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REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS ON THE CONSULTATION UNDER ARTICLE XVIII:12(b) WITH CHILE

1. In accordance with its terms of reference, the Committee has conducted the consultation with Chile under Article XVIII:12(b). The Committee had before it a basic document for the consultation (BOP/45), a decision of the Executive Board of the International Monetary Fund, dated 6 January 1965 (see Annex II) and documentation supplied by the Fund as mentioned in paragraph 4 below.
2. The Committee also consulted with Chile concerning Chile's request for an extension of the Decision of the CONTRACTING PARTIES of 27 May 1959 which waived, subject to specified conditions, the provisions of paragraph 1 of Article II to the extent necessary to allow the Government of Chile to maintain certain surcharges. The Committee is presenting a separate report on that subject to the CONTRACTING PARTIES although the consultation was conducted with both objects in mind.
3. In conducting the consultation, the Committee followed the Plan for consultations under Article XVIII:12(b) recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 8 March 1965. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

4. 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, which was designed to serve both for the regular consultation and for the consultation concerning the waiver, was as follows:

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of January 6, 1965 taken at the conclusion of the last consultation with Chile under Article XIV of the Fund Agreement and to the background material prepared in connection with that consultation. Also on January 6, 1965 the Fund approved a stand-by arrangement with Chile authorizing drawings up to the equivalent of \$36 million in the next twelve months.

"Chile's balance of payments was in approximate equilibrium in 1964, with a small increase in monetary reserves about offset by an increase in import arrears. Net reserves, however, remain at a substantial negative figure. In addition, sizeable debts have been accumulated on account of the compulsory deferment of import payments for 120 days and on account of arrears beyond this deferment period. It is not anticipated that net reserves will rise significantly in 1965. The general level of the various restrictive and import surcharge measures currently applied by Chile does not go beyond the extent necessary at the present time to achieve a reasonable rate of increase in its monetary reserves.

"With respect to alternative measures to restore equilibrium, the Fund invites attention to the decision taken at the conclusion of its recent Article XIV consultation with Chile. The Fund has no additional alternative measures to suggest at this time."

Opening statement by the representative of Chile

5. In his opening statement, a summary of which is contained in Annex I to this report, the representative of Chile traced the history of Chile's efforts to establish a system of international trade regulations consistent with Chile's obligations under the General Agreement. He recalled how fluctuations in the price of copper, Chile's principal export product, have at times hampered these efforts, as was the case in 1957-58. The earthquake of 1960 had also added enormously to Chile's burdens, and tax revenues have been inadequate, partly because of an outmoded tax structure and partly for administrative reasons, not to mention the fact that inflation itself hampers the collection of taxes at appropriate levels. A principal difficulty has also been inflation, all the more difficult to control as Chile has been engaged in an effort to promote industrialization and raise domestic living standards. The representative of Chile then explained that the new Government which took office in 1964 had addressed itself to these problems and had worked out comprehensive plans for reform of the tax administration which might enable Chile to remove the surcharges on imports and also contribute to controlling inflation. Up to now the lack of a working majority in Congress has hampered implementation of plans but late news indicated that the Government would no longer have difficulties on this score. For the immediate future, however, both the fiscal situation and the severe shortage of foreign exchange require that the surcharges continue and that they be used so as to limit imports to bare essentials. It is hoped, as a result of all the measures envisaged, to hold inflation to 25 per cent during 1965 and to reduce it to 15 per cent in 1966 and to 10 per cent in 1967. As consideration has meantime been given, within the General Agreement, to permitting less-developed countries having balance-of-payments difficulties to use surcharges as an alternative to, or in addition to, other restrictions on imports the representative of Chile hoped that it would be possible to extend Chile's waiver to the end of 1966.

Balance-of-payments position and prospects

6. Members of the Committee expressed sympathy with Chile's efforts to achieve internal stabilization. It was noted that balance-of-payments equilibrium was achieved by Chile in 1964 through the pursuit of a flexible exchange rate policy and large foreign loans. The member mentioned that his government's confidence in the ability of the new Chilean Government to improve the balance of payments resulted in an agreement to provide substantial assistance during 1965 to assist the Government of Chile in carrying out its stabilization and development programme. It was his understanding that this programme put primary reliance on the flexible exchange rate and internal fiscal and monetary restraints rather than on import controls. The representative of Chile noted that Chile's difficulties are well described in the Fund documentation. As there explained, a position near equilibrium in the balance of payments had been achieved in 1964, but there will also be need for continued capital inflow to cover Chile's deficit on the current account. Also heavy accumulated external public debt created a need to arrange some deferment of payments. Payments of \$30 to \$40 million due in 1965 have been deferred. Multilateral negotiations on the public debt had recently been concluded in Paris, but the amount which Chile will be required to pay will also depend on bilateral negotiations with creditors which are still in progress. In general outline, the arrangement part of the external debt falling due in 1965 and 1966 over a period of five years beginning after an initial grace period of three years. The representative of Chile added that an initial grace period of three years. The representative of Chile added that it was not possible to use too drastic monetary and fiscal measures to overcome inflation because it would involve too great social costs but the Government would continue to maintain a flexible exchange rate policy and intensify efforts to promote exports to improve its balance-of-payments position.

7. A member of the Committee noted that it appeared that Chile would benefit greatly by the introduction of international arrangements to stabilize primary product prices, including copper, as requested by certain contracting parties. The representative of Chile agreed that a stable and remunerative price for copper would, if also favourable to the development of consumption, be of great benefit, especially as increased copper output is to be a prominent feature in Chile's development plans, along with plans to process more of the mineral locally. He noted, however, that this is by no means Chile's only need, as higher living standards for Chile's growing population imply a need for substantial growth of the economy.

8. In response to questions concerning the development of Chilean exports, the representative of Chile said that Chile plans to effect a 78 per cent increase in exports over the next five years. The principal source of increase will be mineral products, of which it is hoped to export production valued at \$793 million in 1970 instead of \$502 million as estimated for 1965. An increase in agricultural products exports from \$30 million to \$50 million will also contribute to the increased total. In the area of industrial products, an increase of exports from \$50 million in 1965 to \$185 million in 1970 is planned, principally in metallurgical products, products of the fisheries industry and the pulp and paper

industries. Exports of products of the fisheries industry are to increase from \$25 million to \$70 million, and the paper and cellulose industries from \$10 million to \$50 million. To help effect these increases in exports, Chile has already negotiated with a number of private mining companies arrangements looking toward a doubling of Chile's output within the next four to five years; Chile has also adopted and will keep a flexible exchange rate policy and will take other measures to promote exports, including the provision of better credit facilities. And, to ensure a net improvement in the balance of payments, imports will continue subject to very strict control. In this respect, a member of the Committee suggested that after the stabilization and development policies began to take hold, it would appear desirable for the Government of Chile to consider using the flexible exchange rate system in a manner which could make possible significant reductions in the overall level of restrictions; such action could also serve to increase Chile's non-traditional exports.

9. In response to a question concerning export promotion measures, the representative of Chile added that besides the measures already mentioned, there would be a new Foreign Trade Institute which would endeavour to promote exports and which would study such matters as quality standards, market research, advertising, etc.; loans and credits to industries such as the fisheries were also contemplated. Finally, he said, special efforts would be made to develop LAFTA markets, especially as LAFTA has up to now proved more effective in bringing imports into Chile than in promoting exports by Chile to its trade partners. However, he emphasized, this trade was too small a proportion of the total to affect the overall payments to any great extent. In assessing Chile's export programme, he said, it was essential to bear in mind that the export projections he had cited had been prepared on a conservative basis.

Alternative measures to restore equilibrium

10. There was general interest concerning Chile's efforts to increase internal taxation and other steps being taken to combat inflation. The representative of Chile stated at the outset that in his country it was impossible, for political and social reasons, to attempt an abrupt cessation of inflation. Instead, the Government envisages a gradual approach, improving at the same time the relative position of agricultural prices. For 1965 the target is to hold price increases to 25 per cent, as compared with 38 per cent in 1964. This cannot be done by reduction in the Government's expenditures on development, which must increase for social and economic reasons. There should, however, be some possibility of reducing expenditure for current operations, and the tax reform already in effect and a new tax on net worth proposed by the Government will greatly increase the revenue side of the budget. Also, certain tax exemptions are being re-examined and tax administration and implementation is being improved in order to obtain better yields. It should be pointed out that the external deficit, a consequence of the internal one, is not much greater than what the Committee of wise men set up by the Alliance for Progress considered necessary for Chile at this stage of its development policies.

11. A question was asked as to what developments there might be to report concerning what the Fund decision had described as the critical importance of pursuing restrained credit and wage policies; in particular it was noted that an important decision concerning adjustment of wages was scheduled to be taken early in 1965 and the question was asked whether anything was known about the outcome. The representative of Chile indicated that it was the Government's position that both publicly and privately employed workers were entitled to a wage increase equal to the amount of inflation in the past year, estimated at 38 per cent, and that legislation will provide for holding wage increases to that level in private contracts as well as in contracts with the Government.

System and methods of the restrictions

12. With respect to the "prohibited list", it was asked whether goods in this category were really completely barred or whether the term meant that a licence was required to enter such goods. The representative of Chile indicated that, with some exceptions, goods not figuring on the permitted list are actually banned. Exceptions concern non-commercial imports, imports of scheduled products from LAFTA countries and imports into the so-called free zones located in sections of the country relatively remote from the main centres of population. He explained that there were also some goods which were listed as subject to deposits of 10,000 per cent. These might be described as effectively prohibited except when the Central Bank in specific cases waives the deposit requirement. Imports into the free zones were exempt from surcharge, but the goods may only be shipped into other parts of Chile from there after processing. Imports by large mining companies are also exempt from surcharge, as are imports by State enterprises.

13. A subsequent enquiry sought an explanation of the rationale of the exemption from surcharge of imports by these companies, by government agencies and of imports made under deferred payment arrangements or coming from LAFTA countries. The representative of Chile explained that such imports are controlled to a considerable extent in other ways. State enterprises may import only goods needed to carry out approved plans, and the imports of the copper companies, which operate under special exchange arrangements, are reviewed by an agency which attempts to confine imports to goods not obtainable in Chile. All such imports are subject to licence. None of these cases involved discrimination between countries.

14. The policy of favouring the free zones was also questioned as possibly tending to build up industry in locations far removed from the major market in Chile, as for example might be the case with the auto-assembly industry of Arica. The representative of Chile acknowledged that opinions differ in Chile on this policy, but that such development is in fact in accordance with laws in force at the present time.

15. A member of the Committee enquired what was the present status of the draft tariff law, which inter alia switches the tariff to the Brussels Tariff Nomenclature, and whether any changes might result from adoption of that change. The representative of Chile replied that the bill was awaiting action in the Congress and that the Government desired to see it enacted. In answer to a further question, it was explained that at the "proyecto" stage, where the bill still is, there has been no action by the Congress. The Government has not pressed for action up to now because it did not have sufficient votes to ensure passage of the bill without crippling amendments. When the Congress meets again in May, this situation may be different, in which case progress will likely be made.
16. A number of questions were asked about the working of the prior deposit and surcharge system. The representative of Chile explained that until recently the system had been to require prior deposits in dollar bonds, in an amount representing fixed proportions of the c.i.f. value of the proposed import. Importers usually had to pay a rent for the use of such dollar bonds. More recently, the bond deposit was replaced by a payment in Chilean currency of an addition to the import surcharges already in effect and equivalent to the financial cost of renting the bond. Furthermore, in order to retain its power to reimpose import deposits, if necessary, according to Chilean legislation, the Central Bank requires the deposit of the surcharge at the time of the registration of a new import and this amount is afterwards transferred to the Government. LAFTA countries are not subject to either the surcharge or prior deposit requirements.
17. Another recent change was made effective on 15 January 1965 when the Central Bank was empowered to reject all applications for imports of any class of goods if the applications in a given month exceed by more than 5 per cent the average monthly importation of that class of goods over the past twelve months. This power is optional with the Bank and, to ensure non-discriminatory operation, the Bank may only choose between granting all applications and rejecting all.
18. The question was asked how Chile justified, in economic terms, the exemption of one group of countries from charges and prior deposits levied on balance-of-payments grounds, especially as the exempted countries did not have a common monetary system with Chile. The representative of Chile replied that, unlike the situation in some countries, Chile's surcharges and advance payment requirements could not at this stage be classed as pure balance-of-payments measures. Until the new schedule of duties came into effect, these charges were also acting to some extent as protective measures. When the new arrangements are fully in effect, a part of the present charges will disappear, but part will also remain and at that time Chile will have to renegotiate its obligations. It would be impossible to answer the question, in other words, except with respect to an individual product as the combination of the two elements varies.

19. Members of the Committee indicated that, while they appreciated Chile's difficult situation, they had received complaints from traders that Chile's system of import restrictions was exceedingly complex, particularly on the matter of documentation required to effect imports. They hoped that Chile might be able to take this problem into account. The representative of Chile replied that he believed the system as now in force since 15 January might prove somewhat less complex.

20. The Committee thanked the representative of Chile for the information he had supplied, and he, in turn, promised that the views expressed by the Committee would be brought to the attention of his Government.

ANNEX ISUMMARY OF STATEMENT BY REPRESENTATIVE OF CHILE
ON BALANCE-OF-PAYMENTS SITUATION

The serious situation of Chile's balance of payments and monetary reserves has led us, on various occasions, to seek from the CONTRACTING PARTIES an extension of the waiver which allows Chile to apply temporary import surcharges.

Practically all developing countries face a similar situation, and I think the underlying causes are well known to the CONTRACTING PARTIES and I do not need to repeat them here.

As the representative of Chile said at the meeting which took place one year ago, already in 1956 our Government simplified our exchange system and eliminated a considerable amount of restrictions which unfortunately were reimposed in 1957 and 1958 in view of the drastic reduction in the price of copper in the world market. In 1959, a new administration, with the backing of the International Monetary Fund, decided to follow a new exchange and foreign trade policy, based on the establishment of a single exchange market with a realistic rate of exchange. Import prohibitions were eliminated and other trade restrictions reduced. In view of the balance-of-payments problems which the new policy could have created, it was proposed to substitute the existing restrictions for surcharges not exceeding an amount of 200 per cent of the c.i.f. value of the commodities. The CONTRACTING PARTIES granted the necessary waiver in 1959 for a reasonable length of time in order to allow Chile to enact a new customs tariff.

The exchange liberalization policy, started in 1959 and pursued in 1960 and 1961, led, at the end of the latter year, to an exchange crisis which was partly the consequence of the internal monetary expansion to finance heavy expenditure for the reconstruction of the parts of the country devastated by the earthquakes of May 1960, and a national development plan which was put into effect to give Chile a more rapid rate of economic growth.

The Government was compelled, in view of the foreign payments situation, to eliminate many of the liberalization measures previously adopted; two exchange markets were established in October 1962 and import surcharges were temporarily increased. These decisions, and the devaluation of the escudo in the exchange market used for exports and imports, produced some results; at the end of 1963 the Government thought that within a reasonable length of time it could obtain legislative approval of the new tariff and could start new negotiations with the CONTRACTING PARTIES in order to put an end to the system of import surcharges.

However, reality has been different due to powerful commercial and political factors. The new tariff has not been enacted and it was impossible for the Government to push it forward in a period of intense political activity prior to a Presidential election. Not having a homogeneous and solid majority in Parliament, it would have been impossible to start the discussion of the new tariff item by item. Furthermore, even with a considerable improvement, Chile's balance of payments continue to show the same basic weaknesses as in previous years. I will give you some information in order to support this statement.

In 1961 Chile had the largest balance-of-payments deficit in its whole history reaching the figure of \$130 million. This deficit was reduced in 1962 to about half that amount, but at the same time import payments arrears developed making the deficit of 1962 practically equal to that of the previous year. With the exchange measures I referred to above, the deficit was reduced to \$30 million in 1963 and practically to nil in 1964. For the present year, the Central Bank of Chile has projected a small deficit the amount of which will depend on the results of the agreement reached recently in Paris between Chile and its foreign creditors on foreign debt refunding. But this equilibrium in the balance-of-payments is rather weak because it is based, on the one hand, on heavy import restrictions, and on the other hand it has been sustained by an increased amount of foreign loans for reconstruction and development purposes. The net inflow of official foreign capital into Chile increased from \$105 million in 1962 to \$156 million in 1963, and to an estimated \$166 million in the year 1964. For the present year it is estimated that there will be a net inflow of \$155 million. Actual new loan utilization has increased from \$113 million in 1962 to an estimated \$195 million in the present year.

Chile's balance-of-payments problem has been aggravated by the increased burden of the foreign debt. This amounted, at the end of 1962, to \$737 million, including Government guaranteed private debt. During the year 1963, this debt increased by an amount of \$171 million, and in the past year by an estimated amount of \$139 million. If, to the proper external debt, we add some internal debt denominated in foreign exchange, the total service, i.e. amortization plus interest, in 1965 would have amounted to roughly 40 per cent of Chile's total foreign exchange receipts. For this reason the Government of Chile entered into multilateral negotiations with its foreign creditors who were willing to refund the services of the years 1965 and 1966, to be repaid over eight years, with a three years' period of grace.

In relation to future prospects and policies, I will mention a few ideas developed by the Chilean Minister of Finance in a statement made before the Joint Committee on the Budget on 24 November 1964.

It is the programme of the new administration to give an impetus to the economic development of the country and at the same time to achieve a more even distribution of the national product. In this endeavour a set of measures will be put into practice and one of the main objectives of them is to achieve a gradual reduction in the rate of inflation which is one of the main causes of

Chile's payment problems. The Government does not believe that stability can be attained overnight and, looking at the structure of sectoral prices, is planning a price increase not higher than 25 per cent during the present year and expects to reduce and finally eliminate inflation over a period of three to four years. In the first place, wages and salaries have been adjusted by the full extent of the loss in their purchasing power in 1964. Industrial prices will be adjusted by an amount of about 20 per cent and agricultural prices by more than the average increase in the year in order to improve the terms of trade for the agricultural sector.

Monetary and fiscal policies have been designed for an increase in the supply of money not greater than 25 per cent during the year and for the time being the Government will keep a strict control on basic prices.

On the external side the Government policy calls for a flexible exchange rate policy and stimulus to exports by means of tax rebates, simplification of administrative procedures, special credit schemes and direction of public investments towards industries producing for exports. The main ingredient of the Government's export promotion policy is the agreement reached with foreign copper companies to increase by nearly 100 per cent their production in Chile and to increase by about 70 per cent the country's capacity of refining. These and the other measures already mentioned will increase Chile's exports by nearly 80 per cent from 1965 to 1970.

In order to carry out this task, the results of which might be decisive in America's political life, we need, before anything else, to help ourselves, but we also need the assistance of our friends and in this particular case a necessity of the programme is to obtain from the CONTRACTING PARTIES an extension to the end of 1966 of the waiver granted in 1959. The continuation of the import surcharges will not only keep our foreign payments situation in balance, but will also help to finance our Budget. If we request an extension to the end of 1966, it is because this term is adequate and necessary to put into effect the different parts of the Government development and stabilization programme.

This concession should be a relatively easy one for the CONTRACTING PARTIES to give us now, since the Group which prepared the new Chapter of GATT on Trade and Development recommended for approval the proposals of Australia and the United States which would authorize developing countries to use surcharges in place of, or in addition to, other sources for the safeguarding of their balance of payments and their monetary reserves.

We do not doubt that the CONTRACTING PARTIES will understand our situation. We are quite sure of this, and that they will accord the waiver in the spirit which has inspired all their recent action.

ANNEX II

International Monetary Fund Executive Board Decision
Taken at the Conclusion of the Fund's Consultation
with Chile on 6 January 1965

1. The Government of Chile has consulted the Fund under Article XIV, Section 4, of the Fund Agreement, concerning the further retention of its transitional arrangements.
2. Chile's total output of goods and services was estimated to have expanded by about 4 per cent in 1964, but as little progress was made in curbing the wage-price spiral, domestic prices and costs increased by an estimated 40 per cent.
3. Government finances were strengthened in 1964 by an improvement in tax administration and by the implementation of a tax reform which mainly involved higher taxation on income and real estate. The Government's current account surplus increased and, with the complement of external loans and reduced reliance on deficit financing, financed a higher level of public investment.
4. Chile's balance of payments position on current account improved only slightly in 1964, mainly as a result of rising prices for copper; but an increased availability of external economic assistance and some reduction in the outflow of private capital led to the emergence of a small over-all surplus. Exchange rate policy was an important factor in checking the loss of reserves, but there was a further accumulation of arrears during the first ten months although efforts were being made to reduce this increase in the final two months of the year. The demand for imports continued to be restricted by various controls on imports, import surcharges, a compulsory deferment period for the remittance of import payments, and a system of advance deposits for imports.
5. The Fund welcomes the greater emphasis in Chile's economic development and financial policies on the expansion of agriculture and the export base of the economy. The program for a gradual control of inflation over a three-to four-year period, by means of a coordinated set of monetary, pricing and income policies, will require persistent efforts by the authorities. The Fund emphasizes the critical importance of pursuing restrained credit and wage policies, and of taking measures to strengthen further the budget position, particularly by reducing the deficit of State enterprises, and to increase domestic savings so as to help in avoiding an undue accumulation of foreign indebtedness.

6. The Fund notes Chile's policy of maintaining a flexible exchange rate, and stresses the importance of making strenuous efforts to improve the balance of payments, pay off import arrears, reduce the compulsory deferment period for import payments and simplify the complex system of restrictions on trade and payments. The present efforts of the Chilean authorities to renegotiate Chile's foreign indebtedness, together with adequate controls on the contracting of new foreign debt, including suppliers' credits, will be important in avoiding a continuation of the present excessive debt service burden in future years. The Fund does not object to the maintenance on a temporary basis of the exchange system now in effect.

7. In concluding the 1964 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Chile.

