Chile. The institutional arrangements subsequently were rationalized somewhat through the establishment, in 1942, of CONDECOR; the establishment, in 1945, of an annual foreign-exchange budget; and the 1950 reform of CONDECOR and of the foreign-exchange budgeting system, which temporarily allowed the importation of certain machinery, raw materials, and replacement parts at the free-market rate without prior authorization.

During the Phase II period of 1931–55, nevertheless, the underlying pattern of operation remained the same. First, an attempt was made to make the system more rational and unified by setting up a fixed or controlled exchange rate for a significant proportion of international trade. Then, because of internal inflation and lags in exchange-rate adjustments, balance-of-payments crises occurred and the foreign-exchange budget was exhausted. In response, ad hoc measures were implemented: the suspension of licensing for some import or exchange-rate categories (especially luxuries and the gold and wine rates); the piecemeal reclassification of goods to higher rates; and the ad hoc reduction of permitted lists of imports. As a result of these modifications the system remained as complex as it had been initially.[2]

With the introduction of a Phase III regime in 1956, arrangements were altered significantly. In August 1956, Law 12084 abolished the previous system with its specific quotas in the foreign-exchange budget and its import licensing. Under this law, there was established a fairly broad list of goods which could be imported freely by any economic entity upon payment of duties, taxes, and the prior deposit without licenses, except for a few items which required a certificate of necessity from the Ministry of Economics. The newly established Foreign Exchange Commission proposed the original list of permitted imports and subsequent modifications to the Ministry of Finance, which enacted the same by decree. The permitted list generally was expanded throughout the period, although occasionally items that had formerly been on the list were excluded from it.

Early in the Phase IV period of 1959–61, further liberalizations were introduced. In April 1959, Decree 5474 of the Ministry of Finance expanded the permitted list to include almost all commodities (although those not previously included were subject to a 5,000 per cent, 90-day prior-deposit requirement). At the end of 1959 the permitted list effectively was expanded to all imports by making the 3,500 per cent prior-deposit category applicable to all items not mentioned explicitly on the permitted list.[3] A few exceptions to the generally less restrictive system existed: government agencies were still required to obtain permission from the Ministry of Finance for nondefense imports; a quota of 200 vehicles for use as taxicabs was fixed in August 1959; and from July 15 to August 9, 1961, a prohibition was imposed on nondomestically transformed re-exports, which remained in effect for the rest of the year for scrap iron. But generally the regime was the least restrictive one imposed since the Great Depression.

The reversal in 1962 to Phase II policies was accompanied by new import bans. In January 1962, Decree 41 of the Ministry of Finance prohibited the importation of about 700 items considered to be nonessential or in sufficient production in Chile. Application had to be made to the Central Bank for permission to import goods remaining on the permitted list. Approval was usually granted automatically, but sometimes there were considerable delays.

Early in the Frei regime, restrictions were tightened because of foreign-exchange shortages and impending foreign-debt payments. In January 1965, Law 16101 empowered a Central Bank committee to reject import applications for any commodity group for which total import applications during any month exceeded by more than 5 per cent the average monthly import registrations of the past twelve months for that group. When applications for any commodity were rejected, those for all other commodities in the same customs tariff category had to be rejected. Between January and November 1965, such power was used to reject $92 million of import applications.

This new procedure had a number of negative effects: (i) Relatively rapidly growing industries and activities were penalized. (ii) Holders of relatively large inventories within a particular category were favored, since they could submit very large requests and count on pressure from their competitors to ensure eventual acceptance without themselves incurring substantial relative costs because of delays. (iii) Inventory accumulation in excess of actual needs was encouraged because of concern that future dollar applications would not be approved. (iv) A certain random element was introduced into the process in that an "unreasonably" high request for dollars would have to be approved if it did not exceed the allowable limit for that month. But the same request (or a "reasonable" one) *might* be rejected if it was made in a month in which the criterion was not met. (v) Collusion was encouraged among firms in an industry in their attempt to ensure that total requests from that industry would not exceed the allowable limits. (vi) Control by other government agencies over allocation of approved applications within a tariff category had been surrendered in order to avoid charges of favoritism. (vii) Discrimination occurred against items with large seasonal fluctuations. (viii) Very costly delays were introduced, especially in regard to spare parts. (ix) The review committee was subjected to considerable political pressure for approval of certain applications.[4]

Such defects soon became apparent to the authorities. Almost immediately modifications were made so that spare parts worth up to $500 were exempted from the need for prior approval. Once the immediate foreign-exchange crisis had passed, rejections of import applications were less and less frequent. After February 1966 the whole procedure was no longer used.

Throughout the Frei years the permitted list of merchandise imports continued to be used. Initially this list was reduced because of the immediate foreign-exchange crisis. In early 1965, for example, 49 items were removed. Later in that year, however, the list was expanded, especially for machinery and medicine. This expansion continued over the next several years and then accelerated during the last two years of the Frei administration.[5] In January 1970, a Presidential Decree provided for the gradual (so as not to cause undue transition problems) elimination of virtually all import restrictions with the intents of limiting special advantages to imports from LAFTA; encouraging greater domestic efficiency by eliminating undue protection, but retaining the possibility of higher protection for one or two years for infant industries;

and using indirect taxes on luxuries instead of the import regime to limit consumption of items deemed socially undesirable. Throughout the rest of the year, a large number of items were added to the permitted list. By late in the year, virtually the only items not included were automobiles, television and radio receivers, cigarettes, guns, jewelry, alcoholic beverage, carpets, and toys.

The Allende government made no general changes in the use of the permitted lists and related tools. During the first two years of this government, however, a large number of specific modifications were made which discriminated against luxuries,[6] favored mass-consumption imports, and on balance increased the number of permitted items. Many of the added items, however, carried a prohibitive prior-deposit requirement of 10,000 per cent. The Central Bank included them on the permitted list because exceptions could be made more readily from the prior-deposit requirement than from the permitted list for imports generally deemed undesirable, but in specific cases judged advantageous.

### 4.1.3 Time Constraints on Foreign-Exchange Cover for Imports.

In some times of foreign-exchange shortages, informal delays in the delivery of foreign-exchange cover for imports increased, for example, in the first half of 1964 (Ffrench-Davis [1971:88]). The 1965 procedure for obtaining approval of import applications, which is described in the previous subsection, also had the effect of pushing foreign-exchange needs forward by increasing processing lags, even though the procedures announced in January 1965 limited the period between receipt and acceptance or rejection of any application to 90 days.

For the same purpose at other times such delays were formally introduced. In 1958 lags of 20 and then 30 days were instituted as the Phase III regime faltered because of exchange shortages. In the subsequent Phrase IV period such lags were reduced, in 1959, to 15 days after shipment for imports from Western Hemisphere countries and in 1961, to the date of arrival of the shipping documents. At the start of the Phase II period of 1962 the Central Bank reintroduced a compulsory deferred payment period of 90 days, which was increased to 120 days in September of that year. This deferment period remained in force through 1965. Given the lags in other steps of the procedure, such as in the consideration by the authorized Central Bank committee of whether to accept or reject applications, in that year 265 to 315 days elapsed between the initial presentation of an application by an importer and the actual transfer of foreign exchange. The compulsory deferment period subsequently was reduced in small steps until it was eliminated in 1969.

The lag in delivery on sales by the Central Bank to commercial banks provided another time constraint on the availability of foreign exchange. Under the Frei government of 1965–70, for example, this lag ranged from 56 to 82 days, with its peak occurring during the foreign-exchange shortage of late 1967.

Yet another time restriction was introduced in December 1965. Under Central Bank Circular 590 exchange for specified imports had to be purchased at the bank future rate corresponding to the full registration value to provide for immediate cash payment in local currency within 60 days after shipment (which was reduced to 30 days in October 1967). From January 1966 through January 1967, more commodities were added to the list covered by this circular until approximately 80 per cent of private-sector imports were included. For much smaller lists of commodities similar restrictions with maximum time periods of 120, 240, and 360 days also were established in 1967 and 1968.

From the point of view of importers, all these time constraints could result in higher costs. For example, if no part of the cost of the delay was borne by exporters, a 120-day delay implied an increase of 2 to 3 per cent in the real c.i.f. cost of Chilean imports. From the point of view of the Central Bank the primary purpose of these constraints, as noted above, was to push forward foreign-exchange requirements in times of shortages. Several of these time constraints were also introduced, however, to absorb domestic liquidity as part of anti-inflation programs.[7]

### 4.1.4 Prior Deposits on Imports.

In 1956 CONDECOR introduced a new tool into the set of Chilean foreign-sector policies in the form of import prior deposits. Such deposits have been among the most important and most altered measures in the regimes from that time to the present.

The original system included 30-day prior deposits in domestic currency on goods imported on a consignment basis (5 per cent deposit), goods imported on a deferred basis (amount of downpayment), and goods imported on a cash basis. Goods in the last group were divided into six categories. Some examples of the goods included in each category are given below, with deposits specified as percentages of the c.i.f. values:

*Category A* (5 per cent): cellulose, raw rubber, crude oil, wheat, Paraguayan tea, sugar, lubricants, gasoline, kerosene

*Category B* (50 per cent): sewing machines, wool tops, cotton, coffee, asbestos, chassis for trucks and buses, buses, tires, spare parts for motor vehicles

*Category C* (100 per cent): most antibiotics, chemicals, paraffin wax, plastic raw materials, tubes, newsprint, business machines

*Category D* (150 per cent): tin plate, films
*Category E* (200 per cent): pickup trucks
*Category F* (400 per cent): glassless station wagons

Capital-goods imports and imports by large-scale mining enterprises and by the public sector were exempt from the prior-deposit requirements. Banks were allowed to sell foreign exchange only in the amounts specified on the prior-deposit certificates.[8]

At first the use of this new tool implied a substantial liberalization of imports with the same general order of priorities as before, but without the extreme discrepancies among goods. There also was an initial, one-shot anti-inflationary impact as the new system absorbed substantial credit.

Subsequently, however, as the escudo became more overvalued and foreign-exchange reserves declined, the prior-deposit system was modified substantially. In 1957, three new categories were established:

*Category G* (600 per cent): automatic scales, photographic equipment, etc.
*Category H* (1,000 per cent): pineapples, poplin, elastic fabrics, aircraft, buses, etc.
*Category I* (1,500 per cent): spices, locks, trucks, automobiles, etc.

In 1958 the minimum deposit period was increased to 90 days,[9] the percentage required for imports on consignment was increased to 100, almost all items were shifted upward among categories, and a new category was established: *Category J* (5,000 per cent): automobiles, station wagons, buses, pickup trucks, jeeps, typewriters, calculators, etc.

As a result of these major modifications in 1957 and 1958, as well as a host of minor ones, the basic character of the prior-deposit system was substantially altered. Changes were made more and more on an ad hoc basis. Discrimination among goods increased because of the spread in the rate structure and the differences in the deposit periods. Alterations ocurred quite frequently. Favoritism of specific products became more rampant. Some prior deposits became almost prohibitively high.[10] The whole system became much more restrictive.

In the Phase IV years of 1959–61, the dominant tendency was to reduce dependence on prior import deposits by substituting additional taxes in their place. A parallel tendency was to lower deposits on those items for which they were still required. In 1959, for example, deposits were first reduced and then eliminated on deferred payment imports, and all imports carrying prior-deposit requirements of 150 per cent or more were moved to lower categories, i.e., from 150 to 100 per cent, from 600 to 400 per cent, from 1,500 to 1,000 per cent, from 5,000 to 1,000 per cent, and from "not permitted" to 3,500 per cent. In 1960 and 1961 further downward shifts were made in classifications among categories and in the percentage rates for various categories. In November 1961 prior deposits on most imports were abolished.

One major anomaly, however, was introduced into the prior-deposit system in this period. In August 1960 imports of all used merchandise were made subject to a prior deposit of 5,000 per cent on the c.i.f. value of equivalent merchandise in unused condition. Although lower rates were established in January 1961 for certain construction items and boats, the strong general discrimination against the importation of second-hand machinery and vehicles precluded their profitable use as an alternative to new goods.

Another important change in the prior-deposit system in this period was the shift from payment in domestic currency to payment in dollars or in government bonds denominated in dollars. Near the end of 1958 the Foreign Exchange Commission sanctioned prior-deposit payments in short-term Treasury dollar bonds or in dollars in addition to domestic currency. In March 1959 the commission eliminated the eligibility of domestic currency for such purposes. Subsequently it permitted use of medium-term Treasury dollar bonds and obligations of the government debt finance agency (Caja de Amortización de la Dueda Pública). The motivations for these changes were twofold: to lessen the domestic currency liquidity of banks as part of the change toward a more restrictive monetary policy and to shift command over resources to the central government, since the dollar prior deposits were held by the Treasury, not by the banking system (which held prior deposits in domestic currency).

The reversal to a Phase II regime during the foreign-exchange crisis of December 1961 was initiated by the imposition of a 10,000 per cent prior-deposit requirement on all items. For most items deposits were reduced from these prohibitive levels early in 1962, but a system then was established of 90-day prior deposits in fiscal bonds at rates ranging from 10 per cent to 10,000 per cent of the c.i.f. value of imported merchandise.[11] Ffrench-Davis [1971:86] and Jeanneret [1971:150] report that the limited number of eligible bonds effectively constrained import applications. The scarcity rent on the bonds was as much as 30 per cent (which accrued, of course, to the bond owner and not to the government). Later in this phase the restrictiveness of the deposit requirements was slightly reduced.

At the start of the Phase III period of 1965–70, prior deposits in fiscal dollar bonds were replaced by escudo deposits equal to the value of the additional tax plus the added additional tax. At the same time commercial banks were prohibited from directly or indirectly financing prior deposits. The purposes of these changes were to transfer to the fiscal sector the rents previously received by dollar-bond owners without affecting the cost of imports for importers; to rationalize the system by preparing the way for the elimination of the additional and added additional taxes; and to redirect credit from commerce to "directly productive" activities.

During the first four years of this phase, a number of alterations were made which increased the restrictiveness or specificity of the system. Such modifications provided added protection for domestic production of a number of particular items.

The clearly dominant trend throughout this phase, however, was toward simplification of the system and reduction of its impact. After the exchange crisis of 1965, items were frequently reclassified to lower categories or exempted from the prior-deposit requirements; as a result, the importance of prior deposits declined steadily.[12] In 1967 the number of categories was reduced to six (10, 20, 50, 100, 200 and 10,000 per cent). After September 1968, prior deposits could be released and used to pay import duties and other import charges instead of being blocked for at least 90 days as was previously the case (therefore reducing the need for double financing). In 1969, the percentages of the deposits were reduced in four steps from 10 and 20 to 0, from 50 to 15, from 100 to 30, and from 200 to 50. On July 30, 1970, all prior-deposit requirements were eliminated except for the prohibitive 10,000 per cent category.

The demise of prior-deposit obligations once again was of short duration. Less than a month after taking office, late in 1970, the new Allende government established prior deposits of 10,000 per cent for refined sugar, cigars, pipe tobacco, tinplate, commercial aviation aircraft, certain rayon yarns and fibers, merchant ships, fishing vessels, and navigational equipment. This broadening of the use of prohibitive prior deposits was relatively minor in scope, but it represented a definite reversal from the prevalent trend of the previous phase of reducing the use of this policy instrument. In April 1971 (Central Bank Circular 1508), moreover, the 10,000 per cent prior-deposit requirement was extended to over 60 per cent of the import categories included on the permitted list. Subsequently the coverage of this requirement was steadily expanded. The only significant exception to this new trend was the exclusion of parts from the requirement of a 10,000 per cent deposit and prior Central Bank approval. Thus, prior deposits were the major means on the import side by which the government attempted to create a buffer between the international and domestic economies and to increase government control. The increase in the use of prohibitive import prior deposits was the most important single policy change in the move to a much more restrictive foreign-sector regime.

### 4.1.5 Special Regimes.[13]

Import policies have been further complicated by a number of exceptions to the general rules. The most significant probably have been those explicitly recognized as "special regimes." These usually have accorded favorable import treatment to particular regions or industries.[14] The importance of these regimes in the early 1960s is indicated by the fact that they affected 41 per cent of total imports in 1961. Further evidence of their importance at that time is the estimate by Beca, Galvez, and Imperatore [1969:136] that in 1962 customs duties actually collected were only 43.4 per cent of what they would have been had the legal rates applied to all imports, with special regimes accounting for about 80 per cent of the shortfall. The special regimes declined in relative importance during the 1960s, but still affected 18 per cent of imports in 1969 and 1970.

4.1.5.1 SPECIAL REGIMES FOR PARTICULAR REGIONS.

These accounted for 30 per cent of the value of imports under special regimes in 1961 and 74 per cent of such imports in 1970. The motive for establishing these regimes was to achieve better integration of remote areas of northern and southern Chile into the national life. The four major areas covered, in order of the value of imports affected, are the following:[15]

*Arica.* In 1953 Decree Law 303 established a special regime for the department of Arica.[16] This regime is described in some detail because it has been the most important of all of the special regimes and it has served as a prototype in a number of respects for the other regional regimes.

As of 1961, special provisions for this department included: exemption from indirect taxes for industries; exemption from customs duties on imports of raw materials and capital and a single customs duty of 10 per cent on other products with an additional duty of 15 per cent for some luxury goods; a system of drawbacks on the exportation of products assembled or produced in Arica; a special credit system (not subject to the general margins established by the Central Bank) for all industrial enterprises that used only raw materials produced in the area; a 90 per cent reduction in profit and real-estate tax rates for all new industries established in 1959–69; and a geographical monopoly for the Chilean automobile industry.

Movement of goods from Arica to the rest of the country was governed by the general trade regime with the following exceptions: (i) Once in every six months, tourists in Arica could take out goods worth about $40 in duty without paying the duty and goods worth up to about $110 in duty on payment of only the specific and ad valorem charges. (ii) Goods produced in Arica and not produced in the rest of the country were subject to only one-half of the specific and ad valorem duties on the import content and were exempt from additional taxes and prior deposits. (iii) Goods produced in Arica and also produced in the rest of the country (but in inadequate quantities in the judgment of the Ministry of Economics) were subject to 75 per cent of the specific and ad valorem duties on the imported component and were exempt from additional taxes and prior deposits.

In the 1962–64 period import privileges for Arica were restricted, and almost all imports on the general prohibited list were subjected to a 200 per cent additional tax if imported into Arica. At the same time the government effectively created a category of otherwise prohibited luxury imports which could be imported only into areas such as Arica and which could be shipped to the rest of the country only if processed or assembled in the special regions.[17]

During 1965–70 some attempts were made to integrate the special regimes into the over-all trade regime as part of the general trade liberalization. In 1966 a tax was applied on all imports otherwise exempt (but much of this tax was eliminated in March 1968). Also in 1966 the Central Bank was given the authority to adjust the approval of import registrations for the television receiver, automobile, and sewing machine industries in Arica to the need to stimulate the development of similar industries elsewhere. In late 1969, regulations were changed so that any new items on the permitted list imported into Arica were subject to 80 per cent of the normal tax and prior-deposit requirements instead of the previous 25 per cent. After August 1970 import duties and taxes were applied to all but specified classes of goods when imported into Arica for local use.

Under the Allende government, attempts were made to remedy part of the perceived regressive income impact of the Arica regime. The government therefore immediately instituted a requirement that goods be certified by the appropriate government ministry before they could be imported into Arica. Shortly thereafter it required that importers seeking to benefit from the special regime for Arica establish that they had resided there without interruption for at least three years.

Despite modifications under the Frei and Allende governments, Arica has remained the most important of the special-regime areas. In 1971 it accounted for over a third of the value of total approved special-regime import applications. It has continued to provide a means for evading at least part of the general trade regime apparatus. It also has continued to be the home of some of Chile's most inefficient industries.

*Provinces of Chiloé, Aysen, and Magallenes.* In 1956 Law 12008 established a special regime for these three very isolated southernmost provinces of Chile. The area was exempted from import duties on all nonluxury products. The reshipment of imports to the central part of Chile was made subject to the same rules that applied to the department of Arica. In 1958, motor cars, whiskey, wine, beer, and cider were reclassified as nonluxury goods for this purpose and thereby freed from the restrictive quota on luxury imports into this area. Thereafter changes in this regime generally paralleled those for Arica.[18]

*Provinces of Tarapacá and Antofagasta and Department of Chanaral.* In 1958, Law 12858 established a special regime for these northern areas. It authorized duty-free importation of a number of food products, which were not in sufficient production to supply the local demand, in order to compensate in part for the impossibility of substantial agricultural production in these areas because they are located in the Atacama Desert.

*Northern Area.* Also in 1958 Law 12937 established a special trade regime for the northern departments of Iquique, Pisaqua, Tattal, and Chanaral (except for the El Salvador copper deposits) and for all small- and medium-scale copper mining in the province of Antofagasta. Under this regime, all productive enterprises in the area were exempted from import duties and prior deposits on capital goods, fuels, and raw materials (with normal customs duties for reshipments to other areas); a special credit plan was established for industrial enterprises that exclusively used raw materials produced in the area; and a system of drawbacks was instituted for products assembled or produced in the area.

#### 4.1.5.2 Special Regimes for Particular Industries.

Individually, the value of imports covered by these regimes generally has not been as large as that for regions. However, the value of imports coming under (i), below, was second only to that of the department of Arica at times in the 1950s and early 1960s. The value of imports under the special regime for the nitrate industry (see subsection 4.2.2) also was substantial over a long period of time. The following were among the most important special regimes for industry.

i. In 1944, under Law 7896, exemption from all taxes, including customs duties and profit taxes, was granted to the then new (and only) enterprise producing iron and steel ingots (Compañía Acero de Pacífico; CAP).

ii. In 1950, under Law 9618, total tax exemption (including customs duties) was granted to the then newly established National Petroleum Enterprise (Empresa Nacional de Petróleo; ENAP).

iii. Also in 1950, under Law 9839, exemption from customs duties was granted for imports of machinery destined for agriculture, small- and medium-scale mining and fishing, and new industries at least 80 per cent of whose raw materials were of domestic origin. In 1953, Decree Law 208 expanded the special regime for the fishing industry, with broad tax exemptions, special import privileges, and the right directly to use its own foreign-exchange proceeds. Further provisions, favoring fishing and ancillary industries, were added in 1960 and 1961.

iv. In 1956, under Law 12084 the sugar industry was granted total exemption from import duties on beet-refining machinery in order to promote domestic self-sufficiency in sugar production.[19]

v. In 1960 Decree Law 255 established a special regime to promote the modernization of the coal industry. Accelerated depreciation was permitted, and exemptions were granted from all customs duties on imports of machinery and equipment under CORFO-approved investment programs, all customs duties on industrial or domestic coal-using equipment, profit taxes on profits reinvested in CORFO-approved plans, and production taxes in the coal-mining industries.

### 4.1.6 Bilateral, Compensation, and Barter Agreements.

These three forms of agreement constitute a second important class of exceptions to the general international economic regimes of Chile. After foreign credits were frozen, in 1931 (see subsection 4.3.3), a number of importers of Chilean nitrates threatened retaliation. As a result, compensation agreements along the following model were signed with a number of countries.

Two compensatory accounts with fixed, but different, exchange rates, "A" for new business and "B" for frozen credits, were established in each country.[20] In Chile, foreign nationals paid debts in Chilean currency into the B account at the Central Bank. A fixed percentage of the value of nitrate exports (and sometimes other exports) was paid for out of these deposits. Upon arrival of the nitrates in the importing countries, this same percentage of the sale was paid into local B accounts and transferred to creditors whose Chilean credits had been frozen. Commodity imports from the partner country provided deposits for the Chilean A account which were used to compensate nitrate exporters for the part of their shipments not paid for from the B account. In the partner country, credits to the A account came from proceeds of imports from Chile and disbursements were made to exporters to Chile.[21]

Thus, distinct bilateral exchange rates were in effect with each partner country.[22] Since these rates were not adjusted regularly to offset relative price changes, large sums often accumulated in the Chilean or partner country's compensation account. For example, in 1933 Chile had a large positive balance in francs in the A account for the agreement with France. In order to avoid the penalty for not utilizing this balance within the allotted period of time, Chile tried to induce more imports from France by lowering the escudo price for francs from this account, by allowing such francs to be used for previously excluded luxuries (e.g., champagne, wine, silk, cognac, and perfumes), and by promising that French francs would be made immediately available for all imports from France.

The first bilateral agreement was signed with France in 1932. Before a decade had passed, official compensation agreements had been made with Belgium, Germany, Holland, Spain, Sweden, and Switzerland. Private compensation agreements (in which generally only the proceeds for nitrates were blocked) had been made with Austria, Czechoslovakia, Denmark, and Italy. Barter arrangements also had been established with Argentina, China, Costa Rica, Ecuador, Finland, Guatemala, Japan, Peru, Sweden, and the USSR. The trade value of these agreements in the 1930s was evidently significant: Baerresen [1966:6] estimates that they covered 30 to 40 per cent of total Chilean trade in the mid-1930s; Wilson [1937] estimates that in 1936 such agreements covered 60 per cent of Chilean imports and 25 per cent of Chilean exports.

A large number of such agreements continued into the 1950s, and new ones were signed until near the end of that decade. With Chilean liberalization attempts, initiated in 1956 and in 1959, and concurrent worldwide liberalization efforts, the importance of these arrangements declined. In 1963, the last agreement then in operation expired. The Allende government, however, had shown interest in establishing new bilateral and barter arrangements, especially with socialist countries.

### 4.1.7 Government Agencies.

A third group of exclusions from the general foreign-sector regime are those enjoyed by various government agencies, in part to permit independent action by specific government entities, especially government trading and development agencies. At times exemptions also have been granted to the government in general.

#### 4.1.7.1 Specific Government-Agency Exemptions.

A number of government trading and development agencies were established in the 1930s to provide better regulation of international trade and to guide economic development.

Petroleum distribution is an example of an area in which government trading agencies became involved. In 1932 Law 5124 introduced a state monopoly on petroleum imports. Later that year Decree Law 519 established price fixing and rationing for petroleum. Neither law, however, had much immediate impact (although the latter was used for rationing in 1942). Therefore in late 1934 the Compañía de Petróleo de Chile (COPEC) was formed to share petroleum trade with subsidiaries of the Shell and Standard Oil companies, and has continued in that role ever since.

The Agricultural Export Agency (Junta de Exportación Agrícola), established in late 1930, is an example of a combined trading and development agency. This organization subsidized agricultural production and exportation and set minimum agricultural prices. More specifically, in 1933 it established export bounties for oats and barley. In 1934–35 it was empowered to export and import wheat, to fix prices for wheat and related products, and to invest in export-related agricultural production. In 1935 it introduced export bounties for wine.

A number of pure development agencies also were created in the early

1930s (and some in the 1920s), although with very limited funding: Caja de Crédito Agrario, Instituto de Crédito Industrial, Caja de Crédito Minero, Instituto de Fomento Minero e Industrial de Tarapacá y de Antofagasta, and the Caja de Colonización Agrícola. These organizations became much more important in the 1940s when they were able to obtain more money through mandatory Central Bank loans at *nominal* rates of interest of from 1.0 to 4.0 per cent.

Law 6334 of 1939, however, established by far the most important of the development agencies: CORFO (Corporación de Fomento). The new Popular Front government evidently was able to have the necessary legislation passed only because it was linked to relief for the great earthquake of January 1939. In any case CORFO was given broad powers and ample financial resources. In subsequent decades, it became the most important single agency in the policy of substantially increased government economic intervention.

Functionally CORFO basically was (and still is) an investment bank. It financed investment primarily through loans and stock purchases and legally was instructed to use improvements in the standard of living and in the balance of payments as its investment criteria.

CORFO's power originated in its substantial financial resources which enabled it to control over 30.0 per cent of the imports of machinery and equipment in each of ten years in the period between 1939 and 1954 and more than 25 per cent of public investment and more than 10 per cent of total investment in all but three years (1945–47) of the same period. The sources of CORFO's finances included the government, through initial access to funds previously allocated by law to the Caja de Amortización, increased income taxes earmarked for CORFO including a 15 per cent additional tax on the profits of large-scale copper mining, and general-purpose contributions and loans from general revenues; the banking system, through loans, sometimes obtained on CORFO's behalf by the central government; the general public, through stock sales; returns from earlier investments; and foreign official credits, including $17 million from the Export-Import Bank in 1939–40 and a total of $969 million from foreign sources up to 1969.[23]

In recent years CORFO has continued in its primary role as an investment bank. It has also expanded its activities in planning and in plan implementation. An example of the latter function is provided by the 1967 requirement that subjected authorization of import licenses for specified capital imports to the approval of CORFO. Under the Allende government the scope of CORFO was further increased, especially in overseeing the large expansion of the state sector in commerce, finance, and production.

The power which CORFO has had since its inception has resulted in a certain degree of autonomy in its foreign-sector operation. Such independence at times has lessened the capability of the Central Bank, and of related exchange-control organizations, to create and pursue a consistent over-all foreign-sector strategy.

4.1.7.2 GENERAL EXEMPTIONS.

Exemptions granted to the government and quasi-governmental organizations have centered on the prior-deposit requirement for imports and on related taxes, i.e., the additional and added additional taxes mentioned in subsection 4.1.1. Such privileges have been inversely related to the degree of over-all liberalization. They were reduced in the 1959–61 and 1965–70 phases and increased in 1962–64 and after 1970. In restrictive phases these exclusions have substantially favored the recipient institutions over the rest of the economy.

### 4.1.8 Regional Agreements.

In the 1960s, Chile became party to two regional agreements, which have resulted in increased trade under special arrangements.

In early 1960 Chile signed the Treaty of Montevideo which instituted the Latin American Free Trade Association or LAFTA (Asociación Latinoamericana de Libre Comercio; ALALC). The signatories agreed to eliminate gradually all barriers to intraregional trade over a twelve-year period. Decree 22220, issued by the Ministry of Finance in 1961, established the Chilean national list of imports from LAFTA countries with special specific tariff rates and exemptions from ad valorem taxes, prior deposits, charges for embarkation and disembarkation, and consular charges. Subsequent acts extended LAFTA in some limited respects. In late 1965 complementary agreements were signed for the exchange of automobile components with Argentina and Mexico. A LAFTA multilateral clearing arrangement became effective in mid-1966. Under the Allende government a number of bilateral trade and credit agreements with other LAFTA nations were initiated (e.g., credit agreements with Uruguay and Peru in March 1971, with Paraguay in April 1971, with Mexico in January 1972, and with Brazil in February 1972). Chile's national list was revised biennially.

Progress was much slower than had been originally hoped for, however. Agreements were difficult to make. The share of LAFTA in Chilean trade remained constant in the last half of the 1960s. Moreover, in 1969, as part of the over-all trade liberalization program, some of the previous discrimination in favor of LAFTA countries was reduced. Prior-deposit requirements for third countries were eliminated in cases in which imports from LAFTA exceeded $30 million, and the lists of permitted imports were expanded to include all the items covered by LAFTA agreements.

However, in part because of the apparent stagnation of LAFTA, the Frei government took an active role in the promotion of the Andean subregional group throughout the period of its formation which was initiated by the Bogotá agreement of August 1966, right through to the signing of the final accord, in 1969, by Bolivia, Chile, Colombia, Ecuador, and Peru. This agreement had as its aim the creation by 1981 of a free-trade zone, common external tariffs, and uniform policies.

The Allende government continued to encourage the development of Andean economic relations. In mid-1971 a common investment code was established to regulate foreign capital movements, royalties, licenses, patents, and brand names. In 1972, the Andean group reached a decision on how to allocate 73 industrial divisions among the five member countries, thus passing what many observers had considered the most difficult test for this relatively new trade-aid-investment grouping.[24] Moreover, when the list of goods subject to the requirement of a 10,000 per cent prior-import deposit was greatly expanded, in April 1971, imports from LAFTA and from the Andean group were exempted. As a result, effective preferences for imports from regional suppliers became fairly considerable.

## 4.2 EXPORT POLICIES

Major features of Chile's export policies include the following:

i. The over-all export regimes have not been as complicated as the import regimes because total export value is mainly concentrated on just a few products.

ii. For the same reason, major changes in the over-all export regimes have often not coincided with major revisions of the import regimes.

iii. Over the long run, control over the most important export source, large-scale copper mining, has shifted steadily (albeit with short-run reversals) from the foreign-owned copper companies and the U.S. government to the Chilean government. This process culminated in the nationalizations of 1971.

iv. For the first quarter-century after the Great Depression, large-scale mining was subject to a curious combination of very unfavorable NERs for local costs and very favorable NERs for imported components. Moreover, at that time and up until nationalization, returns on foreign-owned factors of production and amortization were practically unregulated.

v. Quantitative restrictions generally have been imposed on specific export products only at times of domestic supply shortages. Most commonly, the restricted products have been agricultural in origin.

vi. Since the beginning of the 1930s, special favorable treatment has been given to nitrates, the former queen of Chilean exports but long a faltering industry. This example suggests that not only vested interests created by import-substitution policies but also those created by export-promotion policies may be difficult to ignore once they are entrenched.

vii. Export-promotion attempts have accelerated in recent phases, but still have had limited coverage and probably have not compensated for the disequilibrium NER policy (see section 5.2). Most of the limited resources involved in such programs, moreover, has been used to subsidize industries for reasons other than their export potential.

### 4.2.1 Large-Scale Copper Mining.

In the 1930s, copper reclaimed from nitrates the position it had held before the War of the Pacific as the dominant Chilean export. Since 1931, the output of large-scale copper mining has accounted for over half of Chilean exports. In 1934, the Chilean share of world copper production also exceeded 20 per cent for the first time in more than half a century. The resurgence of copper occurred almost entirely among the foreign-owned, large-scale companies.

Prior to the Great Depression—and especially before the income tax law of 1925—government policy toward large-scale copper mining had been almost nonexistent. In the Phase II quarter-century from 1931 to 1955, however, government policy favorable to the industry was expanded considerably, and numerous policies were specifically tailored for this industry. Major tools included the multiple exchange-rate system, taxes, international price agreements, and a Chilean copper sales monopoly.

*Exchange-rate policy* had four basic components:

i. Dollars for local production costs were converted into domestic currency at the official NER, which remained constant at 0.01937 escudos per dollar from 1937 on (column 1 in Table A.7). The amount converted was called the legal cost of production. It supposedly reflected actual production costs. But the annual determination of legal costs of production included an element of bilateral bargaining between the government and the companies because of the ever-greater incentive for the companies to reduce domestic currency outlays. The increase in this incentive is clear from the decline in the official PLD-NER—from 7.900 escudos per dollar in 1939 to 0.256 in 1955 (column 1 in Table 3.2).

ii. Dollars for local costs of new investment were converted at the official NER until 1948, at the bank spot NER of 0.043 escudos per dollar from 1948 through 1950, and at the provisional 0.060 NER thereafter. After 1947 a higher NER was allowed for these expenditures than for local labor and variable inputs in hopes of encouraging capacity expansion. As a result, the decline in the PLD-NER for such investment costs was not as great as for local operating expenses, but it still was quite substantial (columns 1, 7, and 10 in Table 3.2).

iii. Direct taxes and imported inputs and investment goods were paid for in dollars without any government intermediation. The incentive to use imported inputs (including labor paid in dollars) in place of domestic inputs increased tremendously because of the above-mentioned declines in PLD-NERs for domestic currency expenditures.

iv. Except for local purchases and taxes and while under the sales monopoly discussed below, the foreign-owned large-scale mining companies generally were *not* required to return their proceeds to Chile. Payments for foreign-owned factors, thus, were unregulated. In this respect these companies enjoyed a unique position among Chilean exporters.

*Taxes* on large-scale copper mining were increased steadily in this quarter-century. Direct taxes were the most important in magnitude, but other taxes also were significant. A sampling of relevant tax-rate changes illustrates the steadily increasing tax burden. In 1939, Law 6334 added a 15 per cent tax for the use of CORFO. In 1940, Law 6457 raised the fourth-category income tax to 9 per cent on mining plus 6 per cent on companies incorporated outside of Chile. In 1941, Law 7145 instituted a 3 per cent surcharge to both relevant components of the fourth-category income tax. In 1942, Law 7160 established an additional tax of 50 per cent on any added income due to increases in the price of copper beyond the base levels established by the same law. In 1944, Law 7750 introduced a temporary fourth-category income tax of 2 per cent for two years. In 1952, Law 7160 increased the additional-tax rate from 50 to 60 per cent. In 1954, Law 11575 imposed a 30 per cent surcharge. The employee contributions to the social security system, moreover, were increased in several steps from 16.43 and 3.1 per cent in 1940 for white- and blue-collar workers, respectively, to 34.36 and 34.20 per cent in 1955.

Copper *price agreements* were in effect in 1942–46 and in 1950–52, although not at the instigation of the Chilean government in the latter case. In 1942 the Chilean and United States governments signed a wartime agreement which lasted until the end of 1946. This agreement fixed the price of copper at 12 cents per pound and waived the United States tax of 4 cents per pound on Chilean copper going to the United States government stockpile.

In 1950, because of the Korean conflict, the U.S. Office of Economic Mobilization unilaterally set the price of copper at 24.5 cents per pound. The failure even to consult with Chile (in contrast to the 1942 price fixing) caused major indignation there. Because of this reaction a conference was arranged, resulting, in 1951, in the Washington Treaty, which established a three-cent-per-pound surcharge for the Chilean government; excluded 20 per cent of large-scale mining copper production from the price ceiling; set up a wage bonus for production increases; and conferred United States credits for imports of machinery and equipment for domestically owned small- and medium-scale copper mining companies. Despite this temporary resolution, the arbitrariness with which the United States had acted left a bitter taste.

In 1952, in response to the 1950–51 copper-price-fixing experience, Law 10255 was enacted. It superseded the Washington Treaty and established the Chilean *monopoly on copper sales.* The Central Bank was authorized to set quotas on copper exports from large-scale mining companies and to buy copper from them at the New York price of 24.5 cents per pound for resale at 35.5 cents per pound, with all profits credited to the Treasury. In 1953 the international copper market weakened considerably owing to the termination of the Korean War, but the Central Bank continued trying to apply the same policy. The result was that large stocks accumulated, most of which were sold at world market prices at the end of the year. In 1954, international copper market conditions further deteriorated. The government announced its intention of selling to the Union of Soviet Socialist Republics. However, a (coincidental?) purchase of 100,000 tons for the United States government stockpile in March reduced the backlog. Soon thereafter the Chilean government abandoned its sales agency.

By the 1950s dissatisfaction with the large-scale copper mining companies was considerable and widespread. From the point of view of the companies, the trade regime had limited the control of their operations, reduced the returns from their investments, and made maintenance of market shares difficult (especially for Anaconda). From the point of view of the Chilean government, negative features included the fall in Chile's share of world copper production from 20.2 per cent in 1934 to 19.2 per cent in 1944–46 and to 11.8 per cent in 1953–54, the drop in net returned value over the 1952–54 period of 16.7 per cent because of reduced sales, and the attenuation in the linkages of large-scale mining to the rest of the economy.

In 1955, therefore, the large-scale copper mining companies and the Chilean government agreed on a *Nuevo Trato* ("new deal") for large-scale copper mining. The *Nuevo Trato* was a considerable rationalization and liberalization of the treatment of large-scale copper. This agreement changed the regime in a number of significant respects: (i) All previous charges were replaced by a single direct tax on profits. (ii) The basic tax rate was to be 50 per cent, with a surtax no greater than 25 per cent. The surtax was an inverse function of quantities and became zero when production reached approximately 190 per cent of the 1949–53 levels (or 140 per cent of previous peak levels). (iii) The limit on depreciation allowances was increased from 5 to 20 per cent of the value of plant and equipment. (iv) Exchange-rate discrimination against large-scale copper mining companies was ended.[25] (v) A government copper corporation (Corporación del Cobre; CODELCO) was established to create national expertise in copper, control exports and quantities, encourage the use of local factors of production, and prepare statistics.

The *Nuevo Trato* was the basic law governing large-scale copper mining for more than a decade. Changes were made during that time, but they did not modify the basic character of the regime. After a few years, however, dissatisfaction once again was widespread. Many Chileans thought that too many benefits had been given to the companies.[26] On the other hand, the companies wanted further guarantees before they expanded their capacities. They shelved new investment plans in 1960 and 1961 because the government would not agree to a twenty-year guarantee against changes in the tax rates and against expropriation. In late 1961, after an impasse had been reached, the legislature responded by authorizing two special surtaxes totaling 13.0 per cent on the profits of large-scale mining. The Socialist party also introduced a bill (which was not passed) to nationalize large-scale copper mining with compensation of $209 million in the form of 3.0 per cent, thirty-year bonds.

In the 1962–64 phase, discriminatory exchange-rate policy was reintroduced as transactions other than with large-scale mining were shifted from the bank spot NER to the bank future NER (see section 3.2). In 1964 CODELCO established a Chilean copper producers' price for use in Chilean sales instead of the United States producer price.

In 1965–70 under the Frei government the frustrations with the results of the *Nuevo Trato* culminated in several major changes:

*Price policy* was altered substantially. The Chilean producer price had been established in 1964, but on the average the price for that year was 0.6 cents per pound less than the United States producer price and 13.3 cents per pound less than the LME (London Metal Exchange) price. On the average in 1965 the Chilean producer price was 0.7 cents per pound more than the United States producer price, but was 23.2 cents per pound less than the LME price. In 1966, however, CODELCO broke sharply with the United States producer price by establishing a Chilean price equal to the average of the LME spot and future prices in August and to the LME future price in October. Subsequently, in 1968, in agreement with the other major copper-exporting developing nations (Zambia, Peru, and the Congo) the Chilean producer price was set equal to the LME spot price. As a result of these price changes, the Chilean producer price per pound exceeded the monotonically increasing United States producer price on the average by 18.0 cents in 1966, 11.7 cents in 1967, 11.4 cents in 1968, 19.1 cents in 1969, and 5.9 cents in 1970.[27]

The government raised *tax rates* on large-scale copper mining. In 1966 it established a 100 per cent surtax on the first 55,000 tons sold at over 42 cents per pound.[28] In 1967 Law 16624 increased the direct-tax base rate from 50.0

to 52.5 per cent. In 1968 the government levied a surtax according to a graduated scale for all sales at prices greater than 40 cents per pound, with the marginal rate ranging from 54 per cent at 40 cents per pound to 70 per cent at 50 cents per pound and higher.

Much more fundamental changes occurred in regard to the *control of Chilean copper.* In his 1964 election campaign, Frei had promised to seek a large increase in copper production capacity and some kind of Chilean participation in the ownership of large-scale copper mining. Even before the inauguration, his representative, Raul Saez, began to negotiate with Kennecott. In 1966, after long negotiations with each of the foreign companies involved and equally long debates in Congress, large-scale copper mining was "Chileanized" under Law 16425 and Decree Law 16624.

These laws included four major provisions. (i) Large-scale copper mining capacity was to be expanded from 580,000 short tons in 1964 to 957,500 short tons in 1970–72 with investments of $147 million in Anaconda properties, $230 million in Kennecott properties, and $157 million in Cerro Corporation properties.[29] (ii) The Chilean government became a 51 per cent owner of El Teniente (with 49 per cent remaining with Braden, a Kennecott subsidiary), a 25 per cent owner of the new Anaconda venture at Exótica (but not of Chuquicamata, the major Anaconda mine, nor of El Salvador), and a 25 per cent owner of the Río Blanco mine being developed with the Cerro Corporation. (iii) Base tax rates were lowered to 44 per cent for El Teniente, 52 per cent on the Anaconda properties (but with accelerated depreciation and the tax rebate for refining in Chile removed so that most benefits would not be received until the late 1970s), and 15 per cent (plus 30 per cent on Cerro's dividends) for the Río Blanco venture. (iv) The share originating in Chile of total world production of each company was not to be reduced when the company's total world production fell.

Two years later, in June 1969, Chile nationalized the Anaconda properties of Chuquicamata and El Salvador. This nationalization gave the Chilean government 51 per cent ownership as of January 1, 1970 (but with participation in profits as of September 1, 1969). The cost of the purchase of 51 per cent ownership was $197 million to be paid in 24 semiannual installments at 6 per cent interest starting on June 30, 1970. The other 49 per cent was to be purchased starting sometime after 1972 but before 1982 and continuing for twelve years more on terms which were to depend on net profits after January 1, 1970. Immediate government participation in profits was instituted for prices above 40 cents per pound. Owing to this nationalization, in 1970 the respective legal participation rates of the Chilean government in profits from the two former Anaconda properties were 75.647 and 76.676 per cent plus the surtax for prices above 40 cents per pound.

Allende, as well as most members of his Popular Unity coalition, had been quite critical of the terms of Chileanization and nationalization of copper under the previous government. In his first month of office the Central Bank revoked access to the bank future rate for any company entitled to only partial surrender of its export proceeds. In his second month of office, Allende sent to Congress a proposed constitutional reform which, together with a general affirmation of the absolute dominion of the state over all subsoil deposits, established specific mechanisms for the complete nationalization of large-scale copper mining. On July 11, 1971, this constitutional reform was unanimously approved by Congress. Five days later the state assumed complete control of the mines.

The constitutional amendment authorized the government to pay the previous owners the book value[30] of the companies minus debts to the state, unpaid taxes, alleged damage to the mines, and "excess profits" since the 1955 *Nuevo Trato.* This payment was to be made over a period of not more than thirty years at an interest rate of not less than 3 per cent. An appeal procedure was established with a special five-man copper tribunal[31] (whose decision would be final) for the foreign companies if they did not agree with the payments so determined. Subsequently the Chilean government publicly pledged to pay off foreign-debt obligations, totaling more than $700 million, which had been assumed by the companies in the large investment program for expanding capacity initiated during the previous phase.[32]

On September 28, Allende stated that the two principal foreign copper companies involved, Kennecott and Anaconda, owed Chile $774 million in excess profits. On October 11, the Comptroller General announced that Kennecott and Anaconda were due no compensation and that Cerro was due a compensation of $14 million.[33] Anaconda and Kennecott appealed these decisions to the special tribunal. In August 1972 the tribunal disallowed the appeals of the copper companies.

Meanwhile, another controversy arose. On December 31, 1971, Chile failed to meet the first installment of $5.8 million in promissory notes due to Kennecott because of still-pending decisions concerning the usefulness of the investment undertaken with the proceeds of these notes. At the same time Chile failed to meet a $14 million obligation due to Anaconda (at least in the judgment of Anaconda) because the government interpreted the decision of the Comptroller General to mean that such obligations were void. In response, Anaconda and Kennecott sought and obtained United States court orders embargoing the New York bank accounts of nine Chilean government agencies. Chile reacted by embargoing all remaining properties of the two companies in Chile, but also announced it would honor $84.6 million of the $92.7 million in promissory notes held by Kennecott.[34] In 1972 and 1973, in further reaction to the nationalization and debt repayment issues, the United States companies succeeded in obtaining court orders that delayed the unloading of Chilean copper in Europe.[35]

### 4.2.2 Other Exports.

In 1932 Law 5107 established license requirements for all exports except those from large-scale mining to ensure the return to the government of a predetermined sum of foreign exchange at a stipulated price or the return by exporters of imports of "primary necessities" previously agreed upon. The NERs for such exports were more favorable than those for large-scale copper mining, but usually not as favorable as for many other imports (see section 3.2).

Throughout the next four decades the general characteristics of the regimes for these exports remained basically the same, although the option of using export proceeds directly for imports was not generally continued. Export licenses were granted automatically if the exporter agreed to ship the exports within a specified period, repatriate all the proceeds within a second specified period after shipment, and liquidate them within a third specified period.[36] As is described in section 3.2, exports steadily were moved to higher NERs, although the applicable PLD-NERs tended to decline.[37] As is also indicated in section 3.2, variations in the PLD-NERs among exports were at times quite considerable. Baerresen [1966:3] claims that the favored exports were determined largely by political influence.

Three exceptions to the general export regimes have been important: quotas on specific products, special regimes for traditional mining exports, and special regimes to promote nontraditional exports:

*Quotas on specific products* (sometimes completely prohibitory) have been a part of export policy since the early 1930s. Their purpose has been to ensure sufficient domestic supplies. The list of quota goods has been changed on the average at least once a year. The quotas have primarily been on agricultural and food products, although the export of other industrial products also has been constrained at times.[38] The government has tended to use such restrictions more when the over-all regime has been relatively restrictive. Even during the most liberal phases, however, quotas have been enforced on specific products in short supply—especially after poor harvests of agricultural commodities. Such quotas have been very important for the affected commodities[39] but generally have not been very broad in their impact.

The most important *special regime for traditional mining exports* (except for large-scale copper mining, on which see subsection 4.2.1, above) has been that for nitrates. In fact, the very first important special regime, established in 1931, was for the nitrate industry, which had once been dynamic, but by then was ailing.[40] In 1931 a monopoly (Compañía de Salitre de Chile) controlling approximately 95 per cent of Chilean nitrate production was formed to attempt (unsuccessfully) to affect world nitrate prices. There was a strong negative public reaction to this attempt because of the associated takeover of $25 million in Guggenheim financial obligations. In any case, President Alessandri dissolved the company in 1933.

In 1934 Law 5340 ratified an agreement between nitrate enterprises and the government which established the basic framework for the special regime in nitrates that was to prevail for the next several decades. This law created the Nitrate and Iodine Marketing Corporation (Corporación de Venta de Salitre y Yodo; CONVENSA) with representatives of both the nitrate enterprises and the government (the latter had veto power) on its board of directors. CONVENSA was given monopoly power over Chilean nitrate sales and entered into the international nitrate cartel. The government was to receive 25 per cent of the profits. Among other things, the major nitrate enterprises received exemptions from indirect taxes on their imports of equipment, machinery, fuel, electrical detonators, chemical imports, and containers. Indirect taxes on nitrate exports—once a major source of government revenue—were eliminated. Thus, a long-enduring policy of subsidizing production and exports of nitrates by special tax exemptions was begun, although such advantages may have been more than offset by the overvalued exchange rate and the government share of profits, at least in more recent years (see the estimates of the nitrate EPRs in section 5.2, below).

Subsequently, further benefits were added,[41] and the name was changed in 1968 to the Chemical and Mining Company of Chile (Sociedad Química y Minera de Chile S.A.; SOQUIM). The basic characteristic of the special regime for nitrates, nevertheless, has remained the same since the 1930s. In the 1960s and early 1970s, it accounted for 6 to 7 per cent of all imports under special regimes. In the late 1960s it was also one of the primary beneficiaries of the drawback program discussed below.

A second important special regime for traditional mining exports has been that for small- and medium-scale copper mining. This sector has been under Chilean ownership and control since before the War of the Pacific, at which time it accounted for as much as 40 per cent of total world production. Provisions of this special regime have included tax exemptions and special investment credits.[42] In 1970 it accounted for 8 per cent of total imports under special regimes.

*Special regimes to promote nontraditional exports* have existed since the 1930s. In that decade, some exporters, as is noted above, were free to utilize their foreign-exchange proceeds directly. Gold exports, for another example, were made at a favorable NER.

A number of special regimes established in the early and mid-1950s also incorporated an element of export promotion. In 1953 the fishing industry was allowed directly to utilize the foreign exchange it generated. Drawbacks were given for products made exclusively from raw materials originating in Arica, Iquique, Pisaqua, Tattal, and Chanaral, which were under regional special regimes (see subsection 4.1.5.1). Special favorable NERs for gold and wine also were available (see section 3.2).

Starting in the late 1950s, however, more general attempts at export promotion were initiated. In 1958 Law 12861 established a special regime for specific exports including (i) exemptions from indirect taxes and customs duties on material inputs applied to operations directly concerned with exports; (ii) rebates of taxes if an exporter could demonstrate that they affected the cost of his exports; and (iii) automatic refunds of taxes, after exportation, at fixed percentages of f.o.b. values, ranging from 0.015 per cent for copper or brass plates or sheets to 26.8 per cent for bulk wine shipments (but from 3 to 6 per cent for most other products). In 1960 these tax exemptions were modified. In 1961 special pre- and post-shipment credits were added.[43] In 1963 a new regime designed to increase exports was established for foreign capital investments.[44] Also in 1963 new lines of preshipment credit were established for agricultural and nontraditional exports.[45]

Despite these greatly expanded provisions, export promotion was not notably successful in the early 1960s. Agricultural exports for 1960–64 remained at about the 1955-59 level. Industrial exports other than of copper declined from 1959 through 1963, although they rose in 1964.

The Frei government, therefore, created a new export-promotion regime. Its basis was established in 1966 by Law 16528 and Central Bank Circular 734. The provisions of Law 16528 included the following: (i) For a specific list of exports[46] refunds of up to 30 per cent of the c.i.f. or f.o.b. value were made on the basis of tax incidence. (ii) The list or the percentage rates could be increased at any time, but could be decreased only after three years.[47] (iii) Foreign exchange from such exports was converted into escudos at the most favorable legal rate from the point of view of the exporter as of the date of export or the date of the return of the export proceeds (at the choice of the exporter).

Central Bank Circular 734 established two types of export-promotion credits: (i) preshipment credits in domestic currency for 126 specific products for up to 80 per cent of the f.o.b. value for 180 days at 9 per cent interest, refinanced entirely by the Central Bank;[48] and (ii) postshipment credits in foreign exchange for a smaller group of products for up to 80 per cent of the f.o.b. value for from 180 days (lowered to 90 days in July 1967) to two and a half years at 9 per cent interest, refinanced entirely by the Central Bank. For those 52 mostly industrial products eligible for both pre- and postshipment credits, the latter cancelled the former.

In late 1966 Decree 1224 of the Ministry of Economics implemented the new regime. It created a list of about two hundred new drawback rates ranging from 0.282 per cent to 29.29 per cent.[49] Products with rates over 10.0 per cent included bulk wine, 29.29 and 27.787 per cent; calcium carbonate, ferromagnesium, and ferrosilic magnesium, 26.0 per cent; newsprint, 20 per cent; champagne and cider, 18.838 per cent; ferrosilicone, 18.0 per cent; bottled wine, 14.038 per cent; and lead minerals and lead concentrates, 11.127 per cent.

Subsequently, more items were added to the list until in mid-1969 it totaled 331 products. Jul [1969:114–117] distinguishes three categories of listed products: (i) Group A—those items on the list as of October 1964 which legally had to be retained at least at the same rates; (ii) Group B—products included explicitly by Law 16528 or by petition of some government agency "for reasons independent of the promotion of exports;"[50] and (iii) Group C—products included for export promotion after the completion of technical studies concerning their potential. In 1966, 1967, and 1968, the respective shares of total drawbacks accounted for by each of these three categories were as follows: A—10, 10, and 3 per cent; B—80, 65, and 66 per cent (with fish meal and fish flour alone accounting for 60, 34, and 27 per cent); and C—10, 25, and 30 per cent (with agricultural and sea products alone accounting for 5, 18, and 23 per cent). An increasing but small proportion of the drawbacks, thus, was devoted to products in which Chile was deemed to have potential comparative advantage.

In 1969 Decree 124 of the Ministry of Economics lowered the rates for 40 products and eliminated the rates entirely for 160, primarily in Group A. These reductions were allowed because the rate of increase in the exchange rate had exceeded the rate of increase in the relevant domestic price index. Selowsky [1971:9] reports that the major drawbacks in effect after this modification were for paper and fish flour (30 per cent); steel and iron (26 per cent); wood (24 per cent); wool (22 per cent); matted rye, fresh fruits, and oils (20 per cent); cardboard, semi-elaborated copper, and beans (16 per cent); onions and garlic (14 per cent); frozen fish products, cellulose, and ferromolybdenum (12 per cent); and molybdenum oxide (9 per cent). According to unpublished Central Bank data, the distribution of drawbacks across sectors for 1969–70 was 23.0 per cent for agriculture, 16.5 per cent for mining, 50.4 per cent for industry, and 9.6 per cent for others. Paper and related products, food products (including fish meal and oils), and nitrates accounted respectively for 24.2, 19.3, and 11.7 per cent of the total.

In mid-1969 preshipment credits accounted for about 0.6 per cent of total credits. They were distributed primarily to cement (33 per cent), agricultural products (22 per cent), sea products (18 per cent), vehicle parts (17 per cent),[51] and paper products (11 per cent). At that time, $104,273 in postshipment credits were outstanding (equal to 0.6 per cent of the value of promoted exports in 1969). They were distributed primarily to machinery parts (55 per cent), chemical products (29 per cent), wood products (9 per cent), and bronze products (8 per cent).

The Allende government from the start stated that it would use expanded drawbacks and credits to promote exports and to help provide a protective buffer between world markets and exporters. In 1971 a number of decrees of the Ministry of Economics and Circulars of the Central Bank generally increased the scope of the drawback system and of the pre- and postshipment credit programs. In that year drawbacks increased approximately 50 per cent in constant escudo terms.[52]

## 4.3 POLICIES FOR OTHER INTERNATIONAL ECONOMIC TRANSACTIONS

Basic characteristics of these policies include the following:

i. Tourism and other personal expenditures have been treated as nonessential luxuries and have been among the first to be restrained at times of foreign-exchange shortages. As a result, the pattern of restraints on these expenditures has coincided quite closely with the over-all restrictiveness of foreign-sector policies.

ii. A number of regimes for foreign investment have prevailed in recent decades. The regulations in these regimes often have been quite specific, and many agreements have been negotiated on a case-by-case basis. A basic objective of most of them is to limit short-term capital movements. This concern, perhaps somewhat paradoxically, has resulted in much greater constraints being placed on capital repatriation and related payments for new investments than for large-scale copper mining.

iii. There was a resurgence of capital inflows on government account after 1955 as part of stabilization and public works programs. As a result, foreign debt increased to one of the highest per capita levels in the world in the 1960s and early 1970s. Therefore, debt payments and debt renegotiations have greatly constrained the options of recent governments.

Three features of NER policies for nongoods transactions should be noted (for details, see section 5.1.1): (i) The applicable NERs generally have been higher than those for most goods trade. (ii) The applicable NERs generally have been increased earlier than those for most goods trade at times of foreign-exchange crises. (iii) The gap between the NERs for goods and for nongoods transactions has narrowed in the early part of all of the more liberal phases.

To obtain EERs for nongoods transactions, of course, other policies must be considered, for example, indirect tax policy. As the following brief review of tax policy suggests, tax rates became significantly high only in recent years.

In August 1954 a tax of 0.015 escudos per dollar was levied on nonmerchandise international transactions. At that time it was equivalent to a 9.4 per cent tax rate, but by the time it was abolished, in 1957, it was equivalent to a 1.9 per cent tax. In August 1956, a 1 per cent tax was established. It was increased to 5 per cent in January 1957, reduced to 1 per cent in July 1957, increased to 2 per cent in February 1958, and abolished in April 1959. In 1964 a 4.0 per cent tax was applied on all purchases of exchange in the brokers' market (except those for which the Central Bank had approved a transfer application). The tax was increased to 6.0 per cent in July 1966, to 10 per cent in January 1967, to 15.15 per cent in January 1970, and to 33.15 per cent in March 1971. In late 1969 the tax was extended to cover capital imported in the form of foreign exchange and re-exported within a year of entry (as well as any related interest and profits on such capital). The minimum waiting period for avoiding this tax was increased to 18 months in May 1970 and eliminated entirely in December of that year.

Most nontax policies affecting nongoods transactions have varied substantially among the different categories of such transactions.[53] In the rest of this section, policies for some of these major categories are reviewed.

### 4.3.1 Tourism and Other Invisibles and Imports for Personal Use.

In recent years quantitative limits on this category of foreign-exchange use have been modified quite frequently. In May 1964, for example, maximum foreign-exchange allocations for travel were established at $300 for Latin American trips and $1,000 for all others. During the foreign-exchange shortage of 1965 these maximums were reduced. In September 1966 they were increased.[54] In the last half of 1968 they were reduced below the 1965 levels. In May 1969 they were increased to the 1966 levels. Between June and September 1970 the Central Bank openly ignored the limits. In October 1970 the maximums were again lowered; at the same time, children under seven were allowed only 50 per cent of the maximum, and a minimum period of 30 days between purchases was established.

Under the Allende government the maximum travel allocations generally were reduced, and the restrictions were made more specific. In November 1970, for example, Central Bank Circular 1454 established maximums of $100 (but no more than $25 per day) for travel within 500 kilometers of the Chilean border, $300 (with a maximum of $30 a day) for travel to other parts of Latin America and the Caribbean, $480 (with a maximum of $30 a day) for travel to the United States and Canada, and $720 (with a maximum of $30 a day) for travel beyond the Western Hemisphere.[55] During the next year a series of Central Bank circulars lowered these limits by 25 to 40 per cent, established an annual total maximum of $540, and introduced more complicated administrative procedures for travelers. Also, the export of Chilean bank notes was limited to 20 per cent of the travel allocation for residents and was prohibited for nonresidents. In addition, all foreign tourists were required to declare all foreign currency that they brought into Chile and to exchange a minimum of $10 per day for adults and $5 per day for children ($8 and $4 per day, respectively, for stays of over a week).[56]

Quantitative restrictions on foreign exchange for other personal uses followed the same general pattern over time as did those on travel. The limits in effect early in the Allende regime are suggestive of the types of transactions so restricted: $100 a month (with an annual maximum of $600) for each beneficiary of family maintenance; $50 a month for books, $200 a year for periodicals; $50 a year for student registration fees; $50 a month for medicine not available in Chile; $1,200 a year for previously contracted insurance premiums; approval of the Superintendency of Insurance for newly contracted insurance premiums; and to obtain foreign exchange for medical treatment abroad, certification of the need for such treatment plus a 200 per cent deposit guarantee.

### 4.3.2 Foreign Investment Other Than in Large-Scale Copper Mining.

Ellsworth [1945:79] claims that a conscious campaign to reduce the rights of foreign investors was pursued vigorously in the 1930s. As supporting evidence, he points to the above-mentioned attempts to establish a state trading monopoly in petroleum and to obtain national ownership and control in the nitrate industry. The default on foreign-debt payments in 1931 (see below) and the existence of exchange control also may have discouraged foreign investment. The prospects for attracting substantial new net foreign investment before the late 1940s were dim in any case, however, because of the Great Depression and the Second World War.

In the early postwar period, as is described in section 3.2, more favorable NERs were allowed for capital inflows in the form of foreign exchange. In late 1950, moreover, transfer guarantees for foreign investment registered upon entry were introduced in a further attempt to encourage foreign direct investment. CORFO also was attempting to facilitate such investment by providing information and other services.

In late 1953 a government decree substantially modified the terms under which new foreign capital could be brought into Chile. Such capital was granted favorable treatment when invested in export industries that could compete on the international market without government assistance; in production for the domestic market of goods that had previously been imported; or in industries in which at least 80 per cent of the raw materials were Chilean in origin and were used in the production of goods for the domestic market at reduced cost to the consumer. The Foreign Investment Commission supervised each application on a case-by-case basis and decided whether or not a particular applicant met the necessary conditions and, if so, exactly what the nature of the terms would be. For approved enterprises the following general guarantees and exemptions were allowed: (i) repatriation of capital after five years in annual quotas not exceeding 20 per cent per year of the value of the investment; (ii) transfer abroad of earnings on the investment for a period of at least ten years and possibly up to twenty years; (iii) exemption from all customs duties and charges on imported machinery and equipment; (iv) a guarantee that no applicable taxes would be changed for at least ten years; (v) freedom for at least ten years from price-fixing regulations and from controls affecting industries in which the investments were made; (vi) the right to re-evaluation of capital for tax purposes in accordance with exchange-rate fluctuations; and (vii) the rights and exemptions in ii and vi above for the reinvestment of earnings on such capital.

Decree Law 258 of 1960 (supplemented by Decree Law 1272 of 1962) established more favorable terms for bringing some capital into Chile. This decree covered new capital brought into Chile in the form of foreign currency, credits, or plant and equipment for the purpose of introducing, developing, improving, or resuming activities related to agriculture, mining, fishing, or any other industry officially defined to be in the national interest. Such capital was exempted from all customs duties and fees on related imported machinery and equipment. It also could receive many specific presidential decree privileges and guarantees for ten years (and in special cases, twenty years), covering such matters as future taxation, depreciation allowances, withdrawal of capital, and remittances of profits.

In 1962 Decree Law 1272 established an alternative set of regulations under which capital brought into the country in the form of foreign exchange could be sold freely in the brokers' market after registration with the Central Bank. These regulations included a nontransferable guarantee of free withdrawal of principal through the brokers' market, but prior authorization by the Central Bank was required for remittance of profits or interest. The foreign investor also could enter into a capital participation agreement with a Chilean entity and have the option of the bank or the brokers' market for entry and subsequent exit of capital and related flows (but exit had to take place in the same market as that chosen for entry), subject to a minimum investment period of three years.

In 1966 the Central Bank modified Decree Law 1272: foreign exchange for repatriation of all earnings on imported capital would be guaranteed under this decree provided that (i) the investment was deemed to be of importance to the Chilean economy; (ii) it had a value of at least $100,000; (iii) the capital stayed in the country for at least three years and subsequent repatriation occurred at a maximum rate of 20 per cent per year; (iv) the exchange was sold in the bank market; and (v) the interest rate on credit to Chilean firms did not exceed the rate prevailing in the domestic market of the investor. The apparent motivation for these changes was the same as for a number of other policies of this phase: export promotion, minimization of transitory capital movements, and governmental control over the form of capacity expansion in order to attempt to assure the most socially productive uses.

Under the Allende government, official policy was to encourage foreign investment, especially in mixed enterprises in which the government had majority control. Such investment, however, was subject to two important provisos: that it did not replace domestic investment and that it helped in the fulfillment of the economic plan. Foreign concerns which already operated in the state area of activity or which were otherwise not consistent with the economic goals of the government were to be nationalized.[57]

### 4.3.3 Official Capital Flows and Foreign Debts.

Before the Great Depression Chile had considerable official foreign-debt obligations (columns 12 and 13 in Table 1.1). With the Great Depression, however, foreign sources quickly dried up. Payments on past debts soon were depleting foreign-exchange reserves. Therefore, in mid-1931 Chile suspended payments of the service charges on foreign debts. In 1936 such payments were resumed at lower interest rates.

Over the next quarter-century or so, official capital inflows were welcomed. Sources included bilateral flows from the United States and Western European countries and flows from international agencies such as the International Monetary Fund.[58] A large proportion of this capital was destined for CORFO-sponsored projects or for stabilization funds related to the 1956 and 1959 attempts at stabilization plus liberalization. Official foreign debt increased substantially during the 1956–61 period because of the conscious decision to finance continuing government deficits abroad in order to lessen short-run inflationary pressures. In the early 1960s the Alliance for Progress provided further official inflows—which also increased the foreign debt (line 1.2.6.5 in Table A.1).

At the start of the Frei administration, foreign-debt payments were of considerable concern. Estimated debt-related obligations in 1965 of $367 million—together with the estimated outflow of $114 million for profits and amortization—would have absorbed almost 70 per cent of the value of exports for that year. As a result the foreign economic regime in some respects was made more restrictive at the start of 1965, as is discussed above. Chile successfully renegotiated the payment of her foreign debt in that year. Immediately thereafter the government became at least verbally concerned about contracting any future foreign debt. In December 1966, for example, the government renounced the acceptance of any more program loans from abroad—although such loans apparently were being accepted again by mid-1967. Also in 1967 a new external source of funds was established with the signing of an agreement with the USSR for the equivalent of $57 million in credits at terms apparently favorable to Chile.

In part because of the debt rescheduling in 1965, the Allende government inherited a fairly large foreign debt—approximately $3 billion at the end of 1970. According to Minister of Finance Zorrilla [1970:1478,1489] (also see Cauas and Corbo [1972:22] and Gunder-Frank [1972:16–18]), the aims of policies regarding official capital flows and foreign debts were to honor past obligations;[59] reschedule payments on foreign loans; reduce future dependence on foreign sources by resorting to them as little as possible and only under centralized state procedures; diversify the sources utilized in the future; and cease to be constrained by IMF policies and procedures.

Through most of 1971, Chile met her scheduled debt obligations. However, in November President Allende announced that Chile would request a renegotiation of debt payments with a consolidation of payments, a three-year grace period, and a long schedule of repayment.[60] Debt payments due later in that year were not made on schedule.[61]

In January and February 1972 Chile conducted negotiations in New York with forty-four private United States banks to which Chile owed more than $600 million. The result was a deferred schedule for payments due between 1972 and 1974.

From February through April 1972 Chile conducted negotiations in Paris with the so-called Paris Club (the United States and ten other major creditor nations).[62] A secret accord in April provided that Chile pay as scheduled 30 per cent of all the debt and interest payments due between November 1971 and December 1972, with six years' grace subsequently to pay those deferred payments in full; the creditors promise to study "with good will" the refinancing of those debt payments due in 1973; and the IMF periodically review Chile's monetary, credit, and trade performance.

In addition to debt renegotiation questions, another policy of the Allende government in this area was to welcome official inflows both from traditional sources, e.g., the IMF, the United States, and from new sources, e.g., the Socialist nations (on the latter, see Chapter 8).

### 4.3.4 Miscellaneous Transactions.

Most of the policies discussed in this subsection did not have a strong general impact nor a long-lasting one. At least for certain subsectors, however, they were very important for a while. Their effects are discussed in Part III, below.

In 1959 Law 13305 established a tax immunity for capital repatriated from abroad to buy tax-exempt dollar bonds. It also granted banks the authority to make loans expressed in terms of foreign currency and to pay interest on foreign-currency time deposits. With the end of the Phase IV period, in December 1961, these provisions were terminated.

In 1962 Law 14949 authorized the government to pay its internally held dollar debts in escudos at the bank spot NER, which was about two-thirds of the brokers' rate which would otherwise have been used.

In 1963 Law 15192 reserved all gold operations to the Central Bank. Later that year the Central Bank announced that it would continue to buy gold coins and bars from individuals and firms, but that it would sell gold only to industrial and professional users associated with the bank and not to other individuals and firms. In 1970 the exclusive power of the Central Bank to deal in gold was extended to all nonjewelry imports.

In 1963, the Central Bank also began to limit the rate of interest allowable on import credits for which it would provide foreign exchange. This maximum was altered a number of times in the 1960s until it was limited to the lower of the prevalent interest rate in the country of export or 1.5 per cent above the New York prime rate in 1969.

At the end of 1970 Central Bank Circular 1464 prohibited paying remuneration in foreign currency to Chileans or to non-Chileans of more than two years' residence. It also prohibited paying more than half of such remuneration in foreign currency to non-Chileans of less than two years' residence and then only with Central Bank approval.

## NOTES

1. These included specific taxes based on the 1928 law; ad valorem taxes of 3, 30, or 62 per cent of the landed value; consular charges of 3 per cent; disembarkation and embarkation charges or port charges of 1 per cent; special taxes on agricultural machinery and parts, cotton, tea, sugar, gasoline, and related imports; additional taxes; and added additional taxes.

2. For example, in February 1951, after the December 1950 reforms, CONDECOR loosened the system further by publishing a reduced list of prohibited imports. Other changes in 1951, however, increased the restrictions in a piecemeal fashion: the list of luxuries which could be imported against gold sales was revised four times, with automobiles put on the prohibited list in the last revision; a new list of imports against the proceeds of wine exports was published; and importation of certain commodities previously permitted from all countries was restricted to countries with which Chile had payments or compensation agreements. In 1952, further restrictions were introduced: on April 24, imports previously quantitatively uncontrolled at the bank spot rate or at fixed rates were suspended or transferred to quantitatively controlled fixed rates (which effectively was a reversal to the system in effect before the reforms of December 15, 1950); on June 4, the importation of luxury items was suspended; and on June 26, an expanded list of prohibited imports was published with exceptions to be made by CONDECOR if domestic supplies were insufficient or if domestic costs were more than 50 per cent above foreign costs. For details, see IMF [1950–56b] and Banco Central [1950–56b].

3. Licenses continued not to be required for permitted imports, but registration with the Foreign Exchange Commission at the time of shipment from abroad was necessary in order to receive foreign-exchange cover.

4. Some of these results would occur with almost any rationing system. Others might have been ameliorated with modifications in the system as it existed, e.g., the allowable percentage increase could be a function of past or planned growth in order not to penalize the faster-growing activities so much.

5. Exceptions to this growing liberalization were primarily of a political nature. All nonhumanitarian direct and indirect trade with Cuba was suspended between April 27, 1966, and November 19, 1970. All direct and indirect nonhumanitarian trade with Rhodesia was prohibited as of February 9, 1967. Direct and indirect nonhumanitarian trade with the Union of South Africa was banned as of June 2, 1968, with a modification as of March 5, 1968, to ban invisible transactions as well, but copper exports were allowed!

6. For example, at the end of 1970 the importation for private use of automobiles valued at over $2,500 (later reduced to $2,200) c.i.f. was prohibited.

7. Some other changes in the 1965–70 regime were motivated in large part by the need to absorb liquidity: in June 1966, the establishment of a minimum downpayment of 20 per cent of the c.i.f. value for imports on a deferred payment basis (terminated in September 1967); and establishment, in June 1967, of special terms with a rebate at a 5.0 per cent annual rate for exchange contracts for import payment cover negotiated at the time of import registration (terminated in November 1970). The former requirement also probably resulted in real costs to the importers.

8. After several months banks were limited to financing a maximum of 100 per cent of deposits for category A, 60 per cent for category B, and 30 per cent for category C. Financing of the other categories was not permitted. These percentages were reduced in 1957.

9. Exceptions were made for some items on consignment, deposits made in dollars or in 120-day no-interest Treasury dollar bonds, and some items in categories A, B, and C.

10. A 5,000 per cent prior deposit for 90 days at a real interest rate of 10 per cent cost the importer 125 per cent of the value of the import.

11. Exempt were the government, municipalities, exporters subject to the "free port" and earthquake special regimes, large-scale mining, and imports from LAFTA countries.

12. The declining importance of prior deposits is indicated, for example, by the steady fall in the ratios of the value of deposits to registered imports from 14.3 per cent in 1964 to 2.9 per cent in 1968 (Joó [1969:17]). Ffrench-Davis [1971:101] reports that the value of imports requiring prior deposits decreased approximately 40 per cent in 1967 and another 40 per cent in 1968 to a level of only about 21 per cent of all imports at the start of 1969.

13. This subsection is heavily based on the work of Jeanneret [1971:349–362]. Special regimes related primarily to exports are discussed in section 4.2.

14. A few special regimes do not fall into these categories. For example in 1960 Law 14117 established a special regime for reconstruction after the May 1960 earthquake by permitting enterprises in the affected area to import machinery and equipment with a single customs duty of 15.0 per cent of the c.i.f. value until 1965.

15. In the first ten months of 1970, for example, 34 per cent of the value of imports under special regimes went to the department of Arica, 17 per cent to the provinces of Chiloé, Aysen, and Magallenes, 16 per cent to the provinces of Tarapacá and Antofagasta, and (under a different special regime) 7 per cent to the departments of Iquique, Pisagua,

Taltal, and Chanaral and the province of Antofagasta. A similar ordering occurred in other years, although the position of the last two groups was at times reversed.

16. Arica borders on Peru, was won in the War of the Pacific, has about 0.6 per cent of Chile's population, and is 1,500 kilometers (900 miles) across the Atacama desert from Santiago.

17. Some prohibited import items, such as most vehicles, could be imported for use in the special areas alone, but could not be shipped to the rest of the country.

18. Recently there have been some exceptions to this statement. For example, in 1970 Law 17382 established a tax of 8.0 per cent on the customs value of goods imported through Chiloé. After the 1971 devaluation, moreover, the southern area received favorable exchange-rate treatment for imports already registered and for certain newly registered imports. Also in 1971 a special point system was established for automobile imports into this area, with positive weights given to the age of any currently owned vehicles, the number of years' residence in the zone, family income, and the number of quarters in which applications had been filed (all subject to the limit of $2,200 c.i.f. in value and the existence of appropriate repair and service facilities for the vehicle being imported).

19. Fontaine [1964] concludes that the net economic benefits from the sugar industry set up under this shelter were negative.

20. For example, the original ratio of the rate for A account transactions to that for B account transactions in the agreement with France was 0.463.

21. Import premiums commanded by any licensing under such agreements generally were, of course, less than those which "free-foreign-exchange" licenses would command.

22. To illustrate, at the end of 1953 accounting dollars established under the terms of payments agreements with the Federal Republic of Germany and Brazil, implied respective rates of 38 and 28 per cent above the dominant bank spot rate, and the free-sterling rate implied a cross exchange rate 35.3 per cent above the spot rate, which had increased to 158 per cent by October 1954.

23. Ellsworth [1945:95–96] reports that because of this funding, CORFO's outstanding loans at the end of 1942 already were approximately double the combined total of all the other development agencies, even though the other organizations had been in existence much longer and had substantial resources at their disposal derived from mandatory Central Bank loans.

24. Difficult decisions remain to be made for petrochemical production, automobiles and trucks, and chemicals and pharmaceuticals, but progress has been much more rapid than had been anticipated in many quarters. See, for example, Novitski [1972].

25. However, large-scale copper mining continued to enjoy the third and fourth components of the exchange-rate treatment outlined above. Moreover, this subsector was exempted from prior deposits on imports, additional taxes, and added taxes.

26. In subsection 7.1.2.3, I evaluate both the short- and the long-run effects of the *Nuevo Trato*.

27. However, the Chilean producer price was below the United States producer price for some time after July 1970.

28. However, the additional taxes of 5 and 8 per cent which had been established in 1961 were eliminated in 1966.

29. Of the investments in Anaconda properties, $58.8 million were from the United States Export-Import Bank, $5.75 million were from the Chilean government, and the rest from Anaconda. For the Kennecott properties $110 million were from the United States Export-Import Bank and guaranteed by the Chilean government, $27.5 million were from the Chilean government, and $92.7 million were on loan from Kennecott and

insured by AID (but of that $80 million in fact were from the Chilean government as the price of 51 per cent control). For the Cerro Corporation properties, $56.4 million were from the Export-Import Bank with a Chilean government guarantee on $35.4 million and $20.1 million were from a Japanese consortium with a Chilean government guarantee on $10.1 million.

30. Hector Humeres, the politically independent Comptroller General, subsequently estimated the book value to be $629 million.

31. The tribunal was composed of a representative of the Chilean Supreme Court, a representative of the court of appeals, and three officials named to their posts by Allende.

32. Welles [1971] reports that these debts amounted to $550 million of principal (including $180 million to the Export-Import Bank, $92 million to Kennecott, $100 million to five major New York financial institutions—Chase Manhattan, Manufacturers Hanover Trust, Chemical Trust, First National City, and Morgan Guaranty Trust—$50 million to the Banca Commerciale Italiana, $18 million to the Cerro Corporation, $15 million to the Japanese Mitsui group, $17 million to the Japanese Sumimoto group, plus some smaller obligations), plus $220 million in interest.

33. Adding to the confusion was a statement by Chilean Foreign Minister Clodomire Almeyda in Washington on October 7 (after Allende's announcement of the excess-profit estimate, but before the announcement of the decision of the Comptroller General) that suggested that Kennecott and Anaconda would be assessed 49 per cent of their excess profits since that was their share in the ownership of the mines prior to the 1971 nationalization (see Welles [1971]). De Onis [1971a, 1971e] claims that in May Allende committed himself to signing a negotiated settlement for $56 million for the purchase of the Cerro properties. However, he reversed his decision and never signed the agreement partly because militants in the government coalition were dissatisfied with terms of the agreement and partly because the U.S. Export-Import Bank refused to grant Chile a credit of $21 million to purchase Boeing airplanes.

34. After surveys by French and Soviet mining experts, $8.1 million were deducted from the original sum of $92.7 million because that much was judged not to have been usefully invested.

35. The post-Allende government has indicated that it might reconsider the question of compensation for the former owners, but not the possibility of returning control to them.

36. The period for shipment usually was 60 days. The period for repatriation varied from 30 to 90 days, depending somewhat upon the restrictiveness of the over-all regime. The period for liquidation generally was 10 days. Longer periods were allowed for certain promoted exports, e.g., in 1970 the shipment limit was 120 days for wood, 180 days for industrial goods and minerals, and 360 days for iron ores, and the repatriation limit ranged from 120 to 480 days for exports on consignment and for specified processed exports. Penalties were imposed for delayed returns. Such penalties were increased during the more restrictive phases. Not all of these time limits were enforced all the time, however.

37. In some cases, such as for gold and wine exports, even the NERs fell.

38. For example, in February 1971 Decree 33 of the Ministry of Economics prohibited the export of industrial products through June of that year. In January 1972, Decree 27 of the same ministry prohibited the export of certain iron products through June of that year.

39. Because of the existence of such quotas, export prices of the constrained commodities have at times exceeded domestic prices, but Chileans have not been able to

arbitrage. In such cases the ratio of foreign to domestic prices overstates the EER because it includes the premium received by the quota recipients.

40. The secular decline in the Chilean share of world nitrate production has been huge: from 66 per cent in 1901–02 to 1.5 per cent in 1960.

41. For example, in 1956 Law 12018 allowed CONVENSA to include amortization, interest, and transportation in its production costs, guaranteed a better NER, and established an investment program for the industry.

42. For example, this subsector received the special credits from the United States that were negotiated in the Washington Treaty of 1951 (see subsection 4.2.1).

43. Credits were made available to favored exporters either 90 days before shipment for up to 100.0 per cent of the returns at 4.0 per cent or with the presentation of shipping documents for 180 days for up to 100.0 per cent of the returns at 3.0 per cent. In November 1961, such credits were extended only to exporters who did not have time deposits in the banking system.

44. This regime included guarantees on access to various exchange rates and on the speed of capital withdrawal. Incoming capital was sold in the brokers' market and servicing and withdrawal was in the bank market. Remittance of profits or interest of up to 7.0 per cent per year of the invested capital was permitted. Withdrawal was allowed to start two years after entry in annual amounts up to 12.5 per cent of the invested capital, subject to the restriction that the total of servicing and withdrawal did not exceed 50 per cent of the increase in repatriated export proceeds.

45. For eligible exports, credit was available in domestic currency equal to 80 per cent of the value for a maximum of 90 days (increased, a year later, to 180 days for industrial products). This credit was refinanced in its entirety by the Central Bank.

46. This list did not include exports from large-scale mining, those which entered the country under special exemptions, semimanufactured copper products, nitrates (until 1968), or services (except for shipping which was added later).

47. However, after January 1967, downward adjustments in the rates were allowed as long as they were not greater than the amount by which the rate of increase in the exchange rate exceeded the rate of increase in the wholesale price index. At the end of 1968 the maximum downward adjustments were limited to the amount by which the rate of increase in the exchange rate exceeded the rate of increase in the consumer price index, except that fish meal and fish oil were guaranteed no decrease for three years.

48. The interest rate later was increased to 12 per cent, but still was below the rate of change of prices; so this credit carried a negative real interest rate. The period for this credit was increased to 360 days in December 1967. The periods in use in 1969 were 90 days for agricultural products, 180 days for most industrial products, and 360 days for cement sent to Argentina and Brazil.

49. A large portion of these new rates established an inverse relation between the drawback rate and the international copper price for small- and medium-scale copper mining. This decree also maintained the previously existing drawbacks at least at the same levels.

50. Among these products were fish meal and oil, paper for periodicals, cellulose, and cardboard, included as a result of solicitations by CORFO prompted by low international prices; steel, as a result of solicitation by the Minister of Economics because of low domestic prices for CAP; shipping, because of losses suffered by the merchant marine; and nitrates, because in 1968, a transfer was arranged to SOQUIM of $5 million in drawbacks, to take place over a period of three years.

51. In early 1970, however, all products of the automobile industry were excluded from these credits.

52. The impact of the export-promotion attempts is examined further in chapters 5, 7, and 11, below.

53. Some other general policies also have applied, but have been relatively unimportant for the purposes of this study. For example, since 1963 private persons buying exchange in the brokers' market have been required to show proof of prior income tax payments.

54. At about the same time the tax of 30 escudos a trip on travel by Chilean residents to other Latin American countries was abolished and the tax on travel to all other locations was increased from 60 to 310 escudos a trip.

55. The relative shift in these maximums favored travel to Latin America and discriminated against travel to the United States and Canada. This shift was consistent with the over-all aims of the Allende government regarding changes in the geographical pattern of international economic and political interactions.

56. These last measures were in part directed at limiting black-market activity in escudos.

57. The value of United States investment alone (including large-scale mining) at the time of the election of Allende was over a billion dollars. The largest nonmining operations included Anglo-Lautaro Nitrate, Boise Cascade, International Telephone and Telegraph, Coca-Cola, Standard Oil of New Jersey, General Motors, Crown Zellerbach International, General Cable, and RCA International, all of which had 1968 Chilean sales of about $10 million at the least, although some were owned partially by Chilean entities. See Szulc [1970] for a complete listing of such enterprises and their sales value.

58. Imports financed by those flows were at times exempted from some import regulations such as the additional taxes and prior deposits.

59. In the case of large-scale copper mining the nature of such official obligations was redefined, however, as is indicated above in subsection 4.2.1.

60. In his announcement Allende noted that in the previous six months the foreign debt actually had been reduced; the foreign debt inherited from the previous government plus the $728 million in obligations taken over from the foreign copper companies made Chile second only to Israel in terms of per capita national debt; and debt payment obligations for 1971–1973 were approximately 40 per cent of total Chilean exports. Furthermore, he claimed that the fulfillment of Chile's scheduled debt payment commitment to date had been made much more difficult by its failure to receive more than $100 million in dividends and taxes from the foreign copper companies prior to nationalization; the closing of approximately $190 million in credit lines by United States banks in part because of the Edward Bank's failure to fulfill its contractual obligations; the drop in international copper prices; and the increase in imports due to the boom in the Chilean economy and to income redistribution. See CORFO [1971a, November 23: 1–2].

61. These included $5.8 million to Kennecott (see subsection 4.2.1, above), $6 million to International Telephone and Telegraph Company, $7.8 million to United States banks, and $4.5 million to the United States Export-Import Bank. For more details, see de Onis [1972b], Vúskovic [1972:544], and Wilcke [1972].

62. The United States held over half of the debt. No other individual country nor all international organizations considered together held as much as a tenth.