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The Free Trade Agreement between the USA and Chile: An Instrument of US Commercial Interests

Rodrigo Pizarro

Abstract

The endorsement of a free trade agreement between Chile and the United States is not built upon the concept of trade gains. The agreement constitutes an important part of the institutional peg to the structural reforms begun by the military government, and thus is an additional restriction to make it impossible to rethink the current development strategy. In the best-case scenario, trade benefits to Chile from the FTA will be marginal, even if we add the possibilities of attracting foreign investment. On the contrary, there seems to be direct costs, in intellectual property for instance, and also considerable political costs. In the case of the United States, on the other hand, the purpose of the FTA is clear; it is an instrument to further its influence in the region. The FTA maximizes opportunities for critical and basic sectors of the US economy such as information technologies, telecommunications and other leading technologies, basic industries, capital equipment, medical equipment, services, agriculture, environmental technology and intellectual property.

JEL Classification

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Key Words

Chile-USA FTA, bilateral free trade agreements, Chilean development model, trade liberalization, regional trade agreements, market access, NAFTA investment disputes

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The expansion of international trade is vital to the national security of the United States. Trade is critical to the economic growth and strength of the United States and to its leadership in the world. Stable trade relationships promote security and prosperity. Trade agreements today serve the same purpose that security pacts played during the Cold War, binding nations together through a series of mutual rights and obligations.

(...) The national security of the United States depends on its economic security, which in turn is founded upon a vibrant and growing industrial base. Trade expansion has been the engine of its economic growth. Trade agreements maximize opportunities for the critical sectors and building blocks of the economy of the United States such as information technology, telecommunications and other leading technologies, basic industries, capital equipment, medical equipment, services, agriculture, environmental technology and intellectual property. Trade will create new opportunities for the United States and preserve the unparalleled strength in economic, political and military affairs.[2]

1. Introduction

The Free Trade Agreement (FTA) between Chile and the United States entered into operation on January 1st, 2004. It has been a strategic objective of the governments of the 'Concertación' (current governing political alliance in Chile) and the principal business associations since the early nineties. Furthermore, the FTA is perceived as the greatest accomplishment of President Lagos' administration.[3] However, when making an unbiased evaluation of the possible benefits of the agreement, it is difficult to

understand why it is considered to be so important, unless, as this paper argues, it is an instrument to maintain the current development strategy.

2. The Context

2.1. Why is this FTA Different from the Rest?

Chile's free trade agreement (FTA) with the United States is different from other trade agreements for two reasons. First, it is a third generation agreement.[4] Despite their names, third generation bilateral free trade agreements have nothing to do with trade; neither are they free, nor do they promote 'freedom' of exchange in the broadest sense. Third generation free trade agreements, in line with the Chile-USA FTA, are about rules, and above all, the commercial interests of the United States. This agreement therefore regulates the rules of the game which considerably limits the autonomy of public policy.

The second reason this treaty is different is because we are dealing with the USA, the only superpower, with perhaps the greatest military and economic power of any country at any time in history. This means that the commitments established within the FTA will be very difficult to alter, making the agreement a solid and credible commitment in the future.

The Free Trade Agreement with the USA involves profound commitments in public policy, which further reduces the ability of the Chilean authorities to modify the current economic development strategy. Therefore, the decision by the current government to accept new restrictions upon its freedom of action in economic policy and international integration constitute a bet in favor of the status quo, and a commitment to the neoliberal economic model.

Therefore, the FTA cannot be analyzed without considering the Chilean economic model or the strategic interests of the United States in the region.

2.2. Why Free Trade?

The basis behind all of the initiatives for economic integration is that 'open economies' grow faster than 'closed ones'. Consequently, economies with low income, especially small countries, must open up to the outside world in order to stimulate economic growth. In this way it is argued, by significantly reducing trade barriers, economic performance and efficiency will improve. Behind this proposition is the conviction that the export sector promotes the rest of the economy, with the additional benefit of

generating productivity gains and possibly introducing new technology because of increased competition and thus creating what is called a 'virtuous circle'.

Therefore, the promotion of trade in goods and services as well as investment flows are positive elements for the economic development of nations. Nevertheless, this positive relationship between trade and economic growth is not without its critics. Some economists have argued that indeed there exists a correlation between international trade and economic growth, but that the causation is actually inverse: first it is necessary to generate the conditions for growth, and later, international trade will increase.

In fact, Dani Rodrik (1999), not exactly a radical economist, argues that he cannot find robust evidence which proves that a correlation exists between the degree of integration and the economic performance of a country. Similarly, Joseph Stiglitz (1999), a new neoliberal critic, claims that trade liberalization, albeit a necessary condition, is not a sufficient one to allow developing countries to reap the maximum benefits of globalization. Often, the strong ideological charge in economic matters misses the final objective behind the initiatives of integration. Integration is only one component of a development strategy, and therefore, must serve to improve the economic performance of countries and bring them out of underdevelopment. It is not an objective in itself.

2.3. The History of Free Trade

Free trade has only recently returned to the mainstream economic policy recipe. During the 19th century, free trade, promoted by England, was considered fundamental by academics for development policy. However, the actual practice of policy makers was quite far from the academic ideal. Curiously, the most protectionist were those countries which today are developed, whereas the more liberal free traders are now underdeveloped.[5]

After the Second World War, free trade once again became a central component of academic thinking, though again not much in practice. It was only in the eighties after the debt crisis that free trade became a central part of the public agenda and the main recommendation of the Bretton Woods institutions (World Bank, IMF and WTO).

However, even today, the theory of comparative advantage by the economist David Ricardo, the inspirer of free trade, generates considerable debate. Sufficient for this is the consideration that the conclusion of the benefits of free trade and comparative advantage depends on maintaining technology and labor mobility constant.

That is true even in Ricardo's framework; better than trade (the free movement of goods) are worldwide immigration (the free movement of people) and free intellectual property rights (the free movement of ideas and technology), a far cry from current thinking and practice in international trade. This, in our view, is the central discussion. While the World Trade Organization agreements and the new generation of bilateral free trade agreements promote free trade, they restrict the movement of people and intellectual property, two areas where free movement would benefit developing countries.

2.4. Integration and the Washington Consensus

The truth is that the nature of the current process of integration through bilateral 'free trade' agreements has little to do with Ricardo and much to do with a specific development strategy promoted by the Bretton Woods institutions, aptly referred to as the 'Washington Consensus'.[6] We will define development strategy as a series of public policies and institutions as well as socio-political arrangements, centered on the promotion of a specific objective of economic development.

The typical policies in the Washington Consensus recipe are the protection of private property of all types, including intellectual property, the subsidiarity of the State including the promotion of the privatization of public companies, fiscal discipline, labor flexibility, non-discrimination of foreign investment and the general adherence to rules rather than discretion in public policy.

This is one of the reasons for the increasing questions raised in academic circles of the benefits of free trade, since due to the current nature of the integration process, it necessarily entails the adoption of the policies of the Washington Consensus. As Rodríguez and Rodrik (2000) explain after reviewing a series of studies showing the relationship between liberalization and growth,[7] "we find little evidence that open trade policies - in the sense of lower tariff and non-tariff barriers to trade - are significantly associated with economic growth".[8]

Moreover, they conclude that "the tendency to greatly overstate the systematic evidence in favor of trade openness has had a substantial influence on policy around the world. Our concern is that the priority afforded to trade policy has generated expectations that are unlikely to be met, and it may have crowded out other institutional reforms with potentially greater payoffs. In the real world, where administrative capacity and political capital are scarce, having a clear sense of policy priorities is of utmost importance. The effects of trade liberalization may be on balance beneficial on standard comparative advantage grounds; the evidence provides no strong reason to dispute this. What we

dispute is the view, increasingly common, that integration into the world economy is such a potent force for economic growth that it can effectively substitute for a development strategy".[9]

Although Rodriguez and Rodrik do not doubt that in general greater economic integration is positive for development, their research points to the fact that this has been overplayed, generating policies in developing countries which emphasize exclusively free trade as the one and only development policy, and consequently undervaluing other more 'profitable' strategies such as institutional reform, for instance.

But in our view, the more important question, which the authors do not confront, is whether the actual way of integrating through free trade agreements does not in itself imply a specific development strategy. Once locked into the new generation free trade agreements, the country chooses, willingly or not, to apply the Washington Consensus recipe.

Therefore, the question in relation to the new free trade agreement is really about the benefits of the Washington Consensus. In the case of Latin America at least, with the possible exception of Chile, the results of the application of the Washington Consensus has been disastrous. Moreover, countries which have followed a more heterodox economic policy such as China, India and Vietnam have been much more successful.[10]

Today there is a certain consensus about what the central determinants of economic development are. More integration is clearly an important factor, but so are general public policies, institutions, social investment and natural resources. Especially important is the relationship between policies and the cultural and institutional make up of the country where these policies are applied. However, through free trade agreements, developing countries may commit to policies and institutions which are not in their interests or which they are not institutionally prepared to adopt.

As Ha-Joon Chang has stated, the current rules of globalization seem to be a way for developed countries to 'kick the ladder' of development. Once they went up the development ladder using a series of discretionary policies including selected protection, specific subsidies, copying intellectual property - none of which would be acceptable under today's WTO and bilateral FTAs - they kick the ladder to stop developing countries from climbing out of underdevelopment.[11]

More than any other treaty, the FTA with the United States is intrinsically related to Chile's development strategy. In effect, on the one hand, given the current trade pattern that exists with the United States, the trade structure based on the use and export of natural resources will be reinforced and, on the other

hand, due to the additional commitments which this treaty involves, the reforms begun under the military government will be fully institutionalized.

Therefore, the discussion about globalization or trade integration by means of new generation free trade agreements cannot avoid considering Chile's development strategy. Specifically, the free trade agreement with the United States will further limit the Chilean government's ability to alter certain policies regarding the development strategy. In effect, adding to the already limited weight of the public sector, the independence of the Central Bank and the formal commitments with the WTO, new restrictions will be placed on various issues, which will close the door for rethinking the development strategy and also limit the opportunities for future change.

As can be seen, the discussion about the treaty's benefits, unavoidably, must also consider the present and future benefits of the current development pattern. Even though the current strategy has generated benefits of an economic boom during the past 15 years, this does not guarantee that it will continue into the future, or that the future Chilean economy should continue being based upon the same framework.

2.5. The Development Model in Chile

After 1973, Chile initiated a complete revision of the economic model applied since the 1930s. Led by the vision of the 'Chicago Boys'[12], it adopted Monetarist and Neoliberal economic policies. As a result, from what was one of the non-socialist economies with the highest State intervention in Latin America and relatively closed to the world, Chile became a market-led relatively free economy.

However, this strategy collapsed in the early eighties and Chile suffered a severe depression with the debt crisis, being one of the most affected countries in Latin America. The crisis was confronted with heterodox policies, raising overall tariff rates to over 35% and intervening in the banking system, among other policies. But it was Hernán Buchi, a young Minister of Finance, who led the return to economic orthodoxy after the depression waned.

Tariffs were reduced, a new process of privatization was initiated, fiscal and monetary disciplines were returned and the overall subsidiary nature of the State was reinstated. At the beginning of the democratic period in the early nineties, the apparent success of Buchi's orthodox policies forced the new government to maintain the same economic policies.

Therefore, the recent growth of the Chilean economy has its origin in the reforms put in place by Buchi. The central features of the program were macroeconomic stabilization, privatization and export promotion. The program was undoubtedly inspired by the Washington Consensus. But Buchi introduced a series of local variants like exports subsidies ('reintegro simplificado'), capital subsidies, specific sectoral subsidies (DL701), debt swaps, etc., which gave Chilean policy its own recipe, not necessarily in line with that of economic orthodoxy. In fact, Buchi deliberately promoted a natural resource-based export model through these subsidies.

Moguillanski concludes in her study of Chilean investment that "the economic model developed after 1974 has had as a central strategy the liberalization and opening of markets; however, and different from what is usually thought, the State was not passive or neutral. It is possible to show that after 1986 there was a very strong intervention of the economy, in the regulation of markets, and the enormous transfer of resources to the private sector. These actions strengthened the development of actors committed to the accumulation. This attitude could be termed State *dirigism*, which was assumed with the debt crisis, but exceeded its initial objective. Within this framework - and similarly with the import substitution period - there was a reliance on a series of multiple policies and instruments, but these were orientated to promote the natural resource export model."[13]

Consequently, Buchi, rightly or wrongly, promoted a specific type of development strategy that centered on the export of natural resources, with heterodox and interventionist instruments applied at the sectoral level. None of these are possible, or at least are more difficult, within the context of the commitments of the WTO and the new free trade agreements.

A free trade agreement with the United States would imply less degree of freedom in introducing heterodox economic policies that would permit a change in the current development strategy. Therefore, the FTA implies a reaffirmation of the existing development model, together with its trade patterns and investment flows from the USA.

2.6. Chilean International Trade Policies

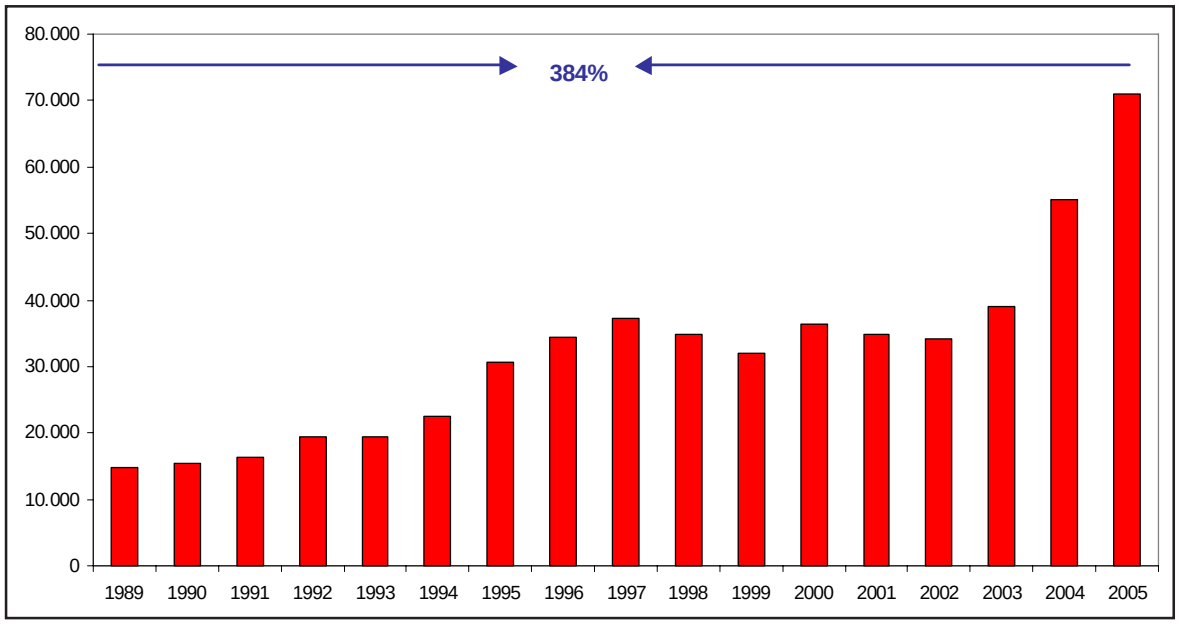
Within the framework of its national development strategy, Chilean governments have pushed for economic integration in three ways: Firstly, with a unilateral and non-discriminatory opening up to the world economy by means of a significant reduction in tariffs in the seventies and eighties; secondly, through bilateral and regional strategies with the signing of economic and free trade agreements with various countries, especially Latin American countries, and the active participation in different regional bodies

like MERCOSUR and APEC; and finally, through the multilateral arena, with the efforts through the World Trade Organization.

Although this open-door policy has significantly improved Chile's 'integration' with the world economy (Chart 1) and significantly increased its exports, even causing some diversification of products and markets, Chilean exports continue to be limited to raw materials and natural resources.

In 1970, Chile exported US$1,112 million, of which 76% corresponded to copper and the remaining 24% to other natural resources of a first degree of processing. In 1985, after the first unilateral integration process, exports increased to US$3,804 million, of which 47% corresponded to copper and 11% to natural resources of second degree processing. In 1990, exports totaled US$8,614 million, maintaining the percentage for copper, while only 13.2% were basic natural resources of second level processing.

Chart 1: Indicator of Openness: Exports plus Imports

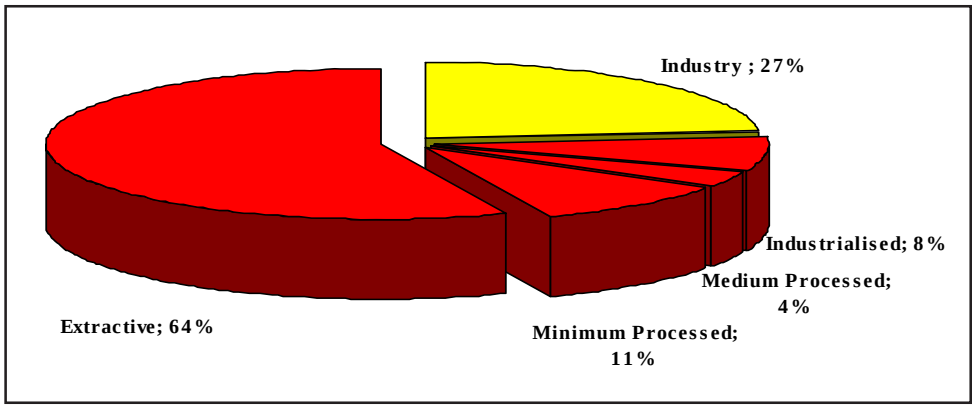


Fuente: Banco Central

In 2000 - on the eve of a series of significant bilateral free trade agreements - exports were US$18,425 million, with processed natural resources being the most important category amounting to US$11,098 million. In other words, 60% of the total exports were composed of basic natural resources with some level of processing. The most significant export sales were in processed copper products, sea products and cellulose, making up 70% of the exports from this category and 43% of the total shipments from Chile to other countries.

Exports of unprocessed natural resources reached US$4,793 million or 26% of the total, with unprocessed copper, fresh fruit and non-metallic minerals being the primary products in this group. This is to say that in the year 2000, after more than 15 years of sustained growth in total shipments, 86% of the export basket still represented natural resources, either with or without some form of processing. Moreover, it is important to point out that the top 15 Chilean exports totaled US$11,229 million, almost 61% of the total exports (with copper cathodes and sections valued at US$ 4,054 million being the primary one, and the other 14 products being natural resources).

Chart 2: Structure of Exports according to the Degree of Processing (2005)



Furthermore, in 2000, only US$2,533 million or 13.8% of the total exports corresponded to manufactured products. Consequently, even though important advances have been made in the volume and diversity of exports, Chilean shipments continue to be highly concentrated on natural resources with little or no processing.

In the course of the 1990s, academic attention focused on what was called the second phase of the export expansion, causing some government politicians to expound rhetorically on this matter. It was anticipated that there would be a second phase in Chilean economic development based on the export of products with greater value added, especially products and services linked to natural resources. The free trade agreement with the USA was considered a major instrument in that policy.

The logic behind the bilateral FTA agreements was precisely to support this strategy. However, after signing agreements with practically all major markets including the USA and the European Union, exports are still concentrated in natural resources. The Chilean process of integration has therefore only strengthened the development strategy centered on the export of unprocessed natural resources.

Today exports are around US$40 billion, of which over 87% are natural resources.

3. The Chile-USA FTA: Market Access

3.1. Market Access

Market access refers to the liberalization of trade in goods between two countries. This may mean the reduction of tariffs, the elimination of import quotas or their broadening and the restriction of para-tariff protection system such as the anti-dumping system, for instance.

The potential gains of a bilateral trade agreement depend on the relative protection between the two countries, and in relation to other countries.

Chile has a relatively simple trade protection system. A non-discriminatory flat tariff of 6% is applied to all imported goods except those for which Chile has signed a free trade agreement. Also there exists a special protection system for traditional agriculture products (sugar, wheat and oilbeans) through a price band system, which in practice implies a significant additional protection.[14] These price bands, though criticized by more liberal minded economists, constitute the main agricultural policy for traditional products. There also exists a special tax on high priced cars and a very restricted and hardly used anti-dumping system, which under no circumstances can be considered a hidden trade protection system.

The USA, on the other hand, has a fairly complex trade policy. The tariff system includes ad valorem rates, nominal rates, permits and quotas, depending on the product. The general logic is an escalating tariff and more protection for higher value added products. Also they have a General System of Preferences (GSP) that is passed into law periodically, benefiting most countries they trade with. Finally they have enormous agricultural subsidies estimated at around US$180 billion.

Despite the complexity of the US system, the actual tariff that affected Chilean products was relatively low, due to their low value added. The average tariff paid was around 1%. Consequently, the actual market access into the American market is quite broad, the exception being wines and, in general, the agro-industry.

3.2 The Arguments in Favor of the FTA

One of the primary arguments in favor of the FTA was improved market access to the US market. This refers to two aspects: first, legally assuring the already open access of the North American market (with 1% average tariff due to GSP), and secondly, the reduction of escalating tariffs for products that

have greater value added. Presumably, the expectation is that Chile would be able to increase the export of new or potential products.

With respect to the first, we would need to suppose that something so dramatic would happen between Chile and the US that it would greatly alter the trade policies already in existence. But if this were to occur, it does not seem reasonable to assume that a legal document such as a trade agreement with a country as small as Chile could really do anything to block that change. It is true that it is better to have it if it does not imply any cost; but when faced with costs, it is necessary to evaluate its true benefits.

Moreover, the concern about legal security for benefits already obtained would seem to be a good argument for greater legal security with Latin American countries, which tend to change their trade policies quite abruptly. Another option would be to sign an agreement with the United States, but within the framework of a regional agreement (FTAA or others), which would truly be an obstacle for a change in the trade policies by the US and consequently would create genuine security of access to the US market.

Table 1: Chilean Exports by Sector to the United States

Export Sector	Amount (US$)	Share
1. Natural Resource	1,390,250,720	54.1%
Fish Product	337,631,460	13.1%
Fruit and Seeds	583,600,760	22.7%
Combustibles	24,818,230	1.0%
Wood	142,863,410	5.6%
Metals (Raw and Refined)	301,336,870	11.7%
2. Processed Natural Resource	1,099,192,800	42.8%
Mudlagos y Espesativos	14,068,520	0.5%
Agriculture and Fish (Processed)	236,146,340	9.2%
Chemical Compounds	159,535,650	6.2%
Wood Derivatives	277,226,840	10.8%
Metals with Added Value	412,215,440	16.1%
3. Other Industrial Goods	78,372,130	3.1%
Furniture	42,016,730	1.6%
Others	36,355,400	1.4%

Source: USITC, 1999.

In the second situation, the argument points to the idea that there would be a sudden surge in the export of Chilean manufactured goods, if there were a decrease in the US tariffs for products with higher value added. This idea supposes two issues: first that tariffs are a serious hindrance to the export of value added goods; and secondly, that Chile has the actual capacity to produce these products and compete in the North American market. Both of these claims are questionable. Access to markets does not occur only when tariffs are lowered, instead it requires the actual capacity to enter the new market.

Table 1 shows Chilean exports to the United States on the eve of the agreement. It can be seen that in 1999, as has been historically the pattern of trade between Chile and the US, 54% of the shipmentswere natural resources, while 43% were processed natural resources and the remaining 3% were industrial goods.

(a) Primary Products

The number of exported products also shows the lack of diversity in Chilean exports to the US. In 1999, Chile exported 1,318 different products to the US; but of these, 81 products represented 87% of the total value of shipments.

Table 2. Primary Products Exported by Chile to the United States, 1999.

Product Description	% of Exports from Chile to the USA	% of Chilean Imports by the USA of each Product	Tariff for Chile	Principal Competitor	% of Competitor's Imports by the USA of Each Product	Competitor's Tariff
Refined Copper, Cathodes and Cathode sections	12.29%	29.97%	1%	Canada	30.77%	0%
Merluza, Fresh and Frozen	6.74%	48.07%	0%	Canada	24.92%	0%
Fresh Grapes (Exported between Jul.1 & Feb.14)	6.04%	90.60%	$1.8/m^3	Mexico	4.99%	0%
Wooden Molding (Pine)	5.21%	37.42%	0%	Mexico	24.11%	0%
Cut Conifer Wood	4.84%	1.94%	0%	Canada	92.21%	0%
Grape Wine	3.89%	7.88%	$0.63/l	France	37.30%	$0.063/l
Fresh Grapes (Exported between Feb.15 & Mar.31)	3.34%	21.59%	0%	Canada	51.13%	0%
Copper sludge, Copper Anodes for Electronic Refining	2.87%	3.34%	$1.13/m^3	South Africa	13.54%	$1.13/m^3
Gold ore	2.31%	3.42%	0%	Canada	40.47%	0%
Frozen Trout Filet	2.10%	10.96%	0%	China	8.49%	0%

Source: USITC, 1999.

Table 2 shows the ten most important export products representing 50% of the total exports to the United States. Six of these products entered the United States with 0% tariff and the others, except for two (refined copper and third-degree harvested fresh grapes which have higher tariffs than their primary competitors) faced the same tariffs as their competitors. In the case of grapes, even at the higher tariff, Chile represented more than 90% of the total US import of this product.

Table 3 shows the Chilean products that obtained first place among imports to the US in 1999. There were 18 such products, of which 10 were exempt from tariffs. Of the others, only two (third-degree harvested fresh grapes and avocados) have tariffs which are higher than their main competitor, which in both cases is Mexico. The other six products have tariffs which are the same as the main competitors.

Table 3: Chilean Products which were First among Imports by the US, 1999.

Product Description	% of Exports from Chile to the USA	% of Chilean Imports by the USA of each Product	Tariff for Chile	Principal Competitor	% of Competitor's Imports by the USA of Each Product	Competitor's Tariff
Fresh Sloe	0.85%	99.88%	0.0%	Argentina	0.07%	0.0%
Peaches and Nectarines (Exported between Dec.1 & May 31	1.41%	99.57%	0.0%	Mexico	0.33%	0.0%
Sodium Nitrate	0.62%	97.40%	0.0%	Germany	2.34%	0.0%
Fresh Cherries	0.22%	94.81%	0.0%	Canada	3.75%	0.0%
Lithium Carbonate	0.64%	91.12%	3.7%	Argentina	8.22%	3.7%
Fresh Grapes (Exported between Jul.1 & Feb.14)	6.04%	90.60%	$1.8/m^3	Mexico	4.99%	0.0%
Molybdenum Oxide and Hydroxide	0.15%	87.99%	3.2%	China	9.19%	3.2%
Other Fiberboard from low density wood	0.26%	86.56%	0.0%	New Zealand	6.13%	0.0%
Fresh grapes (Exported between Feb.15 & Mar.31,	2.87%	86.11%	$1.13/m^3	South Africa	13.54%	$1.13/m^3
Raw Metal; offal & Residue; Powder	0.38%	80.10%	3.0%	Germany	14.25%	3.0%
Potasium Nitrate Fertilizer	0.17%	79.78%	0.0%	Japan	6.87%	0.0%
Fiberboard from high density wood	0.78%	79.03%	0.0%	Austria	6.20%	0.0%
Iodine	1.84%	65.91%	0.0%	Japan	30.48%	0.0%
Mineral fertilizer or Chemical Potasiums	0.16%	65.12%	0.0%	Canada	23.56%	0.0%
Fiberboard from low density wood	0.15%	63.28%	0.0%	Spain	30.36%	0.0%
Canned Mackerel, whole or parts	0.27%	62.93%	3.0%	Thailand	16.55%	3.0%
Ammonium of Molybdenum	0.12%	54.33%	4.3%	China	44.83%	4.3%
Avocados	1.30%	53.18%	$0.112/K	Mexico	24.18%	$0.026/K

(b) Tariffs by Sector

During 1999, Chilean products exported to the US paid an average tariff of 1.97%. More specifically, as can be seen in Table 3, tariffs on Chilean exports fall within a range of 0%-4%. The only product

which shows a tariff very different from the rest of the products is grape wine (in bottles less than 2 liters). The impact of this product on the average tariff is such that the average goes down from 1.97% to 0.91% when it is not taken into account.

Table 4: Average Tariff Per Sector, 1999*

Sector	Average Tariff (% ad-valorem)	Average Tariff** (% ad-valorem)
Natural Resource	**0.42%**	**0.42%**
Fish	0.00%	0.00%
Fruit and Seed	0.89%	0.89%
Combustibles	1.04%	1.04%
Wood	0.00%	0.00%
Metals (Ore and Refined)	0.11%	0.11%
Processed Natural Resources	**3.98%**	**1.49%**
Mudlage and Thickening	1.64%	1.64%
Agriculture and Fish (Processed)	3.27%	3.27%
Grape Wine	23.82%	
Chemical Compounds	3.28%	3.28%
Wood Derivatives	1.03%	1.03%
Metals with Added Value	1.00%	1.00%
Other Industrial Goods	**1.40%**	**1.40%**
Furniture	0.00%	0.00%
Others	3.01%	3.01%
Average Tariff on Chilean Products entering the USA	**1.97%**	**0.91%**

Note: ** Average tariff without considering grape wine.
Source: USITC, 1999.

(c) Escalating Tariffs

The Chilean products which enter the United States are subject to escalating tariffs, which is to say that the tariffs charged on the imports increase proportionally according to the increase in value added. The reduction in the tariffs for goods with greater value added is therefore a declared objective of the negotiations with the United States. However, the evidence shows that this is not generally true. Moreover, there are many products with value added that do not pay high tariffs.

During 1999, many of the products were subject to similar tariffs even when they had different value added. As can be seen in Table 5, only in the case of grapes is there a marked increase in tariffs in relation to the increased value added of the products derived from this fruit.

However, all products are not subject to escalating tariffs. For example, in the case of pears, the opposite occurs, meaning that pear juice has a lower tariff than fresh pears even though the juice is a value added product of fresh pears.

A similar situation can be found with apples and apple juice where the tariff is the same for both products. Even for products whose value added difference is large such as cut wood vs. wooden furniture, the difference in tariffs is insignificant.

The preceding analysis shows that the escalating tariffs used by the United States is not a rule which is applied equally to all products, nor does it affect all Chilean exports.

Table 5: Examples of Escalating Tariffs

Code	Product	Tariff	
		Specific	% (added value)
0806.20.10	Raisins	$0.018/K	1.24%
2009.60.00	Unfermented Grape Juice	$0.044/I	8.35%
2204.21.50	Grape Wine (bottled)	$0.63/I	23.82%
0808.10.00	Fresh Apples	0%	0%
2009.70.00	Apple Juice	0%	0%
0808.20.40	Fresh Pears	$0.00/3K	0.49%
2009.80.20	Pears Juice	0%	0%
4407.10.00	Cut lumber (Conifer)	0%	0%
4409.10.40	Standardized Pine Molding	0%	0%
4411.31.00	Wooden Fiberboard	0%	0%
9403.50.90	Wooden Bedroom Furniture	0%	0%
7402.00.00	Unrefined Copper	0%	0%
7403.11.00	Refined Copper	1%	1%

Source: USITC, 1999.

(d) Potential Products

Even though there is a possibility of decreasing the tariff rates in general and specifically on items with greater value added, the objective of reducing these taxes is to increase access to the North American market. But, as was previously mentioned, the problem of access does not rest entirely upon tariffs, instead it depends upon the actual ability of Chilean products to increase their market share. One way of evaluating the potential success of this agreement is to look at products that are being exported to other countries, but not the United States. To analyze this situation, we will consider some products that PROCHILE[15] classified as 'growing exports' from 1999 to 2000 in its study entitled 'Analysis of Chilean Exports 2000' on the eve of the agreement. Of the 13 products, eight were not sent to the US and only one of the remaining five, 'wool or fine hair blankets' is affected by US taxes. The others, as can be observed in Table 6, are subject to a 0% tariff.

Moreover, of the 26 new products which were exported for the first time in 2000 (in relation to 1999), only five were shipped to the United States and these had tariffs equal to 0%. Of the other 19 which were not shipped to the United States, only one product 'ceramic tile without varnish' would have a US tariff rate greater than 0% but equal to its primary competitor. In this group, seven products have lower tariff rates than those charged to the primary exporter countries of each product to the United States (Table 7).

Table 6: Chilean Exports Showing the Greatest Growth (1999-2000)

Chilean Exports which were not sent to the USA						
Code	**Product**	**Variation (%) in Exports (1999-2000)**	**Exports to the USA (M$ fob)**	**Tariffs for Chile**	**Principal Exp. to the USA**	**Tariff of Principal Exp.**
3902100000	Polypropylene (un.)	50,787.7%	0	0%	Canada	0%
3102300000	Ammonium Nitrate	39.5%	0	0%	Canada	0%
2711130000	Bottled Gas	1,283.9%	0	0%	Canada	0%
4905910000	Map Making	995.6%	0	0%	Canada	0%
2918131000	Calcium Tartrate	411.5%	0	0%	Italy	0%
2003100000	Canned Mushrooms	326.2%	0	0%	Indonesia	0%
4819300000	Paper Bags	196.1%	0	0%	Canada	0%
2917340000	Orthocephalytic Acid	178.4%	0	0%	Mexico	0%
Chilean Exports which were sent to the USA						
Code	**Product**	**Variation (%) in Exports (1999-2000)**	**Exports to the USA (M$ fob)**	**Tariffs for Chile**	**Principal Exp. to the USA**	**Tariff of Principal Exp.**
8207600000	Drilling Tools	1063.0%	9,718	0%	Canada	0%
7323100000	Steel Wool	313.5%	45,903	0%	Mexico	0%
4805300000	Sulfite Wrapping Paper	276.2%	11,080	0%	Italy	0.7%
6301200000	Wool Shaws	171.2%	172,809	4.5%+$0.013 /k	Italy	4.5% + $0.013 /k
1104120000	Flat or Rolled Oats	162.6%	572	0%	Canada	0%

Source: PROCHILE, U.S. International Trade Commission.

Table 7: Products Exported and shipped to the USA for the first time in 2000

Code	Product	Export 2000 (US$ fob)	Exp. to the USA (US$ fob)	Tariff for Chile	Principal Exporter to the USA	Tariff of Principal Exp.	Share of Principal Exp. in the Imp. by the USA
3301130000	Lemon Oil Essence	211,447	67,700	0%	Argentina	0%	64.50%
3604900000	Fireworks Commercial	22,499	2,581	0%	China	6.50%	42.10%
2836100000	Ammonium Carbonate	342,859	342,859	0%	Germany	1.70%	42.00%
4805100000	Semichemical paper for rolling	26,615	7,357	0%	Canada	0%	97.80%
8404200000	Condensors for Vapor Machines	83,891	83,891	0%	Canada	0%	55.60%

Source: PROCHILE, U.S. International Trade Commission.

It is worth noting that of the products exported for the first time in 2000 (in relation to 1999), almost none would be affected by tariffs (Table 8).

Table 8: Products Exported for the first time in 2000 that were not shipped to the USA

Code	Product	Export 2000 (US$ fob)	Tariff for Chile	Principal Exporter to the USA	Tariff of Principal Exp.	Share of Principal Exp. in Imp. by the USA
2528100000	Natural and Concentrated Sodium Borate	106,894	0%	Turkey	0%	91.20%
303770000	Frozen Sea Bass, excluding filets	45,130	0%	Uruguay	0%	26.30%
7103910000	Cut rubies, sapphires and emeralds	28,039	0%	Thailand	0%	31.50%
2804500000	Boron; Tellurium	26,289	0%	Philippines	0%	30%
7110290000	Semi-elaborated palladium	24,452	0%	Russia	0%	65.50%
3006200000	Reagents for blood typing	20,730	0%	UK	0%	65.10%
8479300000	Presses for making particle borrad & fiberglass	259,824	0%	Germany	0%	64.20%
2711110000	Bottled Gas	184,903	0%	Trinidad & Tobago	0%	54.90%
3920910000	Plaques, sheets of poluvinyi butyral butyral	120,787	0%	Japan	4.20%	37.40%
4813900000	Cigarette paper	104,720	0%	Finland	1.50%	60%
6907900000	Unvamished ceramic tile	98,900	13%	Italy	13%	82.80%
2931001000	Tetraethyl Lead	84,148	0%	Japan	8.3%+$0.011/K	93.30%
2207200000	Denatured Alcohol	80,707	0%	Canada	0%	61.90%
2702100000	Lignites	76,084	0%	Canada	0%	97.80%
7003200000	Plaques and sheets of formed glass	60,581	0%	UK	1.10%	61.20%
2815120000	Sodium Hydroxide	60,075	0%	Canada	0%	52.10%
4001220000	Technically specific rubber	44,982	0%	Indonesia	0%	60%
8477300000	Machines for deep fissure cuts	39,053	0%	France	3.10%	50.80%
8478900000	Tobacco elaboration machine parts	38,876	0%	Germany	0%	52.70%
2515110000	Marble and other stone	27,600	0%	Italy	0%	77.30%
2914120000	Methylitic Butane	21,203	0%	South Africa	0%	40.80%

Source: PROCHILE, U.S. International Trade Commission.

The conclusion to this analysis is that due to the open North American market, trade benefits associated with the decrease in tariffs on Chilean export products to this market are only marginal. The legal security for products which already have easy access to the United States does not really seem necessary given the economic stability of that country. Even if there were a major turnaround in these public policies, its seems hard to believe that a country the size of the United States would alter the new policies in response to a free trade agreement with Chile.

Value added products must be evaluated in a global context. Lower tariffs are a necessary condition, but not sufficient to achieve market access. Moreover, there do not appear to be many products that

Chile exports to the United States which have higher tariffs in relation to greater value added. It would appear that wine, which pays an excessive tariff, is one of the few exceptions to this trade policy. Although it might be true that it is better for tariffs to be reduced, it seems that a decrease in escalating tariffs would not be of major benefit to Chile in a free trade agreement with the US.

Even the analysis of formal models suggested that improved market access was of limited benefit. A study by the University of Michigan identified benefits of only US$500 million for Chile, and in the case of the United States, of around US$4,000 million; amounts hardly significant for either country. Similar results were found by the USITC.[16]

In short, the benefits of improved market access are not a sufficient reason for Chile to sign a trade agreement with the United States.

3.3 The Agreement

The FTA that was eventually signed reduced all tariffs immediately for 80% of Chile's main agricultural products; but these were already entering the USA market with very low tariff. There were also gains by the increase in the quotas of certain products - 3,500 tons of milk, for example - but again, these are all marginal benefits. With respect to other priorities such as wines, meat and high value added products, tariff reduction was left until the end of the transition period after 12 years.

On the other hand, Chile reduced its flat tariff rate of 6%, and its traditional agriculture is significantly hurt with the ending of the price band. According to the USA Ministry of Agriculture, the agreement was a success: "Under this FTA, our access to the Chilean market will improve for a series of American agricultural products, including wheat, meat, grains and milk, horticulture and high value food products. More than three quarters of American agricultural products will enter Chile without tariffs within four years, and all tariffs will be eliminated within 12 years."[17]

Additionally, and significantly, tariff reduction had an impact on Chilean fiscal income, forcing the Government to increase value added tax from 18% to 19%. The overall estimated loss of revenue from the reduction of tariffs on USA products was estimated at US$240 million. Even though initially the Government argued it would not increase taxes, later it was forced to do so.

Table 9: Tariff Reduction Schedule under the FTA

US Exports to Chile			Chilean Exports to the US		
Category	**Number of Items**	**% Share**	**Category**	**Number of Items**	**% Share**
Immediate	7088	89.7	Immediate	7520	95.2
3 years	34	0.4	3 years	1	0
4 years	403	5.1	4 years	154	1.9
8 years	225	2.8	8 years	100	1.3
10 years	11	0.1	10 years	64	0.8
12 years	141	1.8	12 years	63	0.8
Total	7902	100	Total	7902	100

3.4 Results after Two Years

It is difficult to evaluate the impact of a trade agreement in such a short time. The US-Chile FTA entered into operation in January 2004. However, as can be seen from Table 10, the improvement in market access amounts to around 57% as compared to Most Favored Nation. However, this is in terms of a considerably low effective tariff. And it needs to be noted that the gain is considerably less than in other agreements.

Table 10: Conditions of Access of Chilean Exports in Trade Agreements (1)

Country	2005 Thousands US$	MFN	Effective Tariff	Reduction in Tariff
Argentina	523,302	9.1%	0.3%	96.7%
Brazil	816,661	7.4%	0.4%	94.6%
Paraguay	36,600	13.5%	1.5%	88.9%
Uruguay	65,627	10.9%	1.2%	89.0%
MERCOSUR	**1,442,190**	**8.3%**	**0.4%**	**94.9%**
Bolivia	208,969	8.9%	5.5%	38.2%
Colombia	308,023	14.4%	0.1%	99.3%
Ecuador	321,884	12.4%	0.1%	99.2%
Perú	636,117	10.0%	3.2%	68.0%
Venezuela	295,509	17.9%	0.2%	98.9%
Andean Community	**1,770,502**	**12.4%**	**1.9%**	**84.9%**
México	1,183,377	29.8%	0.05%	99.83%
The United States	4,447,443	0.7%	0.3%	57.1%
Canadá	411,495	4.7%	0.02%	99.6%
NAFTA	**6,042,315**	**6.7%**	**0.2%**	**96.5%**
Costa Rica	70,850	8.2%	1.8%	78.0%
El Salvador	84,867	3.1%	0.9%	71.0%
Central América	**155,717**	**5.4%**	**1.3%**	**75.8%**
Aladi + C. América	**4,551,786**	**15.4%**	**0.9%**	**94.0%**
Korea	**767,300**	**5.9%**	**3.5%**	**40.7%**
European Union	**4,466,144**	**2.9%**	**1.0%**	**65.5%**
China	**993,946**	**1.2%**	**1.2%**	**0.0%**
India	**45,334**	**18.7%**	**18.7%**	**0.0%**
Total Effective tariff	**15,683,448**	**6.0%**	**0.9%**	**84.4%**

Note: (1) Exports of Copper are not considered.
Source: DIRECON, Foreign Ministry.

In terms of actual benefits, exports to the US grew by about 32% in the period 2004-2005, much higher than the 4.7% in the period 2000-2003. It is difficult to say whether this is related to the FTA, since it is necessary to establish the counterfactual - what would have happened without the FTA. Be that as it may, exports to the USA grew much lesser than those to Korea and the European Union in the same period and with similar agreements in place, at the same time. And in general, trade to the US grew less than overall Chilean exports. But imports from the US did grow much faster than Chilean exports, and much faster than overall Chilean imports.

Table 11: Percentage Growth Rates of Exports With and Without Copper

	Total		Without Copper	
Market	**2000 - 2003**	**2004 - 2005**	**2000 - 2003**	**2004 - 2005**
European Union	-	35.6	9.2	28.6
USA	4.7	32.8	7.4	20.3
South Korea	10.6	47.6	13.8	61.8
Rest of Market	8	39.8	5.3	30.3
Dynamism of Total Imports With and Without Petroleum and Natural Gas (Rates of growth)				
	Total		**Without Petroleum and Natural gas**	
Market	**2000 - 2003**	**2004 - 2005**	**2000 - 2003**	**2004 - 2005**
European Union	3.4	23.2	3.4	23.2
USA	-3.9	35.4	-3.9	35.4
South Korea	7.5	41.1	7.5	41.1
Rest of Market	9.9	30.4	8.0	30.0

Source: Central Bank of Chile

Table 12: Top Products Exported to the United States (in millon US$)

Products exported to the United States	2004	2005	% Share
Copper	799.7	1.749.2	28.0
Salmon and Trout	531.9	566.8	9.1
Grapes	348.5	391.7	6.3
Molibdene Concentrate	98.4	325.9	5.2
Wood products	253.4	265.9	4.3
Other processed Wood products	296.5	234.5	3.8
Gold	112.5	194.6	3.1
Wine	145	147.5	2.4
Other Wood products	70.2	89.7	1.4
Methanol	119.8	88.6	1.4
Subtotal	2,775.9	4,054.5	64.9
Otros	1,792.9	2,193.4	35.1
Total	4,568.8	6,248.0	100

Sorce: Central Bank of Chile

It seems that the FTA had little to do with export growth and much more with the general economic performance of these countries. In any case, the export structure has remained unchanged and there are no discernable differences or growth in those 'value added' products Chile expected. Rather, Chile maintains its exports to the USA concentrated on barely processed natural resources.

3.5 North American Anti-dumping System

3.5.1 The Argument

Anti-dumping is a mechanism by which countries can protect themselves through additional tariffs against the sudden import of products priced below their normal market value, thus causing damage to local industry. The US anti-dumping system is its primary tool for trade protection and is on the verge of being acceptable as a standard under the World Trade Organization.

In 1997, there were 842 open anti-dumping cases in the world, 307 of which were represented by the United States.[18] Chilean products have been seriously affected by their arbitrary nature and certainly their elimination was a central theme of the negotiations. However, if eliminating them or at least restricting their arbitrary nature is beneficial for Chile, this will only impact the assurance of market access for those products which Chile is already exporting to the US such as salmon, wine, raspberries, etc. It seems inconceivable that Chile would be affected by anti-dumping for products having a higher value added, the new products which were the objective of the Chilean negotiators. Consequently, restricting the anti-dumping system, if it could have been achieved, would have only benefited those products that Chile is now competitively exporting to the US, and that is natural resources.

Nonetheless, restrictions to the US anti-dumping system were an explicit objective of the negotiation.

3.5.2 What Happened

There was no concession on the part of the USA on the anti-dumping system; it was implicitly taken out of the negotiation. Not even a panel was established to discuss differences in application, which was the Chilean proposal.

3.6 Political Costs of Increased Market Access

Market access must be evaluated taking into consideration the potential costs. Analyzing the negotiation in parts, we see that while the United States reduced its tariffs down from the average of 1.97% in a period of twelve years, Chile must reduce its tariffs on North American imports down from 6% (beginning in 2004) and eliminate government price protections on certain agricultural products at the same time.

On the eve of the negotiation in 2000, Chile imported US$3,338 million from the United States. Historically, the US has been the primary source of imports. However, this conclusion changes when imports are looked at in terms of large markets. From this perspective, MERCOSUR become the number one supplier of Chilean imports, providing US$4,338 million of its imports in 2000.

Imports from the United States are concentrated in intermediate goods (51.4%) and capital goods (39.5%), while consumer goods represent only 8.4%. The major competitors for the United States are Argentina and Brazil, which compete on more than 30% of the imported goods. Consequently, giving preference to products from the United States causes the products from MERCOSUR to lose their access advantage. The agreement might not impact upon trade creation, but might well divert some Chilean imports from MERCOSUR to the United States.

The aforementioned is a disadvantage because greater preference should be shown to the countries of MERCOSUR given the enormous positive externalities from strong regional integration. For example, increased trade with Argentina allows the strengthening of infrastructural ties, reduces border tensions, strengthens tourism, etc. Consequently, when preference is given to non-regional products to the detriment of intra-regional products, economic opportunities and positive externalities are lost.

It is too early to determine whether there has been trade diversion. What is evident though is that the relationship between Chile and its regional partners has considerably worsened in the last few years, despite having governments of similar ideological background. The truth is that the Chilean commitment to sign an FTA with the United States regardless of the interests of its regional partners, or promoting a regional position through the FTAA, is one of the reasons why tensions remain in the region.

Be that as it may, the main costs (or benefits) of the meager market access benefits are related to the introduction of the 'rules', or rather the commitment with the Washington Consensus.

4. What are the Rules?

Despite the difference in outlook, the reaction of the right wing and the sectors associated with economic groups in relation to the implications of the FTA were similar to the position expressed in this paper. In an article by Instituto Libertad y Desarrollo, a think tank of the extreme right wing party, UDI, stated: "In our country, the consequences of the FTA not only are significant for their economic aspects, but also because *it helps to substantially consolidate the free market model that has successfully been applied for the last three decades*."[19]

Similarly, an editorial by Estrategia, a newspaper associated with Chilean economic groups stated: "Its content (the FTA) *forces the Parts to respect the economic principles in the long run, independently*

of the governments in office, thus becoming a factor of stability and protection of the principles that sustain development. This is not a minor issue if we consider the constant questioning internally by the left of the economic institutionality"[20]

On the other hand, the economist Rolf Lüders, ex-Economy Minister of the Military Dictatorship, argued "Chile has very low tariffs at the moment (..) therefore we are practically in a regime of free trade, and the gains possible are minor. Instead, what the *treaty does is to tie the Chilean institutional economic system, in such a way that the risks of investment should substantially decrease* (..) It will be difficult to change the regime of free trade, the market economy and abandon financial discipline, because the free trade agreements ultimately tie us to those institutions (..) A free trade treaty with the Virgin Islands, really has no importance, because tomorrow we can reject it and absolutely nothing happens. But having signed a treaty with the European Union and another with the United States, rejecting those free trade treaties is extremely difficult".[21]

Consequently, there is general agreement that the market access benefits are minimal. The main benefits (or costs) associated with the FTA are those related to an instrument which keeps in place the economic model designed by the military regime, the Washington Consensus.

Naturally, the differences then are in relation to the benefits of the development model.

4.1 Investments and National Image

4.1.1 The Argument

It was argued that another important benefit associated with the FTA was a potential increase in investments to Chile, due to the increased legal security for foreign investment and the improvement of the Chilean risk rating. This has been identified as one of the important achievements of a free trade agreement with the US.

It was argued that the FTA with the United States takes Chile out of the 'bad neighborhood' which is Latin America and thereby helps the country to attract foreign investment not only from the USA, but also from all other countries. The truth is that there is no evidence to show that the free trade agreement will improve Chile's country risk rating. But even if it were to do so, Chile currently has a very low country risk rating. When compared to other countries in the region, Chile's rating is comparatively much lower. Consequently, although an improvement in this rating due to the FTA causes some impact, most probably it would be marginal.

Without a doubt, legal security of investment will have an impact, mainly for investments from the United States. But as is true in the case of market access, the question is: What type of investments will

this promote? Once again, this takes us back to the discussion of the development strategy and whether a development strategy based on natural resources is viable.

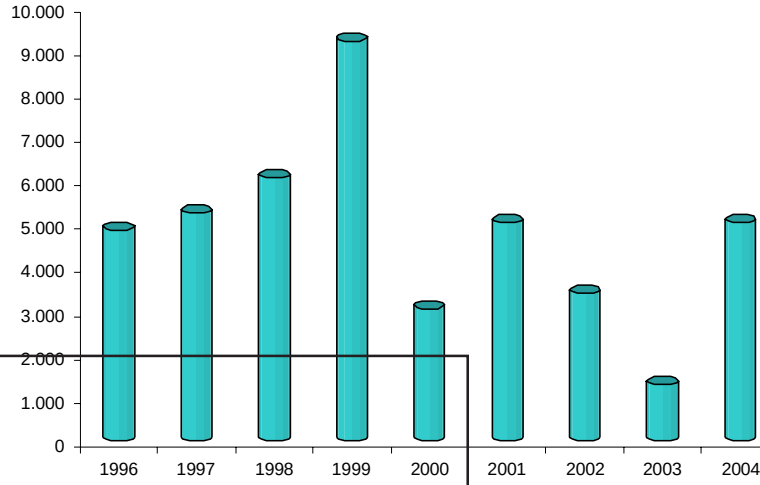
Finally, since increased legal security for investments from the United States represents a cost and gives a relative advantage over other countries, we ask the following question: Does it really make sense to give greater legal security and thereby promote investment from the United States, when historically the largest amount of investments come from that country? Would it not be more appropriate to encourage investment from other countries, thus diversifying the materialized foreign investment in Chile? If the prediction that the FTA with the United States will have an impact upon the investments in Chile, this will result more from the legal security associated with the FTA than from an improvement in the country risk rating.

Notwithstanding the above, the question is regarding the kind of investments that will be made, because the profit of the businesses in Chile would not change due to the FTA; only the legal security of the investments will. Therefore, the investment pattern will continue and will not change as a result of the free trade agreement.

4.1.2 What Happened

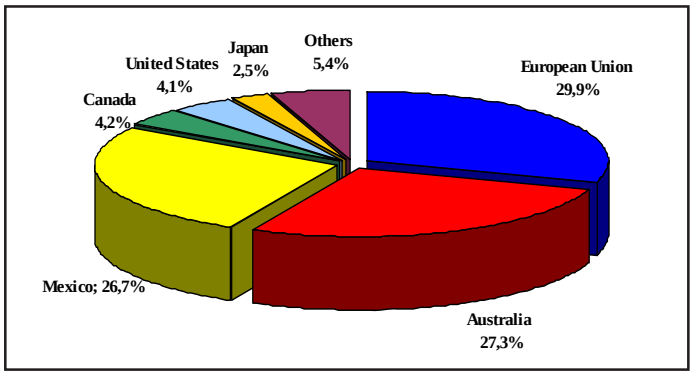
Again, it is difficult to evaluate the impact of the FTA v
the figures do not suggest a significant improvemer
the contrary, investment from the USA has actually
foreign investor is Australia, with whom Chile has r

Chart 2: Materialized Inv



Source: Comité de Inversiones Extranjeras

Chart 3: Materialized Investment by Origin (DL600-Comité de Inversiones Extranjeras)



4.1.3 The Costs

The investment chapter is crucial in understanding the most relevant costs of these types of agreements. The FTA with the United States has been defined as a 'new generation' agreement, which encompasses all aspects including rules about investment. In this respect, the model is, without a doubt, Chapter 11 of the North American Free Trade Agreement, which has been seriously criticized by both detractors and previous supporters.

In the FTA with Chile, the investment chapter is number 10. It is practically identical to the controversial Chapter 11 of the NAFTA.

NAFTA includes a list of rights for multinational corporations, which allow businesses, among other benefits, the right to sue central Governments if they feel that actions which violate their rights have been taken. This affects the Government's ability to protect public interest. Although it is argued that the FTA has clauses which protect public interests, the evidence in the case of NAFTA is much to the contrary.

The clauses which have generated controversy because of how they have been interpreted within the context of a free trade agreement are: national treatment, most favored nation, the prohibition of performance requisites and expropriation.

This occurs because the definitions of investor and investment are broad, permitting a spectrum of interpretations. The actions of the State 'measures' are also broadly defined, thus permitting a spectrum of interpretations of these actions. Clearly, this is a problem since it opens the door for a permanent questioning of the actions of the State, even those meant for the public good.

On the other hand, even as Chapter 10 protects a broad set of rights for the investors, it also establishes a series of obligations on the part of the national state. Many of these rights and obligations are similar to those in bilateral investment agreements. However, the conjunction with the general objectives of the treaty (free trade) and the possibility of directly suing the State have been the recipe permitting the broadening of investor rights far and beyond what was conceived previously, and is directly affecting the capacity of governments to regulate for the common good. Moreover, the private sector is using these treaties to open up markets and restrict legitimate regulations on the part of the State.

This has been the experience of NAFTA that has generated controversy, since it seems these treaties have served to place private interests and rights above public interests and rights. Ultimately, the new FTAs are a way of strengthening private property in all its dimensions against the national government's capacity to regulate for the public good.

To date, the author has found 24 cases in the NAFTA. There are six demands on the Mexican State, of which two are concluded and four are in arbitrage.[22] In the case of Canada, there are three cases of arbitrage; one is concluded and two are notifications of intention.[23] In the case of the United States, there are 6 cases: one in arbitrage; three resolved; and two notifications.[24]

The civil suits in NAFTA amount to more than US$13,000 million. None of these suits can be considered as cases involving arbitrary expropriation by a corrupt government, the original logic behind these agreements; they are rather a systematic questioning of the regulatory power and role of the national government. A classic example is that of UPS, a private US courier service, which is requesting a judgment for US$100 million, because the public postal system in Canada is involved in courier service thus affecting the profits of UPS. This is the first case against a national public service and it could bring about serious consequences in the State's capacity to provide certain basic services.

Another paradigmatic case is that of Metalclad, a waste disposal company which argued that the State of San Luis de Potosí, Mexico, wrongly denied it permission for its disposal plant, affecting its rights as an investor under Chapter 11 of NAFTA. The State governor had concluded that the plant proposed by Metalclad implied an environmental risk and ordered it abandoned. Metalclad sought compensation under the NAFTA, arguing that it had already initiated construction at a cost of US$90 million. It received US$16.7 million. The cases of Waste Management Inc. of Acapulco and Azinian in Desona are similar, with all of these putting into jeopardy the ability of the Mexican State to carry out its environmental policies.

Moreover, the exceptions granted in the FTA for environmental protection were not respected. In fact, in the case of Metalclad, the laud considered environment exceptionality as irrelevant.

Likewise, the case of Cemsa/Feldman was the first under the NAFTA that affected the ability of the State to alter its tax structure. The company sued the Mexican State for US$50 million because it had been denied a tax rebate on the export of cigarettes.

In the case of Pope & Talbot against Canada, the tribunal argued that some government actions could be considered progressive expropriation.

In both cases, the lauds opened the door to questioning the Central Government's capacity to alter its tax structure, and more crucially, in terms of the precedents they set. The argument 'progressive expropriation' was considered valid when government 'measures' affected investor interests, thus opening the door to considering general government measures as a way of expropriation.

Another case that has been notified in relation to the application of a tax is the case of Corn Products International against México. The company sued the Mexican State for US$250 millon, arguing that raising the tax IEPS ('Impuesto especial a Productos y Servicios', a sales tax existent since 1980) constituted a violation of their investor rights. The Mexican Congress introduced a 20% tax on JMAF (jarabe de maíz de alta fructose, maize fructose), on the sale of soft-drinks with fructose, from January 1st, 2002. The firm argued that the tax caused it irreparable damage. It argued that the tax was an expropriation.

But taxes are not the only policies being questioned. In another case, International Thunderbird Gaming Corp. v. México, the regulations of the Mexican State are openly questioned in relation to gambling games. This firm opened a gambling business with the authority of the Governor of the state, but not the Federal Games Director. Even though the Mexican legislation in this matter is confusing, ultimately the regulatory authority is the Federal Games Director. International Thunderbird Gaming Corporation (ITGC), a Canadian company sued the government for US$100 millions.[25] Ultimately, they are seeking a change in the Mexican law. This case opens the discussion on local and national regulations and the use of the FTA as a pressure to impose more liberal ones.

Another case is Haas and Calmark who have questioned the judicial procedures of the Mexican courts. They were apparently victims of a fraud by Mexican citizens; the Mexican courts however could not find evidence of this. Haas and Calmark sought compensation under NAFTA Chapter 11

arguing against due process in the Mexican judicial system. In effect, using the Chapter 11 as an Appeals Court is not only questionable in itself, but it is unfair since this is not a recourse that Mexican citizens can have.[26]

Regardless of whether these suits have been in conformance or not with the stipulations given for investors according to NAFTA, what is clear is that there will be a cost to Chile when greater legal security is given to investors. Beyond the most apparent costs of the increased likelihood for legal actions or other attacks on public policies, a major concern is that the doors of opportunity to be able to alter current development plans through incentives, subsidies or taxes will be closed. That is, governments may be conservative in their application of measures to protect the public good in the fear of affecting investors' rights, as seen in the framework of these Agreements. Is it worth the effort to assume these costs in exchange for the possible, meager benefits previously described?

4.2 Intellectual Property

Middle and low income countries constitute approximately 21% of world GDP, but only 10% of spending on research and development. The countries of the OECD spend more on research and development (R&D) than total Indian GDP.[27] Without exception, developing countries are net importers of technologies. According to Jeff Sachs, the disparity in innovation between countries is even greater than income. Of the patents for inventions in the United States in the year 2000, 94% of the total were from 10 countries that together form 14% of world population.[28] Consequently, for the developing countries, there is no interest in protecting intellectual property; on the contrary, stronger protection rights generate significant costs.

According to Jagdish Bhagwati, a renowned pro-free trade economist, the agreement concerning intellectual property as it relates to trade within the World Trade Organization (TRIPS) does not offer any benefits to South American countries. Much to the contrary, it redistributes the income of developing countries to developed countries and there is no way to argue that international well being has been improved.[29] For this reason, expansion or strengthening of these agreements concerning intellectual property would only mean an additional expense for Chile.

TRIPS only sets minimum standards; but due to its ambiguity, it allows the parties an adequate margin to maneouver through these standards according to each country's situation. Precisely due to the costs that this involves, in the Doha Round of Negotiations developing countries achieved flexibility through the adoption of guidelines regarding intellectual property rights, especially in the case of licensing of medicines.

Chile accepted strong intellectual property protection rights far and beyond TRIPS, which has already generated direct costs of implementation and indirect costs because of higher prices. The pharmaceutical industry will be particularly affected because it will need to increase the prices of its medicines. According to recent estimates by the pharmaceutical industry, if TRIPS takes effect, the price of medicines in Chile will increase by more than 75%. How much will the agreement between Chile and the United States cost?

A sector especially affected will be the small- and medium-sized industry that will have to pay for patents and royalties for software, increasing their production costs considerably.

According to the USITC, the estimated loss to the United States from the non-payment of patent fees amounts to around US$70 million. This is a direct cost to Chile.

"If Chile implements the clauses of intellectual property, the higher protection afforded to its owners will imply potentially more income to American industries that depend on copyrights, patents, commercial secrets and commercially registered marks."[30]

Table 13: US Industry's Economic Loss from Non-payment of Patent Fees by Chile (%)

	1999	2000	2001	2002
Films	25	40	40	40
Music	-	30	35	35
Software and Business Applications	51	49	51	51
Software Entertainment	-	-	80	78
Books	-	-	-	-
Total	-	-	-	-

Source: USITC

Table 14: Industry's Economic Loss from Non-payment of Patent Fees

	1999	2000	2001	2002
	Million US$			
Films	2.5	2	2	2
Music	-	5	12.2	14
Software and Business Applications	47.7	33.1	46.3	59.4
Software Entertainment	-	41	-	-
Books	-	1	1.1	1.1
Total	50.2	82.1	61.6	76.5

4.3 The Environment

There is a lot of rhetoric coming from both sides on the "environment vs. trade" debate. It is important to note that due to problems of information and concern by academics from industrialized nations, studies have concentrated on pollution and contamination and not on natural resource depletion. In this respect, there is no convincing evidence that greater trade openness and particularly free trade agreements generate adverse environmental impact, measured in terms of the amount of contamination (usually, the measurements are based on contaminant emissions).

Although it seems that the prognosis of the creation of pollution paradises has not materialized what has been called a 'race-to-the-bottom' (a race for the most contaminating activities to go to countries with weak environmental standards), there has not been a 'race-to-the-top' (a race to improve environmental standards) either as the Chilean negotiators have argued. Evidence indicates that the environmental effects are negative, positive or neutral depending on the particular circumstances of the country and the type of trade. These are linked to change in the production scale (more quantities being produced) and to change in the composition of exports (production of more contaminating goods).

What the evidence clearly shows is that with the possibility of significant growth in production, adequate regulations are needed so that there will be no significant environmental impact.

Notwithstanding this observation, the above analysis refers to contaminant emissions and this is not the primary environmental problem in Chile. Although, without a doubt, these problems exist on a smaller scale, it is the demand upon the natural resource base that is of a more serious nature. To the degree that exports are based upon the exploitation of natural resources with a low level of processing, while larger countries like the United States that have more open trade markets generate a strong demand for natural resources, this can only create significant pressure upon the raw material resource bank.

The Environmental Review of the USTR of the FTA between Chile and the United States argues correctly that due to the broad access that Chilean products now have within the US market, the environmental impact of the FTA will be minimal. This author shares that view: in and of itself, the FTA will not significantly alter international trade with the US. The concern with the agreement is not only that it will aggravate the amount of pressure upon the natural resource base, but that it will also limit Chile's ability to make changes in its development growth strategy which has already been proven to be non-sustainable. This is because, first of all, it promotes a natural resource-based trade relationship with the United States vis-à-vis MERCOSUR; and secondly, it establishes rules that make it difficult

for Chile to develop other economic activities that do not damage the environment through incentives and subsidies; and finally, it will be even more difficult to generate the necessary regulatory framework for sustainable management of natural resources.

Consequently, the major problem with a free trade agreement with the United States is not the impact that it will generate, but how it will permanently institutionalize a development strategy which will be unsustainable in the future.

4.4 Financial System

One of the most applauded policies during the nineties and one of the reasons Chile was hurt less by the Asian crisis was the 'encaje'. This is a reserve requirement of a year imposed on capital inflows by the Central Bank to increase the cost of bringing short-term capital into the country. It is therefore a mechanism to deter short-term capital volatility.

In periods of high capital flow, the encaje reached levels of 30%, whereas in periods of scarce capital it fell to 0%. Since 1998, the Central Bank has maintained this level. But with the Agreement, the reserve is eliminated with an exceptionality in moments of crisis. However, this is pointless, since the idea behind the reserve is to use it in times of abundance of capital flows, thus avoiding them coming in rather than going out. Although today there is no need for the reserve,[31] renouncing the possibility of applying one is extremely risky and affects the ability of Chile in autonomous economic policy making.[32]

5. Conclusion

The endorsement of a free trade agreement between Chile and the United States is not built upon the concept of trade gains. If anything is clear from our discussion of this matter, it is that in the best-case scenario, the trade benefits will be marginal even if we add the possibilities of attracting foreign investment.

On the contrary, there seems to be direct costs, in intellectual property for instance, and also considerable political costs. The decision to negotiate with the United States has blocked a greater involvement in MERCOSUR, a project that is of strategic importance to Chile. And it is evident today that the poor relation Chile has with its neighbors is related to its option of doing it alone with an FTA with the United States.

Why did the Chilean authorities persist in signing the agreement? The answer is clear: the FTA makes up an important part of the institutional peg to the structural reforms begun by the military government, and consequently, is an additional restriction to make it impossible to seek to alter the current development model.

The debate then should concentrate upon the development strategy and its benefits, and not exclusively upon the FTA with the United States. Ultimately, perpetuation of the current development strategy is the purpose of the new generation of free trade agreements.

In the case of the United States, the purpose of the FTA is clear: it is an instrument to further its influence in the region and for promoting strategic sectors of its economy like intellectual property, electronic commerce and investment, among others. All of these are done in the context of promoting the economic model as represented by the Washington Consensus.

Notes

1 This paper was presented at 'The 2nd International Workshop on ASEAN Expert Collaboration for FTA Negotiations with the US', Co-Organised by International Development Economics Associates (IDEAs), the Good Governance for Social Development and the Environmental Institute (GSEI), and the Institute of Asian Studies, Faculty of Political Science, Chulalongkorn University, Bangkok, 3-4 August, 2006.

2 US Trade Promotion Authority 2002 Act, which authorizes the US Executive to negotiate Free Trade Agreements, División B, Title XXI.

3 President Ricardo Lagos, a democratic socialist, led a center-left coalition government between 2000 and 2006. The coalition has been in office since 1990. It is the same coalition that defeated the military dictator Augusto Pinochet.

4 The literature identifies first generation agreements as having purely tariff reduction commitments. NAFTA is considered a second generation agreement, because it includes investment and other commitments. The USA-Chile FTA is considered third generation because it includes NAFTA plus commitments in intellectual property, environment and labor, and generally is ambitious with regards to regulating matters beyond trade.

5 See Chang (2002) for a discussion.

6 The term first coined by John Williamson, International Institute of Economics.

7 The studies reviewed are Dollar (1992), Ben-David (1993), Sachs and Warner (1995), Edwards (1998), and Frankel and Romer (1999).

8 Rodriguez and Rodrik (2000).

9 Ibid., pp. 62-63.

10 See Rodrik (1999) for a discussion; also see the views expressed by Stiglitz (1999).

11 See Chang, 2002.

12 El Ladrillo is the founding document of the Chicago Boys.

13 Moguillanski, G. 1999, p. 270.

[14] In periods in which international prices have been low, the effective tariff has been above 100%.

[15] PROCHILE is the Export Promotion Agency.

[16] See Brown, Deardorff and Stern, 2001.

[17] Ministry of Agriculture Declaration, December 2002, available at www.fas.usda.gov/scriptsw/PressRelease/

[18] Informe No.31, 2000. Departamento de Planificación, Dirección de Relaciones Económicas Internacionales. Ministerio de Relaciones Exteriores de Chile.

[19] El Diario, 23 December, 2002.

[20] Estrategia, Editorial, 16 December, 2002.

[21] El Diario, interview, 28 January, 2003.

[22] Fireman's Fund; Marvin Roy Feldman Karpa; Robert J. Frank; Waste Management; Gami Investment Inc.; International Thunderbird Gaming Corp. Arbitrage concluded: Azinian, Metalclad Corporation; Notified intentions: Calmark; Corn Products; Hass; Santa Fe, Investment. Source: http://www.dfait-maeci.gc.ca/tna-nac/mexico-en.asp

[23] En arbitraje S.D. Myers Inc. v. Government of Canada, Pope & Talbot Inc. v. Government of Canada y United Parcel Service of America, Inc. ("UPS") v. Government of Canada; demand concluded Ethyl Corporation v. Government of Canada; notified intention Sunbelt Water, Inc. v. Government of Canada y Crompton Corp. v. Government of Canada. http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp

[24] L,., In tribunal Methanex Corp. v. United States of America, resolved: ADF Group Inc. v. United States of America, . Loewen Group Inc. and Raymond Loewen v. United States of America Mondev International Ltd. v. United States of America Notificación de intención: Canfor Corporation v. United States of America, Kenex Ltd. v. United States of America. http://www.state.gov/s/l/c3741.htm

[25] http://www.economiasnci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Thunderbird/Thunderbird.htm

[26] http://www.economiasnci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Calmark/Calmark.htm

[27] See Integrating Intellectual Property Rights and Development Policy, 2002.

[28] See Sachs, 2002.

[29] See Bhagwati, et al., 1999.

[30] USITC, p. 109.

[31] For example, Joseph Stiglitz, as Chief economist of the World Bank argued that market volatility should be faced by developing countries using measures like the Chilean policies. Also see, Edwards (1999) for a discussion.

[32] El Mercurio, cuerpo B., 15 January, 2003.

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