

Chile

INVESTMENT REVIEW

INTERNATIONAL PRESS SELECTIONS DECEMBER 2002

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US AND CHILE REACH FREE TRADE ACCORD

The Bush administration sealed a free-trade deal with Chile that sets new standards in areas ranging from intellectual-property protection to monetary controls, in an important step toward a possible Americas-wide trade agreement by 2005.

The agreement follows two years of grueling negotiations between Washington and Santiago, and marks President Bush's first tangible trade success since Congress gave him expedited powers to negotiate such deals over the summer. It also ends a decade long quest by South America's most advanced economy to open trade flows with its giant partner to the north.

The two countries had US\$ 8.8 billion of two-way trade in goods and services in 2001, which both nations expect will jump in coming years. Upon approval by Chilean lawmakers and the US Senate, the pact will eliminate tariffs on more than 85% of all goods shipped between the two, with the rest being phased out over 12 years. The US sends mainly computers, heavy machinery and cars to Chile, whose exports to the US include copper, paper products, fish, fruits and wine.

The talks were held up for days over Chilean opposition to US Treasury demands that Chile drop all controls on foreign capital entering or leaving the country. Chile long has used limited curbs in times of economic turmoil to protect against the rapid movements of speculative capital. In the end, Treasury officials offered a compromise that marks a big step back from provisions in prior US trade and investment agreements. Under the deal, Chile will be allowed to impose monetary controls for as long as a year without sanctions provided they don't "seriously impede" capital outflows, said Treasury Undersecretary John Taylor, who added "the Chilean government can take

actions as it sees fit". But if the country does impose restrictions, US investors could seek compensation after six months in the case of bond holdings and direct investments, and 12 months for all other types of holdings.

US trade officials said the Chile deal will be sent to Congress by March and is expected to win easy approval. US Trade Representative Robert Zoellick hailed the pact as "state of the art" because it not only lowers tariffs but protects intellectual property and allows for enforcement of labor and environmental standards. US companies have dogged the Chile talks out of concern for how it might affect future trade arrangements with nations such as Brazil and Australia.

The Chile agreement will require the government in Santiago to implement new rules controlling patent and trademark protections. Chile also will have to crack down on copies of US patented drug products.

The US already has free-trade deals with Israel and Jordan, as well as with Canada and Mexico through the North American Free Trade Agreement (Nafta). But the Chile deal is the first bilateral one reached with a country that has a varied agricultural sector.

The agreement will create duty-free trade in three-quarters of all farm goods by 2007, while all tariffs will be eliminated over 12 years. Tariffs on both countries' wines first will be equalized at the lower US levels, and then phased out altogether. Chile also agreed the US could put in place special surge controls if imports of individual farm products shoot up in a given year.

A tough issue was the US insistence that any agreement contain provisions to protect environmental and labor standards, a core concern among many in Congress. In the end the two sides agreed the free-trade agreement would contain language stipulating that fines could be imposed, backed up if necessary by trade sanctions, and only in cases in which a

country wasn't enforcing its own labor and environmental laws.

The Wall Street Journal, December 12

GOVERNMENT LAUNCHES NEW INTERNATIONAL DRIVE TO ATTRACT FDI

In January 2003, the Foreign Investment Committee and the Chilean Economic Development Agency (CORFO) will launch a new international promotional campaign entitled "Chile, A Springboard into New Markets", aimed at encouraging multinational companies to centralize their regional operations in Chile through shared services, call & support-centers, back-office and software development operations.

President Ricardo Lagos will officially launch this effort during a business seminar that will take place on Wednesday, January 8, in Santiago. The event will also feature presentations by the Ministers of Finance, Nicolás Eyzaguirre; Economy and Energy, Jorge Rodríguez-Grossi; and Public Works, Transportation and Telecommunications, Javier Etcheberry. Other scheduled speakers include the President of the Chilean Confederation of Industry and Trade (CPC), Juan Claro, and the Director of the Internal Revenue Service, Juan Toro.

Top executives from Motorola, Unilever and Santander Central Hispano will be discussing why these companies - among another two dozen - decided to locate some of their regional operations in Chile during the last year.

If you or any of your colleagues would like to attend this seminar, please contact Ms. Marcela Riquelme at the Foreign Investment Committee (mriquelme@cinver.cl)

CAMPAIGN FOR CONGRESSIONAL APPROVAL BEGINS

Companies and business organizations spanning the gamut of US industry signaled their strong support for the FTA between the United States and Chile, and pledged to work actively to get the 108th Congress to approve the deal early in 2003.

Speaking on behalf of the US-Chile Free Trade Coalition, co-chair Bill Lane, Caterpillar's Washington Director said: "This historic agreement sets new standards for open trade, and will be of tremendous benefit to US business and to the US and Chilean economies. We owe a debt of gratitude to the negotiators on both sides who have worked tirelessly for two years to make this agreement a reality".

Lane was a co-chair of the US Trade Coalition, which successfully promoted passage of Trade Promotion Authority (TPA) earlier this year. The deal between the US and Chile was facilitated by renewal of TPA after an eight-year lapse, which established a core set of negotiating objectives for US negotiators, and set up an enhanced trade consultative mechanism between the White House and Congress.

"I expect Congress will agree that this ground-breaking agreement will create jobs and improve the economies of both Chile and the US, and is clearly in the national interest", said coalition co-chair Selina Jackson, Public Affairs Manager at United Parcel Service.

The coalition's third co-chair pointed to the benefits of the agreement for both countries and for the overall trading system. "The bilateral free-trade agreement not only helps both our nations economically, it also sets a significant number of valuable precedents for the Free Trade Area of the Americas negotiations and provides region-wide talks a serious shot in the arm", said Ron Covais, Lockheed Martin's Regional President for the Americas.

The US-Chile Free Trade Coalition is formed by companies and associations that support the trade agreement with Chile and are working for its approval by Congress. The Coalition includes The Business Roundtable, the Council of the Americas, the National Association of Manufacturers, the US Chamber of Commerce, the Coalition of Service Industries, the Chilean-American Chamber of Commerce, and an expanding list of other organizations.

CHILE HAILS TRADE DEAL AS FINEST MOMENT

After two years of negotiations, Chile and the US have agreed a broad bilateral agreement which has been hailed in Santiago as the finest moment in more than a decade of aggressive pursuit of trade deals.

Although no panacea for the weak economic growth which has dogged Chile since 1999, last week's free trade accord with the US promises to consolidate the country's sound credit profile and spur much-needed direct foreign investment and modernization. According to union leaders, it should also help address shortcomings in productivity, quality control and industrial relations.

Chile is a remote land of 15 million people with average per-capita income of about US\$ 5,000, and its only development option has been based on finding foreign markets for its largely resource-based economy. Since its initial approach to the US in 1990, it has signed bilateral commercial agreements with Mexico, Canada, Central America, the European Union and South Korea. Low average import tariffs - which in 2003 will settle at 6% - and regional associations have assured it preferential treatment from scores of other countries. Next year, the focus will switch to Asia. By 2010, it says, 90% of foreign trade will be covered by bilateral agreements.

"The more free trade deals the better", says Sergio Olavarrieta, professor of strategy at the University of Chile's business school. "The only way a Chilean company can reach critical mass is through access to outside markets". His point is underlined by the case of Mexico, where Chilean exporters enjoy virtually unrestricted duty-free access. From shipments worth US\$ 212 million in 1994, Chile last year sent about US\$ 830 million worth of exports to Mexico, made up mainly of copper, fruit, fishmeal and forestry products.

Such impressive improvements, however, will not come as easily with the US, which is already an important consumer of Chilean commodity and agricultural staples, most of which benefit from general tariffs of 4% or less.

Many argue that Chile's dependence on natural resources and the slow pace of diversification into value-added industry, will make the going hard in the sophisticated consumer markets of the US and Europe.

Of the US\$ 5 billion in Chilean exports to the EU last year, 67% were natural resources, with a further 26% basic value-added products such as packaged seafood or tinned peaches. Only 7% was products with a value-added component.

Although higher than average in the region, Chilean education standards are well below those of the developed world, and spending on research and development is 0.6% of GDP, compared with around 2.5% per cent in many industrialized countries. The government hopes to lift this to 1% by 2006, although the private sector prefers to copy drug formulae and industrial patents rather than spend on R&D. According to recent studies, investment in personal computers and network servers has remained flat at 1.6% of GDP since 1999, compared with 4.4% in the US.

Academics argue that most small and medium-sized businesses are unfamiliar with foreign markets and thus reliant on international partners for growth. Without modernization and new niche markets, Chile may never again enjoy the 7%-8% growth rates of the 1990's, say a growing number of economists and foreign trade officials.

"Chile's first golden era is over", says Roberto Rensi, a senior officer in the EU Chilean mission. The EU deal, he said, would help it through the second phase of development, where there was greater need for technology transfer and cultural interchange.

The center-left government of Ricardo Lagos is working hard at selling the country as a low-cost, secure platform for foreign enterprise looking to take advantage of its myriad trade deals. Karen Poniachik, Executive Vice-President of Chile's Foreign Investment Committee, is forecasting growth in agribusiness. "The fact that Chile has more markets for its exports will bring more opportunities for joint ventures or other productive investments in this sector", she says.

Ricardo Lagos-Weber, director of multilateral economic affairs, says the deal also brings fresh hope to the textiles industry, which was almost destroyed by Asian imports when Chile began dismantling its trade barriers in the 1980's. But he adds: "Whatever happens to Chile in the next 40 years, we'll be able to look back to December 2002 as the moment in which it was given an important opportunity to advance".

SERVICE INDUSTRIES CALL TRADE AGREEMENT A "MILESTONE"

Dean R. O'Hare, Chairman of the Coalition of Service Industries (CSI), called the conclusion of a free trade agreement with Chile a "milestone" because it achieves substantial liberalization, and because, as the first of a series of bilateral agreements "it sets an appropriately high standard for other trade agreements".

O'Hare said that "for services, the agreement as we now understand it achieves very important cross-cutting and sectoral objectives long sought by CSI and its members". Among the cross-cutting achievements are strong commitments to transparency in regulatory processes, requiring notice to the private sector and the right to comment on proposed regulations.

O'Hare that the agreement with Chile is "the first trade agreement that has ever committed another country to apply the same high standards of regulatory transparency that we enjoy in the US. This is of course particularly important for the heavily regulated service industries".

"It will be an important precedent that, combined with similarly strong transparency commitments in the Singapore draft agreement, will help motivate other trading partners to adopt similar practices", he added.

In e-commerce, both countries confirmed the importance of supplying services electronically, committed to nondiscriminatory treatment of digital products, agreed not to impose duties on digital products, and for hard media digital products agreed to base customs duties on the value of the media. In telecommunications, Chile bound nondiscriminatory access for users to the telecom network. US firms will also have the right to interconnect at nondiscriminatory, cost based rates.

Professionals will receive expedited, simplified entry for temporary assignments under a new form of visa.

In express delivery, Chile confirmed that it has no intention to direct revenues from its postal monopoly to benefit Express Delivery and has affirmed that express delivery is, in fact, subject to the provisions of the FTA. In addition,

some important customs provisions will help expedite express delivery.

"The investment provisions of the agreement are particularly important for service industries, as most trade in services is done through foreign direct investment", O'Hare said. The agreement protects the rights of investors to establish and operate in Chile on the basis of national treatment, i.e., on the same basis as Chilean firms.

The FTA includes an important provision allowing US insurance companies to establish as branches (after a four-year phase in). The agreement also binds Chile's current practice of not requiring regulatory approval for insurance products sold to Chilean businesses. It also provides for expedited procedures for products where approval is required.

In banking and securities, Chile made commitments in asset management for the first time. These commitments assure the ability of US asset management companies to participate in Chile's voluntary savings program under the social security system. The commitments also would permit US firms to establish affiliates to provide services to Chile's social security system. Moreover, US firms may provide portfolio management services to Chilean mutual funds. The agreement also commits Chile to free flow of financial information.

The issue of capital controls, an unresolved matter in the Singapore draft agreement, was settled in the Chile FTA. The Agreement provides for freedom of transfers of capital. However it also provides, in its section on dispute resolutions, provisions for cases in which Chile does find a compelling need to impose such controls. In such circumstances, investors whose funds are blocked are given rights of redress.

CSI (Press Release), December 11

RATINGS AND OUTLOOKS ON CHILE AFFIRMED

Standard & Poor's Ratings Services affirmed its 'AA' long-term local and 'A-' long-term foreign currency sovereign credit ratings on the Republic of Chile. Standard & Poor's also affirmed its 'A-1+' short-term local and 'A-1' short-term foreign currency sovereign credit

ratings on the Republic. The stable outlook on the long-term local ratings and the positive outlook on the long-term foreign ratings were also maintained. The affirmation of the ratings and respective outlooks reflects Standard & Poor's expectation that, in spite of the continued deterioration in Chile's external environment, its policymakers will be able to maintain the sound macroeconomic policies they have followed in the past.

"The adoption of a freely floating exchange rate regime and of an inflation-targeting framework has served the small, dependent economy well, as it has been able to weather the exogenous negative shocks better than it would have otherwise", said Sovereign Analyst Bruno Boccara. "The monetary framework allowed the Central Bank to adopt a counter-cyclical monetary stance during a period of unusual exchange rate volatility", he added.

Standard & Poor's expects 2002/2003 inflation to remain below 3%, the mid-point of the inflation target. Boccara said that, contrary to initial fears, the currency volatility in both 2001 and 2002 does not seem to have hurt the highly leveraged private sector since, as hoped for with the adoption of a freely floating exchange rate, the private sector has become better hedged against currency risk. "The positive outlook on the long-term foreign currency ratings indicate that, in spite of the continued deterioration in Chile's external environment, the risks are still considered to be on the upside", added Boccara. "Assuming that the policy framework continues to remain satisfactory, improvements in creditworthiness will hinge upon the tapering off of Chile's non financial private-sector external debt and the sovereign's ability to return to a real rate of trend growth close to 4%-5%. This, in turn, will depend upon the continued diversification of exports, the further deepening of the local capital markets, and investment in human capital and infrastructure", he said.

Boccara concluded by noting that Chile successfully reached comprehensive trade agreements with both the European Union and the Republic of Korea, and that the adoption of a free trade agreement with the US will provide a much needed confidence shock and a further boost to exports.

Standard & Poor's (Press Release), November 22

NEW REASONS TO USE CHILE AS A REGIONAL INVESTMENT PLATFORM

Building on the competitive advantages of its stable business environment and well-developed financial system, Chile has recently introduced a new law to encourage foreign investors to make more use of the country as a platform for investing in other Latin American and world markets. The law, which entered into force on November 23, constitutes a powerful tool for promoting economic growth and fostering investment in Chile and other countries by both local and overseas players.

The initiative is part of a Pro-Growth Agenda, launched by the Chilean government, in alliance with the private sector, in 2001. This agenda also includes the early ratification of the double-taxation treaties that Chile has signed with Poland, Ecuador, Brazil, Peru, Norway, South Korea and, most recently, Denmark. In line with Chile's rules-based approach to economic management, the new law offers investors the guarantee of even greater clarity and fairness in the treatment of their investments.

The government, political parties, foreign investors and tax experts co-operated closely in the design of this new law, helping to improve the government's original project. While offering new incentives for the use of Chile as an investment platform, the resulting law does so without endangering its low country-risk level or exposing it to use as a tax haven. Similarly, the law includes safeguards to prevent loss of tax revenue and its use as a tax loophole.

The principal provisions of the new law can be summarized as follows:

- A company that is set up exclusively as a platform for investments abroad and in Chile, is exempt from Chilean earnings tax on the profits that overseas shareholders derive from its investments outside Chile. These platform companies can be either public or private companies but, in the latter case, must submit to the same regulation as public companies.
- Up to 75% of the platform company's shareholders can be resident in Chile; non-resident shareholders cannot reside in tax havens.

- Shareholders in the platform company can contribute capital either in the form of shares or equity in other companies, as well as in foreign currency.

- As regards taxes on local shareholders and on investments in Chile, the platform company is treated as a foreign company. As a result, if it invests in Chilean assets, it must pay tax on profits derived from these investments. Similarly, the earnings of the platform company that correspond to Chilean shareholders are liable for the same tax - and have the same right to tax credits - as an investment abroad that repatriates profits to Chile.

- Platform companies that invest in Chile must distribute earnings in the order in which they were obtained, starting with the oldest. As a result, separate accounting is required for earnings from investments abroad and on assets in Chile.

- There are no restrictions on domestic borrowing by a platform company, but its overseas debt cannot exceed the value of the capital contributed by overseas shareholders. In either case, the company must pay the corresponding taxes (stamp tax in the case of Chilean borrowing or a 4% tax on interest payments in the case of overseas debt).

- The platform company cannot invest in tax havens. Tax havens are defined by the Chilean Finance Ministry (www.minhda.cl) based on a list prepared by the OECD. This restriction does not apply if, once shares have been purchased or an investment has been made, a country is subsequently classed as a tax haven.

- Platform companies are not entitled to bank secrecy. Any information that is required must be made available through the Chilean Internal Revenue Service (www.sii.cl), following procedures established in the law and regulations

By exempting platform companies from Chilean tax on overseas earnings, the law addresses the problem of three-way taxation and provides foreign investors with an

additional incentive for taking advantage of Chile's economic and institutional stability, its high-standard infrastructure and top-quality human resources. In addition, because a platform company can include Chilean shareholders, it can capitalize on their familiarity with other Latin American countries and their ability to detect regional business opportunities.

As a result, the new law is expected to foster regional joint ventures between foreign investors and Chilean partners. Moreover, in a bid to facilitate the entry of foreign capital into Chile, the law allows companies that are already established in the region to move their center of operations to Chile, without incurring the transaction costs involved in selling and re-buying assets.

In preparing this new law, the government took special care to prevent Chile's use as a tax haven. It is for this reason that platform companies are not allowed to source equity or hold investments in countries that fall into this category. Similarly, in order to ensure transparency and proper use of the new law, platform companies must renounce bank secrecy, while Chile's Internal Revenue Service has been authorized to provide information about platform companies to its counterparts in the countries in which the companies' headquarters are located.

Similarly, while encouraging investment in Chile and allowing local residents to participate in platform companies, the new law guards against a loss of revenue from taxes on Chileans and on earnings obtained in Chile. To this end, a platform company is assumed, for tax purposes, to be registered abroad, thereby protecting fiscal revenue, without limiting the flexibility that a platform company requires in order to exploit the full potential of local assets and investors.

In addition, the government was concerned to prevent an increase in foreign borrowing which, if significant, could damage one of Chile's most valuable assets - its low country-risk rating. Chile's sound macroeconomic fundamentals - reflected in its risk rating - increasingly set it apart internationally and the government is determined not to endanger this key competitive edge for foreign investors.

CHILE LOOKS TO BECOME THE "IRELAND OF THE AMERICAS"

The following is an editorial published by columnist Andrés Oppenheimer, a journalist and expert on Latin American political issues, in the December 22 edition of the Miami Herald:

While the latest headlines from Latin America tell of a shift to the left in Brazil and Ecuador and anti-free trade protests elsewhere in the region, a major development is going almost unnoticed: Chile is positioning itself to become the Ireland of the Americas. Ireland? Yes, Ireland: a once poor agricultural country with a history of political violence, which after opening its economy and signing free-trade agreements with richer nations has become one of the world's biggest economic success stories.

Between 1995 and 2000, Ireland's economy has grown by an average of nearly 10%, more than any other European country. In the 1980's, Ireland was, alongside Greece and Portugal, one of the poorest members of the 15-nation European Union. Today, it is the third wealthiest European nation, after Denmark and Luxembourg.

There is no reason why Chile could not follow Ireland's steps, says Andrés Velasco, a professor at Harvard University's Kennedy School of Government. In the aftermath of Chile's December 11 free-trade agreement with the United States, and with its existing free-trade deal with the European Union, Chile could become an island of prosperity in Latin America, he says. "Granted, Ireland has received massive economic aid from the European Union, something that Chile is not expected to get from Washington", Velasco said in an interview. "But access to the world's richest markets may prove more important than aid".

Growing Economy: Even before its free-trade deal with the United States, Chile was doing much better than the rest of Latin America. Between 1995 and 2000, Chile's economy grew by an average of 5.2% a year, compared to the region's 1.3% average annual growth rate. While the Chilean economy grew by only 1.8% this year because of lower world copper and cellulose prices, Latin America's

overall economy shrank by 0.5%, according to United Nations Economic Commission for Latin America (ECLAC) figures.

But Chile's most remarkable achievement is that, while poverty grew in many countries of the region, it has reduced its poverty rate by half over the past decade, from nearly 40% to 20% of its population. In other words, there are more than two million fewer poor in Chile today than a decade ago.

Now, with the Chile-US free-trade agreement, which is expected to be approved by both congresses and go into effect in late 2003 or early 2004, some economists project that Chile's exports will grow by 25% and that the country's economy will grow by an additional 1.5% a year. Central American countries are hoping that the Chilean free-trade deal will serve as a model for their own negotiations with Washington, which begin in coming months.

"There is no question that Chile now presents a very sharp contrast with its neighbors on the continent, politically and economically", said John O'Leary, a former US Ambassador to Chile. "The challenge now is to take this historic agreement and put it to work for all the Americas".

Admittedly, the mood in Chile today is anything but exuberant. Chileans have a hard time accepting that their country's phenomenal economic growth of the 1990's has slowed down. And it is also true that while Chile's economic recipes have helped reduce poverty in that country, they have not worked so well in other countries with weaker institutions and more widespread corruption.

Still, Chile's overall success story should send a powerful message to free-trade critics: While there are some countries - like Chile, Ireland, Singapore, Spain and even China - that have reduced their poverty rates by opening up their economies, there is not one single example of a country that has done so in recent decades by closing itself to the global economy.

"In the 1950's, 1960's and 1970's, there were many economies that closed themselves up to the rest of the world, and did extremely well", says ECLAC's Secretary General Jose Antonio Ocampo, whose agency was a leading advocate of nationalist import-substitution policies in the 1960's.

"But in today's world, the successful economies are those that take advantage of the global market opportunities".

Clear Evidence: The figures speak for themselves: Chile's per capita income is US\$ 8,410 a year, Spain's is US\$ 17,850 and Ireland's is US\$ 22,460. By comparison, Cuba and North Korea don't publish similar per capita income figures, which independent economists calculate at anywhere from US\$ 500 to US\$ 4,000 a year, state subsidies and overseas remittances included.

Latin America's critics of free trade are right in demanding changes to help protect the poor. But until somebody comes up with an example of an inward-looking country that has prospered in recent years, there will be little question that economic isolationism is a recipe for failure.

Miami Herald, December 22

METHANEX TO PROCEED WITH CHILE EXPANSION

Methanex Corporation, the world's largest producer and marketer of methanol, announced that it will proceed with the construction of an 840,000 tons per year expansion at its methanol production hub in Punta Arenas (Region XII). The expansion, which has a 20 year natural gas supply contract, is expected to cost approximately US\$ 275 million, including capitalized interest of approximately US\$ 25 million and US\$ 17 million already spent on the project to September 30, 2002. The expansion is expected to be completed by early 2005. In connection with the expansion, the gas contracts for Methanex's existing plants, Chile I, Chile II and Chile III, have been extended to 2025, 2027 and 2029, respectively.

Pierre Choquette, President and CEO of Methanex, commented, "This expansion and the extension of the gas contracts for our existing plants in Chile provide additional low-cost capacity to supply our customer base while securing the low cost structure of the whole Chile site for many years into the future".

Methanex (Press Release), November 12

CHILE IN THE WORLD ECONOMIC FORUM'S NEW COMPETITIVENESS REPORT

In the 2002-2003 Global Competitiveness Report, published by the World Economic Forum (www.weforum.org), Chile climbed seven positions on the previous year, reaching 20th place among 80 economies. It ranked higher than Spain (22nd), Ireland (24th), France (30th) and Italy (39th) and was once again the best-positioned Latin American country, followed by Uruguay (42nd), Costa Rica (43rd), Mexico (45th), Brazil (46th), Panama (50th), the Dominican Republic (52nd) and Argentina (63rd).

According to the World Economic Forum (WEF), Chile's main strengths are its macroeconomic environment, with solid fiscal and external accounts helping to improve access to private credit. The Report also highlighted the quality of Chile's public

institutions, especially in terms of transparency and the laws protecting contracts and private property. With regards to technology, the Competitiveness Index noted Chile's ability to rapidly absorb new technologies, its high rate of Internet penetration and its very competitive Internet Service Provider (ISP) market.

The WEF also pointed to some of the challenges that Chile faces, including microeconomic barriers to competitiveness, unemployment, disparity in the quality of healthcare, standards in math and science education and the level of R&D spending. These are precisely areas which President Lagos' administration has identified as some of its key priorities.

ANGLO, EXXON FINALIZE DISPUTADA DEAL

UK mining group Anglo American completed the purchase of Disputada de Las Condes, the Chilean copper mining subsidiary of US oil giant Exxon Mobil, for US\$ 1.3 billion. The deal was first announced in May and was expected to close by the end of June but was held up by a row over the fate of an option held by Chilean state minerals company Enami to 49% of Disputada, and over how much tax should be paid on the transaction.

The Enami option was not in the original contract of sale, but the question was finally cleared up in October. The tax issue was resolved a month earlier after London-based Anglo American and the Texas oil group agreed to carry out the transaction on Chilean soil rather than as an offshore deal.

Enami and Exxon both went to court over the option issue, but withdrew their legal action after the state company's right to the 49% was recognized in the final draft of the contract. The option, valid until 2028, allows Enami to take up the stake if

Disputada is sold on to another company, and/or every three years. Enami acquired the option by selling Disputada to Exxon in 1978, but under that contract the right to the share would be worth more than the market value of the assets. Under the 1978 sale, the option is to buy shares in Disputada, but in 1998 Exxon converted the company into a limited partnership without shares and so the status of the option became unclear.

Disputada has the 180,000t/y Los Bronces and 70,000t/y El Soldado copper mines and Chagres smelter, all in central Chile. The company produced 252,000 tons of copper in 2002, 17,000 tons in cathodes and the rest in concentrates processed either at Chagres, which has installed capacity of 150,000t, or other smelters. Exxon is in the process of expanding Los Bronces mine by 60,000t at a cost of US\$ 200 million.

When Exxon put Disputada up for sale in August last year, Chile's state copper corporation Codelco wanted to acquire the company and combine the operations of Los Bronces with the Rio Blanco mine at its own 250,000t/y Andina division as the two share the same orebody. But Exxon turned down Codelco's bid in February, paving the way for the deal with Anglo.

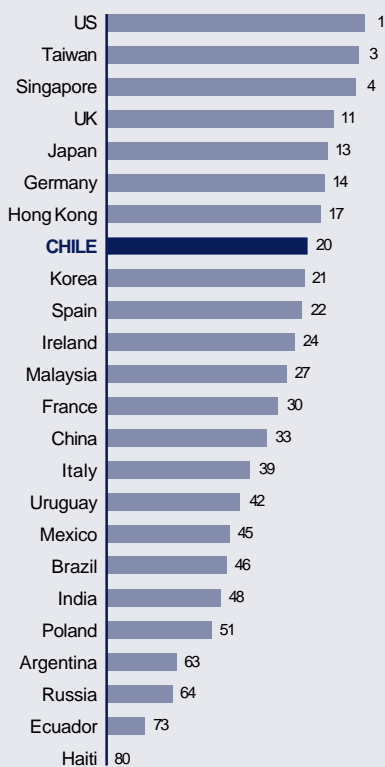
Business News Americas, November 14

BUSINESS SEMINAR IN SYDNEY

President Ricardo Lagos will be the keynote speaker at a business seminar entitled "Doing Business with Chile" that will take place in Sydney, Australia, on February 11, 2003. The event is being organized by the Embassy Chilean in Australia and the Australia-Latin America Business Council.

For more information, please contact Ms. Pilar Mudge, at the Australia-Latin America Business Council, (secretariat@alabc.com.au)

THE 2002-2003 GLOBAL COMPETITIVENESS REPORT (Selected Economies)



Source: World Economic Forum (www.weforum.org).

Q&A WITH PRESIDENT LAGOS

The following are excerpts of an interview with President Ricardo Lagos published in the December 2002 issue of Latin Trade Magazine.

When Wall Street decides to shift its portfolio away from Latin America, why does Chile suffer along with the rest of the countries in Latin America?

It's unfair. I would like to think that the markets are going to be able to differentiate between countries. But if the markets say, 'Look, Latin America is in trouble. Let's get out of Latin America,' there is no questioning it. Ruling a country that is living in a global world means that you have to look after your citizens but also you have to watch what's going on abroad with country risk. It's a strange decision because you have a duty to the 15 million Chileans, but if you're going to do things in the right way, and (if) you are going to take a decision about interest rates or fiscal policy, somebody's going to give you a grade, not in your own country, but abroad. And the grade may have tremendous influence on your country. Therefore, you also have to get good grades abroad.

How will getting "good grades" and global financial gyrations affect your policies?

Everybody will say, 'Why don't you privatize (state-run oil company) Enap?' And I say, 'Look, what am I going to sell? Are they going to pay me for the know-how of the professionals and engineers at Enap?' Enap used to produce almost 100% of all the oil that Chile needed. Not anymore. Now it produces only 5%. But its know-how has allowed it to do explorations in Egypt, to produce oil in Iran and to reach an agreement in Ecuador. Enap is expected to produce, when I leave government in 2006, about 30% of the country's oil needs. Of course, most of our oil will probably come from Argentina or Texas. But the oil that we produce either in Ecuador or in Egypt or in Iran will provide, how do you put it, a "cushion" for what's going on.

So ENAP is a long-term strategic resource?

Of course. That's what I think. And that resource is not because we have oil. It is because we used to have oil and now we have the know-how. Do you know what Outokumpu is? Outokumpu is one of the major copper producers in the world. Outokumpu has quite a large investment in Chile and is one of the major firms in Finland. Does Finland have copper? No sir. Finland used to have it. And Outokumpu was formed when it had copper. Now Finland has the know-how and they produce copper everywhere. And, in addition, of course, Finland sells us capital goods for copper. You see? So, what used to be the raw material now has changed to know-how, and this is what is being done in Enap.

Is the global system adequate for today's financial markets?

Our financial institutions were established after Bretton Woods, after the Second World War. The World Bank was established in order to rebuild Europe. That is why the World Bank is called the bank of reconstruction and development; the reconstruction was for Europe. It was for countries like Chile that they added the word 'development.' But this was in the '40s and the '50s. The IMF was established to oversee exchange rates between the most-developed countries after the gold standard was dropped. What is the situation now? The world has changed. My question would be: Is it possible to live in a world where, in 1998, you have the Russian crisis; in 1999, you have the Brazilian one; in the year 2000, you have Turkey; in 2001, you have Argentina? And the United States...

And now you have the United States. Is it possible to live in a world where every year you have a crisis like that? To what extent will it be necessary to establish a financial architecture appropriate for what is going on in the 21st century when not billions but trillions of dollars move every day with the click of a computer key? That has nothing to do with the financial world of the '40s or the '50s in the 20th century. It's a new world, and now we are fighting against this new thing: terrorism. We have to do it with all of our strength. We have to

say 'no' to terrorism. But whenever mankind has said no to something, then we have to say yes to something. The yes to something is: What kind of financial architecture are we going to build? Some people think that US leaders - in responding to domestic (political) demands - will shape the new world.

Are IMF or World Bank remedies outdated, unfair, or wrong?

Well, there are some questions about accounting practices at the country level that are unfair. Another point is the Washington Consensus. The Washington Consensus stressed the need to have certain monetary or fiscal policies, free trade, low tariffs and low barriers. Fine. But in addition to that, you need to have social policies that are essential to diminish the differences in income and provide access to opportunities. We were able (in Chile) to reduce poverty from 40% to 20% in 10 years. Growth has meaning for many Chileans because now they have better schooling, better health, better housing and better access to a university education. Therefore, the question is, if we had had growth without social policies in order to improve these areas, what would have happened to Chilean society?

Can you give me an example?

We have invested a lot of money in the area of education during the last 12 years. We almost tripled the budget in education in real terms. Educar Chile is a (Web) portal for the educational community that was developed with the (public-private research institute) Fundación Chile. The program is now being provided to several Latin American countries. It is an effort to produce software in developing countries for developing countries.

Where do you see Ricardo Lagos in 10 years?

Well, first I would like to be in good health. But, in addition to that, as former Colombian President Belisario Betancur once said, the best profession is that of a former president. The only problem with that profession is that in order to become a member of that profession, first you have to be president.

Latin Trade, December 2002

CHILE IN THE EYES OF WALL STREET

The following are excerpts from Wall Street Investment Banks' and Rating Agencies' country reports on Chile:

From Crédit Suisse First Boston's "What a Difference a Few Weeks Make", December 19:

- **The Chilean economy has shown significant resilience to the adverse external shocks that have materialized in recent years.** The economy continues to grow, albeit at a modest pace; fiscal and external imbalances are small, and actual and expected inflation remains well within the target range, effectively allowing the Central Bank to ease monetary policy to record low interest rates. Meanwhile, we think progress on the structural reform agenda has been particularly evident in the series of free trade agreements reached in 2002, and political risk remains low, despite recent corruption scandals. **We remain optimistic that Chile should be among the main beneficiaries in Latin America of the expected upturn in global growth in 2003, mainly due to its diversified export platform.**

- We expect domestic demand to support overall GDP growth of 3.5% next year, contrary to what occurred in 2001 and 2002. GDP growth over the past two years was explained almost entirely by the external sector, as domestic demand fell by 0.7% in 2001 and grew only by an expected 0.3% in 2002. **Recent data, however, suggest a modest recovery in domestic demand is under way.** Data for the third quarter showed growth of 3.8% year-on-year in private consumption, the highest growth rate since late 2000. Also, imports of consumer goods rose 3.8% in the three-month period ending in October (the fastest growth rate since early 2001) and industrial output growth has recently surprised on the upside, probably in anticipation of a further strengthening in consumption. Currently, we believe the main obstacle

to the return to growth in excess of 5% in aggregate domestic demand are the prevailing negative conditions in the labor market: namely a stubbornly high unemployment rate and limited job creation outside the public sector.

- Healthy fiscal accounts have allowed the government to follow a counter-cyclical policy, a luxury in most developing countries. The debate last October over the state of the fiscal accounts has triggered clear benefits, among them, a government commitment to a more timely and comprehensive release of fiscal indicators and a better understanding by the market of the fiscal accounts. Latest data show that the consolidated net debt of the central government and the Central Bank is 9.1% of GDP, which compares very favorably to most other countries. We think the 2003 target of a fiscal deficit of 0.7% of GDP is achievable, though it may require spending adjustments, particularly since the government's growth and copper price assumptions seem slightly optimistic (GDP growth of 4.0% and an average copper price of US\$ 0.77 per pound, compared to US\$ 0.73 per pound in 2002). **Our expectations that the public sector will return to a balanced budget in 2004 and to surpluses thereafter suggest the public debt is likely to remain on a stable path in the foreseeable future.** Of greater concern from the sovereign ratings and external stability perspective, however, is the size of the private sector's external debt, which we expect will reach 51.7% of GDP in 2002 (32.7% in 1998) or 184% of exports (159% in 1998).

- We expect inflation of 3.1% next year, well within the Central Bank's target, which should avert the need for a monetary tightening near-term. In our view, the early stage of the recovery in domestic demand is unlikely to create significant pressures on the inflation front in 2003. **This, coupled with our**

expectation of a relatively stable nominal exchange rate, should allow the Central Bank to leave monetary policy with a neutral bias during most of next year. In terms of exchange rate policy, we believe that the bank is still uncomfortable with the existence of a purely floating regime and, at times, seems to be trying to micromanage the performance of the peso. For instance, in mid-October the Central Bank announced potential currency interventions along with the issuance of dollar-linked bonds (the so-called BCDs) in the domestic market in an attempt to discourage speculation against the peso. After the peso strengthened in ensuing weeks, the bank announced a reduction in the size of BCD auctions, probably in an attempt to prevent a further appreciation of the peso. In our view, the implementation of automatic (non-discretionary) currency stabilizing mechanisms (like the ones used at different time periods by Mexico and Colombia, for example) would be more desirable than the current practices.

- Expectations of stronger global growth and higher copper prices should keep external imbalances in-check throughout 2003. In 2002 the trade surplus should be a large US\$ 2.7 billion, or 4.2% of GDP, mainly due to strong export volume growth and depressed imports. This should leave the current account deficit at approximately US\$ 0.3 billion, which will be more than financed by net FDI inflows worth US\$ 1.9 billion. In 2003, the trade surplus should narrow to US\$ 1.9 billion, as import growth should exceed exports (8.4% versus 2.8%) due in part to a low base of comparison. We project a current account deficit of US\$ 1.1 billion in 2003 (1.7% of GDP), which should be entirely financed by net FDI flows. The large non-merchandise deficit reflects high interest payments abroad, mainly by the private sector.

CHILE IN THE EYES OF WALL STREET

- Regarding the agreement reached by the US and Chilean governments to enter into a free trade accord (FTA), although the costs and benefits of this type of agreements typically become evident over the medium-term, particularly for open economies, **we believe that the announcement should reinforce the recent upswing in private sector confidence.**

- **Political risk remains low** despite the recent corruption scandal that led to the potential firing of five members of Congress. In fact, we believe that Chileans, in general, view this episode as a positive lesson that should reduce the odds of further corruption acts in government. Also, we believe that recent discussion about a potential break-up of the ruling *Concertación* was exaggerated; it increasingly appears to have been the result of a misunderstanding of statements made by the leader of *Democracia Cristiana*, Adolfo Zaldívar. On the structural reform agenda, though progress has been evident on the successful negotiation of the three free trade agreements in 2002 (US, South Korea and the European Union), it remains rather sluggish in the case of the government's so-called Pro-growth agenda. Despite this, and the abnormally low GDP growth rates, **the approval of President Lagos remains near 50% in recent polls and only a minority of Chileans believe the country will be in worse shape one year from now.** Popularity levels should rise as the economy strengthens.

From JP Morgan Chase's "Global Economic & Policy Research", December 10:

- Modest acceleration in activity ahead: By the final quarter of the year, economic activity should be up 2.2% after earlier having drifted at a lackluster 1.8% growth pace. Growth has clearly touched

bottom, but acceleration has been disappointingly elusive. **Still, partial indicators like industrial production are pointing north and other sectors that have been a drag this year, like construction and mining, are due to support activity next year.** Lack of improvement in the labor market continues to conspire against a broad-based recovery of household spending, but a revival of durable goods and real-estate purchases lately provides some encouragement. Indeed, the latter may be showing early signs that aggressive monetary stimulus is beginning to work. At this stage, however, investment appears unable to assist. As for external adjustment, it continues to find support in growing non-copper exports, but the end of import compression suggests that overall trade stimulus for GDP is due to moderate. Trade will continue to face conflicting pressures. On the one hand, Latin America's growth constraints operate as a drag. **However, finalization of free trade agreements with the United States and Europe will structurally enhance Chile's geographically diversified trade links.**

- Tame inflation and a relatively stable currency: Running near the midpoint of the Central Bank's 2-4% target range, headline CPI inflation has become a non-issue. To be sure, core inflation, which has fallen since March, is now below that range, at 1.8%. This plainly reflects the weakness of domestic demand and will permit further monetary easing in the event that activity fails to deliver its expected moderate bounce. **Meanwhile, the currency - battered all through third quarter by Brazilian contagion but more fundamentally by slippage in copper prices and the risk of global slowing - has now stabilized at less extreme levels.** This stability is already helping to lure wholesale price inflation back down into single digits. With no strong economic revival yet in

sight, sustained appreciation of the peso is unlikely. But equally, with inflation readings mild and the current account near balance, sustained peso weakness is unlikely too. Discussion of next year's budget has made it clear that fiscal trends are expected to remain steady, with the consolidated red ink figure likely to hover near 3% of GDP in the years ahead. The red ink is a conscious result of Chile's countercyclical fiscal framework, and is not a concern in the sense that it is for other economies in the region. Even so, the deficit highlights that public spending inertia has become more rigid in recent years.

From Goldman Sachs' "Latin America Economic Analyst", December 20:

- Despite an aggressive easing of monetary policy in the year through August 2002, real GDP growth will barely reach 2% in 2002, reflecting the drag from soft global demand and regional uncertainty. **The year 2003 will start on a high note after the Chilean government has managed to conclude free trade agreements with both the United States and the EU in fourth quarter of 2002.** Given that the Chilean economy has opened itself unilaterally to trade over the years, we believe that the marginal impact of these new trade agreements will be relatively small in terms of growth (for instance, nothing compared to what Nafta did to Mexican exports). Over the long term, a more intense exchange with the United States and Europe should lead to a gradual the diversification of Chilean exports away from copper. **However, in the near term, these agreements could increase FDI and further help Chilean assets to decouple from the region.** Our exchange rate forecast at \$ 690, \$ 720 and \$ 670 for the next 3, 6 and 12 months reflects our long-term bullish view on the Chilean economy while reflecting our and our short-term concerns about regional risks.

CHILE IN THE EYES OF WALL STREET

We believe that a cautious macroeconomic policy mix should allow real GDP growth to rebound to around 3.5% in 2003 while inflation should remain around the middle of the Central Bank's targeted range of 3.0%. The downside risks to our forecast reside in weaker global demand, particularly coming from copper-importers in Asia and copper prices. The Goldman Sachs commodities group forecasts copper prices to average US\$ 0.72 cents per pound in 2003, a recovery of 2% relative to 2002.

From Santander's "Inside Latin America", December 18:

- **GDP:** We maintain our estimate of 1.7% for 2002. For 2003 we are lowering our forecast from 3.7% to 3.4% on lower-than-expected export growth. For 2004 we set a target of 4.1%. Economic activity growth has increased just less than 2.0% in the last five quarters. Exports are the main driver, despite the reduction in copper production implemented in 2002. **For 2003 we expect a recovery in exports on the back of higher copper production, although the growth would not be as strong as we previously expected because some mines are likely to continue producing under capacity.**

We continue to expect a moderate recovery in internal demand on the back of higher world economic growth and a recovery in terms of trade. The employment level and economic sentiment restrain growth in demand. Employment should show an average growth of 1.2% in 2002, mainly explained by a growth of employment in the transport and telecom sector and in the retail sector.

Economic sentiment remains low, and we think it will take time to change. **The trade agreements reached with the European Union, Korea and the US should help to change current**

general pessimism and boost investment. However, there are still uncertainties arising from the external scenario. In terms of sectors, we expect mining, with a 7.0% increase, to lead GDP growth in 2003 thanks to higher copper production. We also expect a recovery in the industrial sector from 2.0% to 3.0%, as general exports would increase with a recovery in the world economy and the trade agreements recently reached. The retail sector, due to the still-low employment level, should once again see growth of around 2.0%.

- **Fiscal Policy:** We are adjusting our estimate for the fiscal deficit in 2002 to 1.0% of GDP. For 2003 and 2004 we expect deficits at 0.8%. The central government posted a surplus of 0.1% of GDP in the third quarter of 2003, reversing the deficit registered in previous quarters. The fiscal accounts of 3Q02 showed a moderate increase in revenues, mainly due to an improvement in tax collection. In terms of spending, the government diminished its spending compared with previous quarters, especially in real and financial investment. With these figures, the fiscal deficit in the first three quarters of the year reached 0.5% of GDP, or around US\$ 350 million.

- **Current Account:** We are increasing our estimate of the current account deficit for 2002 from 0.8% to 1.8% of GDP (US\$ 1.2 billion) on the back of a lower-than-expected trade balance surplus. Regarding the trade agreement recently reached by Chile with the European Union, Korea and the US, it is hard to measure its net effect on the current account, as it would boost both exports and imports. 85% of Chilean exports to the US will enter free of tariff from the moment of entry into force of the agreement (likely to be the beginning

of 2004). This percentage will rise to 94.8% in the fourth year. In the short term, the impact on exports would be limited, considering that the average tariff of Chilean exports to the US is small (around 1.0%). However, we believe it will provide incentives for the Chilean economy to add more value to its exports in the medium term. **Aside from the positive impact on the export side, importers from the US should benefit, as the average tariff is expected to be reduced from 7.0% (0% for import of fixed capital assets) to 0%.** Exports to the US represent 19% of Chilean exports, while imports from the US account for 15% of the total.

- **External Financing:** The capital account, excluding international reserves, showed a negative balance of US\$ 180 million in 3Q02 on low FDI inflows and net portfolio outflows. Among the latest, pension funds brought money out in 3Q02 for US\$ 300 million, in line with previous quarters. For the whole year we estimate a relatively low capital account surplus, excluding reserves, of around US\$ 660 million. The flip side is that, due to the low deficit in the current account, there is not much need for external financing. For 2003 and 2004 we expect a slow recovery in capital inflows due to an improvement in the regional economic situation and the positive impact of the trade agreement. In terms of pension funds' foreign investment limits, according to the press there are no changes in the treaty, so AFPs continue to face a limit of 20% including fixed income and equity foreign investment, of which they are currently using only 15.4%. This limit is already scheduled to be increased to between 20% and 30% in 2004.

STRAIGHT-LACED CHILE WARDS OFF LATAM STRIFE

A South American traffic policeman in sunglasses flags down a red van which has just made an illegal right turn. The cop strolls up to the vehicle and peers in the window. The driver smiles nervously, fumbles in his pocket and pulls out a wallet.

In many Latin American countries, this might be the cue for a bribe to change hands. But not in Chile, where the “carabineros” are reputed to be the least corrupt police force in Latin America. More importantly, politics and business in Chile are also cleaner than the rest of the region. Analysts say freedom from corruption has helped Chile maintain a model economy while its neighbors suffer through financial collapse and sleazy politics.

Far from soliciting a bribe, the Chilean traffic cop Oscar Moreira writes a report in duplicate and tells the driver to appear in court in two weeks’ time. The van driver produced no money, but vehicle documents from his wallet.

Cleaner Than Germany: An annual survey by anti-corruption group Transparency International showed Chile as the 17th least corrupt country in the world, one spot behind the United States and ahead of many more developed nations including Germany.

“(A lack of corruption) is a critically important factor in Chile’s long-term economic success and it is something that certainly makes Chile stand out in the region”, said John O’Leary, who was the US Ambassador to Chile until 2001.

Observers say the same public spirit and penchant for order that keeps Chile relatively free of corruption also directly aids the economy.

Chile’s tax collection rate is about 75%, compared to around 65% in neighboring Argentina. Despite high unemployment and weak consumer demand, Chile is still seen as Latin America’s model economy, especially for the strength of its institutions. The Central Bank is proud of its independence from the government while influence peddling among politicians and bureaucrats is seen as minimal.

The second-least corrupt nation in Latin America, according to Transparency International, is Uruguay in 32nd place.

Mexico, which has seen its economy stabilize since the 1994-95 “Tequila Crisis”, was still stuck at 57th on the world index.

Goodwill: Experts say crooked politicians erode business confidence, inhibit tax collection and scare off foreign investors. “Freedom from corruption is goodwill. It doesn’t have peso or dollar value but it has enormous psychological value in terms of the confidence in doing business in that country”, said former Ambassador O’Leary.

Chile is not entirely immune from dishonest cops and politicians but President Ricardo Lagos was quick to announce an anti-graft package in response to accusations of corruption in the Ministries of Transport and Health. As part of the measures, civil servants now must declare their assets upon assuming and leaving a post.

Impressed by Chile’s tradition of transparency and lack of red tape as well as a steady level of trade, many economies, including the European Union and the US, have reached free trade deals the country. Fallout in Chile from the Argentine crisis and Brazil’s financial market volatility has been limited, partly because Chile does relatively little trade with its neighbors.

Tight Purse Strings: Allied to transparency, Chile has had a stable government since former dictator Augusto Pinochet left office in 1990. It also boasts of fiscal discipline which sets it apart from its neighbors. Only twice has it registered a budget deficit in the last 12 years, and once was due to the 1997-98 Asian financial crisis which dried up a key export market for Chile.

In contrast to Brazil and Argentina, which committed the largest sovereign debt default in history in January, Chile has no foreign debt problem. Most of the Andean nation’s foreign debt of around US\$ 40 billion is long term and private. Chileans also have faith in their financial system, flush with cash from local pension funds and bound by strict accounting rules.

“The personal savings rate in Chile is around 22% to 23%, a figure higher than any other country in Latin America”, said former Minister of Finance Carlos Cáceres. The personal savings rate in Japan, one of the highest in the world, is 28%.

So why is Chile almost alone in Latin America in practicing financial austerity and

rectitude? “The historical explanation is that Chile was always an isolated country. It was isolated geographically by the Andes, the Pacific Ocean and the desert”, said political scientist Ricardo Israel. Colonized in the 16th century almost as an afterthought to the Spanish conquest of Peru, Chile had no large gold and silver deposits. Instead, Chileans relied on hard work and thrift. The country made a meager but steady living from fishing and sea trade while much of Latin America swung from booms to busts riding the volatility of precious metals.

Reuters, November 4

CHILE, BOLIVIA AGREE TO SEEK FULL FREE TRADE AGREEMENT

Chile and neighboring Bolivia agreed to seek a full trade agreement to boost sluggish trade between the two Andean nations, a Chilean Ministry of Foreign Relations’ office said.

Trade between the two countries peaked at US\$ 291 million in 1997, following a 1993 framework trade integration deal, but due to weak economic conditions in both countries trade plunged to US\$ 168 million in 2001, a near 10-year low, spurring the desire for a full-fledged free trade deal, Chile’s General Division for International Economic Relations (Direcon) said. The first round of negotiations will be held January 20 and 21 in Santiago, the Chilean capital, it added.

Earlier efforts at brokering a full deal dating back to 1998 have met with little success, but the countries have recently made significant advances in talks. They have agreed to include all goods currently subject to customs duties but to also take into account asymmetries in economic development in both countries.

Chile is one of Latin America’s wealthiest countries and its bonds have the region’s lowest county risk rating, while landlocked Bolivia is one of the regions poorest countries.

Chile has free trade deals or framework integration deals with most of its Latin American trading partners. During 2002, it has also closed free trade agreements with the European Union, South Korea, and the US.

Dow Jones Newswires, November 26

MIF, CHILEAN GOVERNMENT TAKE NEW APPROACH TO VC FUNDS

The Inter-American Development Bank's Multilateral Investment Fund (MIF) and the Chilean Government's Development Agency (CORFO), have joined forces in a bid to jumpstart the development of the venture capital industry in Chile.

The scheme, which will guarantee debt raised by new venture capital funds, aims to encourage local institutional investors - principally Chile's private pension funds (AFPs) - to play a greater role in the industry. Deterred by the failure of some early investments, the AFPs, which manage total assets of US\$ 35.9 billion, have so far committed less than US\$ 200 million to the country's ten private equity funds, set up mostly in the mid-1990's.

Venture capital funds launched under the new scheme will issue bonds that can be acquired by their limited partners, up to a maximum value of twice the l.p.s' equity contribution. These bonds will, in turn, be guaranteed by the MIF, CORFO and the scheme's other backers. "Debt-financing will obviously reduce the funds' returns, but by limiting the risk, we hope to ease institutional investors into the industry", said Claudio Cortellese, an investment officer at the MIF.

The funds will pay interest on the bonds that is the same as the rate for government paper of similar tenor. The funds will also pay a commission to the MIF, CORFO and the scheme's other backers of 1.7% on capital that has been drawn down and 0.5% on uncommitted capital. The commission will cover the costs undertaken by the two agencies in selecting fund managers, for example. MIF and CORFO will also collect 5% of the funds' returns once the hurdle of 7% has been surpassed.

Neither the MIF nor CORFO will contribute equity or quasi-equity to the new funds, emphasized Cortellese, but will, instead, take on a contingent liability against the possible fund failures. In the case of CORFO and MIF, these will amount to US\$ 12 million and US\$ 10 million,

respectively, while other partners, yet to be named, will take on a further US\$ 2 million.

With these guarantees, the scheme plans to guarantee bonds up to a value of US\$ 96 million, allowing it to kick start around seven funds with a total investment capacity of around US\$ 140 million. However, Cortellese emphasized that this would be a gradual process and, initially, probably only two or three managers will be selected to set up funds.

The MIF sees the scheme as a pilot program that it may eventually extend to other Latin American countries. Chile was the first choice, said Cortellese, partly because of its small size, as well as its economic stability.

It is also, he added, one of the few countries where small companies have access to bank borrowing as a source of working capital, although this is usually not provided for more than three years.

As part of the scheme, the MIF and CORFO also plan to put up US\$ 400,000 each towards training programs for local fund managers, lawyers and accountants. "One of the problems in Chile is that fund managers don't have track records, nor a way to acquire experience", said Cortellese.

Fund managers will be selected after a call for proposals, judged for the qualifications of the management team as well as the investment strategy. Fund managers will be restricted to making investments of under US\$ 4 million each, and in companies with annual sales of under US\$ 15 million.

As a condition of the MIF involvement, the program is expected to see at least 30% of resources oriented towards small companies with less than US\$ 5 million in sales. The transaction size for the smaller companies will be less than US\$ 3 million. Addressing the problem of monitoring small investments - another reason often cited by AFPs for not investing in private equity funds - CORFO and MIF plan to take an active role in supervising the new funds. They will, for example, hire a private firm to represent them during the process of due diligence on proposed portfolio investments.

Venture Equity Latin America, December 23

GOVERNMENT SETS MODERNIZATION PRIORITIES FOR 2003

Chile's Ministry of Economy has made the automation of government paperwork, further development of e-procurement portal Chilecompra (www.chilecompra.cl) and online billing its three main modernization priorities for 2003. By end-December or early January the Ministry expects to have online 35 administrative steps for opening a business and complying with export, labor or tax regulations, Economy Undersecretary Alvaro Díaz said.

Moving government paperwork online is part of the Ministry's Single Window plan. The government has budgeted US\$ 3.5 million for solutions that would automate the first 22 processes.

The Ministry's goal is for Chilecompra to publish auction results for all state purchases of day-to-day supplies by April 2003. By December 2004 the portal will be able to host online auctions and receive online payments, and by then there should be 10,000 suppliers using it, with the government saving about US\$ 30 million a year. Three years after that savings should be on the order of US\$ 250 million, as administrative costs will have fallen by 50% and competition between suppliers should have forced prices down 15%.

Online billing requires further development and automation of tax office processes. To this end the Ministry is running a pilot project with 10 companies and expects to have an idea by year-end of problems that will have to be ironed out to prepare the final model, Díaz said. The planned innovations should reduce tax administration costs by 66%, once the system is in general use.

According to Díaz, the government is still in a phase of automating the exchange of information with the private sector and the citizenry, without necessarily changing administrative order. The next step will be to simplify that order by using technology to improve the efficiency of "back office" processes.

Business News Americas, December 6

IMF MANAGING DIRECTOR HORST KÖHLER'S REMARKS IN CHILE

International Monetary Fund Managing Director Horst Köhler made the following statement on December 12 in Santiago. The meetings in Chile, including with President Ricardo Lagos, came at the end of a week-long trip that also took Köhler to Brazil and Colombia:

"The purpose of this - my second visit to Latin America as IMF Managing Director - is to indicate IMF support for the region at a critical time. At the end of this trip, I remain convinced that lessons from successes in the region can help point the way forward for other countries currently experiencing difficulties.

"In Chile, where we expect economic growth to accelerate and inflation to remain low, the authorities have established a strong and credible macroeconomic policy framework based on a floating exchange rate, inflation targeting, and clear rules on fiscal policy. This framework has been supported by low public debt, a strong belief in free trade, and the virtual absence of dollarization. Thus, Chile - like Mexico - has been able to better protect itself from adverse external shocks and maintain positive growth even during periods when international capital markets have been unsettled.

"An important lesson from Chile's experience is that a good macroeconomic framework still needs to be underpinned by the strength and integrity of political and economic institutions. I am impressed by the vigor with which the authorities in Chile are safeguarding and strengthening institutions in key areas such as Central Bank independence and corporate governance, and ensuring financial stability. The Chilean authorities have also told me their conviction that issues of social equity need to be decisively addressed to reap the full benefits of globalization".

IMF (Press Release), December 12

ALPINE AIR CHILE COMMENCING FLIGHTS

Alpine Air Chile, the sole regional all-cargo airline with flights throughout Chile, and a subsidiary of Alpine Air Express Inc., announced that its South American operation is expected to commence revenue flights in December.

The newly created subsidiary, utilizing high capacity Beech 1900/C cargo aircraft, worked with the Dirección General De Aeronáutica Civil (DGAC), Chile's civil aircraft authority, to enable regulatory approval for the aircraft and for all flight operations. The regularly scheduled seven-day air cargo service, with established routes from its base in Santiago, marks the start of new international operations for parent Alpine Air Express subsidiary.

The two routes include northern stops to Antofagasta (Region II) and Iquique (Region I) and southern stops to Concepción (Region VIII), Puerto Montt (Region X) and Punta Arenas (Region XII). Alpine is in discussions to serve a variety of customers including freight forwarders, small couriers and other major shippers and expects these new routes to add significantly to fiscal 2003 net income.

Alpine is also actively seeking to acquire additional routes and customers in Chile and plans to add an additional Beech 1900 aircraft in January as part of its strategy for further expansion in South America.

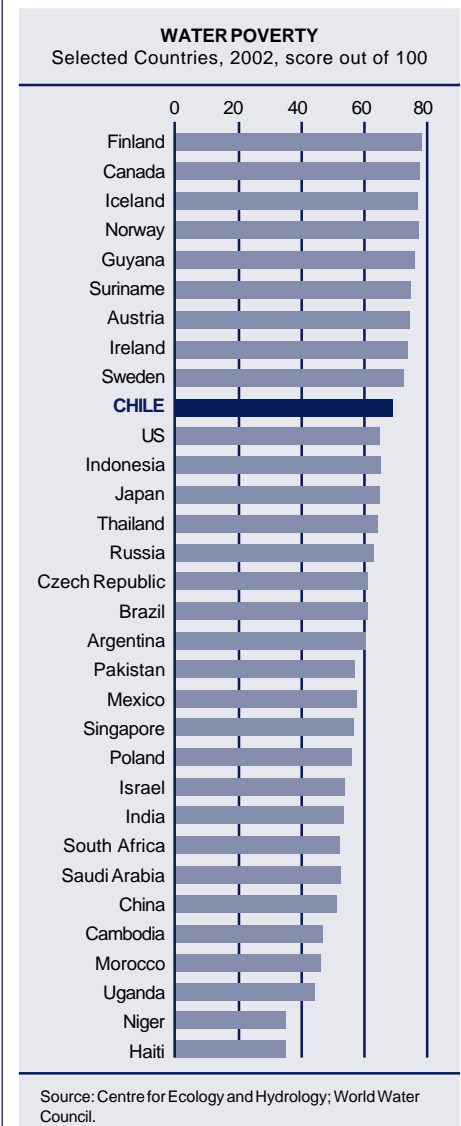
Eugene Mallette, CEO of Alpine Air Express, commented: "We are extremely excited to commence operation from our new base in Santiago, Chile with its well-managed and fast-growing economy. Additionally, the country, pursuing a US & Chile Free Trade Agreement, December 6 completed its 14th Round of Negotiations in Washington, D.C.

"This agreement, in part, hopes to eliminate tariff barriers to commercial exchange, opening up significant new markets and stimulating enormous potential for cargo service. We believe there is a significant opportunity for reliable, consistent and timely air cargo delivery in Chile".

Business Wire, December 9

WATER POVERTY

A new water-poverty index, developed by Britain's Center for Ecology and Hydrology and the World Water Council, grades countries according to their water resources, access, use and environmental impact. Finland is top scorer, with plenty of water wisely used; Haiti comes bottom. On the whole, poor countries do worse than rich ones, with some exceptions: Guyana's score, for example, is raised by good access to safe water, and Japan's is marked down by problems with pollution. America's standing is lowered by inefficient use of water in fields, factories and homes.



The Economist, December 19

Between January and October of 2002, materialized Foreign Direct Investment reached US\$ 1,670 million, as compared to US\$ 4.4 billion for the same months of 2001. The Foreign Investment Statute (D.L. 600) channeled 80.5% of the inflows. The main

recipient sectors were Transport and Communications (23.7%), Electricity, Gas & Water (16.9%), and Mining (23.3%). During those months, materialized FDI came mainly from the United States (35.2%), Spain (17.7%) and Belgium (9.8%).



FOREIGN DIRECT INVESTMENT REPORT / January - October 2002 (in nominal US\$ million)

Instrument/Period	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Jan-Oct 2001	Jan-Oct 2002	Growth rate
Foreign Investment Statute (1)														
- Capital Contributions	572.6	691.8	894.3	1,544.6	1,802.1	3,948.6	3,825.5	4,382.8	8,606.9	2,541.3	4,334.1	3,470.6	1,218.2	-64.9%
- Associated Credits	409.5	307.1	839.8	976.7	1,238.5	873.3	1,404.3	1,589.9	478.7	436.0	399.4	274.6	126.1	-54.1%
Materialized Investment F.I.S. (D.L. 600)	982.1	998.9	1,734.1	2,521.3	3,040.6	4,821.9	5,229.8	5,972.7	9,085.6	2,977.3	4,733.5	3,745.2	1,344.3	-64.1%
Chapter XIV (2)														
- Capital Contributions	98.1	157.8	204.2	410.2	409.5	441.6	920.6	539.3	688.8	735.6	775.2	683.5	325.3	-52.4%
Total F.D.I. Capital Contributions (F.I.S. + Chapter XIV)	670.7	849.6	1,098.5	1,954.8	2,211.6	4,390.2	4,746.1	4,922.1	9,295.7	3,276.9	5,109.3	3,154.1	1,543.5	-62.8%
Total F.D.I. Materialized (Materialized F.I.S. + Chapter XIV)	1,080.2	1,156.7	1,938.3	2,931.5	3,450.1	5,263.5	6,150.4	6,512.0	9,774.4	3,712.9	5,508.7	4,428.7	1,669.6	-62.3%
Capital Remittances	36.4	62.7	174.1	59.5	396.1	333.6	375.5	443.8	281.7	541.4	963.8	590.6	585.7	-0.8%
- Foreign Investment Statute (1)	34.4	61.6	173.2	49.4	392.6	303.4	354.9	119.9	233.9	462.7	674.4	323.1	540.3	67.2%
- Chapter XIV (2)	2.0	1.1	0.9	10.1	3.5	30.2	20.6	323.9	47.8	78.7	289.4	267.5	45.4	-83.0%

(1) Source: Foreign Investment Committee - Chile. Provisional figures as of October 31, 2002.

(2) Source: Central Bank of Chile. Provisional figures as of October 31, 2002.

FOREIGN INVESTMENT UNDER THE FOREIGN INVESTMENT STATUTE (D.L. 600) BY SECTOR 1974 - 2002* (in nominal US\$ million)

SECTOR	AUTHORIZED INVESTMENT									MATERIALIZED INVESTMENT								
	74-95	1996	1997	1998	1999	2000*	2001*	2002*	Total	74-95	1996	1997	1998	1999*	2000*	2001*	2002*	Total
Agriculture and Livestock	292	14	89	25	22	22	18	3	485	163	16	14	12	21	22	10	2	260
Construction	429	49	159	155	415	95	218	165	1,685	303	26	114	280	216	29	166	137	1,271
Electricity, Gas & Water	891	626	1,695	718	5,729	1,882	704	378	12,623	93	406	1,395	495	4,560	860	908	228	8,945
Fishing and Aquaculture	195	4	102	17	2	100	7	5	432	129	21	12	9	1	94	6	0	272
Forestry	205	59	50	38	14	4	3	3	376	133	20	29	37	19	4	1	1	244
Industry	3,980	1,611	510	471	880	516	1,131	142	9,241	2,731	917	593	530	779	191	755	159	6,655
Mining	23,307	642	3,659	1,503	502	1,347	4,799	1,875	37,634	8,558	999	1,705	2,393	1,221	242	898	314	16,330
Services	5,341	2,866	1,295	2,966	2,585	953	658	475	17,139	2,686	1,958	1,197	2,006	1,910	665	705	185	11,312
Transport & Comm.	1,441	1,072	335	183	631	2,275	479	563	6,979	906	459	171	211	359	870	1,284	318	4,578
TOTAL	36,081	6,943	7,894	6,076	10,780	7,194	8,017	3,609	86,594	15,702	4,822	5,230	5,973	9,086	2,977	4,733	1,344	49,867

Note: Materialized investments include amounts authorized each year and in all forms accepted under the Foreign Investment Statute.

Source: Foreign Investment Committee - Chile. *Provisional figures as of October 31, 2002.

MATERIALIZED FOREIGN INVESTMENT UNDER THE FOREIGN INVESTMENT STATUTE (D.L. 600) BY REGION OF ORIGIN 1974 - 2002* (in nominal US\$ million)

