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Chile: Challenges to the Free-Market Model

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An Intelligence Assessment

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August 1982*

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Chile: Challenges to the Free-Market Model

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An Intelligence Assessment

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This paper was prepared by [Redacted]

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[Redacted] Office of African and Latin
American Analysis. It was coordinated with the
Directorate of Operations and the National
Intelligence Council. Comments and queries are
welcome and may be directed to the Chief, South
America Division [Redacted]

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**Chile: Challenges to the
Free-Market Model**

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Key Judgments

Following years of chaos under Allende, the Pinochet government's thoroughgoing economic reform program transformed Chile into a market-oriented, free-trade economy. Diligent pursuit of these policies revitalized the economy by curbing runaway inflation and boosting growth rates.

The world economic downturn, however, has caused Chile to sink progressively deeper into recession since mid-1981. Despite the past success of a strategy that encouraged private initiatives, the abrupt slowdown is intensifying public criticism—including attacks in the press—of the government's free-market policies. President Augusto Pinochet, concerned about the related political costs, has relented and ordered some government intercession. The economic team has been shaken up, and credit and spending limits have been eased to reduce unemployment and bolster domestic industries.

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We believe the near-term outlook is still dim. We project that reduced world demand for Chilean exports and high world interest rates will cause real gross domestic product (GDP) to contract in 1982. Despite improvements in the trade balance, openly available data on other aspects of international payments show that the current account will remain in deficit. Moreover, based on foreign bankers' observations, borrowing will be more difficult to manage. One of the few positive developments this year is that inflation is likely to remain a moderate 5 to 10 percent.

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The stage is now set for growing confrontations between proponents of more scope for private enterprise and domestic critics of economic policy. At this juncture, Pinochet still supports the free-market philosophy, but we believe that worsening recession might gradually change his mind. We also believe that Pinochet could ultimately jettison some or most of his economic policies, especially if they were jeopardizing his political position.

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A gradual departure from current policy would have little immediate impact, but the longer run consequences could be severe. Historical experience with government intervention suggests Chile could once again

*Information available as of 26 July 1982
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face stop-and-go economic performance and could encounter balance-of-payments problems. At worst, we believe economic stagnation would eliminate a key rationale for Pinochet's authoritarian rule, lead to political polarization, and spark popular unrest. [Redacted]

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The United States has a growing stake in Chile's economic progress. Bilateral commercial ties have expanded significantly in the wake of Chile's economic turnaround. Any substantial departure by Chile from the free-market model would leave US businessmen vulnerable to efforts to restrict foreign investment and reduce access to the growing Chilean market. [Redacted]

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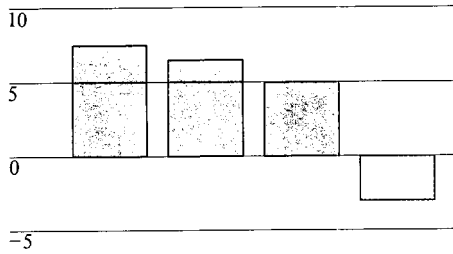
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Figure 1

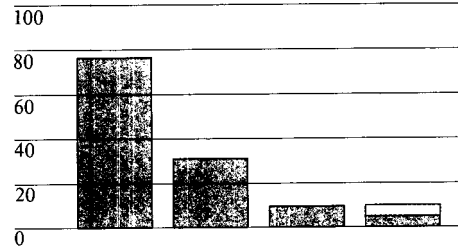
Chile: Economic Indicators

Note change in scales Range

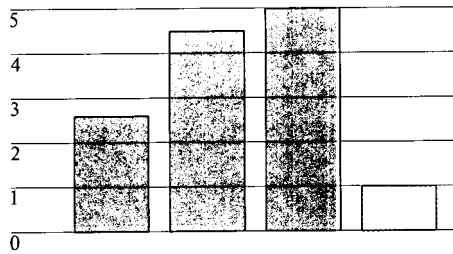
Real GDP Growth
Percent^a



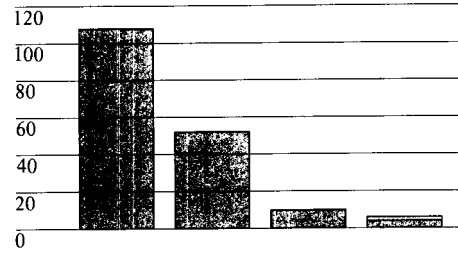
Consumer Price Inflation
Percent^a



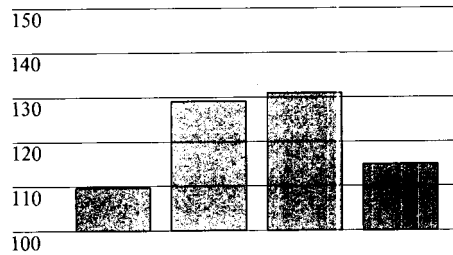
Public Sector Surplus
Percent of GDP



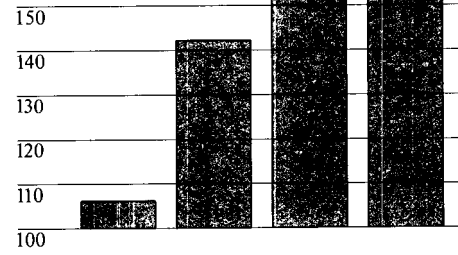
Money Supply Growth
Percent change in M1



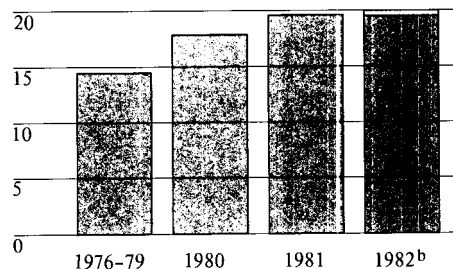
Manufacturing Production
Index: 1969=100



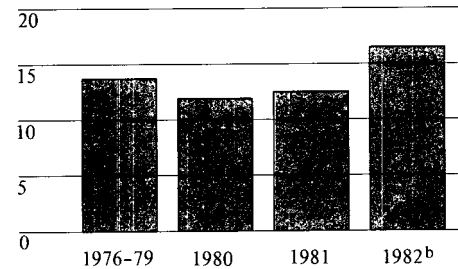
Real Wages
Index: 1977=100



Gross Capital Formation
Percent of GDP



Unemployment
Percent



^a Average annual.
^b Projected.

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Chile: Challenges to the Free-Market Model [redacted]

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The Pinochet Years

The Economic Miracle. The Pinochet government, which took power in 1973, confronted the economic chaos of President Salvador Allende's socialist revolution. Pinochet turned to a group of orthodox economists headed by Finance Minister Sergio de Castro. The new economic authorities, known locally as the "Chicago Boys," implemented throughgoing economic reforms along free-market lines. They revitalized private markets by eliminating price, interest-rate, and exchange controls. The government slashed state subsidies, spending, and borrowing and sold most nationalized firms to private investors. It instituted free-trade policies—tariff reductions and the elimination of trade controls—to improve productive efficiency. Flexible exchange rates were implemented between 1973 and mid-1979. Finally, the new government dismantled barriers to foreign investment. [redacted]

Comprehensive economic reforms along with stringent austerity have revitalized the Chilean economy since 1976 (See figure 1). De Castro's market-oriented policies brought inflation under firm control, restored Chile's international credit rating, and fostered a boom in economic activity:

- Inflation was reduced from triple-digit levels to a little over 30 percent by the end of 1980, causing real incomes to soar.
- External solvency was restored, leading to the resumption of foreign loans and direct investments.
- Real growth continued at a 7-percent average annual rate during 1976-80, improving living standards.

Free-market policies have also resulted, albeit slowly, in structural transformations necessary to improve Chile's long-run economic performance. The elimination of subsidies and import protection shrank the inefficient manufacturing sector. At the same time, reduced government intervention in the economy stimulated private commerce, transportation, and

banking. Trade reforms sparked the growth and diversification of the export base. Dependence on copper exports, for example, declined from the 80-percent level in 1973 to less than 50 percent in 1980; Chile has developed a sizable export trade in fruits, wine, lumber, and pulp as well as resource-based industrial products. Investment reforms also encouraged foreign companies to initiate new mineral projects. Strict fiscal and monetary discipline led to the revitalization of private capital markets. [redacted]

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Political Consolidation. Chile's favorable economic performance has played a key role in minimizing discontent resulting from Pinochet's heavyhanded political leadership. Since seizing power in 1973, President Pinochet has imposed a moratorium on political activity, and has set out to structure a political system that will preclude a resurgence of Marxist leadership. During and immediately after the coup, the government killed thousands of leftists, forced many more into hiding or exile, proscribed political parties, and clamped down on labor union activities. Since then, by skillfully maintaining crucial military support and exploiting the widespread political apathy resulting from the chaos of the Allende years, Pinochet has kept the political opposition off balance, divided, and largely ineffective. [redacted]

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Pinochet maintains a tight hold on domestic politics. He has formulated and won popular approval, in a plebiscite, for a transition plan that effectively bans political activity until 1989. The junta will then nominate a president who is to be approved in a plebiscite for an eight-year term. Only then will congressional elections be called. [redacted]

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Economic Developments in 1981

Advances. Last year, de Castro's continued implementation of market-oriented reforms and free-trade policies registered new successes. Regulatory changes

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Economic Turnaround Masks Vulnerabilities

Despite Santiago's impressive successes, the 1981 slowdown has uncovered important economic weaknesses and trouble spots. For example, Chile's dependence on exports of primary products underlies its sensitivity to shifts in world demand. Minerals—copper, iron ore, precious metals—accounted for 61 percent of total exports in 1980, 64 percent of budget revenues, and 7 percent of GDP. Export diversification into pulp, lumber, and fruits has broadened the export base but done little to reduce Chile's sensitivity to business cycles in key industrial countries. Debt-led growth has increased Chile's vulnerability to falling export earnings and rising interest rates.

Government efforts to increase reliance on the private sector have encountered setbacks. Private businessmen have been reluctant to invest in areas such as energy, minerals, and utilities. Consequently, the Chilean infrastructure has deteriorated in the wake of cutbacks in public-sector investment. Moreover, businessmen have been slow to adapt to the competitive market environment. Capital formation has lagged behind investment requirements, making the capital stock obsolescent and heightening susceptibility to import competition.

The current recession also highlights the political vulnerabilities in free-market policies. Nationwide unemployment has now increased to more than 15 percent, compared with the 5 percent of the Allende years. The poor and unskilled compose the bulk of the unemployed. Consequently, the economic downturn has accentuated a growing disparity in wage earnings and highlighted the increasing concentration of economic assets among high-income groups.

The broader socioeconomic gains of the de Castro years have, however, built a cushion of good will that will not easily evaporate. The government has continued increases in the social spending programs that were made possible by the rapid growth of 1975-81, and this has contributed to an improvement in welfare indicators, manifest in declining mortality rates and reduced malnutrition. Moreover, Santiago retains employment and food distribution programs to cushion the worst consequences of the current recession.

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improved the operation of the private banking system. The government reduced personal taxes to spur individual saving and instituted social security reforms based on individual retirement accounts. Santiago continued tight controls over public spending and the profit performance of state corporations, thereby leading to its sixth successive budget surplus. Monetary expansion was held to a mere 10 percent, sharply down from 50 percent compared with 1980. A free flow of imports improved productive efficiency by stimulating competition. The government further eased obstacles to foreign investment, and turned to overseas firms to develop indigenous energy sources.

The decline in Chilean inflation accelerated. Fiscal discipline, monetary restraint, and the fixed exchange rate policy caused annualized inflation to fall to an estimated 9.5 percent by the end of 1981, compared with 31.2 percent at the end of 1980. The rapid decline in inflation, combined with periodic wage adjustments, contributed to a 9-percent increase in average real wages. Living standards were also bolstered by a decline in the prices of food—which accounts for 60 percent of the budget expenditures of low-wage earners—and a boost in take-home pay for those switching to the private pension system. Predictably, the domestic savings rate also rose, contributing to the growth of the private banking system.

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Table 1

Million US \$

Chile: Balance of Payments

	1980	1981 ^a	1982 ^b
Current account balance	-1,970	-4,445	-2,600
Trade balance (f.o.b.)	-763	-2,455	-500
Exports	4,706	3,925	4,500
Imports	5,469	6,380	5,000
Service balance	-1,320	-2,090	-2,200
Transfers	113	100	100
Capital account balance	3,349	4,761	2,100
Foreign investment	304	381	200
Loan inflows	2,995	4,380	1,900
Errors and omissions	50	0	0
International reserve changes	1,379	316	-500

^a Estimated.^b Projected.

Setbacks. During 1981, however, Chile also experienced a series of domestic and external economic shocks that undermined confidence in de Castro's market-oriented policies. In May the public was shaken by the collapse of a large Chilean sugar conglomerate because of unsound business practices. Public concern about free-market policies was heightened after Chilean banking authorities intervened to prevent the collapse of eight major banks in November.

After five years of boom, unfavorable external developments triggered a severe recession in the second half of 1981. Industrial sales declined an estimated 5 percent during the last quarter because of the drop in demand for Chilean exports, falling copper prices, high world interest rates, and intense import competition. The abrupt slowdown was accompanied by growing unemployment, increasing business failures, increased domestic loan delinquencies, and bad debt. Criticism of the government's failure to respond to worsening economic conditions was increasingly reflected in newspaper editorials.

Failure to make necessary policy adjustments undermined Chile's payments position. The current account deficit more than doubled to an estimated \$4.4 billion mainly because of a severe deterioration in the trade accounts and rising interest payments on the foreign debt. Declining demand and prices for Chilean exports and the fixed exchange rate policy caused the trade deficit to more than triple to \$2.5 billion. Santiago resisted a currency devaluation—the exchange rate of 39 pesos to the dollar had been maintained from July 1979 to June 1982—to avoid a resurgence in inflation. The growing overvaluation of the peso, however, undermined the competitiveness of industrial exports and contributed to a steep rise in imports. Moreover, concern over an expected devaluation coupled with falling mineral prices also contributed to delays in new foreign investment projects, especially in the minerals sector.

Strategy Under Fire

The recent problems of Chile's economy have triggered broadbased opposition to market-oriented policies. Increased bankruptcies have heightened business demands for renewed government subsidies, a return to guaranteed pricing policies, and easier monetary policies. Complaints from other quarters, such as agricultural producers, directed against free-trade policies appear to be part of an effort—uncoordinated thus far—to secure higher tariffs or quotas to stem import competition.

The extreme right—a diverse group of hardline military, state-enterprise directors, and professionals—continues to press for more nationalistic economic policies. US Embassy and press reporting indicates that the right believes that present economic policies have resulted in:

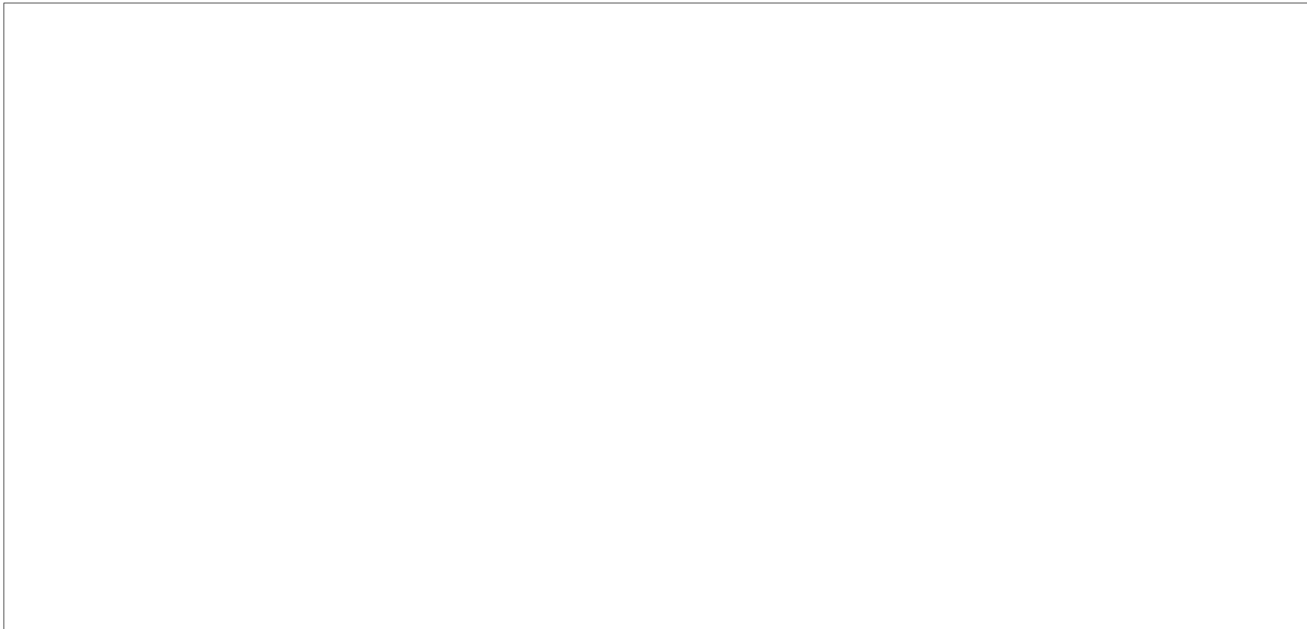
- Excessive dependence on foreign capital.
- Dangerous private concentration of wealth.
- An erosion in the domestic industrial and agricultural base.

To reverse these trends, the extreme right is seeking a return to more state direction of the economy. This would mean increased price controls, new business regulations, expanded public ownership of production facilities, and restraints on multinational corporations.

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Chile's long-quiescent political opposition has publicly shown increasing discontent over the social consequences of free-market policies. The US Embassy reports that the moderate Christian Democrats believe the state should move to blunt the impact of the recession, promote domestic industry, and improve income distribution. The left-of-center Social Democrats publicly stress the need for a return to a mixed economy and increased social welfare benefits. [redacted]

spending was reduced, while income and excise taxes were increased to balance the budget and continue the fight against inflation. [redacted]

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Economic Policy Changes Under Way

De Castro's reluctance to ease restrictive policies caused the Chilean economy to sink progressively deeper into recession and made some policy adjustments inevitable. Industrial sales, for example, dropped an estimated 12.5 percent in the first quarter of 1982. New business failures—an estimated 180 firms folded—and growing layoffs caused unemployment to rise above 15 percent nationwide and 19 percent in the greater Santiago area. As bad loans mounted, the financial position of Chilean banks grew weaker. Housing starts plunged 60 percent through February compared with the same period last year, while consumer sales were down 25 percent. [redacted]

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The worsening recession also triggered criticism of the private initiatives philosophy among a diverse group of President Pinochet's supporters. The progovernment press increased its editorializing about the dangers of inflexible economic policies, and former President Alessandri called on the government in April to modify its economic policies. [redacted]

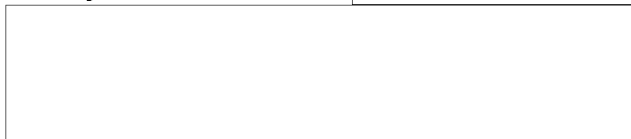
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Despite growing criticism, de Castro continued his course through the early part of this year. In February, for example, he denied the possibility of a peso devaluation, stating that a currency change would trigger strong inflationary pressure. Instead, he enacted new austerity measures in March. Government

[redacted] In late April, Pinochet named the head of the Central Bank, Sergio de la Cuadra, to replace de Castro as Finance

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The Near-Term Outlook
Economic Growth

The rate of economic growth—which slowed to 5 percent in 1981—should decline again this year. Key factors in the slowdown will be:

- *A decline in industrial activity because of reduced sales of consumer goods, cutbacks in state enterprise spending, a fall in new investment projects, and stiff import competition.*
- *A fall in new construction because of high interest rates and tight domestic credit.*
- *Flat agricultural performance because of a lack of adequate financing and price support.*
- *A weak export recovery because of sluggish world demand for primary products.*

Inflation

Santiago had already reduced inflation to less than a 1 percent annual rate in the first quarter. Increased taxes, monetary restraint, growing amounts of idle capacity, and the moderation of real wage increases should continue to restrain inflationary momentum despite new government spending programs and the recent devaluation. Chile's inflation rate probably will range between 5 and 10 percent this year, compared with a 9.5 percent in 1981.

Current Account

Some improvement is likely in the payments position during 1982. We believe the current account deficit will decline more than 40 percent to \$2.6 billion. Despite a weak export recovery, the recent devaluation, a recession-induced fall in imports, and shifts in commercial policy should enable Chile to sharply reduce the trade deficit to \$500 million. Any substantial improvement in world commodity markets will translate into a stronger-than-expected payments recovery.

Capital Inflows

Bank lending to Chile, which has slowed this year, should decline by about 55 percent to \$1.9 billion, while new direct investment will be halved to \$200 million. Borrowing terms—spreads on new loans have tightened to 1.5 percentage points over LIBOR compared to 1 percentage point last year—will continue to toughen. To cover the payments gap, Santiago will probably draw down international reserves by \$500 million and increase short-term borrowing.

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Minister. Domestic critics of current policies reacted favorably, while free-market proponents and Chile's external creditors expressed concern over the policy implications of the shift.

Economic policy adjustments have indeed followed de Castro's departure. To ease unemployment, Pinochet ordered in May increased public work spending; initiation of new, low-income housing construction; and a new government program to hire idle workers in the depressed south. Since then, Santiago has also taken some steps to aid domestic industries. Chile's state copper company will provide commodity credit loans to small producers during periods of low prices, while state sugar beet refineries will purchase domestic crops at prices above world market levels. On

1 June, the government announced measures that lowered the cost of domestic credit and expanded access to short-term foreign loans to ease financial strains. In July the Central Bank took steps to lower interest rates and help banks cope with its bad debts.

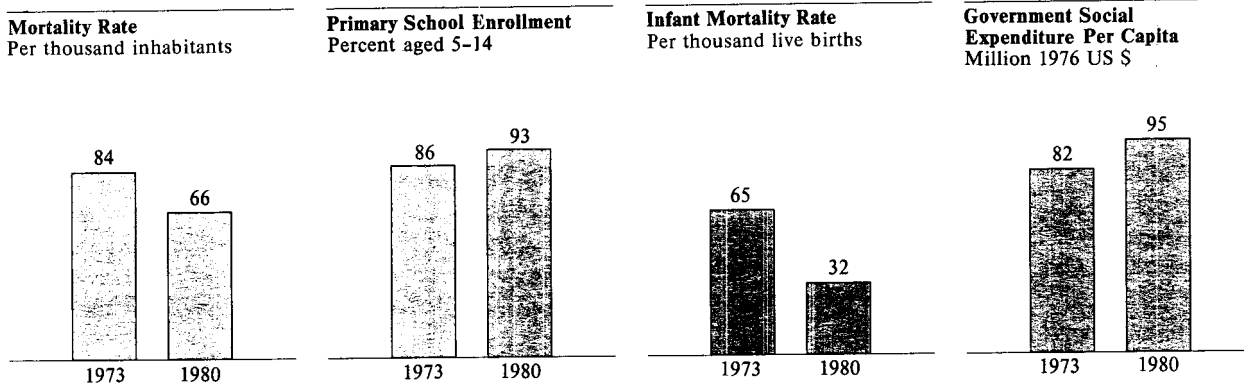
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Santiago also acted to improve the payments accounts. It ended the fixed exchange rate policy on 15 June, announcing an immediate 18-percent peso devaluation and plans to further devalue the peso by about 10 percent over the next year to improve the competitiveness of Chilean exports. The government had previously improved export financing terms while

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Figure 2

Chile: Improvements in Social Welfare



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tightening import financing requirements. Additionally, Santiago will apply countervailing duties to restrict imports being subsidized by foreign governments. [redacted]

Signs To Watch. De Castro's departure has triggered growing confrontations between free-market proponents and the numerous domestic critics. Finance Minister de la Cuadra is less influential than his predecessor. Moreover, Chile's hardline military has gained a beachhead in policymaking. The new Economy Minister, General Luis Danus, favors greater government control over the economy, [redacted]

[redacted]

The emergence of the military in economic policy formulation is now triggering open speculation about the imminent demise of the free-market model in Chile. The US Embassy reports that the opposition has labeled the recent devaluation as a tacit admission of failure for the government's economic policies. Moreover, vested interests are now lobbying for additional government intercessions on their behalf. Even

¹ The hardline military's philosophy envisions an enterprise economy in which the state plays a key regulatory role through price controls and tariff protection. [redacted]

some staunch backers of a free-market model are now publicly calling for increased tariff protection and subsidized credits to pull Chile out of its economic tailspin. [redacted]

Despite these changes, Pinochet is likely to continue to support market-oriented policies over the near term. Even while announcing the shift in economic ministers, he publicly reaffirmed his support for the broad approaches of de Castro. Pinochet has left the Central Bank and the Finance Ministry—the country's two most important economic policymaking posts—in the hands of free-market proponents. Additionally, he personally supports the free-market model because it has earned Chile international respect and has visibly improved living conditions. Indeed, most of the recent economic adjustments are not inconsistent with the free-market philosophy. Moreover, Pinochet almost certainly recognizes that Chile's current economic difficulties are being mainly driven by unfavorable external developments—declining copper prices, falling demand for raw materials, and high world interest rates—rather than by basic flaws in economic strategy. [redacted]

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A worsening or prolonged recession, however, could gradually erode presidential support for market-oriented policies. [redacted]

[redacted]
 he is pragmatic and responsive to social pressures. Pinochet would probably further modify the economic model to protect his political position. Continuing shifts from market-oriented policies would probably be gradual, piecemeal, and with few immediate consequences for Chile's near-term economic performance. [redacted]

Key indicators signaling a shift from market-oriented policies would include:

- Renewed subsidies, tax exemptions, or guaranteed prices to aid broad sectors of domestic industry.
- Government credit to prevent business failures.
- Across-the-board tariff hikes or stringent import controls to blunt foreign competition.
- Reintroduction of nationalistic economic policies to restrain foreign investment in Chile's extractive industries. [redacted]

Beyond 1982

A World Bank Perspective. Any radical departure from free-market policies would harm Chile's economic performance beyond 1982. According to a recent World Bank study, the continuation of market-oriented policies would enable Chile to sustain 5- to 6-percent real growth during the 1980s with low inflation. According to the World Bank, such rapid growth will be required to create the jobs necessary to absorb new workers. Export diversification, increased mineral investments, and continued access to foreign capital would enable Santiago to avoid payments constraints. [redacted]

The World Bank feels, however, that Santiago must overcome serious shortcomings to realize Chile's growth potential. Increased investment in public works will be necessary to prevent energy or transportation bottlenecks. The government must also encourage industrial revitalization. Although modest increases in capacity have taken place, Chile's industrial boom has largely been accomplished through idle capacity, better utilization of existing capital stock,

Table 3

Million US \$
 Except Where Noted

Chile: External Debt and Debt Servicing Burden

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	1979	1980	1981
External debt	7,510	9,415	13,200
Exports	4,645	5,800	5,350
Merchandise	3,763	4,706	3,925
Services	882	1,094	1,425
Debt service	1,538	2,146	2,400
International reserves ^a	1,938	3,123	3,214
Ratio of debt to:			
Exports (percent)	161.7	162.3	246.7
GDP (percent)	29.2	34.4	45.9
Ratio of debt service to:			
Exports (percent)	33.1	37.0	44.9
GDP (percent)	6.0	7.8	8.3
International Reserves (percent)	79.4	68.7	74.7

^a Minus Gold.

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and limited modernization of existing plants. High domestic interest rates, tight credit, and continued import competition will continue to undermine private sector incentives to make necessary new investments. [redacted]

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The World Bank report also points out that additional economic reforms will be needed. The indexation of wages has restrained new job creation, and Santiago is now moving to reduce its impact. Additionally, the government must improve labor mobility and upgrade worker skills. Moreover, it must continue capital market reforms to increase the availability of long-term investment finance and improve the access of smaller industries to credit. [redacted]

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The foreign debt, says the Bank, will have to be carefully managed to avoid external constraints to growth. Past heavy borrowing and rising world interest rates have contributed to a rapid debt buildup and a growing servicing burden. Last year, for example,

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Chile's debt relative to its productive capacity reached nearly 50 percent. Debt servicing, an estimated \$2.4 billion in 1981, represented nearly 45 percent of export earnings. According to the World Bank, this ratio will rise above the 50-percent level during the 1980s. More worrisome is the increased use of short-term credit, which will add to the debt servicing burden and shorten debt maturities. As a result, export shortfalls, the erosion of domestic firm repayment capabilities, or tighter access to world money markets could cause Chile serious repayment problems. [redacted]

An Alternate Scenario. Despite the World Bank's optimism for the longer term, we believe Chile is likely to remain in recession over the next 12 months. We believe that the rebound in world demand for Chilean exports and reduced international interest rates necessary for a vigorous near-term recovery probably will not occur before next year. The recent policy adjustments will ease economic strains but are unlikely to promote a strong economic rebound. This suggests that Chile will encounter difficulty in regaining its past economic momentum. This poorer prospect would, in turn, have important implications for domestic politics, economic policies, and economic performance through the mid-1980s. [redacted]

Changing Political Setting. These economic problems over the longer term could give impetus to stirrings, already evident among the long-quiescent political opposition. The well-organized, but underfinanced, Christian Democrats have recently chosen a new party chief from the center-left to replace the late former President Frei. [redacted]

[redacted]

Despite economic pressures and signs of renewed political activism, destabilizing social violence remains unlikely in the near term. We believe the "economic miracle," the memory of the chaos of the Allende period, and brutally effective governmental repression have instilled political apathy in much of the populace. In this context the Christian Democrats, the key to any serious antigovernment activity, appear unlikely to form a permanent united front with any Marxist organizations, or even with the nonviolent Socialist Convergence. Both the Christian Democrats and the moderate socialists have announced their intention to eschew violence. [redacted]

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The labor movement, so instrumental in Allende's downfall, has been weakened by ideological splits, successful government cooptation, and repression.

[redacted]

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[redacted] Finally, the Falklands crisis and its implications for Chile's deadlocked negotiations with Argentina over the Beagle Channel have diverted public attention from domestic ills and caused a majority of Chileans to look to the government to defend the nation's interests. [redacted]

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The Growing Risk of Compromises. The inherent longer term risk is that political pressures could require Pinochet to modify the market model. Those in Chile who support free-market policies are in the minority and lack a strong political base [redacted] Pinochet is well aware of this and, according to the US Embassy, uses key military and civilian advisers to monitor on-going political developments, popular sentiment, and emerging social pressures. According to the Embassy, Pinochet has modified policy when confronted with widespread evidence that the failure to do so poses unacceptable risks to his political position [redacted]

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Under these circumstances, we believe two different outcomes are possible. An alternate economic leader may emerge who presents Pinochet with a different

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strategy for resolving Chile's current problems. We assign a low probability to any abrupt shift in policy. Economic policy formulation still remains in the hands of free-market proponents and we have yet to observe the emergence of a national leader with well-defined economic alternatives. [redacted]

The more likely course is a gradual shift away from free-market policies. [redacted] Pinochet fears that worsening recession could spark labor demonstrations and trigger social unrest. To prevent this, he would probably jettison parts of the economic model over time to accommodate regime critics and strengthen his domestic political support. In this event, economic policymaking would become less well orchestrated resulting in numerous inconsistencies. [redacted]

The Consequences. We believe that the failure to sustain market-oriented policies over the longer term has worrisome consequences. A gradual reversion to "pre-Chicago" practices—industrialization spurred by import substitution, increased government spending, restraint on foreign investment—could cause the resurgence of many of the serious economic problems of the pre-Pinochet era. [redacted]

The political consequences of long term economic deterioration could be severe. Stop-and-go performance leading to economic stagnation would eliminate the economic rationale for Pinochet's authoritarian rule and could lead to renewed political agitation. The expanding youthful workforce, if it found employment avenues choked off, could be susceptible to mobilization by the opposition parties. Intensified political action, especially if it took antigovernment overtones, could cause Pinochet to consider postponing the transition to civilian rule and to tighten security. [redacted]

[redacted]

If economic distress were to lead to popular unrest, Pinochet, who does not generally yield to pressure, might crack down on groups attempting to speed the pace of democratization. Such action could increase political polarization by radicalizing the moderate labor unions, the Christian Democrats, and the

Socialist Convergence. Faced with economic deterioration and repression, these moderate elements might be driven to an alliance with the radical left, a move that could eventually destabilize Pinochet's government. [redacted]

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Implications for the United States

The United States has a growing stake in Chile's economic progress. Bilateral commercial ties have expanded significantly in the wake of Chile's economic turnaround. During the late 1970s, Chile was one of the fastest growing markets for US trade and investments. [redacted]

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- US exports tripled to \$1.5 billion, about a quarter of Chile's growing import market.
- Private lending grew from negligible amounts to an estimated \$5.8 billion, nearly 60 percent of the country's bank debt.
- US business firms have plans pending for \$5 billion in new investments, nearly 80 percent of the total authorized by the Chilean Government since 1976.

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Any substantial shift from market-oriented policies would damage US commercial interests. Businessmen remain vulnerable to efforts to restrict foreign investment, especially in the minerals sector, or tougher regulation of multinational corporations. At the same time, higher tariffs or import controls would limit the ability of US exporters to make further competitive gains in the Chilean import market. [redacted]

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