Balance-of-Payments Consultations

DRAFT REPORT ON THE CONSULTATION WITH CHILE

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

Consultation with the International Monetary Fund

2. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Chile. In accordance with the agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Chile. The statement made was as follows:

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

"With respect to Parts I and III of the Plan for Consultations, as contracting parties are aware, Chile maintains a system of advance deposit requirements which were considered by the CONTRACTING PARTIES when they took their decision of May 27, 1959. The advance deposits still collected by the Government of Chile have the dual effect of dampening import demand and providing a source of financing for the Government. The Fund continues to hold the view, conveyed to the CONTRACTING PARTIES at their seventeenth session, that the future stability of the balance of payments depends on the maintenance
of an adequate stabilization program. This, in turn, depends on continued efforts to achieve budgetary equilibrium. The Fund considers that the direct and indirect effects on imports of measures maintained by Chile, including the requirement of advance deposits, do not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves.

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

Balance-of-Payments Position and Prospects

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

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

5. The Chilean representative stressed that his Government was resolved to continue its efforts for the monetary stability and the economic and social development of the country. The deficit on the 1961 Budget would be made good by resort to internal taxes and external loans. The prior deposits would be gradually removed. The new customs-tariff would be put into force as soon as it received approval by Parliament.

6. Members of the Committee expressed sympathy with the Chilean Government and people for the difficulties with which they were faced. They felt, however, that the basically sound nature of the Chilean economy provided a confident basis for optimism and that it was most encouraging to see that various effective measures had been and were being taken to maintain stability and equilibrium. It was hoped that the disequilibrium would be soon redressed and further progress would be made in the dismantling of the remaining restrictions.

7. The Committee discussed with the Chilean representative various questions relating to the prospects for Chile's principal exports, the development of export production and the diversification of the economy. A member of the Committee enquired about the prospects for the copper market, noting that the recent signs of its recovering and strengthening might be an indication of increased export earnings for Chile which relied heavily on the export of this product. The representative of Chile noted that, as he had forecast in November last year, the price of copper had further fallen, but that this had partly been compensated by an increased volume of exports. However, reliance could not always be placed on increased output at reduced labour costs, having regard to the social problems and repercussions that might be involved. As regards future prices, although the prospects appeared to be encouraging at the moment, this could not be relied upon as a basis for estimating future foreign exchange earnings. The estimated price for 1961 of 30 cents per pound was not realized, the present average level being only 28 cents. The difficulties of predicting the copper market should be generally known. The fall in copper prices in 1956 and 1957, as might be recalled, had been such as to exceed the most conservative estimates that could have been made. That experience had taught the Chilean Government never again to base its estimates for copper export earnings on higher prices.

In reply to a question, the Chilean representative also noted that the principal importer of Chilean copper remained the United States. The United States had been the almost exclusive market for Chilean copper until the suspension of its tariff concession on this product some time ago.  

1For the complete text of the statement, see Annex I.
After that time an increasing proportion of Chilean copper had been exported to Europe. At present a larger part of the product was again exported to the United States although Europe had in the meantime become a significant market.

8. As regards other exports, the representative of Chile stated that increases in the export of iron ore was possible but it would never reach significant proportions. The tariff structures of importing countries were such that Chile had found it difficult to develop the export of processed products based on the country's resources in ores. In the view of the Chilean Government the industrially more advanced countries should examine the possibility of opening up their markets for processed products so as to facilitate the economic development of primary producing countries such as Chile and to help easing their balance-of-payments problem. Chile was also endeavouring to develop other production based on mineral extraction, e.g. the production of potassium nitrate from the same ore which had hitherto been used primarily for the production of sodium nitrate. On the basis of a detailed study made by the FAO, which showed that Chile had suitable and adequate forestry resources for the production of cellulose products, Chile had already developed certain products including certain types of paper. The production of paper so far had not been enough to meet domestic demand and no exports in substantial quantities were expected. Agriculture was being energetically developed through modernization, rationalization and diversification. Increased production might be relied upon in the near future to cover a substantial part of domestic requirements thus reducing the demand for imports. Chile would be able to increase its vegetable production for export on a competitive basis, but as discussions in Committee II had shown, there was little prospect for the expansion of such exports on account of the protectionist measures applied in some industrialized countries. Efforts at economic development, particularly the rationalization and the diversification of agriculture, had been slowed down as a consequence of the earthquake disaster of last year.

9. Members of the Committee noted from the statistical data supplied by the IMF that Chile's outstanding external debts which stood at $608.3 million at the end of September 1960, were expected to be reduced to $395.3 million by 1964, and asked whether this apparent intention of substantially reducing external debts could indeed be achieved in present circumstances and whether the Chilean Government did not expect new debts to be incurred in connexion with industrialization projects. The representative of Chile agreed that the efforts at reconstruction and development would require the inflow of foreign capital but considered that owing to the burden of debt servicing it was also desirable that outstanding debts be reduced and the incurring of new debts be avoided as far as possible. Debt servicing and repayment
would constitute a decreasing burden on the balance of payments but the substantial amount of $114.8 million to be paid on this account in 1961 would be an important debit item for this year. In this connexion, the representative of Chile agreed with members of the Committee that a country, such as Chile, in urgent need of investment capital should take measures to encourage the inflow of long-term capital so as to avoid reliance on short-term capital as much as possible. Members of the Committee noted that the inflow of private short-term capital in 1959 largely represented a return of Chilean funds from abroad as confidence in the stability of the currency increase and that the out-flow in 1960 appeared to reflect the release of prior deposits in dollars together with the increasing liquidity of the private sector as a result of the resumption of monetary expansion.

Requested to comment on the prospects for 1961, the Chilean representative referred to the erratic nature of private capital movements and the difficulty of forecasting them. The relaxation of restrictions in the form of elimination or reduction of prior deposits was indeed a factor contributing to the increased out-flow of short-term capital in 1960.

10. Members of the Committee noted that the repayment commitments on capital account, though heavy in 1961, would fall off sharply from 1962 and that the loss of reserves in January 1961 had largely been due to this factor. Such payments being non-recurring, there should be an improvement in the remaining months of the year. The present level of net reserves, while lower than in 1959, was still higher than in preceding years. Taking account of external assistance and possible improvements in export earnings, the balance-of-payments and monetary reserve position of Chile in 1961 might well prove better than it appeared to be at the beginning of the year. The representative of Chile stated that his Government was grateful for the aid which the country had been receiving from many countries but that these loans and grants had generally been earmarked for reconstruction use. Despite such external assistance, reconstruction work would still entail a substantial budgetary deficit this year. The Government of Chile would, however, continue its efforts to improve the basic economic situation of the country and to redress the disequilibrium.
Alternative Measures to Restore Equilibrium

11. The representative of Chile recalled the various measures taken by his Government in restoring internal and external equilibrium which had been briefly described in the statement in I/365. As a result of these measures, the Chilean economy had, by the early months of 1960, attained a substantial degree of stability. In this connexion, the representative of the International Monetary Fund observed that between 1952 and 1960 the cost-of-living index in Chile rose by nearly fourteen times and the exchange rate by over eight times, and that against this background the stability which had been maintained since the beginning of 1960 must be regarded as remarkable. The efforts to curtail the wage-price spiral had met with considerable success; the budgetary deficit which had been inherited from previous governments had been greatly reduced; the exchange rate had been stable; and restrictions had been greatly reduced. This stability should be conducive to the inflow of long-term capital which would contribute to an improvement in the balance of payments. The progress that had been made would seem to warrant a "cautious optimism" regarding the future of the Chilean economy.

12. Members of the Committee expressed satisfaction at the internal fiscal and monetary policies which had been pursued by the Chilean Government and expressed the hope that the efforts would be continued. The view was also expressed that the Chilean Government had taken all the desirable steps in this field and that had it not been for the natural disaster in 1960 Chile would by now have been free of the kind of problems which required the attention of this Committee.

13. A member of the Committee noted that, according to the IMF documents, the principal cause of the deterioration in the balance of payments in 1960 had been the rise in import payments which might be attributed principally to the effects of the accelerated pace of monetary expansion. This being the case, the most important policy aim of the Government would seem to be the avoidance of further inflation. However, new legislation had been enacted providing for a general wage increase in 1961 of 15 per cent above the level of wages prevailing in 1959 or 5 per cent above the level recommended for 1960. While social pressures for wage increases might, in certain circumstances, be difficult to resist, it was to be hoped that intensified efforts would be made to ensure a closer relationship between wages and productivity. The representative of Chile stated that the problem of rising prices and wages was one which constantly received primary attention from his Government. The present Government came into power after a long period of inflation and labour agitation and its principal aim had been to prevent the pari passu increase of wages with the cost of living. The recommended increases of 5 per cent and 15 per cent for 1960 and 1961 represented compromises reached between the Government and the labour unions following
prolonged negotiations, strikes and even social unrest. Whilst these increases had been inevitable, the Government was considering new taxes which would have a restricting effect on prices. The low rate of rise in productivity was a common feature in a region such as Latin America and this, together with the low standards of living, was at the core of all the economic problems. The present degree of stability in wages and prices, while not absolute, contrasted most strikingly with the average increase of 30 per cent per year seen in previous years.

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

Methods of the Restrictions

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

(a) imports of goods subject to a deposit of 1,000 per cent or less are exempted from the deposit requirement when coming from countries with which Chile has bilateral payments or compensation agreements. (The GATT secretariat document mentions Argentina, Bolivia, Brazil, Ecuador and Yugoslavia as such bilateral agreement partners.)

(b) the prior deposits do not apply to purchases made by the Chilean Nitrate and Iodine Corporation (COVENSA) from specified countries (Denmark, the Netherlands, Portugal, Sweden, Yugoslavia and UAR /Egypt/).

(c) imports made under loans or credit from IBRD or the U.S. Export-Import Bank, or under U.S. Public Law 480, are exempt from the deposit requirement.
16. Regarding (a), the differential treatment for imports from bilateral payments partner countries, the Chile representative explained that such bilateral arrangements were a legacy of the past and were being gradually terminated. Chile had in fact notified Bolivia and Ecuador of its intention to terminate the bilateral arrangements with them and the agreement with Argentina had been terminated in February 1961. At any rate once the new customs tariff of Chile came into force, all the prior deposits would be abolished. The question of discrimination would naturally ipso facto no longer arise.

17. As regards (b), purchases of the C0Y2NSA, the Chilean representative explained that this Corporation was again a relic of post trading arrangements, having been established a long while ago for the purpose of selling nitrates and saltpetre on the world market. The privilege of exemption from prior deposit applied only to imports from countries purchasing those products from the Corporation, and would likewise disappear with the termination of the prior deposit system itself.

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

19. In regard to all these differential treatments, the Chilean representative emphasized their transitional nature and the certainty of their disappearance upon the introduction of the new customs tariff. It was the opinion of the Chilean Government that these measures were permitted under the terms of Article XIV of the General Agreement, the maintenance of the prior deposit requirement itself being covered by the provisions of Article XII of the Agreement. Some members of the Committee pointed out that there was no ground to assert that the discriminatory applications of the restrictions by Chile was necessarily consistent with the provisions of the General Agreement.

20. An exchange of views took place at the Committee on the relative merits and demerits of prior deposits and other types of restrictions for purposes such as those envisaged in Article XII of the Agreement. The Chilean representative recalled that the present system of prior deposits and surtaxes had been adopted to replace the previous system of direct quantitative licensing controls; the present system was chosen because it was found to be the most suitable system in the present circumstances of Chile. In this connexion the Committee noted a statement by the representative of the IMF to the effect that restrictive measures such as the advance deposit requirements, in as much as they, on the one hand, involve foreign exchange arrangements and, on the other hand, directly affect the importation of specific commodities, must be regarded as embodying both an element of exchange control and an element of quantitative restriction. Consequently, in the view of the Fund, they should belong to the conjoint jurisdiction of the IMF and the GATT.
21. In answer to a question concerning his statement quoted in paragraph 2 above, the representative of the Fund stated the Fund's judgment on the need for achieving budgetary equilibrium should be considered to be neutral on the question of the appropriate source of budgetary revenue; consequently, it would be equally satisfactory from the point of view of the stabilization programmes whether this revenue derived from the net increments of prior deposits or from the customs tariffs.

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

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

24. The Chilean representative, in response to questions, confirmed that it was the intention of the Chilean Government to introduce the new customs tariff as soon as it was approved by Parliament, and to negotiate any increases beyond bound rates before the new tariff entered into force. Whereas the present surtaxes might be either incorporated in the new customs tariff rates or might simply be abolished, it was the intention of the Chilean Government to discontinue the prior deposit requirements immediately upon the entry into force of the new tariff.

25. **General Observation**

Members of the Committee expressed satisfaction at the considerable progress made by Chile in its stabilization programme in 1959 and the first months of 1960 and at its determination to continue with the programme despite the new burden arising from the earthquake in May 1960. They welcomed the progress that had so far been made in the reduction and removal of the prior deposit requirements and expressed the hope that further improvements in the balance of payments would make it possible for Chile to dispense with the restrictive measures in the near future. The Committee noted that it was the firm intention of the Chilean Government to abolish all import restrictions and to rely on the sole protection of the customs tariff, and that it intended to carry out the necessary negotiations under Article XXVIII in order to apply the new customs tariff as soon as it was approved by Parliament and not later than 1 January 1962. Certain members of the Committee specifically urged that this process be completed as soon as possible.
26. The representative of Chile stated that he had taken note of all the views expressed at the consultation and would convey them to the attention of his Government.

Annex I: Statement by the representative of Chile.