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The U.S.-Chile Free Trade Agreement: Economic and Trade Policy Issues

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The U.S.-Chile Free Trade Agreement: Economic and Trade Policy Issues

Summary

On December 6, 2000, the United States and Chile began discussions on a bilateral free trade agreement (FTA) that was completed on December 11, 2002, two years and 14 negotiation rounds later. President Bush formally notified the 108th Congress on January 30, 2003 of his intention to sign the agreement, initiating a legally required 90-day review period prior to congressional consideration of implementing legislation, which is expected later in the year. This report provides background and analysis on Chile's economy, trade relations, and the new bilateral FTA and will be updated periodically.

If the FTA is implemented, Chile would join a select group of only four other countries that have an FTA with the United States (Canada, Mexico, Jordan, and Israel). Although many point to the potential for trade growth between the two countries, if passed, the significance of this FTA runs much deeper: 1) it would be the first such agreement with a South American country; 2) it would be an agreement with one of the most open and reformed economies in Latin America; 3) it would be an example of how trade policy issues, including those with both social as well as economic implications, can be resolved between a small developing country and a large developed one; and, 4) it may prove to be a strategic step toward completing the Free Trade Area of the Americas.

The United States and Chile are putting the finishing touches on the text. The FTA is comprehensive, but despite the variety and complexity of issues negotiated, increased market access would be the primary benefit for both countries. In time, all goods traded between the two countries would receive duty-free access. Fully 85% of bilateral trade in consumer and industrial products would become duty-free immediately, with other product tariff rates being reduced over time. Some 75% of U.S. farm exports would enter Chile duty-free within four years and all duties would be fully phased out within 12 years after implementation of the agreement. For Chile, 95% of its export products would gain duty-free status immediately and only 1.2% would fall into the longest 12-year phase out period.

Other critical issues were resolved including environment and labor provisions, capital controls, increased access for services trade, greater protection of intellectual property, and creation of a new e-commerce chapter. No chapter on trade remedies was included, hence there would be no anticipated change to the antidumping and countervailing duty options currently available to both countries. Finally, there would be a single dispute resolution process for the whole agreement. Commercial cases would rely on standard remedies that could culminate in the suspension of tariff benefits. For environment and labor disputes, remedies may include monetary assessments or fines, which would be placed in a fund to address the problem that generated the complaint. Nonpayment of any such fine could lead to other undefined measures. Although sanctions were not ruled out, there is little anticipation of a future problem that would result in such a response.

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The U.S.-Chile Free Trade Agreement: Economic and Trade Policy Issues

On December 6, 2000, the United States and Chile initiated discussions on a bilateral free trade agreement (FTA). Two years and 14 negotiation rounds later, the two countries announced on December 11, 2002 that an agreement had been reached. President Bush formally notified the 108th Congress on January 30, 2003 of his intention to sign the agreement, initiating a legally required 90-day review period prior to congressional consideration of implementing legislation, which is expected later in the year. This report provides background and analysis on Chile's economy, trade relations, and the new bilateral FTA.

Why A U.S.-Chile FTA?

Trade agreements evoke strong reactions from supporters and opponents alike. Nowhere is this debate more alive than in the U.S. Congress, which for eight years was at an impasse over passage of trade promotion authority (TPA) until it renewed TPA in August 2002 as part of the Trade Act of 2002 (P.L. 107-210).[1] Without TPA, the politically charged nature of trade negotiations made passage of implementing legislation for multilateral and regional agreements more uncertain. In addition to complex multilateral trade arrangements, the United States has pursued simpler bilateral agreements that were expected to be less politically sensitive and therefore more likely to gain congressional approval, especially if TPA had not been renewed. On September 28, 2001, for example, President Bush signed into law the implementing legislation for the U.S.-Jordan FTA (P.L. 107-43). Bilateral FTAs with Singapore and Chile were pursued with the expectation of similar support.

Opposition to bilateral FTAs, however, has heated up for both economic and political reasons. Economists, even those who support free trade, point out that bilateral (and regional) agreements are poor substitutes for multilateral arrangements. Although both countries in a bilateral arrangement may see their welfare improve through trade creation, the agreement may also cause trade (and investment) diversion, which can negatively affect those both in and outside of the agreement.

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[1] Trade promotion authority, formerly known as fast-track trade negotiating authority, is an expedited process for congressional consideration of trade agreements. It provides that Congress will consider trade agreements within a mandatory deadline, under limited debate, and with no amendments as long as the President meets requirements set in the law. See: CRS Issue Brief IB10084, *Trade Promotion Authority (Fast-Track Authority for Trade Agreements): Background and Developments in the 107th Congress*, by Lenore Sek and CRS Report RS21004, *Fast-Track Negotiating Authority for Trade Agreements and Trade Promotion Authority: Chronology of Major Votes*, by Carolyn C. Smith.

Although trade diversion is often difficult to assess, it is a real consideration in pursuing negotiations below the multilateral level.[2]

In addition to economists' questions over the trade effects of bilateral agreements, there is vehement opposition by various interest groups. Perhaps first among many are the import-competing industries that bear the brunt of the adjustment costs of a trade agreement. Despite the welfare gains to society as a whole (e.g. more efficient resource allocation, lower priced imports, greater selection of goods), those industries subject to increased competition face potentially serious pressure to adjust their operations to become more efficient, lower-cost producers. Competition is generally accepted as a tenet of doing business in a market economy, and on a national level, these adjustment costs may be small and lead to greater productivity. When the rules change because of trade agreements, however, affected workers and industries resist strongly and their concerns are a legitimate part of the trade liberalization debate.

Strong criticism of virtually all trade agreements also arises from groups arguing that any arrangement is unacceptable unless it includes strong provisions addressing the impact of the trade agreement on labor and environmental conditions. When joined with other groups protesting "globalization" in general, a formidable coalition is created. Collectively, these interest groups raise the question of whether trade agreements enhance the social welfare of participating countries. Given the intensity of debate and amount of effort and resources needed to consummate an FTA, some questioned whether the marginal gains from a U.S.-Chile bilateral agreement would be justified given that Chile is a small and distant U.S. trade partner, and already has a relatively open economy.

Advocates of the U.S.-Chile FTA responded that it offered both economic and political gains, with Chile seen as a potential strategic foothold in South America, a region historically linked closely with Europe and Asia. From an economic perspective, U.S. business interests considered Chile a prime target for expanding exports and repeatedly stressed the need to reduce the higher tariffs they faced relative to Canada and other countries that already had FTAs with Chile. Lower-cost U.S. imports from Chile also provided benefits to individual and business consumers. Further, the major U.S. imports from Chile (copper, salmon, grapes, wine, wood) had zero tariffs already, suggesting that the adjustment costs to import-competing firms would be low (see **appendix 2**).[3] U.S. investors also saw Chile's political and economic stability attractive for foreign investment.

From a trade strategy perspective, it was argued that a U.S.-Chile FTA would support U.S. initiatives with the Free Trade Area of the Americas (FTAA), currently under negotiation, by encouraging greater Chilean support for U.S. issues and

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[2] For a discussion, see: CRS Report RL31072, *Regional Trade Agreements: An Analysis of Trade-Related Impacts*, by Gary J. Wells. August 3, 2001.

[3] Grapes, copper, refined oil, and wine enter duty free under the Generalized System of Preferences (GSP), which requires periodic congressional reauthorization. Presumably, one important reason Chile pursued an FTA with the United States was to make these zero tariffs a permanent rather than temporary arrangement.

perhaps even helping define key negotiating parameters (e.g. labor and environment provisions) that could be precedent-setting.[4] The U.S.-Chile FTA was also offered as a compelling case for passage of TPA legislation, which would serve as a signal to Latin America and the rest of the world of the U.S. commitment to pursue and complete trade agreements.

Chile also saw a logic in prioritizing an FTA with the United States because export promotion has been a building block of its growth and development strategy. Chile also envisioned increased foreign investment as an attendant benefit of the FTA, and argued that its well-established track record on economic and trade reform made it the Latin American country most ready to negotiate a bilateral FTA. In short, despite its relatively small economy, Chile presented itself as a country ready, willing, and able to negotiate a mutually beneficial FTA with the United States.

In addition to the benefits that were expected to accrue to U.S. businesses, investors, and consumers, an FTA with Chile was also seen as an opportunity for the United States to support economic and trade reform in Latin America, for which Chile had become a regional model. Trade was a big part of the economic growth and development story in Chile, and linked directly to increased productivity, higher standards of living, greater diffusion of technology, and overall modernization of the country. Therefore, the United States, it was argued, should support these gains because they are a foundation for continued economic, social, and political stability and progress in the region. Trade agreements were also presented as playing a role in development and have the added benefit of "locking in" reforms, lending a sense of permanence to economic and political conditions that is conducive to attracting and keeping foreign trade and investment.

Clearly, there were competing viewpoints on the desirability of a U.S.-Chile FTA. A look at Chile's economic development is one way of addressing many, if not all, of the issues highlighted above precisely because Chile has been an early and aggressive reformer of economic and trade policy in Latin America. In this light, to the extent that the welfare of Chilean society has improved with economic openness, it may be one indication that freer trade can support a broad array of economic and political goals. It is with this approach in mind that this report integrates a discussion of Chile's economic growth and development with trade policy issues raised in both the United States and Chile.

Economic Reform in Chile

Chile has become one of the most open, reformed, and developed economies in Latin America, a rebuilding process initiated under the military dictatorship of Augusto Pinochet (1973-90) and accelerated under civilian government following the return of democratic rule in 1990. Chile transformed its state-dominated economy into one grounded in market-based economic principles, first by stabilizing the

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[4] The FTAA would include 34 nations of the Western Hemisphere and is scheduled for completion by January 2005. See: CRS Report RS20864, *A Free Trade Area of the Americas: Status of Negotiations and Major Policy Issues*, by J. F. Hornbeck.

economy and then restructuring it (e.g., lifting price controls, deregulating labor markets, privatizing state enterprises, reducing trade and exchange rate restrictions). As part of the process, Chile weathered some devastating domestic setbacks, including the 1982 economic collapse, followed by the sudden onset of the Latin American debt crisis. Chile survived it all, however, and eventually thrived economically, although not without incurring significant social costs along the way.[5]

Table 1. Chile: Selected Economic and Financial Indicators

	1996	1997	1998	1999	2000	2001	2002
GDP Growth (%)	7.4	6.6	3.2	-1.0	4.4	2.8	1.7
Inflation - CPI Avg. (%)	7.4	6.1	5.1	3.3	3.8	3.6	2.4
Unemployment Rate (%)	6.5	6.1	6.2	9.7	9.2	9.2	8.8
Fiscal Balance (% of GDP)	2.4	1.9	-0.1	-2.2	-0.9	-0.9	----
Current Acct Bal (% of GDP)	-5.1	-4.5	-5.2	-0.1	-1.3	-1.4	-1.8
Terms of Trade (% change)	-15.5	2.6	-12.6	0.9	-0.1	-8.0	----
Foreign Exchange Res. ($bil)	15.5	17.8	16.0	14.7	14.7	14.4	15.6

Data Source: International Monetary Fund and Central Bank of Chile.

Economic reform has continued into the 21st century and actually coincided with a period of strong economic growth that held for most of the last decade (see **table 1**). Currently, Chile is adjusting to the slower economic growth experienced both at home and abroad over the past two years, including a prolonged recession and financial crisis in neighboring Argentina. In 2002, Chile's gross domestic product (GDP) rose by only 1.7%, which was higher than many of its neighbors. Although, this reflects a slower growth rate compared to average economic growth of over 5% in the late 1990s, Chile's economy has proven resilient in the face a global economic downturn and contagion from the Argentine financial crisis.

Chile's current macroeconomic management rests on three policy pillars: a flexible exchange rate; inflation-targeting monetary policy; and strict fiscal discipline aimed at generating a public sector surplus.[6] On the positive side, tight fiscal control has kept Chile's public external debt position relatively low, helping restrain inflation to 2.4% in 2002 and leaving room for monetary policy to support economic growth as well as price stability. Productivity levels have been sufficient to see real wage growth, as well. On the negative side, unemployment has remained around 9%, a nagging problem facing Chilean policy makers.

Trade reform began in the 1970s and helped transform the economy. By dismantling its multilevel tariff schedule and reducing nontariff barriers, Chile sought to engage foreign markets more aggressively and open itself to international

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[5] A detailed summary of this process with an emphasis on trade policy may be found in: CRS Report 97-56, *Chilean Trade and Economic Reform: Implications for NAFTA Accession*, by J. F. Hornbeck. October 17, 1997. pp. 1-9.

[6] Presentation by Chilean Minister of Finance, Center for Strategic and International Studies, February 28, 2001 and IMF, *Chile: 2001 Article IV Consultation*, p. 9.

competition. The uniform average nominal import tariff rate fell from 105% in 1973 to 15% in 1988, and to 11% in 1991 under civilian government. Chile then reduced the tariff rate by 1 percentage point each year until it reached 6% on January 1, 2003. Although not without adjustment costs, the competitive pressures of trade reform have clearly increased productivity and economic growth.

Continuing a trend since the mid-1980s, Chile has recently made a number of simplifying capital market reforms, including abandoning its exchange rate band in favor of a floating system, eliminating many controls on foreign capital, including the one-year, non-remunerated reserve requirement, and reducing and equalizing capital gains treatment of domestic and foreign investment.[7] Changes in capital controls and exchange rate management have been essential to spurring Chile's export-led growth. Privatization and deregulation have also progressed beyond financial services to include telecommunications, energy, and selected public infrastructure, with Chile also leading Latin America in the divestiture of public-owned enterprises.

Chile's record of reform, growth, and development corresponds with increased measures of income and social well being. In 2001, Chile's per capita income level was second only to Argentina's in Latin America and will likely be first once data reflect Argentina's financial crisis. In addition, Chile's human development index (HDI) ranked third in Latin America behind Argentina and Uruguay and ahead of the much larger economies of Brazil and Mexico.[8] Welfare gains for the poorer segments of Chilean society are also being seen, with a relatively low child mortality rate and absolute measures of poverty declining over the past decade and registering lower than most other Latin American countries.[9] High unemployment and a skewed income distribution in line with the rest of the region, however, point to the need to increase the quality and quantity of workforce participation, which is related to improving education, health care, and other public policies.

Chile's Trade Policies and Relations

Over the past decade, Chile's increasingly expansive and independent trade policy portrays a strategy that is commonly referred to as "open regionalism." This approach combines unilateralism with the formation of sub-regional integration groups open to future expansion, such as the Andean Community and the Southern Common Market (Mercado Comun del Sur – Mercosur), among others, while also

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[7] *Latin American Monitor: Southern Cone*. June 2001, pp. 4-5 and Central Bank of Chile, *Press Release*, April 16, 2001.

[8] The Human Development Index (HDI) is a composite measure (education, income, and life expectancy) of average achievement in human development. Worldwide, Chile ranked 39 compared to Argentina (34), Uruguay (37), Brazil (69), Mexico (51), and Venezuela (61). Argentina's rank may fall precipitously once corrected for its current financial crisis. See: United Nations, *Human Development Report 2001*, p. 141.

[9] Less than 2% of Chile's population lives on less than $1.00 per day compared to 9% in Brazil, 12% in Mexico, and 19% in Venezuela. The under-5 mortality rate for Chile is 12 per 1,000 compared to Argentina (22), Brazil (40), Mexico (36), and Venezuela (23). See: The World Bank. *2002 World Development Report*, pp. 234-35.

leaving open the possibility for bilateral and extra-regional trade agreements. As pointed out in one study, it differs from earlier, fundamentally unsuccessful, attempts at economic integration in Latin America by emphasizing trade opening rather than collective sub-regional protectionism.[10]

The "open regionalism" policy took shape in the early 1990s when Chile signed economic complementarity agreements (simplified free trade agreements) with Bolivia, Mexico, Venezuela, Colombia, and Ecuador under guidelines set out by the Latin American Integration Association (Asociacion Latinoamericana de Integracion – ALADI). Similar arrangements followed with Peru and Argentina. Chile has signed FTAs with Canada, Mexico, and Central America. In April and October 2002 respectively, Chile completed negotiations for an FTA with the European Union and South Korea. It is currently courting other countries including Japan, New Zealand, and Singapore, and closing in on an agreement with the European Free Trade Association (EFTA), see **appendix 3**. All are considered part of a strategy to open industrial economies further to Chilean exports. Chile joined Mercosur as an associate member in 1996, limiting its commitment largely because of Mercosur's higher common external tariff. Chile is also an active participant in the World Trade Organization (WTO), seeing it as the venue to settle controversial issues less suited to regional or bilateral discussions.

Trade data reflect Chile's open and independent trade policy. Its exports to the world expanded by 89% over the eight years 1993-2001 (see **figure 1**) and imports grew by 56%. Although Chile is not part of the Andean Community or a full partner of Mercosur, its fastest export growth has been intra-regional, a testament to Chile's trade strategy that combines unilateral reductions in tariff and nontariff barriers with an aggressive effort to enter into bilateral arrangements. From 1993 to 2001, Chilean exports expanded by 126% to Latin America, compared to 100% to the United States, 43% to Japan, 70% to the rest of Asia, and 71% to the European Union. Chile's trade with Canada points to another interesting trend. Although the dollar value of exports is very small, it grew by some 380%, an issue that was not lost on many U.S. business advocates of a U.S.-Chile FTA, who argued that the Chile-Canada FTA put U.S. firms at a competitive disadvantage until a similar or better agreement could be reached with the United States.

As seen in **figure 2**, Chile's direction of trade is diversified, which not only increases opportunities for trade, but also reduces dependence on a few markets and thereby softens exposure to foreign shocks (e.g. Argentina). Its largest export market is the European Union, which accounted for 26% of exports in 2001, followed by Latin America, with 23%. The United States is the largest single-country trading partner, capturing nearly 19% of Chilean exports in 2001, ahead of Japan with 12%. These figures reflect some relative change since 1993, as seen in the growth patterns in **figure 1**. There was a slight loss of Chilean export share to Japan and the European Union, and a slight increase to Latin America. There was also a large

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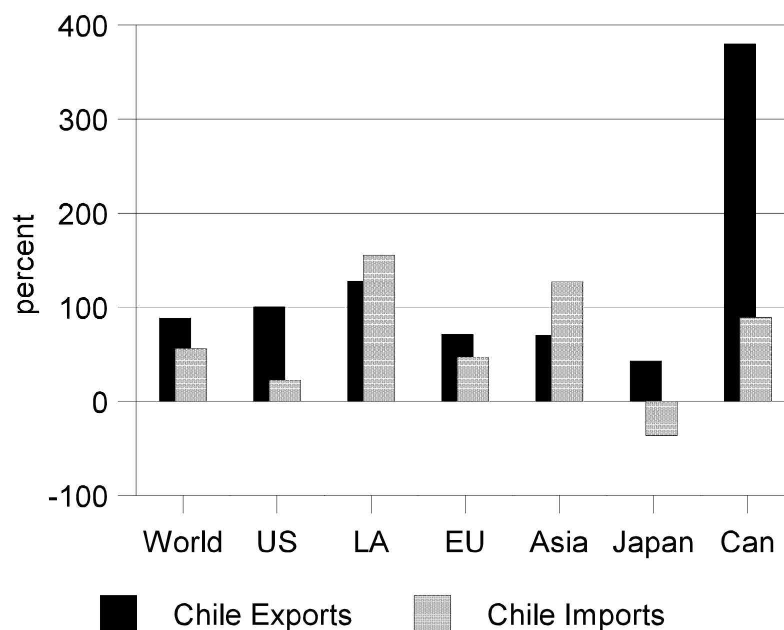
[10] Weintraub, Sidney. *Development and Democracy in the Southern Cone: Imperatives for U.S. Policy in South America*. Washington, D.C. Center for Strategic and International Studies, 2000. pp. 2-3.

increase (from 0.6% to 2.4%) in Chilean export share to Canada, although from a very small base.

Figure 1. Growth in Chilean Trade with Major Partners, 1993-2001



Source: CRS computed from IMF, *Direction of Trade Statistics*.

Latin America is Chile's largest importing area, accounting for 35% of imports, followed by the EU with 19%, the United States with 17%, and Asia with 13%. Japan and Canada follow at a distance with 3% and 2%, respectively. The EU trade presence in Chile declined over the past decade, as it did with other Latin American countries. The relative importance of the United States suggests that Chile has a strong incentive to pursue a bilateral FTA, other than a general preference for expanding its export base.

Chile's open regionalism and export driven trade policy have been challenged, however, for not focusing enough on diversifying the country away from minimally refined agriculture and mining products (copper, fish, grapes, and wood). Manufactured products account for less than 15% of total exports,[11] suggesting two potential problems. First, relying on traditional commodities can provide strong export earnings, but earnings are unpredictable given the volatile nature of commodity prices (see Chile's swings in its terms of trade in **table 1**).

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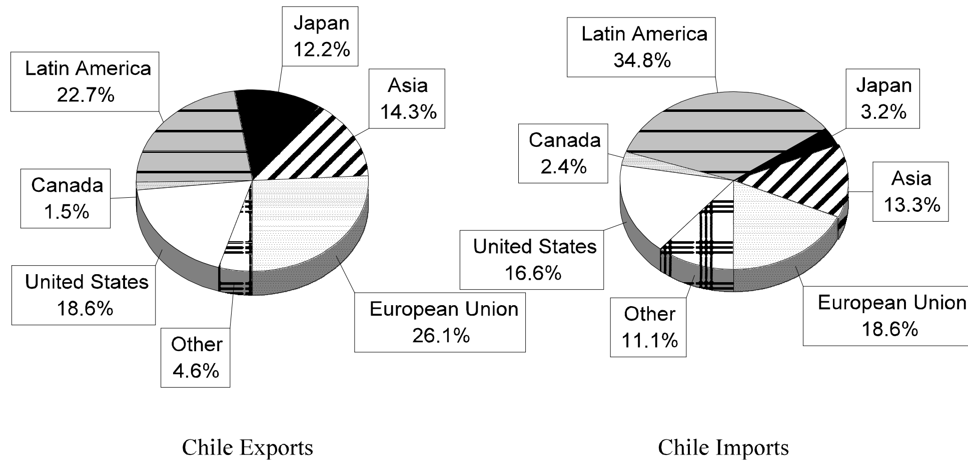
[11] Inter-American Development Bank (IDB). *Integration and Trade in the Americas: Periodic Note, December 2000*. Washington, D.C. p. 14. At the other end of the spectrum, manufactured goods account for 71% of Mexico's exports, reflecting the large amount of maquiladora trade with the United States.

Figure 2. Chile Direction of Trade, 2001



Data Source: Central Bank of Chile. *Economic and Financial Report*, January 2002. pp. 66 and 71.

Second, little movement toward a manufacture-based, value-added approach to export promotion can limit long-term economic growth, a point developed by an Inter-American Development Bank (IDB) study arguing that the relatively poor income growth performance of commodity exporting countries can be traced to this lack of export diversification. Although many Latin American countries have expanded their intra-regional trade, deepening integration with developed economies seems necessary to achieve greater export diversification. The large gains in export manufactures of Mexico and the Central American countries in the 1990s, for example, were related, in some measure, to preferential trade arrangements with the United States. Other Latin American countries had much slower growth of manufactured exports.[12] Whether Chile will adopt export diversification as part of its long-term development strategy is unclear, but Chile's efforts to develop trade relationships with developed economies, including the U.S.-Chile FTA, would seem to be an important component of such a goal.

On Chile's import side, most from developed countries are capital goods, highlighting the link between an open trade policy (lower tariffs on capital goods) and development (capital goods form the investment base for other production). Importantly, there is strong competition in the Chilean capital goods market from firms around the world. Given Chile's many trade negotiations underway, there was pressure exerted by U.S. firms to expedite the Chile-FTA. A closer look at the structure of U.S.-Chile trade suggests there is potential for mutual benefit from strengthening trade ties between the two countries.

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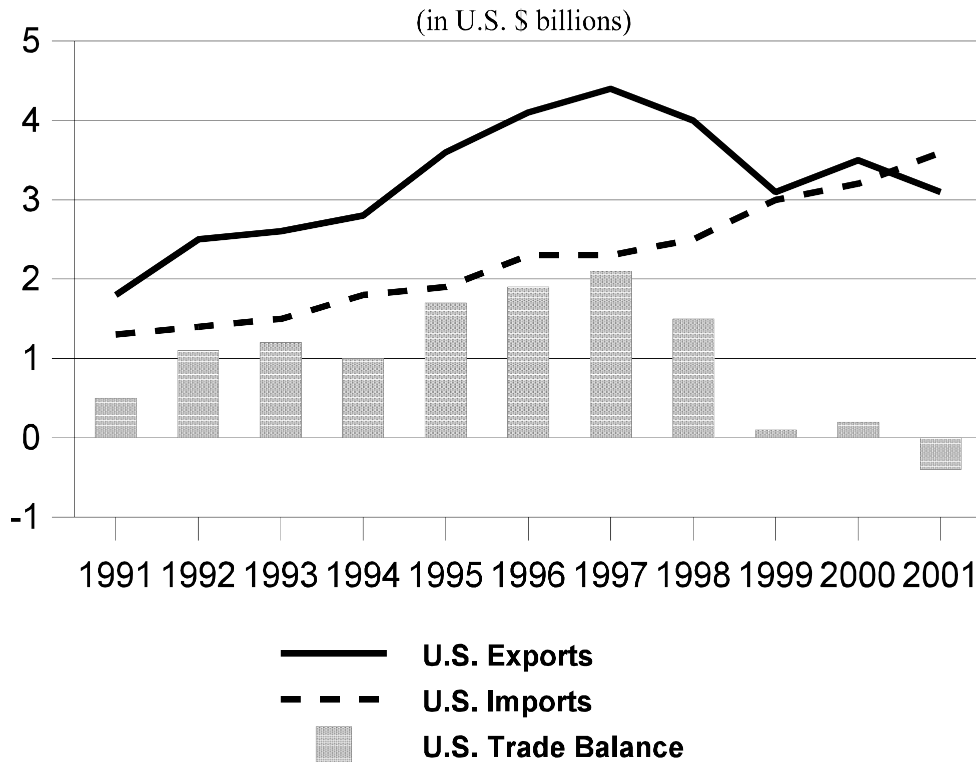
[12] Ibid., pp. 12-15.

The U.S.-Chile Bilateral Trade Relationship

The United States is Chile's largest single-country trading partner, accounting for 19% of Chilean exports and 17% of imports in 2001. By contrast, Chile is the United States' 32nd largest export destination and 37th largest import contributor, accounting for 0.4% of U.S. trade. Chile's relatively small share of U.S. trade has actually slipped slightly in recent years, but its increasing openness to U.S. trade is evident in the numbers. In 2001, Chile's per capita imports from the United States reached $203, up nearly 50% from a decade earlier and significantly higher than other major South American countries considered less liberalized in their trade policies such as Argentina ($108) and Brazil ($92).[13]

Figure 3. U.S.-Chile Merchandise Trade, 1991-2001

(in U.S. $ billions)



Data Source: U.S. Department of Commerce

Trends in U.S.-Chile merchandise trade are shown in **figure 3** (data appear in **appendix 1**). U.S. exports grew by 70% over the past decade, slightly below the 73% growth seen in U.S. exports to the world, and farther behind the 93% growth to Latin America as a whole, excluding Mexico. At a time when Chile continued to open its trade policies, the trend line reflects a noticeable decline from 1997 to 1999, coinciding with the precipitous fall in Chile's economic growth from 7.4% in both 1996 and 1997 to 3.4 % in 1998 and -1.1% in 1999 (see **table 1**.) As economic growth picked up again in 2000, rising to 5.4%, so too did the demand for U.S. goods, but economic and U.S. export trends faltered again in 2001, with the United States running a merchandise trade deficit with Chile for the first time since 1988.

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[13] See: CRS Report 98-840 E, *U.S.-Latin American Trade: Recent Trends*, by J. F. Hornbeck, p. 4.

U.S. imports from Chile have grown steadily since 1991, reflecting continuing U.S. interest in Chilean products and the extended expansion of the U.S. economy. U.S. imports grew by 173% from 1991 to 2001, a higher rate of import growth than from either Latin America, excluding Mexico (116%), or the world (134%). The United States maintained a trade surplus with Chile from 1989 until 2000; in 2001 the trade balance turned to a deficit equal to 6% of total trade between the two countries.

Major U.S. products exported to Chile are mostly capital goods (see **appendix 2**). These include: machinery (31%), particularly computers, office machinery, and industrial equipment such as gas turbines and bull dozers; electrical machinery (16%) including television and radio transmission apparatus, telephone equipment, spare parts, integrated circuits, sound recording equipment and media; vehicles (8%) mostly trucks and passenger cars; aircraft and parts (5%), and optical/medical instruments (5%). In recent years, the U.S. export trends have exhibited a slowing in transportation equipment such as airplanes and automobiles, and a significant increase in computer and electronic equipment.

The top five U.S. imports from Chile are natural resource based goods that reflect some refining of the basic resource, but little value-added manufacturing activity. They account for nearly 70% of total imports from Chile and include: copper articles (19%), mostly refined alloys; edible fruits and nuts (18%), most of which are grapes; fish (15%), mostly salmon; wood (13%), various types of lumber; and beverages (4%), virtually all wine. Recent trends have seen an increase in grape and fish imports, with a steady level or slight decline in demand for copper, wood, and wine products relative to other goods.

Review of Negotiations and Policy Issues

The U.S.-Chile FTA was completed on December 11, 2002, following two years and 14 rounds of negotiations. President Bush formally notified the 108th Congress on January 30, 2003 of his intention to sign the agreement, initiating a legally required 90-day congressional review period prior to consideration of implementing legislation, which is expected later in the year. The agreement as negotiated was comprehensive, covering areas such as market access, investment, agriculture, government procurement, intellectual property rights, subsidies/countervailing duties, antidumping, services, environment, and labor provisions. The breadth of interests negotiated made completing the agreement to the satisfaction of all parties difficult.

The overarching difficulty rests with reconciling the well-established benefits of freer trade, which tend to be enjoyed broadly throughout society, with the costs that fall more narrowly on import-competing sectors of the economy. Concerns of special interest groups also come into play. Crafting the language that can balance these interests falls to country negotiators. Negotiators at the office of the United States Trade Representative (USTR), with congressional guidance provided in TPA legislation, presumably allowed for a broadly acceptable balance to be struck. This section summarizes the major policy issues that had to be reconciled in the negotiating process, followed by a section summarizing the FTA's main features.

Tariffs and Market Access

For the United States, market access and particularly reducing tariff rates, was a central goal of the negotiations. For countries that have trade agreements with Chile, such as Canada, the uniform 6% tariff is being phased out on most goods, an advantage the United States wanted to eliminate. On the other side, the primary U.S. imports from Chile faced zero tariffs under normal trade relations or under the Generalized System of Preferences (GSP), a preferential trade arrangement made by developed countries for developing country imports (see **appendix 3** for U.S. tariff treatment of major Chilean exports). In fact, one of the benefits of the FTA for Chile would be that its exports would not have to rely on periodic congressional reauthorization of the GSP for reduced- or zero-tariff treatment.

The United States and Chile negotiated tariff reduction on a product-by-product basis to establish a schedule, as in the North American Free Trade Agreement (NAFTA), that would define the timetable to phase out tariffs on both sides. There were numerous sensitive products, many of them agricultural, that required longer periods of protection than others.

Nontariff Barriers and Sectoral Issues

In addition to tariff reductions, nontariff barriers (NTBs) presented negotiators with significant challenges. In the United States, low tariffs on most products have caused domestic industries to rely on trade remedy laws to fight import competition. Perhaps the most controversial issue was the application of U.S. antidumping statutes (investigations to determine if goods are being sold at less than fair value), which Chile expressed a particular desire to address in the bilateral FTA. This was not a new issue and was tackled in the Canada-Chile FTA, which provides for the "reciprocal exemption from the application of anti-dumping laws," except under "exceptional circumstances."[14] The thrust of that agreement appears not to force the elimination of antidumping remedies, but to make their use a last rather than first recourse, under WTO guidelines.

Chile maintained that its sensitivity to U.S. antidumping investigations was based on their "frequent and at times unjustified use,"[15] and argued that just the filing of dumping charges initiated a process with significant unrecoverable costs regardless of the investigation's outcome. In recent years, antidumping duty investigations were concluded on Chilean salmon (July 1998), mushrooms (November 1998), grapes (June 2001), and raspberries (July 2001). The International Trade Commission ruled, although not always unanimously, that there was reasonable indication that material injury was caused to U.S. producers in the cases of salmon, mushrooms, and raspberries, but not for grapes.[16]

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[14] *Government of Canada, Canada-Chile* Free Trade Agreement, February 1997. Antidumping was also addressed in the Chile-Mexico FTA.

[15] On Chile's trade agreements, see: [http://www.direcon.cl/acuerdos/index.htm]

[16] ITC antidumping rulings may be viewed at: [http://www.usitc.gov/7ops/7opsindex.htm]

Chile is only one of many countries that criticize the U.S. trade remedy process as being overly cumbersome and protectionist. There is even disagreement within the United States, with some arguing that these laws, or at least their application, should be put on the negotiating table, but there continues to be broad support in Congress for these statutes.[17] The United States indicated that trade remedy laws would not be negotiated unless otherwise directed by Congress and the Bush Administration, and extended an offer to Chile to make the process more transparent. Chile responded with concrete proposals to make this suggestion operational.[18]

The United States also had NTB concerns. Chile's price band system used to maintain domestic agricultural prices amounts to duties being placed on imports above the unified ad valorem tariffs. The USTR argues that even as the unified tariff rates fall, these additional duties can serve to maintain high effective tariff rates. In the meantime, the Chilean price band system was being challenged by Argentina in the WTO. The United States also expressed concern over Chile's sanitary and phytosanitary regulations that restrict imports of U.S. agricultural and meat products. Although some movement had been made in favor of certain U.S. agricultural goods such as citrus, grapes, and apples, others were still restricted. U.S. poultry and red meats still faced obstacles, including Chile's refusal to accept U.S. inspection and grading systems.[19]

IPR and Investment

Among the other issues of special interest to the United States were intellectual property rights (IPR) and investment provisions. Chile has signed the Trade Related Intellectual Property Rights (TRIPS) agreement, but its congress has not passed the required implementing legislation. Until this happens, Chilean intellectual property laws will not be fully consistent with WTO guidelines. Foreign investment and capital control laws have been relaxed in recent years, but some restrictions remain. Also, there are still some inconsistencies between Chilean law and WTO rules on Trade-Related Investment Measures (TRIMs). Given the potential for United States investment to grow in Chile, these provisions were important to U.S. interests.

Labor and Environment

Labor and environment provisions have become accepted as legitimate, but nonetheless, difficult issues to resolve in trade agreements. At the heart of the matter is whether a difference in environmental and labor standards between developed and developing countries creates economic and social issues that should be addressed in

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[17] See: Eiras, Ana I. and Felipe Ward. *Time to Advance Free Trade with Chile*. The Heritage Foundation, July 18, 2001. Also, 61 Senators sent a letter to President Bush expressing opposition to any agreement that would weaken U.S. trade remedy laws and there are similar sentiments in the House.

[18] Conversations with office of the USTR, August 17, 2001 and Embassy of Chile, May 9, 2002.

[19] Office of the United States Trade Representative. *2002 National Trade Estimate Report on Foreign Trade Barriers*. pp. 38-39.

trade agreements. This has led to a strong divergence of opinion, both among groups within the United States, and between developed and developing countries.

Advocates of including labor and environment provisions in trade agreements argue that developing countries enjoy an "unfair" competitive advantage because their lower standards translate into lower costs, which in turn are reflected in lower prices for goods that compete with those produced in developed countries.[20] Over time, the argument goes, the difference in standards leads to investment and jobs moving abroad to take advantage of the lower production costs. On the other hand, most studies show that these costs are usually not high enough to determine business location, where productivity remains the primary factor.[21] There are also social concerns to the labor and environmental issue that relate directly to the human impact of diminished health and living conditions caused by pollution, poverty, and unsafe working conditions. Given countries' different levels of development and therefore capacities to address these issues, there is considerable disagreement over how far a trade agreement should go in engaging these domestic policy issues.

Both labor and environmental groups believe that trade agreements can play a role in addressing their respective concerns. While often linked in general discussion, they have two separate and distinct sets of issues and goals. Labor groups advocate: ensuring that all workers can exercise freely their fundamental rights at work; requiring governments to respect and promote core International Labor Organization (ILO) standards; and using the same dispute resolution and enforcement provisions that apply to other provisions in a trade agreement.[22]

For environmental advocates, major goals include protecting and assuring strong enforcement of existing domestic environmental standards, ensuring that multilateral environmental agreements are not undermined by trade rules, promoting strong environmental initiatives to evaluate and raise environmental performance, developing a systematic program of capacity-building assistance, and assuring that environmental provisions in trade agreements are subject to the same dispute resolution and enforcement mechanisms as are other aspects of the agreements.[23]

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[20] The difference is that the social costs associated with environmental degradation, pollution, poor working conditions, and low wages are not captured in the production process. Through legal and regulatory measures, developed countries require that businesses bear many of these costs, which are then reflected in the final (relatively higher) price of the good or service in the market place.

[21] See: CRS Report 98-742 E, *Trade with Developing Countries: Effects on U.S. Workers*, by J. F. Hornbeck. September 2, 1998, pp 11-13. Productivity and wage levels are, however, highly correlated. See: Rodrik, Dani. Sense and Nonsense in the Globalization Debate. *Foreign Policy*. Summer 1997, Number 107. pp. 30-33.

[22] See: [http://www.aflcio.org], *Off the Fast Track–On the Right Track*.

[23] See: [http://www.sierraclub.org/trade/fastrack/letter.asp], *Principles for Environmentally Responsible Trade.* An important issue for the United States is ensuring that its higher environmental standards defined in law and regulation not be compromised by protectionist challenges. See: CRS Report RS20904, *International Investor Protection: "Indirect Expropriation" Claims Under NAFTA Chapter 11*, by Robert Meltz. May 3, 2001.

Developing countries, including Chile, have expressed two basic concerns regarding the inclusion of environmental and labor provisions in trade agreements: 1) that their sovereignty may be undermined if such agreements endorse higher standards; and 2) that such provisions may be used to justify disguised protectionism. Free trade advocates in the United States and other developed countries have expressed similar sentiments in opposition to placing environmental and labor provisions in trade agreements.

So far, however, the inclusion of labor and environment provisions has been rather nonspecific. NAFTA's side agreements set a precedent in both labor and environment provisions that all parties: 1) not relax standards to attract investment or reduce costs of exports; 2) strive to improve standards over time, and; 3) enforce effectively their laws and regulations. Specific standards were left to each country to set, although the labor side agreement requires that each country "promote"12 basic labor principles: five internationally recognized workers rights that encompass ILO core labor standards and seven others. Dispute resolution rests on an intergovernmental consultation process and relies on the imposition of a "monetary enforcement assessment" to compel compliance. In the case of the labor agreement, three provisions may be enforced by trade sanctions.[24] As of mid-2001, enforcement questions on labor and environmental provisions have been filed, but none have reached the point of a formal dispute settlement panel.[25]

The U.S.-Jordan bilateral FTA, agreed to on October 24, 2000 and signed into law by President Bush on September 28, 2001, took labor and environmental provisions a step farther. It includes most key features of the NAFTA side agreements, but moved the provisions to the main body of the text, thereby placing these provisions under the dispute resolution process of the entire agreement. Significantly, this includes language stating that an affected party may take "any appropriate and commensurate measure," including trade sanctions if the dispute remains unresolved.[26]

Chile recognized the importance of labor and environment provisions when it included them in the 1996 FTA with Canada, but kept them equally general in NAFTA-like side agreements. The labor provisions included an agreement to: abide by ILO "core" standards; enforce effectively and transparently domestic labor laws; establish mechanisms for consultation and information sharing to resolve problems; and use of a "monetary assessment" as a final dispute resolution tool. The environmental provisions called for parties to: set their own levels of environmental protection; enforce effectively and transparently their environmental laws; work cooperatively to protect and enhance the environment; promote sustainable

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[24] See: CRS Report 97-861 E, *NAFTA Labor Side Agreement: Lessons for the Workers Rights and Fast-Track Debate*, by Mary Jane Bolle. Updated January 19, 2001. pp. 3-7.

[25] United States Government Accounting Office. *North American Free Trade Agreement: U.S. experience with Environment, Labor, and Investment Dispute Settlement Cases*. Report No. GAO-01-933. July 2001, p. 4.

[26] See: CRS Report RS20968. *Jordan-U.S. Free Trade Agreement: Labor Issues*, by Mary Jane Bolle. pp. 2-3 and CRS Report RS20999. *U.S.-Jordan Free Trade Agreement: Analysis of Environmental Provisions*, by Mary Tiemann. pp. 2-3.

development; and create the institutions for enforcement and dispute resolution, including provisions to make a monetary assessment.[27] The labor and environment provisions differ from the Jordan model by their placement in a side agreement and their reliance on less stringent dispute resolution options, emphasizing monetary assessments over trade sanctions.

It was unclear whether the Chile-Canada, U.S.-Jordan, or some new or hybrid model would work for the U.S.-Chile FTA. U.S. negotiators looked to congressional action on TPA legislation for guidance and the core debate focused on dispute resolution and enforcement mechanisms, particularly the use of trade sanctions in cases of noncompliance. Chile was on record, however, as flatly rejecting inclusion of any language that allows for the use of trade sanctions.[28]

Postscript: A Summary of the U.S.-Chile FTA

As the United States and Chile put the finishing touches on the text of the recently completed FTA, public support for the agreement appears to be growing. If the agreement is implemented, Chile would join a select group of only four other countries that have an FTA with the United States (Canada, Mexico, Jordan, and Israel). The United States is Chile's largest single-country trading partner, accounting for 18% of total Chilean merchandise trade. By contrast, Chile represents less than one half of 1% of U.S. trade. Despite this disparity, the United States has shown an equal enthusiasm for this agreement for many reasons, not the least of which is the possibility for growth in those industries that trade with Chile, even if such trade represents only a small portion of U.S. commerce.

Considerations other than trade growth, however, point to the importance many attach to implementing the U.S.-Chile FTA. First, it would be the only such agreement with a South American country. Second, it would be an agreement with one of the most open and reformed economies in Latin America, a distinction that makes Chile an interesting case study for investigating the relationship between development and trade policy. Third, it would be an example of how trade policy issues, including those with both social as well as economic implications, can be resolved between a small developing country and a large developed one, which often have different priorities. Fourth, it may prove to be a strategic step toward completing the Free Trade Area of the Americas.

As a comprehensive agreement, the FTA dealt with a variety of complex issues, but increased market access would be the primary benefit for both countries.[29] Duty free access was negotiated for all goods traded between the two countries. Fully 85%

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[27] Government of Canada. *Canada-Chile Free Trade Agreement. Article by Article Chapter Summaries*. February 1997.

[28] Discussions with Roberto Matus, Economic Counselor, Embassy of Chile, August 1, 2001 and office of the USTR, August 17, 2001.

[29] The FTA text has not been finalized or released to the public. USTR summaries may be found at its web site: http://www.ustr.gov.

of bilateral trade in consumer and industrial products would become duty-free immediately, with others receiving reduced tariff treatment over time. Some 75% of U.S. farm exports would enter Chile duty-free within four years and duties on all goods would be fully phased out within 12 years after implementation of the agreement. Exports subsidies on agricultural products would be eliminated, but the United States would be able to respond in-kind if it is damaged by third party export subsidies. There is also a safeguards provision to address possible surges in agricultural imports from Chile.[30] For Chile, 95% of its export products would gain immediate duty-free status and only 1.2% would fall into the longest 12-year phase-out period. If implemented, other important market access gains would include phasing out the luxury tax on U.S. automobiles over four years, less restrictive treatment of textile and apparel products that meet rules of origin criteria (made with U.S. and Chilean components), and reduction over time of Chilean price bands, a provision not included in either of the FTAs Chile negotiated with Canada and the European Union.

Other strides of particular importance to the United States include consolidating and stabilizing rules governing openness of services trade, telecommunications, intellectual property rights (IPR), e-commerce trade, and investment. These areas were of much greater interest to the United States than Chile and reflect gains for highly competitive U.S. industries. There would be few exceptions to the new services rules, benefitting firms working in financial, telecommunications, computer, and professional services. Chile's approach to IPR would also be adjusted to accommodate U.S. concerns over software, music, text, and videos. A new e-commerce chapter addresses the growing trade in digital products. In an unanticipated outcome, no chapter on trade remedies was included, hence there would be no expected change to the antidumping and countervailing duty options currently available to both countries.

Chile would retain the right to use capital controls under limited circumstances, but rules governing free transfers of investment funds would be clarified and strengthened to allow for freer flow of capital between the two countries, a major concern of the United States and one of the last policy areas to be resolved. Dispute settlement over investment would also be more transparent and available as part of the overall dispute settlement provisions, although investor recourse would differ between portfolio and foreign direct investment. Chile also would gain a concession from the United States that eases restrictions on professional and business visas. Language was agreed to covering environment and labor provisions that emphasizes enforcement of local laws and regulations.

A key difficulty was defining dispute resolution language. Although the text has not been released, reportedly, all provisions of the FTA, including environment and labor, would be subject to a single dispute resolution process. The procedure would emphasize resolving disputes cooperatively, through a panel process if needed. In commercial cases where nonconformity to the FTA is found, the agreement would rely on standard remedies that culminate in the suspension of tariff benefits (return

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[30] CRS Agriculture Policy and Farm Bill electronic briefing book, *Agriculture in the U.S.-Chile Free Trade Agreement*, http://www.congress.gov/brbk/html/ebagr53.html.

to MFN treatment) if the issue cannot be resolved. For environment and labor disputes, unresolved problems may result in monetary assessments or fines, and the proceeds would be placed in a fund to be used to remedy the problem that generated the complaint. Nonpayment of any such fine could lead to other undefined measures. Although sanctions were not ruled out, there is little anticipation of a future problem that would result in such a response.

To summarize, the agreement so far has received broad public support, in part because it was able to address the key concerns of both countries, yet make improvements that advocates of freer trade find compelling. As the details emerge, this agreement will be an important document to understand in its own right and because of its potential to influence other negotiations planned or in progress.

Appendix 1. US-Chile Merchandise Trade, 1985-2001

(in US $ millions)

Year	U.S. Exports	U.S. Imports	Trade Balance	Trade Turnover	% Growth in U.S. Exports	% Growth in U.S. Imports
1985	682	745	-63	1,427	------	------
1986	823	820	3	1,643	20.7%	10.1%
1987	796	981	-185	1,777	-3.3%	19.6%
1988	1,066	1,181	-115	2,247	33.9%	20.4%
1989	1,414	1,292	122	2,706	32.6%	9.4%
1990	1,664	1,313	351	2,977	17.7%	1.6%
1991	1,839	1,302	537	3,141	10.5%	-0.8%
1992	2,466	1,388	1,078	3,854	34.1%	6.6%
1993	2,599	1,462	1,137	4,061	5.4%	5.3%
1994	2,774	1,821	953	4,595	6.7%	24.6%
1995	3,615	1,931	1,684	5,546	30.3%	6.0%
1996	4,132	2,256	1,876	6,388	14.3%	16.8%
1997	4,368	2,293	2,075	6,661	5.7%	1.6%
1998	3,979	2,453	1,526	6,432	-8.9%	7.0%
1999	3,078	2,953	125	6,031	-22.6%	20.4%
2000	3,455	3,228	227	6,683	12.2%	9.3%
2001	3,131	3,555	-424	6,686	-9.4%	10.1%

Data Source: U.S. Department of Commerce.

Appendix 2. Major U.S.-Chile Product Trade and Tariff Rates, 2001

(% of total dollar value)

Major U.S. Exports	% of Total	Tariff Rate	Major U.S. Imports*	% of Total	NTR Tariff Rate**	Free under GSP#
Machinery: - Computers, - Office mach. parts - bulldozers - other	31% (7%) (7%) (3%) (14%)	7%	Edible Fruit and Nuts: - grapes (0806) - fruit (0809)	18% (11%) (3%)	$1.13-1.80/m^3$ $.002-.005/kg	yes yes
Electrical machinery	15%	7%	Copper: - refined (7403) - unref. (7402)	21% (18%) (3%)	1% free	yes
Vehicles (new)	7%	7%	Fish (mostly salmon): - fillet (0304) - fresh (0302) - frozen (0303)	13% (11%) (1%) (1%)	free free free	
Aircraft	6%	7%	Wood (lumber) - (4407, 4409, 4411)	13%	free	
Medical instruments	5%	7%	Beverages: - wine (2204)	4% (4%)	$.063/lit.	yes
Plastic	5%	7%	Organic Chemicals: - methanol(2905)	4% (4%)	8%	yes
Organic chemicals	2%	7%	Oil: - not crude(2710)	3%	$.525/bbl	yes
Other	29%	7%	Other	24%		
Total	100%		Total	100%		

Data Source: U.S. Department of Commerce.
*By HTS number = Harmonized Tariff Schedule of the United States. Note, HTS numbers are not provided on U.S. exports, which are subject to Chile's 7% nominal uniform import tariff rate. This rate will fall to 6% on January 1, 2003, where it is scheduled to remain under current law.
**NTR is the general or normal tariff rates (also known as most favored nation rates) applied to products not given preferential tariff treatment. It is provided to show the tariffs that would be imposed if products were not given preferential treatment under GSP (see below).
#GSP = Generalized System of Preferences or preferential tariff treatment given to select developing country imports by developed countries.

Appendix 3. Chile's Multilateral, Regional, and Bilateral Trade Agreements

Agreement	Date Effective	Type
WTO (GATT)	January 1995	multilateral free trade agreement (FTA)
APEC	November 1994	regional association
Mercosur	October 1, 1996 (associate member)	regional customs union
FTAA	negotiating (January 1, 2005 deadline)	regional FTA
LAIA	January 1980	regional association
• Bolvia	July 1, 1993	economic complementarity agreement#, FTA to be negotiated
• Venezuela	July 1, 1993	economic complementarity agreement
• Colombia	January 1, 1994	economic complementarity agreement
• Ecuador	January 1, 1995	economic complementarity agreement
• Peru	July 1, 1998	economic complementarity agreement
• Argentina	signed May 19, 2000	economic complementarity agreement
Canada	July 5, 1997	bilateral FTA
Mexico	1998	bilateral FTA
Central America*	signed October 18, 1999	FTA framework agreement
European Union	negotiations concluded April 2002	FTA
European Free Trade Association	under negotiation	FTA
Japan	pre-negotiation impact studies completed	bilateral FTA
Singapore	under discussion	bilateral FTA
New Zealand	under discussion	bilateral FTA
South Korea	negotiations concluded October 24, 2002.	bilateral FTA
United States	negotiations concluded December 11,2002	bilateral FTA

limited trade agreement negotiated under guidelines see forth by the Latin American Integration Association (LAIA), known in Spanish as the Asociacion Latinoamericana de Integracion (ALADI).
* Guatemala, Honduras, Nicaragua, El Salvador, and Costa Rica (ratified January 2002).
Data source: Organization of American States. Foreign Trade Information System. This may be found at: [http://www.sice.oas.org] and Embassy of Chile.