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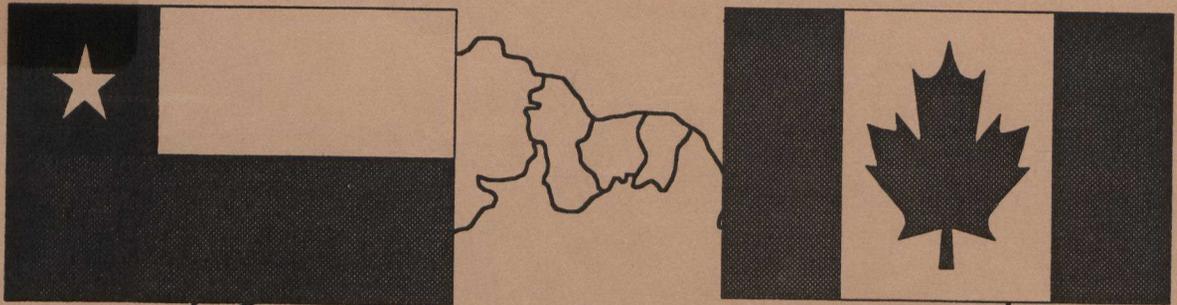
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# Chile-NAFTA Preparedness Study



Commissioned by the Canadian Embassy  
in Santiago, Chile  
Department of Foreign Affairs and International Trade

prepared by  
Fernán Ibáñez  
and  
Felipe Larraín

September 1994

*The opinions expressed in this study are those of the authors and do not necessarily represent the view of the Government of Canada.*





UNCLASSIFIED

January 18, 1995

CHILE'S READINESS FOR NAFTA ACCESSION

BUSINESS OPPORTUNITIES FOR CANADA

On December 11, 1994, the Heads of Government of Canada, the United States, Mexico and Chile announced their decision to begin the process by which Chile will accede to the North American Free Trade Agreement (NAFTA).

To this end, officials from the NAFTA partners have been directed to undertake the preparations necessary to begin negotiations, including focusing on relevant technical procedures and institutional issues.

The decision announced in the "Four Leaders' Statement on Chile" was the culmination of Canada's efforts during 1994 to ensure that the NAFTA becomes the principal tool for trade and investment liberalization in this hemisphere, and possibly beyond.

One of the elements in Canada's initial preparations for the accession of Chile to NAFTA was the attached study, commissioned by the Canadian Embassy in Santiago, Chile and the Department of Foreign Affairs and International Trade. It was prepared by two leading Chilean economists and consultants, Fernan Ibañez and Felipe Larraín. The opinions expressed in this study are those of the authors, and do not necessarily represent the views of the Government of Canada. The study, however, does provide a useful overview of many of the issues that will likely be addressed during the negotiations.

It is our hope that this preliminary work, examining the Chilean trade and investment regime and identifying possible business opportunities for the Canadian private sector, will be a helpful starting point for your own analytical work, as Canada and its NAFTA partners work through the preparatory discussions and accession negotiations with Chile.

Yours sincerely,

Keith Christie  
Lead Negotiator  
NAFTA Accessions

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*Report prepared for the Canadian Embassy in Chile. The views expressed in this report are those of the authors and do not necessarily represent the views of the Government of Canada.*

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## EXECUTIVE SUMMARY

### **Overview**

Existing trade legislation as well as business practices in Chile are open and well established. Trade in goods and services, as well as investment, is based on non-discriminatory principles. This openness would greatly facilitate the negotiation of a trade agreement. In addition to its economic openness, Chile has a long tradition and a proven track record of active participation in international agreements. It was a founding member of GATT and a signatory of most of the international treaties mentioned in NAFTA.

Assuming an accession to NAFTA on the basis of the existing Agreement (with any exceptions to be included in the annexes), Chile would have to introduce only a limited number of both legal and procedural changes to fully comply with NAFTA provisions.

The main anticipated legal changes include: extension of the coverage period of patents, elimination of the one-year restriction for repatriation of foreign capital, inclusion of the binational panels instance in the trade remedy legislation, establishment of new domestic legislation to cover the issue of emergency actions, improvement of legal procedures regarding trade remedy actions, and harmonization of legal and institutional procedures for enforcement of environmental standards.

The main anticipated procedural and institutional changes include: price bands in the agricultural sector, further opening in the financial sector, possible standardization of procurement procedures in state-owned enterprises, change of certification procedures in customs, reinforcement of conformity-assessment bodies for trade-related standards, stricter enforcement of labour legislation, and development of compatible criteria for certification of professional standards.

In addition to the above, and as was the case with NAFTA, it is expected that a substantial part of the negotiating time will be spent, by each party, in drawing up lists of reservations and exceptions related to each chapter and discussing enforcement procedures.

One of Chile's principal strengths as a candidate for accession is that its economy is sufficiently open that it is unlikely that it will seek many reservations. An additional strength is that, because it is a unitary country, there will be no provincial or local reservations.

## 1. Background

For more than a decade, Chile has had an increasingly open economy with low, uniform tariffs, practically no non-tariff barriers, non-discriminatory treatment of foreign investors, stable rules, and only very few sectoral restrictions on the participation of the foreign or domestic private sector. In such a context, the possible accession of Chile to NAFTA, and/or to bilateral free-trade agreements, is seen by representatives of the Chilean public and private sectors as a logical next step. Some of the most commonly mentioned arguments in favour of such a move are the possible contribution of NAFTA towards enhanced international free-trade, the expected increase in business with the other NAFTA members, a signal to the rest of Latin America about the validity of the free-market economic model, and the powerful incentive it may provide in the pursuit of additional national and intra-regional discipline in dealing with trade related topics such as protection of the environment, anti-dumping legislation, government procurement, and others.

## 2. Trade in Goods

Chile's present trade regime already fulfils most of the NAFTA provisions regarding trade rules. Chile has a uniform tariff barrier of 11%, practically no non-tariff barriers and extends the most favoured nation treatment (MFN) as well as national treatment principles to all imports. Minor exceptions to the general rule are a few agricultural products subject to a "price band" and a system of simplified drawback for non-traditional exports. Both cases would probably be part of the negotiations.

Rules of Origin currently used in Chile are those of the ALADI (Asociacion Latinoamericana de Integracion) system, which are different from those defined in NAFTA. Nevertheless, it is anticipated that the impact of a possible change of system on the present basket of exports of Chile, essentially natural resource-based, would not be significant. The main challenge will be that of implementing the new system within a reasonable time period.

Customs Procedures in Chile differ from those in NAFTA in that they follow the ALADI tradition of having certified public or private agencies issue certificates of origin. In contrast, NAFTA procedures rely on certificates issued by the exporters themselves.

Recently, however, Chile has been moving in the direction of the latter scheme and should not have significant problems in adopting NAFTA procedures.

The main issue concerning emergency actions is that Chilean legislation does not allow the Government to depart from its uniform tariff regime. Accordingly, Chile would have to develop special national procedures and legislation to cover the requirements of emergency actions under trade agreements. It may not be easy for the Government to introduce exceptions in a successful trade policy based on non-discrimination among sectors.

The Standards chapter in NAFTA provides clear rules aimed at reducing the scope for using standards as disguised barriers to trade. Two guiding principles in that chapter are that standards must be non-discriminatory and that parties should seek to ensure that provincial, state and local governments comply with the provisions of the chapter. Chile fully complies with both principles: with the first, because the principle of non-discrimination is a principle specifically spelled out in the Constitution and applied to all economic activities; the second, because Chile is a unitary country and, therefore, all of its standards apply nation-wide. Chile may need, however, additional reinforcement of the institutional structure related to conformity assessment bodies.

### **3. Government procurement**

Chilean government procurement procedures are essentially transparent and non-discriminatory. In practice, there is no explicit reserve for local producers and no, or very little, preferential treatment is given to local bidders. Most provisions in Chapter 10 of NAFTA are therefore fulfilled at least in substance. Thresholds for open bidding are lower than those in NAFTA and there is plenty of available information.

The central government has uniform regulations for procurement, with strict scrutiny on non-discriminatory procedures and on transparency, both of which are ensured by the Government Comptroller's Office. Chile does not have separate legislation for provincial governments or municipalities.

State-owned enterprises, in turn, enjoy a large degree of autonomy and have no special requirements on reserves or on preferential treatment for local suppliers. Nevertheless, while their procedures are transparent, they lack uniformity and, in some cases, do not fully comply with the kind of formalities established in Chapter 10 of NAFTA.

Negotiations in these matters may centre around maintaining agile but non-discriminatory procedures and about the levels of thresholds.

#### **4. Investment**

The present Chilean legislation on foreign investment is essentially in agreement with NAFTA's Chapter 11 provisions. Topics such as national treatment (i.e., non-discrimination), most-favoured-nation treatment, right for capital and profits repatriation, expropriation and fair compensation procedures, and settlement of disputes between foreign investors and government are already well established principles in Chile's Constitution and in its Foreign Investment Statute. In addition, they have been included in more than a dozen bilateral investment treaties signed by Chile in recent years.

It is not expected, therefore, that difficult points would appear in the negotiations of this Chapter. The few existing exceptions to national treatment (e.g., fishing vessels) and to sectoral freedom (e.g., oil exploration) are rather minor when compared to the list of exceptions which Canada, Mexico and the United States included in the annexes to Chapter 11 of NAFTA. They are not expected, therefore, to become major negotiating obstacles. A point to negotiate, on the other hand, may be the existing one-year minimum permanence period for foreign capital.

In any event, even without NAFTA, Canada's investment in Chile has been very significant in recent years (The largest in terms of commitments by country for 1990 and 1992). Significant investment opportunities are still awaiting for Canadian investors, particularly in the mining sector.

#### **5. Trade in Services and Temporary Entry**

Of the different types of services whose trade is regulated by chapter 12 of NAFTA probably the most significant in the relationship between Chile and Canada is the exchange of professional services and, in particular, those of technical and engineering consulting. NAFTA's

essential requirements in this matter are that member countries extend national treatment to foreign service providers and that they do not require such providers to establish "local presence". Chilean regulations are quite open and essentially fulfil these requirements. Provision of individual professional services follows the non-discrimination principle. In the case of firms, it is only for the provision of services to government offices, that a formal local "identity" is required in order to ensure legal responsibility in the country.

Recent positive experiences with exports of Chilean engineering and with joint ventures between Chilean and foreign engineering firms have opened significant business opportunities for Canadian professionals consultants in Chile.

Temporary Entry for business visitors to Chile is in practice simple and expedite. At present no visas are required for temporary entry of visitors from most countries in the world, including the three NAFTA member countries. Access for intra-company transfers, as well as temporary residence for investors and business people, are also easily obtainable and have presented no problem to a significant number of foreign companies which have established offices in Chile.

## **6. Intellectual property**

Most NAFTA provisions in Chapter 17 appear to be well satisfied by existing Chilean legislation related to copyrights and industrial property, including trademarks, patents, industrial designs, and industrial models. Chile is already a signatory to most of the Conventions on these matters mentioned in NAFTA.

Formal procedures for application and registration of patents and trademarks are fair, transparent and simple. Settlement of disputes over registration of patents and trademarks have well established procedures with different instances for appeal.

Enforcement of existing laws is guaranteed, at least in paper, through appropriate powers in the administrative branch and in the judicial authorities. Nevertheless, the industrial property law is still rather new and its track record of application is not yet conclusive.

A few specific topics may be subject to negotiations, as follows: a) there are differences concerning the term of protection of patents (15 years in Chile, 17 years under NAFTA); b) pharmaceutical patents are not retroactive under the existing Chilean law; c) the concepts of trade secrets and layout designs of semiconductor integrated circuits may need to be specifically incorporated in the Chilean legislation.

Some of the above issues may have already been superseded in as much as Chile's adherence to the recently completed GATT Uruguay Round will require changes in the Chilean intellectual property legislation, which are coincident with NAFTA.

## **7. Dispute settlement mechanisms**

Chile's position with respect to dispute settlement procedures, and in particular, to those in anti-dumping and countervailing duties, tends to resemble that of Canada. In fact, as both countries are middle-size economies dealing in world markets dominated by larger players, both have traditionally supported more transparent and clearly enforceable trade rules in international forums, most recently during the Uruguay Round. Both Chile and Canada are also active members of the Cairns Group which promotes more liberal agriculture trade. NAFTA regulations, included in Chapter 19, do not appear to differ much from the equivalent Chilean legislation, with the sole exception of binational panels for which there is no precedent in the Chilean legislation.

Although Chilean trade remedy procedures are transparent and well established, a closer examination reveals some differences with NAFTA that may require some changes of legislation. Amendments should include additional transparency and additional opportunities for hearings of interested parties. They should also add concrete opportunities for judicial reviews. In fact, the schedule of Chile in a possible annex to chapter 19 would essentially replicate many of the amendments to domestic legislation that the other NAFTA signatories included in Annex 1904.15.

Some of the amendments will address the issue of binational panels, an essential element of NAFTA, which builds on the successful experience of the FTA between Canada and the U.S.A.. Binational panels are established in order to review anti-dumping or countervailing duty determinations made by the administering agencies in the member countries.

Chapter 20, which concerns the institutional structure of NAFTA, should present even fewer difficulties than Chapter 19. Moreover, because the present Chilean political and economic direction was significantly ratified in the recent presidential and congressional election, major opposition to the idea of the settlement of disputes through working groups or through the appeal to Arbitral Panels would be quite unlikely.

The main doubts about this chapter, voiced privately by government officials, relate to the convenience or inconvenience for a small country like Chile of incurring the human and economic costs of a rather "heavy" institutional structure in NAFTA. Nonetheless, the advantages of a binding and impartial dispute settlement mechanism, such as that which exists in NAFTA, may not have yet been fully appreciated in Chile.

## **8. Environmental Standards**

The existing Chilean environmental legislation contains numerous standards disseminated in several laws and regulations. They do not, however, follow a consistent pattern or logic, as they were devised as emergency solutions to isolated cases. Most of these standards follow international criteria, but they cannot be added up or structured under one single body. Moreover, if they were all enforced at the same time, they would completely disrupt some sectors of economic activity.

In response to the above, the executive branch recently obtained Congressional approval for a new body of legislation, which sets the basis for an integral and well-structured approach to environmental protection. The proposed legislation, which follows a more up-to-date approach to environmental matters, meets the basic NAFTA principles and guidelines on environment.

The main points to negotiate will be the past and present institutional and legal capacity for enforcement of environmental standards. In this respect, a point of discussion may be the legal prerogatives and the budgetary support that the regulatory bodies (CONAMA and COREMAs) will have.

## **9. Labour Standards**

Present Chilean labour legislation complies with the principles and guidelines established by the North American Agreement on Labour Cooperation (Labour supplementary accord).

The standards in the agreement are not substantially different from those existing in Chile. Enforcement may still benefit from additional strengthening (e.g., appointment of more inspectors, increased on-site monitoring), but no difficulties can be anticipated in the negotiation of either a bilateral labour agreement with Canada or an accession under the existing NAFTA agreements.

Chilean labour legislation complies with ILO guidelines, with the sole exceptions of the right to unionize which is restricted for the armed forces and individuals working in the defence institutions and the right to collective bargaining which is restricted for temporary workers. Both discrepancies are allowed as exceptions by the ILO.

## **Part II: SECTORAL ANALYSIS - BUSINESS OPPORTUNITIES**

### **10. Agriculture and Agro-industry**

Chile's agricultural sector is very heterogeneous. Traditional and low-profitability crops (such as wheat, maize and sugarbeets) coexist with modern, competitive, and export-oriented activities such as fruitgrowing and agro-industry. Overall, the sector represents around 8% of total GDP, though it has experienced uneven growth over the last decade. Strong dynamism between 1984-89 has been followed by near stagnation in the 1990s due to falling external prices, a significant appreciation of the real exchange rate, and rising export restrictions in foreign markets, especially in Europe.

Liberalization will likely be slower in agriculture than in other sectors, and sensitive goods may take 10 years or more to become fully liberalized. The most likely outcome in a negotiation would be a couple of bilateral treaties with Canada and the U.S., as was the case in NAFTA. Chile already has an FTA with Mexico, under which only the products subject to the price band mechanism (wheat, sugar, and oilseeds) have been exempted from either gradual or accelerated tariff elimination.

Chile is probably more liberal than NAFTA members in agricultural trade. Although Chilean tariffs (set at 11%) are higher than those of NAFTA members, no quantitative restrictions exist. Apart from some isolated instances (e.g., poultry cuts), sanitary and phyto-sanitary measures have not had a significant impact on imports from North America. As Chile gives no subsidies to agriculture, price bands are likely to be the only sensitive issue in negotiations.

### **Potential for Canadian exports of goods and services**

Canada is the largest exporter of wheat to the Chilean market. Trade liberalization would, therefore, provide increased opportunities for Canadian exporters of wheat, oilseeds and other similar crops. In addition, Canada's experience in fruit growing and in agro-industry could prove valuable for the continuing expansion of these sectors. Opportunities also exist for Canadian firms to establish joint ventures with local producers or exporters, oriented to the international markets, and to provide farming machinery.

## **11. Telecommunications**

Privatizations in the second half of the 1980s completely reversed state ownership in this sector. At present, all telecommunication companies are in private hands. Ambitious development plans, led by CTC (Compania de Telefonos de Chile), will imply a boost in equipment spending of several billions of dollars over the next few years.

NAFTA's Chapter 13 sets the rules for participating countries with respect to: (a) access and use of public telecommunications transport networks; (b) provision of enhanced value-added services; and (c) standards-related measures to regulate the attachment of terminal equipment to public networks. Provision of long-distance telephone and other basic services was purposely excluded from NAFTA negotiations because the market has been organized around regulated monopolies.

A few identifiable points of discrepancy between Chilean legislation and Chapter 13 are the following: a) there are limitations in Chile to the interconnection of privately leased or owned circuits to the public network; b) regarding the pricing of private services, NAFTA

contemplates only a flat rate, while in Chile the price would be freely negotiated between user and supplier; c) NAFTA requires each country to accept tests from laboratories in the territory of another member country and may face technical objections from the regulatory agency in Chile (SUBTEL).

### **Opportunities for Canadian suppliers of goods and services**

The telecommunications sector in Chile is very dynamic and competitive and is likely to grow faster than Chile's GDP for many years to come. Thus, it provides significant opportunities for firms providing technologically advanced equipment and specialized consultancy. CTC's medium-term development plan, for example, considers a total investment in excess of US\$1.5 billion for the next 5 years. Smaller companies have similar expansion plans.

Chile's telecommunications sector is open to all foreign companies and to imports of equipment from any origin. If Chile accedes to NAFTA, Canadian suppliers will gain a competitive edge over non-NAFTA suppliers to the extent of the 11% uniform import tariff. Sources in Chile's major telecom companies have expressed their interest in more aggressive Canadian marketing of equipment for telephone lines, rural communications, mobile phones, and private service terminals.

### **12. Financial services**

Chile's financial market is today one of the most developed in all Latin America. After the 1982-83 economic crisis, regulations were improved and the regulatory power of the authorities was enhanced. Since the second half of the 1980s, the financial sector has experienced fast growth, with institutional investors, especially pension funds and insurance companies, playing a major role in the market.

The country's financial industry has been quite open for many years. Nonetheless, the authorities still perceive that the banking sector is overextended and, thus, do not accept applications to open new banks are not accepted. This restriction, however, does not discriminate between local and foreign investors.

NAFTA accepts that existing national regulatory schemes cannot be dismantled in the short run without severe damage to the host country. Article 1410 states that each country has the right to: protect investors, depositors and other market participants; maintain the safety and soundness of its financial institutions; and ensure the solvency and stability of its financial system.

Chile's legislation falls halfway between that of Canada and the U.S.A.. It has almost no barriers to foreign ownership (similar to the U.S.A.), but it has strict entry requirements and proportionately fewer banks (similar to Canada). On power setting, Chile is also closer to Canada, as powers are set by rule, and not determined on a case-by-case basis as it is in the U.S.A.. Unlike both countries, however, only Chile's central government has the power to regulate, and regulations have nation-wide validity.

A negotiation of Chile's accession to NAFTA must consider that the country's market is rather small and already very open. Chile's objective in negotiations will probably focus on gaining additional access to the NAFTA-expanded financial markets and to facilitate the flow of financial services to and from Chile.

### **Opportunities for Canadian institutions**

In spite of the openness of Chile's financial industry and of the presence of 23 foreign banks, only two Canadian banks participate in the Chilean market, through their ownership of minority stock positions in two domestic banks. Under the current law and regulations, Canadian capital may without restrictions buy higher stakes in existing banks or may establish insurance companies, securities dealers, and other financial institutions.

### **13. Energy**

Oil exploitation and refining are still in the hands of the state, although distribution is done through private firms. Electricity generation and transmission are mainly under private ownership. National consumption of energy is diversified among a number of sources. Petroleum is by far the most important, representing 42% of total energy consumption. Hydroelectricity, natural gas, coal, and firewood account for around 14% of total consumption each.

Chile's energy sector is very liberal. Even if the exploration and exploitation of hydrocarbon fields can only occur under concession from or through joint ventures with the state, this is unlikely to create a conflict in Chile's NAFTA negotiations for several reasons. First, the concessions regime is transparent and offers clear incentives that have already attracted foreign companies. Second, Chile's regime is far less restrictive than Mexico's, whose state-owned PEMEX controls virtually everything in the petroleum sector. Third, Canada's provincial governments also have the ownership of energy resources. And finally, the ownership restriction applies only to the hydrocarbon sector, which is not Chile's most attractive. Chile would most probably not ask for protection of supply provisions because NAFTA members are not significant suppliers of energy to Chile.

#### **Potential for Canadian businesses in Chile's energy sector**

Average annual investment in the oil sector has been close to US\$150 million for the last 10 years. As the national production of crude oil has declined significantly, Chilean authorities are seeking to attract foreign investors into this sector. This offers an opportunity for Canadian firms for the exploration and exploitation of new sites. The distribution of refined oil and derivatives is fully open to foreign companies. Canadian firms may also participate in Chile's oil sector through the supply of equipment and spare parts to new and existing operations. As well as in the gas pipeline and gas conversion projects currently underway.

**Electricity generation and transmission** are very dynamic sectors, fully open to private capital. Thus, Canadian firms, with well-known expertise in this field, can participate directly in the development of new plants and in joint ventures with Chilean firms into other Latin American markets. (For example, TRANSALTA has joined Chilgener for a project in Argentina). Most of the equipment used in the construction of these plants (turbines, generators, transformers, etc.) is imported. Important suppliers are U.S.A., Japan, and Canada.

Canada has been one of the main suppliers of imported metallurgical and bituminous coal to Chile in recent years. While strong competition can in the future be expected from other suppliers like Colombia, Chile's accession to NAFTA would increase the competitiveness of Canadian producers.

## 14. Mining

Chile is now the world's largest producer and exporter of copper, potassium nitrate and sodium nitrate and the world largest producer of rhenium, lithium, iodine and molybdenum. The mining sector's contribution to GDP was 6.6% in 1992 and its share of total exports was 47%, with copper exports representing 82% of this total. Although in recent decades copper mining has been mainly in the hands of the state, the recent development of several new private mines has led to a significant decline in the public sector's share in copper production.

The openness of the mining sector to trade and investment in Chile and in the three members of NAFTA renders it very unlikely that it could pose any obstacle in Chile's potential negotiations to join NAFTA.

### Potential for Canada in Chile's mining sector

Canada's presence in Chile's mining sector has been growing rapidly in recent years, and some of that country's most important mining companies are operating in Chile. Placer Dome, Rio Algom, Falconbridge, Cominco and Lac Minerals are significant examples of Canadian involvement in the exploitation or construction of new projects in copper, gold and silver. (The largest projects include Quebrada Blanca, Cerro Colorado, Zaldivar, La Coipa and El Indio.)

Other important opportunities for Canadian companies lie in the provision of mining equipment such as heavy trucks, power shovels, drilling equipment, loaders, crushers and motorized vehicles. CODELCO's recent association with Canada's INCO-CMS to produce machinery equipment is a good example of lines of possible businesses. The largest imports of equipment now come from the United States, followed by Germany, Brazil, Japan, the United Kingdom and Canada. Demand for equipment for 1994-96, is estimated to be in the order of US\$500 million per year. Non-traditional opportunities could also exist in the Canadian expertise in project financing for mining operations through capital markets, which for years was a booming activity in Canada.

## 15. Forestry

Forest products, which represented 7.8% of total Chilean exports in 1975, have increased their share to 11.5% --or over US\$1.1 billion-- in 1992. The contribution of forestry to GDP has risen from 2.14% to nearly 3.5% in that period. Chile has a competitive advantage in the forestry sector, based on favourable soil and weather conditions, low production costs, and a convenient location of plantations relative to processing plants and ports. The main challenge in the medium-term for this sector is the volatility of international prices for some of the most important forestry products such as pulp and sawn softwoods.

Conflicts in the forest sector during Chile's negotiations to join NAFTA are unlikely to occur. First, Chile represents a very small share of the world export market in all sub-sectors of forestry (in pulp, for example, Chile's share is less than one percent). Second, Chile has no non-tariff trade barriers for final products, raw materials or equipments. And third, Chile faces no special restrictions to its forest exports in NAFTA markets.

One area where differences of opinion may arise between Chile and the NAFTA countries is the existence of subsidies for reforestation with softwoods, in Decree Law 701, and with native forests in a new law still under consideration by Congress. These subsidies have a large environmental value, and could be justified on economic grounds due to the presence of externalities in tree growth. Nonetheless, the U.S. has strongly contested the existence of similar subsidies in Canada (i.e., "stumpage fees" for softwoods).

### **Potential for Canada in Chile's forestry sector**

Even maintaining the current level of natural forests, total wood availability will more than double between 1990 and 2000. Thus, a substantial increase in forest industry output can be forecast. A recent government projection shows an increase of 44% in lumber production, of 76% in wood-based panels and of 150% in pulp and paper production.

This substantial expansion in productive capacity will require major imports of specialized goods and services and will open many opportunities for Canadian business. Potential areas of interest for Canadian suppliers exist in: consultancy and training in wildlife

management and organization of national parks; training and technology in tree breeding, nurseries and plantations; machinery and equipment for plant breeding, planting, thinning and pruning; felling and logging equipment; specialized log transportation trucks; kiln instruments, equipment, chambers and control systems; stationary sawmill chippers for softwoods, and pulp mill chippers for softwoods and hardwoods; engineering consulting for new mills, and adaptation of existing ones to operate on Eucalyptus; and studies on the impact of natural deforestation.

CHILE - CANADA

NAFTA

MARCH 1994



**CHILE - CANADA**

The main objective of this study is to assess how Chile's legal and regulatory regime complies with, or would comply with, in order to meet, the disciplines of NAFTA. A primary objective was also to identify possible business opportunities for Canada in those specific sectors, which may result as a consequence of Chile's accession to NAFTA.

The study was commissioned in October 1993 by the Canadian Embassy in Santiago. A study originally intended for working purposes, was issued in early January 1994. This final version has benefited from very useful comments received from Canadian as well as Chilean government officials.

Part I of the study analyses the legal and institutional framework included in the successive chapters of the NAFTA Agreement. Part II addresses sectoral topics, including a review of the special chapters in the agreement (e.g.,

due to the potential "conflicts of interest", we have discussed some of the findings of this work with some of our colleagues in the Ministry of Finance. We are deeply thankful

**MARCH 1994**

for their expert insights. Any misinterpretations of those findings or any mistakes contained in the study, are our own

The authors



## FOREWORD

The main objective of this study is to assess how Chile's trade, investment, legal and economic regimes comply with, or would have to be modified in order to meet, the disciplines of NAFTA. A secondary objective has been to identify possible business opportunities for Canada in some specific sectors, which may result as a consequence of Chile's accession to NAFTA.

The study was commissioned in October 1993 by the Canadian Embassy in Santiago. A First Draft, mainly intended for working purposes, was issued in early January 1994. This final version has benefited from very useful comments received from Canadian as well as Chilean Government officials.

Part I of the study analyzes the legal and institutional matters which are included in the successive chapters of the NAFTA agreement. Part II addresses sectoral topics, including a review of those sectors that have special chapters in the agreement (e.g., agriculture and energy).

With all due respect to potential "conflicts of interest", we have discussed some of the findings of this work with some of our colleagues at Chile's Ministry of Finance. We are deeply thankful for their valuable insights. Any misinterpretations of those insights or any mistakes contained in the study, are our own responsibility.

The authors



**PART I: REVIEW OF NAFTA-CHILE FRAMEWORK**



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## 1. BACKGROUND

### 1. BACKGROUND



## 1. BACKGROUND

At present, and for more than a decade, Chile has had an extremely open economy with low, uniform tariffs, practically no non-tariff barriers, non-discriminatory treatment to foreign investors, stable rules, and very few sectoral restrictions to the participation of the private sector. In such a context, the negotiation of an access to NAFTA and/or to other bilateral free-trade agreements has to be seen as the logical next-steps.

In 1993, the Chilean economy enjoyed its tenth consecutive year of growth. Output expanded at 6 percent, following on over 10 percent growth in 1992. Since 1985, Chile has lived one of the most dynamic periods of its economic history, with average GDP growth in excess of 6% per annum. By the end of 1993, unemployment had declined below 4.5% of the labor force, the lowest rate in almost three decades, and one of the lowest in the world.

Inflation, in turn, has experienced a sustained decline since 1990. After rebounding in 1989 due to a significant expansion in aggregate demand, and again in 1990 due to the oil price shock, in 1991 it went down to 18.7 percent, and then to less than 13% in 1992 and 1993. In fact, reducing inflation to single-digit rates has become a national objective, possibly feasible within the next couple of years. If achieved, it will place Chile with the Asian NICs as one of the countries with lowest inflation in the developing world.

In spite of this optimistic outlook, 1993 brought a test for the Chilean economy, as the price of copper --still Chile's principal export-- plummeted. This added to the price declines of some major Chilean exports, such as cellulose, fishmeal and fresh fruit. As a result, the country registered its first trade deficit since 1985. It served as reminder that Chile is not immune to adverse external shocks. But the vulnerability of the Chilean economy has declined sharply since the mid 1980s. Copper is still the country's principal export, but accounts now for little over 35% of total shipments (down from about 80% in the early 1970s);

trade partners have also been significantly diversified (no single country accounts for more than 18% of Chilean exports or imports); the external debt crisis is over; and the fiscal budget is in surplus. In sum, Chile is now probably in better shape than ever before to weather an external storm. The performance of 1991, when Chile's GDP grew by 6% while U.S. GDP declined by 1.2%, attests to this reduced vulnerability.

Since the mid-1980s, economic growth has been led by the export sector. Copper has been the most important Chilean export for the last six decades, and still is. But the most dynamic components of exports have been non-copper shipments, whose rate of growth has exceeded 10% for several years. The success of the export sector has not been random, but rather the result of a carefully designed strategy.

Chile has pursued a strategy of global trade liberalization since the mid-1970s. The goal was, quite clearly, to integrate the country fully into the international economy. As a result, exports have increased dramatically. From about 12% of GDP in 1965, exports are now close to 35% of GDP, a ratio similar to that of South Korea. In 1992-93, Chile's exports reached almost US\$10 billion, about 3 times the level of exports in the early 1980s. Trade has grown from about US\$7 billion in 1986 to nearly US\$20 billion in 1992-93. Measured by imports or exports, Chile is today the most open economy of Latin America.

Foreign investment into Chile has also shown considerable growth since the mid-1980s, and reached over US\$2.5 billion in 1993. This is equivalent to over 6% of GDP, and constitutes an all-time record for the country. As a result of significant capital inflows since the late 1980s --both in the form of investment and credits-- Chile has accumulated foreign exchange reserves of over US\$10 billion, equivalent to 12 months of imports or to more than a quarter of GDP.

Of course, Chile faces important economic and social challenges today. Fast growth has highlighted important needs in infrastructure development (roads, ports and urban infrastructure);

if inadequately attended, these could become an impediment to sustained high rates of growth. Strong capital inflows have put downward pressure on the real exchange rate, a crucial element in Chile's successful export drive. The threat of protectionism in some of Chile's major export markets --especially in Europe-- is also a cause for concern.

In the social area, major reforms are needed in health and education to improve the quality of these services. And in spite of over one decade of uninterrupted growth, about one third of the country's population still live in poverty. The Chilean society bears a responsibility to make the fruits of progress reach these sectors. It is widely recognized, however, that only in an environment of sustained economic growth Chile will be able to solve the problem of poverty.

Despite these challenges, the overall outlook is very good. Political and economic reasons indicate that the strong recent performance of the Chilean economy can be extrapolated into the foreseeable future. Chile is reaping now the fruits of a process of economic reforms that started in the mid 1970s, and has been consolidated and legitimized in democracy. Moreover, the political consensus about the need to maintain and strengthen the model of a free market economy is a crucial guarantee against policy reversals in the future. It is precisely those sharp policy swings that hampered Chile's economic development in the past, and that have done so much harm in Latin America.

Over the last four years, Chile has had a very successful experience of political transition. Both democracy and free markets are consolidating fast, with all the major segments of society cooperating in this effort. Competing political forces, both in the government coalition and in the opposition, have made significant attempts at cooperation, and in several important cases such as the tax reform and the labor reform, broad consensus have been reached.

The recent presidential election of December 1993 provided significant support for the Government coalition, whose Presidential candidate, Eduardo Frei, obtained 58% of the popular

vote. At the same time, the election resulted in a continuity of the basic balance of power in Congress between the government and the opposition. President-elect Frei's basic campaign theme was continuity of the economic policies of the Aylwin administration.

A small but dynamic economy like Chile views NAFTA as a major step towards enhanced international free-trade, and as a signal to the rest of Latin America about the validity of the free-market economic model. It is also seen by some government officials, as well as by private sector representatives as a powerful incentive for introducing additional national and intraregional discipline in dealing with topics such as protection of the environment, antidumping legislation, government procurement, and others.

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## 2. TRADE RULES AND PROCEDURES

### 2.1 Imports, exports and market access for goods

Chilean commercial procedures are simple and straightforward. As a general rule, all imports are affected by a uniform tariff of 11% over their CIF value. Quantitative restrictions do not exist, and there are no export taxes. In addition, Chile clearly complies with Article 101 of NAFTA, which extends the national treatment obligation of GATT to goods of other member countries.

The only special treatments for imports are those reserved for the agricultural sector (described in an appendix to this chapter), and for a limited number of agricultural products. As discussed in chapter 13 of this report, sugar, wheat and oilseeds have a scheme of price bands designed to smooth the price received by domestic producers. These bands result in the application of import duties when the international price falls below a predetermined minimum price.

## 2. TRADE RULES AND PROCEDURES

### Drawbacks

The Chilean trade system contains a number of policies aimed at correcting anti-export biases. These include the refund of VAT, a drawback of customs duties effectively applied to imported intermediate goods (effective drawback), and a simplified drawback for smaller exporters, based on a theoretical use of imported inputs (simplified drawback).

The rationale for these policies is as follows. The VAT is paid by the final consumer in the domestic market. With exports, the final consumer is foreign, and thus the exporter would be effectively exporting taxes if he did not receive the tax refund. On the other hand, without the drawback of customs duties effectively applied to imported intermediate goods, the exporter would face negative effective protection.

The simplified drawback allows the rebate of a given portion of the value exported, without reference to the effective amount of imported goods. This mechanism is aimed at providing some kind of drawback for small exporters who would otherwise probably fail to



## 2. TRADE RULES AND PROCEDURES

### **2.1 National treatment and market access for goods**

Chilean commercial procedures are simple and straightforward. As a general rule, all imports are affected by a uniform tariff of 11% over their CIF value. Quantitative restrictions do not exist, and there are no export taxes. In addition, Chile clearly complies with Article 301 of NAFTA, which extends the national treatment obligation of GATT to goods of other member countries.

The only special treatments for imports are those reserved for the automotive sector (described in an appendix to this chapter), and for a limited number of agricultural products. As discussed in chapter 13 of this report, sugar, wheat and oilseeds have a scheme of price bands designed to smooth the price received by domestic producers. These bands result in the application of import duties when the international price falls below a predetermined minimum price.

#### **Drawbacks**

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The simplified drawback allows the rebate of a given portion of the value exported, without reference to the effective amount of imported inputs. This mechanism is aimed at providing some kind of drawback for small exporters who would otherwise probably fail to

ask for a rebate under the general scheme. As such, it can imply a subsidy to small exporters. In 1992, only goods classified under tariff headings with less than US\$18 million in exports could receive a rebate of between 3% and 10% of the value exported (See Table 2.1). There is, however, an exceptions list of products that are not allowed to receive this duty drawback.

**Table 2.1**  
**Simplified Drawback for Small Exports (1992)**

<u>Exports with drawback rights</u>	<u>Drawback rate</u>	<u>Export ceiling in 1991</u>
Value exported in a tariff heading equal to or less than US\$5,000,000 in 1990	10%	US\$ 9.830.000
	5%	US\$ 14.745.000
	3%	US\$ 17.694.000

Given Chile's current trade policy, the elimination of drawbacks contemplated in NAFTA's Article 303 will certainly be part of the negotiations. The most probable outcome will be an agreement on a long phase-out period. In this respect, Mexico's eight-year period has established a precedent.

#### **Tariff reduction schedules**

The possible incorporation of Chile to NAFTA will imply a reciprocal reduction of import tariffs between Chile and current NAFTA members. Of course, this reduction (and eventual elimination) would not occur in one step. The precedents established in the Chile-Mexico FTA and in NAFTA provide an important operational precedent.

#### **Phase-outs in Chile-Mexico FTA**

In 1991 Chile and Mexico subscribed a free trade agreement (FTA), a very simple treaty that applies mostly to trade in goods. It contains two basic phase-out regimes. The general scheme consists of a one-time reduction in import tariffs to 10% in January 1992. As the Chilean tariff rate is 11%, and Mexico has a

differentiated tariff structure, this reduction obviously generates a stronger effect on Chilean exports. From 1992 on, a gradual reduction leads to zero tariff in January 1996.

A second phase-out regime, which applies only to some goods, is a slower version of the general phase-out. It stipulates the same one-time reduction to 10% in January 1992, but subsequent tariff reductions would only start at the beginning of 1994, in such a way that the zero rate would be attained by January 1998 (See Table 2.2).

Some exceptions apply to these phase-out schemes. There is a special treatment for the automotive sector, consisting of a one-time elimination of tariffs in January 1996. The list of exceptions also include the agricultural products subject to price bands. No mention is made, however, of the Chilean prohibition to import used vehicles and about the simplified drawback scheme.

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**Table 2.2**  
**Phase-outs in Chile-Mexico FTA**

<u>Date</u>	<u>Maximum common tariff</u>	
	<u>General Phase-out</u>	<u>Delayed Phase-out</u>
1-1-1992	10.0%	10.0%
1-1-1993	7.5%	10.0%
1-1-1994	5.0%	8.0%
1-1-1995	2.5%	6.0%
1-1-1996	0.0%	4.0%
1-1-1997	0.0%	2.0%
1-1-1998	0.0%	0.0%

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**Phase-outs in NAFTA**

NAFTA provides four phase-out categories: immediate elimination, five, ten, and fifteen annual steps, all of which start in January 1994. The base rates for calculating the phased elimination incorporate the Generalized Preferential Tariff for Canada and the Generalized System of Preferences for the United States. For Mexico, the base rates are the effective tariffs. These are differentiated by product, with a maximum of 20%.

According to NAFTA, all quantitative import restrictions are

to be eliminated, and so are any export restrictions, such as export taxes. NAFTA recognizes, however, that in special circumstances, such as natural resource depletion or short supply, export controls might be enforced provided they do not disrupt normal trade patterns. For example, Canada will be able to restrict exports of logs and fish. Also, Mexico can limit the imports of used cars for 25 years.

### **Conclusions**

Chile's trade regime, which currently extends the MFN and national treatment principles to all imports, already fulfills most NAFTA obligations regarding trade rules. The few minor exceptions, agricultural products --sugar, wheat and oilseeds-- and the automotive sector will need special negotiations, as was the case in NAFTA. These exceptions, however, seem to be rather unimportant, particularly when compared to those in NAFTA.

Other issues that will require negotiations are the elimination of duty drawbacks and the timing for elimination of import tariffs. In both cases, special phase-out programs will be certainly required.

### **2.2 Rules of Origin**

The Chilean import regime is based on the most favored nation principle (MFN). At the same time, as a developing country, Chile is a beneficiary of the Generalized System of Preferences (GSP). Both facts explain why Chile has not required to establish its own rules of origin to determine the relevant tariff to apply to its imports.

The only exception to the MFN principle is the tariff preferences that Chile is allowed to negotiate with other countries belonging to the Latin American Integration Association (ALADI). According to the Montevideo Treaty that created this Association, member countries may negotiate bilateral tariff preferences, which may be limited to specific products or cover the whole tariff universe. A clear example of the latter type of agreements are the

FTAs recently negotiated by Chile with Mexico, Venezuela and Colombia.

In all the above agreements, as well as in other partial agreements within ALADI, Chile has used the "General Origin Regime", as described in ALADI's Resolution 78 of 1987. Because this is the country's only experience with the subject, the next sub-section will explain briefly the main features of ALADI's rules of origin. Then, those rules will be contrasted with those contained in NAFTA. Finally, a number of potential problems that Chile might have in adapting to NAFTA's rules of origin will be identified.

#### **ALADI's rules of origin**

The General Origin Regime for ALADI considers the following types of goods to be originated in country members that participate in tariff preference negotiations:

- a) Goods completely elaborated in the territory, which use only materials from signatory members of the agreement.
- b) Goods produced through processes that consist of simple assemblies using imported materials, provided that the CIF value at the port of destiny of the materials originated in third countries does not exceed 50% of the FOB export value of such goods.
- c) Goods elaborated using materials from third countries, provided that they result from a transformation process, defined by the existence of a change in the tariff classification. In case this requirement cannot be met, it would be enough if the CIF value at the point of destiny of the materials originated in third countries does not exceed a 50% of the FOB export value of such goods.
- d) Goods included specifically in the Resolution Annex covering mineral, vegetal, animal and sea products.

Up to now, the agreements signed by Chile under ALADI have established, with minor exceptions, the commitment to use these rules. Such is the case of the automotive sector, where agreements have established local content percentages below 50%. At the same time, the agreements signed have established the possibility of

relaxing the rules of origin in the future, with the intention of promoting trade among member countries in the most efficient way.

As a general principle, Chile privileges rules of origin that help to foster trade, and that are not transformed into an instrument of hidden protectionism. Moreover, given the neutrality Chile's trade and economic policy, the country has no interest in using rules of origin as part of an industrial policy.

#### **NAFTA rules of origin**

NAFTA establishes minimum processing requirements for goods to qualify as originated in any of the member countries. These rules are generally based on the change of tariff nomenclature of the harmonized system. At the same time, these changes may be complemented or replaced, according to the particular case, with regional content requirements of 60% or 50%, depending on the accounting methodology used (transactions method or net cost method).

To define these rules product by product, member countries had to review all productive processes involved in the production of goods covered in the tariff schedule and identify the inputs utilized. Only in this way were NAFTA countries able to define the rules contained in chapter 4. In the cases of automobiles and textiles, the rules clearly show the effect of sectoral lobbies whose great influence was finally captured in NAFTA.

A brief analysis of NAFTA rules of origin shows important differences with the ALADI regime. First, ALADI considers a good originating from a member country if imported materials used to produce such good are classified in a customs position under the ALADI tariff nomenclature (NALADI) which is different to that of the good. Thus, ALADI has not defined specific rules product by product; rather, it has limited itself to establish a general requisite, without studying the specificities of the respective production processes for each exportable good.

Second, ALADI uses FOB export prices of final goods and CIF imports prices of the imported materials to calculate the share of

inputs over final products. NAFTA, on the other hand, introduces the concept of net cost method, which requires knowing each production cost of every single input in order to calculate the regional content. This requirement is particularly important for the automotive sector, where only the net cost approach may be used.

Finally, many concepts used in NAFTA --such as accumulation, de minimis, and fungible materials-- are not considered in the ALADI regime. These considerations serve to highlight the tremendous effort involved in defining the different concepts that are involved in the calculation of NAFTA rules of origin.

### **Chile and NAFTA rules of origin**

This subject need not be as traumatic in Chile's potential accession to with NAFTA as it was during the negotiation of NAFTA. The problem in rules of origin has more to do with the lack of understanding of the system in Chile.

To determine the extent to which the current NAFTA rules may impose limits on Chilean exports, it is necessary to work out a very detailed, product-by-product exercise. Natural-resource based products in the present export bundle would most probably qualify as originary from Chile. These are the bulk of Chilean exports.

Special attention must be given to the automotive and textile industries, which caused so much tensions during NAFTA negotiations. Chile has only two vehicle assembly plants of vehicles, Peugeot-Renault and General Motors. Both have their main orientation to the domestic market, although they export a limited number of vehicles to neighboring countries. Domestic content is around 15% in the case of Peugeot and 35% in the case of GM. These low percentages and the low levels of production, make the whole issue of sectoral rules of origin more a theoretical problem than a real one in the case of Chile.

In textiles, Chile has begun to export mainly apparel to the U.S. market. To determine whether these exports might be affected by NAFTA rules of origin, it would be necessary to perform a

special study on the subject that goes well beyond the scope of the present report. Given the low levels of textile production in Chile, this should not be an important concern for any of the current NAFTA members.

## **Conclusions**

Because Chile's exports of manufactured products are small, the negotiation of rules of origin is unlikely to revive the conflicts originated in NAFTA. In this subject, Chile's "problems" would probably have more to do with lack of understanding of the system than with fundamental obstacles to fulfill NAFTA rules.

The challenge will be to implement the new system of rules and procedures in a reasonable time period, and with the necessary information to interested parties within the country. As with many other domestic issues, this will certainly require close cooperation between the private and public sectors in Chile.

### **2.3 Customs Procedures**

This section deals with the procedures adopted by NAFTA countries to certify that a good qualifies as originating in a member country. These procedures are extremely novel for Chile. Hence, they need to be carefully studied in order to assure their application in the country.

Customs procedures cover aspects related with the issuance of certificates that must be presented at the port of entry of the importing country, the verification of their validity, and the corresponding penalties for those exporters or producers that incur in false certification.

Chilean exporters use the ALADI customs procedures, which do not resemble the ones introduced in NAFTA. According to ALADI procedures, certificates of origin can be issued only by state agencies and/or producers associations, duly enabled by the Government. These agencies, both public and private, are registered at the ALADI Secretariat in Montevideo, and charge a fee for the services provided. The Chilean Government has delegated its

responsibility on the following agencies.

<u>Public Agencies</u>	<u>Type of products covered</u>
SAG	agriculture
SERNAP	fishing
CONAF	forestry
COCHILCO	mineral
<u>Private Agencies</u>	
SOFOFA	manufactures

As recently as 1992, however, certificates of origin for manufactured products were issued by the Central Bank. With the 1990 Organic Law that created an independent Central Bank, some of its previous responsibilities --including the issuance of certificates of origin-- were given back to the Government. During 1992, the Government delegated this function to the private sector, and signed a contract with SOFOFA, Chile's largest private manufacturing association.

According to this contract, SOFOFA must issue the certificates, verifying that the information presented by the exporters satisfy the rules of origin under ALADI. The contract is subject to periodic revisions, and the Government may unilaterally terminate it if procedures used in the issuance of certificates prove to defective.

ALADI's procedures do not contemplate special penalties for exporters that provide false information to the agencies issuing the certificates. The exporter is required, however, to declare under oath that the information she provides is, to the best of her knowledge, correct.

According to the Chilean system, the only possible sanctions for the provisions of false certificates are the suspension of the tariff preference in the importing country and/or the imposition of penalties for injury, according to domestic law.

## **NAFTA Procedures**

NAFTA procedures require the exporters themselves to issue their certificates of origin, based upon information provided by the producers. Hence, no special agencies are needed, as in Chile presently. NAFTA members commit themselves to sanction false certification by producers or exporters with the same penalties that would apply to an importer contravening the country's customs laws and regulations. Sanctions may consist of criminal, civil, or administrative penalties.

Regarding verification, NAFTA allows parties to conduct them in the territory of the trading partner, but limits are placed on visits for such a purpose. Verifications can check records of the past 5 years, that must be maintained by exporters and producers as an additional obligation.

Finally, member countries agreed to provide "advance rulings" before importing a good into their territory. These rulings are intended to establish whether a given rule of origin is fulfilled or not, based on the information provided by the importer in the country or by the producer in the trading partner.

## **Conclusions**

Chile's customs procedures differ significantly from those described in Chapter 5 of NAFTA. The Chilean system follows the ALADI tradition of having certified private or public agencies issue certificates of origin. In contrast, NAFTA procedures rely on certificates issued by the exporters themselves.

Notwithstanding the above, Chile should not have significant problems in adopting the NAFTA customs procedures. In fact, the recent transfer of these responsibilities from the Central Bank to the Manufacturers Association (SOFOFA), signals the fact that the Chilean government is willing to rely more on the private sector in this matter. Transferring the responsibility for certificates to the interested parties seems to be the natural next step. Moreover, in the context of Chile's long tradition of respect for the law, the imposition of special sanctions for the provision of false



## ANNEX 2-1: CHILEAN TREATMENT OF THE AUTOMOTIVE SECTOR

Imports of new vehicles are subject to an 11% flat import duty while the import of used vehicles is prohibited under Chilean legislation, except for use in the First Region (far north) and for re-export to other countries.

### **Fiscal credit**

The Chilean legislation, however, establishes a special treatment for the domestic car assemblies,<sup>1</sup> as specified in a contract denominated 'Estatuto Automotriz'. According to this, assemblies benefit from a fiscal credit in the form of a cash refund, which is proportional to the value of national content. This credit applies only to vehicles produced and commercialized in the country.

The 'Estatuto' was recently modified, so that the fiscal credit is to be completely eliminated by 1999. Under the original rule, the credit rate of 40% had to be reduced 10% per year starting in 1992. Nonetheless, the initial 40% was extended until 1996, subject to the condition that firms export at least three times the difference between the 40% credit and what they should have otherwise received (i.e., 30% in 1993, 20% in 1994, 10% in 1995 and 0% in 1996). If the export requirement is not met, the rate of fiscal credit is reduced by 10% per year to disappear completely in 1996.

Estimations by the Ministry of Economics show that the total fiscal cost for the period 1992-1998 will be US\$47 million, of which US\$32 million correspond to the credit for national production of vehicles. The minimum export requirements to apply for this credit are estimated as US\$227 million for the period

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<sup>1</sup> In 1992, domestic assemblies produced only 19,000 vehicles, out of total sales of about 110,000. The two main producers are Automotriz Franco-Chilena S.A. (Peugeot-Renault) and General Motors Chile S.A.

1992-1996, or around US\$45 million per annum.

### **Special tax treatment**

As we have mentioned, the Chilean flat import duty of 11% applies also to vehicles. There are, however, two additional taxes to all kinds of vehicles, both imported and produced internally. One is the engine size tax, the other the luxury tax.

**Engine size tax:** This tax applies to imported vehicles with engine size larger than 1,500 cc, as well as the imports of parts required for assembly in the country. The general formula for calculating this tax is the following:

$$\text{Tax} = (\text{cc} \times 0.03 - 45) \times \text{CIF value}$$

Beginning in 1990, this tax entered into a gradual phase-out of a linear 10% per year.

Nonetheless, the amount of the tax cannot exceed US\$6,000 in 1986 US dollars, adjusted annually according to the US wholesale price index. Thus, for 1993 this value was US\$7,172. But because this tax declines according to the above schedule, the effective maximum for 1993 was  $\text{US\$7,172} \times 0.6 = \text{US\$4,303}$ .

There is a special rebate of 75% of the tax in the following cases: (a) Imports of pick-up trucks with a load capacity between 500 and 2000 kgs. (b) Jeeps and utilitarian vehicles. (c) Vehicles for passenger transport, with a capacity between 10 and 15 seats. (d) Parts and pieces used in the assembly of vehicles described in (a), (b), or (c).

A full tax rebate (100%) applies in the following cases:

(a) Imports of pick-up trucks with a load capacity over 2000 kgs. (b) Vehicles for passenger transport, with a capacity of more than 15 seats. (c) The parts or pieces used in the assembly of vehicles described in (a) or (b). (d) Vehicles such as ambulances, tractors, armored vehicles, and in general special duty vehicles.

**Luxury tax:** This tax applies to vehicles over a certain CIF value, and is calculated as:

Tax = 85% x CIF VALUE over US\$8,000 in 1986 US dollars, adjusted with the US wholesale price index.

The tax does not apply in the following cases: (a) Vehicles for passenger transport, with a capacity of more than 15 seats. (b) Imports of pick-up trucks with a load capacity of over 2,000 kgs. (c) Parts or pieces used in the assembly of vehicles described in (a) or (b). (d) Special duty vehicles.

#### Fiscal credit

This special tax regime does not discriminate between imports and internally produced vehicles; as such, it is a matter of domestic policy and should not be an issue in NAFTA negotiations. There is a growing consensus among Chilean authorities, however, that the automotive sector should not have any special treatment. This is reflected in the gradual phasing out of fiscal credit for national content and in the engine size tax.

Currently there is legislation presented in Congress that would also allow for a reduction of the luxury tax. It must be noted, however, that this tax applies to a variety of goods, including jewelry, yachts and other "luxury" items. Thus, there are further aspects to be considered in the treatment of this specific tax.

Chile is already seeking to eliminate preferential treatment in the automotive sector by 1999. Mexico's terms of accession to NAFTA established a tariff phase-out period of 10 years for all vehicles except light trucks (5 years), and 5 years for most auto parts. In addition, restrictions on the imports of used cars will be phased out over 25 years. Having these terms as a reference, it is unlikely that the automotive sector would provide a significant obstacle to Chile - NAFTA negotiations.

## ANNEX 2 - CHILEAN TREATMENT OF THE TEXTILE SECTOR

Textiles are subject to the general 11% import tariff, and thus enjoy no special protection. In particular, it must be stressed that Chile is not a signatory of the Multifibre Agreement. Nonetheless, as with all other imports, the Chilean commercial system allows the application of trade remedies. This is accepted in the GATT for the case of subsidies and dumping by the trading partners, or even when the national industry suffers substantial damage from a surge in imports (safeguards article XIX).

In Chile, these measures have been applied with caution. Between 1982 and 1991, only around 1% of the total import items benefited from compensatory measures, and only a handful received this treatment for a long period of time. For example, only 12 products enjoyed compensatory measures for more than two years between 1982 and 1991, and 14 products received this protection for 1 to 2 years during the same period (See Table 1).

In spite of this limited application, textiles have benefited the most from these measures. Out of the 12 products enjoying compensatory measures for more than two years between 1982 and 1991, 8 are textiles. They correspond mainly to processed products, such as clothes and fabric.

From 1991 onwards, the degree of protection through trade remedies for the textile sector has been reduced substantially. This has been coupled with a fall in foreign prices, as well as a surge in imports from the Far East. Chile also allows the imports of used clothes, which come mainly from Europe at extremely low prices. All these elements have caused a very difficult situation for the textile industry. Accordingly, textile producers and labor unions have demanded the imposition of measures to protect the national industry, such as the application of higher tariffs, and the prohibition to import used clothes. The authorities, however, have generally not bowed to these demands. Only some compensatory measures have been undertaken, such as those affecting imports from China in late 1993.

The FTA between Chile and Mexico does not consider a special treatment for the textile sector. Nonetheless, some textile products were included in the list of Chilean delayed phase-out products.

NAFTA, on the other hand, establishes that tariff elimination with Mexico will be phased out in ten years for apparel and eight years for fabric. It also establishes some special rules of origin for the treatment of textile products. In general, textile products may benefit from tariff reductions in NAFTA partners if they are produced from yarn made in a NAFTA country, and only sometimes fibre. This corresponds to the so-called "triple transformation" for apparel and "double transformation" for fabric. NAFTA also provides for the application of import restrictions in the case of a surge in textile imports.

The Chilean textile industry is highly dependent on imported fibre from non-NAFTA members. Thus, it might be difficult for Chilean textiles to benefit from NAFTA if the principles of "triple transformation" for apparel or "double transformation" for fabric are applied. In essence, Chilean textile producers would have to choose between importing fibre from NAFTA countries in order to have access to NAFTA, or importing from regular suppliers and being excluded from NAFTA. This sensitive point will probably arise during negotiations.

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Table 2.3

Products enjoying compensatory measures for more than two years  
(1982-91)

<u>Product</u>	<u>No of years</u>
Cotele fabric	6
Tires	5
Wool fabric	5
Milk products	4
Matches	4
Apparel	4
Cotton fabric	3
Carpets	3
Sheets	3
Tapestry	3
Cotton bags	2
Towed vehicles	2

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Table 2.4

Products enjoying compensatory measures for one to two years,  
1982-91

<u>Product</u>	<u>No of months</u>
Coverlet	25
Fish cans	23
Shoes	23
Aluminum sheets	23
Cement	23
Velvet	20
Polipropilen sacs	17
Liquifier	17
Hot-pressers	17
Glassware	17
Refrigerator	15
Steel cables	15
Tile	12

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### 3.1 NAFTA Member Special Provisions

NAFTA provides a number of types of safeguards, including special provisions that apply only among NAFTA countries, special treatment between NAFTA countries when applying safeguards under the GATT, and specific safeguard provisions in the areas of textiles, apparel, and agriculture.

Special provisions among NAFTA countries allow a Party to take action against imports from another Party when as a result of the reduction of duties provided for in NAFTA, the good is imported in such increased quantities, in absolute terms, and under such conditions as that the imports of such goods from that Party alone constitute a substantial cause of serious injury ... to a domestic industry producing a like or directly competitive good.

In principle, these special provisions apply only during the transition period. They can be applied in cases of serious injury to a domestic industry, but only with the consent of the other Party and subject to compensation by the importing Party.

## 3. EMERGENCY ACTION

Remedies under the above conditions can take the form of suspending further reductions of any import duty provided for under the NAFTA. Alternatively, the importing country may increase the rate of duty on the good, to a level that is not to exceed the lesser of: (i) the MFN duty rate in effect at the time the action is taken, or (ii) the MFN duty rate in effect on the day immediately preceding the date that the NAFTA entered into force.

NAFTA also specifies that each Party retains its rights and obligations under Article XIX of the GATT. Emergency actions by a NAFTA member under Article XIX will ordinarily not apply to imports from the other Parties except in the following circumstances: (a) imports from a Party account for a substantial share of total imports, and (b) imports from a Party contribute importantly to the serious injury, or threat thereof, caused by imports.

Finally, NAFTA also includes provisions that allow for special



### 3. EMERGENCY ACTION

#### 3.1 NAFTA Emergency Action Provisions

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Special provisions among NAFTA countries allow a Party to take action against imports from another Party when as a result of the reduction or elimination of a duty provided for in NAFTA, the good is imported "in such increased quantities, in absolute terms, and under such conditions so that the imports of such goods from that Party alone constitute a substantial cause of serious injury ... to a domestic industry producing a like or directly competitive good".

In principle, these special provisions apply only during the transition period. After this period, however, they can be applied in cases of serious injury to a domestic industry, but only with the consent of the other Party and subject to compensation by the importing Party.

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Finally, NAFTA also includes provisions that allow for special

safeguards in textiles, apparel and agricultural trade. Emergency action provisions in textiles and apparel will remain in effect only during the transition period. Actions may be taken only once during this period and may be maintained for a period not exceeding 3 years. Unless there is consent of the Party against which the action is taken, actions cannot have effect beyond the expiration of the transition period. A Party taking an action under these special provisions must provide "mutually agreed trade liberalizing compensation" that shall be limited to textile and apparel goods, unless the Parties otherwise agree.

In the case of agricultural products, on the other hand, special provisions remain in effect for ten years and can be applied to sensitive imports enumerated in a list negotiated by Party members.

### **3.2 Chilean Safeguard Provisions**

Chilean trade law does not allow the Government to depart even temporarily from its uniform tariff regime whenever unanticipated increases in imports threaten to injure a local industry. The Chilean trade regime is so liberal that there is no competent investigating authority to evaluate all relevant factors and make determinations on safeguard measures; these measures are simply not part of the Chilean law.

As with rules of origin, perhaps the only close experience with the subject can be found in Chilean agreements under ALADI. In these agreements, countries follow the so called "Regional Safeguard Regime", approved by country members in Resolution 70 of April 1987.

Article 1 of Resolution 70 states that "member countries may apply safeguard clauses, transitorily and in a non-discriminatory manner, with the intention to suspend totally or partially the fulfillment of the commitments assumed in any of the mechanisms of the Montevideo Treaty of 1980 (the one that creates ALADI) when:  
(i) necessary to restrict imports to correct balance of payments disequilibriums, or (ii) the import of one or more products

originated from the region causes, or threats to cause, serious injury to domestic producers of similar goods.

Safeguard clauses applied under the above article may have a duration of only 1 year and, under certain specified conditions, may be extended for a similar consecutive one year period.

ALADI agreements are based on the preferential treatment that country members give to other Parties of the Treaty. This preferences may be negotiated on a product by product basis or following a more universal approach. In either case, safeguard action under ALADI should be understood as the temporary suspension of the preferential tariffs applied under the agreements.

Procedures established in Resolution 70 are so general that they are open to different interpretations by country members. The detailed procedures contained in NAFTA should be considered in Chile as a step in the right direction. The country would have to develop national procedures in order to satisfy the standards imposed to NAFTA members. This should require the appointment of a competent investigating authority, transparency of the proceedings through public disclosure of petitions, publication of notices by administering authorities, the holding of public hearings, etc.

In conclusion, no major obstacles may be perceived from the Chilean side to create domestic legislation and procedures that cover the issue of emergency action in the context of trade agreements. The only point that might arise is the existence of special safeguard mechanisms for different sectors of the economy (agriculture and textiles, for example). The Chilean Government may not want to introduce exceptions to its trade policy, characterized by uniform rules applicable to all sectors of the economy. In any case, this should be a point to discuss during negotiations.



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## 4. STANDARD-RELATED MEASURES

Each member country is allowed in NAFTA to adopt, maintain, or apply standard-related measures relating to safety, the protection of human, animal or plant life, the protection of the environment or consumers, as well as border measures to ensure the enforcement of its standards. Nevertheless, the Agreement imposes certain disciplines on the establishment of such standards and on their enforcement. While each Party has the right to establish the levels of protection that it considers appropriate when pursuing its legitimate objectives of safety and protection, measures must be non-discriminatory and cannot create an unnecessary obstacle to trade between NAFTA members.

Standard related measures must be based on international standards, except "where such standards would be an ineffective or inappropriate means to fulfill legitimate objectives". Another important objective is the promotion of compatibility and equivalence in the setting of standards and conformity assessment procedures, to the greatest extent possible. To comply with this objective, NAFTA establishes several procedural requirements that member countries must follow.

### 4. STANDARD-RELATED MEASURES

#### The Standard System in Chile

Chile has a system of official standards that covers all sectors of the economy. Standards are voluntary unless the authority declares them binding. From the approximately 1,800 existing official standards, about 30% are binding.

In general, the enforcement of binding standards becomes effective at the marketing stage and not at either the importation or production stages. In any event, enforcement of regulations is non-discriminatory and regulations are the same for imported and locally manufactured products.

The National Institute of Standards (NIS) is the organization responsible for the development of national standards in Chile. The NIS is a private non-profit corporation that relates itself with



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the Government through the National Development Corporation (CORFO).

When a new standard must be introduced in the country, the NIS leads a participative process in which all interested parties, public and private, are consulted. Increasingly, new standards in Chile are based on accepted international standards.

Chile is a signatory of the GATT Code on Technical Barriers to Trade. As such, Chile is compelled to notify all interested Parties about its intention to introduce new standards in its territory, and assign adequate opportunities for interested parties to express their comments on them.

In practice, however, Chile has not been able to create a satisfactory institutional framework responsible for the Code's implementation. The Ministry of the Economy is currently studying the most effective institutional organization to implement the obligations contained under the GATT Code.

In terms of procedural requirements, Chile considers extremely positive the commitment to "accredit, approve, license or otherwise recognize conformity assessment bodies in the territory of another Party on terms no less favorable than those accorded to such bodies in its territory".

Given the institutional differences among NAFTA countries and Chile, however, one might expect that the above procedural requirement will not enter into effect immediately for Chile. As in the Mexican case, Chile may need some years to establish assessment bodies acceptable to other Parties, and hence benefit from a mutual recognition system.

### **Conclusions**

Chile already fulfills two of the basic principles that guided NAFTA's discussions on this subject. Its legislation on standards is non-discriminatory, and all standards are of national application (there are no standards set at either provincial or municipal level). Moreover, Chilean standards are increasingly based on accepted international standards. And as a signatory to

the GATT Agreement on Technical Barriers to Trade, Chile has already accepted most of the obligations contained in NAFTA.

Institutionally, however, Chile has not yet been able to completely fulfill its notification obligations. The country may still need some years to establish acceptable conformity assessment bodies. As it was the case with Mexico, this may be one of the points to negotiate.

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Trade, such as Chile, has a long history of maintaining its trade and investment opportunities and has been successful in doing so.

In practice, however, Chile has been able to maintain a satisfactory institutional framework for the implementation of the most effective institutional arrangements for the obligations contained under the GATT Code.

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## GOVERNMENT PROCUREMENT

### 5. GOVERNMENT PROCUREMENT

2. GOVERNMENT PROCUREMENT

## 5. GOVERNMENT PROCUREMENT

Government procurement procedures --the purchase of goods and services by the central government, municipalities, and state-owned enterprises for their own use-- reflect very clearly two basic principles, one institutional and one economic, present today in Chile: the organization as a unitary government (as opposed to federal government) and the application of non-discriminatory policies between sectors and/or suppliers.

Chile does not have, strictly speaking, a code of government procurement. Instead, purchases by the government are expected to maximize efficiency in the use of public funds. As a consequence, each agency is encouraged to buy at the best possible combination of price and quality, regardless of the origin of goods and services. These principles are equally valid for government offices, municipalities, and state-owned enterprises.

Moreover, as it has been discussed elsewhere in this report, the non-discrimination principle is embodied in the Chilean Constitution (article 19). Therefore, strict control of the application of this principle comes from the Government itself, through the Comptroller's Office (Contraloría General de la República), an insatiable "hunter of irregularities". In addition, any violation of the non-discrimination principle or significant irregularity in procurement can, and probably will, be investigated by the House of Representatives and prosecuted through the judiciary system.

### 5.1 **The Central Government Supply Office**

One institution within the Ministry of Finance operates as a Central Government Supply Office (Dirección de Aprovisionamiento del Estado, DAE). Nevertheless, other government offices are not forced to buy from it, unless the price and other conditions are more competitive than those offered by alternative private suppliers. DAE's operating procedures, in turn, require all of its purchases to be made through either private or public bidding

(depending on amounts).

In practice, DAE's only advantages are the better prices it can obtain through bulk purchases, and the non-profit nature of its purchasing services. Considering the objectives of this report, it is worth mentioning that DAE's bulk purchases favor the participation of large suppliers, and, therefore, of foreign suppliers. The usual procedure for any government office in need of supplies (which may include from small orders for stationery to a new computer, or from a piece of furniture to an automobile) is to quote prices from DAE. Subsequently, the interested office requests direct or private bids from private suppliers, according to established procedures. It then decides on the basis of price and quality. It is worth underscoring that DAE is a self-financed agency and, as such, has to respect market prices and cannot practice unfair competition.

There are detailed instructions on thresholds for open tendering, for selective tendering, for private bids or, exceptionally, for direct purchases. It is worth clarifying here that the basic principle is that of relating increased openness of procedures to increasingly higher thresholds. This is a minor formal departure from the NAFTA use of thresholds, which is more related to the type of entity (state-owned corporations, federal government entities, etc). While in Chile thresholds may show slight variations among different entities, they tend to follow the general pattern established for DAE:

- a) open tendering, for purchases over US\$157.700. (3.600 UTM<sup>2</sup>)
- b) selective tendering, for purchases between US\$9.130 and US\$157.700.
- c) private purchase, for purchases under US\$9.130.

In all three cases, there is transparency, non discrimination,

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<sup>2</sup> UTM is the Unidad Tributaria Mensual (monthly tax unit), an index of constant purchasing power that evolves monthly according to the CPI. In December 1993, one UTM was equivalent to Ch\$18,619, or slightly over US\$43.

and plenty of available information about results and about the process for bidding or for selection. The main difference in the case of open tendering is procedural. Here, the notice asking for bids has to be published in at least three newspapers, and the submission and opening of tenders has to be made in public, in the presence of the bidders or their representatives. In the case of selective tendering, the opening of the bid can be made in a private act, in the presence of at least two of the purchasing agency officials. Information about the content of the different bids remains at the disposal of all interested parties.

Although the by-laws of DAE establish that under equal price and quality, locally manufactured products will be preferred (art. 3 D.F.L. 353/60), this criteria is seldom applied in practice, and is a remnant of the initial wording of the law. In any case, this criteria is inconsistent with Chapter 10 of NAFTA and certainly one point where the Chilean legislation would require some change. The operating procedures also establish that bidders must be registered in a "Suppliers Registry", a permanent list of qualified and reliable suppliers; but access to this list is completely open and periodically updated as new suppliers appear on the scene.

In summary, the bidding process is transparent, the thresholds for open tendering are very low, and there is no special treatment, in practice, given to local bidders. Therefore, these procedures can be easily related --and, if needed, rewritten-- to reflect NAFTA's Chapter 10 provisions.

## 5.2 Services

Procurement for services is not regulated through DAE, but follows similar principles of non-discrimination and, whenever possible, of transparent bidding. Services by individuals can, in some special cases (e.g., small contracts, quality requirements associated with specific individuals, etc), be hired directly. This is a frequently used procedure by strong defendants of international competitive bidding, like the World Bank. Services by firms, on the other hand, are always subject to open or selective

procurement depending on the size of the contracts.

With respect to personal services, the only existing restriction on nationality applies for the hiring of individuals as permanent government employees (contrato de planta). Foreign professionals are eligible, however, for temporary or fixed-term contracts in government agencies. An example to illustrate such openness is the case of a Swedish lawyer currently working for the Foreign Investment Committee, on successive one-year contracts, to assist in international tax studies and to be part of the Chilean team negotiating Foreign Investment Protection Treaties.

### 5.3 Public Works

Another important area of government procurement is that of construction contracts, which, in a majority of cases, are governed by the procedures of the Ministry of Public Works. This Ministry has been responsible for an overall investment program of about US\$700-800 million annually in recent years; its activities are expected to increase to about US\$1-1.2 billion per year for the period 1994-2000. Again, the procurement for construction contracts, consulting services or combinations of both, is done through open or selective tendering. Both will be fully open to locals and foreigners, with the sole limitation of registration in the Ministry's Contractors Registry (Registro de Contratistas).

The Contractors Registry, or list of qualified suppliers, is readily accessible. Its main purpose is to expedite the processing of needed information concerning the track record of contractors: legal status, past experience, financial solvency, professional qualifications, etc. All a foreign firm needs to qualify is a local "identity", which can take the form of a locally incorporated agency or a representation office. The purpose of such a local entity is to assure financial and judicial responsibility in Chile for foreign firms' contracts.

In recent years, construction firms from different foreign countries, (Argentina, Brasil, Italy, Spain, France, etc) have been actively and successfully bidding, alongside Chilean firms or

sometimes in joint ventures with them, for all kinds of construction contracts (road building, airports, ports, tunnels, irrigation projects, etc.). Benito Roggio, an Argentinean construction company, for example, was one of the successful bidders (as part of a consortium) for the construction of the new international airport terminal for Santiago.

In addition to the above mentioned local open tendering procedures, the government agency will use normal IBRD (World Bank) procedures, and thus will call for international open bidding when the amount of contracts goes over US\$4 to 6 million (depending on loan agreements and types of projects) for construction bids, or over US\$500,000 for consulting services. For bids under the above thresholds, the international agencies have accepted the Ministry of Public Works (MOP) procedures, which have been in place for nearly thirty years, as they were established and published in the official gazette back in 1965.

A recent development in the area of public works has been the new system of "concessions", which opens the building and operation of infrastructure projects to the private sector. The procedure for concessions is also based on open bidding, and decided on the basis of technical standards, proposed tariffs or tolls, terms of the concession, and payments to and from the government as necessary to finance the proposed project. Only one such project has been awarded so far: a traffic tunnel 120 kilometers north of Santiago (Túnel El Melón). This system of concessions, established by law in 1991 and started in 1992, is open on an equal footing to local and foreign firms.

#### **5.4 The Public Health Sector**

As an example of procurement in a different sector of the government, the procedures of the Ministry of Public Health were also reviewed. They are no different from those described for the rest of the central government. In fact, the Ministry of Public Health (MPH) has two major types of procurement: (a) investments, which are partially financed under multilateral institutions (IBRD,

IDB) and bilateral cooperation; and (b) operational expenditure for the acquisition or renewal of equipment and nondurable goods.

In the case of investments, procurement procedures are similar to those described for public works, with predominance of international competitive bidding. Both local and international bidding are equally open to domestic and foreign suppliers. As for operational expenditures, goods and services would be acquired through either selective tendering (in the case of consulting) or through open tendering (in the case of supplies). The Ministry has also a Central Supply Agency which takes advantage of bulk purchasing but, as it was the case with DAE, hospitals and autonomous services have no obligation to buy from such agency. In every situation, decisions are based on a comparison of the prices of the Agency with those of private suppliers.

#### **5.5 The educational sector**

Another example of sectoral procurement is provided by the procedures employed in the Ministry of Education. Their basic principles do not differ from those in use by the rest of the government. There is, however a special program, cofinanced by the World Bank, (Programa de Mejoramiento de la Calidad de la Educacion-MECE), which at present is responsible for the largest percentage of acquisitions by the Ministry. Procedures have been established in agreement with the World Bank. The majority of acquisitions under this program consist of teaching materials, libraries, textbooks, computers and software, and some building repairs.

Procedures of acquisition are the same as those in DAE, but the thresholds are slightly different: direct purchase, under US\$20,000; selective tendering, between US\$20,000 and US\$250,000; and open tendering for orders over US\$250,000. All tenderings are performed through DAE in order to take advantage of DAE's experience. All biddings are transparent, well informed and scrutinized by the Government Comptroller. World Bank regulations authorize a preference for local suppliers with a difference in

price of up to 15%. This preference has seldom been applied and it has become a regular occurrence that foreign suppliers win the bids.

## 5.6 State-Owned Companies

In order to illustrate the situation of state-owned enterprises, two cases were analyzed in detail: the railroad company (Empresa de Ferrocarriles del Estado - EFE) and the state-owned copper company (Corporación Nacional del Cobre - CODELCO).

In both cases the experience confirms the principle of complete autonomy in procurement, subject to scrutiny by the Government Comptroller in the case of EFE, or to internal and external audits in the case of CODELCO. None of the two, nor any other state-owned enterprise, has any restrictions or obligations concerning preferences to local suppliers. On the contrary, both enterprises do substantial purchasing of foreign supplies and services.

In the case of EFE, the purchasing procedures tend to be more structured, with thresholds for direct purchase (under US\$25.000), for selective tendering (up to US\$250.000) and for open tendering (over US\$250.000). Along the years, EFE has compiled its own list of qualified and reliable suppliers, but, while being in the list may expedite bidding, registration is not a prerequisite to bid.

Average expenditures of EFE through the above procedures amount to about US\$15 million per year in current spending (supply parts, fuel, office supplies, etc.) and a total expected US\$80 million of new investments during the next three years.

CODELCO's procedures are less rigid in terms of thresholds and more decentralized, with decisions delegated to the company divisions. Divisional managers are responsible for purchases up to about US\$3.5 million, the Executive Vicepresident of Operations for purchases up to US\$15 million, and the Contract Committee (senior managers) for purchases over US\$15 million. As a reference point, the total amount of purchases by CODELCO amounts to around US\$950 million per year, including operational inputs (grinding balls,

explosives, tires, chemical products, fuel, etc.), contracts for construction, and consulting.

A register of qualified suppliers has also been compiled along the years but, again, this register is open to new suppliers and does not discriminate between nationals and foreigners.

While there is transparency in the procedures, there is no operating manual for purchases that covers the activities of the whole corporation. Procedures are essentially based on divisional guidelines.

### **5.7 Defense institutions**

Purchases by the defense institutions, which are subject to specific reservations in the NAFTA annexes to Chapter 10, deserve special attention. In Chile, the armed forces enjoy one of the few exceptions to the normal tariff system, as they are exempted from both import tariffs and the value added tax. The sector is, therefore, an already existing free trade market. Considering that, in addition, defense institutions also have to respect the non-discrimination principle, and given the magnitude of resources at their disposal, this sector represents an area particularly attractive for foreign suppliers.

As in many other countries, the defense institutions play an important role in the support of civilian activities (e.g., construction of roads in isolated regions, assistance in cases of national emergencies like floods or earthquakes). They also benefit from tariff and VAT exceptions for equipment and inputs to be used in those activities. Therefore, the sector also offers ample opportunities to Canadian suppliers of mobile steel bridges, construction machinery, telecommunications equipment, aircraft, and other.

Probably the only restriction to full transparency in defense purchases is one of normal occurrence in other countries as well. The fact is that, for reasons of national security, procurement is predominantly made by selective private tendering. Particularly in the procurement of arms, war materials, war vehicles, and other

elements for defense purposes, it is important to secure quality, technology, guaranties and spare parts. Consequently, short-lists of suppliers predominate over more traditional tendering procedures.

Nonetheless, the non-discriminatory principle also applies in this sector. So much so, that the Government has accepted or considered joint-venture agreements with foreign manufacturers of arms or equipment within the military manufacturing facilities (FAMAE, ENAER, ASMAR).<sup>3</sup>

An example of such ventures is the association between Western Canadian Marine Group and ASMAR. The Canadian consortium contributes the design, the engineering and the electronics for coastal patrol vessels which are constructed in the ASMAR ship yards and exported to third countries.

#### 5.8 Conclusion

Government procurement procedures in Chile are quite transparent and non-discriminatory. Although the law allows for preferential treatment to local bidders, in practice there is no such preference. Most provisions in Chapter 10 of NAFTA are adequately fulfilled, including low thresholds for open bidding and plenty of available information.

The central government has uniform nation-wide regulations for procurement and strict supervision and scrutiny by the Government Comptroller's Office, which enforces non-discriminatory procedures as well as strict transparency.

State-owned enterprises, in turn, enjoy a large degree of autonomy, with no guidelines and no special requirements on preferential treatment to local suppliers. Although strictly supervised on transparency by internal and/or external audits as well as by Congress, they do not always have uniform procedures.

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<sup>3</sup> Fabrica de Maestranzas del Ejército, FAMAE; Empresa Nacional de Aeronáutica, ENAER; and Astilleros Marítimos de la Armada, ASMAR.

While their procedures are clear and transparent, in some cases they do not fulfill the kind of formalities established in Chapter 10 of NAFTA.

As a consequence of the above, it may be said that procurement by the government and by state-owned enterprises offers interesting opportunities to Canadian suppliers which may decide to undertake more aggressive selling campaigns in this market.

Some officials in the Government believe that more strict adherence to Chapter 10 provisions could be beneficial to Chile in introducing additional discipline to the already transparent procurement procedures. Others believe that very strict formalities, like those in Chapter 10, could introduce unwanted rigidities and unnecessary cost increases in the government's operating costs.

Negotiations about government procurement should be rather simple. Because in the case of Chile there will be no significant list of exceptions or reservations, negotiations may probably center around maintaining agile but non-discriminatory procedures, about the level of thresholds and on the opening of special government purchasing programs of current NAFTA members to Chilean suppliers.

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## 6. INVESTMENT

### Investment Statute (No. 162)

10 years, since 1974. Chile has had stable foreign  
legislation and policies. The basic principles, applied  
Foreign Investment Statute (Law No. 162), are that  
of the country and the local market, and of  
the foreign investor's investment to encourage  
issued in 1974, has been modified through  
the years, it has remained in the same  
in rules.

all of these policies and of the overall  
performance, Chile has been quite successful in  
attracting direct investment. This trend has been  
since 1990, when the country returned to a  
democratic and stable political situation.

## 6. INVESTMENT

in 1990, Chile received 4.5 billion  
dollars in direct investment, an  
increase of 11% over 1989. In  
1991, direct investment was 4.5 billion  
dollars, a 1% increase over 1990.  
The total foreign capital inflow in 1991  
was 5.5 billion dollars, a 10% increase  
over 1990.

as a result of the increase in  
investment, Chile has been able to  
attract a significant amount of  
foreign investment. This has been  
due to the country's stable political  
situation and its open economy.  
The government has implemented  
policies that encourage foreign  
investment and protect the rights of  
investors.



## 6. INVESTMENT

### 6.1 The Foreign Investment Statute (DL 600)

For nearly 20 years, since 1974, Chile has had stable foreign investment regulations and policies. The basic principles, spelled out in the Foreign Investment Statute (Decree Law 600), are those of non-discrimination between locals and foreigners, and of non-discretionary processing of investment applications. Although the original DL 600, issued in 1974, has been partially amended through several laws along the years, it has retained its basic principles signaling stability in rules.

As a result of these policies, and of its overall macroeconomic performance, Chile has been quite successful in attracting foreign direct investment. This trend has been particularly strong since 1990, when the country returned to a fully democratic system and to full diplomatic and economic relations with western democracies.

Since 1988, Chile has received an accumulated US\$6.8 billion of materialized foreign investment under the DL 600 regime, an average of almost US\$1.1 billion per year. If other forms of foreign investment are also included (e.g., sale of Chilean company shares through ADRs), total foreign capital inflow reached US\$2.6 billion in 1993 alone. Relative to the size of its economy, Chile has one of the highest rates of foreign investment in the world (6% of GDP in 1993).

The essential principles of DL 600 can be summarized as follows:

- a. Guarantee of non-discriminatory treatment to foreign investors.
- b. Guaranteed right of repatriation of capital and profits (capital after one year, and profits with no delay).
- c. No economic sectors or geographical regions reserved for national investors.
- d. No limits to foreign ownership or to the duration of foreign participation.
- e. Non-discretionary processing of foreign investment contracts.

- f. No performance requirements of any type.
- g. Option of invariability of tax regime for up to 20 years.

The above principles are reflected, for added security, in every foreign investment contract. The system is administered by an autonomous agency of cabinet level: the Foreign Investment Committee (FIC). The Committee is a Board consisting of four Ministers (Finance, Economic Affairs, Foreign Affairs and Planning) and the President of the Central Bank. Under them, an Executive Vicepresident's Office, with a staff of 12 professionals and 6 clerical employees is responsible for the day-to-day activities related to promotion, approval and registration of foreign investments.

The term "approval" requires clarification because, in practice, it has been basically a formality to ensure that the investor and the recipient company are legal and known entities, and that the investment is not in conflict with public morals or with legal economic activities. Between 1990 and 1992, for example, out of 986 applications reviewed, only two were rejected, because of unclear origin of the investment funds.

#### **The foreign investment contract**

A foreign investment application is expected to include only summarized legal information about the investor and the investee, about the expected amount of the investment, and the sector where it will be materialized. The review and approval period can be as short as 48 hours, and as long as a couple of months, depending on the quality of information supplied by the investor. After approval the State signs a contract with the foreign investor where all the rights of the investor are spelled out. Any funds brought into Chile during the processing of the application are fully covered by the contract.

It is important to mention that, while investors have another option for investment which does not require either approval or

contract,<sup>4</sup> they have predominantly preferred the DL 600 contract which provides them with additional guarantees. Each contract sets the rules for the right to transfer profits and capital, the right to national treatment, the unrestricted guaranteed access to foreign currency in the official market, the possibility of tax invariability, and a brief description of the purpose of the investment. Because the contract requires the consent of both signing parties in the event of a modification, it gives unconditional security to the investor about of the continuity of the rules affecting his investment.

In case of disputes, foreign investors have the right to a legal review about interpretation or execution of the foreign investment contract, and they can sue the authorities through a normal judicial procedure. They are also allowed to invoke a "Protection Appeal", a constitutional recourse for the guarantee of some of the fundamental rights having to do with the freedom to undertake any economic activity and to be treated in a non-discriminatory way (Article 19 of the Chilean Constitution).

Moreover, D.L. 600 reaffirms the non discrimination principle, and provides for a special recourse for foreign investors. Under such recourse (art. 9 of D.L. 600) the investor has the right to obtain a decision from the Foreign Investment Committee on whether any administrative regulation or new legislation can be considered discriminatory. If that is the case, the law establishes a time limit to modify the regulation.

### **Investment protection treaties**

Starting in 1990, the Chilean government decided to further reaffirm the principles in DL 600 through the negotiation and signature of Investment Protection Treaties (IPT). Their basic contents are the same as in DL 600, but they add an arbitration clause. To clear the way for the signature of such treaties, the

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<sup>4</sup> Chapter XIV of the Foreign Exchange Law.

Government started by signing the ICSID<sup>5</sup> Convention, which was subsequently ratified, in 1991, by the Chilean Congress. Chile was, therefore, one of the first Latin American countries to take distance from the so-called "Calvo doctrine" (which precludes disputes to be resolved outside the judiciary system of the host country) and to accept international arbitration for the settlement of investment disputes.

Between 1991 and 1993, Chile negotiated and signed 14 IPTs with the following countries: Germany, Spain, Argentina, Switzerland, France, Belgium, Denmark, Sweden, Italy, Norway, Netherlands, Finland, Venezuela, and Malaysia. The policy is to continue negotiating with other countries. Preliminary discussions for an IPT with Canada have also taken place recently.

These treaties incorporate most of the clauses in Chapter 11 of NAFTA: national treatment, most-favored-nation treatment, right to transfers, expropriation and compensation, settlement of disputes, etc.

The only topics included in Chapter 11, which are not incorporated in the IPTs are those dealing with Performance Requirements (article 1106) and with composition of Senior Management and Board Directors (article 1107). Both articles are, nevertheless, non applicable in the case of Chile, because no requirements are imposed on foreign investors and there is no obligation to appoint either local management or Chilean directors (except for a couple of minor exceptions mentioned below). Because the above matters have already been dealt with, and negotiated, in the investment treaties, there should be no major problems in meeting the obligations in Chapter 11 of NAFTA.

With respect to the relationship between Chilean and foreign partners in any joint venture, there are no special regulations other than local legislation governing corporations. As it is normal practice in international business, shareholders agreements

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<sup>5</sup> International Center for the Settlement of Investment Disputes from the World Bank.

are freely negotiated among partners.

An important topic during NAFTA negotiations was that of the procedures for expropriation and compensation. In the case of Chile, this matters are clearly established in the Constitution (article 19 paragraph 24, and in Decree Law 2186, of 1978), in terms that are in full compliance with article 1110. Expropriation is only justified for a public purpose, which in Chilean legal language is described as "public need" (utilidad publica) or "national interest" (interes nacional), both of which need to be qualified as such by Congress. Expropriations must also be on a non-discriminatory basis, in accordance with due process of law. The payments of compensation shall be equivalent to fair market value and, unless a special agreement is reached as to the form of reimbursement, must be paid in cash and without delay. Concerning transfer of payments, this matter is regulated by the legislation on foreign investment, which guarantees the transferability of capital resulting from the sale of all or part of an investment and/or of compensations.

## 6.2 Debt-Equity Conversions (Chapter XIX)

Although still "alive" as a legal alternative for investment by foreigners, the debt-equity conversion mechanism, otherwise known as Chapter XIX,<sup>6</sup> is today completely out of use.

This scheme started operations in 1985, when Chile's foreign debt papers were traded in secondary markets at almost 50% of face value. The Central Bank provided the owners of such papers with the equivalent in Chilean pesos of their face value minus a fee (in the order of 10 to 12 percent of face value). The investor could, then, use those pesos to buy a company or invest in a project in Chile.

Nearly US\$3.5 billion of debt were recovered through this mechanism between 1985 and 1990. Today, Chilean debt paper is internationally traded at around 95% of face value. At this price,

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<sup>6</sup> Because it is Chapter XIX of the International Exchange Law (Ley de Cambios Internacionales) of the Central Bank of Chile.

and considering the commissions involved in the purchase of debt papers and in their exchange at the Central Bank, the system has turned unattractive. As a consequence, no new transactions have been registered during 1992 and 1993. While investments under Chapter XIX had larger resident periods for capital and profits, and special operating rules, it would be impractical to discuss them because they are probably not going to be part of any negotiation.

### 6.3 Possible exceptions to Chapter 11 of NAFTA

Some of the few exceptions, which could become points of discrepancy between Chile's foreign investment legislation and Chapter 11 of NAFTA, are the following:

a) The repatriation of capital, under the present rules in DL 600, may take place only after one year of the entrance of such capital into the country. This restriction, whose only purpose is to discourage short-term speculative capital from coming into the Chilean markets, has been accepted by all the countries with which Chile has signed investment treaties. Formally, it has been dealt with in a special protocol stating that: "notwithstanding the provisions of article 5 (about transfers) the Republic of Chile retains the right to allow the repatriation of equity capital at the latest after one year has elapsed from the date it was brought in by the investor".

b) Under the Chilean constitution, activities related to the exploration or exploitation of hydrocarbons are to be undertaken exclusively by the state. Local and foreign investors can do so only by entering into joint-ventures or "risk contracts" with the National Petroleum Enterprise (Empresa Nacional de Petróleos - ENAP). Uranium exploration and exploitation is subject to similar regulations. Notwithstanding the above, the restriction has become a "non-issue" in view of the limited oil and uranium reserves which have been prospected in Chile.

c) Coastal trade (cabotage) is restricted to Chilean vessels, but foreign-owned vessels can bid for cargoes exceeding 900 tons.

d) Under the fishing law, any fishing vessel operating under Chilean flag, has to be owned either by Chilean individuals or by companies with majority Chilean capital. Nevertheless, on the basis of reciprocity, this prohibition can be waived to nationals from countries which provide the same privilege to Chilean nationals.

e) In radio and TV stations, there is no limitation to foreign ownership in the operating company, but the president, executive director and manager of the company have to be Chilean nationals. Examples of foreign ownership in TV stations are those of Televisa, from Mexico, which owns 49% of channel 9, and CANWEST of Canada, which recently acquired 49% of channel 4.

f) In printed media, owners of newspapers and magazines have to be Chilean, as well as the responsible directors. The only exceptions are scientific and artistic publications, and publications in foreign languages.

With respect to article 1114 (environmental measures), the Chilean Government will certainly endorse paragraph (2) which states that "the parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures". In fact, although compliance with specific environmental and health standards is not spelled out as such in the obligations included in the foreign investment contract, it becomes an implicit requisite resulting from the obligation to respect all existing and future Chilean legislation, including non-discriminatory standards related to the conservation and protection of human, animal and vegetable life or health.

#### 6.4 Conclusion

The existing Chilean legislation on foreign investment presents a significant coincidence with NAFTA's Chapter 11 provisions. Topics like national treatment (or non-discrimination), most-favored-nation treatment, transfers, expropriation and compensation, and settlement of disputes between foreign investors and the government, are not only part of Chile's Constitution and/or of its Foreign Investment Statute (D.L. 600)

but have also been negotiated and included in more than a dozen bilateral investment treaties signed by Chile in recent years.

Aspects of Chapter 11 which are not normally included in such treaties, i.e., the agreement to avoid performance requirements or to avoid unnecessary restrictions on senior management, have also been part of the Chilean foreign investment practice and economic policies for years.

It is not expected, therefore, that difficult points could appear in the negotiations of this Chapter. The few exceptions to national treatment or to sectoral freedom just mentioned are not expected to create major problems, especially when compared to the lists of exceptions which Canada, Mexico and the United States included in the annexes to Chapter 11 of NAFTA.

At present, and even without NAFTA, Canada's investment in Chile has developed very strongly. As of the end of 1993, Canada was the second largest foreign investor in Chile, with nearly US\$4 billion of registered investment, or 16.4% of the total approved in Chile between 1974 and 1993. This reflects a growing attraction to Canadian investors of Chile's mining sector.

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## 7. CROSS - BORDER TRADE IN SERVICES

As advanced economies become increasingly knowledge-based service economies, it is critical that the opportunities for service industries not be limited to domestic markets. Both producers and consumers of services will benefit from the increased competition that will result from expanded international trade in services. This chapter discusses the basic principles governing cross-border trade in services. Separate chapters will discuss special rules which apply to some sectors, i.e., finances and telecommunications.

It is a principle which NAFTA requires in this matter is that member countries extend best national and most-favored-nation treatment to cross-border service providers of other member countries without requiring such providers to establish a "local presence" as a prerequisite to providing their services, except as required for legitimate public policy reasons. The main areas of services covered by Chapter 12 of NAFTA are those of professional services.

## **7. CROSS-BORDER TRADE IN SERVICES**

Notwithstanding the general principles, some sensitive sectors have been exempted from the rules, providing scope for introducing non-conforming measures in the future. Canada, for instance, has inscribed reservations to permit all layers of government full flexibility regarding public law enforcement, correctional services, income security or insurance, social welfare, public education, public training, health, basic telecommunications services, minority affairs, some air and maritime transportation, etc. The chapter does not create obligations or rights on government procurement involving services as these are addressed in a separate chapter.

An important element in the regulation of trade in professional services is the development of mutually acceptable professional standards. To this end, the Agreement (Annex 1210.5) encourages the relevant bodies in their respective territories to develop appropriate and compatible standards and criteria for

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In essence, what NAFTA requires in this matter is that member countries extend both national and most-favored-nation treatment to cross-border service providers of other member countries without requiring such providers to establish a "local presence" as a prerequisite to providing their services, except as required for legitimate regulatory reasons, such as consumer protection. The main areas of services covered by Chapter 12 of NAFTA are those of professional services.

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An important element in the regulation of trade in professional services is the development of mutually acceptable professional standards. To this end, the Agreement (Annex 1210.5) encourages the relevant bodies in their respective territories to develop appropriate and compatible standards and criteria for

licensing and certification of professional services. These standards and criteria may consider the following matters: education, examinations, experience, conduct and ethics, procedures for continuing education, scope of practice, requirements for local knowledge, etc.. Two special sections of the Annex to Chapter 12 set out specific provisions for foreign legal consultants and for temporary licensing of engineers.

Special emphasis is also given in NAFTA to transportation services and, in particular, to land transportation. This is a topic less relevant to other potential NAFTA countries because what was essentially pursued and achieved in the Agreement was to lay the foundations for the development of more integrated truck, bus and rail transportation services throughout the geographic North American subcontinent. Far away countries like Chile may only benefit or participate in this part of the Agreement in those sections dealing with specialty air services.

#### **Professional Services in Chile**

From the viewpoint of Canadian business opportunities, the most significant increases in cross-border services with Chile may be expected in some specific areas of technical and engineering consulting. Existing Chilean legislation is very liberal in this matter, and provision of professional services in the private sector is totally non-discriminatory. Any firm may hire any foreign professional for as long as needed. Professional registration is not a prerequisite in Chile to work either in private or in autonomous state-owned companies. Only government offices (ministries) require a professional degree, obtained or validated in Chile. And foreign degrees can be revalidated in Chilean universities without significantly cumbersome procedures.

A special case is that of foreign professionals willing to participate in the Contractors and Consultants Register in the Ministry of Public Works. In order to facilitate such registration and avoid the procedures of revalidating the foreign degree, Decree Law 1903 of 1990 grants degree recognition by the decision of three

professionals of the Ministry of Public Works.

A potential point of negotiation between Chile and NAFTA will be that of recognition of degrees for Chilean professionals. Currently, recognition of foreign degrees in Canada and U.S.A. is reportedly very difficult.

The Chilean legislation is also very open concerning services provided by foreign firms. Private firms and autonomous state-owned companies have no restrictions for the hiring of foreign service companies. In the public sector, the only requisite will be that of a local "identity" (which is not necessary equal to local "presence"). The local "identity" can be as simple as a representation office with enough powers to ensure financial and judicial responsibility to represent the foreign firm in the bidding for engineering or construction contracts. According to the law, local representatives must be recognized professionals. Foreign firms may opt between hiring local professionals as representatives, or going through the recognition procedure described above. The legal procedures for establishing a local affiliate or for appointing a representative are extremely easy and can be as simple as the notarization of a power of attorney.

### **Potential Opportunities**

A brief overview of the engineering consulting business in Chile may help identify a few business opportunities for Canadian engineering firms.

The largest grouping of consulting firms is the Consulting Engineers Association of Chile (Asociacion de Ingenieros Consultores de Chile - AIC). Its membership includes 44 firms, which employ 3900 professionals. In addition to AIC, there are about 200 small companies which employ about 1000 professionals. The total annual sale of services is estimated at about 10 million professional hours. Out of this total, 80% is local engineering at an average value of about US\$20 per hour, and 20% of foreign engineering at an average value of about US\$65 per hour. Total revenues in this business amount to about US\$290 million per year.

Apart from the local consulting business, many firms in the Association have been quite successful in exporting engineering services in areas such as mining, software, fishing and management of public utilities.

In view of the difference in costs between Chilean and foreign engineering services, there should be a wide variety of opportunities for joint ventures between Chilean and Canadian consulting firms. These joint ventures could have the dual purpose of tackling the local Chilean market and serving other markets in Latin America and in North America. A recent agreement was signed to this end between AIC and the Canadian Association of Consulting Engineering in order to collaborate in the development of their affiliates and, in particular, to support activities related to certification of ISO-9000 and to the potential accession of Chile to NAFTA.

### **Conclusions**

Chile applies quite open policies for the provision of services by foreign professionals. Such provision may take the form of employment in a local firm, operation as an individual consultant, or operation as a foreign consulting firm. In all three cases operations with the Chilean private sector and with autonomous state-owned companies is completely open and unregulated. Operations with government offices are subject to certain formalities which, although still quite open, will require recognition of degrees in the case of individuals, and establishment of a local "identity" (not necessarily a local presence) for firms.

Chile has a long and solid tradition of professional training and will welcome the development of mutually acceptable professional standards so as to further improve the criteria for licensing and certification of professional standards. A potential point of negotiation may be the reciprocity of criteria for recognition of degrees where Chilean authorities believe Chile is more liberal than the other NAFTA members.

Recent experiences of exports of Chilean engineering to other Latin American countries, coupled with substantial cost differences between Chilean and Canadian engineering services, open good opportunities for joint ventures between engineering firms of the two countries to tackle both the local Chilean market as well as some foreign markets.



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## 8. COMPETITION, MONOPOLY AND STATE ENTERPRISES

NAFTA's Chapter 15 establishes disciplines on the activities of monopolies and state enterprises based on the principle of no discrimination in the purchase and sale of goods. Parties may designate or maintain monopolies -- public or privately owned -- but are required to "adopt or maintain measures to proscribe anti-competitive business conduct and take appropriate actions, recognizing that such measures will enhance the fulfillment of the objectives" of the NAFTA.

Article 1502 requires each member country to ensure, through appropriate control, that any privately-owned or government-owned monopoly acts in a manner that is not inconsistent with the obligations under the Agreement. In particular, monopolies are expected to act solely in accordance with commercial

## 8. COMPETITION, MONOPOLY AND STATE ENTERPRISES

practices including cross-subsidization or predatory

To help achieve the above purposes, Parties recognize the importance of cooperation and coordination among their authorities, and agreed to establish the Working Group on Trade and Competition to report and make recommendations on relevant issues of the competition between competition laws and policies and trade in the trade area.

The disciplines of NAFTA's Chapter 15 regarding both the promotion of free competition and the adequate behavior of enterprises -- public or private -- are appropriately covered in the domestic laws.

Further trust legislation is contained in Decree Law 211. The law declares illegal and proscribes any act or attempts to restrict free competition within the country. A non-exhaustive list of practices condemned by the law



## 8. COMPETITION, MONOPOLY AND STATE ENTERPRISES.

### 8.1 Antitrust Legislation.

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To help achieve the above purposes, Parties recognize the importance of cooperation and coordination among their authorities, and agreed to establish the Working Group on Trade and Competition to report and make recommendations on relevant issues of the relationship between competition laws and policies and trade in the free trade area.

The objectives of NAFTA's Chapter 15 regarding both the promotion of free competition and the adequate behavior of monopolies --public or private-- are appropriately covered in the Chilean domestic laws.

Chilean antitrust legislation is contained in Decree Law 211, of 1973. This law declares illegal and proscribes any act or agreement that attempts to restrict free competition within the country. A non-exhaustive list of practices condemned by the law

includes: price-fixing agreements; establishment of production quotas; acts tending to restrict production, transportation or distribution; allocation of exclusive market zones, and contracts, negotiations or associations to reduce or stop production. Legislation applies in a nondiscriminatory way to local as well as foreign entities.

The Law provides sanctions and/or preventive controls to enforce the legislation. The preventive role is performed by either the "Regional Preventive Commissions" located in every region of the country and by the "Central Preventive Commission", located in the Metropolitan Region (Santiago). The preventive commissions can be consulted in advance of concluding a transaction that could result in a monopoly. The commission can adopt measures of suspension of commercial agreements and setting of temporary maximum prices for goods under investigation. These measures may be appealed before a National Resolutive Commission, which, in addition to serving as an instance of appeal, has the power to impose sanctions including dissolution of partnerships, application of fines, and prosecution of criminal action for severe violations of the antitrust legislation. The sanctions imposed by the resolutory commission can be reviewed by the Supreme Court.

The secretariat of these Commissions is located at the "National Economic Attorney's Office", whose head represents the interest of the people.

Antitrust legislation, as described above, complies satisfactorily with the principles and guidelines included in Chapter 15 of NAFTA. Moreover, the record of enforcement in this particular subject may fulfill without major problems the requirements of a NAFTA negotiation.

## 8.2 State Enterprises

Regarding state monopolies and/or state enterprises, the State of Chile has not abdicated from maintaining or even creating them. Nevertheless, the Chilean Constitution (Article 19, para. 21) imposes severe limits to the entrepreneurial activities that can be

performed by the State. In fact, the creation of any new state enterprises requires a special law with high majority of votes (ley de quorum calificado). This strict requirement has, in practice, greatly reduced the entrepreneurial role of the State in the economy and makes it extremely difficult to create new state enterprises. Moreover, very few of the remaining state-owned enterprises enjoy a monopolic position. Among those which do, are the regional water and sewage enterprises (EMOS), and the national railroads (FFCC) in those areas not served by private railroads.

In any event, if a state monopoly or a state enterprise violates free competition practices, it can be sued and sanctioned just as any private company. This procedure of Chilean legislation is in accordance with article 1502 of NAFTA.

A similar situation applies with respect to their treatment towards foreign investment. Based on the constitutional right of non-discrimination, also established in Decree Law 600 of Foreign Investment, domestic monopolies and state enterprises must give the same treatment to local and foreign investors.

### 8.3 Conclusions

The objectives of NAFTA's Chapter 15 regarding both the promotion of free competition and the adequate behavior of monopolies --public or private-- are appropriately covered in the Chilean domestic laws.

Antitrust legislation in Chile complies satisfactorily with the principles and guidelines included in NAFTA. Moreover, the record of enforcement in this particular subject may fulfill the requirements of a NAFTA negotiation.

Regarding state monopolies and/or state enterprises, the State of Chile may maintain or even create them, a fact that is permitted by NAFTA. Nevertheless, the Chilean Constitution (Article 19, para. 21) imposes severe limits on the entrepreneurial activities that can be performed by the State.

If a state monopoly or a state enterprise violates free competition practices, it can be sued and sanctioned just as any

private company. Again, this procedure of Chilean legislation is in accordance with NAFTA obligations.

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## 9. TEMPORARY ENTRY

The objective of NAFTA's Chapter XVI is to ensure that business travellers from all three signing members can count on secure access to the other member countries and, therefore, may be able to pursue the business opportunities created by the Agreement. NAFTA does not intend to create a common market for the movement of labor; but sets the governing principles and rules under which citizens of each country may have access to the other countries on a temporary basis to pursue business without meeting a labor-market test.

NAFTA identifies four categories of travellers eligible for temporary entry, as follows:

- business visitors, who are engaged in the international business activities resulting from the Agreement, which are included in a special annex to the chapter;

- traders and investors, who are engaged in substantial trade and investment between the member countries;

- intra-company transferees, who are employed by a company in a capacity that is managerial or involves a specialized knowledge and who are transferred within a company or its subsidiaries between member countries; and

- professionals, who are seeking to enter another NAFTA country on a temporary basis to provide services. Eligible professionals are specifically listed in an annex (1603.D.1). To further advance these matters, the Agreement established a working group with representatives of all three parties.

### Existing Chilean Legislation

Temporary entry is defined in the Chilean legislation as a stay of less than 90 days, without the intention of immigration or of participation in the labor market. Visas for temporary entry are rather simple and straightforward. Information about them is readily available in Chilean consulates around the world. Overall, the requisites for a visa or reasons to deny it in the Chilean



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legislation tend to comply with the rules of NAFTA.

Moreover, at present the citizens of the three member-countries of NAFTA do not need a visa for temporary entry to Chile. Business visitors who derive their income from abroad and do not receive any income from Chilean sources can freely operate in Chile with a tourist visa. If such a visitor performs a paid activity, even if paid from abroad, he should obtain a 30 day permit from the Ministry of the Interior. This permit is regularly granted, and requires only a simple application.

For periods of more than 90 days, and when the presence of a person is justified in the country, she will get a renewable temporary residence for one year. Among the justified reasons, the law includes being an entrepreneur, an investor, or a trader with interests in Chile. It also includes being a professor, a scientist, an academic or a professional whose presence in Chile is required by a Chilean corporation.

Until recently, more than a problem of temporary entry, Chile presented a problem of temporary exit for foreigners in temporary residence, who were required to obtain "sailing" permits for any trip abroad. As a consequence, they had to incur in monetary costs as well as time losses. This obstacle was removed through a new law (19273) in December 1993, which eliminated the sailing permit and made exit and reentry more expedite.

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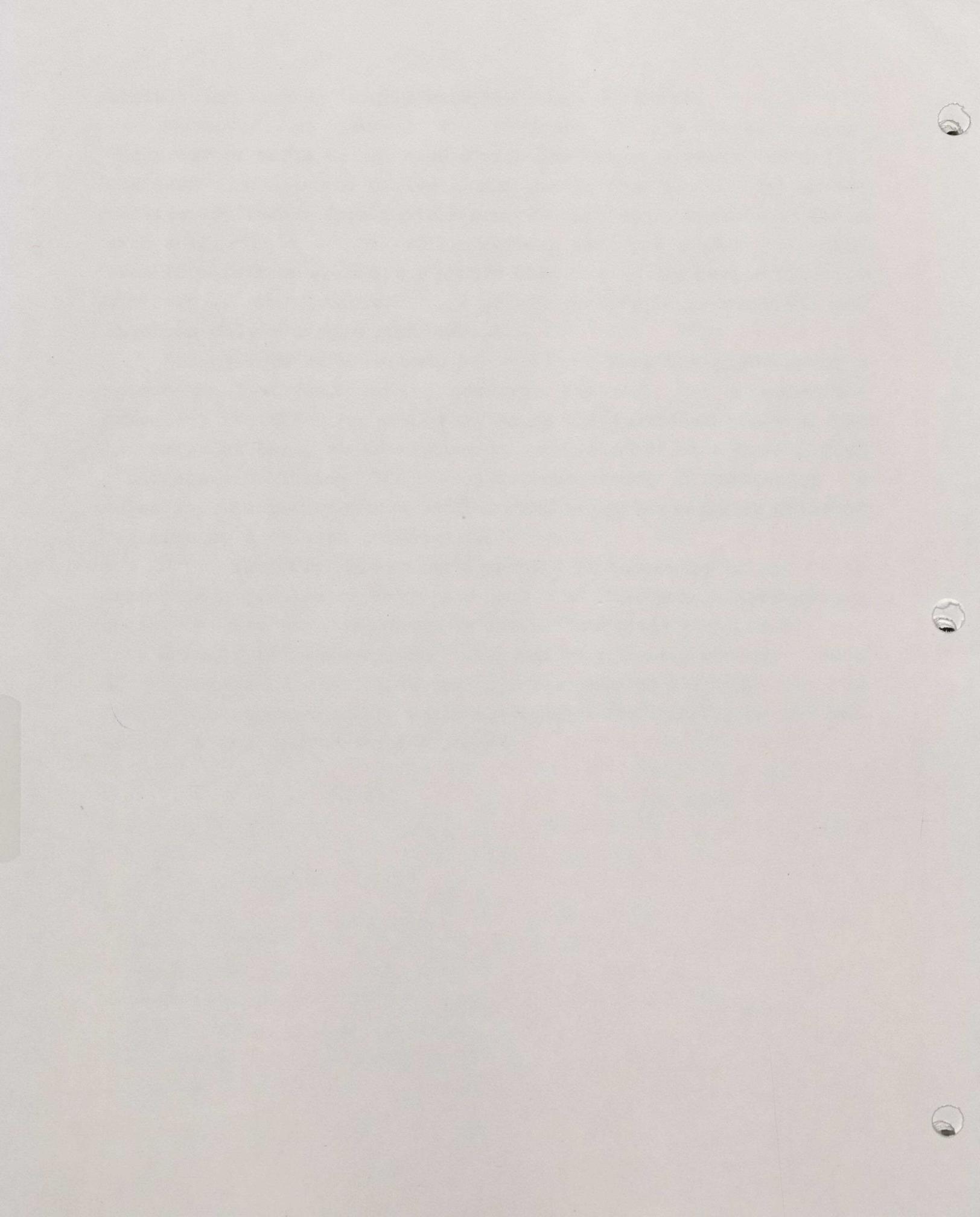
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## 10. INTELLECTUAL PROPERTY

Protection and enforcement of intellectual property rights are provided in the Chilean Constitution and in two specific pieces of legislation: Law N°17.336 of 1970 (updated in 1990 and 1992), about copyright, and Law N°19.039, of 1991, about industrial property. Chile is also a signatory of three of the four international conventions mentioned in article 1901 of NAFTA: the Geneva Convention about Phonograms (1971), the Berne Convention about Literary and Artistic Works (1971) and the Paris Convention about Industrial Property (1867). The adherence to the UPOV Convention, about new varieties of plants, is presently under consideration by the Government.

Intellectual Property Rights are guaranteed by the Chilean Constitution, which among a list of fundamental and personal guarantees includes the right of authors over their intellectual and artistic creations (Article 19, section 25). Furthermore, the Constitution guarantees trademarks, models, technological processes and other similar creations, and establishes procedures of compensation in the event of expropriation of patents and industrial properties, which are identical to those established for other types of physical properties or investments.

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While the volume of patenting in Chile is rather limited and proportionate to the size of its market and of its technological activity (about 1.000 new applications per year), the registration of trademarks is very active. During the last couple of years it has reached a volume of about 33.000 new or renewal applications per year. According to international statistics, Chile is among the ten countries in the world with the largest volume of trademark applications.

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### 10.1 **The Copyright Law**

The Copyright Law (N°17.336) covers all aspects of intellectual creation including: all types of scientific, literary

or artistic works; sound-recordings; films; videograms; software programs; etc., all of which are clearly defined and described in the text of the law. Protection granted by that law covers, in a non-discretionary way, the rights of Chilean as well as those of foreign authors resident in Chile. This protection is granted for the duration of the author's life and extends for 50 years after death, on behalf of his or her heirs. Foreign authors non-resident in Chile benefit from the protection provided to them by the international conventions signed by Chile.

The law provides to the authors of the registered works the exclusive right to authorize or prohibit the publication, reproduction, adaptation, emission, public audition or distribution of such creations. The copyright in Chile comprises both the moral and the economic right of authors. Even if the right of exploitation is transferred, the author will retain the paternity right and, therefore, his or her work cannot be altered or mutilated. By virtue of the economic right, the author may freely transfer such right for the purposes of its exploitation and full enjoyment of the benefits derived from it.

There should be no doubts about the protection provided to computer programs as they are specifically included in the law. The same holds true for the compilations of data or other material which by reason of the arrangement of their contents constitute an intellectual creation. While there is no specific mention in the law about rental of computer programs, it is understood that by virtue of the property right over the programs, only their authors or the holders of the economic rights over those programs may rent them or authorize their use by third parties.

The producers of sound recordings, another topic specifically included in Chapter 17 of NAFTA, are also protected by the copyright law. The term of protection is the same as in NAFTA, that is, 50 years from the end of the calendar year in which the fixation was made.

The protection of encrypted program-carrying satellite signals is, however, not equally clear. In fact, there is no specific

sanction in the Chilean legislation for the manufacturing, import or sale of decoding devices. The only protection granted in such case is that of the copyright law, which will make a civil offense the unauthorized transmission or distribution of decoded signals with a commercial purpose.

Sanctions for violations of the law and misuse of the author's creations include pecuniary compensations, penalties, and, in extreme cases, such as proven bad faith or falsification, imprisonment. The judicial authorities are also empowered to dictamine a confiscation of books, sound recordings or any other unauthorized reproduction of the author's work, and to confiscate any sum obtained from the distribution of such reproduction.

## 10.2 The Industrial Property Law

Law N°19.039 on industrial property covers trademarks, patents on inventions of products or processes, utility models (instruments, tools, spare parts, etc.), and industrial designs.

Only a few subjects are excluded from patentability:

- a) Plants and animals.
- b) Diagnostic, therapeutic and surgical methods for the treatment of individuals and animals.
- c) Economic or financial methods, principles or plans which are easily verifiable.
- d) Inventions which go against morality, public order or national security.

The term of protection for patents is 15 years from the date of granting the patent. Nevertheless, the law also establishes sanctions for the use or imitation of a patent for which a file has already been presented and for which a patent would be eventually granted. Assuming between 2 to 4 years for the application procedures, the period of effective protection becomes 17 to 19 years counted from the date of filing. This is one of the few areas of possible conflict with Chapter 17, where the period of protection has been set at 17 years from the date of granting and

20 years from the date of filing.

Notwithstanding the general terms mentioned above, the Chilean law also establishes that in the case of inventions already patented abroad, the term in Chile will be limited to the remaining protection period available in the country where such invention was patented, but not exceeding the aforesaid 15 years.

Another topic of potential disagreement with Chapter 17 is contained in one of the provisional articles of the Chilean law, and refers to the protection of pharmaceuticals. Only pharmaceutical products that have applied for a patent in their country of origin after the publication of law 19.039 (January 25, 1991) may apply for a patent in Chile. In other words, there is no retroactivity in the patenting of pharmaceutical products.

With respect to the extent of coverage, the Chilean law is quite similar to NAFTA regulations contained in Chapter 17. Coverage is non-discriminatory between nationals and foreigners and includes all economic activities without limitation of region, market or quantity of products.

Procedures for application and registration of patents are transparent and well defined. They provide adequate timing for presentation and examination of applications, public notice of such applications, a reasonable opportunity for affected parties to oppose the application, an opportunity for the applicant to respond, and reasonable time for completing the registration and publication of the patent. The same procedure applies to the registration and publication of trademarks.

The law provides two administrative instances and one judicial instance for disputes related to the applications, registration or opposition of patents and trademarks. The first instance for a claim will be the Head of the Industrial Property Department in the Ministry of Economy. His decision may be appealed before an Arbitral Tribunal composed of three members, appointed by the Ministry of Economy: one is freely elected by the Ministry, one is proposed by the Chilean equivalent of the Attorney General (Consejo de Defensa del Estado), and the third is selected from a list of

three candidates presented by the Court of Appeals of Santiago. The third and final instance is the Supreme Court, which is always an available instance but is used only in extreme cases.

Enforcement of intellectual property rights is fair and equitable under Chilean law. Judicial Authorities have the powers required in article 1715 to order the necessary investigations, to compensate the right holder for injuries suffered, to order the infringer to pay the right holder's expenses, to confiscate the infringer's products and give them to the right holder for appropriate disposition. Moreover, the law requires the judicial authority to impose a fine on the infringer at Government's benefit, in addition to the above compensation.

Procedures for registration, disputes, and law enforcement for other areas of intellectual property --such as trademarks and industrial designs-- are the same as those for patents, with the exception of the term of protection. Trademarks are protected for 10 years, which can be indefinitely renewed, whereas industrial designs are protected for a non-renewable term of 10 years. These terms are the same contemplated in Chapter 17 of NAFTA.

Two subjects in NAFTA are rather new in Chilean business practices, and, while no particular problems are anticipated, they will need to be integrated in the Chilean legal system: Trade Secrets and Layout Designs of Semiconductor Integrated Circuits.

The Trade Secret concept is not explicitly developed or defined in the existing Industrial Property Law. Nevertheless, article 284 of the Chilean Criminal Code makes it a criminal offense to reveal any secrets of the company in which a person has been or is currently employed. Similar sanctions are established for any public servant that would reveal any confidential information to which he has access by virtue of his work. A reasonable discussion and negotiation about the concept and the future integration of an operational definition in the administrative procedures of the Department of Industrial Property, seems quite feasible.

The regulations about semiconductor layout designs, on the

other hand, are completely absent from the Chilean legislation and would require special review.

### 10.3 Conclusion

Most of NAFTA's provisions in Chapter 17 appear to be well satisfied by existing Chilean legislation on copyrights, and on industrial property, including trademarks, patents, industrial designs, and industrial models.

Procedures for application and registration of patents and trademarks are fair, transparent and simple. Settlement of disputes over registration of patents and trademarks have well established procedures with different instances for appeal.

Enforcement of existing laws is guaranteed through appropriate faculties in the administrative branch and in the judicial authorities.

Notwithstanding the above, there are a few points that may generate discussion during negotiations: a) the track record of application of the industrial property law is still rather new, and the experiences about violations of the law and application of sanctions are, not yet conclusive; b) there are differences concerning the term of protection of patents (15 years in Chile, 17 years under NAFTA); c) patents for pharmaceutical products are not retroactive under the Chilean law, and, therefore, Chile will not provide coverage to pharmaceutical products patented in their countries of origin before January 1991; d) the concepts of trade secrets and layout designs of semiconductor integrated circuits need to be further clarified and/or specifically incorporated in the Chilean legislation.

It is worth noting, however, that the discussion on most of the above topics has, in practice, been superseded by the recent agreements in GATT's Uruguay round. In effect, under the TRIPS chapter the duration of patent rights, the trade secrets, the protection of satellite signals, have all been covered. Being Chile one of the active participants of the round, it will have to adapt its legislation to fulfill its obligations upon official signature



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of this agreement. As a consequence, many of the topics would be resolved by the time of a possible NAFTA negotiation.



## 11. DISPUTE SETTLEMENT MECHANISMS

Chile's position with respect to dispute settlement mechanisms, and in particular to those of antidumping and countervailing duties, will closely resemble that of Canada, as both countries are middle-sized economies dealing in a world market with several larger players. It is not by chance that these topics have been longstanding goals of both countries in international trade and that both have supported more transparent and clearly enforceable trade rules in the recently concluded Uruguay Round of GATT.

The private sector and the governments of both countries are acutely aware of the impact that unfair trade remedy actions may have on trade in products such as timber, fruits, fish and others. Effective and binding dispute settlement legislation and mechanisms have been in the tradition of a law-abiding country like Chile.

## 11. DISPUTE SETTLEMENT AND INSTITUTIONAL PROVISIONS

Given this background, there should be no problem for Chile to accept the principles and procedures contained in chapters 19 and 20 of NAFTA, as well as the sector-specific mechanisms described in the respective chapters.

### 11.1 Antidumping and Countervailing Duty Disputes

Chapter 19 of NAFTA, building on the experience of the existing FTA between Canada and U.S.A., adopted the procedure of replacement of judicial review of final antidumping or countervailing duty determinations, with binational panel review. These binational panels issue binding decisions which administering authorities must implement for a particular case. Moreover, if the panels find that such authority has erred on the basis of the same standards as would be applied by a domestic court, they can send the issue back to the local authority for reconsideration.

NAFTA also provides in part 3 a list of desiderata in the administration of antidumping and countervailing duty laws, which appear not to be legally binding upon the Parties. These provide

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The private sector and the governments of both countries are acutely aware of the impact that unfair trade remedy actions may have on trade in products such as timber, fruits, fish and others. Effective and binding dispute settlement legislation and mechanisms have been in the tradition of a law abiding country like Chile, where it is seen as the most effective means for dealing with "security of access" to foreign markets. Given this background, there should be no problem for Chile to accept the principles and procedures contained in chapters 19 and 20 of NAFTA, as well as the sector-specific mechanism described in the respective chapters.

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NAFTA also provides in part a list of desiderata in the administration of antidumping and countervailing duty laws, which appear not to be legally binding upon the Parties. These provide

inter alia for the publication of notices regarding the initiation of investigations, and the times for submissions of information; the according of reasonable access to information; the provision of opportunity for interested parties (including foreign interests) to present facts and arguments; the protection of confidential (business proprietary) information; and the preparation of administrative records.

Finally, in a matter that may be of significant interest to Chile, Chapter 19 includes (Annex 1904.15) the necessary amendments that each one of the member countries has agreed to introduce in its domestic trade remedy legislation, in order to bring them into conformity with the rules of NAFTA.

### **Chilean Trade Remedy Law and Procedures**

The procedures to establish trade remedy actions in Chile are contained in Law N°18.525 of 1986. This law provides that the President of the Republic has the right to apply antidumping and countervailing duties following on the proposal made by a special Commission on trade distortions. Before making its recommendation, this entity should be convinced --after appropriate investigation-- that a trade distortion on specific imports of goods may produce serious and imminent damage to national production. The distortion must be of such nature that it artificially reduces the exporting prices of the goods, creating unfair competition in the recipient market of the imports.

The Commission on Trade Distortions is regulated through Decree N°575 of 1993. This Commission was established to analyze and determine price distortions on imported goods. Its members are: two representatives of the Central Bank, one representative from the ministries of Finance, Economy and of Foreign Affairs, the Head of the National Customs Service and the National Economic Attorney (Fiscal Nacional Económico). The technical secretariat of the Commission is located in the Central Bank.

The procedures for filing a claim, and the subsequent investigations and decisions, are transparent and well established.

The procedure starts with the filing of a claim at the Technical Secretariat. Within 10 days the Secretariat must inform the claimant whether the claim is inappropriate or has insufficient information; otherwise, it will be submitted without delay to the Commission. Within 5 days of its submission, the Commission must decide whether to start an investigation or not. Such decision must be publicly informed by a notice in the Official Gazette. If the decision is to initiate an investigation, the notice must describe the products involved in the claim, the identification of the claimant, the producers, the exporters and importers of the merchandise, and a description of the trade distortion and the expected damage it may produce to other local producers of the good. It must also indicate where and when should the response to claims be filed.

The Commission is instructed by law to hold hearings with all parties which have expressed their interest in writing. It should also inform the Chilean Ministry of Foreign Affairs about the claim with the purpose of communicating it to the country whose products are under investigation. This is done in order to facilitate official consultations and proper advice from foreign governments to the affected exporters. Interested parties have a 30-day period for the submission of evidences, facts and arguments in support of their respective positions.

The Commission, in turn, has a 90-day period, counted from the day of the publication in the Official Gazette, to adopt a decision about the existence of distortions and to recommend (or not) appropriate countervailing duties, minimum customs values, or antidumping duties. Such measures are applied by Presidential Decree based on the Commission's report. The Commission may, if justified, recommend the application of provisional remedies during the first 60 days of the investigation, measures that will be effective until a final resolution is made. In any case, the resulting compensatory measures have a duration of only one year. If the trade distortion persists, the measures can be renewed every year and for as long as they are needed but repeating the hearing

process before each renewal.

### **Chilean Procedures and NAFTA**

The above procedures have several differences with those presently in use in the NAFTA countries and/or with those included in Chapter 19. Some of those differences are: the composition of the Commission on trade distortions, the timings and deadlines involved during the investigation process, the use of minimum customs values and additional tariffs, the duration of the remedies imposed, the non-existence of separate bodies to determine injury and existence of subsidies or dumping, respectively, and the non-existence of judicial instances for review of the Commission's determinations, apart from the Protection Appeal recourse contemplated in the domestic Chilean law.

All the above differences will certainly imply that Chile will have to adapt its domestic law in order to fulfill NAFTA standards. The schedule of Chile in a possible Annex to Chapter 19 would probably replicate many of the amendments to domestic laws by NAFTA countries included in annex 1904.15.

In principle, Chile could be willing to modify its domestic law as long as changes imply more transparency of procedures and opportunities for interested parties to present facts and arguments, and concrete opportunities for judicial reviews.

Given the protectionist bias of some antidumping legislation found elsewhere --US and EU are two examples-- Chile will not necessarily follow those examples to modify its domestic legislation. In fact, the opinion of some government officials consulted is that the Chilean system has been extraordinarily effective to avoid protectionist pressures. For example, the Chilean record on trade remedies since the creation of the Commission shows no antidumping duties at all.

### **The issue of binational panels**

There is no precedent in the Chilean legislation of the use of binational panels to review trade-distortion determinations by

domestic agencies. Neither has Chile any obligation to notify or consult with any other country in case of planning to amend its national trade remedy legislation.

The closest equivalences that can be found in the protection appeal at the local level, and some arbitration procedures of which Chile has been part, at the international level. The instance of Protection Appeal has been established in the Constitution and affects any administrative measure, including Presidential decrees, considered by the affected party, foreign or domestic, to be in violation of Article 19, section 21 of the Chilean Constitution. That article consecrates the fundamental right of residents to develop any economic activity which is not contrary to public order or national security. This appeal is of normal occurrence, although not frequent, and is submitted by any affected party in the respective Court of Appeals.

At the international level, Chile has been historically very open to the settlement of international disputes through arbitration (recent examples are the arbitral decisions for border disputes with Argentina, the arbitral recourse accepted under all the recently signed investment protection treaties, and the dispute resolution mechanisms included in the FTAs with Argentina, Mexico and Venezuela, which are structured under ALADI (Asociación Latinoamericana de Integración)).

In view of the above experience, and considering the fact that it is in Chile's interest to have expedite dispute settlement mechanisms, the issue of binational panels should not be difficult to negotiate and integrate into the Chilean legal system.

### **11.2 General Dispute Settlement Procedures.**

NAFTA's Chapter 20 covers institutional arrangements for the operation of the Agreement and for dispute settlement procedures in those matters that have to do with the interpretation or application of the Agreement, but were not included either in Chapter 19 or in the sector-specific procedures of other chapters.

Chapter 20 builds in these matters on the experience gained in

the operation of the FTA between Canada and United States. The main changes in NAFTA, as compared with Chapter 18 of the FTA, are an enhanced institutional relationship resulting from the establishment of the Free Trade Commission, and a greater commitment to reach agreements at the level of working groups, as opposed to seeking agreements through litigations under formal dispute settlement procedures.

Other significant improvements on FTA Chapter 18 include the existence of consensus rosters of persons acceptable to all member countries, the process of "reverse selection" of panel members, third country nationals as Panel Chairs, specialized procedures for financial services' disputes, etc.

In terms of dispute settlement procedures, Chapter 20 provides for three stages. First, any Party can request consultations with any other Party within the following deadlines:

- a) within 30 days of the delivery of a request for consultations;
- b) within 45 days of delivery of such a request if another Party has subsequently requested or has participated in consultations regarding the same matter; or
- c) within 15 days of delivery of such a request for consultations regarding perishable agricultural goods.

Second, Parties can formally request a meeting of the Commission, which has 40 days to resolve and is empowered to extend a wide range of good offices, conciliation and/or mediatorial services.

The third stage is to request the establishment of an Arbitral Panel under Article 2008 of NAFTA. In order to form a panel, the Parties are to establish and maintain a consensus roster of 30 members.

In addition, and as a separate alternative, Article 2005 deals with the option of Parties to take their disputes to the GATT in lieu of a NAFTA panel. It is established that either forum may be chosen by the complaining party but, once the choice is made, the disputes shall be resolved in that forum to the exclusion of the other.

It is difficult to anticipate in all certitude how difficult could be the negotiations with Chile around Chapter 20. On the basis of historic experiences as those mentioned in the discussion of Chapter 19, however, it is worth mentioning that Chile has a very good track record of successful and active participation in international forums and in multilateral and bilateral working groups (e.g, the Andean Pact Secretariat, LAFTA working groups, GATT's Uruguay Round, etc.).

Chile also has a long tradition of negotiations with, and acceptance of, decisions from international arbitration panels, whether it has been for territorial matters (e.g., border disputes with Argentina), or economic matters (e.g., the already mentioned arbitration clauses in the bilateral investment protection treaties). In addition, Chile is a signatory of the 1958 U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, as well as of the 1975 Inter-American Convention on International Commercial Arbitration. Chile is also a founding member of GATT and a frequent user of GATT panels (e.g., the GATT Apple Panel).

On the basis of the above, Chapter 20 should present very few, if any, obstacles in a NAFTA-Chile negotiation.

### **11.3 Institutions.**

The Free Trade Commission of NAFTA is composed of cabinet-level representatives or their designates. It is responsible for holding consultations and for establishing arbitral panels. It can also establish standing committees, working groups or expert groups and it can delegate responsibilities for information gathering. More specifically, NAFTA establishes about twenty sectoral working groups (e.g., Committees on Trade in Goods, on Worn Clothing, on Sanitary and Phytosanitary Measures, on Small Business, on Financial Services, etc; and working groups on Rules of Origin, on Agricultural Subsidies, on Trade and Competition, etc). The idea behind the sectoral groups is to create a greater obligation by the signing Parties to seek agreement on a daily basis and to prevent

technical disagreements from becoming a full-blown political dispute.

From Chile's standpoint, potential discussions may be more related to economic considerations than to legal aspects. An issue brought up by Chilean government officials is the convenience or inconvenience for a small country like Chile of incurring the human and economic costs of the rather "heavy" and time-demanding institutional and procedural structure of NAFTA (Commission, Secretariat, National Section of the Secretariat, working groups, technical groups, "ad hoc" committees, etc.), in view of the size of its trade with the NAFTA countries (21% of total Chilean trade in 1992).

As pointed out in the sections of this report dealing with Government Procurement, Intellectual Property, Standard-Related Measures and others, the question confronting the Chilean Government would be whether the additional benefits to be accrued from joining NAFTA clearly justify the additional costs mentioned above. This point may have to be taken into consideration not only with respect to a possible accession of Chile to NAFTA but also regarding a few other countries that could follow.

#### **11.4 Conclusions.**

Chilean authorities have expressed their favorable opinion concerning the acceptance of appropriate dispute settlement mechanisms, particularly in the area of antidumping and countervailing duties. This position closely resembles that of Canada, since both are middle-sized economies dealing in a world market dominated by several larger players.

Chilean domestic procedures regarding trade remedies are formally well established and rather transparent, but were found to have several differences with those of NAFTA. This implies that Chile will have to adapt its domestic law in order to fulfill NAFTA standards. The schedule of Chile, in a possible Annex to Chapter 19, would essentially replicate many of the amendments to domestic laws by NAFTA countries included in annex 1904.15.

Probable domestic amendments could cover more transparency of procedures and additional opportunities for interested parties to present facts and arguments. They should also include concrete opportunities for judicial reviews. On the other hand, there is public recognition of the protectionist bias of some antidumping legislations found elsewhere -US and EU are two examples- and Chile will probably avoid following these examples in modifying its domestic legislation.

Chile has a long tradition with, and acceptance of, decisions from international arbitration panels. Considering that it is in Chile's interest to have expedite dispute settlement mechanisms, the issue of binational panels should not be difficult to negotiate and integrate in the Chilean legal system.

Finally, a point of potential discussion brought up during discussions with government officials, is related to the convenience or inconvenience for a small country like Chile of incurring the human and economic costs of the rather "heavy" and time-demanding institutional and procedural structure of NAFTA.

As pointed out in other chapters of this report (e.g., Government Procurement, Standard-related measures), the question confronting the Chilean Government would be whether the additional benefits to be accrued from joining NAFTA clearly justify the additional costs mentioned above. Among the benefits, the advantages of binding and impartial dispute settlement mechanisms such as those of NAFTA, may deserve additional appreciation. These points may have to be taken into consideration not only with respect to a possible accession of Chile to NAFTA but also regarding a few other countries that could follow.



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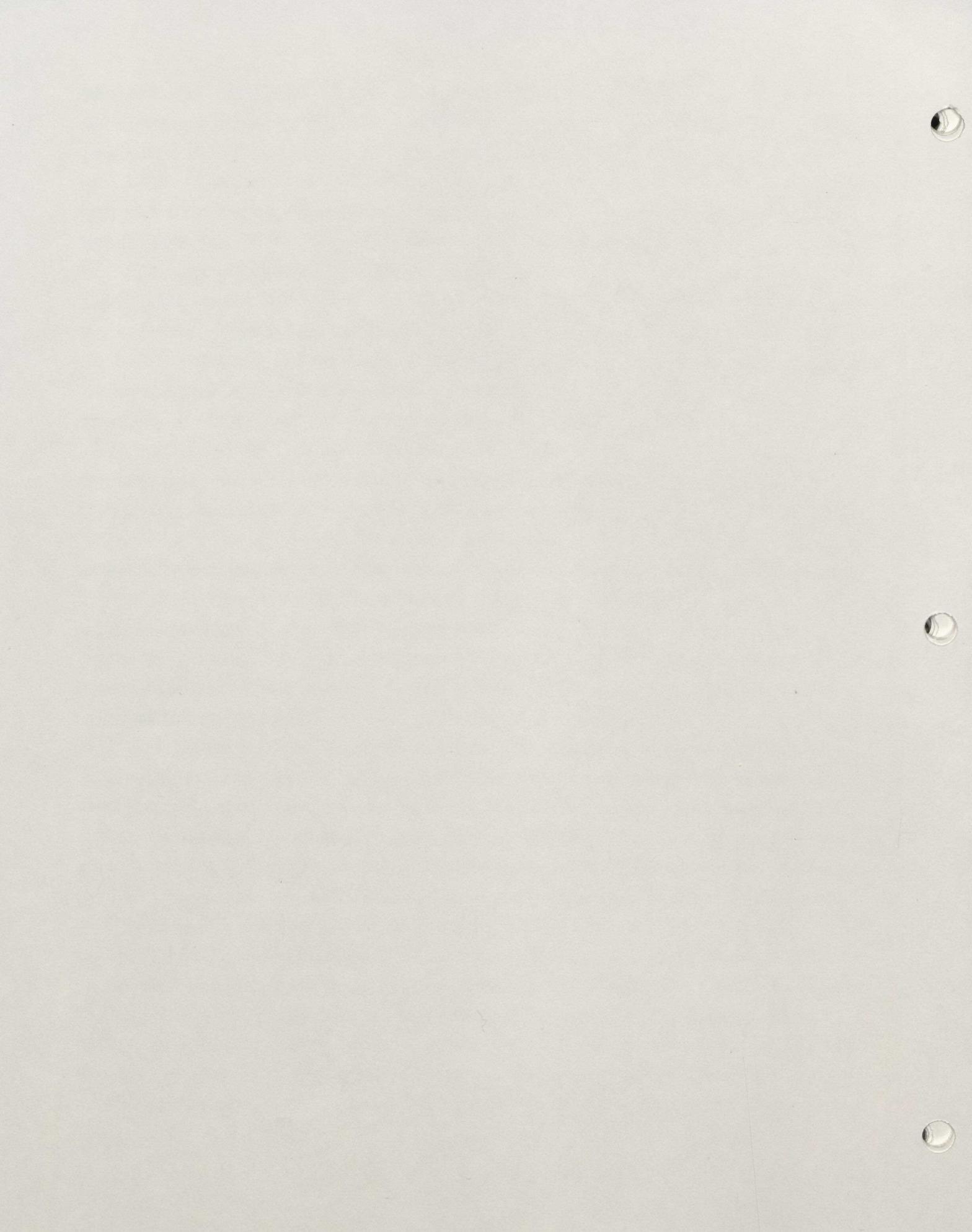
ENVIRONMENTAL STANDARDS

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## STANDARDS

## 12. ENVIRONMENTAL STANDARDS

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Environmental protection was, since the very beginning, one of the major topics of discussion during NAFTA negotiations. Opponents of the treaty consistently argued that further trade liberalization would result in significant incremental environmental damage. Those in favor of NAFTA have argued that trade liberalization, on the contrary, may well promote an even more careful use of environmental resources.

The intensity of the discussion produced what government officials from Mexico, Canada and the United States, have lauded as the "greenest" trade agreement ever negotiated. So much so, that some analysts claim that, if anything, NAFTA may err in the direction of giving too much emphasis to environmental matters. And efforts to enforce environmental standards through trade policy measures invite a serious risk that importing countries will invoke spurious environmental claims in order to protect domestic markets.

Several environmental provisions in NAFTA are similar to those in GATT. In particular, NAFTA allows other specified environmental agreements to take precedence. This is an important provision for Chile since one of those agreements is the Montreal protocol on substances that deplete the Ozone Layer (1987), in which Chile has been a very active member.

### 12.1 NAFTA's supplementary agreement on the environment

While there is no special chapter about the environment in the main body of NAFTA, a supplementary agreement was signed (the North American Agreement on Environmental Cooperation). Its main objective is to set the ground for stronger cooperation on the development and improvement of environmental laws, regulations, policies and practices. In addition, sector-specific measures with environmental implications have been included in the respective chapters of NAFTA. Examples of such measures are the subcommittees for the compatibility of vehicle emission standards, and for the compatibility of standards related measures from local, provincial,

and state authorities.

The supplementary accord begins affirming the right of each country to choose the level of protection of human, animal or plant life or health, or of environmental protection, that it considers appropriate. Nonetheless, in what is probably a new departure from traditional international trade agreements, it contains general statements committing the signatories to work jointly in the enhancement and protection of human, animal and plant life, and the environment.

To facilitate the implementation of these general statements, part two of the accord establishes the requirement of periodic preparation and publication of reports on the state of the environment, the need to promote education in environmental matters, the assessment of environmental impact, and so on. More important yet, part two spells out suggestions for specific actions to be taken by each government in order to ensure enforcement of each party's legislation. Examples of such actions are: appointing and training inspectors; monitoring legislation compliance through on-site inspections; public releasing of non-compliance information; and the initiation of judicial or quasi-judicial proceedings to seek sanctions or remedies for violations of environmental regulations. The enforcement measures are probably the key point that may differentiate environmental policies in most countries of the region. As discussed later on, this may become one of the key elements of negotiation with Chile.

The rest of the supplementary accord spells out details about the creation of the Commission for Environmental Cooperation, which comprises a Council, a Secretariat and a Joint Public Advisory Committee. The functions of the Council are clearly established, and so are the steps to be taken in order to facilitate the provision of information as well as the consultation and resolution of disputes.

## 12.2 Chilean environmental legislation

In the past, Chile has concurred to the signature of several

international agreements concerning environmental issues (Toxic Waste, Basel 1989; Antarctica, Washington 1959 and Madrid 1991; Ozone Layer, Montreal; Marine Life, 14 different agreements). But it is fair to say that real concern about environmental problems (such as air pollution in Santiago, water pollution in coastal resorts, native forest overcutting, depletion of some marine species, etc.) is very recent. The public institutions to overview and handle environmental problems are CONAMA (National Environmental Commission) and the COREMAs (Regional Environmental Councils), which were only established within the last four years.

Chilean environmental concerns used to respond to isolated problems in different industries, regions or activities that endangered human or animal life. During 1991, as a first major effort to develop a modern and comprehensive legal regime on the matter, the government undertook a complete survey and inventory of all existing legislation with environmental implications. The result was a compilation of 718 (!) laws and decrees. An annex to the initial compilation identified another 58 legal texts in 1993.

A General Environmental Law was recently approved in congress and promulgated by the outgoing Aylwin administration (Law 19300 of March 1994). This law creates a framework for environmental laws in Chile, similar in intent to the National Environmental Policy Act of the United States. It sets forth some basic criteria which would include the "polluter pays" principle, the forms of regulation that should be considered in environmental policy, and provides the legal backing for the institutions in charge of enforcement of environmental policies (Comision Nacional del Medio Ambiente-CONAMA and Comisiones Regionales del Medio Ambiente -COREMAs ). This law does not set standards, but rather establishes the procedures to set specific standards in follow-up legislation. Article 24 of the law authorizes the President to establish all the above mentioned standards by Presidential Decree.

This General Law is, in fact, the first legal instrument to set forth a systematic approach to environmental issues in Chile. The law covers five areas: environmental impact assessments,

quality standards, emission standards, prevention plans, and preservation standards.

While the law was still in Congress, and based on the increased public awareness on environmental problems, the government had taken important steps in the direction of the law. It set up strict emission standards for the mining industry and levels of toxic emissions in certain geographic areas, the compulsory use of catalytic converters in all new cars imported after September 1992, the installation of sewage treatment plants in large cities, a strict enforcement of forest management plans by CONAF (although still with limited financial resources).

At present, as it was mentioned before, existing standards are, in many areas, comparable to those in Canada or the U.S.A.. There are detailed and well developed standards for potable water, for emission of industrial liquid residues, for emissions of stationary and mobile sources, for air quality. Most of those standards are, in principle, well enforced by different responsible institutions: Sewage Services Superintendency (Superintendencia de Servicios Sanitarios), Environmental Health Service (Servicio de salud del Ambiente), Ministry of Transportation, etc.. Nevertheless, and in spite of the existence of several other institutions and numerous other standards such as those mentioned above, the prevailing opinion among technicians and authorities is that there is still a long way to cover in terms of enforcement and coordination. The new law may certainly improved the situation, but a sustained budgetary effort will also be required to accompany the required changes in enforcement capabilities.

While it took some time to create the necessary awareness in Chile, all recent actions demonstrate that there would be little, if any, resistance to the standards and cooperation arrangements established either by NAFTA or by its supplementary accords. Three recent Supreme Court rulings may serve to illustrate the prevailing attitude towards this matter:

(i) People of Chungará vs. Ministry of Public Works: this ruling prohibited the use of water from Lake Chungara for irrigation in

parts of the Chilean desertic valleys;

(ii) People of Chañaral vs. CODELCO: The court ordered CODELCO to stop throwing its tailings into the Bay of Chanaral; the company had to spend US\$21 million to build a tailing dam);

(iii) Farmers vs. Pacific Mining Company: case similar to that of Codelco.

The above rulings have shown the validity of the protection appeal as an effective legal tool to guarantee the constitutional right to live in an environment free of contamination. In addition to this recourse, the new environmental law has defined a new type of violation (Action due to Environmental Damage), which can be prosecuted in any first instance court in which the damage occurred.

### 12.3 Conclusion

The existing Chilean environment legislation contains numerous standards disseminated in several laws and regulations. The latter did not follow a consistent pattern or a logic, but rather represented emergency solutions to isolated cases. While many of these standards follow international principles or criteria, they cannot be added up or structured under one single body. If they were all enforced today at the same time, they could even stop completely some sectors of economic activity.

Because of the above and due to a more up-to-date approach to environmental matters, the Congress has recently passed a new body of legislation which, at least in paper, sets the basis for an integral and well-structured approach to environmental protection. The new legislation meets all NAFTA's principles and standards. In this case, while there is basic agreement in the fundamentals, the initiation of negotiations under NAFTA could accelerate the implementation of the legislation and the establishment of enforcement mechanisms. The substantial issues for negotiation may probably center around the enforcement capabilities and resource availability for such enforcement.

## ENVIRONMENT ANNEX

As an additional contribution to the environmental discussion an interesting piece of evidence has been found to indicate that Chile's accession to NAFTA, by itself, would not be detrimental to the environment, and could even improve environmental conditions. Indeed, recent studies show that the sectors likely to expand in case Chile enters a FTA with USA are precisely those that have less negative impact on the environment. And moreover, those sectors contracting as a result of the FTA are those that have the most negative impact on the environment. Because the US is the largest client of Chile within NAFTA, the qualitative thrust of the results would be similar in evaluating NAFTA instead of the FTA.

Table I presents estimates of the likely impact of a FTA between Chile and the US for several economic sectors, both in terms of export and imports. As shown, the sectors that contract the most are chemicals, non-electrical machinery and electrical machinery. The sectors that expand most are food and beverages, agriculture and clothing. Table II presents a ranking of contaminating industries according to the Exphum index, which measures the toxicity of emissions in each of the industries. As shown, the sectors that contract are among the most detrimental to the environment according to this classification.

**Table 12.1**  
**Estimates of trade creation in an FTA Chile - USA (base 1990)**

<u>Sector</u> (SIC class.)	<u>Description</u>	<u>Exports</u>	<u>Imports</u>	<u>Net</u>
111-130	Agriculture	14204	1144	13060
220	Copper & Iron	642	0	642
211	Petroleum & Gas	0	0	0
212	Coal	0	1932	-1932
230-240	Other mining	25	618	-593
311-314	Food, Bev. Tob.	19338	2286	17052
321	Textiles	4592	7307	-2715
322	Clothing	9029	740	8289
323-324	Leather & Shoes	3428	206	3222
331	Wood	685	693	-8
332	Furniture	864	177	687
341	Paper	32	1347	-1315
342	Prints	76	963	-887
351-352	Chemicals	3280	32119	-28839
353-354	Petroleum refining	10	1327	-1317
355	Rubber products	543	4187	-3644
356	Plastic products	63	6135	-6072
361 to 363	Clay and glass	3205	3456	-251
371	Iron and steel ind.	12	3022	-3011
372	Non-ferrous metals	0	1576	-1576
381	Metalic products	294	11722	-11426
382	Non-elec. machinery	528	84315	-83787
383	Elec. machinery	239	31628	-31389
384	Transport material	894	18839	-17945
385	Prof. equipment	42	6181	-6139
390	Other industries	266	1291	-1025
<b>Total</b>		<b>62290</b>	<b>223210</b>	<b>-160920</b>

Source: Rodrigo Valdés (1991), "Una metodología para evaluar el impacto cuantitativo de una liberalización comercial: Aplicación al ALC entre Chile y EEUU", in A. Butelmann and P. Meller, Estrategia Comercial Chilena para la década de los 90, CIEPLAN.

Table 12.2  
Ranking of industries according to the Exphum index

<u>Sector</u> (SIC class.)	<u>Description</u>	<u>Index</u>
371	Iron and steel ind.	349.9
323	Leather ind.	279.9
351	Industrial chemicals	279.4
356	Plastic products	175.6
372	Non-ferrous metals	151.2
331	Wood industry	138.8
321	Textiles fabric.	137.2
342	Prints	109.3
341	Paper	108.3
381	Metalic products	90.1
353	Petroleum refining	78.6
332	Furniture	61.3
352	Other chemical prod.	48.2
382	Non-electrical machinery	46.8
383	Electrical machinery	45.8
362	Glassware	43.6
390	Other manufacturing ind.	41.7
354	Petroleum and coal deriv.	29.4
361	Clay	29.2
311	Food	24.6
355	Rubber	22.2
322	Clothing	17.5
382	Professional equip.	15.9
384	Transport material	12.9
369	Non-metalic minerals	12.3
324	Shoe production	11.7
313	Beverages	10.4
314	Tobacco	5.3
<b>Industrial average</b>		<b>84.9</b>

Source: Andrés Gomez-Lobo (1992), "La cuestión ambiental en un ALC con EEUU", in Estrategia Comercial Chilena para la década de los 90, CIEPLAN.

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### 13. LABOUR COOPERATION AGREEMENT

Opposition to NAFTA, especially in the United States, focused on potential job losses and downward pressure on wages. The root fear was that low wages and poor enforcement of labor standards in Mexico could attract foreign investment, deprive U.S. workers of their jobs, and drive down U.S. wages. While the same themes were discussed in Canada, the issues were less sensitive because of the geographic distance that makes the migration problem less acute. It is beyond the scope of this study, however, to discuss the validity of the pauper labor arguments just mentioned, or to assess the occupational impact of NAFTA.

The official response to the labor concerns was a series of bilateral agreements to promote closer cooperation and joint actions on a variety of labor issues. In the context of NAFTA, the response was twofold. On the one hand, explicit safeguards were set through the most sensitive sectors, such as glassware, some footwear, ceramic tile, certain fruits and vegetables, etc.

Improved safeguard mechanisms were also established to protect sensitive industries against a flood of imports, and strict rules of origin attempted to ensure that the free-trade benefits of NAFTA accrue to North American workers. Interestingly, however, only the United States and Canada obtained 15-year transition periods, while Mexican tariffs on all manufactured products will be eliminated within 10 years. NAFTA also establishes special safeguards in the form of tariff-rate quotas for sensitive agricultural products and a different causation test for textiles and apparel.

#### 13.1 NAFTA's supplementary labor agreement

As a second mechanism to meet labor concerns, a supplementary accord (the North American Agreement on Labor Cooperation) was signed. This agreement sets forth a list of guiding principles for labor: freedom of association, right to collective bargaining, right to strike, prohibition of forced labor, labor protection for



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children, minimum employment standards, elimination of employment discrimination, etc.

The agreement also reaffirms full respect for each country's constitution and recognizes each member's right to establish its own domestic labor standards, as it is the case for environmental standards. It provides, however, a list of actions through which the governments are expected to enforce their legislation (Part two, article 3). Such actions include: appointment and training of inspectors, monitoring compliance through on-site inspections, encouraging mediation, conciliation and arbitration services, and initiating proceedings to seek appropriate sanctions or remedies for violation of labor laws.

Through the establishment of a Commission for Labor Cooperation, a Council, a Secretariat, and the National Administrative Office of each country, the Agreement sets the ground for improved levels of information on employment conditions and for long term improvement of such conditions in the NAFTA countries. The supplemental agreement is expected to make an important contribution to the enforcement of labor standards by using the trinational commission to expose offenders and by ultimately authorizing trade countermeasures if governments do not succeed in halting the abuses.

### 13.2 The Chilean labor legislation

The current Chilean labor legislation covers a wide spectrum of standards that meet most of the existing international guidelines in this matter. Moreover, in many respects it provides more benefits and guarantees to workers than existing legislations in developed economies. One of the reasons for such wider coverage stems from a different philosophical approach in labor legislation. A comparison with labor legislation in the United States may illustrate the point. Whereas workers and legislators in the U.S. prefer an open labor legislation where everything is permitted unless it is specifically excluded, Chilean workers feel more comfortable in a tighter regulatory environment where as many

benefits as possible are established by laws or regulations.

Examples of benefits established by law in Chile are: paid maternity leave for six weeks before and twelve weeks after childbirth; prohibition to use scab workers during the first 15 days of strike; compulsory provision of day-care centers in any firm employing more than 25 female workers.

Labor principles included in the NAFTA supplementary accord are all included in the current Chilean legislation. One of the few points of discrepancy, not with NAFTA but with American and Canadian legislation, could be in collective bargaining at the industry level. Such form of negotiation is allowed in the Chilean legislation, but discouraged in practice by large employers.

One should also mention that Chile has not ratified ILO agreements 87 and 98, that deal with freedom of unionization and collective bargaining, respectively. In spite of this, most experts agree that Chile's legislation adapts to those agreements, and thus Chile could easily ratify them in the near future.

More specifically, Chile's labor legislation excludes the possibility of unionization to those in the armed forces and the police. This restriction also applies to civilian personnel in enterprises dependent of the armed forces (FAMAE and ENAER) or in the Ministry of Defense. In most of these cases, the ILO has granted exceptions to the general rule of freedom to unionize. There are no other restrictions to unionization in Chile.

Collective bargaining is restricted to temporary workers, such as those in agriculture and construction that perform very specific, transitory jobs (i.e. harvesting). The reason for this provision is simple: the legislation establishes specific rules and procedures that can easily take over 45 days, which is generally longer than the contract period. For this very reason, the Aylwin Government's labor reform established the right to voluntary "collective conventions", not ruled by existing regulations but by the joint free will of workers and their employer(s). This alternative does not exclude any type of worker and can be carried out at the firm, industry, regional, or national levels. The main

difference with collective bargaining is that the convention does not contemplate the right to strike.

The provision of "needs of the company" to lay off workers is a good balance between the requirements of a market economy and the respect for the rights of workers. This provision replaced the right of employers to lay off workers with no expression of cause and with no right of appeal to justice, as prevalent during the military government. The current law allows workers to know the reason of their lay-off, and restored the right of appeal to the judicial system. Moreover, the law increased the ceiling for severance payments from 5 to 11 years, and allowed for a 50% surcharge in case the labor judge rules the layoff to be unfair or ill-based.

Thus, Chilean legislation eliminated the "simple layoff", which is what the ILO does not accept. It stopped short, however, of allowing the mandatory rehiring of laid-off workers. This allows the necessary flexibility for companies, while taking care of workers' rights. This has been complemented by improved retraining programs. An unemployment insurance scheme will be implemented soon.

With respect to social benefits, social security is compulsory through a private pension fund system, and medical insurance is provided either through the National Health Fund, FONASA, or through private medical insurers (Institutos de Salud Previsional-ISAPRES). Total contribution for the two concepts is 17% of the base monthly salary (10% for retirement and 7% for medical insurance).

Enforcement of labor legislation is constantly strengthened through specialized government agencies and, in particular, through the Labor Inspection (Inspeccion del Trabajo). This agency has direct dependency from the Ministry of Labor and ensures that workers and their organizations receive proper attention in their complaints and in the necessary advice. As an illustration of the coverage of inspections, it is worth mentioning that in 1992 alone, 41,000 firms were monitored for compliance with labor laws, and

that 760,000 workers (out of a working force of about 5.1 million) benefitted from such inspections.

### 13.3 Conclusion

Present Chilean labor legislation complies with the principles and guidelines established by the North American Agreement on Labor Cooperation (Labor supplementary accord). The standards established in the agreement are not substantially different from those existing in Chile. While enforcement may still benefit from additional strengthening, no difficulties can be anticipated in the negotiation of either a bilateral labor agreement with Canada or an accession to the existing NAFTA mechanisms.

Moreover, Chilean labor legislation complies with ILO guidelines. The only differences lie in the right to unionize, which is restricted for the armed forces and individuals working in defense institutions, and the right to collective bargaining, which is restricted for temporary workers. Most of these discrepancies are allowed as exceptions by the ILO.

Regarding the employment impact of NAFTA, Chile's economy is already very open and presents a low level of unemployment. As a consequence, no problem is anticipated in this front.



**PART II: SECTORAL ANALYSIS - BUSINESS OPPORTUNITIES**

PART II. SECTORAL ANALYSIS - BUSINESS OPPORTUNITIES

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## 14.1. Overview of the growth of the agro-industrial sector

### Background

The growth of the agro-industrial sector around 14% of total Gross Domestic Product (GDP) has not experienced uneven growth over the last decade. While the 1981-1983 economic crisis, agriculture's contribution to GDP was only 10% less than total GDP, this grew to 14% between 1984 and 1989, as part of an overall recovery. The Statistical Appendix shows the evolution of agricultural production. As a result of this, the Chinese agricultural sector moved from a deficit in the early 1980s to a surplus of around 500 billion yuan in 1989. The Statistical Appendix also shows the evolution of the agro-industrial sector because of falling exchange rates (between 1981 and 1992) and rising export restrictions, especially in Europe. Nonetheless, external pressure will ease with the end of the international recession and the exchange rate will stabilize or appreciate smoothly. China's long-term economic strategy will continue to be based on export-led growth and it is expected that the agricultural sector will remain one of the most dynamic and important, especially in the agro-industrial sub-sectors such as fruit-growing and agro-industry.

## 14. AGRICULTURE AND AGRO-INDUSTRY

The Chinese agricultural sector is widely heterogeneous. It includes traditional crops such as wheat, corn and sugarbeets, and more modern and sophisticated sub-sectors like fruit-growing and agro-industry.

In 1991, China's real GDP growth rate will recover slightly, which is not surprising given the upward trend of 1990. Beyond 1992, an upward trend is expected to continue as a long-term trend, but at a much slower pace than in 1990.



## 14. AGRICULTURE AND AGROINDUSTRY

### 14.1. Overview of the agricultural and agroindustrial sector

#### **Background**

The Chilean agricultural sector represents around 8% of total Gross Domestic Product (GDP), and has experienced uneven growth over the last decade. During the 1982-1983 economic crisis, agricultural GDP fell (although considerably less than total GDP), then grew substantially between 1984 and 1989, as part of an overall export boom. (Table I in the Statistical Appendix shows the evolution of sectoral GDP and exports.) As a result of this, the Chilean agricultural trade balance evolved from a deficit in the early 1980s of almost US\$400 million to a surplus of around US\$1 billion a decade later (See Table II in the Statistical Appendix).

In recent years, growth has stagnated because of falling external prices, a significant appreciation of the real exchange rate (almost 10% per year in 1991 and 1992) and rising export restrictions in foreign markets, especially in Europe. Nonetheless, external prices will recover with the end of the international recession, and the real exchange rate will stabilize or appreciate smoothly.<sup>7</sup> Chile's long-term economic strategy will continue to be based in world markets, and it is expected that the agricultural sector will remain one of the most dynamic and innovative, especially in the non-traditional sub-sectors such as fruitgrowing and agro-industry.

The Chilean agricultural sector is widely heterogeneous. It includes traditional and low-profitability crops such as wheat, corn and sugarbeets, and more modern and competitive sub-sectors like fruitgrowing and agroindustry.

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<sup>7</sup> In 1993, Chile's real exchange rate will recover slightly, which is not surprising given the adverse terms of trade shock. Beyond 1993, an appreciation cannot be ruled out as a long term trend, but at a much smoother pace than in 1991-92.

This heterogeneity has influenced the degree of protection that each sector faces. Traditional crops are basically import substitutes. They are subject to a price-smoothing device (price bands) that establishes a variable import tariff so that the domestic price of wheat, sugar, and oilseeds falls within the limits of the band. In principle, price bands are not designed to be a protection scheme, but in practice they have operated as such. All other sectors of the economy (excluding automobiles) are subject to the flat 11% import tariff, with no additional protection.<sup>8</sup>

### **Traditional crops**

This sector has traditionally been of great importance, due to its wide geographical coverage, the employment it generates, and the number and relatively small size of its producers. It represents about one third of agricultural GDP.

**Wheat** is the main traditional crop, with 400,000 to 600,000 hectares under cultivation each year. Its share in the total value of the agricultural production is around 19%. Due to the fall in production during the 1982-1983 crisis, a system of price bands was introduced. The maximum and minimum prices of the band are set annual on the basis of the evolution of FOB prices during the last 60 months.

As a result of this new price scheme, domestic production recovered; imports fell and became nil in 1989. The fall in world prices in recent years has depressed production somewhat, and has induced increasing imports. Wheat production is concentrated mainly in small producers in the central-south part of the country. Canada is today, the principal source of wheat imports (Durum variety) to Chile.

In contrast to wheat, **corn** production is highly technified.

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<sup>8</sup> Countervailing duties are available to offset export subsidies granted by other countries. Imported milk, for example, is subject to such duty, as a response to widespread subsidization of this product in Europe and the United States.

Demand for this product comes mainly as animal consumption (basically poultry and pigs). This sector is open to external competition, with 90% of imports coming from the United States. Another important product of this sector is **seed corn**. Over the last decade, Chile has become an important producer and exporter of this product, due to the favorable climatic conditions and the inverse seasonality with the main final markets (the United States, Europe and Japan). The main competitor for Chilean production in the United States market is Canada.

The Chilean **sugarbeet** sector is an important source of employment. There are between 9,000 and 11,000 producers that employ directly and indirectly some 60,000 people. The market for sugarbeet is characterized by a monopsony, with a sole buyer: IANSA, the national sugar producer. In the early 1980s, the crisis in the agricultural sector resulted in 88% of domestic sugar consumption coming from abroad. Beginning in 1982, a plan to encourage sugarbeet production was put in place. Initially it took the form of a subsidy; since 1986 it has consisted of a price band similar to the one implemented for wheat.

Other important products in this sector are **tobacco**, which is very labor intensive and has experienced fast export growth, and **oleaginous** production. The latter has also been subject to a price band.

### **The fruitgrowing sector**

This sector developed its export potential since the mid 1970s, and quickly became the most dynamic in agriculture. Indeed, the total area covered by fruit plantations grew from 65,000 hectares in 1974 to over 130,000 hectares in recent years. This surge was concentrated mainly in the years 1984 to 1989, with a gradual stabilization in recent years. The structure of fruit plantations is shown in Table 3 of the Statistical Appendix.

The most important product in this sector is grapes, around 80% of which are exported. The main final markets are the United States, with a share of 69% of grape exports, and Europe, which

represents 18% of that total. The importance of Chilean grape exports in final markets is very significant. In the U.S., around 90% of total off-season imports come from Chile, and this represents wholly 30% of total consumption. The share of Chilean grapes in European consumption is not as large as in the U.S., but is also quite substantial. Other important fruit exports from Chile are peaches, nectarines, apples and plums; in these products, however, Chile's share of the main consumer markets is low.

### **Vegetables**

Vegetable production, especially that oriented to the internal market, is mainly done by small farmers. Larger producers, however, have also entered the market, centering in exports and in the provision of inputs to agroindustry. This has induced an increase in the export share of the sector, from 10% in 1980 to over 20% in recent years.

Asparagus is an important new product in this sector, due to its potential for exports. The principal market for fresh asparagus is the United States, with a share of over 75% in total exports of this product. The United States, however, represents only a minor share in Chile's exports of processed asparagus, which is partly explained by the high tariffs faced by this product. This practice of placing higher tariffs on products with higher value added is a common feature of the main industrial markets (Europe, Japan, and the U.S.).

### **14.2 The agroindustrial sector**

Agroindustry has experienced considerable growth since the second half of the 1980s. This development has come together with a major expansion in the installed capacity to process fruits and vegetables. Dehydrating plants increased from 19 in 1986 to 30 in 1990, cold storage facilities rose from 13 to 32, tomato concentrate plants from 5 to 10, and fruit concentrate installations from 6 to 11 during the same period. Overall, exports of processed vegetables and fruits have come to represent 18% of

agricultural exports and around 3% of total exports.

### **Processed vegetables**

Exports of processed vegetables reached US\$102 million in 1992, representing 6.4% of total agricultural and agroindustrial exports. These were mainly in the form of pulp and pastes (over 40% share), seeds (17%), dehydrated products (17%), and canned and frozen vegetables (10% and 9%, respectively).

Tomato is, by far, the most important vegetable used in agroindustry. Processing capacity has grown exponentially, from 17,000 tons of concentrates and 5,600 tons of canned products in 1988, to 85,000 tons and 14,000 tons, respectively, in 1991. The main output produced is tomato paste, followed by canned tomatoes at considerable distance; production of tomato juices and sauces, however, is currently marginal. One third of exports of tomato concentrates go to Brazil, and about one quarter to the United States.

### **Processed Fruits**

Exports of processed fruits were about US\$200 million in 1991, representing 70% of total agroindustrial exports. The most important among them are dehydrated fruits, with a 37% share, fruit juices (32%), and canned and frozen fruits (13% and 12%, respectively).

The increase in foreign demand coupled with the rise in the availability of abundant raw materials have given an important boost to national production of fruit juices, which traditionally have not been important in the Chilean agroindustrial sector. Clearly, the surge in production of fresh fruit does not mean that 100% of production qualifies for export. A significant minority share of production (which varies by fruit) is left behind for local consumption, and as input to agroindustry. With the development of this sector, however, some new plantations have been geared specifically to supply agroindustry.

In 1989-92, 11 juice plants were among the most modern in the

country. Exports of this product have grown spectacularly, rising from US\$17 million in 1988 to US\$76 million in 1992 (a 450% increase). Of these, apple juice represents 76% of the total, with grape juice accounting for half the rest. The main markets for this product are the United States, followed by Japan, Australia, and Canada.

#### 14.3 The Chilean Agricultural Sector and NAFTA

In case Chile joins NAFTA, the most likely outcome in agriculture is a couple of bilateral treaties with Canada and the U.S. This was the precedent established in NAFTA for agriculture, which happened before the completion of the GATT Uruguay Round negotiations on agricultural issues, resulting in a collection of bilateral treaties between each pair of countries, rather than one trilateral treaty, as was the case in all other sectors. If Canada can resolve GATT-NAFTA issues with the United States it may be possible to have an agricultural chapter that applies to all NAFTA parties.

Chile already has an FTA with Mexico, which includes agriculture. Under such agreement, only the products subject to the price band mechanism (wheat, sugar, and oilseeds) have been exempted from either gradual or accelerated tariff elimination.

In the event Chile starts negotiations to join NAFTA, it is likely that liberalization will be slower in this sector, with exception lists of sensitive goods taking a period of up to 10 years to become fully liberalized. Price bands are likely to be the most sensitive aspects in Chile's agricultural sector for this negotiation. In fact, price bands are the only truly special treatment that Chile applies in agriculture.

To keep things in perspective, however, it is fair to say that Chile is probably more liberal than NAFTA members in agricultural trade. Although Chilean tariffs (set at 11%) are higher than those of NAFTA members, nontariff barriers do not exist. Sanitary and phytosanitary measures are not a significant barrier to imports

from North America.<sup>9</sup> And --in sharp contrast to current NAFTA members-- the Chilean government gives no subsidies to agriculture that cannot be justified strictly in economic terms.<sup>10</sup>

The United States currently has significant agricultural import quotas, and has obtained waivers from the GATT for them every year since the 1950s; it also has marketing orders which pose severe restrictions to imports during the U.S. production season. Mexico, on the other hand, has a government agency (CONASUPO) which used to intervene in farm production, food processing and retail sales. Canada, in turn, has maintained a sophisticated supply management system for agricultural products such as dairy, poultry and eggs. Thus, agriculture remains highly protected in all three countries.

GATT's Uruguay Round is a significant step in the opening of the agricultural sector on a multilateral basis. It establishes a gradual liberalization process in the sector over 6 years for industrial countries and 10 years for developing nations. This includes a commitment to eliminate virtually all non-tariff barriers, converting these into tariffs. In addition, tariffs are to be reduced by 36% over 6 years (from a 1986-88 base). Export subsidies will be scaled down by 36% in value and 21% in volume over the implementation period. And domestic support programs will be cut by 20%.

The above provisions certainly support NAFTA's liberalization program. And Chile already complies with most of them (it has no non-tariff barriers, no export subsidies and no domestic support programs). One should not get the idea, however, that free world trade will prevail in agriculture. Even after full implementation of the Uruguay Round's agreements, this sector will remain the most

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<sup>9</sup> In case of Chile's accession to NAFTA, any remaining disagreements in this matter are likely to be resolved through the Committee on Sanitary and Phytosanitary measures.

<sup>10</sup> There is a subsidy to successful irrigation projects that can help recover infertile lands.

distorted one in international trade.

#### 14.4 Business opportunities for Canada

Canada is a net exporter of agricultural goods, with exports of about US\$13 billion and imports of around US\$9 billion per year. As such, it stands to gain significantly from trade liberalization in agriculture, both in the GATT's Uruguay round and through regional treaties like NAFTA. Chile is a relatively small market, but may provide opportunities for Canadian exporters in traditional crops such as wheat, barley, and oilseeds. In return, Chile has a major competitive edge in fresh fruits and some segments of agro-industry, whose exports are likely to benefit the most from an FTA.

The Chilean import-substituting agricultural sector, mainly consisting of traditional crops, is subject to price bands, as mentioned. There is no other form of protection such as quotas or licenses, except for the general 11% ad-valorem tariff. These imply the imposition of variable import tariffs, which are raised when the international price falls below the preestablished lower limit of the band. The negotiations prior to Chilean accession to NAFTA could result in a reduction of these import barriers.

The final status of protection for Chile's traditional crops will depend on three main issues: (a) the implementation of the result of the recently completed Uruguay round of GATT regarding agricultural goods; (b) the evolution of the process of agricultural restructuring, currently under way in this sub-sector;<sup>11</sup> and (c) the extent of liberalization for Chilean exports granted by Canada and the U.S. in agriculture and other sectors.

Indeed, NAFTA specifies that parties should endeavor to work towards domestic support measures that have minimal or no trade distortion effects, and measures that are exempted from any applicable domestic support reduction negotiated under the GATT. If

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<sup>11</sup> Lower profitability and the prospects of trade integration with countries such as Argentina, have prompted a natural restructuring process in the traditional sector.

the GATT talks are successful in limiting the degree of domestic protection to agricultural producers, the Chilean import substituting sector could face increasing foreign competition, in particular from important grain producing countries such as Canada and the United States.

In contrast, Chile's agricultural export sector is highly competitive, and subsidies to export activities are non-existing. The main barriers for the development of this sector lie in tariff and non-tariff barriers in the developed world. These are particularly high in processed products, like apple juice and canned fruits and vegetables. A reduction of these barriers resulting from a free trade agreement would imply a substantial increase in exports of these products, probably inducing the adoption of new technologies and new methods of production in the agroindustrial sector.

The experience of Canada in fruit growing and agroindustry could prove valuable for the continuing expansion of these sectors. In case Chile joins NAFTA, some large Canadian firms may become interested in establishing joint ventures with large local producers or exporters, oriented to the international markets.

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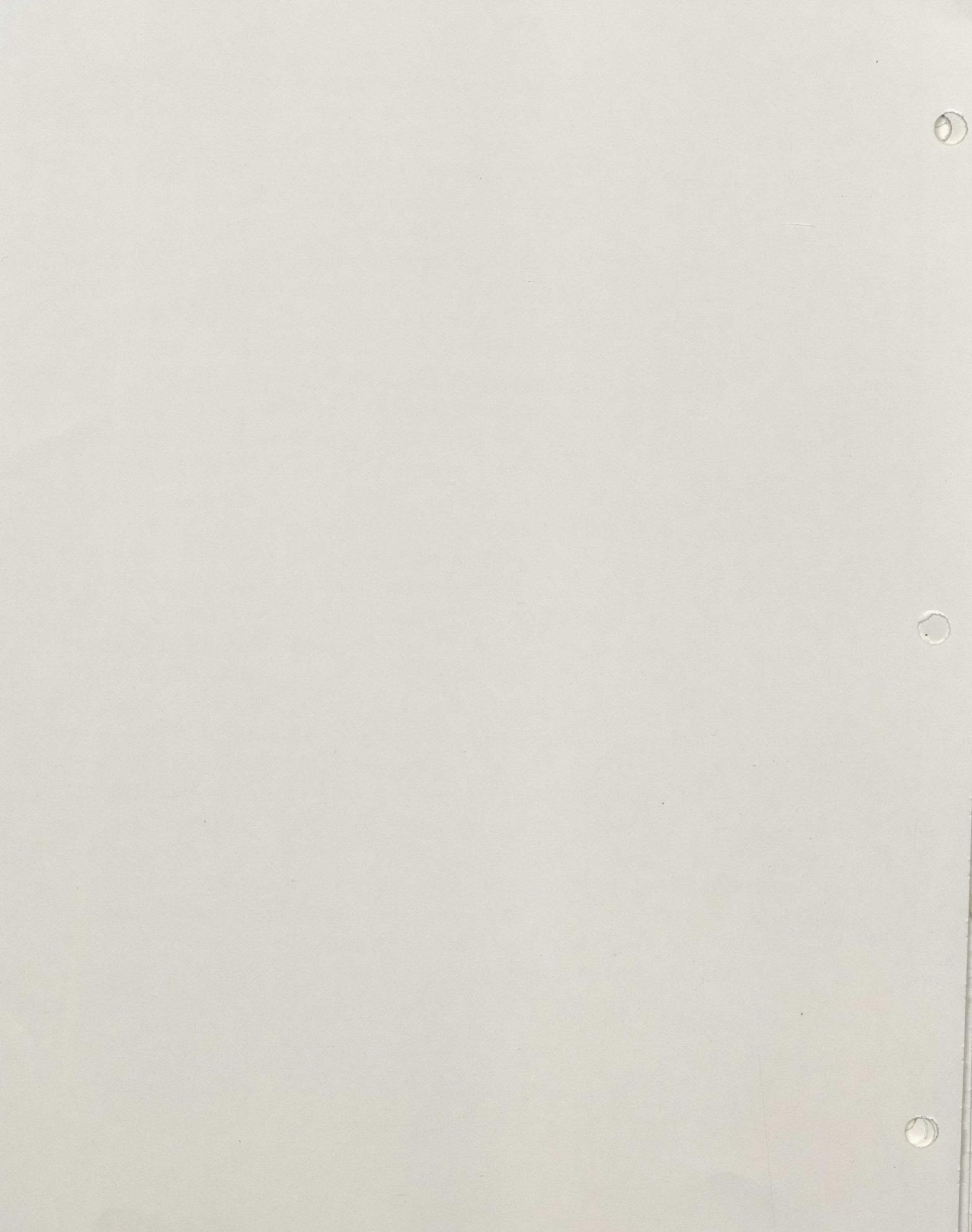
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## 15. TELECOMMUNICATIONS

### 15.1 Overview

Until recently, this sector was almost completely under state ownership. Following the privatizations in the second half of the 1980s, however, the situation reversed almost completely. Now all important companies are in private hands.

The strong situation of the Chilean economy has allowed for ambitious telecommunications development plans, which will imply a boost in equipment spending that will reach US\$500 million in 1995 (See Table 1 in the Statistical Appendix).

### 15.2 Telecommunication services and products

In Chile there exists a variety of services defined by law. These include public, limited, and intermediate services. Public services are classified in fixed and mobile telephony, public telegraphy, telex, and radio. Intermediate services are defined as those which satisfy the needs of transmission and computation of public utility concessionaires.

Private entities can provide for their own telecommunications needs. In such cases, the services are classified as limited, and have no access to the public network. Private services are not recognized explicitly in the legislation, but also exist. These include the renting of infrastructure and equipment to telecommunication firms. For example, the (state-owned) national petroleum company (ENAP) satisfies its telecommunication needs renting infrastructure and equipment from the (privately owned) national telecommunications company (ENTEL). Some of the firms providing each of the above services are detailed in Table 2 in the Statistical Appendix.

The most important single service is the local and long distance telephony, with a share of approximately 50% of total revenues in the sector.



## 15. TELECOMMUNICATIONS

### 15.1 Overview

Until recently, this sector was almost completely under state ownership. Following the privatizations in the second half of the 1980s, however, the situation reversed almost completely. Now all important companies are in private hands.

The strong situation of the Chilean economy has allowed for ambitious telecommunications development plans, which will imply a boost in equipment spending that will reach US\$500 million in 1995 (See Table 1 in the Statistical Appendix).

### 15.2 Telecommunication services and products

In Chile there exists a variety of services defined by law. These include public, limited, and intermediate services. **Public services** are classified in fixed and mobile telephony, public telegraphy, telex, data transmission and faximile. **Intermediate services** are defined as those which satisfy the needs of transmission and commutation of public utility concessionaires.

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The most important single service is the local and long distance telephony, with a share of approximately 50% of total revenues in the sector.

### 15.3 Market participants

All this sector is currently under private hands. The only exceptions are the private and intermediate services demanded by state-owned firms, which are not available to the public. At present, there are eight companies that have concessions for the provision of public services. These are:

- Compañía de Teléfonos de Chile (CTC, including CTC celular).
- Empresa Nacional de Telecomunicaciones (ENTEL).
- VTR (including CNT and TELECOY).
- Complejo Manufacturero de Equipos Telefónicos (CMET).
- Compañía Telefónica Manquehue (CTM).
- CID Comunicaciones (CIDCOM).
- Cooperativa Rural Eléctrica de Llanquihue (CRELL).
- TELECOM (ENTEL is a share owner).
- VTR Celular (VTR is a share owner).
- TELEX Chile (including CHILESAT and CHILEPAC).

The **Chilean Telephone Company** (CTC) was born as a modern company in 1927, when it was purchased by ITT. It functioned as a foreign-owned private entity until it was nationalized by the Chilean government in 1971. In 1974, Chile's Development Corporation (CORFO) acquired 89% of the shares of CTC. By 1986, CORFO had reduced its share to 49%, and in 1988 CTC became totally private.

CTC provides 95% of the national telephone service, including the basic urban telephone services. CTC owns approximately 95% of all telephone lines in Chile, and its principal business is to provide local telephone services. Domestic long distance services are provided between Santiago and Valparaíso-Viña del Mar through a microwave radio-link. Additionally, CTC operates a cellular telephone network in those areas, and provides international long distance services through rented circuits.

CTC has designed a medium-term development plan whose aim is to satisfy fully the existing demand for basic telephone services, improving their quality and reliability. The main goals of this

plan are presented in Table 3 of the Statistical Appendix.

The dynamic expansion of CTC and its potential growth in long distance telephony has resulted in legal controversies with ENTEL, the major long distance operator. A new telecommunications law is currently under discussion in Congress. It will probably result in the segmentation of the market between local and long distance telephony; the government's position is to allow CTC to participate in both markets through separate companies. A rapid decision in this matter would facilitate prompt operation of a dialled multicarrier system, which allows for free choice among competing long distance carriers.

The **National Telecommunications Company** (ENTEL) was originally created as a state-owned monopoly for long-distance communications. Its main source of income is still long-distance telephone services --both national and international-- which represent about 80% of total revenues (mainly due to the demand generated by CTC). The company has a microwave trunk network, transverse links and satellite links for national and international communications. In addition to telephony, it offers a selection of services ranging from telegraphy and data links to television signals and radio transmission and videoconferencing.

Until 1989, ENTEL maintained a monopolistic position in the long-distance market. This changed in 1990 with the entry of CHILESAT, a company providing national and international long distance services. With the possible entry of a CTC subsidiary in this market, ENTEL will probably face increasing competition.

ENTEL has a number of subsidiary companies, such as SATEL (providing all types of telecommunication services) and TELECOM (providing cellular telephone services).

VTR is a private Chilean company that started to operate in Santiago in the early 1980s, providing mainly data transmission services and especially telex. At present it has extended its operation to other areas such as computer services and informatics.

VTR has the concession for a number of public telecommunication services, including cellular telephony, data

transmission; it has recently started to provide intermediate services. The latter was authorized with the purpose of opening up competition in the long distance communications field. Thus, VTR appears as an alternative to ENTEL for users of long distance telephone services.

A point worth mentioning is the foreign participation in the ownership of several of the largest telecommunications companies. Telefónica de España and foreign ADR holders own nearly 70% of CTC: Telefónica de España and --until recently-- the Chase Manhattan Bank and Banco Santander owned 40% of ENTEL; Italcable owns 25% of VTR; Bell South owns 50% of CIDCOM cellular; and so on. Moreover, some of these stock blocks have been changing hands with no objection from the authority. In fact, there is widespread impression that foreign ownership and free movement within the sector has facilitated its very dynamic growth.

#### 15.4 Regulation of the public services

The provision and operation of telecommunications services, systems and equipment in Chile is regulated by the Telecommunications Law, which specifies which telecommunications services require a concession (permit) from the Undersecretary of Telecommunications. Among those services requiring a concession are public, intermediate and limited services.

Concessions are valid for a fixed period of time and may apply only within a specified geographic area. By virtue of receiving the concession, the holder is obliged to provide services to all parties requesting the service in the area of the concession for a specified period of time. The concession holder must also provide service to those users located outside the concession area who are willing to pay for the extensions needed to provide the service.

Technical rules have been established governing the routing, transmission, signalling and assignment of numbers in the Chilean telephone network. Every new installation must comply with these technical specification set forth by the Undersecretary of Telecommunications. Non-compliance of these norms can carry the

consequence of terminating a concession.

Along with technical norms and concessions, the Telecommunications Law provides that, in general, prices for telecommunication services should be established by market forces. Nonetheless, if the Antitrust Commission, charged with assuring free market conditions in various sectors of the Chilean economy, determines that market forces are distorted in a given sector of the industry, prices and tariffs will be regulated. This is the case for local basic telephone services, where natural monopolies exist.

In the regulated sector, the structure, level and indexing of user tariffs are fixed by a decree issued by the Undersecretary of Telecommunications and the Ministry of Economics. The procedure to determine such tariffs is based on an economic model designed to result in tariffs for various telephone services which reflect the real cost of providing those services, including a given rate of return on capital. This tariff-fixing process takes place every five years, and results in the setting of maximum tariffs. The law also establishes the prohibition for service providers to discriminate among users in the same concession area.

During 1993, the government introduced a bill to Congress for a new telecommunications law. One of the main elements of that law, would be to reinforce the technical capabilities of the Undersecretariat (Subsecretaría de Telecomunicaciones -SUBTEL) which, until now, has proven rather weak, underbudgeted and technically unprepared to resist the lobbying power of the telecommunications companies and groups.

### **15.5 Development in private services**

Chile was the first country in Latin America to offer private telecommunication networks and is today the most technologically advanced country in the region. In spite of being a relatively small country in the region, it holds about half of all private data transmission circuits in Latin America.

This sector is open and very competitive. The CTC Data Red

Company (a CTC subsidiary) offers private digital services in data transmission. Also, Entel Data (an ENTEL subsidiary) offers package commuting, also provided by VTR and Chile Pac. In 1990, Chile introduced the International Business Service (IBS), a private telecommunication system through satellite that allows Chile to be connected to the rest of the world. This is reckoned to be one of the most important tools designed in the telecommunications field in the last five years to help the development of organizations and firms.

Chile was the first country in Latin America where cellular telephone services began to operate. At present, these are spreading around the continent, with more than 200,000 cellular telephones in operation. There are four companies that offer the cellular telephone service in Chile, two for each concession zone. There is roaming among them, that is, the possibility to use the same cellular telephone in every geographical location. The market is highly competitive, and this has resulted in the lowest cost of service in Latin America. The total number of cellular telephones and the service cost in some Latin American countries is presented in Table 4 of the Statistical Appendix.

#### 15.6 Compatibility with NAFTA

NAFTA's Chapter 13 sets the rules for participating countries with respect to:

- (a) measures related to the access and use of public telecommunications transport networks;
- (b) measures related to the provision of enhanced value-added services;
- (c) standards-related measures related to the attachment of terminal equipment to public networks.

The establishment and provision of long-distance telephone and other basic services were purposely excluded from the NAFTA negotiations. The reason was that the market has been organized around regulated monopolies. While in Chile there is no restriction of accession to the installation and operation of basic telephony,

it is not expected that this would be a topic for negotiation.

The emphasis of the Chapter is in ensuring equal treatment to enhanced value-added services, as well as common North American rules for providers and users of telecommunications and computer services. The agreement is expected to create a more competitive environment for telecom equipment companies. The Chapter also establishes a common approach for the standardization of the telecom equipment attached to public networks, and sets up a Telecommunications Standards Sub-Committee.

A few identifiable points of discrepancy between Chilean legislation and Chapter 13 are the following:

(a) There are restrictions in Chile to interconnect privately leased or owned circuits to the public network. This interconnection is explicitly prohibited in Chile because it omits the cost of use of the public network which is implicit in the regulated tariff.

(b) The pricing of private services could also represent a discrepancy, as NAFTA contemplates only a flat rate; in Chile the price would be freely negotiated between user and supplier (Law 18.268, article 29).

(c) With respect to standards, Article 1304 section 6 requires each country to accept tests and results from laboratories in the territory of another member country. This may face technical objections from the regulatory agency in the Chilean government (SUBTEL).

A matter where no objections are anticipated is that of conditions for the provision of enhanced value-added services. At present, there is freedom in the provision of many services under agreement with the concessionaire of public telephone services, subject to the fulfillment of technical conditions which are compatible to those in Article 1303.

A final word about Article 1305 (Monopolies) and Article 1306 (Transparency). Monopolies in Chile are regulated not only through tariffs and technical standards. The largest Chilean telephone company --CTC-- is a public corporation which trades in both the

Chilean and New York stock exchanges. As such, it is subject to the scrutiny of governments and independent private auditors, and it fulfills all the requisites set forth in NAFTA.

As for transparency, due to the dynamism of the sector, the lack of an up-to-date legislation (the new telecoms law has been in discussion in Congress since mid 1992), and a rather intensive lobbying by the largest companies (which has included several legal fights), the regulatory environment of the sector has lacked full transparency. Being an exception, as it is, to the normal governmental procedures, it has created a certain climate of uncertainty among investors. Chilean telecommunications is a sector that could certainly benefit from the disciplines imposed by a NAFTA negotiation.

#### **15.7 Opportunities for Canadian Suppliers of Goods and Services**

The telecommunications sector in Chile can be characterized as extremely dynamic and competitive both in public and private services. Technological developments, however, have gone faster than the government's regulatory capacity. In any event, the openness of the Chilean economy and the strong perspectives for this sector in the near future open up business opportunities for firms providing technologically advanced equipment and specialized consultantship in telecommunications.

Opportunities in the telecommunications sector are highlighted by CTC's medium-term development plan, whose total investment -- principally in equipment and technology-- will topple US\$1.5 billion during the next 5 years. This is clearly the main investment program in the industry. Smaller companies participating in the telecommunication sector, however, have aggressive expansion plans of their own. In a fast-growing country that has privatized its telecommunications sector relatively recently, it is likely that this industry will grow more than Chile's GDP for many years to come.

Moreover, as mentioned, entry into Chile's telecommunications sector is open to all companies, regardless of their country of

origin, and no restrictions to foreign ownership apply. This stands in sharp contrast to Canada's restriction on foreign ownership of telecommunications companies, set at a maximum of 20 percent.

Unlike the case of Mexico, for example, no special protection applies to the import of telecommunications equipment into Chile, other than the flat 11% tariff. In case of Chile's accession to NAFTA, Canadian suppliers will gain a competitive edge over non-NAFTA suppliers, to the extent of this 11% tariff. Sources consulted in the major telecom companies of Chile have even expressed their regret about not having more aggressive Canadian suppliers in telecom equipment for telephone lines, rural communications, mobile phones, and private service terminals.

origin, and no restrictions on foreign ownership apply. This stands in sharp contrast to Canada's restriction on foreign ownership of telecommunications companies, set at a maximum of 10 percent. In the case of Mexico, for example, no special protection exists for the import of telecommunications equipment into Chile. In the case of Chile's accession to the GATT, the major telecommunications companies of Chile have even expressed their regret about not having more aggressive policies in telecommunications equipment for telephone lines, televisions, mobile phones, and private service terminals.

Services are open to foreign suppliers in Chile and services are being provided in that country. However, the government has expressed its strong preference for telecommunications services to be provided by Chilean companies. This preference is based on the fact that telecommunications services are a natural monopoly and that the government has a strong interest in maintaining control over this sector. The telecommunications sector is highlighted as a priority area for investment in Chile's development plan. The total investment in telecommunications is estimated at US\$1.5 billion during the next 5 years. This is clearly the main investment program in the industry. Smaller companies participating in the telecommunications sector, however, have aggressive expansion plans for this growing country. In fact, Chile is likely to be the telecommunications sector relatively recently, it is likely that this industry will grow more than Chile's GDP for many years to come.

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## 16. FINANCIAL SERVICES

### 16.1 Overview

Chile's financial sector has suffered a profound liberalization that started in 1974. Since then, it has experienced major progress and high technification. Today, it is probably the most developed financial market in all Latin America. This process of development, however, has not been smooth. Indeed, the development of the financial system can be divided roughly in three phases:

(a) 1975-1981. In this period, the financial system was deregulated almost completely. Interest rates were set free, and entry to the banking industry and capital account was gradually liberalized. At the beginning of the 1980s, the Chilean financial legislation -- both for the domestic market and for international capital flows -- was extremely liberal.

(b) 1982-84. Due to the economic crisis of 1982-83, and the massive indebtedness incurred by the banks, some regulations came back; in 1983, the authorities even intervened the administration of the two principal private banks.

(c) 1985-1993. Drawing on the lessons of the 1982-1983 crisis, regulations were improved and the regulatory power of the authorities (the superintendencias) was enhanced. Later on, in 1985, the intervened banks were reprivatized. In the second half of the 1980s, the Chilean financial sector and capital markets experienced fast growth. Institutional investors, especially

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pension funds and insurance companies, started to play a major role in the market.

## 16.2 The banking sector

For many years, the Chilean banking sector was wide open for both national and foreign institutions. Witness of this is the fact that, for a relatively small market as the Chilean, there are 36 commercial banks and 4 financial houses ("financieras"). Twenty three out of the 36 banks, or almost two-thirds of the total, are foreign. All domestic banks but one (Banco del Estado) are private, and have been so for about 15 years.<sup>12</sup> Foreign banks account for 20% of assets of the banking system, and 15% of its equity (See Table 1 in the Statistical Appendix).

The operation of the Chilean banking sector is regulated by the General Banking Law (DFL No. 252), which dates back to 1960, and whose main modification took place in November 1986. A new project modifying the banking law is currently under discussion in congress; its main provision is the opening of new lines of business for banks.<sup>13</sup> The Superintendency of Banks and Financial Institutions is the entity charged with the enforcement of the law and the regulations.

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<sup>12</sup> It must be noted, however, that several domestic banks were intervened in January 1983. Although they remained under private ownership, their administration was nominated by the State for a few years until they were capitalized by private investors.

<sup>13</sup> The project also redefines capital adequacy standards, and presents new rules for the payment of subordinated debt (this is the debt that some banks still have with the Central Bank as a result of the 1982-83 crisis).

## Regulations affecting foreign banks

In principle, foreign banks can establish in Chile under one of two options: through a subsidiary, or through a representation office. The latter, of course, is much more limited than the former (a representation office, for example, cannot obtain deposits from the public). In case a foreign bank decides to establish a subsidiary, it also faces two alternatives: through an agency depending directly from headquarters, or forming a Chilean corporation.

The Superintendency can repeal an application for the establishment of a foreign bank in two cases:

(a) If the by-laws of the specific foreign bank enter into conflict with Chile's General Banking Law.

(b) If the foreign entity does not offer enough guarantee about its solvency, and thus may endanger the domestic financial market.

Traditionally, (b) has implied that only banks with international recognition have been able to establish themselves in Chile, thus denying this possibility to banks incorporated in "financial heavens" and "off-shore centers". Indeed, the Superintendency did not approve the establishment of BCCI in Chile when the bank applied for it. Analogously, the law forbids the incorporation of national banks whose owners do not have a well-known and solid reputation.

It is worth noting that this legislation does not imply discrimination, as it reaches for the maximum solvency of the

banking entities wishing to participate in the Chilean market. The exclusion of dubious banks incorporated in financial heavens implies just prudence.

In practice, however, the authorities will not approve today applications to establish new banks in the Chilean market. This stems from a diagnosis that there are too many banks operating in the domestic market, and the authorities would like the current ones to strengthen. Thus, they encourage joint ventures between local and foreign banks, especially in the case of weak local banks teaming up with stronger foreign partners. Thus, the only practical way for a foreign bank to establish in Chile is through one of two ways: a joint venture with a local bank, or a direct purchase of a domestic bank.

The General Banking Law indicates that foreign institutions established in Chile must comply with the same legislation and regulations as their domestic counterparts. This is reflected, for example, in the need to form a local board of directors (without restriction of nationality), in case the bank chooses to establish a subsidiary.

The law does not discriminate between foreign and domestic banks. Foreign banks are entitled to the same rights and duties as domestic banks. Also, the foreign bank cannot invoke rights derived from its nationality. As an example, small deposits (whether in foreign or in domestic banks) are equally covered by state insurance.

The minimum capital required for the establishment of a bank

is around US\$10 million, independent of the bank's nationality. However, foreign banks cannot publicize the capital and assets of their headquarters without also publicizing these same variables for the subsidiary.

### 16.3. Insurance companies

The insurance market has experienced significant growth in Chile since the mid-1980s. Part of this growth is due to the evolution of the Chilean economy, but most of it stems from the development of private pension funds (present assets close to US\$14 billion, or more than one third of GDP). Thus, the fastest growing segment of the market for many years has been life insurance, closely tied to the provision of old-age, disability, and survival pensions.

Out of a total of 20 general insurance companies in Chile, 7 are owned by foreigners, and have a substantial share of the market: they account for 61% of the assets, 31% of the capital, and 25% of the profits. Life insurance companies total 26, with 11 under foreign ownership. The latter have a majority share of the market (more so than in general insurance), with 52% of total assets, 41% of capital and 55% of the profits.

The operation of insurance companies is regulated by DFL No251 of 1931. In contrast to the situation in the banking sector, this legislation does not provide for the establishment of foreign subsidiaries or agencies of foreign insurance companies. The law establishes that insurance activities can be performed only by

corporations that participate exclusively in the insurance business. Thus, foreign institutions wishing to participate in this market must constitute a corporation directly.

Foreign competition is assured by allowing the free contracting of insurance with foreign firms abroad. These operations are subject to the same taxes affecting insurance with domestic companies.

The law allows the contracting of insurance with foreign firms, provided the foreign institutions comply with the following requisites:

- (a) Capital of at least UF 300.000<sup>14</sup> (US\$7.5 million approx.)
- (b) The foreign entity must certify that it is legally constituted in the foreign country.

(c) The foreign entity must certify that, in conformity with the respective foreign legislation, it has no hindrance for the provision of insurance abroad.

#### 16.4 Securities trading

The trading of securities in Chile is regulated by the Securities Law (Ley del Mercado de Valores), which dates back to 1981. This activity is performed by two types of intermediaries: stock brokers and securities dealers (agencias de valores).

Measured by total assets, the size of the stock brokers market

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<sup>14</sup> The UF (Unidad de Fomento) is a unit of constant purchasing power that fluctuates daily according to the evolution of the Chile's CPI during the previous month. As of December 20, one UF was worth Ch\$10,619, or about US\$25.

approached US\$1 billion in June 1993. Firms under foreign ownership accounted for one fifth of total assets; another important share (37%) was held by subsidiaries of domestic banks. The shares in total capital were 23% and 24%, respectively. Total assets under management of securities dealers surpassed US\$500 million in June 1993, with almost 70% of these belonging to the foreign-owned companies. (See Table 3 in the Statistical Appendix.)

According to the Securities Law, the requirements of capital, solvency, and liquidity are set through general regulations by the Superintendency of Securities and Insurance (Superintendencia de Valores y Seguros). The operation of stock brokers and securities dealers can be performed only through the establishment of a corporation in Chile, that must be registered at the Superintendency. Other activities that have the same requisite are mutual funds, capital funds, risk classification companies, financial consultants, and so on.

As noted previously, the legislation only provides for the requisites established by the Superintendency. So, besides from the need to establish a corporation and other adequacy standards, there is no discrimination between securities dealers or stock brokers owned by foreign or domestic capital.

#### **16.5 Chilean Financial Services and NAFTA**

The need to have a separate NAFTA chapter for financial services stems from the rather particular characteristics of this sector: (a) trade in financial services differs substantially from

trade in goods; (b) the financial sector is more regulated than most other sectors; and (c) countries have adopted national approaches to regulation that are not only different, but sometimes even incompatible.

Additionally, some financial services require active presence of the supplier of the service near the customer (e.g. retail brokering, consumer loans, retail deposit gathering, etc.), while others can be provided through a "long-distance" approach (e.g. loans to large corporations by international banks, underwriting of securities for corporations, etc.). In one case, the relevant issue will be that of the right of establishment, while on the other it will be that of freedom in cross-border transactions.

To further complicate negotiations in the financial sector, proper attention has to be given to existing national regulatory schemes, which cannot be dismantled in the short run without severe damage to the host country. NAFTA clearly accepts this principle, and in Article 1410 states that nothing in the agreement shall prevent the Signatory Party from: protecting investors, depositors and other market participants; maintaining the safety, soundness, and integrity of its financial institutions, and ensuring the solvency and stability of its financial system.

Just as Canada and the U.S. have adopted contrasting approaches for the regulation of their financial institutions, Chile has its own regulatory approach (as mentioned before). With respect to ownership restrictions, Chile, Canada and the U.S.A. have almost no barriers to foreign ownership in the banking sector.

Regarding entry requirements, it is closer to Canada's legislation, as it has strict entry requirements and proportionately fewer banks. On power setting, Chile differs from both Canada and the U.S., as powers are set by rule, and not determined on a case-by-case basis.

In one area, there is a major difference between Chile and both Canada and the U.S.: the responsibility of provincial governments in Canada and state governments in the U.S. in regulating the financial sector. Because Chile is a unitary nation, only the central government has the power to regulate, and regulations have nation-wide validity.

To keep things in perspective, however, it is important to contrast Chile's situation to that of Mexico, whose banking sector was completely nationalized in the early 1980s, and only recently has been privatized. Moreover, for many years only one foreign bank (Citibank) operated in Mexico, and the sector was closed to foreign participation. This situation has changed very recently, with the economic reforms that Mexico has undertaken, and due to its incorporation to NAFTA. Mexico will allow Canadian banks, securities dealers, and insurance companies to establish wholly owned subsidiaries or to buy existing firms starting in 1994. But a limit on the overall share of foreign firms in financial market will apply during a transition period of 6 years (which could be extended if the foreign share goes over 25% of the market).

Chile's financial industry, on the contrary, has been quite open for many years. After a proliferation of local and foreign

banks in the late 1970s, the authorities decided not to accept more applications to open new banks. This was importantly influenced by the 1982-83 crisis, and by the authorities' perception that the banking sector was overextended. In any case, this restriction does not discriminate between local and foreign investors.

A negotiation of Chile's accession to NAFTA would therefore differ to that with Mexico in at least two aspects: (a) Mexico was a very closed market and Chile is very open; and (b) Mexico is a very large and potentially attractive market, whereas Chile is a smaller market. As a consequence, Mexico had a large stake to trade in for concessions in other sectors. Chile's objective, on the other hand, may be focused on gaining additional access to the NAFTA-expanded financial markets and to facilitate the flow of financial services to and from Chile.

One important aspect in facilitating the opening of these markets and the flow of funds and cross-border services may be the mutual recognition of national regulatory institutions as responsible for the solvency and soundness of financial institutions. The same is true for regulatory agencies responsible for overseeing stock markets and stock transactions.

A final word is necessary about Canadian financial institutions. In spite of the openness of Chile's financial industry, and of the participation of 23 foreign banks in this market, it is important to mention that only two Canadian banks (Bank of Nova Scotia and National Bank of Canada) have participation in the Chilean market through their ownership of

minority stock (29% and 9%, respectively) positions in two Chilean banks (Sudamericano and Osorno). It is possible, therefore, that Chile's policy of not approving the applications of new banks could be contested by Canada in case of Chile's accession to NAFTA. In such a case, this issue could become part of the negotiation process. Under the current law and regulations, Canadian capital may own insurance companies, securities dealers, or purchase an existing bank (or enter into a joint venture with an established bank), but will not be allowed to open new banks.

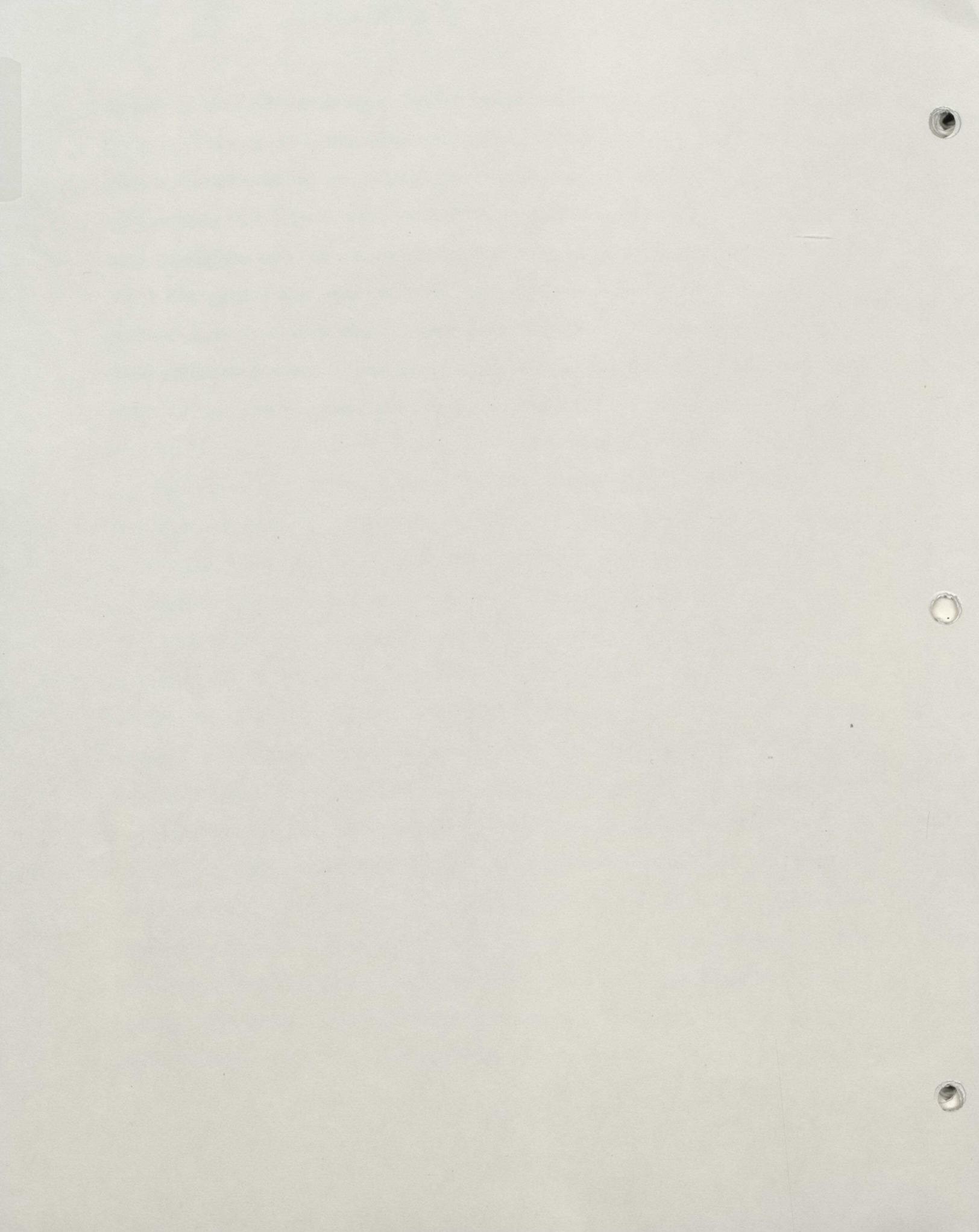


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### 17.1 Overview

The Chilean energy sector is widely heterogeneous, both in the market structure and orientation of each sub-sector, and in the structure of property. Oil exploitation and refining are still in the hands of the state, although distribution is made by private firms. On the other hand, electricity generation and transmission is now mainly under private ownership, after the privatization round of the second half of the 1980s.

National consumption of energy is diversified among a number of sources. Petroleum is by far the most important source, representing 42% of total consumption. Hydroelectricity, natural gas, coal, and firewood come at a considerable distance, accounting for around 14% of total consumption each (see Table 1 in the Statistical Appendix).

## 17. ENERGY

### 17.2 Petroleum

For a long time, the production of oil in Chile has been in decline, with the slow depletion of existing fields, and the lack of significant new discoveries of reserves. Nowadays, close to 80% of national consumption is imported. Thus, the main activities in this sector are the import of crude, its transportation and refining, and the distribution of refined products to final users.

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The petroleum sector has been liberalized progressively since the mid-1970s. Prices are now freely determined by the market for

all petroleum products. There is free entry to import, refine, and distribute oil in Chile. With the flat 11% tariff as the only import barrier, prices of oil and oil derivatives move along with world prices.

### **Exploration and exploitation**

A number of sedimentary basins have been studied along the Chilean territory, representing a total area of nearly 300,000 square kilometers. They are located mainly in the straits of Magellan, the southernmost end of the central valley, and northern Chile. Of these, the most significant and the only one under current exploitation is the Magellan basin, which represents 29% of the total area.

The only company pursuing exploitation is the state-owned Empresa Nacional de Petroleos (ENAP). This is explained by the fact that, under constitutional mandate, the state is the sole owner of all hydrocarbon deposits. Nonetheless, the state can pursue exploration and exploitation in association with national or foreign private investors. The law provides several incentives for these joint ventures, in the form of special petroleum-operation contracts. These are risk-contracts guaranteeing the contractor a previously agreed compensation in petroleum (that can be exported or purchased by the State). In addition, when authorized by the Presidency, the contractor may be granted special tax treatments (which include a reduction for 10% to 100% of payable income tax).

Several explorations through risk-contracts with American and

Canadian firms (Hunt-USA, Hamilton-Norcen-USA, Maxus-USA, Eurocan-Canada) have been pursued in northern Chile. To date, however, the results have not been promising.

### **Refining and distribution**

There are two refineries and a topping plant in Chile, all of them subsidiaries of the National Petroleum Company (ENAP). Each refinery is located near a main urban center, one in Con-Con (close to Santiago and Valparaiso-Viña del Mar), the other in Concepción.

The distribution of liquid fuels has been traditionally handled by three big companies: ESSO Chile (since 1913), SHELL Chile (since 1919) and COPEC (established in 1934). In 1979, however, a change in the regulation allowed a number of new, smaller firms to start operations. In addition to the three traditional firms, six new companies now operate in the market (ABASTIBLE, APEX, COMAR, ENEX, GAZPESA, and TEXACO).

### **17.3 Electric power**

Traditionally under public sector ownership, the electric power sector was privatized almost completely between 1985 and 1989, both in generation and distribution. In fact, it has become one of the most dynamic sectors in the economy, and one that concentrates a substantial share of stock-market transactions.

Newly privatized companies in this sector have been the pioneers in the internationalization of Chilean enterprises. ENDESA and ENERSIS, for example, have actively participated in Latin

America's privatization process, and now own a significant share of electricity generation and distribution in Argentina. More recently, Chilean companies have been looking with great interest at Peru's privatizations in the electric power sector.

### **Generation**

Due to Chile's geographical features, the electric power sector is physically divided into four independent areas. In the far north, the plants supplying the local interconnected system are mostly coal- or oil-burning thermoelectric plants. In central Chile --an area covering nearly 92% of the country's total population-- the local interconnected system is supplied mainly by hydropower. Finally, in the southern area of the country --a region of quite difficult access-- electric power is generated either by small hydroelectric plants or by oil and diesel. Due to the scant population of the area, most plants supply only specific locations, such as Punta Arenas or Puerto Natales. A decomposition of electric installed capacity by type of generation is provided in Table 2 of the Statistical Appendix.

Electricity generation is open to private capital by concession, with a pricing scheme regulated by state agencies. The main principle behind this regulated pricing system is the charging of marginal costs in the prices to distributors. Generation companies are allowed, however, to sell energy directly to big consumers under a freely set price.

This sector is in private hands, except for the Colbún-

Machicura hydroelectric plant which is still under public sector control.

### **Distribution**

The distribution of energy to final consumers is separated from its generation, except in the southern part of the country. Because electricity distribution companies are natural monopolies, their pricing system is also regulated. The maximum tariffs that can be charged are computed every four years taking as a basis a model company, with typical consumer density and a representative cost structure.

#### **17.4 Coal**

As with petroleum, the state is legally the sole owner of all coal fields. The possibility for exploration and exploitation of coal by private investors is available only under concession. Concessions are, by law, a real and immovable right. Thus, the concession holder has exclusive rights to freely explore and exploit his claim.

Ownership in the coal sector is mixed. Coal exploitation is concentrated in one state company (ENACAR) and three private firms (SCHWAGER, CARVILLE, and COCAR). Of these, ENACAR has suffered deep financial problems over the last couple of years, and has avoided bankruptcy only through heavy subsidies from the state. The reason for this decision is the dependence of some 150,000 people -- located in a highly concentrated geographical area-- on these

mining works. The government has insisted, however, that this is a temporary measure used only to give the opportunity for cost reduction and modernization.

The main reserves of coal are located in the 8th, 10th and mainly in the 12th regions (see Table 3 in the Statistical Appendix). Considering only demonstrated reserves (about 600 millions of metric tons), the Chilean demand for thermal coal can be met for about 150 years. This demand reflects mainly the use of coal by thermoelectric power plants. But because these plants operate as a supplement to the hydropower stations (because of cost considerations) actual demand for coal depends critically on the unpredictable behavior of hydrology. The main end users of coal are industry and mining.

#### 17.5 Gas

Gas fuels used in Chile include natural gas and manufactured gas. Until now, natural gas has been produced only as a by-product of petroleum exploitation in the Magellan area, and has been used only in the surroundings of that area. A new project, however, is likely to change this situation. If this goes as scheduled, a pipeline will supply natural gas from Argentina to the central region of Chile.

Manufactured gas is produced from naphtha cracking processes, and has been used mainly in the Santiago area. In other parts of the country, manufactured gas is produced in steel mills (as in Concepción) or by coal distillation. Also, since 1978 GASCO, the

now private distributor of gas in Santiago, has been conducting studies for production and use of biogas from trash landfills. This project has been successful, and biogas now provides over 30% of manufactured gas in Santiago.

The incentives for natural gas exploration and exploitation are similar to those given for petroleum operations. That is, the contractor receives an agreed compensation and has the possibility of receiving a tax deduction.

Natural gas is a competitive substitute for the more expensive imported fuels. So far, however, natural gas has only been found in the southern area of Magallanes. Distance makes it unfeasible to send it to the more industrialized central region. This situation could eventually change if the new pipeline that could bring natural gas from Argentina goes through, or from discoveries of new sites.

#### **17.6 Chile's Energy Sector and NAFTA**

As a large exporter of energy products (US\$16 billion in 1991), Canada's interest is clearly in the side of liberalization of the energy sector. Chile --although a net importer of oil, coal and (in the near future) gas-- will certainly support this goal. Indeed, Chile's energy sector is very liberal, and it is unlikely to cause any significant conflict in future NAFTA negotiations.

Prices of energy products are freely determined by the market for all products, except those where a natural monopoly exist. The latter is the case of electricity distribution, where a clear

regulation exist, and prices are set on the basis of marginal costs (as they should be). Foreign investors are allowed to participate in all sub-sectors. And imports are subject to the regular, flat 11% tariff as the only trade barrier. Thus, the Chilean Government will quickly agree to one of NAFTA's rules for the sector: the commitment not to apply restrictions on imports or exports (except in limited situations).

The only departure from a totally liberal setting is that Chile's Constitution stipulates that the state is the sole owner of all hydrocarbon deposits. As such, private exploration and exploitation of hydrocarbon fields can only occur under concession from the state. This restriction, however, is unlikely to create a conflict in Chile's NAFTA negotiations, for several reasons.

First, the concessions regime is transparent and full of incentives, and has already attracted foreign companies (including Canada's EUROCAN). Second, Chile's regime is far less restrictive than Mexico's, whose state-owned PEMEX controls virtually everything in the petroleum sector (exploration, exploitation, refining, processing, and pipelining). Third, Canada's provincial governments also have the ownership of energy resources. And finally, the ownership restriction applies to the hydrocarbon sector, which is not Chile's most attractive. Furthermore, Chile is unlikely to demand protection of supply provisions in an eventual negotiation with NAFTA, because NAFTA countries are not significant suppliers of energy products to Chile.

### 17.7 Potential for Canadian Businesses in Chile's Energy Sector

Over the last 10 years, average annual investment in the oil sector has been close to US\$150 million, of which less than one third has gone into exploration. This has been clearly insufficient to prevent a significant decline in the national production of crude petroleum. Chilean authorities thus have a clear interest in attracting foreign investors into this sector. This presents an opportunity for Canadian firms to become involved in the exploration and eventual exploitation of new sites. A Canadian firm (EUROCAN) has already participated in exploration through risk-contracts in the northern region of Chile, although so far with negative results.

It is important to bear in mind, however, that the gas pipeline from Argentina (which will supply natural gas to the central region of Chile) will likely reduce the demand for crude derivatives. But the transition from oil to gas will not be instantaneous. The public transportation system, for example, would face important technological changes in the process of transforming diesel engines to gas-fueled engines.

Canadian firms may also participate in Chile's oil sector through the supply of equipment and spare parts to new and existing operations. The distribution of refined oil and derivatives is also fully open to foreign companies.

As with oil distribution, electricity generation and transmission are open to private capital, and thus Canadian firms can participate directly in the development of new plants.

Also, most of the machinery and equipment used in the construction of these plants (turbines, generators, transformers, etc.) is imported. Nearly 20% of this equipment comes from the USA, with other important suppliers being Germany, France, Japan and Brazil. The strong expansion that this sector will experience in the near future opens an interesting area for Canadian firms to get a share of this market.

The largest reserves of coal existing in Chile are located in the far south, which makes it difficult to use them in the central region. Also, the declining production of the state-owned ENACAR has already meant that some local coal consumption has been met by foreign suppliers.

Canada has been one of the main suppliers of imported metallurgical and bituminous coal (54.7% and 11.0% of total imports, respectively, as shown in Table 4). Strong competition can be expected, however, from other suppliers like Colombia, with large reserves and low production costs.

One of the main opportunities for foreign firms in the Chilean gas sector is in the exploration and exploitation of new reserves. A Canadian firm has participated through risk-contracts in oil and gas exploration in northern Chile, although results have not been encouraging.

As mentioned, the future construction of the gas pipeline from Argentina to central Chile may imply a reconversion of the public transportation services, switching from diesel to gas use. The supply of equipment for this "new" fuel, used in a massive scale,

could provide interesting business opportunities for Canadian firms.

The possibility of using natural gas as raw material in the development of new industrial operations such as methanol or ammonium-urea plants in the Magellan area is also present.

could provide interesting business opportunities for Canadian  
investors, particularly in the area of power generation, and  
the possibility of using heavy oil as a fuel source in the  
development of new industrial plants. The potential for  
development of new industrial plants in the region is also  
great, and it is expected that the Canadian firm will  
be able to provide a significant contribution to the  
development of this market.

The largest reserves of coal in Chile are found in the  
Antofagasta region, which makes it difficult to use them in the  
central region. The declining production of coal in Chile  
has already led to a significant increase in the demand for  
foreign supplies.

Canada has been one of the main suppliers of imported  
metallurgical coal to Chile, and it is expected that this  
supply will continue to be significant in the future. The  
large reserves and low production costs of coal in Chile  
make it an attractive source of supply for the country.

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gas sector is in the exploration and exploitation of gas reserves.  
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As mentioned, the future construction of the gas pipeline from  
Argentina to central Chile may imply a reconversion of the public  
transportation services, switching from diesel to gas use. The  
supply of equipment for this "new" fuel will be a massive task,

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18.1 Overview

Chile has traditionally been labeled as a mining country. During the XIX century it was the world's largest copper producer. Early in the XX century it became the largest nitrate producer of the world. As of 1992, Chile is the world's largest producer and exporter of copper (32% of total world exports), potassium nitrate and sodium nitrate. The country is also the largest world producer of vanadium, lithium, bismuth and molybdenum; the fifth largest producer of borax; the seventh largest producer of selenium; the eighth largest producer of silver, and the ninth largest producer of gold.

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The mining sector's contribution to GDP was 6.6% in 1992 (see Table 1 in the Statistical Appendix). But the importance of this sector goes beyond its contribution, as the share of mining products in total exports is 34% on that year. Copper exports represented 82% of this total. Copper mining has been widely in the hands of the state for the last twenty years. Among the corporations, Codelco (Codelco de Chile) represented 57% of total copper exports in 1992. However, the development of new private mines (of which Codelco is the largest) has led to a significant decline in the state's share in copper mining.

In the last years the mining sector has attracted a major share of foreign investment. In the period January-October 1993, the mining sector attracted the largest amount of the almost US\$2 billion of

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### 18.1 Overview

Chile has traditionally been labeled as a mining country. During the XIX century it was the world's largest copper producer. Early in the XX century it became the largest nitrate producer of the world. As of 1993, Chile is the world's largest producer and exporter of copper (22% of total world exports), potassium nitrate and sodium nitrate. The country is also the largest world producer of rhenium, lithium, iodine and molybdenum; the fifth largest producer of boron; the seventh largest producer of selenium; the eighth largest producer of silver; and the ninth largest producer of gold.

The mining sector's contribution to GDP was 6.6% in 1992 (see Table 1 in the Statistical Appendix). But the importance of this sector cannot be underestimated, as the share of mining products in total exports was 47% on that year. Copper exports represented 82% of this total. Copper mining has been mainly in the hands of the state for the last twenty years, through the Corporacion del Cobre (CODELCO), which represented 57% of total copper exports in 1992. More recently, however, the development of new private mines (of which Escondida is the largest) has led to a significant decline in the public sector's share in copper mining.

In recent years the mining sector has attracted a major share of foreign investment. In the period January-October 1993, the mining sector accounted for 45.7% of the almost US\$2 billion of

materialized external investment. Also, the biggest single investment projects have been made in this sector.

## 18.2 Copper mining

Copper mining is mainly done by CODELCO in five productive divisions: Chuquicamata, El Teniente, Salvador, Andina and Tocopilla. Although CODELCO's annual production is over 1 million tons, it is expected that it will decline to 800,000 tons by the year 2010, due to a fall in average grades. In spite of this, it is expected that Chile's share of world primary copper production, which was 22% in 1990, will increase to 25% by the mid-1990s, due to the implementation of expansion programs in present companies and to new private investments.

CODELCO faces a number of challenges. The need for an increase in productivity has strongly appeared in the face of rising costs due to declining grades. In fact, extraction methods have not varied significantly over the last 15 to 20 years, while labor costs have severely risen. 1992 was the first year to see an increase in productivity in recent times.

One of the measures to overcome these difficulties has been the approval this year by Congress of the new CODELCO law. In a nutshell, the new law empowers CODELCO to dispose of currently unexploited mining rights, allowing its free association with private investors.

The first practical result of this new law has been the association between CODELCO and a Canadian-North American

Consortium, Cyprus - Lac Minerals, for the joint exploitation of the El Abra claim (with CODELCO retaining 49% of property). This represents a direct payment from the foreign investors of over US\$500 million, with an additional US\$1 billion committed for the implementation and exploitation of the project.

However, this law does not consider eligible for joint ventures with the private sector those claims that qualify as "reposition" claims (those used for expanding the production of existing divisions). In practice, this has left out some of the biggest claims existing (Mansa Mina and Radomiro Tomic). State exploitation has also been suspended (or significantly slowed down) due to budgetary reasons.

The most important investment project carried out in recent times has been the Escondida copper mine. This represented over US\$800 million in direct investment, thus making Escondida the largest private mine in Chile. Some of the new projects in copper mining are given in Table 2 of the Statistical Appendix. In total, these new projects will increase copper production to more than 2.3 million tons towards the year 1996, 69% of which will be extracted from open pit mines.

Second in importance to CODELCO is the state-owned Empresa Nacional de Minería (ENAMI), with a completely different nature and functions. Its major objective is to encourage small and medium-sized mining. Thus, ENAMI does not exploit mine sites; rather, it buys minerals from private entrepreneurs, which are then processed, smelt, refined and marketed.

### 18.3 Gold and silver mining

In 1992, the Chilean production of gold was 33,774 kilos. Only a decade before, it barely surpassed 3,000 kilos. This impressive growth began with the start-up of the El Indio mine at the end of the 1970s. Traditionally, gold production came as a by-product of copper mining. Only with El Indio has gold mining in itself become a principal activity, mainly as open pit operations.

Foreign companies currently produce most of the gold in Chile. The increase in gold production will thus depend on new prospections and new foreign investment. Projects for gold production currently under study, however, could expand production to 37.5 tons in 1995.

As with gold, silver production has increased substantially over the last decade. In 1980, the annual production of silver was under 300 tons, while in 1992 it has climbed to over 1,000 tons. Medium-term projections, however, estimate silver output at around 900 tons by 1995 (See Table 3 in the Statistical Appendix). In Chile, silver comes mainly as a by-product of copper and gold exploitation, while direct silver mines are very small.

### 18.4. Iron mining

Iron mining in Chile is made up exclusively of open pit operations, and is completely under the hands of Compañía Minera del Pacífico. This is a subsidiary of Compañía de Acero del Pacífico (CAP) S.A. de Inversiones (formerly a group of state enterprises), a holding company which also owns the Huachipato

Siderurgy and the Huasco Pellet Plant.

The investment of CAP S.A. companies that are now being developed are estimated at an accumulated US\$850 million for the period 1989-1994. The most important project at the Huachipato steel mill has been a coke plant with a capacity of 500,000 tons per year, inaugurated in 1990. Total investment for this plant was US\$140 million.

#### 18.5 Non-metallic or industrial minerals

Non-metallic mining mainly consists of the exploitation of nitrate, lithium and calcium carbonate. It is worth noting that Chile is the second world producer of iodine (a by-product of nitrate) and lithium, which are mostly exported. Calcium carbonate is used basically in the production of cement for the domestic market, thus depending heavily on the overall growth rate of the economy.

Several projects will be undertaken in the near future regarding aluminum refining, an area not yet developed in Chile. One of them is the Alumisa Project, which contemplates an initial investment of US\$1.1 billion. Its location is the far south of the country (XI region), where low-cost hydroelectric power is readily available. The raw material would be imported from Australia. This project could imply a substantial economic impact for the country, and especially for the region. With annual production estimated at around US\$400 million starting in 1996, it would triple regional GDP.

Another aluminum processing plant, with an investment of US\$1.5 billion is under study by Endesa, the largest power generating company in Chile. It is similar in its characteristics and location to Alumisa.

#### 18.6 Potential for Canadian Exports in the Chilean Mining Sector

Canada already has a significant presence in Chile's mining sector through the ownership of significant stakes in several large projects. Some of the most important mining companies in Canada, such as Placer Dome, Río Algom, Falconbridge, Cominco and Lac Minerals are heavily involved in the exploitation of copper, gold and silver. The largest projects include Quebrada Blanca, Cerro Colorado, El Abra, La Coipa and El Indio. This presence has been growing fastly in recent years, and now Canada is one of the main foreign investors in Chile.

Besides from direct participation in the ownership of companies, the main opportunities for Canadian companies in the Chilean mining sector are in the provision of equipment for new projects and for the development of existing projects. An estimate of the demand for equipment for the next few years gives an approximate figure of around US\$500 million per year for 1994-96 (see Table 4 in the Statistical Appendix).

The largest kinds of equipment imported are heavy trucks, power shovels, drilling equipment, loaders, crushers and motorized vehicles, reflecting the importance of copper mining in this sector (see Table 5 in the Statistical Appendix). However, the strong

expansion of private investment in this sector will imply a declining share in total production for CODELCO, and some diversification in equipment needs.

In the last few years, the largest volumes of imports of equipment have come by far from the United States, followed by Germany, Brazil, Japan, the United Kingdom and Canada. (See Table 6 in the Statistical Appendix).

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## 19.1 Overview

The Chilean forestry sector has been one of the main contributors to the export boom experienced by the Chilean economy since the mid-1980s. Forestry exports, including processed and unprocessed products, represented 7.8% of total exports in 1975, and increased their share to 11.3% in 1992. This figure is even more impressive considering that the share of exports in Gross Domestic Product (GDP) peaked at almost 33% in 1992, and was only 21% in 1975. The contribution of this sector to the country's GDP has increased from 2.14% in 1975 to nearly 3.5% in 1992.

In spite of its very rapid growth since the mid 1970s, the Chilean forestry sector is still small compared to the forestry industries of the Northern Hemisphere. This has a favorable aspect, in that a strong expansion of Chile's forest exports would not have a significant depressing effect on international prices.

Chile's international competitive advantage in the forestry sector is based on very favorable soil and weather conditions, low costs of production, and a convenient location of plantations with respect to processing plants and ports. The only shadow of doubt about the medium-term evolution of this sector is cast by the weak situation in the international markets for some of the most important forestry products.

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## 19.2 Resource base

The Chilean soil and weather conditions are very favorable for the growth of trees. Indeed, an examination of Chile's soil use capabilities reveals that, out of a total surface of 75.8 million hectares, 44% of the soil (32.8 million hectares) is suitable either for productive or for conservation forestry, with an additional 10.8% (8.2 million hectares) currently used for grazing, which could significantly expand the potential for industrial wood plantations (see Table 1 in the statistical appendix).

There is a sharp contrast, however, between the territory suitable for forestry and the land area currently under plantation or with productive natural forests. Presently, less than 50% of the potentially forestable land supports forests.

Chile's native forests are basically under private ownership; of a total of 15 million hectares, 13.2 million are privately owned, which include 3.5 million of productive hectares. Their economic role in the Chilean forestry sector, however, is not very significant, as native forests represent 5% of the total forest output. This is explained by a variety of factors, including government regulations, public opinion and green movements, isolation of productive forests and smallness of standing volumes due to overmaturity.

During the last century, two main exotic species have been introduced in Chile. These are **Pinus Radiata** (which came from California) and **Eucalyptus Globulus** (from Australia). The former

has been traditionally used for pulpwood and sawnwood, while the latter, traditionally used for pit props in coal mining, only in recent times has been industrially processed.

The total land surface under industrial plantations is around 1.5 million hectares, with radiata pine accounting for 85% of the total.

It is important to note that the increase in plantation forestry is the main cause of the surge of Chilean forestry exports. This increase in plantations began basically in 1974, when the government provided strong incentives and subsidized plantations (as explained below).

### 19.3 Current legislation

Ninety five percent of all plantations and natural forest are privately owned. The rest are managed by the SNAPSE (Sistema Nacional de Areas Silvestres Protegidas), the government entity which manages Chile's National Parks and Forest Reserves, dependent of CONAF (Corporación Nacional Forestal).

The forestry sector has been a subject of legislation since the XVI century, but regulations currently in place are recent. Decree 701 of 1974, and its amendments of 1980, establish the following rights, limitations and incentives for forestry practices:

Private ownership rights are understood here as with other forms of real estate. A prohibition of all harvesting and reforestation not approved by CONAF applies, however. Thus, a

management plan must be submitted for approval by this agency before the exploitation of a native forest. But some species, like **Araucaria araucana** and **Fitzroya cupressoides** (Alerce) cannot be harvested at all.

The following tax incentives exist for forestry operations: an exemption from territorial taxation (2% of the value of the land), and a 50% reduction of personal taxes applied to income earned from these operations.

As with native forests, regular private ownership rights also apply to plantations. In contrast to native forests, however, there are no restrictions on forestry practices, unless the owner has declared that his estate is suitable only for forestation ("forestry land"). In this case, a Management Plan must be submitted to CONAF, with the only requirement being that the owner must commit to keep the land forested.

If located in soil unsuitable for agriculture, the plantations have the same tax incentives described above. In addition, however, about 70% of the costs of plantation and silvicultural practices are reimbursed to the plantation owner. This has been the most important incentive for the development of the forestry sector over the last two decades.

The practical effect of this legislation has been the creation of a substantial plantation base of around 1 million hectares (see Table 2 in the statistical appendix) with a relatively small cost in subsidies of around US\$71 million.

In contrast, the regulation of native forests has ensured

neither its conservation nor its rational exploitation. A new law is currently being discussed in Congress, which puts a strong emphasis on conservation, but also proposes a subsidy on replantation of productive native forests.

#### 19.4 The Forest Industry

Despite its recent development, Chile's forest industry is diversified and modern in most of its sub-sectors. In particular, the branches of pulp and paper, sawmilling and wood based panels have developed to become internationally competitive.

In 1976, total consumption of raw materials stood at 4 millions of cubic meters of logs underbark. Since then it experienced fast growth, reaching 17 million cubic meters in 1992 (see Table 3 in the statistical appendix).

Sawmilling remains the largest consumer of raw materials in the forest sector, although its importance has declined in recent years. As with other forest industry activities, sawmilling has experienced fast growth, more than tripling lumber output between 1975 and 1992 (960 millions and 3,217 millions of cubic meters, respectively). Despite this, sawmilling is characterized by a large number of small and low-productivity sawmills, although this situation has been slowly reversing in recent times. As with much of the forest industry, sawmilling is oriented almost exclusively to the export market.

This sub-sector of the forest industry is very heterogenous. Indeed, the four basic product lines (plywood, fiberboard,

chipboard and medium-density fiber (MDF) present considerable differences in efficiency and market orientation. Fiberboard, plywood and chipboard are basically oriented to the internal market, with exports representing less than 50% of total production. In contrast, the newly started plants producing MDF are focused on the external markets.

In just a couple of decades, this industry has changed its orientation from the internal to the external markets. Along the process, it has become one of the most dynamic sectors in the Chilean economy.

As of 1993, pulp production is considerably smaller than installed capacity, due to a major revamping of existing plants since 1990. Despite this, the depressed price of pulp in the international markets has provoked a difficult situation for the industry during the last year.

For all papers and cardboards, exports from Chile almost double imports from the rest of the world. Except for newsprint, which is produced by two medium-sized modern mills, the rest of the papers and cardboards are produced in small scale plants. The production of newsprint is focused on the external market (Latin America), while the rest of the paper and cardboard production is centered almost exclusively in the domestic market.

#### **19.5 Possible elements in NAFTA negotiations**

Tensions or eventual conflicts in the forest sector during Chile's negotiations to join NAFTA are not expected. First, Chile

represents a very small share of the world export market in all sub-sectors of forestry (in pulp, for example, Chile's share is less than one percent). Second, Chile has no trade barriers for final products, raw materials or equipments other than the 11% flat import tariff. And third, Chile faces no special restrictions for the entry of its forest products in NAFTA markets.

There is one area, however, where differences of opinion may arise between Chile and NAFTA countries, which is the existence of subsidies to reforestation and to native forests in Chile. These subsidies have a large environmental value, and could be justified on economic grounds due to the presence of externalities in the growth of trees. Nevertheless the United States has contested a similar support mechanism used by Canada through what the U.S. considers low "stumpage fees"; these fees represent a royalty or charge (the equivalent of rent) which must be paid to the provincial governments for the right to carry out forestry operation on government-owned land. Unlike Canada, most Chilean forests are privately owned, but the subsidy under DL 701 may be contested on similar grounds.

#### **19.6 Potential for Canadian Business in the Forestry Sector**

The potential for Canadian exports in the forestry sector is closely linked with the future trends of this sector. Indeed, the reliance on plantations makes it possible to project industrial wood availability toward the end of the present decade. Even maintaining the current level of natural forests, total wood

availability will more than double between 1990 and 2000. A recent government projection shows an increase of 44% in lumber production, of 76% in wood-based panels and of 150% in pulp and paper production over this period.

This expansion will imply strong growth in sectoral exports. Compared to the level of 1990, exports of wood-based panels will be 44% higher in the year 2000, while pulp and paper exports will expand by 200% during the same period (see Table 4 in the statistical appendix).

Obviously, these results cannot be taken at face value, due to the evolution of international markets. Still, they show a strong potential for continuity of the rapid growth enjoyed by the sector in recent years.

Much of the total investment required to face this substantial expansion in productive capacity will be in the form of imported specialized goods and services, thus opening an opportunity for countries with substantial experience in the forestry sector such as Canada. Estimates of the total investment in each sub-sector for the period 1992-2000 are presented in Table 4 of the statistical appendix.

#### **Areas of interest for Canadian suppliers**

This section identifies potential areas of interest for Canadian suppliers of goods and services in several sub-sectors of the forest industry.

## **Silviculture**

- Consultantcy and training in wildlife management and organization of National Parks.
- Training and technology in tree breeding, nurseries and plantations.
- Equipment for wildlife and nursery laboratories.
- Machinery and equipment for plant breeding, planting, thinning and pruning.

## **Forest harvesting**

- Technical planning and equipment selection for site preparation and harvest.
- Felling and logging equipment.
- Loading and unloading equipment
- Specialized log transportation trucks.

## **Kiln drying**

- Consultantcy in the planning and design of kiln drying operations.
- Kiln instruments, equipment, chambers and control systems.

## **Chipping equipment**

- Portable softwood chippers, to run in conjunction with logging operations.
- Stationary sawmill chippers for softwoods, and pulp mill chippers for softwoods and hardwoods.

- Stationary chippers for export operations.

### **Sawmills**

- Sawmilling feasibility studies, programming design and engineering.
- High technology machinery and equipment.
- Wood preservatives and anti-stain chemicals.

### **Pulp and paper**

- Engineering consulting for new mills, adaptation of existing ones to operate on Eucalyptus.
- Machinery and equipment.

### **Environmental studies**

- Studies on the impact of natural deforestation.
- Studies on the impact of plantations growth.

**PART III: FINAL COMMENTS**

- Stationary chippers for export operations.

#### Sawmills

- Sawmilling feasibility studies, programming design and engineering.
- High technology machinery and equipment.
- Wood preservatives and anti-stain chemicals.

#### Pulp and paper

- Engineering consulting for new mills, adaptation of existing ones to operate on Eucalyptus.
- Machinery and equipment.

#### PART III: FINAL COMMENTS

- Studies on the impact of natural deforestation.
- Studies on the impact of plantation growth.

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## Attorney's Response to Commentary Generated by ITC's Report

In response to your request based on the comments from ITC, we are pleased to submit the answers as follows:

### General

1. Chile's exchange controls are unlikely to pose an obstacle to U.S. exports. First, these controls are very minor. Second, they are expected to be dismantled gradually, as it has been happening recently.

2. A contract concerning the structure of Chile's Government will be struck to your advantage.

### Legal Issues

3. It is in the legal tradition of Chile to publish laws and regulations with due opportunity for comment and to inform about administrative and judicial review procedures.

### Trade Rules and Procedures

12. **20. RESPONSES TO QUESTIONS ON INTERIM REPORT** ...ing  
comp...  
...ever,  
enjoy these measures. For example, compensatory measures have been applied to butter, powder milk and cheeses among milk products; to shirts, overcoats, pants, and sweaters among apparel. And so on.

### Standards

4. Each ministry has jurisdiction over its own sector (e.g., standards related to construction of houses are declared binding by the Ministry of Housing, whereas those related to construction of roads are declared binding by the Ministry of Public Works).

5. The National Institute of Standards develops some standards. Others are developed by specialized technical institutions or industry associations. Tests performed by these institutions can be recognized as those of the NIS if these institutions are accredited by the respective ministries.

### Procurement

6. Chile does not use procurement contracts as a tool of either price or performance requirements.

7. In fact, the bid challenge procedures used in Chile have been recognized as reasonably effective by international bidders.

20. RESPONSES TO QUESTIONS ON INTERIM  
REPORT

## *Authors' Response to Commentary Generated by Iterim Report*

In response to your request based on the comments from Ottawa, we are pleased to submit the answers as follows:

### General

1. Chile's exchange controls are unlikely to pose an obstacle to NAFTA accession. First, these controls are very minor. Second, they are expected to be dismantled gradually, as it has been happening recently.
2. A document containing the structure of Chile's Government will be provided to you separately.

### Legal issues

3. It is in the legal tradition of Chile to publish laws and regulations with due opportunity for comment and to inform about administrative and judicial review procedures.

### Trade rules and procedures

12. Tables 2.3 and 2.4 provide examples of products enjoying compensatory measures. Not all products in each category, however, enjoy these measures. For example, compensatory measures have applied to butter, powder milk and cheeses among milk products; to shirts, overcoats, pants, and sweaters among apparel. And so on.

### Standards

2. Each ministry has tuition over its own sector (e.g., standards related to construction of houses are declared binding by the Ministry of Housing, whereas those related to construction of roads are declared binding by the Ministry of Public Works).
3. The National Institute of Standards develops some standards, while others are developed by specialized technical institutions or industry associations. Tests performed by these institutions can be as binding as those of the NIS if these institutions are accredited by the respective ministries.

### Procurement

6. Chile does not use procurement contracts as a tool of either policy or performance requirements.
8. So far, the bid challenge procedures used in Chile have been considered reasonably effective by international bidders.

## Investment

1. The approval process has not been eliminated because it represents an extremely useful tool for gathering statistical information about the real impact of foreign investment in Chile.

2. The approval process refers only to the inflow of foreign exchange to Chile and to the remittance of profits and capital, but not to the right of operation in specific sectors (which is guaranteed by the Constitution for all parties).

3. To the best of our knowledge, the preference for a written contract does not refer to any instability or inadequacy but rather to preference of investors for a long-term (20-30 years) stability of rules.

4. There are no specific restrictions for domestic investors and foreign investors. All investors receive the same treatment in Chile.

## Dispute settlement mechanisms

3. Our claim refers to the fact that while Chile has been willing to actively participate in dispute settlement procedures, all such procedures have an administrative "cost". In the case of NAFTA, the number of commissions and working groups is large and therefore the cost will be proportionately high.

## Forestry

2. The US\$71 million of subsidies under DL 701 represents the accumulated amount from 1974 to 1982 (See Eladio Susaeta, "The Chilean Market for Canadian Goods and Services in the Forestry Sector", December 1992)

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