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Economic Committee Papers - Chile - Economic Report

OFFICE MEMORANDUM

TO: Mr. C. F. Owen

FROM: O. J. McDiarmid *ojm*

SUBJECT: Chile Economic Report

DATE: July 12, 1966

The following comments are on Volume I of the Report. Of course I found it a good analysis of the Chilean economy.

1. Political Situation. Since the Frei Government is a reform administration, it would be helpful to have some discussion of the basis of its power so that one could make a better judgment of its durability. In attempting to hold the line on real wages, government expenditures and bringing about tax reform, it may encounter heavy weather politically. I recognize that speculation about its survival would not be appropriate in an economic report but some discussions of its position in relation to the centers of power in Chile would be helpful.

2. Productivity and Income. It is a little difficult to understand how inflation can be controlled when real wages are increasing via labor contracts and in 1965 Government borrowings from the banking system were higher than in previous years. There is no discussion in the report of real wages in relation to productivity. I appreciate this may not be measurable from available statistics but some appraisal of the situation seems necessary to evaluate the chances for stability.

3. Private Investment. We are told that private investment is in a slump despite the inflationary situation. I wonder if this is connected with the land reform program or what other factors may be responsible. Mention is made of the need to develop a capital market in Chile. A substantial study on this subject was done by Dr. Woodlief Thomas sometime ago and I wonder what happened to the results of that enterprise. The Report exhorts the private sector to improve its performance, but from a quick reading I don't quite understand what is responsible for the underlying disappointing situation in respect of private investment. Perhaps this is developed more fully in the sector volumes but it seems important enough to receive more attention in the main report. Is there widespread opposition to the Frei reforms?

4. Controls. The Report is not very positive on this subject, though its general position is the orthodox one of being against direct control. Does it agree with the Government that direct controls are inevitable under present conditions and that a freeing-up of the price mechanism will have to wait further disinflation?

5. Fiscal Performance. The Report frequently refers to the high ratio of the tax revenues to GDP but always including Social Security taxes.

July 12, 1966

Since the Social Security System does not appear to be a very effective instrument for public saving, it would be interesting to know the ratio of tax revenue of GDP without the Social Security taxes. This might give a better basis for international comparisons.

6. Other Points. I think the Report could be more readily (quickly) digested if it had a few summary tables in the text on such matters as the use of total national resources, the over-all fiscal situation and the balance of payments. I am sure that these are all covered in Volume II but they have to be dug out. Mention is made of the need for exchange rate reform and cost sharing formula for foreign assistance but neither subject is treated very explicitly. The same is true of the changes in the copper agreements. I understand that copper used to be treated somewhat like oil as far as Government revenues are concerned; now, however, the Government is apparently a partner in the copper business. A brief description of the changes in the copper arrangements would be helpful. The Report refers to the 1965 Fund Consultation's Report for information about fiscal and monetary details and the Government's guidelines. At the same time, it has considerable discussion on the fiscal and monetary situation. I have doubts about the technique of referring to a Fund Report and, assuming this covers the point when fiscal policy is so important to an economic appraisal as it is in this case. I think the Bank Report should be as comprehensive as necessary to deal with the matter.

cc: Mr. Wright
Mr. Maiss
Mr. Gilmartin

OJM/aga

File

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