

Out of the copper era

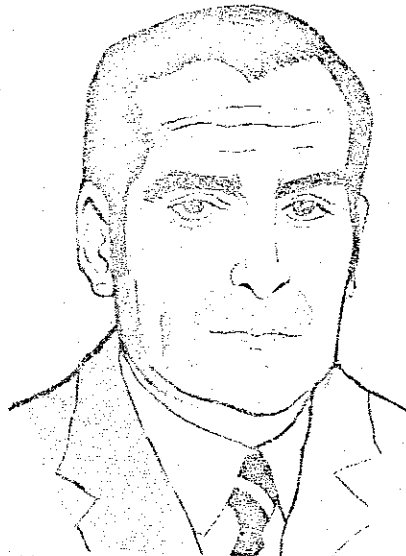
Before 1974 we tried to produce everything at home, to save dollars at any cost. Import substitution was all important and nobody cared about exports," explained Theodor Fuchs, central bank director responsible for trade. "There was great concentration on the industrial sector: if we could build up industrial output and domestic technology, we would eventually achieve high employment in industry. The other sectors were unimportant." This policy, with minor variations, has been the same for 40 years.

It was maintained by two principal weapons. First, import duties were kept at prohibitive levels, in some cases over 1,000%. The average tariff level in 1973 was almost 100%. Secondly, the exchange rate was held at an artificially high parity, and the use of multiple exchange rates was common. The complications of the system required an army of bureaucrats. "The most serious effect was probably on agriculture," argued Fuchs. "Land utilization was low, because of the low price of agricultural goods, although it was called excessive greed on the part of the farmers. This in turn led to the land reform and the land appropriations. But the real problem was the exchange rate, not the behaviour of the farmers."

Moreover, little domestic technology was generated; it was much cheaper to import plant and machinery and other intermediate goods where tariff levels were low. Then, in an attempt to develop a local capital goods industry, Government investment was provided to develop local technology, and new tariffs were introduced. Unfortunately the prices of the domestically produced goods were so high, and the quality so low, that the sector never became competitive.

The aim of increasing employment in industry was unsuccessful too, because of the capital-intensive nature of the investment. The Government then stepped in to provide jobs, principally in the bureaucracy. The Pinochet government was able to cut the number of employees in the central public sector by half.

The problems were not restricted to imports. Dependence on copper exports increased, as exporters found it more



Pablo Baraona, Economics Minister

difficult to combat the exchange rate. "A 30% subsidy was being given on fishmeal exports," said Fuchs, "and special credits, with a negative interest rate of 25% a year in real terms, were provided for those close to the government. Only very few enterprises could export; one result was that a massive black market in foreign currencies developed."

The new policy, as in the rest of the economy, is to allow the market to determine the correct flow of resources. Thus, the first stage was to abolish the prohibition of certain imports (one of the few still prohibited, colour television, was de-restricted in April this year).

It was also necessary to reduce the tariff structure and the administrative controls that existed for certain imports. The maximum nominal tariff rate has

now been reduced from over 1,000% to 20% at the end of the first quarter of 1978, with the one exception of the motor industry. The average nominal tariff rate has been reduced from 94% in the second half of 1973 to 15% by the end of March this year. The target is to reduce both figures to 10% by June 1979.

The argument for maintaining protection of the automobile industry is based on three factors: first that the industry is still a developing one, and, secondly, that the car plants are owned by powerful multinationals (General Motors, Citroën, Peugeot and Fiat) who could withdraw their investment or exert considerable pressure on their parent governments. Thirdly, the suppliers to the motor industry constitute a significant industry.

The automotive contracts were inherited from the previous government, and, although negotiated to conform with the new economic policy, they have been fundamentally respected.

Nevertheless, the 115% tariff on cars and the 80% tariff on trucks will gradually be decreased by annual reductions to 55% for cars by 1983.

Fuchs believes that the exception of the automotive sector was a mistake.

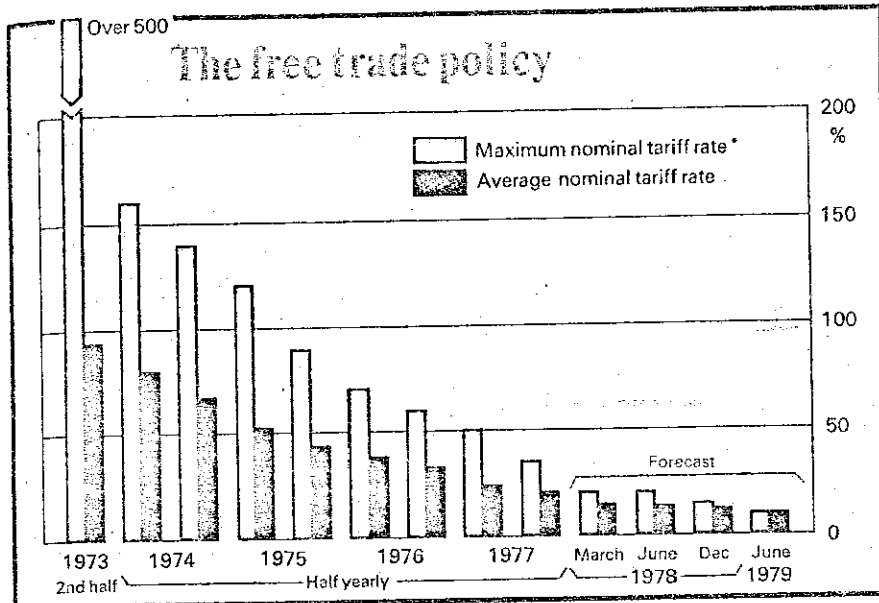
"But it's a useful mistake, as it will show up the old policy."

The principal criticism of the tariff policy is that it has been introduced too fast, causing excessive dislocation of a domestic industry unable to compete with the flood of imports. Instead of putting companies out of business and rendering their assets useless, a slower policy might have allowed more adaptation.

Fuchs, however, says that, if the economic managers erred, they erred on the side of being too slow. "The velocity

The adjustment of domestic production to compete with imports has been dramatic within the last few years. I don't think that the propensity to import will be a constraint on growth. And we have always said that we shall not adjust the balance of payments through tariffs, prohibitions etc, but through movements in the real exchange rate. The impact of a small movement in this rate has been seen to be considerable.

Pablo Baraona, Economics Minister



*Motor industry constitutes the only exception

with which the economy adapted was much more rapid than we thought," he argued.

The second plank of the external policy was the reduction of the real peso-dollar exchange rate, to increase the comparative advantage of Chilean exports and to encourage growth of non-traditional exports such as food and forestry. This was aided by the introduction of preferential financing schemes, including rediscount facilities with the central bank, which allow longer terms than have been available through the commercial banks; the exemption of exports from value added tax; the streamlining of administrative procedures in connection with foreign exchange and trade transactions; and the formation in 1974 of the export promotion institute Pro-Chile.

These measures have resulted in a major shift of productive resources from non-competitive import substitution industries into export industries, a move that the economics team feel was necessitated by the seriousness of the external position in 1973. The resulting disruption is considered to have been warranted by the success of the shift.

This success can be seen most obviously in the growth of non-mineral exports. In the 1960s these non-traditional exports accounted for between 7% and 16% of total exports; copper accounted for between 60% and 80%, and other minerals, together with timber products, fish, and fishmeal accounted for the remaining 13% to 23%. In 1977 non-traditional exports took a 30% share of total exports, which had increased significantly, while copper's share was depressed to 53% — both because of the low copper price and the increase in other exports. Other traditional exports took the remaining 17%. The total value of exports soared from about \$850 million in 1972 to \$2.2 billion last

year, with non-traditional exports rising from only \$87 million to \$650 million over the same period, a per annum growth rate of 70%.

"Excluding the mining sector," said Andres Concha, executive secretary of Pro-Chile, "the export growth has been tremendous. The strongest performances have come from the forestry sector, from

agricultural products and from agro-industry. With agricultural products we are producing in the southern hemisphere and selling to the northern, giving us a seasonal advantage." Concha also pointed to the diversification, both in terms of products and destinations, that Chile had managed to achieve. "In 1973 Chile exported to 46 markets; in 1977 we reached 93 and the number will increase further. We have also started to sell entirely new products that Chile had never previously tried to sell abroad."

Chile's past to low exposure to foreign trade does mean that the export growth has come from a low base. In 1970, for example, total exports accounted for only just over 10% of GDP, and copper exports were responsible for the bulk of this. It also means that the impact of Chile's increased export growth on world markets is minimal. "We are only exporting about \$2 billion worth of products a year," argued Concha. "Any growth effectively has no impact on the total volume of world trade. We just minutely increase our share of the pie. This also means that trends in world trade have little impact on non-traditional exports."

But world trade does affect the copper price and the value of copper exports, and Chile remains heavily dependent on copper to balance its trade and payments.

Ending the Andean connection

Until the end of 1976 Chile was one of the six member countries of the Andean Pact, the body set up in 1969 in an attempt to promote a Latin American common market. There are in the member countries, and a common external tariff of 70%, fixed in order to encourage free trade between the member countries. There have been attempts to integrate industrial long-term planning.

Chile probably benefited less from the Andean agreements than the other countries — Bolivia, Colombia, Ecuador, Peru and Venezuela. For instance Chile, together with Peru, carried the deficit on inter-Andean trade that matched the surpluses built up by Colombia in particular, but also by Ecuador and Venezuela.

But the decision to break with the other five members was due to Chile's different approach to foreign investment and to the common external tariff — both major factors in the new economic policy. It was thought that the Andean Pact regulations on foreign investment were discouraging investment, while the tariff of 70% was

fuelling inflation, and allowing inefficient local industries to survive. The Chileans wanted the external tariff to be reduced to 12%; the other partners would agree only to 26%.

There is some evidence that the level of foreign investment in Chile has picked up since its departure from the Andean Pact, although this could well reflect the better performance of the economy rather than the easier terms on dividends and repatriation of capital.

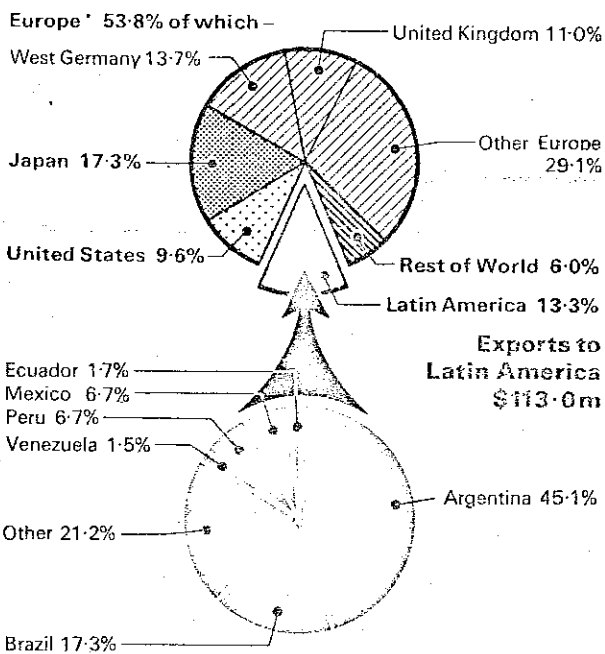
Chile's move outside the Andean Pact wall may actually have discouraged foreign investors keen to sell within the region. Chile's trade with the Andean sub-region has also continued to expand, although the rate of growth may have slowed. In 1977 the only sharp changes on previous patterns were an increase in exports to Venezuela, and a decrease to Peru — the latter caused by the lost tariff advantage.

It remains a moot point whether Chile's departure has been an overall advantage. That depends on the comparison between new foreign investment in Chile and in the other five.

Chile's main trading partners

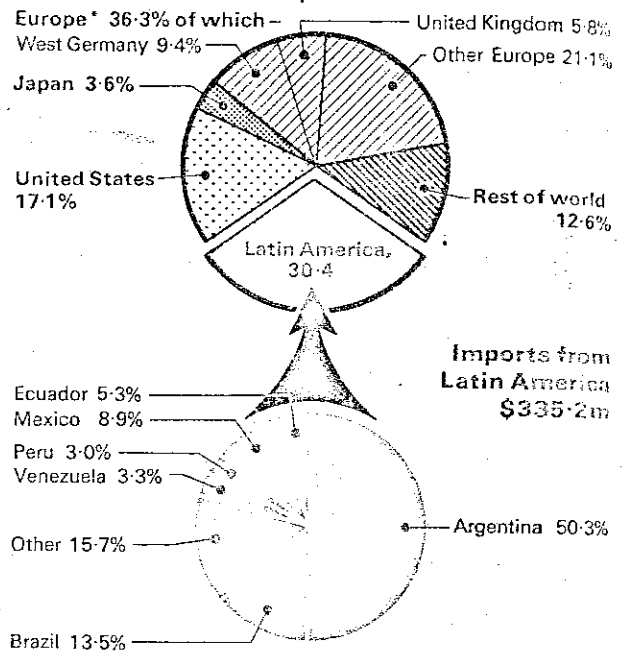
Chile's exports 1972

Total: \$849.2m



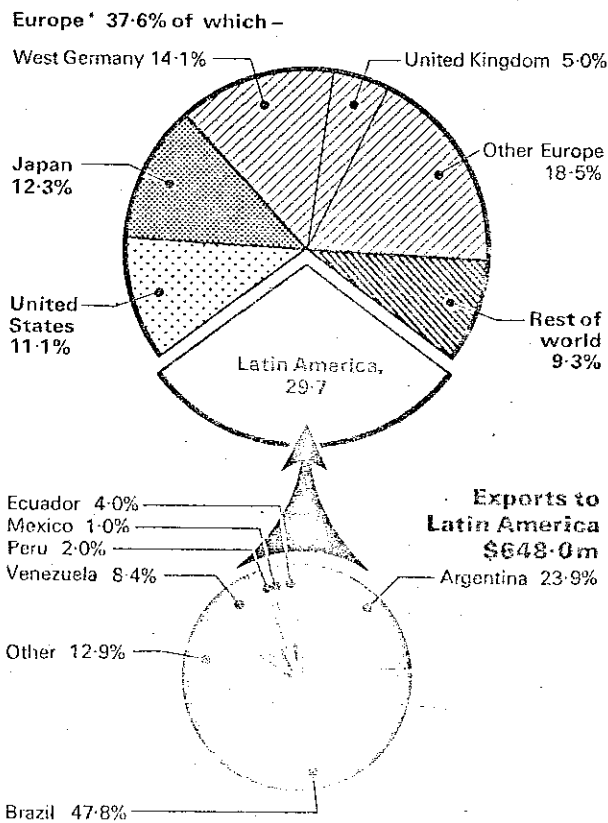
Chile's imports 1972

Total: \$1102.6m



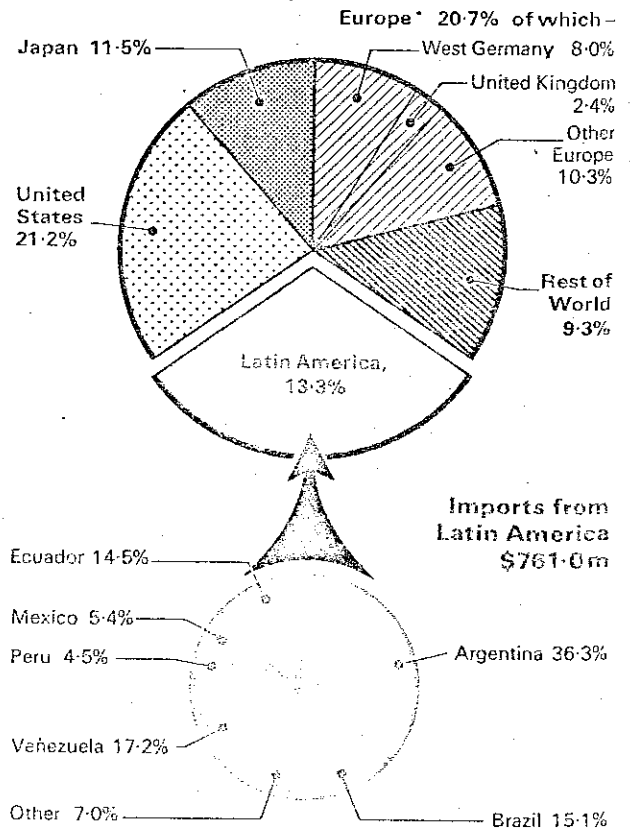
1977

Total: \$2182.0m



1977

Total: \$2299.0m



*includes both west and east Europe

Chile's biggest creditors

LOANS TO THE CENTRAL BANK¹

Lender	Contract date	Term in years	Annual interest rate (%)	Amount (\$ million)
US AID (L-031)	June 2, 1966	40	2.5	9.8
Consortium of Belgian Banks	January 15, 1969	12	6.0	4.5
Banco do Brasil	August 22, 1972	11	7.0	10.0
Banco do Brasil	August 22, 1972	12	7.0	1.6
Canadian Banks	January 29, 1974	5	Libor + 2.0	3.5
EDC, Canada	January 29, 1974	10	8.0	4.6
Banco Central do Brasil	January 7, 1974	6	Libor + 1.0	5.0
Banco Central do Brasil	January 7, 1974	6	Libor + 1.0	50.0
Consortium of Swiss Banks	December 26, 1975	16	8.0	25.0
Credit National, Paris	July 5, 1965	13	6.5	7.4
DABA, West Germany	February 8, 1966	17	3.5	4.2
Cekobanka, Prague	September 8, 1972	13	3.0	13.0
Cekobanka, Prague	May 16, 1973	10	4.5	0.1
Bulgarian Foreign Trade Bank	May 16, 1973	10	3.0	0.1
Bulgarian Foreign Trade Bank	June 29, 1972	10	5.0	1.7
Banco Central, Argentina	June 2, 1971	14	2.5	7.2
Banco do Brasil	December 13, 1976	12	7.5	210.0
Sercobe, Spain	January 14, 1976	10	7.0	50.0
Banco do Brasil	November 3, 1967	20	7.0	50.0
KFW (AL-166) ⁴	July 3, 1974	18	8.0	40.0
KFW (AL-197)	March 30, 1964	15	3.0	9.9
KFW (AL-199)	October 28, 1965	15	5.5	2.4
KFW (AL-201)	September 23, 1965	15	3.0	0.6
KFW (AL-212)	September 23, 1965	15	5.5	2.4
KFW (AL-260)	November 3, 1965	15	3.0	5.7
Moscow Narodny Bank	March 17, 1966	25	3.0	4.7
Wozchod Handelsbank	April 26, 1974 ²	4.5	Libor - 1.5	25.0
Ost West Handelsbank	March 18, 1975 ²	4.5	Libor - .5	6.5
Eurobank	June 6, 1974 ²	3	Libor - 1.5	10.0
Consortium of Socialist Banks	September 2, 1974 ²	4.5	Libor - 1.5	35.0
Banco Nacional Comercial Exterior, Mexico	1972	180 ds. ³	Libor - 0.5	50.0
Credit National, Paris	October 20, 1972	13	6.0-8.0	20.0
Deutsche Bank	February 8, 1966	17	3.5	4.2
Consortium of Banks (First Chicago Ltd)	April 6, 1977	4	Libor + 2.25 ⁶	23.7
Deutsche Sudam. Bank	June 3, 1977	5	Libor + 2.0	75.0
First Wisconsin Nat. Bank	December 9, 1976	4	Libor + 2.25 ⁶	23.7
Consortium of Banks (Morgan Guaranty)	June 7, 1976	5	Libor + 2.5	5.0
BID (314 OC/CH)	May 21, 1977	4	Libor + 2.5	125.0
BID (312 OC/CH)	March 17, 1977	3	Variable	0.5
Deutsch Sud. Bank (increase)	September 23, 1976	20	8.6	21.0
ICO Spain	October 6, 1977	4	Libor + 2.25	23.7
Banco Com. Exterior, Spain	November 29, 1977	15	5.5	10.0
Banco do Brasil	August 19, 1977	7	8.05	100.0
Banco Santander	August 17, 1977	16	8.0	10.0
Swiss Credit	August 12, 1977	5.5	Libor + 2.0	25.0
Swiss Credit	November 10, 1977	4.5	VA ⁷ + 1.75	17.8
Swiss Credit	November 10, 1977	4.5	VA ⁷ + 2.625	6.9

¹ This credit is related to the use of special 90 day lines of credit contracted by the Banco Central de Chile.

² Outstanding credits renegotiated on these dates.

³ Renewable.

⁴ Kreditanstalt fur Wiederaufbau, Federal Republic of Germany.

⁵ For translation purposes the exchange rate used was that of the Superintendent of Banks as of December 31, 1977.

⁶ Refers to Euro-Deutschemerk Rate.

⁷ Refers to average rates for Swiss bank debentures.

Source: Banco Central de Chile

Not a pretty profile

Chile's borrowing status has changed dramatically in the past two years. In 1975 the international banks treated the country with embarrassed silence. Today Chile can play the reluctant bride to the flattering — some say over-flattering — suitors from New York and Europe.

The first medium-term loan made to the new Government — \$125 million, three and a half years, one year's grace at a spread of Libor plus 2½% — was not signed until May 1976. "Today," said one foreign banker, "they are getting really very aggressive on their spreads. The biggest private companies here are receiving two to three calls a week, principally from the US banks, asking them if they want any money: you can imagine what competition in the public sector is like."

The two most recently signed credits raised \$300 million. Of this, \$210 million was raised for the central bank and led by Morgan Guaranty, for six years. A \$90 million loan for Corfo, led by Chase Manhattan, was for seven years. Spreads for both were 1¼%. The Morgan loan started life as a \$150 million loan, and was increased by \$60 million because of the level of interest.

This new-found support has allowed Chile the luxury of developing a strategy for its debt and borrowing. First, the economics team has decided that it will honour its debts in full, and that it will not re-negotiate in spite of the very heavy level of debt burden spread over the next three years.

Secondly, as Enrique Tassara, the central bank's manager of external finance, explained: "We are trying to minimize the cost of our loans; we are trying to diversify both in terms of currency that we borrow and the banks that we borrow from; and we are trying to extend the maturities that we borrow for. This also means extending the grace period so as to reduce the debt impact of new borrowings on the burden we face for the next few years."

The public sector in particular is moving very rapidly to reduce spreads and reduced fees. "The spreads being asked," said Tassara, "have declined much more quickly for the big public enterprises than

we thought a few months ago. We have had a lot of offers recently, and we hope that within perhaps six months, spreads will be lower than 1¼%, probably moving down to something like 1¼% or 1⅜%."

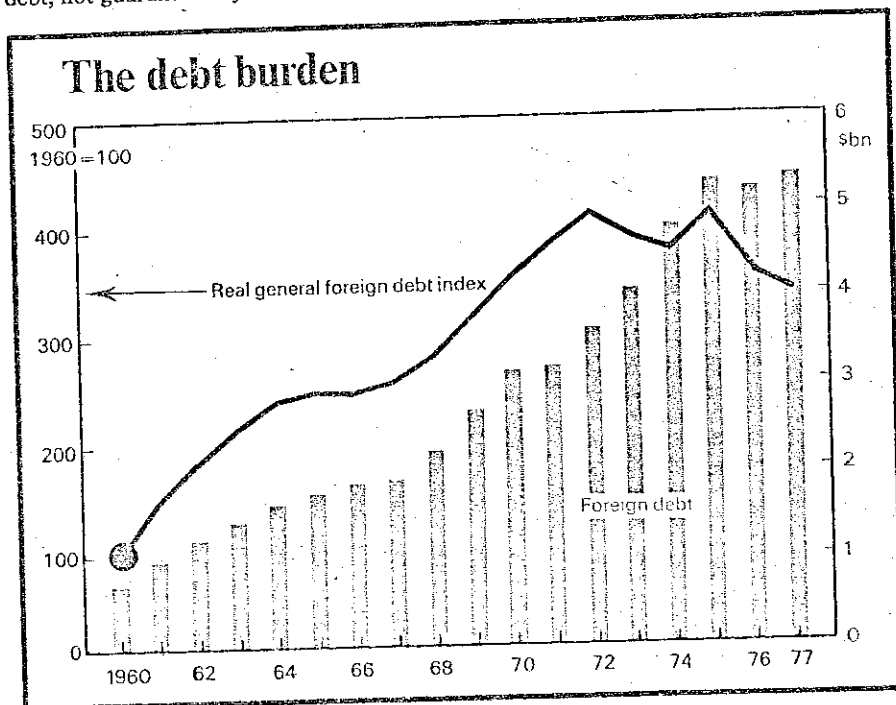
It is also planned that new syndicated credits will have a term of at least eight years, while the central bank is keen to do a bond issue, partly because of the long term available. "We expect that before long we could get 10 or 12 year money with a bond issue," Tassara said, "and that is good for our general debt profile." Discussions are under way with several houses, including Dillon Read.

The debt profile does not look attractive. At the end of 1977 the total contracted external debt of the public sector and of the private sector guaranteed by the public sector with a term of one year or more, including loans from the IMF, totalled \$4.1 billion, of which \$3.55 billion was outstanding. Net international reserves of the central bank at the same date were \$164 million. (The \$67.6 million of gold holdings are still valued at \$42.2 an ounce.) Private sector debt, not guaranteed by the State, was es-

timated at a further \$1.35 billion, making the total indebtedness \$5.4 billion. At the end of December 1976 the debt profile suggested that 1978 interest and principal repayments might be \$1.2 billion, almost the same as for 1977, and up from 1976's \$1 billion. Both previous annual repayments were met in full.

This means that the 1978 debt/export ratio, assuming goods and services exports this year of \$2.8 billion, will be 43%, slightly better than last year's 46%. If exports continue to grow as forecast, the debt/export ratio declines rapidly, to 38% next year, to 30% in 1980 and to 16% in 1982. But this is only the debt that was in existence at the end of 1976; the planned future borrowings will add further to interest due.

Besides the medium- and long-term foreign debt, there is the short-term debt, mostly to foreign banks, incurred to finance foreign trade operations and the short-term cash requirements of state and private corporations. These amount to rather more than \$500 million, and have been growing as trade has expanded. However, there is every reason to expect



Repayments have not always gone smoothly

Chile's future debt repayments, though dependent on the outlook for copper and the continued expansion of non-traditional exports, now look reasonably assured. Its past repayments, however, have a more chequered history.

At the end of 1977 officially renegotiated loans, and loans covered by special renegotiation agreements, totalled \$745 million, or just over a fifth of the total direct and indirect debt of the public sector. Three debt renegotiations have taken place since 1972, but still outstanding is \$24 million of debt negotiated by the Allende Government from Bulgaria and the USSR, in spite of the offer by Chile to re-negotiate.

At the beginning of June 1978, however, agreement was reached between the International Bank for Economic Co-operation in Moscow and Chile on repayment of a \$50 million debt to four East European countries; the debt is to be repaid over the next three years.

In April 1972, \$243 million of payments due between November 1971 and December 1972 were

renegotiated; in March 1974 there was a further rescheduling of \$476 million due for payment in 1973 and 1974; and then in May 1975 an agreement was reached with seven creditor countries for \$210 million falling due in 1975. A further \$28.6 million, due to another six countries, was not renegotiated, but payments are nevertheless being made on the same basis as for the \$210 million.

The re-negotiations have taken place through the Paris Club. Some of the Paris Club member governments do not recognize the Chilean Government and have therefore refused to discuss the debt question. But at the direct creditor level agreements have been reached with several European government institutions, and several European and American banks.

Repayment terms have now been agreed with the foreign copper corporations, including Anaconda, Cerro, and Kennecott, whose Chilean assets had been nationalized by the previous regime. Repayment started in 1977 and will be made over the eight-year period to 1985.

that they will continue to be rolled over on improving terms.

The central bank itself employs a quite sophisticated series of ratios in an attempt to assess its own creditworthiness. In terms of import cover, the ratio of total external debt to GNP, and the debt/export ratio, it does not stand up well. However, in terms of the compressibility of imports its position is stronger. Both food and petroleum imports have been declining as a proportion of total imports, GNP and exports; the growth in imports has come from consumer and capital goods — the former at least quite easily compressible. There is also the belief that Chile's economy is adaptable to changes in the internal and external economic environment; the evidence is the performance of the past few years.

Tassara believes that the debt profile will improve after 1980. "We think that the debt/export ratio will decline as the payments of past re-negotiated debt decline, and as we pay off the nationalization debts related to the copper mines which are an important part of the total

up to 1981. As these special debts are repaid it is easy for us to see that the profile will be better in the future."

A further factor in the country's favour is the tight control over foreign borrowing by both the public and private sector. All borrowings have to receive the approval of the Comité Asesor de Créditos Externos (The Committee for Examining Foreign Loans, or CACE) which includes representatives of the Finance Ministry, the Economics Ministry and Odeplan. The central bank presides over the Committee. Before coming to CACE, a public sector borrowing plan has to be approved by the ministry responsible — say the Ministry of Transport for a loan for the railways — the Budget office, to see whether in the domestic context the plan can be paid for, and Odeplan which assesses the economic and social feasibility of the project. CACE then studies all these reports, and places the debt in the context of the existing debt repayments, the balance of payments, and the other foreign debt being raised.

Private sector borrowings do not need

the approval of the Committee before negotiations start, but approval is needed before signature; and the central bank lays down various rulings on terms, spreads, the grace period, the cost and maturity. For a 24-month loan the cost, including fees, must be less than over Libor. CACE has an additional role as one private sector borrower explains: "A private borrower can ask the Committee which banks to contact to get foreign financing. You are not obliged to follow their advice, but they can be helpful."

This helpfulness ties in with a policy to let the private sector shoulder more of the foreign financing. The previous limit placed on the commercial banks' short-term foreign borrowings has been relaxed, and has the term over which they can now borrow medium-term money. "The central bank started to take foreign loans when it was still difficult for the Chilean commercial banks to get medium-term foreign credits", Tassara said. "But it is not the business of the central bank to act as an intermediary; so we are trying to get the private and commercial banks to act directly, taking all the risks of the operation themselves. This is the direction we plan increasingly to take in the future, although the central bank will continue to take some loans." To date central bank borrowings have frequently been offered to the commercial banks at the original spread, plus a 1% or 1½% margin. "One advantage of the policy," continued Tassara, "is that some foreign banks only want to lend, say, \$5 million. The central bank needs much larger amounts, but for the commercial banks it is practical to take smaller amounts."

The policy has some way to go; at the end of last year private sector debt not guaranteed by the State was less than a quarter of the total. Of the total private debt of \$1.3 billion, less than 60% consisted of short- and medium-term bank loans. The rest was supplier finance and short-term interbank lines of credit.

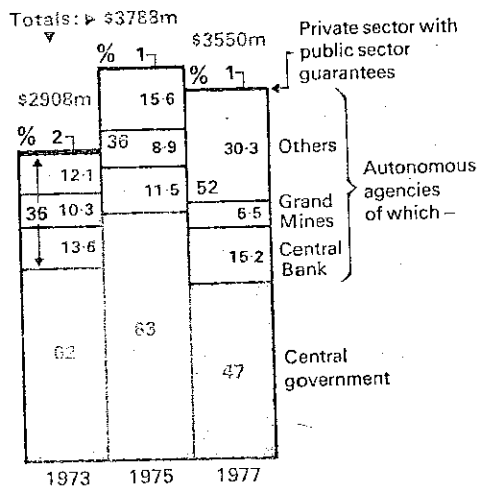
Analysis of the debt shows that the Government of Chile remains much the biggest borrower. The debt of the central bank, however, has been rising, while that of Corfo, the publicly-owned copper mines, other public companies, and the private sector with State guarantees, has been reduced in real terms.

The bigger and more profitable state agencies will continue to seek credits. Codeleo (the copper corporation) and Enap (energy), in particular, have major investment programmes; Corfo may continue to borrow to provide funds for its less credit-worthy affiliates.

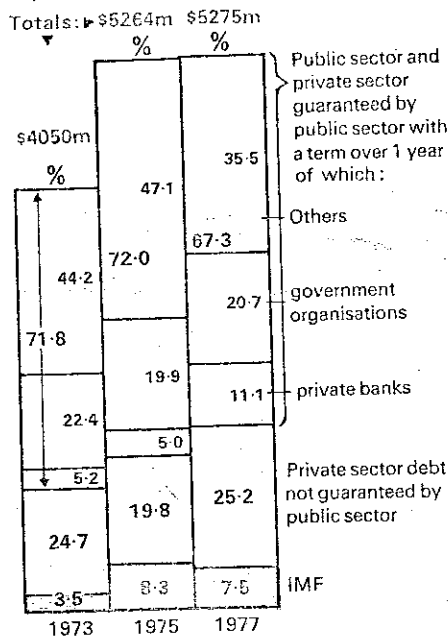
Chile's dependence on syndicated credits from international banks has increased with the recent series of loans. The funds have largely been used to pay off existing debt, notably the debt incurred in the nationalization programme

The debt pattern

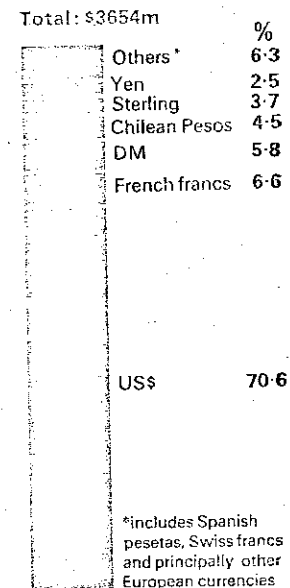
By borrower*



By lender†



By currency*



Debt figures as at year-end *External public sector debt and private sector debt guaranteed by the public sector †Total external debt

and the debt that was re-negotiated in the early 1970s. Another feature has been the reduced rôle of suppliers' credits, while the central bank, according to Sergio de la Cuadra, is considering repaying some of the expensive loans it contracted earlier, and refinancing with cheaper debt.

Because of the increasing dependence on foreign private sector finance, and because of the increase in the real debt that is planned, Chile is now pursuing two new policies; diversification by currency and of banks. Total indebtedness is forecast by the National Plan to rise to \$5.9 billion (in 1977 dollars) from the present level, excluding private sector non-state-guaranteed debt; in nominal

terms the increase looks rather sharper — up to \$8 billion.

To raise this, Tassara is keen to spread the load. "To date most of the funds offered have been in dollars; but in the future we might try to use some mixed loans in the same way as the Mexicans and the Brazilians have operated; this is because we think that some potential managers and lead managers prefer that sort of structure; we also want to do this because of the diversification we have seen in our foreign trade, especially to Japan and to Asia. Secondly, if you look at the syndicated credits we have borrowed, you can see that the level of participation by foreign banks has increased

from about 20 banks to 49 in the recent Morgan loan — many of them regional North American banks that have not traditionally been in Chile. They become involved with Chile, a little bit later they decide to send a man down here to visit, and they then begin to work more closely with us."

The central bank prefers in general to work with the bigger banks and those which have specialized in syndicated lending. It also likes banks which can introduce a number of smaller banks into a loan, and particularly introduce non-US banks, in an attempt to increase the international financial community's awareness of Chile.

This is one reason why a bond issue is being considered. "We have received several offers," Tassara said, "from banks in different countries and for different currencies. One problem that we are resolving at the moment is that of the waiver of sovereign immunity. But we think it is important to participate in what is a new market for us, to introduce the name of the country. It would be the first time since the 1920s that we have been into the bond markets."

It is a measure of Chile's improved credibility that it can consider such an issue. Another good sign is the number of banks which have started to include Chile in their round trips to South America, attracted both by the still relatively high spreads and by the new borrowings being planned, particularly by the private commercial banks and the biggest private sector industrial companies. □

Medium term borrowings planned for 1978

Amount (\$ million)	Borrower	Lead Bank
125	Central Bank	Wells Fargo
210	Central Bank	Morgan Guaranty
22	Central Bank	Bank of Tokyo
90	Corfo	Chase Manhattan
46	Endesa	Citicorp
60	Banco del Estado	Libra Bank
34	Lan-Chile	Citicorp
14	Enap	Citicorp
30	Codelco	Libra
100	Cap	Bankers Trust
50 approx.		International institutions
100 approx.	Suppliers' credits	
500 approx.	Private sector	
50		Bond issue, not yet confirmed

Attracting the extractors

The importance of foreign direct investment to the Chilean economy is proved by the sacrifices that Chile's economic team has accepted in order to attract it.

First, Chile withdrew from the Andean Pact group of nations because of its rules. "We have resolved," said Sergio de Castro, who was then Economics Minister and is now Finance Minister, "that these rigid and absurd regulations should not be maintained, since they impede the flow of foreign investments."

Secondly, with its new legislation, Chile has chosen to treat foreign investors on exactly the same footing as their domestic counterparts. In a country so generously endowed with mineral and other resources this is not an empty gesture.

The government recognizes that, if Chile has substantial natural resources and investment opportunities, it does not have the capital to develop them. Foreign investment is seen as the missing ingredient.

The long-term growth target of about 7% per annum implies a very high investment level, in total — according to de Castro — some 15% of GNP. "If these were to be obtained by domestic savings," he argued at the time of leaving the Andean Pact, "we would have to impose an extraordinary sacrifice on the consumer which is not possible in Chile or in any other country in the region." Chile is following both the possible solutions; first, it is increasing the level of its foreign debt, and secondly, it is trying hard to attract foreign investment.

Juan Ramon Samaniego, the executive secretary of the Committee of Foreign Investments explained the benefits associated with foreign investment.

"First, it brings in the technology that we do not have. Secondly, it gives us a new market; normally when foreign corporations come to work in Chile they have already developed their markets. Thirdly, foreign investment supplements domestic savings."

The level of foreign investment in the first couple of years after the military Junta took over was, not surprisingly, low. Impetus has now begun to pick up, particularly since the publication of the new laws. By the middle of March this year foreign investments totalling \$2.3 billion

had been approved, though not yet disbursed. The biggest single planned investment — over \$1 billion by Exxon Minerals — depends on the results of surveys now being commenced and will, in any case, take several years to spend. Out of the \$2.3 billion, \$2.2 billion is destined for the mining sector, where disbursements are bound to take time. This leaves little for the rest of the economy.

One criticism of the government's policy towards foreign investment in mining is that Chile is giving away too much of its irreplaceable resources at too low a price, especially at a time when the copper price remains so depressed. The Investment Committee's defence is that, given the technique of public biddings, used by Chile in selling mining interests, the price achieved must represent a fair market price at the time. In the case of two of the biggest investments — by Noranda Mining and Falconbridge — the State has taken a direct stake and also participates through the tax system, so that 75% of the profits of these joint ventures remain in Chile.

Samaniego commented: "I believe that, worse than what we might lose due to a difference in valuation of assets and therefore in the selling price, is what we have lost due to not having extracted these resources quickly."

Outside mining, the lion's share of in-

vestment has gone to industry (9.8%) and to services (4.4%). The figures refer to the end of 1977 — before the inclusion of the Exxon statistics. If the size of the total investment to date is disappointing, there are two favourable trends. The first is the number of companies that have taken the decision to invest, 33 in industry and 29 in the service sector by the end of last year; the second is the increased display of interest since March 1977, when the investment statutes were changed, and when the profitability of Chilean industry generally could be seen to be improving. Returns on foreign investment have picked up from just 7% in 1974 to 12.3% in 1976 and a somewhat higher figure last year, which is comparable to investment return in other Latin American countries.

The average number of new investments approved per month — reflecting fairly accurately the level of applications — was 2.7, involving a sum of \$2 million per month up to March 1977. In the 12 months since the law was introduced the rate has been 10.6 applications per month, involving a little over \$6 million.

Besides offering more liberal dividend and repatriation policies, the new legislation is based on three principles.

First, foreign investors are treated exactly like domestic investors, with the exception that the foreigner is entitled to

Enter the mining companies

Foreign investments approved by the Chilean government since October 1974 include the following:

	(\$ million)	
Exxon	1000	Copper mining
Falconbridge	500	Copper mining
Noranda Mines	350	Copper mining
Metallgesellschaft	38	Lead and zinc mining
Foote	23	Lithium mining
Marvis Corporation	27	Copper mining
Esso	15	Energy and gasoline
Royal Dutch-Shell	12	Oil derivatives
Arco Petroleum Chile and Amerada Hess Petroleum Chile	11	
Goodyear Tire	15	Oil Exploration and Service Tyre Manufacturing

transfer abroad his capital and profits but has less access to the domestic capital markets.

Secondly, there is no direction of foreign investment towards sectors of the economy that the Government is keen to develop. It is happy that the investor should be guided solely by his expectation of the return on capital invested.

Thirdly, the procedures for getting approval to invest have been simplified to the point where they are almost automatic, and where bureaucratic controls have been reduced to a minimum.

Samaniego considers that the approval mechanism and the conditions on foreign investment are now as attractive as they can be made. "I believe that the process now works perfectly. The policy is automatic and it is a policy that the foreign investor likes because it is impersonal and makes no distinctions, and is therefore very stable in the long run. And I believe that we have demonstrated that it is very efficient; we approved the Exxon project in just one week."

He defends the lack of direction by arguing that a good agricultural investment is better for the country than a bad industrial one. "The Chilean state does not set priorities by sectors. To the state, the agricultural sector, the mining sector or the fishing sector are all equally important. Investment should be determined solely by the concept of rentability."

The reaction against previous controls is a factor in this *laissez-faire* policy, and explains why comparative advantage and free market forces are considered so important. "In Chile in the past," said Samaniego, "we had seven local factories

How the new law helps

PROJECTS APPROVED BETWEEN 1974 AND MARCH 1978

	Number	Amount (\$ thousand)	Mean (\$ thousand)
Former Decree Law 600	87	65,521	753
New Decree Law 600	111	74,362	670
Big Mining Projects	6	2,211	
TOTAL	204	2,340,883	

Monthly Average:

Former Decree Law 600 (32 months)	2.7	2,048
New Decree Law 600 (12 months)	10.6	6,197

Source: Foreign Investment Committee

making refrigerators for 10 million poor inhabitants; it was crazy. We had 22 car manufacturers. The fact that a project is an industrial one does not mean that it will be a good one. It may turn out to be disastrous."

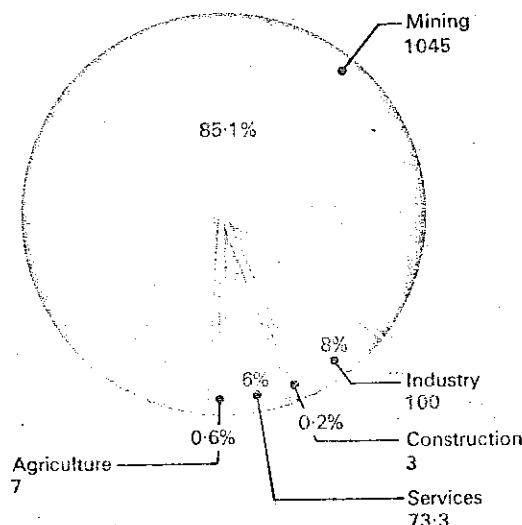
There have been six major copper investments to date, including Exxon, Falconbridge Nickel Mines and the Canadian company Noranda. Falconbridge's investment, in conjunction with Canadian Superior Oil, the Superior Oil Company, and McIntyre Mines, is a 51% stake in an exploration contract of the Quebrada Blanca copper deposits in the Far North, which could eventually yield

an average of 100,000 tons of fine copper annually, and which may require a total investment of \$500 million. Noranda is planning to invest up to \$350 million in exploiting the Anzacollo copper mine, while the San Jose Corporation will be investing up to \$100 million in gold mining.

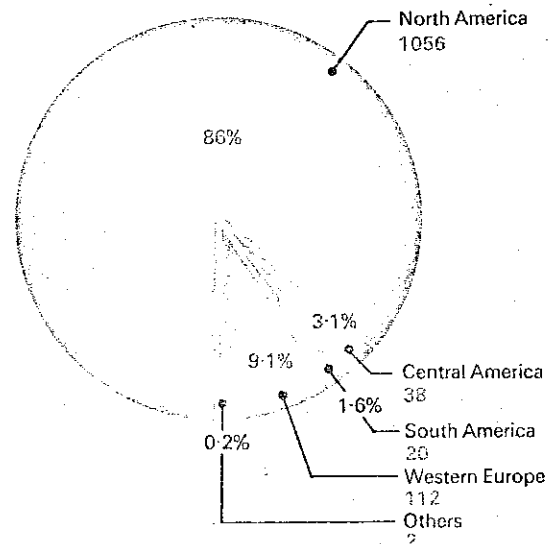
After copper the sector provoking most interest is offshore oil. Atlantic Richfield has reached long-term agreement with the Chilean oil company (ENAP) for the exploration and exploitation of potential oil deposits, which might require \$1 billion of capital expenditure; and another oil company is believed to be completing discussions with ENAP for

Foreign investment in Chile (US \$m at end-December 1977)

By sector:
Total: 1228



By area:
Total: 1228



the rights to another large tranche of ocean bottom.

Investment in the financial sector has been slower. The biggest of the development banks, Banco Unido de Fomento, has attracted foreign shareholders, and several international banks including Lloyds Bank International, Bank of America, Banco de Brasil, Manufacturers Hanover and Bank of Boston have representative offices or other involvements. Several international banks are also said to be considering setting up full banking offices.

It is not likely, however, that any branch networks will be set up by foreign banks, in spite of the obvious keenness of the present economics team to attract such involvement. The memory of the previous régime's expropriations is discouraging; so is the present paucity of savings.

In the longer term an important factor in determining the level of foreign investment will be the political reputation of the régime and the economic management of the country. The reputation on the latter score is beginning to be consolidated, and Samaniego believes that this should be sufficient to attract considerably higher levels of new investment.

"My experience is that in the rest of the world we have two totally different images; first there is the political image — human rights and so on — and secondly there is the assessment of us by the entrepreneurs as economic managers. This, I believe has improved a lot, and if an entrepreneur is really interested in a project then he can overcome a lot of domestic pressure. Noranda Mining, for example, overcame the obstacles put in its way."

The Investment Committee is confident that the growth in foreign investment has only just started and is set to continue; and is not worried by such precedents as ITT's interference in Chilean Government affairs. Asked about the power of multinationals, Samaniego replied: "The important thing is to have a good Inland Revenue Service."

The Exxon success

The biggest foreign investment in Chile, at least in terms of potential, has been made by Exxon, the world's biggest industrial corporation. At the end of 1977 ENAMI, the National Mining Company, announced that it had sold 87% of the outstanding stock of the Las Condes Mining Company to Exxon Minerals for \$107 million. Exxon has since offered to buy the shares still privately held, and has received acceptances for a large proportion.

Las Condes' principal assets are two substantial copper mines, the disputada mine and the Soldado mine, whose joint production — small by Chilean standards — was 37,000 tons in 1976.

Exxon is now engaged on a study that will take two and a half years to ascertain

What the law says

On March 18, 1977, Decree Law 1748 (New Decree Law No. 600) altered the regulations affecting foreign direct investments in Chile. The new law governs all new foreign investments in freely convertible currency as well as in assets of machinery and equipment, whether new or used, technology in different forms, investment-related credits and capitalized earnings with a right to transfer abroad.

The principal features of the regulations are:

1. There is no limit on profit and capital remittances, except that capital must remain in Chile for three years before it may be remitted.
2. Foreign exchange for profit and capital remittances will be available under the same conditions as apply to Chilean nationals purchasing foreign exchange to cover general imports.
3. There is no time limit on how long a foreign investment may remain in Chile.
4. There are no provisions requiring foreign investors to sell part or all of their investment to Chilean nationals.
5. Foreign investors have the same rights and obligations as Chileans, except that access to domestic credit facilities is limited.
6. Foreign investors may opt for "tax invariability" in which case they

pay a total tax of 49.5% on taxable income for a period of 10 years or they may opt once only to become subject to the same taxes which are applicable to Chilean investors.

7. Import duty and value-added taxes are to be "invariable" on imported machinery not produced in Chile for the period needed to implement the investment.
8. Existing foreign investments may become subject to the provisions of Decree 1748 until March 18, 1978.
9. All foreign credits associated with foreign investment, that is, their terms, interest, commission, and other charges, must be those authorized by the Central Bank of Chile.

As under previous legislation, the Chilean Foreign Investment Committee negotiates a separate contract with each foreign investor. Contracts normally stipulate the time limit before which the investment must be implemented.

The new law provides simpler rules which make authorization almost automatic; and stipulates that foreign investments up to \$5 million are authorized by the executive secretary with the sole approval of the president of the committee.

In the case of mining investments, the time limit is eight years, in others three years. The Committee may, however, extend the period, for instance if oil exploration activities must first be completed.

the size and quality of the reserves, and the probable costs of increased production. If the forecasts are satisfactory, it will proceed with a \$1 billion investment programme to increase production and reduce costs for the Disputada mine, so that it will be operating in the bottom third of the cost curve of world producers.

While Exxon is cautious about the probable development in the copper price, believing that it may not recover until the 1980s, it was clearly attracted by the very fair price at which ENAMI sold the mines.

John Finley, now the president of the Chilean company, said: "We were exceedingly impressed with the way in which the Ministry and the other parties involved responded, answering our questions and expediting the turnover. We won the bid on December 26, and took over the corporation in February."

Within Chile, Exxon is treated as any other domestic or foreign mining company. Finley explained: "We will not have any dividend problem because of the overall Chilean dividend policy, which is very internationally oriented."

The only peculiar aspect of the deal is that, built into the contract, the Government has the right to buy back at any time 49% of the company at a value which is largely pre-determined and includes an element of indexation.

Although Exxon has been investing in metal production on a broad scale as part of a plan to diversify gradually away from oil, the Disputada purchase was the first by the corporation of an operating concern abroad and the largest potential investment in a non-energy related field outside the US. It therefore marks a success for the Chilean foreign investment policy, at a time when success was needed. □

Banking on the banks

Virtually the entire banking sector of Chile was nationalized under the Allende government. The first banking policy of the present government was therefore to start the denationalization programme, which is now largely complete, with the exception of a few equity stakes still held by Corfo, the state holding company.

The government has also been trying to develop an orderly and efficient capital market capable of channelling domestic and foreign funds to the most profitable borrowers, it has also implemented the monetary policy of the anti-inflation programme and encouraged the return of foreign banks, financial institutions and lenders to Chile.

The denationalization has been largely successful; the orderliness of the capital markets has been severely strained on one occasion, and the direct involvement of the foreign banks has so far been disappointing, although their rôle as lenders reflects the new credibility of Chile.

Before 1973 the country's monetary policy was characterized by heavily subsidized credit, usually allowing the borrower a negative real rate of interest, and by selective allocation of credit to those sectors regarded by the state as of national priority — principally the industrial sector, and in particular the import substitution industries. The new policies assign the traditional rôle of the capital markets to the banking sector. It is for the banks to attract private and public saving, and to deploy them freely in the economy to stimulate output.

The central bank therefore moved rapidly from the fixed interest rate system which had been practised for two decades to the freeing of interest rates; a sophisticated monetary correction system for all financial transactions and financial statements was also quickly introduced, to deal with the distorting effects of the very high inflation rates.

The laws which had created artificial barriers within the banking system were reorganized; discriminatory taxation for different types of financial instrument were abolished in a general attempt to improve the efficiency of the markets.

There are still stringent restrictions; their aim is to control the expansion of the monetary aggregates. The Minister of

Finance presides over the Monetary Council, which is responsible for monetary policy, and which fixes the guidelines for the operations of the capital market, as well as credit policy, foreign exchange, tariff and savings policies. Its tight monetary policy is carried out through alterations in the minimum reserve requirements for demand and time deposits, open market operations and control of foreign exchange transactions. In spite of the free market approach, the central bank retains the rôle of directing credit to priority sectors such as exports, agriculture, and plant diversification by rediscounting or refinancing lines of credit with the commercial and development banks.

The high minimum reserve requirements and the low level of domestic and foreign saving has meant that interest rates, now free to move upwards, have reached extremely high levels, even in real terms. In November 1976, for instance, the real average interest rate of the banks and other financial institutions reached 9% per month. The nominal rate was 13.2% per month. Borrowing thus became prohibitively expensive for all but the most desperate. The result was increased insolvency. The problem was exacerbated by the depleted stock of money, caused by the high inflation rates and the decapitalization of the public and private corporations during the 1970-1974 period.

It was a combination of the very restrictive monetary policies followed at the end of 1976, and the lack of control over the newly freed banking sector, that led to an embarrassing dislocation of some sectors of the capital markets. Deposits were shifting from the commercial banks to the *financieras* or private investment companies, attracted by the higher interest rates that the latter were able to pay because they were minimally

supervised and restricted. The commercial banks retaliated by opening their own *financieras*, which also expanded rapidly and under insufficient control.

With the tightening of interest rates, a number of the private companies found themselves unable to meet their obligations and went bankrupt. Unfortunately, the collapse of the informal houses was felt by the regulated market. *Financiera Regional* (capital \$130,000), the savings cooperative *La Familia* (capital \$100,000) and *Financiera GAIN* (capital under \$100,000) went under; and the central bank was forced to intervene in the affairs of at least one major commercial bank — *Banco Osorno la Union* — to stop the rot spreading.

An already serious situation was worsened by rumour, and complicated by fraud, the flight to Argentina and elsewhere of some of the involved parties, and prison for others. In a market already cramped by the dearth of saving, the crisis had serious repercussions; although Chile's central bank will point out that the total size of the parallel financial market, suspended after the insolvencies, accounted for only about 9% of the total volume of funds placed in the financial markets, and that the banks which actually became insolvent accounted for only about 2% of total funds.

The informal *financieras* were rapidly closed down, and new legislation was introduced to limit the formal *financieras*. They had to increase their capital to 75% of the capital of the commercial banks by the beginning of 1979; and the need to show that they were capable of doing this within 60 days of the announcement put many of the companies out of business then and there.

It was ruled, too, that the only promissory notes to be traded in the market were those of public or private corporations with a capital of over

At the time we first came to Europe the central bank effectively operated with no more than 10 European Banks. Today we are dealing with more than 60.

Vasco Undurraga, representative of the Central Bank of Chile for Europe.

\$1 million. Greater financial disclosure is now required, and tougher sanctions have been introduced.

There was a rapid shift of funds back into the coffers of the commercial banks, as security again became the saver's principal requirement. The losses of individuals were reduced by a temporary guarantee from the State for all individual investments, up to about \$3,000. The guarantee is being replaced by an investment insurance scheme. The belief now in Chile is that the episode of the *financieras* was unfortunate, but that the lesson has been learnt. Antonio Marchant, the secretary of the Association of Commercial Banks, remarked: "Look what happened to the fringe banks in the UK! We think that the problem here has now been fully resolved."

Control of the banking system is also facilitated by the state's ownership of the Banco del Estado, which alone accounted for 32% of total domestic currency loans at the end of last year and 51% of demand deposits. "We compete directly with the other commercial banks on both loans and deposits," explained Francisco Ibanez, the bank's president. "We also act as the state's banker; but because this money has a reserve requirement of 85%, and because there is no idle money left on deposit, we see it as a burden rather than a benefit."

The savings structure of the Banco del Estado is different from the other commercial banks, as it depends much more heavily on the small saver. It now has over 2.5 million time deposits. This allows the bank to pursue a different, more stable interest rate policy. The Banco del Estado had been the only bank allowed the dual rôle of commercial and development bank, although this monopoly is now being altered.

During 1977 there was a steady softening of interest rates in real terms, and, even more sharply, in nominal terms, as inflation has decreased. The aim of the central bank is to develop the level of saving and to move to an equilibrium between savings and investment. The projected increase in economic activity of 7% GNP growth per annum is expected to lead to higher levels of internal and external saving. It is thought that the

As the economy expands and external confidence in the Chilean economy builds up, the private sector in general and private banks in particular should assume a more preponderant rôle in obtaining foreign financing. Therefore the Central Bank of Chile should gradually phase out from its rôle of intermediary in obtaining foreign funds for the private sector and instead concentrate on its basic functions of supervisory agency, formulating the policies with regard to the country's public and private foreign indebtedness.

Vasco Undurruga, representative of the Central Bank of Chile for Europe.

A third of the loans

HOW THE BANCO DEL ESTADO DOMINATES THE CHILEAN BANKING SYSTEM: 1977 LOANS IN DOMESTIC CURRENCY

Banks	December (Millions of Chilean pesos)	September	Ranking	Percent Total
Banco del Estado	3,361	7,315	1	32%
Chile	980	3,311	2	14
Español	482	2,559	3	11
Crédito e Inversiones	348	1,837	4	8
Talca	292	1,533	5	7
Nacional del Trabajo	417	1,135	6	5
Concepción	358	1,086	7	5
Sudamericano	336	1,042	8	5
Osorno y la Union	488	778	9	3
O'Higgins	183	748	10	3
Constitución	23	349	11	2
Israelita	75	340	12	1
Continental	101	275	13	1
Comercial de Curicó	131	277	14	1
Citibank	5	113	15	*
Yugoslavo	62	67	16	*
Regional de Linares	16	37	17	*
Do Brasil	11	26	18	*
Real	—	20	19	*
Total Loans	7,676	22,856		100%

* Less than 1%

savings ratio will move gradually to the point where a savings investment equilibrium is reached at about 15% of GNP.

"The banks will have to, and will be able to, evolve very fast," said Marchant. "As interest rates come down they will provide a major new incentive to the economy and to borrowing; and, while we have the various instruments of a developed capital market, it is a question of the market expanding rapidly enough."

To supplement domestic saving, and to contribute experience and expertise to the capital market, the central bank is keen to attract foreign bank direct investment and to expand the level of foreign borrowing by the commercial banks in their own

names, thus taking some of the weight of the borrowing programme off the shoulders of the state.

Restrictions on the establishment of foreign bank operations in the country have been minimised; they are now entitled to establish representative offices of branches and to operate on the same basis as local banks. The man to whom department they have to apply is Miguel Ibanez, the Superintendent of Banks. "We assess the solvency of the bank," he explained, "on the basis of various financial statements that must be provided. As with any Chilean commercial bank, the minimum capital must be the equivalent of \$4 million."

Banco de Brasil, Banco Real, Banco del Estado de São Paulo, Banco de Santander and Citibank have operational offices, while several others, including Deutsche Bank, Lloyds Bank International and Bank of America have representative offices. Miguel Ibanez added that two or three others were presenting their applications and might be setting up soon.

Several of the foreign commercial banks with representative offices in Chile are dubious about the benefits of a branch network. Given the low level of domestic saving, the fact that a representative office is largely sufficient to organize lending, and the political stigma, the

Half the deposits

HOW THE BANCO DEL ESTADO DOMINATES THE CHILEAN BANKING SYSTEM: 1977 DEMAND DEPOSITS IN DOMESTIC CURRENCY

Banks	December (Millions of Chilean pesos)	September	Ranking	Percent of Total
Banco del Estado	5,677	12,008	1	51%
Chile	1,719	3,076	2	13
Crédito e Inversiones	694	1,232	3	5
Sudamericano	563	970	4	4
Español	508	945	5	4
Nacional del Trabajo	536	935	6	4
Concepción	464	794	7	3
O'Higgins	380	672	8	3
Talca	396	655	9	3
Osorno y la Union	608	644	10	3
Comercial de Curicó	370	529	11	2
Continental	217	338	12	1
Constitución	47	219	13	1
Israelita	130	217	14	1
Citibank	15	57	15	*
Yugoslavo	23	30	16	*
Do Brasil	24	25	17	*
Real	—	23	18	*
Regional de Linares	13	23	19	*
Total Demand Deposits	12,394	23,402	—	100%

* Less than 1%

Source: Chile Economic News

balance is not very attractive. Miguel Ibanez believes that the foreign banks are already playing an important rôle. "They will continue to play this rôle with greater force in the future, since they clearly contribute new techniques, and increase the performance of the banking sector, quite apart from their rôle in intensifying trade with their countries of origin."

In an attempt to make acquisitions by foreign banks more feasible, the government has relaxed the legislation which used to limit the shareholding in any one bank to 1.5% for individuals, and 3% for companies. The idea behind the limit had been to stop concentration of control of the banking sector in a few hands. However, as Miguel Ibanez admitted: "In practice we realized that the limitation could not be policed. Much higher percentages have been amassed through nominees. The limitations were discouraging foreign banks which had expressed an interest in buying important packets of shares in Chilean banks."

The commercial banks have significantly increased their credit lines with foreign banks, taking both short and medium-term credit; in fact the commercial banks have moved rapidly up to the limits set by the Central Bank on foreign borrowing. "We are able to get five-year money now, with a two year grace period, and we would like to go longer,"

Marchant said. "The spread is now about Libor plus 2%, plus commission; the spread a year ago — when you couldn't get five year money — was Libor plus 3%, plus a 1½% fee for three-year money. The rate is moving in the right direction."

Banco del Estado was recently reported to be signing up a \$70 million foreign loan with a consortium of banks, which would take foreign debt up to the permitted ceiling of 25% of capital and reserves. Francisco Ibanez, the bank's president, suggested that the ratio would shortly move up to 40%, allowing a further spate of borrowing by the commercial banks. He said that the response to their borrowing had been good. "We had offers for more than double the \$70 million we wanted, and we are dis-

In the first half of 1975, the critical variable was the balance of payments. I was President of the Central Bank at the time, and quite truly, at the end of June, we had almost no foreign exchange. If we had done less in the way of cutting expenditure or increasing taxes in the correction programme, or had devalued less, or anything else, then perhaps we would not have been able to do anything at all.

Pablo Baraona, Economics Minister

cussing a margin of about 1¼% over Libor." The size and the state ownership of the bank entitles it to a better rating than the other commercial banks obtain.

Medium-term foreign borrowing ties in with a new decree law that allows the commercial banks to lend medium-term money, although the market will remain thin. Previously the commercial banks could only lend up to one year. This new regulation almost eliminates the functional difference between the commercial and development banks, although the differences in their strategies are likely to remain.

Commercial banks are also entitled to finance real estate operations, a sector previously reserved for the savings and loan associations. These changes are regarded as the first of several designed to move towards a multiple banking system, where specialist and general banks exist side by side, and where no particular bank is entitled to a monopoly of any particular type of business.

The capital market's principal problem remains the short-term nature of credit. The lack of long-term financing is felt most acutely in the construction industry, where housing remains depressed. But the problem is much more general: investment projects in both industry and agriculture are unduly short-term or forgone altogether for want of intermediate and long-term financing.

Those few investors with access to longer-term credits from abroad are given substantial competitive advantages, which tend to distort domestic resource allocation in the short run. A huge gap remains at the long end of the financial markets.

The other problem, the lack of size, is a question of time. Though considerable progress has been made, it has been estimated that the ratio of all privately held money, including time and savings deposits and MI, is about 10% to 13% of GNP. In economies at a similar stage of development, the ratio is usually close to 25%; and in the most successful developing economies, such as South Korea, it may be 50% to 60%. Chile has been successful in directing the lending of the commercial banks towards the open capital markets; it still has to develop the capacity of the markets. □

A long maturity

Development banks are new to Chile, but much needed, in view of the short-term nature of the banking system's lending. At present there are only five:

- Banco Unido de Fomento
- Banco Hipotecario y de Fomento de Chile
- Banco Hipotecario y de Fomento Nacional
- Banco de Fomento de Valparaiso
- Banco Regional de Fomento de Bio-Bio

Their total lending is still small. Together with the commercial banks, as they lengthen the term of their lending, the development banks will need to fill the void created as the state (particularly through Corfo) reduces its rôle as long-term provider of funds for development. The development banks will also have to supply the huge sums required for long-term investment if the national plan forecasts are to be met, channelling either domestic savings or foreign loans to the borrowers.

I believe that in all countries in which problems exist similar to the ones we faced, whether they have natural resources or not, the only way to change or grow is to open the economy. I think that this has been the experience of the Chilean model.
Pablo Baraona, Economics Minister

The charter for the development banks became law in 1965; however, under the Frei (Christian Democrat) and Allende (Marxist) administrations, no banks emerged. The change of financial climate encouraged the formation of the first of the development banks in 1974, and the sector has developed gradually since. Although they concentrate on long-term lending, the banks are empowered to effect all the typical operations of an investment bank.

Sergio Vergara, the executive secretary

of the Asociación of Development Banks, explained: "We can issue debentures and bonds and any other instruments to attract resources; we can grant all types of loans and subscribe capital to Chilean stock companies; we can issue an guarantee the placing of shares, debentures and other obligations; we can grant endorsements and guarantees and we can effect exchange operations."

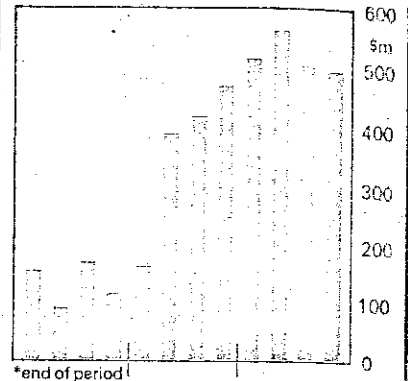
The development banks can also operate as mortgage banks and even as short-term lenders. They therefore provide working capital, import and export financing, and other short-term financial services, competing directly with the commercial banks, and putting themselves in danger of becoming general banking work horses.

The minimum working capital requirements of the banks are 75% of the minimum working capital requirements of the commercial banks, about \$2.8 million. Foreign investors have been encouraged to participate in the banks and also to provide long term lines of credit. The biggest of the development banks, Banco Unido de Fomento, is 40% owned by foreign shareholders, including Manufacturers Hanover International Finance Co., the Bank of Tokyo (Panama), Banco de Brasil, and Banco Exterior de España. Over \$25 million of the bank's credits and loans came from foreign banks and financial institutions at the end of 1977, over 75% of the bank's total outstanding loans and obligations of \$36.6 million. The development banks also have access to credits raised by the Central Bank.

It is clear that the development banks have a long road to travel. Increased direct foreign bank investment in the sector would be the best catalyst; the alternative is substantial foreign borrowing. Now that commercial banks are allowed to undertake medium-term lending, the development banks will also be facing greater competition. □

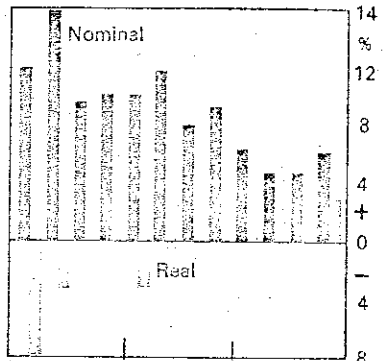
The Money Economy

Reserves*



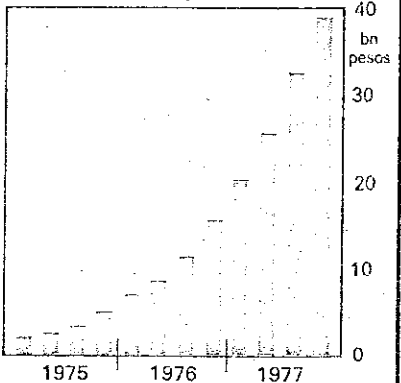
*end of period

Interest rates*



*end-quarter monthly interest rates for 30 day deposits

Money supply*



*money in circulation, billion pesos

Velocity

