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**CHILE'S TRADE REGIME LEADS TO STRONG ECONOMIC GROWTH, BUT
INCREASING EMPHASIS ON REGIONAL AGREEMENTS
COMPLICATES TRADE POLICY**

Chile's liberal and transparent trade regime - in place now for almost 20 years - and its successive unilateral reforms have resulted in strong economic growth and lower inflation. According to a new WTO Secretariat report on Chile's trade policies and practices, Chile's low and uniform tariff and its commitments in the WTO demonstrate its determination to pursue liberal trade policies on an MFN (Most-Favoured-Nation) basis.

Chile's current preoccupation with regionalism, however, reflects its concern over possible exclusion from a growing number of regional preferential trade agreements. The WTO report notes that its membership in a range of overlapping agreements, many with different rules of origin, has added a measure of complexity to the Chilean trade regime.

The WTO report and a policy statement prepared by the Government of Chile will provide the basis for a discussion on Chile's trade policies and practices in the WTO's Trade Policy Review Body on 23 and 24 September.

Chile applies, on an MFN basis, a uniform tariff of 11 per cent and is reportedly considering a further tariff cut. While applied tariffs are well below Chile's WTO bound rate of 25 per cent (31.5 for some agricultural goods) and export subsidies are to be eliminated, the report points out that a few specific sectoral non-tariff policies remain.

Chile has bilateral trade agreements with Canada, Mexico, Colombia, Ecuador and Venezuela and is an associate member of MERCOSUR¹. Chile is also participating in the Asian Pacific Economic Cooperation forum (APEC) and is currently negotiating an agreement with the European Union. These regional agreements, says the report, have resulted in differential treatment between Chile's trading partners and a rise in inter-sectoral discrimination as tariffs are phased out over varying periods for different goods and over different time periods.

Chile's trade balance is highly dependent on copper exports. Primary goods, including copper, fruits, wines, forestry and fishery products, represent about 85 per cent of Chile's exports. The report notes that a dualism seems to have developed between Chile's agricultural goods destined for export and those which are import-competing. While an efficient fruit and forestry sector produces goods mainly for export, other agricultural products are less competitive, some being protected by a price band mechanism. About 10 per cent of Chile's exports are manufactured goods, mainly processed from natural resources.

The report notes that important reforms in services have taken place since 1990. Chile is open to foreign direct investment in all sectors, including services, where existing market access is much greater than Chile's current market access commitments under the General Agreement on Trade in Services. Privatization of the telecommunications sector started in 1992 and is now complete. Banking laws are currently being modified to increase foreign access to the Chilean financial market and Chile is now drafting a new competition law and updating its legislation on intellectual property.

The report concludes that the possibility of locking in Chile's reforms through further binding commitments at the multilateral level essentially depends on the willingness of its WTO partners to move forward in a similar manner, for example, through a new round of trade-liberalizing negotiations.

Note to Editors

The WTO Secretariat's report, together with a report prepared by Chile will be discussed by the WTO Trade Policy Review Body (TPRB) on 23 and 24 September 1997. The WTO's TPRB conducts a collective evaluation of the full range of trade policies and practices of each WTO member at regular periodic intervals and monitors significant trends and developments which may have an impact on the global trading system. The two reports, together with a report of the TPRB's discussion and of the Chairman's summing up, will be published in due course as the complete Trade Policy Review of Chile and will be available from the WTO Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

The reports cover the development of all aspects of Chile's trade policies, including domestic laws and regulations, the institutional framework, trade policies by measure and by sector. Since the WTO came into force, the "new areas" of services trade and trade-related aspects of intellectual property rights are also covered. Attached are the summary observations from the Secretariat and government reports. Full reports will be available for journalists from the WTO Secretariat on request.

¹Mercado Comun del Sur - Trade agreement which entered into force on 29 November 1992 between Argentina, Brazil, Paraguay and Uruguay.

Since December 1989, the following reports have been completed: Argentina (1992), Australia (1989 & 1994), Austria (1992), Bangladesh (1992), Benin (1997), Bolivia (1993), Brazil (1992 & 1996), Cameroon (1995), Canada (1990, 1992, 1994 & 1996), Chile (1991), Colombia (1990 & 1996), Costa Rica (1995), Côte d'Ivoire (1995), Cyprus (1997), the Czech Republic (1996), the Dominican Republic (1996), Egypt (1992), El Salvador (1996), the European Communities (1991, 1993 & 1995), Fiji (1997), Finland (1992), Ghana (1992), Hong Kong (1990 & 1994), Hungary (1991), Iceland (1994), India (1993), Indonesia (1991 and 1994), Israel (1994), Japan (1990, 1992 & 1995), Kenya (1993), Korea, Rep. of (1992 & 1996), Macau (1994), Malaysia (1993), Mauritius (1995), Mexico (1993), Morocco (1989 & 1996), New Zealand (1990 & 1996), Nigeria (1991), Norway (1991 & 1996), Pakistan (1995), Paraguay (1997), Peru (1994), the Philippines (1993), Poland (1993), Romania (1992), Senegal (1994), Singapore (1992 & 1996), Slovak Republic (1995), South Africa (1993), Sri Lanka (1995), Sweden (1990 & 1994), Switzerland (1991 & 1996), Thailand (1991 & 1995), Tunisia (1994), Turkey (1994), the United States (1989, 1992, 1994 & 1996), Uganda (1995), Uruguay (1992), Venezuela (1996), Zambia (1996) and Zimbabwe (1994).

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TRADE POLICY REVIEW BODY

CHILE

Report by the Secretariat

INTRODUCTION

Chile has now maintained a liberal, transparent trade regime for almost two decades, coupled with sound macroeconomic policies and structural reforms. The benefits, in terms of strong economic growth and reduced inflation, have become increasingly evident. Thus, despite an increased emphasis on regional agreements since 1990, the authorities plan to continue the process of unilateral liberalization by further reducing the MFN tariff rate and eliminating certain sectoral programmes. However, the conclusion of a range of overlapping regional agreements, with different rules of origin, has added a measure of complexity to the Chilean trade regime that did not previously exist.

THE ECONOMIC ENVIRONMENT

The Chilean economy has grown continuously since 1990, at an average rate of 6 per cent in real terms. This trend is likely to continue in the immediate future. This outstanding performance is the result of structural adjustment policies that started in the mid-1970s, combined with sound macroeconomic policies, aimed at controlling inflation and external balances. The reduction of inflation from 27 per cent in 1990 to 6.6 per cent in 1996 is an important achievement. The aim is to continue reducing inflation to levels comparable with industrialized countries; however, this could be difficult, given the widespread use of indexation in the economy. Domestic savings and investment have been maintained at high levels of around 25 per cent of GDP since 1990, with positive effects on productivity.

While Chile is open to foreign direct investment leading to a strong inflow of FDI since 1990, certain restrictions on the capital account are maintained to limit short-term, speculative capital movements. Capital inflows have contributed to upward pressures on the exchange rate, which has appreciated steadily in real terms by 24 per cent since 1990. Despite this appreciation, Chilean exports, such as fruit, wines, forestry and fisheries products, have continued to grow strongly; the authorities attribute this trend to the growing productivity of the economy. However, export growth may also be linked to elements of the duty drawback system, which has a (notified) subsidy component. Despite export diversification, Chile continues to be highly dependent upon copper and the economy remains sensitive to fluctuations in world copper prices. To cope with the resulting volatility of income, the Chilean government operates a stabilization fund out of its copper revenues.

TRADE POLICY DEVELOPMENT

Chile's main MFN trade policy instrument is the uniform tariff, introduced in the late 1970s. This currently stands at 11 per cent; at present (July 1997) a proposal for a reduction in the rate, reportedly to 7 or 8 per cent, is before Congress. Even the present level is well below Chile's WTO ceiling binding commitments of 25 per cent, with 31.5 per cent for some agricultural goods. The neutrality of the tariff is somewhat diminished by differential tariff treatment under regional agreements, as noted below, and by a few specific sectoral non-tariff policies which benefit a few agricultural goods (a price-band/variable levy system), the forestry sector (production subsidies), the automotive industry (local-content and export performance requirements) non-traditional minor exports (export subsidies via "simplified" drawback), and imported capital goods (under the system of deferred payments of custom duties).

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Chile notified the latter three measures as export subsidies to the Secretariat and is committed to phasing them out within the periods stipulated in the WTO Agreements. No quantitative estimates were available of the subsidy components, so that the degree to which Chile's export performance and, especially, diversification can be attributed to these programmes, is not clear.

The overall liberalization of the Chilean economy has increased the need for effective domestic competition regulations. In this context, the authorities are at present drafting a new competition law to update that of 1974, seen by the authorities as inappropriate in the current structure of the market. Legislation on intellectual property and contingency trade measures (anti-dumping and countervailing measures) is also of being updated.

SECTORAL DEVELOPMENTS

Primary Industries

Chile continues to rely heavily on exports of primary goods, namely copper, fruit, fish and wood products. A price band mechanism provides protection for some importable agricultural products (wheat, wheat flour, edible oils and sugar), while exportables are priced at world levels even in the domestic market. As a result, a dualism seems to have developed in Chilean agriculture, whereby producers of exportables are continually striving to enhance productivity and improve quality in order to maintain their place in the international market and gain access to new markets, while the less productive importables sector lags behind. The production subsidy for forestry plantations, which appears to benefit mainly small producers, is likely to have had a positive impact on the environment, since it is only granted for plantings in deforested land.

The role of the State in Chile's trade has further diminished in recent years, with the exception of the mining sector, where CODELCO, a state-owned company, is the major producer and exporter of copper. In spite of the dominant role of the State in this sector, private investment remains important. The fisheries sector is subject to tight regulation through a licensing and quota system to prevent over-exploitation of available resources.

Manufacturing

Chile's manufacturing production and exports are, as might be expected, largely based on the processing of natural resources. However, some diversification has been achieved through the export of manufactured products, not based on natural resources, to Latin America under preferential agreements.

Only the automotive industry is subject to a special regime, with local-content and export balancing requirements. This programme is a remnant of the old import substitution regime, and is due to be eliminated in 1998. In terms of production, the industry is small, there are only three plants and annual average production during 1990-1996 amounted to some 18,000 vehicles (mainly pick-up trucks).

Services

Since 1990, the services sector has undergone important reforms. A bill to modify the banking law is currently being discussed in Congress; this includes an expansion of the scope of banking activities within Chile through increased access for foreign banks, wider authorization for Chilean banks to operate abroad, and the adoption of the international standards laid down by the Bank for International Settlements on capital requirements and supervision.

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Privatization of the telecommunications sector was begun in 1992, allowing free competition in this market; rates, especially for long distances services, have been reduced substantially, and new technology has been introduced. Currently, State intervention in this sector is limited to fixing tariffs when there is market failure, particularly in the field of interconnection.

More than half of Chile's merchandise trade is already conducted through private ports. A Bill has been presented under which port management would be decentralized and remaining ports would be privatized, leaving the State with only a regulatory role. The authorities also aim to increase private participation in the administration of roads, airports and railways.

Chile welcomes foreign investment in its services sector, and thus treatment of foreign nationals has gone beyond the commitments made under the GATS. In addition, the recently ratified free-trade agreement with Canada includes services; these will also be included in the framework agreement to be negotiated with the European Union. As noted, foreign presence is especially important in the financial and telecommunications sectors, where the benefits of technology transfer have become particularly evident.

TRADE POLICIES AND FOREIGN TRADING PARTNERS

During the last 20 years, Chilean trade policy has been based on unilateral reforms, supplemented by multilateral commitments (albeit at a lower level). However, since 1990, Chile's trade relations have become increasingly focused on the negotiation of bilateral trade agreements, with Canada and Mexico (in the absence of full NAFTA membership), and also with Colombia, Ecuador, Venezuela and MERCOSUR. A framework agreement with the EU is under negotiation. In pursuit of regional goals, Chile has a clear preference for concluding free-trade agreements that do not inhibit its own freedom to undertake further unilateral reforms. Chile is also active in APEC; its interpretation of the "open regionalism" principle is that it leaves open the option of further unilateral reforms, rather than MFN application of measures agreed within the region.

The negotiation of the various bilateral agreements has led to growing differences in treatment of domestic industries, since tariffs are being phased out over varying periods for different goods, and under different time-frames overall, under each agreement. The resulting complexity is reinforced by the fact that rules of origin also differ among agreements and by sector. This renders their consistent application difficult and could also lead to sub-optimal sourcing.

Chile's current preoccupation with regionalism reflects a clear concern not to be left outside the growing number of preferential schemes and lose markets to insiders, but the announced intention to make further unilateral tariff cuts demonstrates its simultaneous commitment to the pursuit of liberal trade policies on an MFN basis. The possibility of locking in these reforms through binding commitments at the multilateral level essentially depends on the willingness of other WTO partners to move forward in a similar manner, e.g. through a new round of trade-liberalizing negotiations.

TRADE POLICY REVIEW BODY

CHILE

Report of the Government

INTRODUCTION

The Chilean economy has undergone far-reaching transformations over the past two decades. From a heavily regulated import-substitution-oriented economy at the beginning of the 70s, it has switched to the consolidation of a development strategy based on the expansion of Chile's markets through exports, private investment incentives and a balancing of the principal macroeconomic variables.

Chile has a small economy, open to foreign trade, whose growth is essentially based on a high rate of investment and the performance of the export sector, reflecting its solidity and the efficient allocation of productive resources.

The multilateral trade system, based on clear and transparent regulations, is one of the pillars of the economic development strategy adopted by Chile.

In formulating its economic policy at the domestic level, the Government placed emphasis on stability, both economic and institutional, by creating and developing an appropriate regulatory framework designed to favour private initiative while at the same time safeguarding the guiding principles of equality and development with equity.

In tackling the challenges of development over the next decades, the current administration plans to encourage reforms aimed at increasing the productivity and improving the competitiveness of the Chilean economy by further opening up its trade and stimulating investment in physical and human capital. To that end, through various legal initiatives, the Government has set itself the priority of increasing investment in infrastructure and education.

GENERAL FEATURES

Chile is a unitary, democratic, presidential republic with separation of State powers. It has a bicameral Congress and an autonomous Judiciary, and has independent surveillance bodies to oversee Government activities, such as the Office of the Comptroller General of the Republic, the Constitutional Court and the State Defence Council. Moreover, it has a tradition of democracy, albeit interrupted from 1973 to 1989.

For administrative purposes, Chile is divided into 13 regions with its capital, Santiago, belonging to the so-called Metropolitan Region. This region is predominantly urban (97 per cent) and accounts for almost 40 per cent of the total population and more than 40 per cent of GDP. Only 16.5 per cent of the country's population is rural.

According to estimates based on the 1992 Census, the population should reach 14,622,354 in 1997, with a density of 19.1 inhabitants per km². The average population growth rate is 1.64 per cent.

As regards social development, according to the most recent studies, during the period 1992-1996 the number of persons living below the poverty line fell from 4,351,579 to 3,345,176 thanks to sustained

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economic growth coupled with target-oriented social policies. However, income distribution figures show that growth has not benefited the different population groups to the same degree.

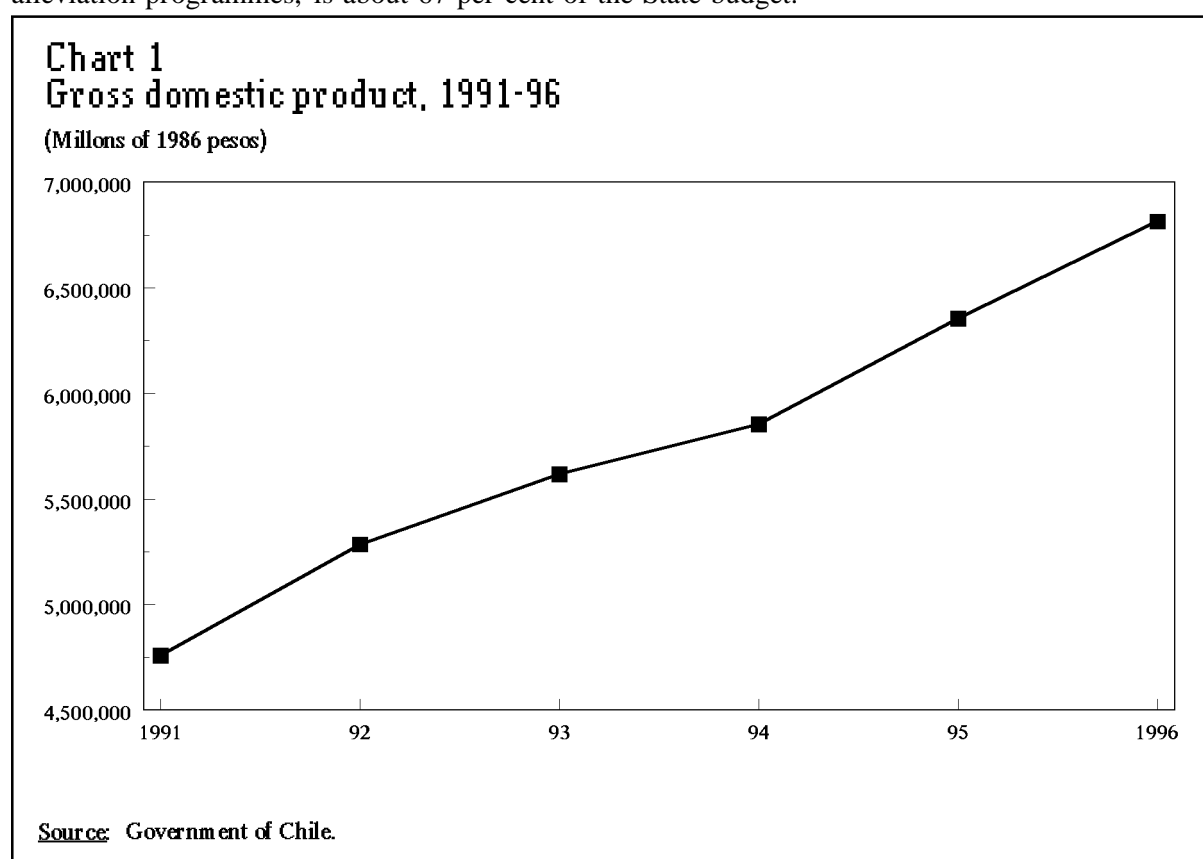
At the same time, social indicators have improved significantly. Illiteracy does not exceed 4 per cent, live expectancy at birth is close to 78 years and infant mortality in 1994 was 11 per thousand live births. Progress has also been made in overcoming the problem of undernutrition among children in that 95.7 per cent of the population now receive primary education, and 79.2 per cent receive secondary education.

MACROECONOMIC ENVIRONMENT

Fiscal policy is formulated by the Government through the Ministry of Finance. The Central Bank of Chile is responsible for the administration of monetary and exchange policy in accordance with the relevant constitutional organic law. The full autonomy of the central bank is enshrined in the Political Constitution of the Republic.

The priority of macroeconomic policy is to ensure that the basic indicators remain balanced by controlling the liquidity of the financial system and the inflation rate on the domestic front, and seeking a sustainable current account position on the external front. The Central Bank of Chile achieves this by adjusting the interest rate. Meanwhile, exchange policy focuses on stabilizing the exchange rate at its long-term value.

Fiscal policy focuses on maintaining a balanced budget with a growth rate that is consistent with GDP growth and with the country's basic macroeconomic objectives. The share of fiscal expenditure allocated to social policies, i.e. education, health, housing, social security and poverty alleviation programmes, is about 67 per cent of the State budget.



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This stabilization effort has led to an average GDP growth rate for the period 1991 to 1996 of about 7 per cent, which is partly due to the increase in the rate investment (growth fixed capital formation), which for the same period was about 25.6 per cent of GDP on average. This investment, in its turn, was largely financed by an increase in domestic saving, which grew from 12 per cent of GDP in the mid-80s to an average of 25 per cent in the 90s.

Chart 1 above shows the evolution of GDP over the period under consideration. The annual GDP growth rate was positive throughout, varying between 3.3 per cent of 11 per cent. It actually declined between 1992 and 1994 before resuming once again a level close to the economy's annual growth potential, estimated at about 7 per cent for Chile.

Chart 2 shows an effective decline in the inflation rate from 18.7 per cent in 1991 to 6.6 per cent in 1996. The estimated rate for 1997 is 5.5 per cent. This trend is largely due to the decline in the rate of price increase in the tradeables sector. It should be stressed that the decline in inflation was gradual, and it was therefore possible to avoid sudden price fluctuations.

The current account deficit has been stabilized at a sustainable level of 4 per cent of GDP or less, estimated to be the level that the economy is capable of absorbing. Meanwhile, the real exchange rate appreciated steadily from 1991 at an average annual rate of 4.4 per cent owing to the increase in productivity of the tradeables sector and the strong inflow of capital into the country. Finally, a sensible fiscal policy enabled average fiscal retrenchment to increase to 4.9 per cent of GDP between 1991 and 1996.

In view of the rapid increase in GDP and domestic demand, the monetary authority introduced policies over the past few years aimed at cooling down the economy to avoid overheating by increasing the interest rates of Central Bank bonds. More recently, however, monetary policy has tended towards a gradual relaxation of liquidity restrictions introduced at the end of 1995 through a progressive lowering of interest rates.

The medium-term macroeconomic objective is to maintain the balances achieved and to make further progress in ensuring economic growth and lower inflation. To that end, the monetary authority will continue to focus its efforts on achieving a level of activity that is consistent with the potential growth of economy, ensuring the participation of both the public and private sectors in overcoming the challenge of price stabilization and sustained growth.

TRADE ENVIRONMENT

As mentioned at the beginning of this Report, the Chilean economy is small and open, and its trade policy is directed towards further opening up. This has been possible thanks to the unilateral reduction or elimination of protective measures, the introduction of trade facilitation mechanisms, improvement of the regulatory framework, active participation in the multilateral trade system and the conclusion of trade agreements at the subregional and bilateral levels.

Performance of the external sector during the period 1991-1996

As a result of the country's integration into international markets, foreign trade surged during the period 1991-1996 both in terms of volume and value of exports and imports, as can be seen in Chart 3. The year 1996 saw a fall in the value of exports of 4.9 per cent as a result of the fall in the international price of two principal exports, copper and cellulose. Nevertheless, the volume of goods traded that year increased 13.7 per cent and trade grew 3.4 per cent.

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In 1996, the balance of payments showed an increase in net international reserves of US\$1,180.8 million owing to capital flows in the form of direct foreign investment and portfolio investment, attracted both by the interest rate differential and the improbability of a devaluation of Chilean peso.

Trade in services showed increasing vitality, with the result that exports of non-financial services represented 23.8 per cent of exports of goods during the period 1991-1996. The most important subsectors were tourism, port services, freight and insurance.

The main goods exported were copper (39.3 per cent), fresh fruit (7.8 per cent), cellulose (4.4 per cent) and fish flour (4 per cent). However, the share in trade of non-traditional exports with higher valued-added, such as food, forestry products and other industrial goods, is growing. Thus, the share of natural resource product exports in overall exports decreased from 62 per cent in 1991 to 57 per cent in 1996. At the same time, there was an increase in the share in overall exports of processed natural resource products (28.5 per cent to 32.2 per cent) and industrial goods (9.6 per cent to 10.8 per cent).

According to the latest statistics, there are four main macro-markets of destination for Chilean exports. The first of these is Asia, which accounts for about one third of total exports. Chile's principal Asian partner is Japan, although trade with the People's Republic of China, Philippines and Hong Kong-China has increased considerably. Trade with the European Union accounts for a quarter of overall trade, with the United Kingdom (5.8 per cent) and Germany (4.8 per cent) as the leading partners. As regards Latin America, there has been a marked increase in exports to Brazil and Argentina, whose share in overall exports is 6.1 per cent and 4.6 per cent respectively. In the market comprising the NAFTA countries, trade with Canada has been the most dynamic: although its share is small compared to the other NAFTA countries, in 1996 it increased 45.4 per cent over the previous year. However, the most important partner remains the United States, which accounts for 16.7 per cent of Chile's total world exports.

As regards imports, the main markets of origin are: NAFTA (30.5 per cent), Latin America (26.5 per cent), European Union (19.8 per cent) and Asia (15.5 per cent). Within these macro-markets, imports from the United States (23.1 per cent), Argentina (9.2 per cent) and Brazil (6 per cent) lead the way.

As a result of these trends, the trade balance for 1996 was negative. This is largely explained by the deficit with the United States, Argentina and Mexico, since trade with the European Union and Asia was positive on aggregate.

TRADE POLICY

Chile began to liberalize its trade in the middle of the seventies, and continued to extend the process over the next two decades, strengthening its international ties through multilateral and bilateral agreements. At the same time, it pursued its unilateral efforts to open up the economy through tariff reductions and a uniform tariff, currently 11 per cent *ad valorem*.

At the domestic level, the Agreements reached with the framework of the WTO entered into effect in January 1995. The country now has a set of clear, transparent and non-discriminatory regulations, and has adopted a number of measures to facilitate trade. These include the modernization of the National Customs Service, of the financial system and of telecommunications, as well as investment in infrastructure.

As regards its strategy of integration into international markets, Chile, a founding member of the GATT and subsequently the WTO, favours the multilateral trade system as a means of developing links with its trade partners.

In keeping with that approach, the Chilean Government's trade strategy combines unilateral opening up with multilateral economic negotiation. At the regional level, the Government of Chile subscribes to the principle of **open regionalism** as a tool for the creation of trade in accordance with the relevant multilateral regulations.

Unilateral Opening Up

Since its last Trade Policy Review, Chile has lowered its *ad valorem* tariff applied uniformly to all imports by 4 per cent. Indeed, in June 1991, the tariff was reduced from 15 per cent to 11 per cent.

The *ad valorem* tariff bound by Chile in the framework of the Uruguay Round trade negotiations dropped from 35 per cent to 25 per cent with the exception of certain agricultural products (wheat, wheat flour, sugar, oils and dairy products), which were reduced to 31.5 per cent. In connection with the liberalization plans adopted in the framework of an Asia-Pacific Economic Cooperation Council (APEC), Chile advanced its bound tariff reduction schedule by four years, as a result of which the binding came into effect as of 1996 instead of 2000 as originally stipulated.

The Executive has announced that it will submit a bill to Congress providing for a tariff reduction of some 3 per cent. This new reduction will become a reality provided it can be fully compensated through increases in other forms of tax revenue.

Multilateral Trade System

Chile has been a member of the multilateral trade system ever since the GATT came into existence. Most of its current trade is governed by the provisions of the WTO Agreements, which form an integral part of its domestic legal system.

Chile considers that the WTO should be a dynamic, future-oriented multilateral organization capable of incorporating the new dimensions of international trade into its agenda at the appropriate time in order to encourage the creation of trade flows contributing to the prosperity of its Members. Thus, during the preparatory work for the Singapore Ministerial Meeting, Chile supported the creation of working groups to address, separately and in an exhaustive manner, the issues of investment and competition policy in terms of their relation to trade, without prejudging the results, in order to lay the foundations for the development of new multilateral disciplines in the future if necessary and desirable.

With respect to the negotiations that have taken place on trade in services, Chile made substantive contributions in the area of basic telecommunications, fully respecting the most-favoured-nation clause. Similarly, it made conditional offers in the field of maritime transport, and hopes that the negotiations on financial services currently under way will reach a satisfactory conclusion. As regards professional services, Chile is particularly interested in the discussions of the relevant WTO Working Group. Thus, the recommendations issued by that Group will be used as a reference for future negotiations, and will be seen as disciplines aimed at facilitating trade in professional services.

Chile is of the opinion that trade liberalization efforts at the multilateral level should be revived as a means of increasing economic growth and development opportunities. Thus, it supports the inclusion

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in the future WTO calendars of negotiations of a horizontal nature leading to the elimination of tariff barriers affecting trade in non-agricultural goods in general, together with the planned negotiations in the agricultural and services sectors.

Chile considers that the accession to the WTO of new members is essential to the continued strengthening of the multilateral trade system, and is concerned at the lack of progress over the past two years in the accession procedures currently under way.

Regional and Bilateral Initiatives

The development of closer economic and cultural relations with the countries of Latin America is one of Chile's foreign policy priorities, reflected in the Economic Complementarity Agreements (ACE) and the Partial-Scope Agreements (AAP) concluded under the auspices of the Latin American Integration Association (LAIA). These agreements establish tariff preferences with Bolivia (ACE) and Peru (AAP). Free-trade agreements with Mexico (1991), Venezuela (1993), Colombia (1993) and Ecuador (1994) have liberalized more than 90 per cent of reciprocal trade in each case. An association agreement with MERCOSUR, which entered into force in October 1996, will liberalize the entire tariff universe. The bulk of trade will be free of customs duties within eight years, i.e. by 2004.

At the same time, Chile is negotiating the dismantling of the lists of exceptions in the Agreement with Venezuela, having recently completed such negotiations with Colombia. It is hoped that by the end of this year, the agreement with Mexico will be extended to cover, *inter alia*, services and investment. An agreement on free trade in goods is currently being negotiated with Peru, while in the case of Bolivia, the range of products covered by preferences has been extended.

In the wake of the decision of the 1994 Miami Summit to work towards the establishment of a Free Trade Area of the Americas (FTAA), Chile participated in the 12 working groups responsible for doing the necessary technical groundwork. The negotiations are expected to begin formally at the Second Summit of the Americas to be held in April 1998 in Santiago.

5 July 1997 saw the entry into force of a far-reaching free-trade agreement with Canada under which more than 80 per cent of reciprocal trade was freed from customs duties with immediate effect. The agreement covers investment and services, and provides for mutual exemption from anti-dumping duties.

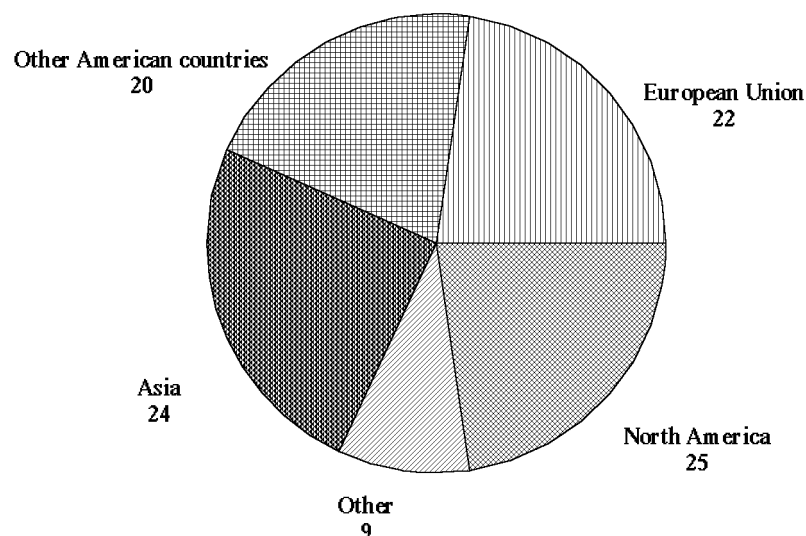
Chile is an active party to APEC. It should be stressed that the 18 APEC member countries together account for 50 per cent of Chile's total exports. As a member of APEC, Chile has undertaken to liberalize its trade in goods and services, and investment, by 2010, and has indicated that it intends to do so through the conclusion of bilateral or plurilateral free-trade agreements.

Since February 1996, Chile has participated in the Organization for Economic Cooperation and Development (OECD) as an observer in the Trade Committee and the Committee on International Investment and Multinational Enterprises.

Finally, in June 1996, Chile concluded a Framework Cooperation Agreement with the European Union and its member States, the ultimate objective of which is to form an association between the two parties. The section on trade provides for progress towards complete liberalization of trade both in goods and services. This is to be achieved in two stages: the preparatory stage and the association stage. The first stage is already under way.

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Chart 4
Trade, 1996
(Percentage)



Source: Government of Chile.

Taking account of all of the instances of trade liberalization mentioned above and the current trade structure, an estimated 90 per cent of all trade should be covered through this strategy by the year 2010. This is reflected in Chart 4, which shows that approximately 22 per cent of Chile's trade is with the countries of the European Union, 24 per cent with Asia, 25 per cent with North America and 20 per cent with the rest of America.

INSTITUTIONAL ENVIRONMENT

Tax environment

The efficiency of the Chilean tax system is reflected in the low incidence of tax evasion, the absence of any elements that could distort productive decisions, and low administrative costs. The Chilean tax system is also equitable, in that income tax is progressive.

During this decade, a number of tax changes have been introduced in order to make up for certain shortages in the social expenditure area without harming the tax structure or affecting public finances, while at the same time progressively improving the positive aspects of the system in terms of efficiency and fairness. In 1990 VAT was increased from 16 per cent to 18 per cent (Congress is currently discussing whether to maintain that level or to reduce it to 17 per cent), and a number of other changes were introduced involving, in particular, an increase in the number of tax payers covered by the effective income regime. In 1993, accrued profits once again replaced profits actually received as a basis for the taxation of enterprises, and mechanisms were introduced to encourage saving and investment. In 1995, taxes on cigarettes and gasoline were increased, and new legal restrictions were introduced on the personal use of corporate goods for the purpose of evasion.

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A number of reforms emanating from the tariff reduction bill being prepared by the Government (see Section IV) are currently under consideration. As mentioned, this reduction must be compensated entirely through tax revenue, i.e. through a number of measured increases in indirect taxes and a series of measures to combat evasion of such taxes.

A tax reform bill is also being drawn up for 1998 with a view to further increasing the efficiency and fairness of the tax system by simplifying the way in which it operates, enhancing the efficiency of tax control and reducing administrative costs to a minimum both for the tax authorities and the tax payers. This reform should have a neutral effect on fiscal accounts so as not to jeopardize the macroeconomic balances.

Reform of the State

Government policy in this area has tended towards privatization of enterprises operating in competitive markets, or in regulated markets where State presence is not required to ensure the supply of goods or services.

Pursuing this privatization policy, begun in the 70s and covering revenue-earning enterprises as well as a large number of service enterprises, the State disposed during the period 1991 to 1996 of half of its shares in the Iquique Duty-Free Zone as well as most of its shares in companies involved in maritime, air and land transport. In 1996, the main State electrical company was transferred to the private sector, and efforts are currently being made to speed up the privatization of the last State electrical concern.

The Legislative is currently studying a number of bills relating to port-service and health enterprises. The Government's privatization strategy is not necessarily directed towards transferring all State property into private hands, but rather, towards finding an efficient combination of private capital and State participation which can differ for each case. This policy may result in pure and simple privatization just as it may generate companies, joint ventures, franchises and other types of business partnerships. However, the intention of the authorities is that the control of these enterprises should be in private hands with the State playing only a regulatory role while continuing to share in their ownership by maintaining a minority interest.

One of the most interesting projects involving private equity participation has been in the field of infrastructure. Aware of the importance of road and port infrastructure in the development of the country, the Government introduced a system of concessions to the private sector in which the private companies themselves provide the necessary capital for the work and maintenance. Thus, the State does not have to allocate resources to that sector and may use them for social projects.

In the mining sector, the Government announced its intention to maintain its ownership of the Chilean Copper Corporation (CODELCO), the main copper-producing company of Chile. However, considerable domestic and foreign private capital investments have been made in that sector, and many more are planned.

Competition policy

Ever since 1959, Chile has had regulations in support of free competition. As of 1973, these regulations became fully applicable at the institutional level with the establishment of a judicial mechanism for investigation, prosecution and punishment of anti-competitive practices.

This mechanism operates both at the national and regional levels through the investigating body, the National Economic Prosecutor's Office, and the institutions with decision-making power, i.e. the Regional Preventative Commissions and the Resolutive Commission, to which the Prosecutor's Office and the parties affected by any anti-competitive act may turn. Some of the rulings of the Resolutive Commission, such as those imposing fines, dissolving companies or banning them from certain professional functions may be brought before the Supreme Court.

The relevant legislation was merged into a single text in 1980. At the same time, the State eliminated all regulations relating to pricing with the exception of those concerning certain basic public utility services.

Studies have just been completed on a bill to be submitted to Congress in the near future for legislative approval. This bill strengthens the National Economic Prosecutor's Office, granting it increased resources with which to carry out its task of controlling, preventing and punishing anti-competitive practices as rapidly and as efficiently as possible. At the same time, consideration is also being given to the possibility of restructuring the Prosecutor's Office and giving it the wherewithal to fulfil the task of supervising and controlling practices which could hinder competition.

Reform of the financial sector

The Chilean financial system is highly competitive and well integrated with the outside world. Over the past years it has also undergone various far-reaching reforms in its institutional structure aimed at revitalizing the way in which it operates.

Thus, thanks to the so-called capital market reforms, institutional investors such as pension funds, insurance companies and mutual funds were given access to new and improved financial instruments while maintaining appropriate safeguards. At the same time, a solid body of regulations governing conflicts of interests and insider information was introduced with a view to ensuring the transparent functioning of the market.

The banking system operates efficiently, and its solvency and stability are steadily improving. Nevertheless, a reform aimed at acquiring new business, facilitating the internationalization of operations of banks established in Chile, bringing capital adequacy regulations into line with the suggestions of the Basle Committee, and basing the granting of licences on standardized criteria is currently in the final stages of legislative approval.

Investment

Chile maintains and has continued to develop an open and transparent trade policy for goods and services, coupled with a comparable investment regime. The legal and institutional system favours foreign investment, a fact which, together with the country's political and macroeconomic stability, accounts for the average annual growth rate in investment flows into the country of some 34 per cent during the period 1991-1996. This is a clear reflection of investor confidence in Chile.

The foreign investment regime provides access to a broad range of economic activities both in goods and services production, and non-discriminatory treatment of natural and legal persons is enshrined in Chile's Constitution.

During the period 1991-1996, 40 per cent of foreign investment went to the mining sector, while a growing share, averaging 29 per cent per annum, went to the services sector, chiefly to tourism and telecommunications.

MORE

Similarly, starting in 1992, there was a significant increase in Chilean investments abroad. This was due to new measures aimed at deregulating the exchange market and important liberalization initiatives in the rest of Latin America. Thus, close to 90 per cent of Chilean investments were made in that region, principally in the financial and services sectors.

Another form of investment that is on the increase involves the placement by certain Chilean firms of ADRs (American Deposit Receipts) on the New York Stock Exchange, further contributing to the promotion of the policy of internationalization and opening up of the Chilean economy.

On the domestic front, investment has remained stable, oscillating between 25 per cent and 29 per cent of GDP. This has been possible essentially thanks to the savings of enterprises and of contributors to pension funds through the Pension Fund Administrators (AFP). The AFP have the authority to invest on behalf of their contributors in low-risk assets, thereby contributing to the dynamism of the economy and the expansion of the stock market.

CONCLUDING REMARKS

Chile is a developing country whose main source of growth is foreign trade. After going through a long and difficult process of transforming production during the 70s and 80s, Chile has begun to consolidate its development strategy based on increased international integration led by private initiative and structured around unilateral, bilateral and multilateral initiatives.

The multilateral strengthening of trade is one of Chile's trade policy priorities. A strong, law-based multilateral trade system provides the perfect basis for the expansion of international trade and the best guarantee that the rights and obligations of its members will be respected, regardless of their size and relative weight.

Chile takes the view that the multilateral trade system can only be efficient and continue to grow and acquire strength if it is based on legal regulations. This requires an added effort to eliminate from the system all traces of arbitrary discrimination, such as the possibility of applying selective safeguards, anti-dumping duties without proper disciplines, exceptions to MFN treatment in the General Agreement on Trade in Services and the proliferation of quantitative restrictions, particularly in agriculture. Similarly, recourse to unilateral and extraterritorial measures provided for in certain domestic legislations undermines the protection, certainty and stability provided by the rules of international law.

Aware of the importance of free trade to Chile's development, the Government has extended its legislative reforms to favour even greater liberalization of trade in goods and services and of investment flows. It is the Chilean Government's intention to continue this liberalization process by all the means placed at its disposal by the multilateral trade system while at the same time working on the domestic front to modernize its instruments and institutions in conformity with the objective of promoting the internationalization of the economy on the basis of a strategy of development with equity.

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