

## Letter on Efforts to Eliminate Chilean Capital Restrictions, January 2002

January 10, 2002

The Honorable John B. Taylor  
Under Secretary for International Affairs  
Department of the Treasury  
Room 3432  
1500 Pennsylvania Avenue, NW  
Washington, D.C. 20220

Dear Under Secretary Taylor:

On behalf of the Investment Company Institute,<sup>1</sup> I am writing to express our support for continued negotiations with Chile for a commitment on eliminating capital restrictions in the Chile-U.S. Free Trade Agreement (FTA). The U.S. asset management industry hopes that a Chile-U.S. FTA will include meaningful commitments for the asset management sector, which could be a precedent for multi-lateral negotiations in the World Trade Organization.

We understand that one of the issues that remain controversial in the negotiations with Chile and will require high-level discussion is Chile's restrictions on repatriation of capital for portfolio investments. As you know, there are three ways in which a foreign investor can invest in Chile. Until recently, foreign investors using these methods to invest were not permitted to repatriate capital for a period of time, ranging from one to five years, although Chile may not have been enforcing the restrictions in practice. In 2000, the Central Bank eliminated the capital repatriation restrictions for one of these methods, although it is unclear to what extent foreign investors that are already investing in Chile can take advantage of the liberalization.

U.S. mutual funds are typically long-term investors.<sup>2</sup> U.S. mutual funds, however, are required by the federal securities laws to invest substantially in liquid assets and to price their shares daily. Repatriation restrictions and similar measures that are designed to make it harder for foreign investors to get their money out of a country make it difficult for funds to comply with mutual fund pricing and liquidity regulations under U.S. laws. These types of measures also restrict an asset manager's ability to make portfolio decisions.

Consequently, these types of restrictions discourage investment by U.S. mutual funds in the Chilean securities markets.<sup>3</sup> For example, historically, U.S. mutual funds typically invested in Chile only through American Depositary Receipts because of liquidity and pricing concerns. Chile's practice of not enforcing the repatriation restrictions has not alleviated regulatory concerns of U.S. mutual funds. Accordingly, we believe that Chile should make a binding commitment not to re-impose the capital repatriation restrictions. The uncertainty created by the possibility that Chile may decide to re-impose these restrictions or enforce existing restrictions at any time creates significant concerns for foreign investors.

Some countries have argued that capital controls are necessary to address speculation and volatility in the financial markets. We believe, however, that restrictions on capital flow discourage long-term foreign investments and governments should find less burdensome means to counter short-term speculation of the domestic market.

We understand that capital restrictions are an important issue for U.S. trade negotiators. This issue is of critical importance to the financial services industry as well. We hope that Chile will make a binding commitment in the Chile-U.S. FTA to remove the remaining capital restrictions or at least to commit not to impose repatriation measures that are more restrictive than the current law.

\* \* \*

We would be pleased to answer any questions or discuss any of these issues further. You may contact me at (202) 326-5826 or at [podesta@ici.org](mailto:podesta@ici.org) or Jennifer S. Choi at (202) 326-5810 or a [jchoi@ici.org](mailto:jchoi@ici.org).

Very truly yours,

Mary S. Podesta  
Senior Counsel

cc: Joseph L. Engelhard  
Mary Beasley

## ENDNOTES

<sup>1</sup> The Investment Company Institute is the national association of the U.S. investment company industry. Its membership includes 9,040 open-end investment companies (“mutual funds”), 484 closed-end investment companies, and 6 sponsors of unit investment trusts. Its mutual fund members have assets in excess of \$6.9 trillion, accounting for approximately 95% of total industry assets, and over 88.6 million individual shareholders.

<sup>2</sup> Institute research studies on the behavior of U.S. emerging market funds during the 1990s have demonstrated that these funds have not been a source of instability in the markets in which they invest. See [“U.S. Emerging Market Equity Funds and the 1997 Crisis in Asian Financial Markets,”](#) Perspective, June 1998 (Institute research report, which examine actors of shareholders and portfolio managers of U.S. emerging market equity funds during 1996 and 1997, found that shareholders reacted calmly and portfolio managers reacted to the crisis in measured fashion); [“U.S. Mutual Funds: Hot Money or Stable Source of Investment Capital?”](#) Perspective, December 1996 (Institute research report, which examined the behavior of shareholders and portfolio managers of U.S. emerging market funds during the 1990s, found that shareholders did not redeem shares in large volumes during periods of market weakness and portfolio managers did not shift investments between countries in a manner that would exacerbate price swings).

<sup>3</sup> Chile also has imposed a reserve regulation (Encaje) that requires a foreign investor to deposit a certain percentage of its investments with the Central Bank of Chile with no interest for the duration of the investment. Although Chile has eliminated this requirement, we understand that the Central Bank of Chile is empowered by Article 49 of the Constitutional Organic Law to re-impose the requirement at any time. We believe this type of requirement imposes undue burdens on foreign investors by, in effect, requiring foreign investors to provide Chile with an interest free loan.