



REPORT TO THE CONGRESS

Survey Of Program Loan Assistance To Chile

B-163772

Agency for International Development
Department of State

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

MAY 29, 1968



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

The General Accounting Office has completed a survey of program loan assistance to Chile under the Alliance for Progress as administered by the Agency for International Development, of the Department of State.

This survey was designed to identify significant underlying social, economic, and political problems as they related to United States assistance efforts in Chile and to ascertain how these problems had been, and were being, dealt with. We believe that the survey will provide the Congress with a broad look at program loan assistance as it has been applied in one country and give the General Accounting Office the insight needed for further reviews and evaluations of foreign assistance programs.

Program loans administered by the Agency for International Development have amounted to \$250 million, or almost 70 percent of the total assistance to Chile by the Agency since the inception of the Alliance for Progress in 1961.

Chile has initiated significant legislative and administrative reforms and recently has taken steps indicating that additional reforms may be forthcoming. It seems clear, however, that much remains to be done if the underlying problems in Chile are to be overcome and the purposes of the assistance are to be accomplished.

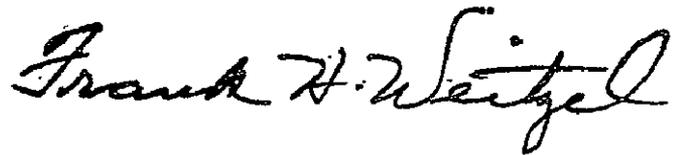
The accompanying report outlines what the Agency considered to be the social, economic, and political problems of Chile; the key obstacles to achievement of needed reforms; the accomplishments under the Alliance for Progress; and the rationale for program loans.

The Agency furnished us with its comments on this report. Modifications or revisions have been made, where appropriate, to reflect the Agency's views.

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This matter is being reported to the Congress because of the continuing congressional interest in the Alliance for Progress and in the administration of the foreign assistance programs.

Copies of this report are being sent to the Director, Bureau of the Budget; the Secretary of State; and the Administrator, Agency for International Development.

A handwritten signature in cursive script, reading "Frank H. Weitzel". The signature is written in black ink and is positioned above the typed name.

Acting Comptroller General
of the United States

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REPORT ON SURVEY
OF
PROGRAM LOAN ASSISTANCE
TO CHILE
AGENCY FOR INTERNATIONAL DEVELOPMENT
DEPARTMENT OF STATE

INTRODUCTION

The General Accounting Office has made a survey of program (nonproject) loan assistance to Chile under the Alliance for Progress as administered by the Agency for International Development (AID) of the Department of State. Our survey was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

The survey covered, in general, the period from the inception of the Alliance for Progress in 1961 through April 1967. The basic purpose of our survey was to identify the more significant social, economic, and political problems of Chile as they related to United States assistance efforts in Chile and to ascertain how these problems had been and were being dealt with.

Information contained in this report was compiled from program documents, reports, correspondence, and other pertinent records available at AID offices in Washington, D.C., and in Chile. Accordingly the views presented in this report concerning such matters as the social, economic, and political problems of Chile; the key obstacles to achievement of reforms; the accomplishments under the Alliance for Progress; and the rationale for program loans are those expressed primarily by AID and, to a lesser extent, by international organizations.

The officials primarily responsible for administration of program loan assistance to Chile during the period covered by our survey are listed in the appendix to this report.

ACCOMPLISHMENTS UNDER THE ALLIANCE FOR PROGRESS

Since creation of the Alliance for Progress in August 1961, Chile has initiated some significant legislative and administrative reforms. Some of the more significant accomplishments are described below.

1. In December 1962, a law was passed providing for the reorganization of the administrative structure and the auditing function of the Internal Tax Service to tighten tax collection procedures. Moreover a complete reassessment of all real estate, rural and urban, was initiated on the basis of a law passed in November 1962. This reassessment resulted in an average increase of 300 percent in assessed value. A law simplifying the stamp tax by reducing the number of separate rates from 300 to less than 60 was passed in September 1963. An administration-supported bill increasing income and inheritance taxes was enacted in February 1964. As a result of these administrative and legislative reforms, the tax yield increased 76 percent in real terms between 1961 and 1966.
2. AID initiated a customs administration technical assistance project in fiscal year 1963, to bring about an increase in the overall efficiency in the customs and tariff functions. Primarily as a result of this project, customs revenue increased about \$36 million between 1963 and 1966. Two laws providing for further improvements in the customs service were passed in fiscal year 1967.
3. An agrarian reform law was enacted in 1962, and a constitutional amendment permitting deferred payment for expropriated agricultural land was passed in September 1963. Although the program has not progressed as rapidly as planned, about 2.5 million acres of land have been expropriated and about 8,000 families have been resettled since 1965. A new agrarian reform law was signed by the President on July 16, 1967, and a constitutional amendment to facilitate expropriations was approved earlier in 1967.

4. A National Planning Office, which was established in 1964, received legal status in July 1967. A Secretary General of National Planning has been appointed to serve as Presidential planning advisor and as liaison with ministries, agency heads, international agencies, and the private sector. In 1966, a procedure was established providing that sectoral planning offices were to prepare sectoral plans and identify priorities and projects. Each sectoral plan was to be submitted to the National Planning Office for coordination with the overall plan and with other sectoral plans. Thereafter the sectoral budgets were to be adapted to the extent possible with the sectoral plans. On completion of our survey, an overall development plan was in process of being prepared.
5. In 1965, the increase in the number of primary school students was 175,000, compared with the normal annual increase of about 40,000. Moreover a seventh and an eighth grade have been added to the former 6-grade elementary school system.

The Frei administration came into power in November 1964. AID has pointed out that the Frei administration had inherited an economy inordinately dependent on large Government expenditures and foreign assistance, a monopolistic private sector producing limited quantities of products at high prices, a stagnant agricultural sector, and an educational system which worked to deny opportunity to the majority of the people. According to AID, the Frei administration had inherited also serious and chronic inflation which exacerbated social tensions and reduced incentives to save and invest productively.

Although the Frei administration has accomplished some significant reforms and the steps it has taken offer promise that additional reforms may be forthcoming, much remains to be done. AID believes that, in future years, significant reforms and improvements will be needed in the agricultural and industrial sectors, in the educational system, and in fiscal and monetary policies.

ASSISTANCE AND OBJECTIVES

UNITED STATES OBJECTIVES

A major United States interest in Chile lies in the pivotal role Chile can play in demonstrating to Latin America and to the world that economic development and social justice can be achieved within a democratic framework. United States objectives in Chile are (1) the success of the reform, development, and stabilization program consonant with the goals of the Alliance for Progress and (2) harmonious relations between Chile and the United States and Chilean support for major United States policy objectives in Latin America and elsewhere.

The long-range assistance plan in which the United States is participating aims at eliminating the need for concessional assistance to Chile by the early 1970's through a broadly based program of financial assistance geared to Chilean self-help commitments and performance.

Key elements of the assistance plan are:

1. Economic stabilization and the closely related reforms of public finance and the monetary system.
2. Improvement in the institutional context of Chilean economic life through reform and elimination of the maze of restrictions and interferences which hamper economic activity.
3. Major expansion and improvement in education, to provide the manpower basis for accelerated, long-range economic and social developments.
4. Rapid and substantial increases in the output from all productive sectors of the economy, which will involve concentrated effort in the agricultural sector, major redirection and improvement in the quality of public investment, and revitalization of private investment.

According to AID a necessary condition of the whole concept of the assistance plan is stabilization. Without

the elimination of the chronic inflation which has sapped the vitality of the nation, there is little prospect of achieving self-sustaining economic growth or meaningful permanent progress in other areas.

UNITED STATES ECONOMIC ASSISTANCE

United States economic and technical assistance to Chile from its inception through June 30, 1967, as reported by AID is summarized in the following schedule.

	Obligations and loan authorizations								Total
	Before Alliance for Progress	Since the Alliance for Progress (fiscal year)						1962-67	
	1962	1963	1964	1965	1966	1967			
(000 omitted)									
AID and predecessor agencies:									
Grants:									
Development projects	\$ 21,028	\$ 2,364	\$ 5,359	\$ 3,396	\$ 2,805	\$ 3,097	\$ 3,040	\$ 20,061	\$ 41,089
Earthquake reconstruction and rehabilitation	20,000	-	-	-	-	-	-	-	20,000
Emergency relief	3,939	-	-	-	250	107	-	357	4,296
	<u>44,967</u>	<u>2,364</u>	<u>5,359</u>	<u>3,396</u>	<u>3,055</u>	<u>3,204</u>	<u>3,040</u>	<u>20,418</u>	<u>65,385</u>
Loans:									
Program loans	10,000	-	35,000	55,000	80,000	80,000	-	250,000	260,000
Development projects	17,680	39,961	-	20,800	3,300	17,250	12,500	93,811	111,491
Earthquake reconstruction and rehabilitation	100,000	-	-	-	-	-	-	-	100,000
Other	835	-	-	-	-	-	-	-	835
	<u>128,515</u>	<u>39,961</u>	<u>35,000</u>	<u>75,800</u>	<u>83,300</u>	<u>97,250</u>	<u>12,500</u>	<u>343,811</u>	<u>472,326</u>
Total loans and grants	<u>173,482</u>	<u>42,325</u>	<u>40,359</u>	<u>79,196</u>	<u>86,355</u>	<u>100,454</u>	<u>15,540</u>	<u>364,229</u>	<u>537,711</u>
Food for Peace (Public Law 480):									
Title I	67,900	-	-	-	-	19,800	-	19,800	87,700
Title II	-	-	-	-	4,800	300	4,200	9,300	9,300
Title III	42,400	6,600	5,500	9,600	10,400	4,700	3,800	40,600	83,000
Title IV	-	-	16,500	17,300	-	-	-	33,800	33,800
	<u>110,300</u>	<u>6,600</u>	<u>22,000</u>	<u>26,900</u>	<u>15,200</u>	<u>24,800</u>	<u>8,000</u>	<u>103,500</u>	<u>213,800</u>
Export-Import Bank loans	<u>273,200</u>	<u>800</u>	<u>15,500</u>	<u>16,000</u>	<u>8,200</u>	<u>100</u>	<u>262,200</u>	<u>302,800</u>	<u>576,000</u>
Social Progress Trust Fund	-	<u>18,700</u>	<u>4,900</u>	<u>4,500</u>	<u>5,800</u>	<u>1,500</u>	-	<u>35,400</u>	<u>35,400</u>
Institute of Inter-American Affairs	<u>5,100</u>	-	-	-	-	-	-	-	<u>5,100</u>
Peace Corps	<u>900</u>	<u>1,000</u>	<u>900</u>	<u>1,500</u>	<u>2,700</u>	<u>2,700</u>	<u>1,141</u>	<u>9,941</u>	<u>10,841</u>
Exchange Stabilization Fund	-	-	-	<u>15,000</u>	<u>4,000</u>	-	-	<u>19,000</u>	<u>19,000</u>
Total economic assistance	<u>\$362,982</u>	<u>\$69,425</u>	<u>\$83,659</u>	<u>\$143,096</u>	<u>\$122,255</u>	<u>\$129,554</u>	<u>\$286,881</u>	<u>\$834,870</u>	<u>\$1,397,852</u>

NON-UNITED STATES ASSISTANCE

Chile has been among the world's largest per capita recipients of external financial assistance. This assistance

has averaged \$200 million annually in recent years. The main contributors have been the United States, other free-world countries, and international lending agencies. The United States has been by far the major contributor.

International lending agencies provided the following financial assistance to Chile for fiscal years 1964-67.

	Fiscal year			
	<u>1964</u>	<u>1965</u>	<u>1966</u>	<u>1967</u>
	————(millions)————			
Inter-American Development Bank	\$18.7	\$ 4.9	\$62.2	\$32.0
International Bank for Reconstruction and Development	24.0	4.4	2.8	60.0
United Nation Special Fund	.8	1.7	4.9	(a)
Other United Nation funds	.8	1.1	1.0	(a)
International Finance Corporation	—	.3	1.2	—
	<u>\$44.3</u>	<u>\$12.4</u>	<u>\$72.1</u>	<u>\$92.0</u>

^aNot available.

In addition to the foregoing, Chile had outstanding drawings from the International Monetary Fund of \$114 million as of March 7, 1966.

Other free-world countries provided the following financial assistance to Chile for calendar years 1963-66.

	Calendar year				Total
	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	
	————(millions)————				
Germany	\$ 8.59	\$11.12	\$ 4.13	\$29.54	\$ 53.38
Italy	6.17	3.00	.62	3.00	12.79
United Kingdom	.85	1.46	3.50	4.59	10.40
Canada	5.41	4.85	2.32	.52	13.10
Other	<u>.37</u>	<u>.96</u>	<u>6.93</u>	<u>9.56</u>	<u>17.82</u>
	<u>\$21.39</u>	<u>\$21.39</u>	<u>\$17.50</u>	<u>\$47.21</u>	<u>\$107.49</u>

Chile has also received substantial amounts from United States voluntary agencies and private foundations. The Ford, Rockefeller, and Kellogg Foundations have provided educational, scientific, and charitable assistance to Chile in substantial amounts. The social welfare programs of United States voluntary agencies, excluding Public Law 480 programs, have averaged \$7 million annually in recent years.

OVERSEAS ADMINISTRATION OF AID PROGRAM

Part II of Executive Order 10893 of November 8, 1960, set forth the responsibilities of United States Ambassadors for coordination and supervision of the functions of all United States agencies abroad. Section 201 provides that:

"The several Chiefs of the United States Diplomatic Missions in foreign countries, as the representatives of the President and acting on his behalf, shall have and exercise, to the extent permitted by law and in accordance with such instructions as the President may from time to time promulgate, affirmative responsibility for the coordination and supervision over the carrying out by agencies of their functions in the respective countries."

On the basis of conversations with the Ambassador to Chile and other members of the country team, including the Director of the AID Mission, and our observations, it appears that the Ambassador recognized and was carrying out his responsibility for the coordination and supervision of AID functions. The AID Mission staff in Chile, including United States specialists serving in that country under AID-financed contracts, consisted of United States citizens and foreign nationals, as follows:

	<u>June 30</u>	
	<u>1966</u>	<u>1967</u>
United States citizens:		
AID direct-hire employees	34	34
Other Federal employees	9	7
Contract employees	<u>23</u>	<u>20</u>
	<u>66</u>	<u>61</u>
Foreign nationals:		
AID direct-hire employees	105	97
Contract employees	<u>10</u>	<u>18</u>
	<u>115</u>	<u>115</u>
Total	<u>181</u>	<u>176</u>

PROGRAM LOANS

AID programs have been administered in recent years under various techniques or forms of assistance, with a major break between program assistance and project assistance. Program assistance is not tied to a specific project. It involves the transfer of nonproject resources, most commonly in the form of commodities under either loans or grants, under circumstances where the totality of the resources made available, rather than their particular use, constitutes the primary United States concern. Project assistance is used to aid in the development or accomplishment of specific undertakings or integrated enterprises, such as the building of a factory or a specific project in the field of health or education.

AID has pointed out that the program loan serves two key objectives--first, it finances the cost of importing a variety of commodities which the recipient country could not otherwise afford and, second, it is an effective tool for encouraging self-help measures and for influencing the recipient country to adopt sound overall economic policies. Because the program loan is normally a large loan and because it is focused not on a particular project but rather on the needs of the entire economy, AID believes that program loans provide a large degree of leverage to encourage and support sensible policies with an economywide impact--broad-gauged fiscal and monetary reforms, exchange reforms, and institutional improvements--or whatever other steps may be called for in a particular country's circumstances.

Program loans have been made to Chile to provide broad budgetary and balance-of-payments support for Chile's development programs as a whole. Program loan levels have been determined following AID's analysis of the balance-of-payments outlook and the public investment program projected by the Government of Chile (GOC). Dollar disbursements under program loans were made in increments, subject to periodic review by AID of Chilean performance and the undertaking of promised self-help measures.

Since creation of the Alliance for Progress, program loans have totaled \$250 million and have constituted about

70 percent of the total AID assistance to Chile. The following schedule shows the dates and amounts of these loans.

<u>Date of</u> <u>loan agreement</u>	<u>Amount</u>
	(000,000 omitted)
1-31-63	\$ 35
4-13-64	55
1-15-65	80
2-15-66	<u>80</u>
	<u>\$250</u>

These loans are long-term (40 years, including a 10-year grace period), low-interest-bearing loans and are repayable in United States dollars.

FINANCING OF PROJECTS

Although the financing of specific projects does not constitute the primary United States concern in providing program assistance, the funds may be used for this purpose. In Chile, program loans have been used to finance projects selected by AID from GOC's annual investment budgets. Of the \$250 million provided in program loans, about \$25 million was used by GOC ministries to finance the dollar or foreign exchange costs of projects in the public sector and about \$224 million worth of generated local currency was used to finance the local currency costs of projects also in the public sector. The local currency was made available to GOC by the Central Bank of Chile in exchange for letters of credit issued by AID in equivalent dollar amounts. The letters of credit were later used by private importers to cover the costs of importing goods and services from the United States.

Program loans have been allocated to projects selected by AID in the following sectors of the economy.

<u>Sector</u>	<u>Dollar equivalent</u>				<u>Total</u>
	<u>1963</u>	<u>1964</u>	<u>1965</u>	<u>1966</u>	
	(000 omitted)				
Transportation	\$ 3,240	\$16,100	\$29,973	\$16,664	\$ 65,977
Industry and mining	1,389	14,521	17,451	20,649	54,010
Housing	7,638	11,942	-	10,942	30,522
Education	4,166	1,408	14,181	15,562	35,317
Agriculture	11,573	10,714	15,936	8,030	46,253
Health and sanitation	3,148	122	988	662	4,920
General and miscellaneous	<u>3,846</u>	<u>-</u>	<u>1,471</u>	<u>6,241</u>	<u>11,558</u>
	<u>\$35,000</u>	<u>\$54,807</u>	<u>\$80,000</u>	<u>\$78,750</u>	<u>\$248,557</u>

The relatively low priority of some projects included in investment budgets has been a source of concern to AID regarding the utilization of program loans, because the selection of projects for AID financing does not limit total financing to high-quality economic development projects. Funds provided from sources other than AID were used to finance other projects listed in the investment budgets, and the manner in which these other funds were used had a direct bearing on the need for AID financing of overall deficits in the investment budgets. Mission officials believe that the program loan technique has helped to improve the total resource allocation of the investment budgets.

RATIONALE AND OBJECTIVES OF PROGRAM LOANS

Loan of \$35 million--January 31, 1963

On the basis of discussions with GOC officials in November 1962, the United States proposed to provide \$60 million in general support of GOC's integrated stabilization-development program. This support was to be conditioned on GOC's carrying out a stabilization program which would include International Monetary Fund (IMF) standby assistance and on GOC's following through with its reform measures and its development program. The \$60 million package was to consist of a \$35 million program support loan from AID, a \$15 million balance-of-payments loan from the Export-Import Bank, and \$10 million from the Treasury's Exchange Stabilization Fund. The local currency generated by the Export-Import Bank and the AID loans were to be available for financing appropriate segments of GOC's public investment program.

The \$35 million AID program loan funds were to be disbursed in increments conditioned upon GOC's entering into an IMF standby arrangement and taking monetary and fiscal measures satisfactory to AID, which would ensure achievement of planned investment levels.

AID was to ensure that local currency funds generated by the loan proceeds would be utilized exclusively for financing key elements of the capital investment program in the public sector. In January 1963, GOC entered into a 1-year standby arrangement with IMF in an amount equivalent to \$40 million.

Following the 1963 program loan agreement, the Mission reported to AID that the fungibility of funds would set a natural limit on the extent of United States control of the local currency proceeds of the loan. Since certain programs and projects in the 1963 GOC investment budget had already been financed by specific foreign credits, the remaining programs and projects to which the \$35 million loan proceeds could be applied were mostly social overhead programs.

The Mission's report in November 1963 stated that some important reforms had been taken and that others were under

way but that Chile's democratic political institutions, party system, and traditions made reform slow and difficult. The lack of adequately planned projects in the public investment program had held the growth impact of expenditures below potentials and had limited Chile's ability to obtain foreign assistance.

The Mission pointed out that it could withhold additional program support for GOC's development plan until such time as corrective measures were taken on basic economic and development policies but that this alternative would cause an economic deterioration which would adversely affect the manifold United States interests in Chile. The Mission recommended continued assistance at a relatively high level in order to enable the Alessandri administration to retain such gains as it had made and, toward the end of 1964, to provide its successor with a reasonable starting point for new development undertakings.

Loan of \$55 million--April 3, 1964

In its recommendation for a 1964 program loan of \$40 million, AID stated that the circumstance of an election year would limit the ability of GOC to introduce desirable, but politically unpopular, economic and administrative reforms. The disbursement of the program loan was calculated to encourage maximum self-help and reform efforts, particularly in the taxation field. The overall assistance plan, of which this loan was a key element, was designed to encourage other foreign lenders to contribute more to Chile's development and to reduce the need for United States assistance on concessionary terms.

GOC subsequently requested emergency assistance from the United States to finance a supplemental public investment program for maintenance of employment levels and to cover balance-of-payments requirements to stabilize the exchange rate and to slow the rate of price inflation. On May 29, 1964, the AID Administrator approved a \$15 million increase in the program loan. The additional funds were provided as a cash transfer to GOC with the provision that GOC would subsequently provide documentation of imports to identify the funds with the United States goods and services imported.

Loan of \$80 million--January 15, 1965

In July 1964, AID stated that GOC's development plan did not provide a sufficiently realistic basis on which to estimate when the economy should be in a position to maintain a satisfactory growth rate without resorting to external financing on concessional terms, due, in part, to the fact that the plan was out of date. AID stated also that GOC was beginning to prepare comprehensive plans for the education, agriculture, and transportation sectors and for urban development. AID called for the Mission to press for necessary revisions of the 10-year plan. AID further stated that program support should be provided only if GOC was taking reasonable steps to achieve the goals of the Alliance for Progress.

Program support was asserted to be a natural device for influencing the allocation of Chilean resources, the adoption of various economic and social policies, and other actions, because negotiations at the proper level would lead to an examination of broad economic policies, such as the investment budget and balance-of-payments problems. Disbursement of program loan funds could be more easily related to overall economic performance than could project assistance. AID further stated that, to the maximum extent consistent with other elements of the assistance plan, the United States would encourage the use of local currency proceeds of program support assistance so as to improve the project development and execution process in Chile, influence the allocation of GOC budgetary resources, or benefit from the attribution of such funds to politically desirable activities, or all of these.

The AID statement called for measures to influence GOC economic and financial policies and to institute reforms to encourage better use of resources and to increase GOC revenues. The statement called also for a 3-year program of administrative improvement and reorganization of GOC development planning processes and project execution capabilities at all levels in support of Chilean public investment programs. The statement also established goals to bring about basic reforms and improvements in the Chilean educational system and in the agriculture sector.

In November 1964, the Mission reported that, in its final year, the Alessandri administration had been able to undertake only a few of the basic steps to resolve Chile's continuing economic problems.

The change in administrations in Chile in 1964 required a reorientation of United States assistance. Progress in recent years has consequently been limited. Urgent requirements were that project preparation be rapidly improved if Chile was to utilize all available external sources of assistance and not continue to rely on program loans and that more United States assistance be directed promptly into more productive investments. The Mission's proposal for 1965 was to establish the foundations for development over the ensuing 6-year period, with no expectation for accelerated economic growth in 1965. The Mission recommended higher levels of assistance to aid the new administration in effecting its reform program in a timely manner and in implementing its public sector development program.

The United States assistance program for Chile for fiscal year 1965 was developed in a series of negotiations with the Frei administration which began in October 1964. The initial GOC presentation sought \$150 million in program assistance for 1965. From an AID analysis of the proposed GOC program, it appeared to AID that the investment budget was excessive and inflationary, public sector savings and fiscal plans were inadequate, overvaluation of the exchange rate was continuing, and incentives for private, productive investment were lacking. During the final negotiation, the United States was able to persuade GOC to institute self-help measures to alleviate the problems in this area. GOC agreed to submit a letter of intent to the Inter-American Committee on the Alliance for Progress (CIAP) committing GOC to these self-help measures and outlining its plan to achieve its objectives for economic growth and social welfare. On this basis, AID agreed to provide an \$80 million program loan.

The GOC letter of intent to the CIAP pointed out that GOC was undertaking a revision of the development plan for the period 1965-70. The revision was to cover general targets and objectives for the 6-year period and detailed plans and programs for the 1966-67 period. GOC's letter contained

a number of broad performance commitments regarding policy and legislative measures proposed for achieving a satisfactory rate of development. In its letter of intent, GOC stated that it would give increasing attention, in its public investment program, to the more productive sectors of the economy and that it would give preferential consideration, in the allocation of counterpart funds from external assistance, to projects in the fields of agriculture, industry, and secondary and technical education.

Disbursement of the program loan was to be related to quarterly tests of GOC performance, which were to be much tighter and more extensive than before. The quarterly reviews were to be aimed at correcting developments which were contrary to overall objectives and at encouraging, guiding, and accelerating measures required to promote growth.

AID anticipated that the quarterly reviews of progress would permit better judgment of the advisability of providing certain assistance levels in future years.

AID stated, in October 1965, that United States assistance in 1965 had been directed toward influencing and guiding the basic decisions and policies which would have long-term developmental significance. AID pointed out that the bench marks of progress during the year had been the adoption and implementation of stabilization and development policies, legislation, and reform programs. According to AID, progress had been made in decelerating inflation, increased public investment had contributed to an expansion of economic activity and employment, and the balance-of-payments equilibrium had been maintained. AID stated at that time that it intended to apply more stringent conditions in 1966 to step up progress in the fields of economic stabilization and growth, institutional development, and social reform.

AID believed that GOC not only would have to make additional efforts to stabilize the economy and expand production but also would have to undertake a thoroughgoing reform in its economic and social structure.

AID stated that a basic target of the assistance was to eliminate the need for United States economic assistance (especially program loans) on concessional terms in the early 1970's. Achievement of this target depends, to a large extent, on the timing of GOC's plan to expand copper production.

AID further declared that future considerations must include the limited leverage that such assistance has in shaping overall GOC development policy, since United States assistance contributes less than 5 percent of the total GOC budget.

In January 1966, in response to an inquiry from AID as to when program lending to Chile could end, the Mission replied that forecasts in this regard had been too optimistic. The Mission stated that traditional attitudes and patterns had proven to be more obstinate, and progress had proven to be slower, than had been anticipated by either GOC or AID. The Mission stated that the fact that the level and conditions of program lending were strongly influenced by political factors had complicated problems of using such assistance to provide incentives and the means of implementing the required reforms. The Mission pointed out that GOC had benefited in 1965, and was benefiting in 1966, from high copper prices, debt rescheduling, and high levels of United States and other external assistance. However, the GOC had been unable to capitalize on these favorable circumstances and to make more significant progress in solving long-run problems.

Uncertainties precluded the Mission from specifying a particular year in which program loan assistance could be terminated. The Mission concluded that there would be a continuing need for concessional assistance to Chile beyond the 1970 date anticipated and for an increased level of such assistance if copper prices were to fall or if Chile's creditors were to fail to agree to further debt rescheduling after 1966. This conclusion was based on the premise that program loans must be continued until balance-of-payments, budgetary, and monetary equilibrium are obtained. The Mission suggested that AID give further consideration to whether program loans are the most effective way of

accomplishing the economic and social development objectives of GOC and AID.

AID further stated that substantial accomplishments had been recorded in 1965 but that difficulties of achieving economic stabilization objectives and carrying out organizational reforms had become apparent. Some social changes required increased GOC expenditures. Organizational changes in GOC were found to be more difficult than had been anticipated for technical, as well as political, reasons. The Frei administration faced strong, and to a large degree--at least temporarily--effective, political opposition to proposed changes that traditionally influential groups looked upon as a threat to their interests. AID believed however, that the accomplishments were significant.

Loan of \$80 million--February 15, 1966

In the negotiations with GOC for the program loan for 1966, AID had considered making a loan of \$90 million. However, difficulties were encountered due to GOC's increasing its investment budget, which increased the need for inflationary borrowing from internal sources. AID subsequently decided to make a program loan of \$80 million and to later consider as a project loan the \$10 million loan originally planned for private sector capital imports.

United States objectives in 1966 were to provide a level of assistance and obtain GOC commitments which would enable Chile to:

1. Increase the level of investment to the extent necessary to effect key structural changes and to broaden the productive base, without making cutbacks in employment, consumption, and social programs to an extent which would jeopardize social and political stability. Agrarian reform, copper expansion, and an increased flow of funds for private investment were to be essential elements in this effort.
2. Correct distortions in the financial structure, which continued to be a serious cause of inflation.

The program loan was designed to accomplish these objectives by (1) permitting an increase in imports of about 21.5 percent over 1965 imports and a liberalization of the import system, (2) requiring a stronger budgetary performance, thereby reducing the single most refractory source of inflationary pressure in Chile, and (3) obtaining specific steps, some legislative--such as agrarian reform--and some administrative--such as completion of sectoral plans in agriculture, industry, and education--which would lay the groundwork for accelerated change and development.

In a letter to the CIAP dated February 2, 1966, GOC outlined its targets for achieving financial stability and economic growth so that living conditions would be improved and, by the early 1970's the need for concessional external assistance would be eliminated.

The letter set forth the steps that must be taken to improve conditions in agriculture, industry, and education. Regarding development planning, the letter stated that GOC was still in the process of preparing an overall plan. A detailed sectoral projection for the economy was to be prepared by the end of April 1966. A detailed budget for 1967, including a sectoral allocation of public investment, was to be available by the end of July 1966, and it was to be consistent with the plan. The letter mentioned that the International Bank for Reconstruction and Development was providing technical assistance in project preparation and reviews. The development objectives of GOC were dependent upon financial stability and GOC's increased ability to finance improvements. A matter of highest priority was to reduce the rate of inflation during 1966 to no more than 15 percent.

INTRODUCTION OF SECTOR LOANS

In October 1966, the Mission recommended the award of sector loans for agriculture and education of \$25 million and \$10 million respectively. A sector loan is a confined type of program loan; it is not confined to a particular project but is confined to a particular sector of the economy, such as agriculture or education. The Mission believed that this new type of loan would provide a direct linkage between the AID program and the sectors involved, because specific United States dollar funds would be earmarked for use in agriculture and education and would be governed by the performance criteria of the respective GOC ministries. The sectors in question, and not GOC as a whole, would get United States assistance if performance was satisfactory. The withholding of funds would be directed at the nonperforming sector rather than, as under the program loan method, at the GOC program as a whole.

AID awarded an educational sector loan of \$10 million in June 1967 and an agricultural sector loan of \$23 million in October 1967.

In December 1966, GOC officials advised the Mission that GOC would forego 1967 program loan assistance because of increases in copper prices. However, because of a decrease in copper prices, AID awarded a program loan of \$15 million to GOC in October 1967.

In its program assistance paper covering the \$15 million program loan, AID included the following comments concerning the use of separate sector loans as the result of a change in its technique of providing assistance.

"Most major policy conditions of the U.S. assistance program were included under the program loan. In 1963 and 1964 these conditions related primarily, though not exclusively, to monetary, fiscal, and exchange rate policy. In 1965 and 1966 they included policies and institutional reform measures related to industry, education, agriculture, transportation, and other areas. Goals and targets in these areas were included in a letter from the Finance Minister to the

Chairman of CIAP. Quarterly reviews were held with appropriate high-level government authorities to determine progress under this program and the funds were released in quarterly (roughly equal) tranches on the basis of satisfactory performance against stated targets.

"Despite the considerable progress realized through these loan programs, *** changing conditions and emphasis brought a change in the technique of handling the 1967 program. The program loans, which were large, included conditions affecting the activities of a number of Ministries and agencies. Yet the loan was signed by the Finance Minister who held primary responsibility for performance in all sectors without having sufficient authority to always assure adherence to all conditions. It was the Finance Minister who bore the major part of the political pressures for difficult reform measures which Ministers in areas other than finance gave less concern to stated conditions and were not always held directly responsible for their failures. Hold-backs on tranche releases became difficult when, for example, financial conditions were fully met but agricultural forward price announcements were not made as agreed.

"In 1967, therefore, the program was divided between the program loan and separate sector loans in agriculture and education. Each of these have separate conditions related to the specific areas with certain over-riding conditions on public sector investment levels, fiscal policy in general, monetary policy, and exchange rate performance affecting disbursements on all loans. Each of the sector loans is to be signed by the Minister responsible for the area concerned and by the Finance Minister because of the financial conditions."

We believe that the use of sector loans has merit, because they should provide opportunities for more effective direction of purpose and concentration of effort in those sectors for which they are provided.

SOCIAL, ECONOMIC, AND POLITICAL

PROBLEMS OF CHILE AND

ACCOMPLISHMENTS AND NEEDED REFORMS

ALLIANCE FOR PROGRESS OBJECTIVES

In August 1961, all members of the Organization of American States except Cuba signed the Charter of Punta del Este, proclaiming their decision to unite in a common effort to bring their peoples accelerated economic progress and broader social justice within the framework of personal dignity and political liberty. The charter provides, that:

1. The American Republics agree to work toward the achievement of the following fundamental goals in the present decade.
 - a. To achieve, in the participating Latin American countries, a substantial and sustained growth of per capita income at a rate designed to attain, at the earliest possible date, levels of income capable of ensuring self-sustaining development and sufficient to make Latin American income levels constantly larger in relation to the levels of the more industrialized nations.
 - b. To make the benefits of economic progress available to all citizens.
 - c. To achieve balanced diversification in national economic structures.
 - d. To accelerate the process of rational industrialization.
 - e. To raise greatly the level of agricultural productivity and output.
 - f. To encourage programs of comprehensive agrarian reform.

- g. To eliminate adult illiteracy and, by 1970, to ensure, as a minimum, access to 6 years of primary education for each school-age child in Latin America.
 - h. To increase life expectancy at birth and to increase the ability to learn and work productively, by improving individual and public health.
 - i. To increase the construction of low-cost houses for low-income families and to provide necessary public services to both urban and rural centers of population.
 - j. To strengthen existing agreements on economic integration, with a view to the ultimate fulfillment of aspirations for a Latin American Common Market.
 - k. To maintain stable price levels.
 - l. To develop cooperative programs designed to prevent the harmful effects of excessive fluctuations in the foreign exchange earnings derived from exports of primary products and to adopt the measures necessary to facilitate the access of Latin American exports to international markets.
2. The American Republics recognize that to achieve the foregoing goals it will be necessary:
- a. That comprehensive and well-conceived national programs of economic and social development be carried out in accordance with democratic principles.
 - b. That national programs of economic and social development be based on the principle of self-help and on the maximum use of domestic resources.

- c. That, in the preparation and execution of plans for economic and social development, women be placed on an equal footing with men.
- d. That the Latin American countries obtain sufficient external financial assistance to supplement domestic capital formation and reinforce their import capacity and that a supply of capital of at least 20 billion dollars from all external sources during the coming 10 years be made available to the Latin American countries.
- e. That institutions in both the public and private sectors be strengthened and improved.

The United States promised to assist those participating countries whose development programs established self-help measures and economic and social policies and programs consistent with the goals and principles of the charter.

On November 22, 1965, President Johnson informed the Latin American governments that the United States was prepared to extend the Alliance for Progress beyond the 10-year period foreseen in the Charter of Punta del Este.

KEY OBSTACLES TO ACHIEVEMENT OF OBJECTIVES

AID has attributed the slow pace of economic reform in Chile partly to the Chilean political situation. Twelve political parties have been legally constituted in Chile, and nine parties are currently represented in the Chilean Senate. Until the 1965 congressional elections, no single party had been able to achieve a majority in either of the legislative chambers during recent decades. For the President of Chile to fulfill his programs, he had to compromise with other political parties by bringing their leaders into his Cabinet or by trading votes in the Congress.

In November 1964, the Mission reported that, in its final year, the Alessandri administration had been able to undertake only a few steps to resolve Chile's continuing economic problems. The ability of GOC to introduce desirable, but politically unpopular, legislation or administrative reforms was limited, because of the presidential elections in September 1964 and because of a possible Communist-Socialist Coalition Popular Action Front victory.

The Frei administration came into power in November 1964, but its program was initially blocked until March 1965 by a holdover Congress. In the March 1965 elections, President Frei's Christian Democratic Party won 82 of the 147 seats in the Chamber of Deputies but only 13 of the 45 seats in the Senate. The lack of a majority in the Senate has posed problems for the Frei administration's legislative program.

AID, in its 1967 and 1968 budget presentations to the Congress, pointed out the following key obstacles to achievement of objectives.

"Chile has a long tradition of constitutional democracy. However, the fruits of that democracy have so far been largely for the few, with much of the population living in ignorance and poverty and with little hope of improvement. The new administration inherited an economy inordinately dependent on large government expenditures and foreign assistance, a monopolistic private sector producing limited quantities of

products at high prices, an educational system which worked to deny opportunity to a majority of the people, and a stagnant agricultural sector. It also inherited serious and chronic inflation which exacerbates social tensions and reduces incentives to save and invest productively.

"Frei, elected with a mandate for change, has faced, and continues to face; enormous problems. Although Frei's popularity is extremely high, his government's program of stabilization, reform and development is resisted by the traditional ruling groups who seek to preserve what they can of their former privileges, and by a very active, strong, and always vocal far left which supports Marxist solutions and seeks--sometimes successfully--to frustrate Frei's more moderate approach."

The traditional ruling groups have been able to retain control over economic resources and to exercise important political influence at all levels of government. With a relatively small number of large farms and a large number of small farms, Chile ranks near the top of Latin American countries for land-ownership concentration. The large landowners frequently reside in urban areas and engage in other activities. A relatively small group of families dominates the industrial sector and controls most of the large industrial concerns in Chile and the major private banks.

The Frei administration came into power in 1964 committed to a broad program of economic and social reform that would reach into nearly every facet of Chilean life. Considering the comprehensive nature of the proposed reforms and the obstacles mentioned above, the first 2 years of the administration were taken up, to a considerable extent, with planning and preparation. Although some reforms have been achieved and steps have been taken that offer promise that additional reforms may be forthcoming, much remains to be done.

Some of the more significant problems, accomplishments, and needed reforms are discussed in more detail in the following sections of this report.

PUBLIC FINANCE

The public sector of Chile consists of the Central Government, the municipalities, 45 decentralized agencies, and about 44 social security funds. Central Government income is derived almost entirely from tax revenues. Income of the rest of the public sector is derived from revenues from social security contributions, goods and services sales, investment income, and loan repayments.

In terms of both revenue and expenditure, the decentralized agencies rival the Central Government in their impact on public finances. These agencies fall into four major groups. The first group is composed of a number of social security institutions with distinct costs and benefits for workers in particular classifications. The second group is composed of GOC commercial entities which include five transport enterprises. The third group is composed of specialized agencies in the fields of industry, housing, urban improvement, hospital construction, and food distribution. The fourth group is composed of state universities and miscellaneous agencies.

Major difficulties have arisen from the status and role of the decentralized agencies. Each of the 45 agencies has its own set of functions and problems. In recent years, approximately 46 to 50 percent of GOC operating expenditures have been transfers to decentralized agencies to cover their operating deficits. Some 50 percent of GOC capital expenditures have been transfers to such agencies.

On an overall basis, the current or operating budget has consistently shown a surplus which has been used to finance deficits in the capital or investment budget. As pointed out in a prior section of this report, program loans also have been used to finance deficits in the investment budget.

Development programs and investment planning and budgeting

GOC prepared a national development program to provide Chilean economic policy for the 10 year period of 1961-70. Preparation of the program was completed shortly before the

earthquakes of May 1960. It gained the acceptance of the Alessandri administration when it was revised, after the earthquakes, to integrate the reconstruction requirements with development.

The main objectives of the program were to achieve a growth rate of 5.5 percent in gross national product (which had traditionally averaged 3.2 percent) and to create a favorable climate for private investment by providing the necessary public investment for infrastructure; by stimulating the private sector through public works and direct investments for housing, irrigation, and land resettlement; and by promoting mining, forestry, and fisheries.

At the request of GOC, an international organization evaluated the 10-year plan. The evaluation report, in April 1962, stated that the development program was not unreasonable in magnitude and balance and that its targets could be achieved, provided that the necessary monetary, fiscal, and reform measures were taken. The report stated that execution of the program would require administrative changes in (1) planning and coordinating the public sector investment, (2) selecting and determining the priority of projects, and (3) formulating projects.

In February 1962 GOC submitted its 10-year plan to another international organization for evaluation. The evaluation report, submitted to GOC in October 1962, pointed out that the plan offered a comprehensive program whereby a satisfactory rate of economic development might be achieved in the face of the many problems, provided that all sectors of the Chilean society were willing to make the necessary effort.

In November 1962, the Mission reported that the major shortcomings of the 10-year plan were:

1. The lack of any clear priorities.
2. The lack of definite projects and studies sufficient to form the basis for loan agreements.
3. The low investment rate projected for the agricultural sector, which did not provide for the

necessary increase in agricultural output or for the requirements of financing a land reform program.

In November 1963, the Mission stated that experience over the first 3 years of the 10-year plan's execution had suggested that there had been only a limited commitment to the development effort on the part of the administration and the Chilean Congress. Vital political-economic decisions were taken on fiscal and monetary matters, wage and price policies, mobilization and use of resources, and related matters with little apparent reference to Chile's development requirements as set forth in the plan. The plan thus appeared to serve the needs of Chile's external policy in regard to foreign assistance more than it served as a practical and meaningful guide to internal policy decisions on economic and development matters.

In July 1964, the AID Administrator issued a long-range assistance statement regarding Chile. The statement pointed out that GOC's development plan took a questionable approach to financing and that the plan was out of date. The administrator stated that the United States would press for continuing realistic revision of the plan's targets in the light of changing circumstances.

GOC has been unable to prepare investment budgets based on well formulated specific projects. Planning, to the extent that it has been done, has been dispersed throughout the public sector at the ministerial and agency levels and has not been coordinated. Moreover the ministries and their respective divisions have been weak in the selection and formulation of specific projects. The fact that GOC was unable to formulate acceptable projects limited its capacity to effectively absorb and utilize large loans for specific projects.

The Frei administration has stated its intention to take a variety of steps designed to strengthen the planning, budgeting, and implementing of the development program. A National Planning Office (NPO) has been created. A Secretary General of National Planning has been appointed to serve as Presidential planning advisor and as liaison with ministries, agency heads, international agencies, and the private sector.

In March 1964, AID provided a \$3 million project loan to cover feasibility studies. Of this loan, \$2.25 million was to be available to finance the costs of economic and technical studies for determining the feasibility of specific development projects in the public and private sectors. The remaining \$750,000 was to be available to finance the costs of technical assistance to NPO, the Budget Bureau, and other agencies involved in project planning and preparation. An amendment to the loan agreement also permitted the use of funds available for the preparation of general surveys and prefeasibility studies designed to assist in the identification, appraisal, and formulation of priority development projects.

According to AID, this loan has contributed to the establishment of a Project Evaluation Office in the Budget Bureau that is concerned with project identification, selection, evaluation, and preparation of feasibility studies. The Project Evaluation Office is developing criteria and techniques for coordinating the project activities of the various GOC operating agencies. As of August 1966, little progress had been reported in project preparation in key GOC development agencies. Most of the economists and planners were devoting their energy to sectoral-plan preparation.

In 1966, a procedure was established within GOC, which provided for a sectoral planning office for preparing the sectoral plans and identifying priorities and projects. Each sectoral plan was to be submitted to NPO for coordination with the overall plan and other sectoral plans. Thereafter, the sectoral budgets were to be adapted, to the extent practicable, to the sectoral plans.

At the time we completed our review, the overall development plan was being prepared by NPO and a budget reform bill was pending before the Chilean Congress. AID advised us that this bill required that:

1. Each project or program, before being included in the budget, be submitted to NPO and the Budget Bureau for technical, economical, and priority review.
2. Budgetary controls be installed over obligations and expenditures.

Housing

An influx of the rural population to urban areas and a relatively high birth rate have created a serious housing demand in Chile. About 75 percent of residential construction is directly financed by GOC. Housing is the largest single item in, and has consumed up to 25 percent of, the annual investment budget. About \$30.5 million in program loans have been allocated to housing projects. The budgetary emphasis on housing construction has diverted a substantial portion of public sector resources away from more productive areas. In GOC's administration of its housing program, problems have existed regarding project planning, construction, facilities, and property management.

During the 1964 election campaign, President Frei had promised a housing program of 360,000 new starts, or an average of 60,000 units annually during his 6-year term. In 1965, 52,162 units were initiated, but in 1966 only 28,736 were initiated. In addition, 48,000 emergency houses were constructed after the 1965 earthquake and storms. In 1966, 2,974 urbanized sites were prepared for self-help construction. In May 1967, the President presented a revised housing program; however, the 360,000 target remained the same but differed in composition and quality from his original program.

In response to a GOC request, AID has reviewed GOC's needs for technical assistance in the field of housing, and discussions are under way on a proposed project.

Transportation

Transportation in Chile absorbs about 20 percent of investment resources. Moreover, about \$66 million in program loans have been allocated to transportation projects. No clear understanding has existed of the relation between transportation and economic and social development goals; the contributions that improved transportation can make to increased production; or the interrelationship of investment decisions outside the transportation sector with those being made in the transportation sector. Transportation goals have not been translated into identified and well-justified projects.

AID technical assistance in the area of transportation has involved the preparation of a national transportation planning process delineating Chile's transportation needs; the system best suited to meet these needs; and the financial, organizational, and administrative requirements for building and operating transportation facilities.

Reported progress has included gathering statistical information on the nature, capacity, and deficiencies of transportation in various regions of Chile; conferring with all GOC agencies with transport functions; and preparing a national transportation investment program for the period 1966-70. An appraisal of the major economic and technical needs of the domestic air transport system has been made. Economic and technical appraisals of the transportation needs of areas in various provinces have been accomplished.

AID has stated that work on national transportation planning has been adversely affected by the inadequate institutional framework in GOC to bring together the different GOC agencies related to transport. Project implementation has been slower than expected due to the delays in establishing a GOC office to handle all transportation matters and in preparing sectoral plans from which information necessary to the projection of transportation requirements may be obtained.

Social security

The Chilean social security system absorbs about 7 percent of the gross national product. It is costly, inequitable in its coverage and distribution of benefits, and draws heavily from fiscal revenues. It does not cover broad segments of the population. Social security legislation has grown on a piecemeal basis, and there are now some 400 laws governing the system. The system involves 44 different funds, each with its own legal status, assets, property rights, and personnel. Government transfers have accounted for one third of all social security contributions. The deficit of the principal fund is increasing, and pressures for greater fiscal transfers are growing.

AID and GOC have recognized the need to make fundamental changes in the Chilean social security system. One of the objectives of the social security reform is to make social security independent of any budget subsidies, thus freeing GOC resources to finance productive investment programs. We were advised by AID officials that it appeared unlikely that GOC would present major reform legislation for the social security system or that AID would propose any long-term assistance in this field in the near future.

Health

AID has reported that medical care for middle and upper class families in Santiago, Chile, is very good but that it is practically nonexistent for families in the poorer and more isolated parts of the country.

AID has had a number of health projects in Chile since the inception of the Alliance for Progress. About \$640,000 has been expended for technical assistance for projects involving influenza and measles immunizations, pediatric surgical equipment, mobile health units, medical and dental equipment, and medical training for the national police force.

Taxation

Problems

The primary problems in taxation have been (1) a series of substantive tax laws which have been unsuited to revenue needs, difficult to administer, and not adjusted to modern concepts of economics or tax incidence and (2) a tax administration which has been inflexible and inefficient. The assessed tax value of real estate has been less than 10 percent of market value. Many minor taxes cost more to administer than they have yielded in revenue. The incidence of tax evasion has been estimated at over 50 percent.

The Internal Tax Service has been greatly overcentralized. Other difficulties have been: cramped and poorly utilized office space, unsystematic audit procedures, and a personnel system based primarily on seniority rather than on ability.

Accomplishments

A tax modernization project was initiated by AID in 1962 and is scheduled for completion in 1970.

The objectives of this project are:

1. To reorganize and improve the Internal Tax Service and the tax collection functions of the Ministry of Justice.
2. To assist (through research, analysis, and training) in developing a tax policy for increasing revenues and for ensuring a more equitable distribution of the tax burden.

United States aid to this project has consisted mainly of furnishing tax advisors and training GOC tax administration personnel in the United States. AID has a contract with the Harvard University Law School, which provides three resident advisors to work with a high-level GOC tax policy commission. This group is undertaking research on

tax policy and designing and drafting implementing legislation, regulations, and rules required to effect reforms in the present tax system.

In December 1962, a law was passed providing for the reorganization of the administrative and the auditing function of the Internal Tax Service to tighten tax collection procedures. Moreover a complete reassessment of all real estate, rural and urban, was initiated on the basis of a law passed in November 1962. This reassessment resulted in an average increase of 300 percent in assessed value. Forgiveness of nonpayment of past taxes has been stopped, and heavy inroads in the collection of delinquent taxes have been made. The Tax Fraud Department, established in the Internal Tax Service, has, for the first time, actively and successfully prosecuted tax evaders.

A law simplifying the stamp tax, by reducing the number of separate rates from 300 to less than 60, was passed in September 1963. An administration-supported bill to increase income and inheritance taxes was enacted in February 1964.

As a result of these administrative and legislative reforms, the tax yield increased 76 percent in real terms between 1961-66.

Customs

Problems

The Customs Service of GOC operated without a permanent general superintendent from 1961 until December 1964. The resulting lack of leadership adversely affected the entire Customs Service, and a substantial deterioration took place in discipline, intraagency coordination, internal controls, and employee morale. No effective periodic reporting system has been in operation between the field and central offices. The administrative and internal audit functions have not been performed.

At the operational level, the Service has been plagued with cumbersome and unnecessary procedures and delays. No

system existed to ensure that all arriving cargo was documented and that such cargo was withdrawn from customs only after payment of the required duties. Effective supervision had not been exercised over appraisers to ensure that their findings as to classification, value, and quantity of merchandise were valid. Accurate foreign trade statistics and other vital data important to development planning had not been compiled. Costly losses and damage to merchandise were frequent occurrences with the result that legitimate claims often remain uncompensated.

Accomplishments

AID initiated a customs administration technical assistance project in fiscal year 1963 to help bring about an increase in the overall efficiency of the customs and tariff functions. For the purpose of increasing revenue collections, improvements were to be made in the Customs Service structure and in its operational effectiveness, internal coordination, and staff training.

Merchandise-handling procedures were instituted that are expected to reduce significantly the loss and damages that take place annually in the ports. Legislation was enacted establishing two internal control units. Significant violations were uncovered by the internal audit unit. A system for determining and controlling the valuation of merchandise for customs purposes was approved. Two laws were passed in fiscal year 1967 providing for various improvements, including the revision of customs auction procedures, the assignment of more funds for the Service, and the provision of overtime pay. An auditor's office was established to exercise supervision over appraisers. A merchandise accounting system is in the process of being installed.

Other internal project accomplishments include the issuance of more reliable and timely foreign trade statistics, the elimination of some procedural complications for clearing imports, and the elimination of a 2-year delay in preparing efficiency reports on the Customs Service staff.

A national plan for the repression of contraband has been completed and is now under consideration. A new basic customs law is being drafted.

Primarily as a result of these improvements, customs revenue increased about \$36 million between 1963 and 1966.

EDUCATION

Problems

Although the educational situation in Chile is somewhat better than in other Latin American countries, it is far from satisfactory. The average educational level for all Chileans over 15 years of age is 5.9 years in urban areas and 3.5 years in rural areas. About 1 percent of the population attends schools of higher learning. The existing educational systems have three major weaknesses: (1) they aim at producing an elite group far removed from practical application of knowledge, (2) they are highly centralized in the metropolitan areas, and (3) they place excessive emphasis on theoretical considerations. Emphasis has traditionally been upon academic training and the liberal professions with the result that few people have vocational skills.

The chief problems in primary and secondary education are a high dropout rate and a type of training not related to priority economic and social needs. In higher education, there is a lack of educational planning and coordination. Most of the staff members in the universities are only part-time teachers who spend a major portion of their time in private practice.

Accomplishments

In the interest of alleviating problems in education, AID has supported the GOC's objectives which are:

1. To encourage and assist reform of educational systems to make them more responsive to the country's needs.
2. To absorb the backlog of deficit of primary education.
3. To expand secondary and vocational education to meet the needs of the country and the aspirations of the people.

4. To upgrade higher education to produce leaders with the knowledge necessary to carry out developments and maintain growth.
5. To eliminate illiteracy and carry out adult education.

Educational expenditures by GOC have amounted to over 20 percent of its operating budget. About \$35.3 million of AID program loans have been allocated for maintenance, repair, and construction of schools. The equivalent of about \$1 million in local currency generated from Public Law 480 programs has been used for school construction.

Technical assistance has consisted of such items as teacher training, manpower and education planning, an education system survey, a school repair project, and the training of Chileans in the United States in economics and social science. In addition, a \$2.1 million project loan was made for the purpose of constructing 15 schools in low-income areas.

In 1965, the increase in the number of primary school students was 175,000, compared with the normal annual increase of about 40,000. In 1966, a seventh grade was added to the former 6-grade elementary school system, and, in 1967, an eighth grade was added. According to AID, an estimated 25,000 students have been retained in school who would otherwise have dropped out.

GOC is committed to a program of educational reform as a major vehicle for social mobility and as a basic element in its effort to accelerate economic development. Educational opportunities have increased in recent years. The Ministry of Education has prepared a preliminary outline for a 5-year comprehensive education reform plan designed to improve the quality of classroom instruction, increase the number of students attending schools in all areas of public education, and provide equal educational opportunities to all citizens.

The Frei administration, in its first 2 years, concentrated on expanding the educational system at the primary and secondary levels. According to AID, greater attention must be given in future years to increasing the administrative efficiency, reforming curricula to meet the social needs of the country, and upgrading the quality of instruction. The establishment of a vocational educational system appropriate to Chilean requirements will be particularly important.

AGRICULTURE

Problems

Once a net exporter of agricultural products and practically self-sufficient in the production of foodstuffs, Chile now imports about 20 percent of its food requirements. In recent years the value of food imports has exceeded that of exports by over \$100 million annually. During the period 1952-66, agricultural production has increased about 2.25 percent annually, while the Chilean population has increased at an annual rate of about 2.5 percent. This disparity has resulted in a decrease in standards of living and a steady increase in food import requirements. It has been estimated that about 65 percent of the agricultural products imported could have been produced domestically. This situation has resulted in a heavy drain on the available foreign exchange and has contributed to the steady pressure of inflation.

The stagnation in agriculture stems, in part, from governmental policies and the way they have been administered. Responding to political pressures from the urban population, GOC has applied price controls on a variety of basic agricultural products. A policy of protection and import restrictions aimed at easing balance-of-payments difficulties and encouraging industrial development has been in effect over most of the past decade. Imports of agricultural commodities, on the other hand, have been permitted on a relatively liberal basis. These trade policies have kept agricultural prices lower than other prices, have reduced incentives to farmers, and have discouraged agricultural expansion.

Another limiting factor in agricultural expansion has been Chile's monopolistic and inefficient marketing system. It has been estimated that 20 percent of the semiperishable agricultural products and 35 percent of the perishable products are lost before they reach the consumer. This situation has been caused primarily by inadequate management, storage, processing, and distribution procedures.

A factor contributing to Chile's lag in agriculture has been the pattern of land ownership and use. With a

relatively small number of large farms and a large number of small farms, Chile ranks near the top of Latin American countries for land-ownership concentration. Over 73 percent of all families gainfully employed in agriculture either own no land or own less than 12 acres each. The large landowners frequently reside in urban areas and engage in other activities. Some hold land for reasons of prestige and power and as a hedge against inflation. In 1962, 87 percent of the working class received about 34 percent of the total agricultural income. There is little indication that these statistics have changed materially since 1962. This situation has eliminated a majority of the rural population as a functional part of the economy and has adversely affected industrial and urban production due to the depressed rural market.

Accomplishments

AID made rural area improvement its top-priority goal for 1962 and initiated three technical assistance activities designed to assist GOC in its effort to improve conditions in the agricultural sector. AID's overall objectives were to build a firm socioeconomic foundation in rural Chile so as to permit the rural people to take part in, and benefit from, economic advances to be made and to continue assisting GOC in executing and attaining the goals of the 10-year plan. These three technical assistance activities involved rural extension, marketing, and improvement. The basic elements comprising these and later activities were (1) the furnishing of advisors and/or technicians, (2) the furnishing of participant training courses for Chilean nationals, (3) the financing of construction costs, and (4) the furnishing of commodities, generally equipment. These activities formed the primary base for AID assistance through fiscal year 1964.

Rural extension and marketing were later made an integral part of an agricultural development project initiated in fiscal year 1965. This project became a part of AID's overall technical assistance program for assisting GOC in stimulating agricultural production.

Other AID technical assistance projects in agriculture have included water resources planning, small rural

industries, rural cooperative development, farm worker development, and cooperative education.

About \$46.3 million in program loans have been allocated to the agricultural sector. Projects in the GOC investment budget financed by program loans have included infrastructure development in the areas of irrigation systems, dams, and canals; livestock research and improvement; agrarian reform; credits to farmers; marketing; conservation; and agricultural production and research.

An agrarian reform law was enacted in 1962 and a constitutional amendment permitting deferred payment for expropriated agricultural land was passed in October 1963. It was planned that 5,200 farmers would receive land under the program during 1963; but Chile attained less than 20 percent of this goal in 1963, and progress was even less during 1964.

As part of the 1965 program loan agreement, GOC was to undertake certain self-help measures designed to increase prices of agricultural products and improve marketing conditions. The Mission subsequently reported that, in the first 8 months of 1965, prices at the wholesale level rose by about 34 percent for agricultural products, compared with about 25 percent for industrial products. GOC undertook a program to improve marketing, but the Mission reported that the program had progressed slowly and might not be ready for financing within the 1966 program loan.

In a February 1966 letter to the Inter-American Committee on the Alliance for Progress, GOC set forth proposed agricultural self-help measures. These proposed measures included new legislation and a constitutional amendment regarding land-tenure reform, a multiyear agricultural development plan, improvements to increase prices, and reductions in the overvaluation of local currency (the escudo). Before July 1966, GOC was to take certain actions and to introduce such legislation as was needed to give the Minister of Agriculture the legal and administrative authority to arrive at policy, planning, and organizational decisions and to follow and guide the day-to-day operations of the agencies responsible for executing agricultural development programs.

By September 1966, GOC was to complete a multiyear plan for agricultural marketing. By January 1966 a schedule for 1966 investments in agricultural marketing facilities was to be completed.

In November 1966, AID reported that the land reform program was proceeding at a satisfactory rate under existing legislation. The amount of land expropriated increased from 464,000 acres in 1965 to over 1 million acres in 1966.

AID informed us in January 1968 that the land-tenure reform legislation had been enacted into law in July 1967 and that about 8,000 families had been resettled subsequent to 1965.

The agricultural development plan has not been completed; however, we were informed that legislation enacted in July 1967 had given the Minister of Agriculture the legal and administrative authority to arrive at policy, planning, and organizational decisions.

The Mission stated in October 1966 that, despite some improvement in the agricultural sector under the Frei administration and the high priority given by GOC to agricultural development, performance left much to be desired. The Mission believed that a proposed agriculture sector loan would enhance the possibilities of success. An agriculture sector loan of \$23 million was awarded by AID in October 1967.

INDUSTRY

Problems

A relatively small group of families dominates the private sector with extensive agricultural, industrial, commercial, and financial interests. For all practical purposes, this group has been able to retain control over economic power in Chile, outside the mining area, and to exercise important political influence at all levels of government. This group also controls most of the large industrial concerns in Chile and the major private banks. It generally has been conservative in its attitudes; lacks aggressiveness; is status quo, rather than growth, oriented; and prefers to operate with minimum competition in a protected, as well as a limited, market. Within this group it is possible to find many enlightened and growth-oriented entrepreneurs, but they are generally the minority.

The small- and medium-size industrialists comprise the majority of Chilean producers, but they are the least dynamic and growth minded. They are unorganized and are not represented in the major private sector organizations, government agencies, or the Chilean Congress. These industrialists lack adequate credit on reasonable terms, technological know-how, and trained managers and technicians.

Other groups in the private sector include the modern industrialists, the trades and services, and the foreign investors groups. The modern industrialists group is one of the less powerful but increasingly influential business groups and is active in food, clothing, construction, and light-consumer-goods fields. This group has been a leading force in promoting growth-oriented free-enterprise concepts in Chile.

The trades and services group has shown the greatest growth in recent years but contributes the least to the expansion of the productive base of the economy. Of this group, only the large importers and wholesale distributors are well organized and have successfully defended their interests.

The foreign investors group, dominated by the large copper producers, includes international manufacturing and utility companies. The international manufacturing companies are generally growth oriented, carry out extensive research in an effort to develop the national market, and have progressive public and industrial relations programs. They are the major sponsors of new industrial technology in Chile and, through in-plant training, are actively raising the level of technical skills in Chile.

The stagnation of industrial production stems, in part, from government policies and the way they have been administered. In attempting to deal with recurring inflation and balance-of-payments crises by piecemeal attacks on the symptoms rather than the basic causes, GOC has built up a maze of bureaucratic regulations and controls over every aspect of the economy. This situation has introduced unpredictability into business planning and has discouraged productive investments.

Accomplishments

AID assistance to Chile for industrial development since the inception of the Alliance for Progress has been provided primarily through technical assistance and program loans. About \$54 million in program loans have been allocated to projects in the industrial sector.

Beginning in 1965, program loan agreements contained self-help measures to be undertaken in the industrial sector by GOC. The 1965 agreement required that GOC stimulate increased private savings and investments in productive enterprises through the adoption of appropriate policies and through the establishment of a private investment fund. This goal was not met; however, GOC increased the amount of investment credits available to private firms sponsoring new projects or expanding existing facilities.

The 1966 program loan agreement self-help measures stipulated that improvements be made in administrative procedures related to authorization of new private investments, an industrial planning staff be organized; and a sector plan be prepared. Also substantial investments were to be promoted in various industries. A report on legislative

restrictions on economic activities of industrial firms was to be prepared with a view to removing the restrictions through legislation. In addition, industrial credit to the private sector was to be increased 30 percent over 1965 and a private development bank was to be created.

AID records show that an industrial planning staff had been created and that the sector plan had been scheduled for completion in 1967. A number of improvements in administrative procedures had been made, and legislation to help stimulate investment had been drafted. At the time of our review, the report on legislative restrictions had not been prepared. Indications were that the goal of a 30 percent increase in industrial credit to the private sector would be reached. The development bank had not been created. The Mission stated that, although specific objectives of the individual sectors had not been entirely accomplished, GOC's performance under the program loans in relation to targets had been reasonably satisfactory.

Copper

Chile's copper exports are the largest single source of foreign exchange earnings. Two United States companies, the Anaconda Company and the Kennecott Copper Corporation, produce about 85 percent of Chile's annual copper output. They generate about 60 percent of Chile's total annual foreign exchange earnings. Copper industries employ about 1.5 percent of the labor force but produce an estimated 5 percent of the gross national product.

During the 1964 presidential campaign, President Frei had countered the plan for expropriation of the American-owned copper-mining interests in Chile, advocated by the opposition, with a plan to Chileanize the copper industries. The Chileanization program, which became government policy with President Frei's inauguration, included (1) greatly increased copper production, (2) association of the State in the administrative and marketing policies of the companies, and (3) increased domestic refining and fabrication of copper metal.

Legislation embodying a far-reaching agreement between GOC and the foreign copper companies was enacted in January

1966. The basic provisions of the law called for GOC to acquire 51 percent of the Kennecott Copper Corporation's Chilean subsidiary, the Braden Copper Company, and a 25 percent interest in subsidiaries of the Anaconda Company and the Cerro Corporation. It was estimated that, by 1970, annual copper production would increase to more than 1.1 million metric tons compared with about 583,000 metric tons in 1965. Another aspect of the copper agreement was a prospective increase in the annual refining capacity from 275,000 metric tons in 1964 to 700,000 metric tons by 1970.

DERIVATIVE PROBLEMS

Inflation

Following a near paralysis of the Chilean economy in the early 1930's, which resulted from a substantial decrease in the world demand for copper, the increased public and private domestic savings needed to offset the decrease in foreign exchange available for imports did not materialize. The inability to increase savings and the corresponding propensity to increase consumption by deficit financing created serious financial problems. This situation subsequently brought about chronic and rampant inflation, as much as 75 percent a year during the decade of the fifties.

GOC initiated a stabilization program in early 1959 and was successful in resisting a renewal of serious inflation until 1962, although the disastrous earthquakes of 1960 necessitated emergency expenditures, the use of reserves, and additional external financing. Until 1962, the cost of living was relatively stable, production increased, and a relatively large budget deficit was financed without recourse to excessive internal borrowing. Gold and foreign exchange reserves reached record levels.

Financial conditions deteriorated substantially in 1961 and 1962. Although production continued to increase in 1961, investments lagged. Increases in public investment caused the budget deficit to increase to an unprecedented level. The inflationary threat anticipated from the 1962 deficit and the balance-of-payments situation discussed in the following section set the scene for the initial requests for United States assistance under the Alliance for Progress.

Inflation was held to a rate of about 10 percent in 1961. The inflationary trend which had been anticipated materialized in 1962 and resulted in an inflation rate of about 28 percent for that year. Although the United States and the IMF contributed substantial sums to GOC for stabilization purposes in 1963 and 1964, inflation in those 2 years amounted to 45 percent and 38 percent, respectively.

In those 2 years, GOC adhered to the required increase in its budget surplus, held Central Bank credit expansion within the agreed limits, and permitted a partial devaluation of the exchange rate. However, the level of monetary expansion was still too large to reduce the rate of inflation.

Of the numerous reforms planned by the Frei administration, economic and financial stabilization was given the highest priority. It was GOC's intention to limit the price increase to 25 percent during 1965 and to continue to reduce inflation in the following 2 years to 15 percent and 10 percent, respectively, in order to achieve practical economic stability.

The rate of inflation was held to about 26 percent in 1965 and to about 17 percent in 1966. However, the rate of inflation increased to about 22 percent in 1967 due largely to private-sector wage increases and to adverse weather conditions which greatly reduced the supply of certain essential foodstuffs.

The magnitude of inflation has limited the willingness of the Chilean private sector to contribute to capital formation. It has reduced the savings rate, promoted capital flight, and contributed to a counterproductive allocation of resources. Inflation has encouraged high investments in inventories and the growth of the service sector at the expense of the industrial and agricultural sectors.

The exchange-rate policy pursued by GOC has created an unrealistic relationship between internal and external prices and has generated uncertainty about future exchange-rate transactions. GOC has also resorted to price controls to reduce the impact of inflation on the living standards of the masses. These factors, together with rapidly expanding domestic demand, have operated to discourage investment in products for domestic consumption and export. Recurring budget deficits and an inadequate budget and planning system have made it extremely difficult to deal with problems regarding inflation and the balance of payments.

As a result of long periods of inflation, the various interests within the Chilean society have established techniques to automatically readjust the value of savings, investments, and wages as prices rise. Although these techniques have tended to make inflation more palatable, they have made the return to more stable conditions difficult.

According to AID, lasting progress in the control of inflation and the balance of payments requires much more than changes in monetary, fiscal, and exchange-rate policies. Inflation and balance-of-payments deficits have resulted largely from basic characteristics of Chile's political, economic, and social structure. AID has stated that any improvement is only temporary, unless progress is made in eliminating the basic causes of low rates of savings, investment, and production; the inefficient use of resources; and Chile's heavy dependence on income from copper exports.

In its 1968 budget presentation to the Congress, AID listed stabilization and the closely related reforms of public finance and the monetary system as key elements of future long-range United States assistance plan for Chile.

Balance of payments

Historically, Chilean exports have tended to rise and fall with the international price-and-demand schedule for copper. In some periods, Chile has managed to keep the magnitude of its imports related to its export earnings and to show a surplus in its trade balance. The trade balance for the 15-year period 1945 through 1959 showed a deficit for 3 years and a surplus for 12 years.

The historic pattern grew worse in 1960 and 1961. Exports held their own, but imports rose steadily causing deficits of \$89 million and \$175 million, respectively. Gold and foreign-exchange reserves of the Central Bank declined from \$131 million in December 1959 to \$113 million in December 1960 and \$74 million in December 1961. The net-reserve position of the Central Bank declined from a small positive balance in December 1959 to a negative balance of \$161 million in December 1961.

This situation led to an acute foreign exchange crisis, and exchange transactions were suspended until January 1962. On the reopening of the exchange market, a series of temporizing measures were devised to deal with this crisis. A dual-rate exchange system was established with the official free banking rate held at the level which had been fixed in 1959 and with a fluctuating brokers' rate. Commercial transactions were conducted through the bankers' market, and all others were conducted through the brokers' market. Heavy import surcharges were imposed and certain imports were prohibited entirely. Foreign-exchange payments were deferred for 90 days (later extended to 120 days).

These measures, together with drawings from external credits--principally from the United States--enabled Chile to struggle through until October 1962, at which time a partial devaluation of the official exchange rate and increased import surcharges reduced the demand for foreign exchange.

According to an international organization, Chile's balance of payment has suffered from the following basic structural problems.

1. Overdependence on a single commodity--copper.
2. A marked trend toward rising imports of foodstuffs and raw materials due to the expansion of domestic demand and the stagnation of agricultural production.
3. Limitations on capital goods imports due to the trend mentioned above.
4. The increase in external indebtedness which has generated interest and repayment obligations that have claimed a substantial portion of all export revenues.

In 1962, the first year of the Alliance for Progress, the balance-of-payments situation improved somewhat. However, the year ended with a balance-of-payments deficit of \$73 million. Inadequate public savings forced heavy reliance on inflationary Central Bank borrowings in 1961 and

1962. Inflationary pressures, in turn, discouraged private savings and investment, channeled them into nonproductive uses, and encouraged consumption and capital flight.

The IMF standby arrangement and the financial assistance from the United States in 1963 was to aid Chile in its crucial balance-of-payments situation. During 1963, GOC exercised drawing rights of \$40 million from IMF. Continued pressure on the balance of payments, despite rising levels of assistance, reflected a sharp rise in imports and continued capital flight. Notwithstanding these factors, the balance of payments was substantially improved and the deficit was reduced to about \$27 million. This reduction was achieved by the pursuit of a flexible exchange-rate policy coupled with special devices for restricting import demand. The balance-of-payments improvement was assisted by the increased external loans that Chile received.

In 1964 the balance of payments reflected a surplus of about \$23 million. This improvement was due mainly to high levels of foreign assistance, some increased export earnings, and Central Bank restrictions on imports.

During 1965, Chile's balance of payments reflected a surplus of about \$60 million. Favorable external factors that contributed to Chile's balance-of-payments performance were: improved terms of trade, increased foreign financial assistance, and renegotiation of Chile's external debt. Due to demand pressures in world markets, there was a sharp rise in the export prices for copper while import prices of certain items, such as sugar, cotton, and tea, declined. In 1966 there was an estimated balance-of-payments surplus of about \$112 million.

APPENDIX

OFFICIALS PRIMARILY RESPONSIBLE
FOR ADMINISTRATION OF
PROGRAM LOAN ASSISTANCE
TO CHILE

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
SECRETARY OF STATE: Dean Rusk	Jan. 1961	Present
ADMINISTRATOR, AGENCY FOR INTER- NATIONAL DEVELOPMENT:		
David E. Bell	Dec. 1962	July 1966
William S. Gaud	Aug. 1966	Present
ASSISTANCE SECRETARY FOR INTER- AMERICAN AFFAIRS AND U.S. COORDINATOR, ALLIANCE FOR PROG- RESS:		
Teodoro Moscoso	Feb. 1962	Jan. 1964
Thomas C. Mann	Jan. 1964	Mar. 1965
Jack Vaughn	Mar. 1965	Feb. 1966
Lincoln Gordon	Mar. 1966	June 1967
Covey T. Oliver	July 1967	Present
UNITED STATES AMBASSADOR TO CHILE:		
Charles W. Cole	Sept. 1961	Oct. 1964
Ralph A. Dungan	Nov. 1964	Aug. 1967
Edward M. Korry	Aug. 1967	Present
DIRECTOR, AID MISSION TO CHILE:		
Charles H. Lee	July 1961	June 1963
John P. Robinson	June 1963	June 1967
Sidney Weintraub	June 1967	Present