

June 20, 1991

A U.S. ROLE IN CHILE'S DEMOCRATIC AND ECONOMIC REFORMS

INTRODUCTION

Chile has become a model of economic and democratic progress in the developing world. It has moved farther and faster than any other Latin American country toward free market economic reform and has posted seven straight years of economic growth. With last December's election of Christian Democrat Patricio Aylwin Azocar as President, Chile's "economic miracle" has been accompanied by a peaceful transition from dictatorship to democracy.

Now Chile hopes to go further. It is seeking to negotiate a Free Trade Agreement with the United States and play a pivotal role in advancing George Bush's Enterprise for the Americas Initiative (EAI), which would create a Western Hemisphere free trade zone.¹

Welcome Desire. The Bush Administration should welcome Chile's desire to become a free market champion in Latin America. It should enlist Aylwin's help in drafting a working plan for the EAI, while beginning to establish a timetable for free trade area negotiations with Chile.

1 An FTA would remove such barriers to trade as tariffs and quotas and seek a broad liberalization in the commerce of goods, services and investment between the U.S. and Chile.

Tense Years. U.S.-Chilean relations, of course, have not always been so cordial. During the military government of General Augusto Pinochet Ugarte from 1973 to 1990, tensions mounted between Washington and Santiago because of charges that Chile was violating human rights and denying political freedoms. Relations were further soured after the September 21, 1976, car bomb assassination in Washington of Orlando Letelier, an exiled former Chilean Foreign Minister who had served in the Marxist government of Salvador Allende Gossens. The crime was linked to Chile's secret police, the National Intelligence Agency (DINA).² As a result, economic and military cooperation between the U.S. and Chile was curtailed severely in the late 1970s and most of the 1980s.

Whatever the problems with Chile's external relations, Pinochet boldly rebuilt the Chilean economy, laying the foundation for Chile's new role today as a regional engine of democratic and free market reform.

After his democratic election last year, Aylwin has upheld the Pinochet government's free market economic reform program and has improved Chile's protection of human rights record by forming on April 25, 1990, the Presidential Commission for Truth and Reconciliation to investigate human rights abuses. This commission on March 4 issued the so-called Rettig Report, named after the commission's president Raul Rettig. The report documents some 2,279 human rights abuses under the Pinochet government. The report also offers a blueprint for judicial reform, continued human rights investigations and compensation to those who suffered under Pinochet.³

Return to Normal. The U.S. should want to see the Aylwin government succeed in institutionalizing democratic and free market reforms in Chile. For the first time in over fifteen years, the U.S. and Chile are enjoying full economic relations and are developing joint security assistance, training and education programs. All sanctions and restrictions on U.S. military assistance, loans, credits, and other economic or security aid to Chile, imposed by Congress following the 1976 Letelier murder, were lifted last December 1, opening the way for a full normalization of U.S.-Chilean relations. U.S. military help is vital to the Aylwin government for it faces continued threats from Chile's left-wing terrorist groups and drug traders.

Chile's economic and political success story may teach important lessons to other less developed countries in Asia, Africa, and Latin America. Most important, by striking a free trade deal with the U.S., Chile can set an example for other Latin American countries — including Argentina, Brazil, Colombia, Peru, and Venezuela — by becoming the first country to participate in Bush's Enterprise for the Americas Initiative. By linking its economy to the North

2 See James R. Whelan, *Out of the Ashes: Life Death and Transfiguration of Democracy in Chile* (Washington, D.C.: Regnery Gateway, 1989), pp. 735-742.

3 See "Reaction to the Rettig Report," *Andean Newsletter* No. 53, April 8, 1991, pp. 2-4.

1990 CHILE STATISTICS

Official name: Republic of Chile

Capital: Santiago (estimated population 5.5 million).

Chief of State: Patricio Aylwin Azocar

Political status: Independent republic proclaimed on September 18, 1810; military rule imposed September 11, 1973; constitutional democracy restored December 14, 1989.

Key political parties: Christian Democratic Party, The National Renovation Party, Independent Democratic Union, the Social Democratic Party, Party for Democracy, the Radical Party, the Movement of the Revolutionary Left, and the Communist Party.

Area: 302,778 square miles, nearly twice the size of California.

Population: approximately 13.1 million.

Population growth rate: 1.6%.

Ethnic groups: 95% European and European-Indian, 3% Indian, and 2% other.

Infant mortality rate: 18 deaths/1,000. Life expectancy - 72 years.

Adult literacy rate: 94%.

Work Force: About 4.7 million: 34.1% industry and Commerce; 30.3% services and government; 19.3% agriculture, forestry and fishing; 6.7% construction; and 2.3% mining.

Unemployment rate: 5.7%

Natural Resources: Copper, timber, fish, iron ore, nitrates, precious metals, and molybdenum.

Agricultural products: fruits, wheat, potatoes, corn, sugar beets, onions, beans, livestock, wool, and poultry.

Gross domestic product (GDP): \$27.8 billion

Per capita income: \$2,111

Economic growth rate: 2.1%

Inflation: 27.3% (18% projected for 1991).

External debt: \$18.6 billion

Total exports: \$8.3 billion (U.S. 22%) - copper, molybdenum, iron ore, seafood and fishmeal, fruits, forestry products, and wine.

Total imports: \$7.1 billion (U.S. 16%) - petroleum products, machinery, transportation equipment, electronic equipment, consumer durables.

Defense forces: 101,000

Terrorist threat: Manuel Rodriguez Patriotic Front (FPMR) - about 1,000 cadres; Lautaro Youth Movement (MJL) - about 500 cadres.

Source: The World Factbook, 1990 (Washington, D.C.: Central Intelligence Agency), pp. 61-62; Background Notes, "Chile," United States Department of State, November 1990.

Heritage InfoChart

American Free Trade Area, which will include Canada, Mexico and the U.S., the Aylwin government could help accelerate free market economic reform and free trade throughout the Americas.

By developing good relations with the Aylwin government, Washington can fortify Chile's free market and democratic leadership, while helping to advance U.S. economic and security interests in Latin America. These include promoting free market reforms, strengthening democracy, curbing the drug trade, and defeating terrorism. By rewarding Chile's progress, Washington will encourage the spread of similar economic and political reform throughout the Americas. By contrast, a cold shoulder from Washington could trigger a socialist and anti-democratic backlash throughout the region.

Understanding this, the Bush Administration should:

- ◆ **Stress Washington's strong support for the Aylwin government's democratic reforms and pursuit of a free market economy.** This will ease Chile's difficult transition from military government to democracy. Argentina, Brazil, and Paraguay have suffered economic and political turmoil during such transitions. If Chile becomes an engine of reform in the region, these countries could look to it for solutions to their political and economic problems.
- ◆ **Pursue quickly a Free Trade Agreement with Chile.** Bush formally should announce his administration's intent to negotiate a free trade pact with the Aylwin government. The Office of the United States Trade Representative (USTR) should draw up a timetable for launching U.S.-Chile Free Trade Agreement talks. The White House should urge Congress to task the International Trade Commission, an independent U.S. government body which rules on disputes concerning international trade law, with producing a report on the effects of a free trade pact between the two countries.
- ◆ **Work closely with Santiago in launching the Enterprise for the Americas Initiative (EAI) throughout the region.** Bush should establish an inter-agency EAI task force within the U.S. government to develop an action plan to create a hemisphere-wide free trade zone to spur economic reform and growth. The U.S. also should seek Chile's help in



forming an official hemispheric working group that would meet monthly to discuss how to promote the EAI.

- ◆ **Expand security cooperation with Chile's military and police forces to promote democratic values and respect for human rights and to counter terrorism.** U.S. contact with Chile's security forces could foster a greater respect for civilian authority. The U.S. also could provide valuable training and material for countering Chile's communist terrorism threat. This assistance should focus primarily on education programs for Chilean officers, intelligence sharing on terrorist groups, spare parts and maintenance for U.S.-manufactured military equipment, and urban warfare training to combat terrorism.
- ◆ **Work closely with the Aylwin government to defeat Chile's growing drug trade.** Because of the crackdown they face in Colombia, the Caribbean, Mexico, and Peru, drug traffickers increasingly are using Chile as a transit point for cocaine and as a source of drug-related chemicals for cocaine processing. Before the cartels establish a strong foothold in Chile, Washington should give Santiago the resources, intelligence, and training to fight the war on drugs. The U.S. Drug Enforcement Administration (DEA) and State Department's Bureau of International Narcotics Matters (INM) should give Chile's anti-drug units technical intelligence on drug shipments and training in drug interdiction strategy.

CHILE'S LEADERSHIP IN FREE MARKET ECONOMIC REFORM

George Bush told a special joint session of the Chilean Congress last December 6 in Valparaiso, Chile that:

Chile has moved farther, faster than any other nation in South America toward real free market reform and the payoff is evident to all with seven straight years of economic growth; in exports alone a 15 to 20 percent increase in value in each of the past five years. This explosive growth has secured for Chile a growing impact on the world economy.

Bush's assessment of Chile's progress in on the mark. Chile's road to economic leadership in Latin America is the outcome of a process that began when Pinochet took office in 1973. By pursuing such free market economic reforms as a bold privatization program, freer trade, and lower taxes, Pinochet guided Chile down a road of economic prosperity. Chile now is next in line after Mexico to strike a Free Trade Agreement with the Bush Administration, and even more important, to play a leadership role in promoting Bush's Enterprise for the Americas Initiative.

Allende's Socialism

Pinochet had come to power after a coup, following prolonged internal turmoil, toppled Salvador Allende's government. Its socialist policies of state ownership, high trade barriers, and excessive government regulation brought the Chilean economy to near collapse in the early 1970s. Writes Johns Hopkins University economist Steve H. Hanke: "The Allende government had engaged in price controls for most essential goods and services. With prices set at artificially low levels, production was discouraged – particularly in the agriculture sector – and the nation's growth rate was retarded. Moreover, the fixing of prices for public services contributed to Chile's enormous [1973] budget deficit of 13 percent of GNP."⁴

Allende set tariffs at an average rate of 100 percent on such foreign goods as agricultural products, automobiles, and electronic equipment and further restricted imports by imposing quotas and import licensing fees. Before Pinochet came to power, Hanke explains: "the domestic capital market in Chile was highly repressed: most banks were government-owned, negative real interests rates were typical, and quantitative restrictions on credit were pervasive." By setting interest rates below the level of inflation, the incentives for savings were destroyed. The reason: Chileans would lose more money through inflation than they would gain by interest earned on their savings. Because of the negative real interest rates, Chileans were encouraged to go into debt by borrowing. In an effort to prevent this, Allende placed restrictions on the amount people could borrow from banks. The harvest of these economic policies was bitter. In 1973, Allende's last year in office, Chile's gross domestic product shrank by 5.6 percent.

The Pinochet Free Market Revolution

This all has changed. When Pinochet seized power in September 1973, his government launched far reaching free market economic reform. This accelerated in 1985 when Hernan Buch became Finance Minister. During its sixteen years in power, the Pinochet economics team:

◆◆ **Introduced a debt-for-equity program.** Chile was the first Latin American country to pursue debt-equity swap policies aggressively, and its debt management remains a model for the developing world. Through this technique, investors purchase part of a country's debt from a creditor bank at a substantial discount and exchange the debt for local currency, bonds, or state-owned equity shares from the debtor government.⁵

4 Steve H. Hanke, "Chile's Economic Revival," paper delivered at a Heritage Foundation Conference on "The Unknown Revolution: Chile's Transition to Democracy," Washington, D.C. September 16, 1988.

5 For more information see Melanie Tammen, "Energizing Third World Economies: The Role of Debt-Equity Swaps," Heritage Foundation *Background* No. 736, November 8, 1989.

◆ ◆ **Privatized public enterprises.** Approximately 39 percent of Chile's gross domestic product was in the hands of the Allende government in 1973. Today only 25 percent is controlled by the government. Pinochet's privatization drive sold to the private sector roughly 460 large state companies, worth some \$2 billion, including banks, the steel, electric, and telephone monopolies, agro-industrial plants, textile companies, mining interests and airlines. Even the once insolvent Chilean social security system was placed in private hands in 1981. This program led to the birth of Chile's "popular capitalism" strategy, a policy which dispersed economic power among various sectors of the economy. This program's success was largely achieved by permitting public sector workers to use accumulated retirement funds to buy shares in privatized firms.

◆ ◆ **Liberalized the foreign investment codes.** Through Decree Law 600 of 1974, foreign investors are offered favorable terms regarding taxation, expatriation of profits, legal protection, and respect for property rights. Estimate experts at the U.S. Embassy in Santiago: "some \$6 billion of foreign investment has been attracted to Chile since 1985." By the mid-1990s, moreover, foreigners are expected to commit some \$19.75 billion in new capital to Chile's economy.⁶

◆ ◆ **Reduced trade barriers.** Pinochet was an early champion of the free trade area concept. Chile eliminated between 1974 and 1979 all non-tariff barriers and reduced tariffs to a flat rate of 10 percent for all products. During Chile's 1982-1983 recession, however, tariffs were hiked to 15 percent for all products, where they remain today. Chile's outward-looking economic liberalization policies have transformed it from an isolated economy to one of the world's most open and dynamic.

◆ ◆ **Lowered taxes.** During the Pinochet years, Chile's tax rates were cut across the board. The top individual rate was dropped from 65 percent to 50 percent; the top business rate was dropped from 30 percent to 10 percent. The value added tax (VAT) was cut from 20 percent to 16 percent.

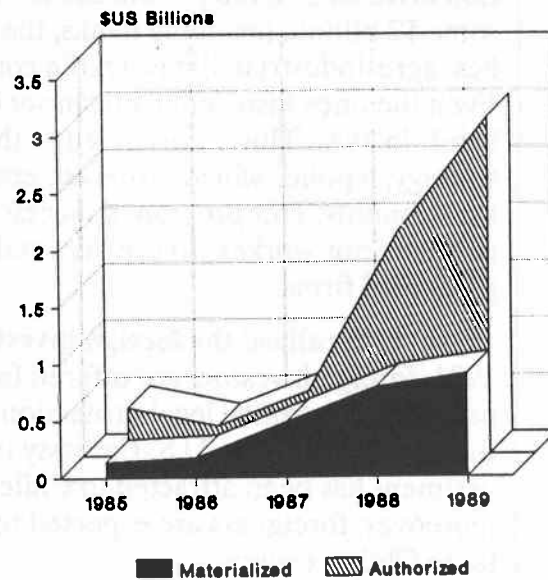
The results of Pinochet's reforms are evident today: inflation is down from approximately 1,000 percent in 1973 to 27.3 percent last year, and is expected to drop to 18 percent this year; Chile attracted over \$1.3 billion in foreign investment last year, an all-time record representing 5 percent of Chile's \$27.8 billion gross domestic product (GDP)⁷; overall foreign and domestic private investment in Chile is expected this year to reach some 20.1 percent of its GDP, the highest in 20 years; exports, which represent close to 30 percent of the GDP, should continue to grow 20 percent a year and reach about 35 per-

6 Mark Svolo, "Chile Stays on Track," *The Times of the Americas*, November 11, 1990.

7 According to the U.S. Commerce Department, U.S. profits on investment in Chile have been above 40 percent per year for the past four years.

cent of GDP by 1995; unemployment has fallen from 15.1 percent in 1985 to 5.7 percent last year; and according to Aylwin's Finance Minister Alejandro Foxley, the economy is expected to grow at about five percent this year.⁸ Most Latin American countries now are trying imitate the Chilean economic success story. Many of them are seeking to sign free trade pacts with the U.S. and participate in a program of regional economic integration through the Enterprise for the Americas Initiative.

Chile Foreign Investment Authorized and Materialized



Source: Central Bank of Chile

Heritage DataChart

Aylwin Stays a Free Market Course

Except for the Communists, who comprise less than 5 percent of the electorate, all major Chilean political parties back the Pinochet economic model. The disastrous experience of neighbors Argentina, Brazil and Peru, which suffered from inflation, economic stagnation and high unemployment following their transitions to democracy in the 1980s, has convinced Chile's leaders that their free market reform program should not be hampered by costly state-supported social welfare programs. To the relief of Chile's business community, which feared that Aylwin might bring back socialism, the new government has continued to privatize state-owned industries, encourage the private sector to diversify exports, and limit public spending.⁹ Nor is there any sign of a return to the steep taxes and repeated currency devaluations practiced by the Allende government.¹⁰

The Chilean economic miracle has impressed the world's financial community. After only one week's discussions in New York, last September Chile and a group of international banks, including Chase Manhattan Bank National Association and Citibank, N.A., agreed to restructure Chile's \$4.8 billion

8 This figure was provided by Foxley at a May 3, 1991, Heritage Foundation lecture.

9 Arturo Valenzuela and Pamela Constable, "Democracy in Chile," *Current History*, February, 1991, p. 53.

10 InterAmerican Opportunities Briefing, "Money Matters," The International Freedom Foundation, April/May 1991, p. 3.

commercial debt. The result is a postponement of \$1.8 billion worth of equity payments due in the next four years. The debt restructuring plan also gives Chile a break on interest payments, stretching out the time in which they must be paid from once every six months to once a year. An estimated \$462 million will be saved each year as a result of these two measures. As a sign of bankers' trust in Chile, Santiago received on March 20, 1990, \$320 million worth of bonds from the same group of international private banks that renegotiated its debt in September 1990. This marks the first time since the Latin American debt crisis began in 1982 that a government has obtained credit because of its good international credit record.¹¹

Another sign of Aylwin's commitment to a free market policy is his government's efforts to attract new trading and investment partners abroad. Chile's traditional partners are Argentina, Australia, Brazil, Britain, France, Germany, Italy, Japan, Spain and the U.S. Now Chile is seeking increased trade and investment opportunities with Canada, China, Mexico, the Soviet Union and other countries. The government hopes to stimulate with these new initiatives a 15 percent annual increase in such exports as wine, fruits, vegetables, light manufactured goods, seafood, and fishery and lumber products, which account for 50 percent of Chile's total exports.¹²

SEEKING A FREE TRADE AGREEMENT WITH THE U.S.

Since Chile has expressed its interest in negotiating a Free Trade Agreement (FTA) with the U.S., trade talks may begin prior to completion of the U.S.-Mexico FTA.

There are five reasons why the U.S. should sign a free trade pact with Chile. A U.S.-Chile FTA would:

Reason #1: Launch Bush's Enterprise for the Americas Initiative. An FTA with Chile would be the cornerstone of a campaign to spur support for the Bush initiative. Argentina, Brazil, Peru and other South American states would not want to isolate themselves from Chile's rapidly growing economy or from the eventual North American Free Trade Area.

Reason #2: Promote long-term Chilean economic and political stability. A U.S.-Chile FTA would consolidate Chile's free market program and guarantee that reforms continue. The economic rewards generated in Chile by new jobs, additional foreign investment,

11 Svolos, *op. cit.*

12 Copper is Chile's primary export. It produces approximately one-quarter of the world's supply, drawing in an estimated \$4 billion in 1989.

and cheaper foreign goods, would generate support for the Aylwin administration and its free market policies.

Reason #3: Increase U.S. access to Chile's rapidly growing market. Chile is Latin America's fastest growing market for U.S. capital equipment, heavy machinery, computer and telecommunications equipment, engineering services, and chemical products.

Reason #4: Provide further investment opportunities for U.S. companies in Chile. American companies, already have some \$1.5 billion invested in Chile, mainly in banking, finance, insurance, investment funds, computer services, engineering, mining, forestry, agriculture, and telecommunications. According to the Commerce Department, U.S. profits on investments in Chile have been above 40 percent per year for the past four years. By locking in or improving Chile's favorable investment laws on tax treatment, property rights guarantees, and access to natural resources, an FTA would invite further U.S. investments.

Reason #5: Bolster the economic competitiveness of both countries. Competitions of U.S. and Chilean companies not only will improve in terms of Pacific Rim nations like Japan, South Korea, and the Republic of China on Taiwan, but also in terms of the European Community. The reason: American companies will be able to combine their technology and highly skilled labor with Chile's cheaper labor and resources to cut the prices of their products in the global market. The amount of capital available for U.S. and Chilean products will grow as global demand for their products increases and their operations expand.

The U.S. and Chile signed a trade and investment framework agreement on October 1, 1990, which paves the way for a U.S.-Chile FTA. The accord establishes a joint U.S.-Chile Council on Trade and Investment to monitor bilateral economic ties and to open markets further in both nations. According to a June 1 White House press release, agenda items for the council include: "cooperation in the Uruguay Round of multilateral trade negotiations in the General Agreement on Tariffs and Trade (GATT), increased market access, adequate and effective protection for intellectual property rights, investment policy, and the reduction of barriers to trade and investment in the

hemisphere. The Council also will consider the creation of working group to address these and other issues.”¹³

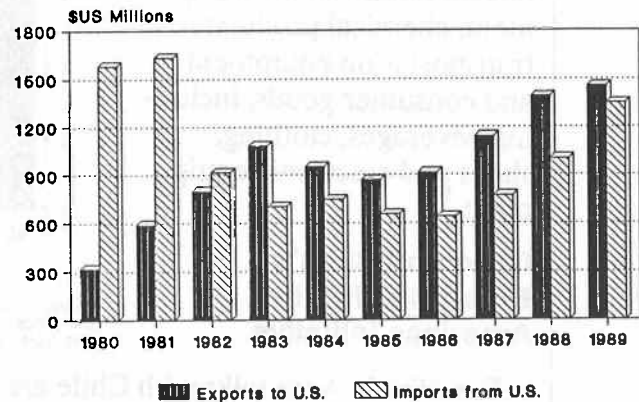
Deputy U.S. Trade Representative Jules Katz told the Senate Finance Committee on April 24 that “besides Mexico, Chile is the only other Latin American or Caribbean country whose economic liberalization efforts are at an advanced stage that would allow the [Bush] administration to consider negotiating a free trade agreement over the next two years.”¹⁴

An FTA with Chile would not be difficult to achieve. The reasons: U.S.-Chilean relations have been expanding for several years, Chile has a free market economy with low trade barriers, and an FTA would be a natural outgrowth of existing trends in trade. Trade between the U.S. and Chile totalled approximately \$3.2 billion last year, up from \$2.8 billion in 1989 and \$1.5 billion in 1985.

The U.S. is Chile’s principal trading partner, accounting for about 16 percent of Chile’s total imports and absorbing 22 percent of its exports.¹⁵

According to the Central Bank of Chile, Chilean exports to the U.S. last year reached almost \$1.46 billion. These exports consisted mainly of copper, fresh fruit, gold, fresh seafood, wood products, ceramics, and some textiles.

U.S.-Chile Trade Balance



Source: Foreign Trade Technical Department, Central Bank of Chile

Heritage DataChart

13 Besides Chile, the U.S. has similar agreements with Bolivia, Colombia, Costa Rica, Ecuador, Honduras, and Venezuela, with others still under consideration. Chile is negotiating trade agreements with Mexico and Venezuela, and exploring the possibility of free trade talks with Canada and Colombia.

14 *Inside the White House*, May 2, 1991, pp. 14-15.

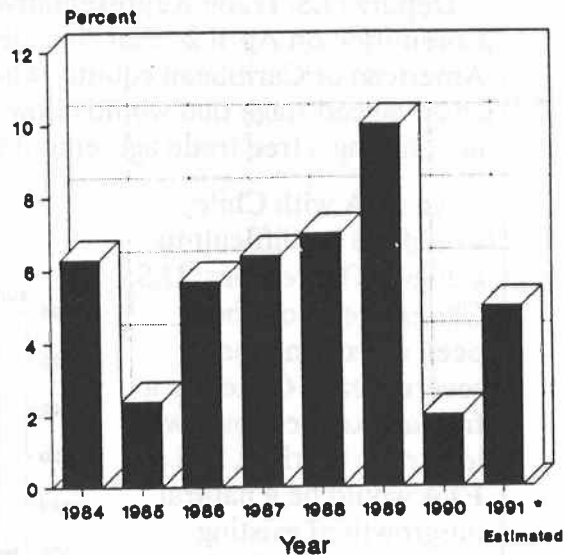
15 *Chile Economic Trends Report*, Embassy of the United States, Santiago, Chile, November 1990, p. 19.

Last year's U.S. trade surplus with Chile was \$351 million, compared to \$103 million in 1989. U.S. exports to Chile, America's 34th largest market, totaled some \$1.7 billion, an increase of 18.5 percent from 1989, and included heavy machinery, computer and telecommunications equipment, chemical products, transportation equipment and consumer goods, including beverages, clothing, shoes and electronic equipment.¹⁶

Chile and Bush's Enterprise for the Americas Initiative

Free Trade Area talks with Chile are only part of a larger campaign by the Bush Administration to expand free trade in Latin America and the Caribbean. On June 27, 1990, Bush announced that he was launching an Enterprise for the Americas Initiative.¹⁷ The U.S. seeks through the EAI to spur hemispheric economic prosperity through expanded trade, increased foreign investment, and debt restructuring.¹⁸ The Bush plan has received strong support throughout the Americas and was the main reason for his trip last December to Argentina, Brazil, Chile, Uruguay, and Venezuela. Chile was the first country to back the EAI, with Finance Minister Foxley pledging his support in a Washington press conference the day after the plan was announced.

Chilean Economic Growth 1984-1991



Source: U.S. State Department, *Chile Economic Trends Report, 1990* and from other sources

Heritage Datasert

16 For more information see "Trade and Investment Relations Between Chile and the United States During 1989," The Embassy of Chile, Washington, D.C., June 1990, pp. 1-45.

17 "Chile and U.S. Sign Accord Seen Leading to Free Trade Pact," *The Wall Street Journal*, October 2, 1990.

18 According to testimony by Assistant Secretary of State Bernard Aronson at an April 25, 1991, Senate Foreign Relations Committee hearing, the EAI will help the U.S. promote its other long-term interests in the Latin America and the Caribbean, including "the strengthening of: 1) democracy, 2) political stability, 3) free market reform and stable economic growth, 4) anti-drug and terrorism cooperation, 5) environmental protection, and 6) regional cooperation to deal with post-Cold War crises and regional security. The EAI will help the U.S. accomplish these goals because: 1) it establishes a closer-knit and more effective partnership with the countries in the region and 2) the economic growth which it stimulates will provide the resources to meet the goals of that partnership."

Vast Market. If successful, the EAI will create a hemisphere-wide free trade area stretching from Alaska to Tierra del Fuego, on the southern tip of South America. A U.S.-Chile FTA will put pressures on other Latin American and Caribbean countries to negotiate FTAs with the U.S. and other countries in the region, and thus advance the EAI's goal of a hemisphere-wide free trade area. This could be achieved by a series of bilateral FTAs, such as with Mexico and Chile, or by the creation of regional free trade blocs, such as the *Mercosur* (for southern market) Southern Cone Common Market consisting of Argentina, Brazil, Paraguay, and Uruguay.¹⁹ Because of Chile's free market leadership in the region, the Aylwin government will play a pivotal role in determining the success or failure of the EAI.

The Aylwin government, however, has made it clear to the *Mercosur* countries that their free trade arrangement with Chile would not be feasible until they further reform their economies along free market lines. Chile could give free market expertise and technical advice to its neighbors launching new economic programs. By setting such an example, Chile can hasten the pace of regional economic reform which will make the EAI feasible.

ADVANCING INTER-AMERICAN SECURITY THROUGH U.S-CHILEAN COOPERATION

Security cooperation between Washington and Santiago ceased in 1976 when the so-called Kennedy-Harkin legislation prohibited U.S. arms sales to Chile and banned all security assistance. This legislation arose from congressional concerns over Chile's alleged human rights violations, possible sponsorship of terrorism, and the 1976 murder in Washington by the Chilean secret police of Orlando Letelier. The restrictions, however, were lifted last year following Secretary of State James Baker's December 1 certification that Chile is "complying with internationally recognized principles of human rights," not aiding or abetting international terrorism, and is taking "appropriate steps to bring to justice by all legal means available" those indicted in the Letelier case. Baker's certification was required by section 726 (b) of the International Security Cooperation and Development Act of 1981, and clears the way for resumption of U.S. security ties with Chile.

Improved security ties are important to America and Chile. Communists within Chile continue to destabilize the government despite Aylwin's democratic election and improved human rights program. Leading Chilean Congressman Alberto Espina from the National Renovation Party (RN) told Heritage analysts this year in Washington that "Chile's most critical problem

¹⁹ The presidents of Argentina, Brazil, Paraguay, and Uruguay signed on March 26 the Treaty of Asuncion which formalizes an agreement to form a Southern Cone Common Market. This free trade area, to be completed by 1994, will have a population of 190 million and a total GNP of \$416 billion.

today is terrorism." As an example, he cited the April 1 terrorist assassination in Santiago of Jaime Guzman, a prominent Senator with the conservative Independent Democratic Union Party (UDI) and a former close advisor to Pinochet. Besides leading to greater death and destruction in Chile, a dramatic increase in terrorism also could fuel tensions between Chile's armed forces and the Aylwin administration. This kind of instability could jeopardize Aylwin's free market reforms. And this could hamper Bush's EAI and diminish the prospects for free trade in Latin America.

The Terrorism Threat

Public opinion polls in Chile show that terrorism is the "top concern" for over 30 percent of the Chilean people. Although it will not release the exact numbers, the State Department is on record that, "Terrorism in Chile increased significantly in 1990, notably since the March 23 inauguration of [Aylwin]." ²⁰ Mainly responsible are radical leftist Chilean splinter groups. The primary assailants are the communist-affiliated Manuel Rodriguez Patriotic Front (FPMR) and the Lautaro Youth Movement (MJL).

Chile's largest terrorist group, the FPMR, was formed in 1983 and has a suspected membership of some 500 to 1,000 cadres. Its leadership is unknown. The FPMR is associated with the Chilean Communist Party (PCCCh) and has received weapons and urban terrorism training from Cuba and other communist countries since the early 1980s. According to the Chilean government and U.S. intelligence officials, these countries have sent such weapons as M-16 rifles and rocket launchers left behind by the American forces after the Vietnam War, as well as Soviet-made small arms, grenades, grenade launchers and AK-47 rifles to the FPMR. The FPMR wants to "expel all U.S. influence from Chile and create a communist, pro-Soviet regime."

The Santiago-based MJL was created in 1982 and has several hundred "hard core" supporters. They are Marxist-Leninists and likely receive terrorist training from Cuba and the Sandinista Party in Nicaragua. The MJL is a violent, anti-American group that advocates the overthrow of Chile's democracy. According to Chilean security officials, its leadership comprises radical leftists and known criminals. They tend to infiltrate and work most closely with radical students and the urban poor. They have assassinated policemen, robbed banks, bombed buildings and burned churches.

Anti-U.S. Attacks. Chile comes in third, behind Colombia and Peru, as the South American country most plagued by terrorism. ²¹ The State Department's *Patterns of Global Terrorism: 1990* report asserts that Chile "topped the list of nations worldwide where anti-U.S. attacks have occurred," with 61 incidents in 1990 alone. While most terrorist assaults have been

²⁰ *Patterns of Global Terrorism: 1990*, United States Department of State, April 1991, p. 19.

²¹ "Government Will Fight Terrorism," *Andean Newsletter* No. 54, May 6, 1991, p. 1.

minor and directed against the U.S. Consular Annex in Santiago, U.S.-Chilean educational and business centers, Mormon churches and other American property, two incidents appear to have been intended to cause U.S. casualties. The first was an attack last November 17 in which a Canadian citizen was killed and a U.S. Embassy employee injured by a bomb at a softball game in Santiago. The second occurred later that month when three American sailors and five other people were injured by a bomb at a restaurant in the port city of Valparaiso. The FPMR released statements in Santiago soon afterwards claiming responsibility for both murders.

Major Counterattack. The Aylwin government has mounted a major anti-terrorism drive to meet the terrorist challenge. Aylwin announced a 150 percent hike in spending for Chile's police forces, called the *Carabineros*, and a 400 percent increase for its Department of Investigations, Chile's counterpart to the U.S. Federal Bureau of Investigation.²² Aylwin also declared on April 3 that he "will not negotiate" with terrorists. A few days later, on April 18, he announced the creation of a Public Security Coordinating Office, which serves as an advisory organization overseen by the president and top civilian officials "to coordinate all security and public order measures."²³

By placing the anti-terrorism command under civilian control, Aylwin hopes to undercut the terrorists' claims that the military is still carrying out human rights abuses. The Public Security Coordinating Office also will serve as a central command center to coordinate all anti-terrorism investigative, information, intelligence, and policy activities. This should improve the efficiency of Chile's anti-terrorism campaign.

The Chilean military intelligence services support Aylwin's anti-terrorism drive. They have turned over files on the guerrilla groups to the police forces and the Department of Investigations and have offered the civilian authorities anti-terrorism intelligence and expertise. Since their role will be purely advisory, the military will not be able to interfere with the civilian government's investigations.

Chile and the War on Drugs

Next to terrorism, Chile's most pressing security problem is the illegal drug trade. Chile increasingly is used by drug smugglers as a transit route for Bolivian cocaine bound for the U.S. and Asia. The principal method for smuggling narcotics is by hiding packets of cocaine and other illegal drugs in shipments of Chilean seafood. Because they are perishable, containers of fresh swordfish, mackerel, and salmon and other seafood are not inspected by Chilean authorities or U.S. customs agents. Bolivian cargo on its way though Chile to the U.S. and Europe also is not inspected by Chilean authorities.

22 Nathaniel C. Nash, "Chilean Plan Anti-Terror Drive," *The New York Times*, April 3, 1991.

23 *Andean Newsletter*, No. 54, May 5, 1991, p. 2.

Another drug smuggling method is for drug traffickers to use Chilean passports to sneak drugs into the U.S. The reason: The U.S. does not identify Chile as a major drug producing country, and therefore does not monitor its citizens closely at U.S. airports and border crossings.

Chile also is a source of chemicals for processing cocaine. Ether and acetone are used for such purposes in Bolivia, Colombia, and Peru. There are no restrictions on purchasing such "precursor" chemicals from the Chilean companies that manufacture, export, and import them. This makes them easy for the drug cartels to obtain.

Restricting Drug-Related Chemicals. Chile is trying to tackle this problem. In February 1990 Chile ratified a 1988 South American agreement on narcotic substances that places restrictions on the sale and transportation of drug-related chemicals. Further, the Chilean legislature is considering additional measures aimed at making these chemicals more difficult to purchase. New laws would mandate background checks on potential customers and place restrictions on transportation of the chemicals.

Aylwin also established in October 1990 a National Council for Drug Control to combat the narcotics trade. It is headed by Vice Minister of Interior Belisario Velasco, a long-time leader within the Christian Democratic Party. Comprised of high-level Chilean government officials, this anti-drug council will advise Aylwin on measures to stop the illegal drug trade through Chile. Its battle plan includes increasing significantly the number of police assigned to anti-narcotics units and the construction of four new regional anti-drug command posts, which will direct Chilean anti-drug efforts at the local level.²⁴ These command posts will oversee drug interdiction efforts along Chile's borders, monitor roads and highways used to smuggle drugs, and coordinate drug raids on safehouses and landing strips.

The U.S. is pleased with the tough anti-drug policies of Chile and has launched a modest anti-narcotics program with Chile funded by the State Department's Bureau of International Narcotics Matters (INM). This program's fiscal 1990 budget was \$153,000, which was used for training and equipment for Chile's police forces, customs agents, and Coast Guard. The amount for fiscal 1991 was increased slightly to \$200,000.²⁵

U.S.-Chilean Military Relations

U.S.-Chilean security ties, which were severed in 1976 because of Chile's human rights record, are beginning to improve because of Santiago's democratic and human rights reforms.

24 "Narcotics Country Profile: Chile," U.S. Department of State, April 18, 1991.

25 The United States Information Service (USIS) also has a small program to assist Chilean authorities in reducing their domestic drug abuse problem. This program provides anti-drug education and information to Chilean youth, and is helping the Chilean authorities develop anti-drug public relations campaign.

As a result, the door has been opened for renewed U.S. security cooperation with Chile. American military aid to Chile stands today at around \$500,000, but is expected to be increased to \$1.15 million next year. This will be used primarily for military education programs, spare parts, maintenance and manuals for Chile's U.S.-manufactured aircraft. Following a March 1991 visit to the U.S. by Chilean Defense Minister Patricio Rojas, Chile and the Bush Administration agreed on a program of military education and training for Chilean officers at various U.S. military institutions. Among them are the U.S. National War College in Washington, D.C., the Air University at Maxwell Air Force Base in Montgomery, Alabama, and the Naval War College at Newport, Rhode Island. This is a university program that provides advanced degrees in military-related fields to mid-level Chilean officers.

According to the Pentagon, Chile's armed forces can now purchase weapons, military equipment, spare parts and manuals from the U.S. Previously they could not do this because of the Kennedy-Harkin restrictions on military sales to Chile. Chile's Air Force wants to obtain spare parts, components, and manuals for its U.S.-made F-5 *Tiger* fighters, A-37 *Dragonfly* ground attack jets, C-130 *Hercules* transport planes, and UH-1H *Huey* helicopters. The Pentagon and the Chilean Defense Ministry also are exploring whether to establish joint-information networks and information banks to exchange up-to-date information on national security studies and medical science and technology.

ENLISTING CHILE AS AN ENGINE OF REFORM IN LATIN AMERICA

Relations between the U.S. and Chile are no longer under a cloud of suspicion and mistrust. With Chile's return to democracy, strong support for free market reforms, and improved human rights conditions, the two countries are poised to cooperate on spreading democracy and free markets throughout Latin America.

Chile is today a model of reform and progress in the region and thus deserves U.S. support. The Bush Administration's primary objectives should be to create a U.S.-Chile Free Trade Area, which will cement further Chile's free market program; enlist the Aylwin government in a campaign to promote Bush's Enterprise for the Americas Initiative, which will create a Western Hemisphere free trade zone; and assist Chile in its battle against terrorist violence and drug trafficking.

To achieve this, the Bush Administration should:

◆ ◆ **Pursue quickly a Free Trade Agreement with Chile.**

Chile's impressive free market reforms make it a good candidate for an FTA with the U.S. An FTA would eliminate all tariff and non-tariff barriers between the two countries. A free trade pact with Chile would create economic growth and jobs in both countries.

The problem is that the Office of the United States Trade Representative and the Commerce Department have hinted that they would prefer postponing negotiations with Chile until the U.S.-Mexico FTA is completed, probably sometime in mid-1992. This would be a mistake for four reasons. First, the U.S. should strike an FTA with Chile while Bush has the special negotiating power granted by Congress. This so-called fast track authority will expire in 1993. Second, negotiating an FTA with Chile would be fairly easy because its economy is deregulated, relatively small, and open to international trade. Third, such major American labor groups as the AFL-CIO have stated that they would not be as concerned over an FTA with Chile as they have been with Mexico. Finally, an FTA with Chile will encourage other countries in the region to seek similar agreements, not only with the U.S., but with their neighbors as well.

The signing by Santiago and Washington of a free trade framework agreement last October 1 is an important first step toward achieving a U.S.-Chile FTA. A trade and investment framework agreement officially launches talks between two countries on lowering trade barriers and expanding investment. This agreement created a U.S.-Chile Council on Trade and Investment which will monitor commerce between the two countries and lay the groundwork for freer trade and an eventual FTA.

The principal objectives of the FTA negotiations should be: the broad expansion of commerce, services, and investment between Chile and the U.S.; the gradual elimination of tariffs and non-tariff barriers to trade, guaranteeing access to markets in both countries; and the creation of a U.S.-Chilean commission to arbitrate and resolve trade disputes.

Negotiations should cover all sectors of the economy, which include such areas as agriculture, banking, energy, financial services, mining and telecommunications. The key benefits to Chile would be the creation of jobs, increased export earnings, more American investment, a more competitive economy, and greater political stability resulting from economic growth and prosperity. The benefits for the U.S. would be increased markets for American goods; lower priced, better quality products for consumers; more jobs; and a more stable and economically prosperous Latin America.

◆ ◆ **Work closely with Santiago in promoting the Enterprise for the Americas Initiative.**

For other countries in Latin America and the Caribbean, a trade pact between the U.S. and Chile will serve as a powerful incentive to adopt free market reforms, pay their debts, and again become attractive markets for U.S. exports. The EAI seeks to create a Western Hemisphere free trade zone stretching from Alaska to the southern tip of South America, making it by far the world's largest, most competitive, and dynamic market. The U.S. hopes to accomplish this by entering into free trade accords with individual countries or blocs of countries that have adopted market reform programs.

Chile is the logical candidate for expanding the EAI in South America. As the Latin American vanguard of the EAI, a U.S.-Chile FTA could convince other regional countries to adopt free market reforms and liberalize their trade policies, thus laying the foundation for the EAI goal of a hemisphere-wide FTA.

To make this a reality, the Bush Administration should create a EAI task force of key officials at the assistant secretary level from the Departments of Commerce, Treasury, State, Defense, Justice and Education plus the U.S. Trade Representative and the Environmental Protection Agency, to meet monthly to develop U.S. policy on the EAI. As a first policy suggestion, this task force should call for the U.S. International Trade Commission to prepare a study on the likely benefits of a U.S.-Chile FTA. Creation of an EAI task force also would give the Latin American governments confidence that Washington is serious about the EAI. Latin American leaders have complained in recent months that Washington is ignoring the EAI proposal.

◆ ◆ **Expand security cooperation with Chile's military and police forces to promote democratic values and respect for human rights and to counter terrorism.**

The Chilean terrorist groups FPMR and the MJL could undermine Santiago's democratic and free market gains, setting back hopes for a free trade area agreement and the EAI. These groups also threaten the Chilean people and the security of the country. Chile, meanwhile, is still learning to manage its fragile relationship between the civilian authorities and the military, which governed the country for over sixteen years.

It is in Washington's interest to help improve relations between civilian authorities and the armed forces in Latin America's emerging democracies to prevent a return of military dictatorships in the region. U.S. programs to help the Chilean security forces combat terrorism and drug trafficking, besides giving them the technical expertise to cope with these problems, have the added benefit of spreading democratic values among these institutions.

The Bush Administration has a security assistance program for Chile underway, but is limited. Called the International Military Education and Training (IMET), it is administered by the Pentagon and gives technical training and educational opportunities to foreign military and security personnel. The Bush Administration has asked Congress for \$150,000 for the IMET in Chile. This is not enough and is only a fraction of what other Latin American and Caribbean nations receive.²⁶ Chile deserves more because of the threat posed to its elected government by terrorist groups and its need to launch a thorough program of military reform designed to improve human rights and

²⁶ Belize, a tiny Central American nation with no terrorist threat, a far smaller military, and no need for military reform, receives roughly the same amount of IMET funding as Chile.

foster closer military-civilian relations. A larger IMET grant also would show good U.S. faith that the Aylwin government is on the right track. At the very least, the IMET program should be doubled for fiscal 1993. This new money could be used for education and training programs, which would foster greater respect for civilian authority within the armed forces, improve leadership capabilities, teach military tactics and strategy, provide instruction in the use of new military equipment, and teach defense logistics. Such training would bolster the caliber of Chilean officers and improve overall U.S.-Chilean relations by encouraging closer military contacts.

Bush also has requested from Congress some \$1 million of military assistance to Chile for next year. Chile's neighbors receive roughly the same amount of military aid from the U.S., and it is needed to help Chile combat terrorism and drug traffickers. The money should be used to purchase spare parts and manuals for Chile's U.S.-manufactured aircraft and helicopters, including their F-5 *Tiger* fighters, A-37 *Dragonfly* ground attack jets, C-130 *Heracles* transports, and UH-1H *Huey* helicopters. If Chile stays on its reformist course and requests additional U.S. military aid, Washington could provide more helicopters, coastal patrol boats, communications equipment, intelligence information, and military training. This military equipment need not be new. It could be old helicopters and patrol boats which are already paid for and are being retired from U.S. service. This way there will be no additional cost to the American taxpayer.

Washington also should consider launching with Chile what the U.S. Justice Department calls an International Criminal Investigative Training Assistance Program with Chile. Administered by the Justice Department and the Agency for International Development, this program offers foreign countries police training and expertise. Chile is not part of this program, but it should be. With assistance from U.S. anti-terrorist and anti-narcotics experts, Chile's security and police forces could improve the effectiveness of their anti-terrorism and counternarcotics programs. Training should be designed to improve police patrolling, intelligence gathering, criminal identification and investigation skills. The Bush Administration, moreover, should invite members of Chile's security and police forces to attend training and education programs at the FBI Academy in Quantico, Virginia, where they could train in these law enforcement skills.

◆ ◆ **Work closely with the Aylwin government to defeat Chile's growing illegal drug trade.**

The Latin American drug network is spreading to Chile. The international drug cartels increasingly are using Chile not only as a transit point for cocaine smuggled to the U.S., but as a source for drug producing chemicals. To help the Aylwin government prevent the drug trade from gaining ground in Chile, Washington and Santiago should expand anti-drug cooperation. If Washington fails to do this, the drug cartels will continue to expand their trafficking routes in the Americas to elude Washington's anti-drug operations in the northern Andes, the Caribbean, and Mexico. The U.S. now provides only

\$200,000 for counternarcotics assistance to Chile, which is primarily used to train and equip Chile's police forces, customs agents and the Coast Guard. This amount should be increased to \$500,000. With this additional assistance, Chile could expand its program to detect drug shipments along its borders with Bolivia and Peru; expand training in narcotics identification, radar use, and surveillance operations for anti-drug personnel; increase the number of Coast Guard vessels allocated to drug interdiction; and bolster anti-drug searches at airports and port facilities. The U.S. also should establish joint programs between Chile's security forces and the U.S. Drug Enforcement Administration. American and Chilean officials could share technical intelligence on illegal drug operations, and DEA personnel could serve as liaisons on Chile's anti-drug operations. DEA teams also could train Chilean police to conduct raids on suspected shipments and drug "safehouses," and mount undercover operations to penetrate drug trafficking organizations. Helping Chile in this way will prevent the drug cartels from further shifting their smuggling operations to Chile from Bolivia, Colombia, Mexico, and Peru.

◆ ◆ **Stress Washington's strong support for the Aylwin government's democratic reform program and free market reforms.**

Bush and Aylwin agreed in their second meeting, held in Santiago on December 6-7, to support Chile's free market program, strengthen its new democracy, and improve bilateral security ties. Bush's trip to Chile was the first by an American president in three decades. It is vital for the U.S. that the Aylwin government's program succeed. Not only would it serve as "an engine of reform" for others in Latin America, it would also bring greater economic and political stability to Chile, which is in Washington's interest. If Chile is rewarded for its economic and political progress by strong U.S. support and interest, then other important countries in the region, namely Argentina and Brazil, might follow as well.

To demonstrate U.S. support for Aylwin's reform programs, the Bush Administration should propose creating a "Binational Commission," consisting of cabinet-level representatives from both governments, which would meet once a year to explore avenues of cooperation on the Enterprise for the Americas Initiative, negotiating a U.S.-Chile FTA, security relations and other key issues. A U.S.-Chile commission could advise Bush and Aylwin on trade, investment, debt, counternarcotics, anti-terrorism, education, health, and environmental issues. Sub-cabinet level working groups also could be formed and meet every half year. This group could tackle economic, security, and social policy concerns in great detail, including forging an FTA, and devising a tough counter-terrorism program. This commission could serve as a regular forum for discussion and would demonstrate that U.S.-Chilean relations have returned to normal.

CONCLUSION

Chile may be at the most important political and economic point in its history. Not only has it launched a democratic reform program, it stands poised to negotiate a free trade area agreement with America. If properly cultivated by the Bush Administration, Chile could become a strong advocate of the American President's dream of creating a hemisphere-wide free trade area in the Americas.

The success or failure of Chilean President Patricio Aylwin's democratic and free market reforms is important to U.S. economic and security interests in Latin America. Chile's economic leadership in Latin America and in the rest of the developing world will be crucial in America's plans to champion free trade, market economies, and democracy in the Americas. Seeing U.S. support for Aylwin's political and security program, other countries will be more likely to reform their economies along the Chilean model. Chile's success in combating communist terrorist groups and the drug cartels also will encourage others in the region to do the same.

Sign of Faith. The Bush Administration can fortify Chile's gains and create strong incentives for free market reform in Latin America by signing a free trade pact with Chile. An FTA with Santiago will help institutionalize Chile's free market revolution and advance Chile's economic growth. Bush also must work with Chile to promote the Enterprise for the Americas Initiative. This will assure the U.S. new and vibrant markets throughout the Western Hemisphere and help spread economic prosperity and political stability in the region. Further, by giving Chile security assistance, Washington will help Santiago defend its new democracy from extremists on both the Left and Right.

These policies would represent a sign of good faith in Aylwin's leadership. By contrast, indifference or inaction by Washington could result in a setback for free markets, democracy, and security in the region. In the long run, Aylwin's success or failure will help determine whether all of Latin America remains mired in poverty, debt, drugs and violence, or joins the U.S., Canada, Mexico and other Latin American countries in creating a vast, prosperous and stable free market in the Western Hemisphere.

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