

Since Mexico did not restrict capital flows before its peso crisis of December 1994, advocates of capital controls have pointed to this crisis as a dramatic example of the consequences of unrestricted capital mobility. However, given the severity of the attack on Mexican peso, it is unlikely that restrictions on capital flows would have allowed Mexico to delay the collapse of the peso.

Chile has maintained for some time reserve requirements and repatriation restrictions on capital inflows. Chile's deposit requirements (*encaje*) lock-in for one year 30% of foreign-credit financed investments. Chilean authorities maintain that capital controls are used to stabilize the value of Chilean peso in the short-term. The *encaje* regime also generates important revenues for the Chilean government as no interest payments are made on the deposit requirement.

A good proportion of foreign direct investment in Chile has been in the mining sector, which is of long-term nature. The long-term investors in Chile lose the use of their capital and forgo the return on their borrowed money. As a result, the deposit requirement allows the Chilean authorities to raise revenues at the expense of long-term foreign investors. Moreover, the deposit requirement in Chile, thought to be a prudent measure, in fact ends up discouraging investment in Chile and hurts small business.<sup>1</sup>

Since 1973, Chile has achieved significant improvement in its macro-economic performance. Capital controls do not appear to have been a significant ingredient in the Chilean economic success. The successful performance of Chile is generally attributed to a prudent and consistent macro-economic policy and a wide range of structural reforms. Consequently, financial success and stability in Chile cannot be exclusively attributed to restrictions on capital inflows, as some Chilean commentators would suggest.

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<sup>1</sup> The Director of the Central Bank of Chile, María Elena Ovalle was quoted as favouring the elimination of the *encaje* requirement. On November 24, 1995, in a press conference following Senate approval of her nomination to the Bank, Mrs. Ovalle stated that the *encaje* "affects small and medium sized enterprises and restricts investment". Mrs. Ovalle further commented that "a greater development of the financial market was needed, allowing for wider coverage of individuals and firms." Source: Internet, [http://www.copesa.cl/DE/1995/11\\_30/economia.html](http://www.copesa.cl/DE/1995/11_30/economia.html).