

**IDE APEC STUDY CENTER**  
**Working Paper Series 01/02 – No. 7**

**The Comprehensiveness of  
Chilean Free Trade Agreements**

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**MARCH 2002**

**APEC STUDY CENTER**  
**INSTITUTE OF DEVELOPING ECONOMIES**

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**The Comprehensiveness**  
**of Chilean Free Trade Agreements \*/**

**March 2002**

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\*/ This paper is submitted for Project “WTO Liberalization Process and the Formation of FTA Networks in the Asia Pacific Region”, of the APEC Study Center of the Institute of Developing Economies, Japan External Trade Organization (JETRO), Chiba, Japan.

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## **I. Introduction**

Chile in the past two decades has been a showcase of trade liberalization and economic reforms not only in Latin America but also worldwide. What is not well known, however, is that though the country has followed this “opening-up” policy via three routes of liberalization (unilateral, regional and multilateral), the most dominant since the mid 1990s have been bilateral and plurilateral preferential trade agreements (PTAs), in the form of free trade agreements (FTAs), rather than common markets or customs unions. In fact, in the Western Hemisphere, Chile is one of the Latin American countries, besides Mexico, which has promoted one of the most active policies of FTAs. These agreements not only address the “border” issues but also deal with a wide dimension of trade and investment that were once thought to be internal issues (e.g. investment, services trade, competition policy, government procurement, enforcement of intellectual property rights, labor and environmental issues). Another new aspect of Chilean FTAs is the geographical coverage, going far beyond the countries in Latin America covering the United States, Canada, the Asia-Pacific, and Europe.

The FTAs or other agreements signed by Chile are believed to operate under the principle of “open regionalism” and to have a “GATT/WTO plus” focus. More importantly, they are said to be “comprehensive” in nature and scope that involve almost all aspects of bilateral economic relations. The Chilean conception of open regionalism involves first the extension of preferences through FTAs that are compatible with the rules and regulation of the WTO, especially in conformity with Article XXIV of GATT 1994 and Article V of GATS, and that might go beyond the rights and obligations of the WTO. Their conception also involves the progressive removal of barriers to economic exchange and proactive measures to reduce transaction costs at the national and regional levels, by way of harmonizing facilitation policies and improving infrastructure among member countries. This conception of open regionalism, however, does not satisfy the more exigent understanding of the concept that requires the extension of liberalization benefits to non-members on an unconditional Most Favored Nation (MFN) basis. Nonetheless, this is partially compensated for by the unilateral tariff reductions of the past two decades and particularly by the current program of unilateral reduction of MFN rates by 1% annually to reach 6% in 2003.

Under this orientation towards open regionalism, the country's FTAs are seen as a "stepping stone" towards the deepening of the WTO multilateral process, more than just the consistency of FTAs with the WTO. Although they are quite aware that discrimination is the essential feature of regionalism, the Chilean authorities view their version of "open regionalism" as an effective strategy of international economic opening, which stresses bilateral/regional cooperation on the reduction of bilateral or intra-regional transaction costs. This strategy is conducive to a reduction of uncertainties and improvement of credibility, thus making it easier for the private sector to plan and invest.

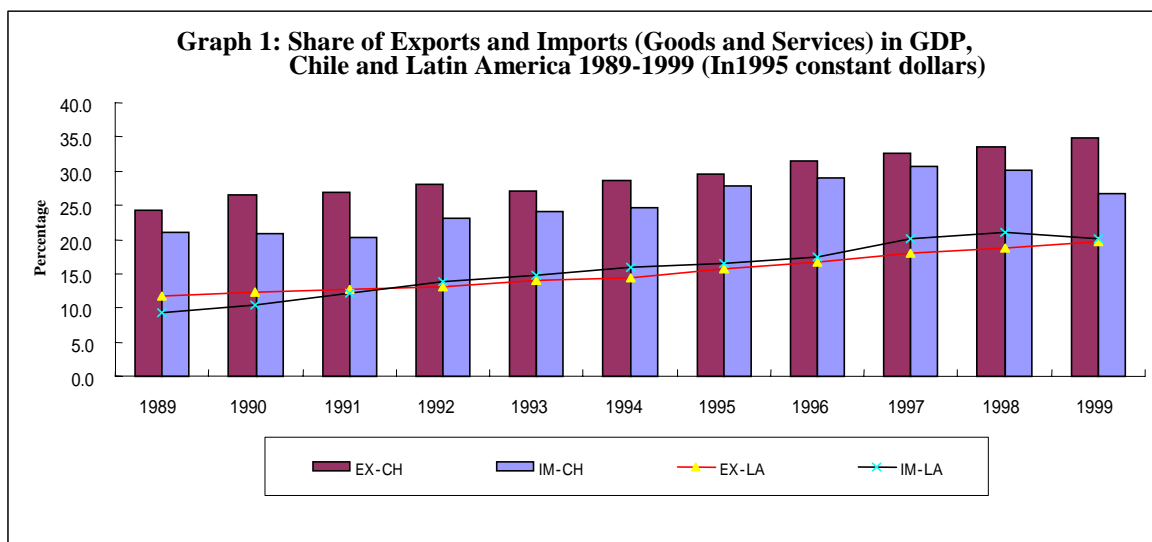
The objective of the paper is to describe the nature of the Chilean trade strategy in the 1990s and to shed light on the degree of "comprehensiveness" of Chilean FTAs by analyzing basically two aspects, namely: i) how "wide" the FTA in question is in terms of number of negotiation areas (i.e., the inclusion of border as well as non-border issues); and ii) how "deep" the principles, disciplines and modalities are within one negotiation sector. To address the second aspect of comprehensiveness, several negotiation areas are examined in Chapter III, in comparison to the major bilateral, regional, plurilateral agreements that exist within the Western Hemisphere.

The paper argues that the Chilean strategy has been comprehensive but at the same time selective in some aspects. By selecting the areas that are important to individual countries, Chile and its trade partners not only address the access problems of each trade route, but also keep a realistic agenda in light of the lack of interest of some countries to go beyond the rules set by the WTO. Chile also has several "sensitive" sectors to which the government considers it appropriate to apply a differential treatment or protracted schedule for their liberalization. The paper suggests, however, that the strong NAFTA-like nature of the Chilean FTAs, the existent and forthcoming alike, is likely to reduce the problems of coordination that may arise from the multiplicity of FTAs. This foundational relation facilitates the convergence process among them. This resemblance to the NAFTA is at present providing a solid foundation and framework for the forthcoming Chile/United States FTA. At the same time, the similarity in structure assists the attempt of the United States to use the latter FTA as a template for the Free Trade of the Americas (FTAA). In this context, Chapter IV

describes the negotiation process of Chile/US FTA and points out some of the difficulties encountered.

## II. Trade Performance and Negotiation Strategies in the 1990s

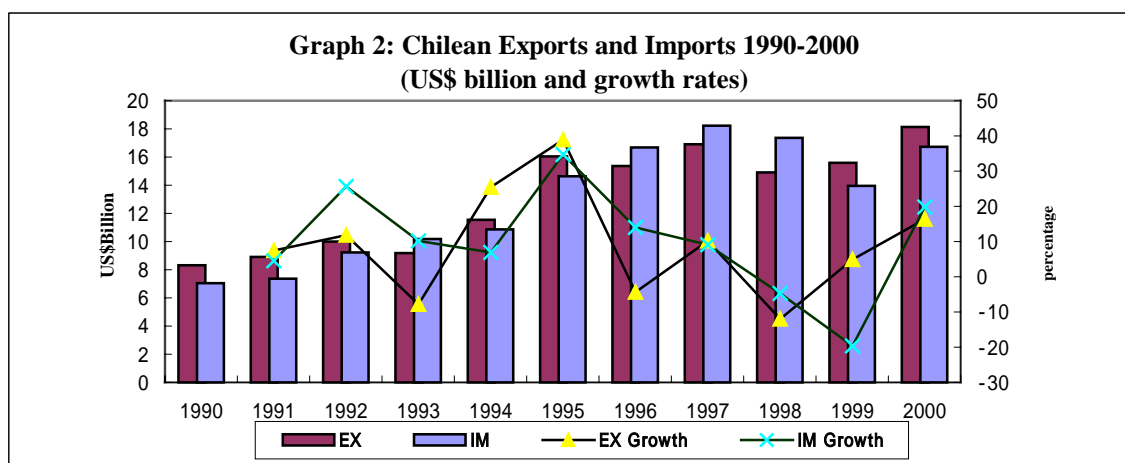
When considered within a global scale, Chile is a country with a small population (15 million) and limited internal market (GDP of US\$71 billion and Per Capita GDP of US\$ 4,580 in 2000). To cope with this reality, Chile has opted for a process of trade liberalization in order to increase its presence in the global market. Since the beginning of the 1990's, this liberalization has been intense and dynamic, with active policies based on both foreign policy and economic considerations. These efforts have been accompanied by the deregulation of key sectors of the economy and the introduction of greater competition in areas such as the supervision of banks, insurance companies, and securities, and have opened new fields of business. Privatization and private investment in public infrastructure have been promoted, all with a greater level of transparency.



Chile's growth pattern, especially since the mid 1980s, can be categorized as "export-led" (Agosin, 1997). Export expansion and diversification have elevated substantially the country's openness, transforming it into one of the most open Latin American economies (Graph 1). In 1995 constant dollars, towards the end of the 1990s, exports and imports accounted for roughly 35% and 30% of GDP, respectively. Exports

of non-factor services have also risen drastically.

Nonetheless, this seemingly flawless export performance has not been free of problems. The export sector is in a gradual process of recuperation from the Asian crisis, which lasted to 1999 (Graph 2), while the country faces a persistent deficit in its current account. Furthermore, although the share of nontraditional products in total exports rose substantially over the last decade, there remain doubts about the ability of the current natural resource-based export structure to sustain high rates of growth over the medium and long term. Such dependency may dampen future economic growth because of the high instability of export income and the low value-added in such exports. Chilean exports originate from large firms, whereas small and medium-sized firms present less than 5% of total national exports (Corfo 2000). There also still remains other structural problems related to low technological and human capabilities in the productive sector in general and some export sub-sectors in particular (Silva 2001).



Today, Chile already accesses to a huge international market of 434 million consumers through numerous PTAs, principally in the form of FTAs. The government's aspiration is to have 90% of its potential world trade partners covered by other FTAs before 2010. Up to now, the country has concluded 11 trade agreements with 15 countries.<sup>1</sup> Chile's FTAs with Canada and Mexico are of a wide-ranging, NAFTA-style

<sup>1</sup> Chile has implemented Economic Complementation Agreements (ECAs) with the following countries or groups (Bolivia, Colombia, Ecuador, MERCOSUR, Peru and Venezuela (the agreement with Cuba is pending for approval) and FTAs with Canada, Mexico and Central America (Costa Rica, El Salvador, Honduras, Guatemala, and Nicaragua). The negotiation of Chile/Central America agreement, which came into effect in February 14<sup>th</sup>, 2002, was divided into two parts; the first corresponded to the joint commitments of all the



pact (for a summary of many agreements, see Table 1). In April 2000 Chile began negotiations on an FTA with the European Union, and similar negotiations are underway with the Republic of Korea. Efforts are also being made to work out FTAs with the European Free Trade Association (EFTA), New Zealand, Australia, Singapore and Japan. In early December 2000, Chile began negotiations on a FTA with the United States, also envisioned as a NAFTA-style pact. The negotiations for a FTA with the United States are likely to act as a catalyst on the establishment of the Free Trade Area of the Americas (FTAA). In addition, full membership for Chile in the Common Market of the South (MERCOSUR) could bring great advantages if the technical difficulties posed by tariff discrepancies can be overcome. Thanks to these efforts, Chile has been able to consolidate itself as one of “nodes” of “new generation” FTAs in the Americas, besides Mexico (IDB 2000).<sup>2</sup>

Chile’s trade policy has been executed through three pillars of liberalization, unilateral, regional and multilateral. What stands out the most among these pillars is the country’s strong adherence to bilateral and plurilateral agreements from the beginning of the 1990s. In fact, Chile is one of the Latin American countries that has promoted one of the most active policies of these agreements. In addition, Chilean trade integration policies of the 1990’s differ from those promoted since the 1960’s in three respects: i) they involve FTAs instead of the creation of common markets or customs unions; ii) they have dealt with the different dimensions of trade and investment; and iii) they involve agreements that are not limited to the countries in the region (although priority is given to them), such as the United States, Canada, the Asia-Pacific economies, and the European Union, as is the case of the Latin American Integration Association (ALADI) (Sáez and Valdés 1999). It is important to point out that the ongoing FTA negotiations do not take place necessarily within a sub-regional or regional context; the present initiatives involve countries and groupings that are not geographically contiguous.

Although other countries in the Western Hemisphere also made important advances in regional integration by way of FTAs, the majority of the accords signed in

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countries, while the second to the bilateral protocols. On the same date, the bilateral protocol between Chile and Costa Rica also came into effect.

<sup>2</sup> A “node” can be defined as a country or group of countries that pursue FTAs with a broad range of partners, geographically contiguous or not, for the purpose of diversifying their trade and investment flows.

the early 1990's belong to the so-called "first generation", based on the structure of the ALADI model; these agreements deal mainly with tariff and non-tariff barriers on the movement of goods across national borders. They are based on the structure of the 1980 Treaty of Montevideo, ALADI's founding charter, which is limited to regulating the trade of goods. These agreements have general regulations on trade and have only a "fragile" disposition on dispute settlement. The so-called Economic Complementation Agreements (ECAs) signed by Chile belong to this category.

The agreements made during the latter half of the decade belong to the "second generation", mimicking the composition of NAFTA. These agreements take into account those aspects that were once thought to be internal issues, such as provisions on investment, services trade and competition policy, government procurement, enforcement of intellectual property rights, etc., and often have dispute settlement procedures similar to those of the WTO. The FTAs signed by Chile with Canada and Mexico belong in this category. The agreement with Central America, which came into effect in February 14<sup>th</sup> 2002, has also a similar structure. Chile's agreement with MERCOSUR goes somewhere in between, surpassing ECAs with a detailed agenda of bilateral integration, but whose norms do not reach the complexity of an NAFTA style agreement (Sáez 2001; IDB 2000).

As a result, FTAs and other agreements signed by Chile have "cascading" effects where one agreement leads to another with increasing liberalization commitments (Devlin and Estevadeordal 2001). Chile began the cascading process by signing a simple ALADI-type FTA with Mexico first, later signing a number of similar agreements with other countries in Latin America, and by then attempting to enter the more comprehensive NAFTA. When this attempt failed due to the lack of the fast-track authority of the United States, the country turned to Canada to sign a NAFTA-like agreement. Chile then upgraded its simple Mexican FTA to NAFTA-like standards.

It should be recalled that the first generation agreements signed by Chile (Mexico, Venezuela, Colombia and Ecuador) were being negotiated in parallel to the Uruguay Round. These agreements cover principally tariff reductions and to a much lesser extent commitments on air and maritime transport. During the Uruguay Round, the member countries agreed to bind "ceiling tariffs" at rates much higher than those

actually applied. For these reasons, the first generation agreements did not present serious problems of coordination with respect to the multilateral system.

**Table 1: Status of Bilateral Agreements of Chile**

Agreement	Tariff Reduction Programs Rules of Origin	Coverage and Status
CANADA	<ul style="list-style-type: none"> <li>- Came into force: 5 July 1997</li> <li>- 18 tariff elimination programs to be applied until 2013</li> <li>- Rules of Origin: NAFTA type, but less demanding</li> </ul>	<ul style="list-style-type: none"> <li>- Trade in goods, services, and investment based on the NATFA model</li> <li>- Tariff reduction programs underway as scheduled; process will be completed in 2014</li> <li>- Opening of negotiations on financial services in 1999</li> </ul>
MEXICO (ECA No. 17) <sup>a</sup>	<ul style="list-style-type: none"> <li>- Came into force: 1 January 1992</li> <li>- 2 programs of linear tariff reduction lasting 4 and 6 years, respectively</li> <li>- Rules of Origin: Based on modified ALADI and NAFTA</li> </ul>	<ul style="list-style-type: none"> <li>- Trade in goods: tariff reduction program completed</li> <li>- New treaty: services and investment; includes intellectual property, technical obstacles</li> <li>- Sanitary and phyto-sanitary measures</li> <li>- Air transport</li> <li>- Opening of negotiations on financial services, anti-dumping measures, and government purchases in 1999</li> </ul>
VENEZUELA (ECA No. 23)	<ul style="list-style-type: none"> <li>- Came into force: 1 July 1993</li> <li>- 2 programs of tariff reduction lasting 4 and 6 years, respectively</li> <li>- Rules of Origin: Based on Resolution 78 of ALADI</li> </ul>	<ul style="list-style-type: none"> <li>- General rules based on the ALADI model</li> <li>- Trade in goods: tariff elimination program complete</li> <li>- Treaty envisages an undertaking to expand trade in services</li> </ul>
COLOMBIA (ECA No. 24)	<ul style="list-style-type: none"> <li>- Came into force: 1 January 1994</li> <li>- 2 programs of tariff reduction lasting 4 and 5 years, respectively</li> <li>- Rules of Origin: Based on Resolution 78 of ALADI</li> </ul>	<ul style="list-style-type: none"> <li>- General rules based on the ALADI model</li> <li>- Trade in goods: tariff elimination program complete</li> <li>- Negotiations have been begun to incorporate trade in services and investment</li> </ul>
ECUADOR (ECA No. 32)	<ul style="list-style-type: none"> <li>- Came into force: 1 January 1995</li> <li>- 2 programs of tariff reduction lasting 3 and 5 years, respectively</li> <li>- Rules of Origin: Based on Resolution 78 of ALADI</li> </ul>	<ul style="list-style-type: none"> <li>- General rules based on the ALADI model</li> <li>- Trade in goods: tariff elimination completed</li> <li>- Treaty envisages an undertaking to expand trade in services, the matter is being studied</li> </ul>
PERU (ECA No. 38)	<ul style="list-style-type: none"> <li>- Came into force: 1 July 1998</li> <li>- 4 tariff reduction programs lasting 5, 10, 15, and 18 years, respectively</li> <li>- 5 special tariff reduction programs for textile sector lasting 3, 6, and 8 years, respectively</li> </ul>	<ul style="list-style-type: none"> <li>- General rules based on the ALADI model</li> <li>- Trade in goods: tariff reduction program underway; to be completed 1 January 2012</li> <li>- Treaty envisages an undertaking to expand trade in services</li> </ul>
MERCOSUR (ECA No. 35)	<ul style="list-style-type: none"> <li>- Came into force: 1 October 1996</li> <li>- 2 tariff reduction programs started in 1997, lasting until 2013</li> </ul>	<ul style="list-style-type: none"> <li>- Less elaborate rules than in the NAFTA models, but include other areas of integration</li> <li>- Trade in goods: tariff reduction program underway; to be completed by 1 January 2014</li> <li>- Participation in institutional structure of MERCOSUR</li> <li>- Physical integration</li> <li>- Undertaking to negotiate on trade in services</li> </ul>
BOLIVIA (ECA No. 22)	<ul style="list-style-type: none"> <li>- Came into force: 6 April 1993</li> </ul>	<ul style="list-style-type: none"> <li>- Partial-Scope Agreement covering a specific number of products</li> <li>- It is proposed to expand this agreement to incorporate more products</li> </ul>

Source: Prepared with the data from the Department of Economic Studies of DIRECON; Sabastían Saéz and Juan Gabriel Valdés "Chile and its "lateral trade policy", *CEPAL Review*, No. 67, April 1999, Table 3; and Sabastían Saéz ""Aspectos institucionales y económicos en las negociaciones comerciales de Chile", in Antoni Esteveadoral and Carolyn Robert eds., *Las Americas sin barreras*, Inter-American Development Bank, Washington D.C., 2001.

<sup>a</sup> ECA: Economic Complementation Agreement

Chile's orientation towards unilateralism up to 1993 was related to the fact that the country was not a major trading entity at the world level, and that it did not have "natural" trading partners. Both meant that Chile could always keep encountering niches in external markets (Meller 1996). By contrast, the agreements of newer generations (with MERCOSUR or Canada) were negotiated when the Uruguay Round commitments had been already in vigor, and when new areas such as services and investment had appeared on the multilateral agenda as binding commitments. This required greater coordination efforts among distinct branches of Chilean authorities (Jara 2001).<sup>3</sup> The country's arduous efforts in export diversification have enabled the country to rank itself as one of the largest exporters of certain products as well, whose national production strongly affect their prices at the international levels.<sup>4</sup>

Perhaps the single most important reason for the change of emphasis from unilateralism in the 1970s and 1980s to the signing of FTAs was that the already low Chilean tariff at the end of the 1980s (15%, lowered to 11% in 1991). This low level of tariff meant that large efficiency gains were unlikely to be reaped by further unilateral liberalization. At the same time, the country's main trading partners maintained high tariffs or other trade barriers for products in which Chilean producers had attained comparative advantage.

Another reason for forging FTAs was the costs associated with not having such agreements. For instance, not having a FTA with the member countries of MERCOSUR would have generated a shift in the group's imports away from Chile toward suppliers within MERCOSUR. The entry into force of MERCOSUR's common external tariff left without effect the previous tariff preferences granted to Chile by individual MERCOSUR members in agreements signed in the framework of ALADI. Similar costs were also thought possible from the expansion eastward of the European Union, and from Mexico's membership in the NAFTA.

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<sup>3</sup> The most important challenges in coordination to the Government and the private sector in Chile involved the issues related to: different models of rules of origin (see Chapter III); effects on preferences that arise from unilateral tariff adjustments or from new bilateral agreements. The latter often results in needs for compensation for the old trade partners (Jara 2001).

<sup>4</sup> Trade expansion and diversification in the last two decades converted Chile into one of the largest exporters of certain items on the world level, such as copper and other minerals (nitrates, iodine, lithium), fisheries (salmon, trout, fish meal), pulp and processed wood, fresh fruits (table grapes, avocados, apples, kiwi, etc.) and wines.

During the early 1990's, Chile had avoided getting involved in customs unions. The bilateral and multilateral trade accords signed by Chile on the most part did not interfere with the country's ability to discuss trade policies with other countries, and also maintained Chile's autonomy in handling its internal macroeconomic policies. For example, Chile has received many invitations to join the MERCOSUR, but has declined, hoping for a chance to join the even more prestigious NAFTA. This hope, however, was redirected due to the inability of the United States to work out the Chilean accession to NAFTA, as well as to the booming trade figures between Chile and the MERCOSUR. Since 1990, these numbers grew from US\$ 1.8 billion to almost US\$ 4.5 billion by 1995. Such figures prompted the eventual signing of a FTA between Chile and MERCOSUR (O'Keefe 1998).

Chile's global objective of FTAs seems to be twofold: i) mutual trade openness among signatory countries; and ii) the reduction of transaction costs of international economic relations, by providing a set of rules applicable to the members which ensure stability, stimulate transparency through specific obligations, and ensure the fulfillment of the rules through instruments which reduce the incentives to depart from them ("lock-in" effects). In short, Chilean FTAs emphasize "dynamic" effects more than "static" ones.<sup>5</sup>

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<sup>5</sup> In reference to the recent Chilean trade diplomacy, Sáez and Valdés (1999) stress that economic theory alone cannot answer the question of what type of agreements should be negotiated. The Vinerian criteria clearly do not answer all the questions regarding to agreement types, mainly because they do not address all the issues involved in the present state of international trade. In their view, international agreements have two functions. First, they promote a trade openness that allows the countries involved to take advantage of the benefits of trade. Such desire for openness stems from the base established by game theory, which rationalizes the increase of trade barriers if no negotiations are made. A joint strategy will insure the full employment of the gains from comparative advantage. Secondly, they reduce the transaction costs that are incurred in international economic relations. These are the costs that cannot be eliminated with a unilateral decision, and require a set of rules to ensure a stable trade environment. In addition to these new dimensions of trade policy, there is a pre-established condition of international trade that must be taken into account. Taking full advantage of the opportunities granted by trade depends not only on the policies of the country, but in the end requires the cooperation of its trade partners. Operating in an international market incurs costs that originate from uncertainty and domestic market flaws, as well as deficiencies in transparency and irregular patterns of behavior on the part of trade partners. Thus, it is the function of international agreements to correct these market failures, reducing the transaction costs of trade and investment.

### III. The Chilean Conception of “Open Regionalism”

#### III-1. The Concept

There is no official definition of the concept by the Chilean authorities or universally accepted use in the country. Nonetheless, in broad economic terms, the Chilean notion of open regionalism portrays a trade strategy to enhance the benefits of regional liberalization without jeopardizing the continued vitality of the multilateral system. For example, ex President Eduardo Frei in his Annual Speech to the Congress in May 21<sup>st</sup>, 1994 stated: (authors’ translation):

Our country adheres fully to the principle of open regionalism, that conceives regional agreements as a mechanism to expand trade and investment, but that upholds the requirement that these agreements strengthen an ever freer world trade system. This is the formula that allows to make unilateral opening of our economy compatible with the signing of bilateral agreements and at the same time to actively participate in multilateral negotiations.

Similarly, Van Klaveren (1997; 1998) asserts that the “open” character of Chilean regionalism in practice manifests in three ways. First, distinct options available for regional markets are not seen as mutually exclusive, but rather complementary. This way, there is no incompatibility issue between MERCOSUR and FTAA or between the membership to APEC and the deepening of relationships with the European Union. Second, the agreements are open to new members (i.e., inclusiveness, rather than exclusiveness, of membership). And third, the deepening process of regional schemes is likely to be compatible with global trade, by avoiding the surge of new barriers in goods and services that are imported from outside the region, a minimum requirement for a FTA to be justified under Article XXIV of GATT. He emphasizes that the last point is probably the most decisive element of the Chilean open regionalism, but in turn admits that it is a more difficult condition to satisfy, because by definition a trade agreement of a preferential character tends to discriminate against third countries.<sup>6</sup>

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<sup>6</sup> The term, regionalism inevitably involves preferential reductions of trade and non-trade barriers among a subset of countries that might, but not necessarily, be geographically contiguous, while multilateralism means a non-discriminatory reduction of trade barriers extended to the whole set of countries of the world trading system. Therefore, *discrimination* is the essential feature of regionalism. But then, *unilateral* reduction of such barriers will be also deemed multilateralism (Srinivasan 1998). In this sense, as Bhagwati (1998) stresses, it is necessary to distinguish between multilateralism as a “process” (i.e., multilateral trade negotiations) for liberalization and multilateralism (i.e., MFN) as an “outcome”.

At least in the Chilean context, there is consensus with regard to two principles of trade: i) agreements should limit trade diversion in the Vinerian sense to a minimum; and ii) agreements should increase the volume of trade among the members, while at the same time maintaining the volume of trade with the rest of the world (Kemp and Wan's theorem). The latter, an underpinning of the Chilean open regionalism, suggests that agreements should not create additional trade barriers to third countries, thus ensuring a positive movement in overall wellbeing.<sup>7</sup> An additional criterion may be that other countries should also benefit from the concessions made by Chile, in conditions of equity and reciprocity (WTO 1997: 21).<sup>8</sup>

A more strict interpretation of open regionalism, however, would require not only open membership but also the extension of concessions and privileges under unconditional MFN basis to non-members. Admittedly, the strong focus on the Chilean FTAs does not lead to an automatic multilateralization of the concessions on a MFN fashion. However, in practice, the liberalization schedules of Chile's FTAs that have a similar timetable would lead to a convergent tariff structure and other measures around the year 2006 (including the FTAA and the time schedule that was agreed in the IV Ministerial Conference in Doha).

Thus, paradoxically, the proliferation of FTAs gradually nullifies the importance of tariff preferences offered by FTAs themselves, and at the end what matters the most is the final result (converged, low tariffs and non-tariff barriers), not the process (by way of bilateral or plurilateral FTAs or multilateral negotiations). While it is necessary to maintain preferences for FTA partners in the short and medium term, the signing of FTAs with almost all trade partners would eventually lead to zero effective tariffs on almost all imports, or free trade, contrary to the high "bound" MFN rates of

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<sup>7</sup> Analyzing the case of MERSOCUR, Estevadeordal, Goto and Sáez (2000) argue that there has been a dramatic trade expansion in both intra-regional and inter-regional trade, suggesting that this regional agreement has brought about trade creation rather than trade diversion. On the other hand, those who advocate total reliance on the multilateral process argue that RTAs divert trade by creating preferential treatment for member countries vis-à-vis non members. They maintain that trade diversion is still substantial, as found in the case of European Union (Frenkel and Wei 1998) and Mercosur (Yeats 1997) and, Bhagwati (1998) asserts, in NAFTA as well. Despite 50 years of efforts in trade reduction, there still remain serious discrimination and trade diversion (Bhagwati 1998; Hoekman, Schiff and Winters 1998).

<sup>8</sup> The need for reciprocity reflects, in a sense, the conformity of Chile's open regionalism with that of the United States: the U.S. concept of open regionalism that liberalization should be extended to non-members only on a conditional MFN basis through reciprocity to avoid free rider problems, comes into conflict with the Asian conception of open regionalism that trade and investment liberalization is based on an unconditional MFN fashion.

GATT/WTO. From this perspective, in the future the tariff issues will become less important in the FTA negotiations, and as this occurs, the relevance of other issues in FTAs will become more paramount.

Another critical, and often controversial, element of open regionalism is the interpretation of Article XXIV of the GATT. In the area of goods exports, one of the most relevant questions is whether to allow the exclusion of certain products from the tariff reduction process, as this article does. In general terms, the standard is to eliminate, within a reasonable period (ten years), customs duties and other obstacles to trade for “substantially all the trade”. The questions are whether “substantially” should be interpreted qualitatively (i.e., no major sectors such as agriculture or textiles are excluded) or quantitatively (i.e., share of trade of the member countries). The same ambiguity remains in the area of trade in services (GATS V).

The issue of whether the proliferation of FTAs would ultimately lead to zero effective tariffs and/or protection on all imports depends not only on the number of FTAs that the country signs but also on the coverage of the agreements signed. If products and sectors (and measures and “modes of supply” in the case of services) that are exempt from the liberalization obligations are numerous and/or adopt a more lenient liberalization time-schedule, it becomes increasingly difficult for an individual FTA to perform as a propelling force to reach free trade. In this respect, Chile does not exclude *a priori* any sector or product from trade negotiations, except the controversial price band on several agricultural products.<sup>9</sup> Furthermore, as mentioned earlier, Chile avoids raising barriers to trade with countries outside the region, a principal condition of Article XXIV for authorizing the establishment of an FTA.

### **III-2. Trade and Investment Effects**

Chile’s trade with its free trade partners has grown substantially over pre-agreement levels in almost every case (see Table 2) (IDB 2000: Table 13). Export growth to non-FTA members has been spectacular as well. In this sense, Chile seems to have done

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<sup>9</sup> For example, with Chile/Mexico agreement since January 1<sup>st</sup> of 1998, bilateral trade in goods has been totally free of tariffs, with an exception of several agricultural products. In the case of Chile/Canada agreement, 80% of all tariffs that were affecting the bilateral trade were eliminated immediately after the agreement came into effect. The general liberalization program will continue to 2003, while a special liberalization program will be



quite well in minimizing trade diversion with third countries. The present scheme of unilateral tariff reduction (i.e., a five-year plan to reduce tariffs by one percentage point per year to 6% by January 1<sup>st</sup>, 2003) is testimony that Chile maintains its commitment to apply free trade policies based on the MFN principle. Chile's highly diversified foreign trade by region of origin and destination is a cause for, or a result of, the government posture that the optimal policy is to negotiate FTAs with all of main trading partners. The export diversification process can be also seen in number not only of market destinations but also of products and exporters (Silva 2001).<sup>10</sup>

**Table 2: Chilean Trade Flows, by Regions and Countries, 1990-2001**

(US\$ Millions)

Year	Andean Community <sup>a</sup>	MERC-OSUR <sup>b</sup>	Mexico	Canada	United States	Central America <sup>c</sup>	Asia-Pacific area <sup>d</sup>	European Union	Total
<b>Exports of Goods</b>									
1990	304.6	652.0	57.7	56.2	1469.2	12.9	2159.8	3279.8	8580.3
1993	566.8	1089.2	130.8	61.1	1655.2	54.4	2839.7	2544.5	9416.2
1997	1118.8	1863.1	376.3	131.0	2710.5	67.4	5629.0	4144.1	17017.0
1998	1185.0	1633.8	488.5	143.5	2603.7	71.7	3692.8	4148.3	14753.9
1999	1059.8	1520.2	622.8	173.5	3087.5	94.8	4319.1	4123.0	15914.6
2000	1228.0	1709.1	819.7	243.7	3183.7	107.0	5235.0	4540.9	18425.0
2001 (1 <sup>st</sup> half)	675.8	855.1	401.6	137.9	1789.9		2405.8	2407.8	9609.6
<b>Imports of Goods</b>									
1990	506.3	1124.0	100.8	224.3	1373.4	4.4	915.4	1882.4	7023.4
1993	454.7	1761.0	209.7	203.1	2477.4	19.4	1853.8	2312.3	10629.8
1997	914.2	3193.2	1076.2	432.5	4332.6	71.1	2904.2	3957.8	18111.6
1998	720.7	3130.3	849.9	494.5	4025.8	37.2	2822.5	3850.3	17087.4
1999	795.3	3092.4	578.8	407.7	3022.5	33.4	2197.7	2848.5	14022.0
2000	993.5	4337.7	615.6	512.0	3338.5	19.3	2722.4	2880.3	16842.5
2001(1 <sup>st</sup> half)	418.0	2476.6	272.8	217.5	1528.7		1366.0	1606.4	8566.0

Source: Prepared with the data from the Department of Economic Studies of DIRECON, "Comercio Exterior de Chile", various years, and el Banco Central de Chile, "Indicadores de Comercio Exterior", various years.

<sup>a</sup> Chile maintains an Economic Complementation Agreement (ECA) with this group.

<sup>b</sup> Comprises figures from Argentina, Brazil, Paraguay, and Uruguay.

<sup>c</sup> Comprises figures for Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

<sup>d</sup> Comprises the APEC countries, excluding the United States, Canada, Mexico, Australia, New Zealand and Russia.

applied to a limited number of products, which will continue to the year 2014. This agreement also establishes not to increase any existing tariff, nor adopt a new tariff.

<sup>10</sup> The number of product items exported by the country increased from 2,300 in 1990 to almost 3,790 in 1999, while the number of exporters rose from 4,100 to 6,020 during the same period. Similarly, the destination countries for exports jumped from 122 to 174 during the decade (Chile, Foreign Investment Committee 2001).

More importantly, Chile has emphasized the importance of sub-regional, regional or even hemispheric markets. The underlying thinking is that regional trade agreements (RTAs), in a framework of open regionalism, can be a device to foster a diversification of exports, towards more connected to overall regional markets, fostering economies of scale: in the presence of economies of scale, what otherwise would be a costly trade diversion, can become a cost-reducing and welfare-enhancing trade diversion (Freund 1998). RTAs can enhance non-traditional exports, differentiated products and products of more value-added and intensive in knowledge, because the typical export basket to regional markets consists of these goods and services, which is distinct from that to developed economies with a much larger share of primary products. Thus, the learning curve associated with experience in regional markets can serve as a platform for new international markets (Devlin and Ffrench-Davis 1998).

In this context, it is important to point out that the Chilean export basket to its neighboring countries shows a much higher concentration of manufactured exports, which are not common to Chilean exports to the developed world. Pursuit of regional markets is thought not only to minimize the major cost of bilateral FTAs, which is trade diversion, but also bring about “dynamic” effects that are associated with regional integration.

It should be noted that the dynamic expansion and diversification of Chilean exports involved not only the goods sectors but also trade in services. While the participation of agriculture, mining, fisheries, and manufacturing in GDP dropped to 35% in 1999 from 38% in 1990, that of services increased from 62% to 65% during the same period. As of October 2000, while the sectors related to goods absorbed 29.5% of national labor force, the services sectors employed the rest. In addition, Chilean trade in services has grown from US\$ 1.8 billion in 1990 to 4.1 billion in 1998, at a rate 44% faster than the exports of goods; services exports grew 10.5% per year, whereas goods exports grew at an annual rate of 7.4%. Services represent roughly 20% not only of total Chilean exports but also imports (Table 3). The dynamism of this sector is also reflected in that almost 40% of the materialized foreign direct investment (FDI) between 1990 and 1998 was directed to this sector, with a total amount of US\$ 12.7 billion (Prieto 2001).

**Table 3: Share of Services in Total Exports and Imports:  
Merchandise and Services**

Region/Year	Exports				Imports			
	1990	1995	1998	1999	1990	1995	1998	1999
Latin America and the Caribbean	17.5%	16.0%	15.6%	13.5%	22.3%	17.9%	16.3%	15.5%
Chile	18.1%	17.2%	21.7%	19.5%	22.7%	20.0%	19.6%	22.7%

Source: extracted from ECLAC (2001), *Panorama de la inserción internacional de América Latina y el Caribe*, Table III. 11a, p. 97

As one of the dynamic effects, by way of economies of scale and competitive gains under imperfect competitive and market structures and the elimination of contingent protection, membership in a RTA is more likely to promote industrialization than unilateral or multilateral liberalization (Puga and Venables 1998). The flow of FDI to some or all of the FTA member countries is also likely to increase. Besides, a reduction in uncertainty about policy reform associated with the “lock-in” or “anchoring” of policy reforms through the FTA may increase investment from all sources and change other behaviors as well. Moreover, the location of industry among member countries will be likely to be affected in a manner that enhances growth potential.<sup>11</sup> As a piece of evidence for these investment effects, not only Chilean inward FDI increased in a sustained manner (Table 4), but also outward FDI to the MERCOSUR and some Andean Community countries grew rapidly in the 1990s (Table 5). With respect to incoming FDI, there has been a remarkable increase from Canada in the aftermath of the signing of the bilateral agreement. The Chilean authorities argue that the dynamic nature of these inward and outward investment processes has attracted the interest of foreign investors and transnational corporations to diversify their access to new markets in Latin America using Chile as a reliable “springboard” or “gateway”.

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<sup>11</sup> Either (1998) argues that incentives for small countries going into RTAs with larger countries can be substantial because a reform-minded small country can more easily achieve reform after linking up with a large country, since the RTA gives the small country a significant advantage over other small countries in attracting FDI. When tariffs are low, the value of FDI is greater, making developing countries more eager to sign RTAs, even if they are required to make most of the concessions.

**Table 4: FDI Statute (DL600) by Country of Origin 1974 - June 2001:Materialized Investment**

(US\$ millions)

Country/period	1974-1989	1990-1995	1996	1997	1998	1999	2000	2001 <sub>a/</sub>	Total
United States	2,248	4,097	2,264	935	1,358	1,909	734	1,118	14,663
Spain	527	263	488	1,498	896	4,583	711	280	9,245
Canada	499	2,376	571	811	899	450	665	103	6,375
United Kingdom	384	508	232	201	412	311	205	168	2,420
Australia	241	343	109	181	385	6	38	197	1,500
Japan	144	372	148	164	323	224	53	53	1,482
Italy	21	33	325	19	6	51	96	914	1,463
South Africa	42	419	74	476	330	40	4	10	1,395
Netherlands, The	177	126	121	363	169	181	83	84	1,305
France	95	135	66	63	150	608	43	24	1,184
Cayman Islands	5	121	13	194	85	214	39	1	672
Argentina	33	178	97	60	97	47	92	7	610
Finland	0.1	359	59	13	84	3	3	-	521
Switzerland	56	196	46	45	104	44	0.2	1	493
Bermuda	21	141	1	11	241	41	15	1	473
Germany	67	105	- 7	26	147	69	9	9	425
Belgium	11	5	80	0.1	103	104	20	20	345
Brazil	75	73	16	26	26	48	5	8	276
Other	462	742	119	145	160	150	184	127	2,089
<b>Total per period</b>	<b>5,111</b>	<b>10,592</b>	<b>4,822</b>	<b>5,230</b>	<b>5,973</b>	<b>9,086</b>	<b>2,998</b>	<b>3,125</b>	<b>46,936</b>

a/ provisional figures as of June 30, 2001

Source: Chile, Foreign Investment Committee (www.foreigninvestment.cl)

**Table 5: Chilean Foreign Direct Investment Abroad in the 1990s: Investment Officially Detected**

(US\$ millions)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 <sub>a/</sub>
Argentina	11	63	640	606	1,608	2,611	3,433	2,299	839	326	220
Brazil	3	2	-	10	288	112	977	1,222	602	260	98
Peru			12	31	651	1,052	611	418	449	294	10
Colombia		2	10	1	116	28	896	133	101	59	
Venezuela	-	-	-	-	-	-	247	423	102	220	95
Mexico		1	-	3	17	20	27	18			
USA		1	-	4	30	30	-	75	45	55	
<b>Total</b>	<b>15</b>	<b>192</b>	<b>671</b>	<b>742</b>	<b>2,795</b>	<b>4,158</b>	<b>6,368</b>	<b>4,731</b>	<b>2,244</b>	<b>1,417</b>	<b>552</b>

a/ First Semester of 2000 only.

Source: Camara de Comercio de Santiago, *Inversión Chilena detectada en el exterior, Informe 2000*, Departamento de Estudios, September 2000.

### III-3. Chilean “New” and “Deep” Regionalism

In Latin America, a “New Regionalism” began to appear in the second half of the 1980s and consolidated itself in the 1990s. This new regionalism contrasts to the old Post-War integration initiatives that were characterized by: i) the state-led import substitution industrialization model of development; ii) an inward-looking orientation; iii) a high level of selectivity with the application of multiple positive lists; and iv) skepticism regarding private markets and great concern about the presence of, and dependence on, foreign firms (Devlin and Estevadeordal 2001).

The new regionalism supports structural reforms to make economies more open, market-based and competitive. The scope of liberalization disciplines in the new regionalism tends to be comprehensive and more rapid, universal and sustained in terms of application. It also attracts foreign investment and has more functional and cost effective institutional arrangements. Another facet of the new regionalism refers to a multi-dimensional process of regional integration that includes political, social and cultural aspects.<sup>12</sup> Mistry (1995) argues that new FTAs have built-in features, which make them multilaterally friendly rather than multilaterally resistant. The new regionalism is driven by market forces rather than fiat, the forces of globalization, transnationalization and global competition, by the globalization of financial markets, capital flows, consumer demand, and by the global ease with which technology and innovation can now cross national frontiers. Thus, the very forces that are driving regionalism are compelling it to be multilaterally friendly.

The central features of the new regionalism in Chile are therefore regional liberalization which work in tandem with unilateral and multilateral trade opening, product differentiation, economies of scale, competition, investment and learning-by-doing and externalities. Another main feature is the liberalization not only of goods but also of services, movements of capital and labor,<sup>13</sup> the harmonization of regulatory

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<sup>12</sup> For example, Van Klaveren (1997; 1998) and Palacios (1995) identify a new regionalism in Latin America which involves a significant process of convergence between diverse initiatives at the sub-regional, regional and even hemispheric levels, and a new orientation towards the rest of the world based on much less rigid and non-exclusive alliances and groupings.

<sup>13</sup> These new contexts of trade were first addressed in the Tokyo Round of GATT in 1974-1979, where the trend of discussing technical barriers, government purchases, anti-dumping and countervailing duties, and subsidies was set. Such advances were furthered in the negotiations of the Rome Treaty, NAFTA, and the Uruguay Round, when even newer issues like services, intellectual property, and investment were dealt with. In

regimes and trade facilitation measures,<sup>14</sup> and the emergence of North-South regional agreements. In fact, reducing transaction costs at the regional level, by way of harmonizing facilitation policies and improving infrastructure, (e.g., telecommunications, transport,<sup>15</sup> and trade finance among member countries, has become an important policy objective. The new regionalism also involves new approaches to older issues, such as rules of origin, contingent measures for imports, and dispute settlements. Due to this orientation, open regionalism is often referred to interchangeably as new regionalism whose main features are the liberalization of domestic regulatory measures.

In trade literature, dealing with “beyond the border” issues has been termed “deeper integration.” In “shallow integration”, which revolves around reducing measures applied “at the border” (tariffs, quotas, etc.), different national regulatory policies are determined and administered at the national level. In deep integration, common rules and policies and/or supra-national implementation are adopted, and international negotiations have increasingly centered on domestic regulatory policies that are alleged to impede the ability of foreign firms and products to contest a market. Hoekman (1998: 4) goes even further to say that deep integration “consists of explicit actions by governments to reduce the market segmenting effect of differences in national regulatory policies that pertain to products, production processes, producers and natural persons. In practice, this requires decisions not only that a partner’s policies are equivalent (mutual recognition) but also to adopt a common regulatory stance in specific areas (harmonization). The latter approach may be complemented by decisions to cede enforcement authority to a supra-national authority”.

The FTAs or other agreements signed by Chile are said to be “comprehensive” in nature and scope that involve almost all aspects of bilateral economic relations, the trade of goods (market access, rules of origin, customs procedures), services,

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addition, there have been recent efforts to include the topics of the environment and labor rights in the negotiations.

<sup>14</sup> The inclusion of the last, facilitating trade through non-tariff and non-border reforms, is a new focus of the concept. Such initiatives and measures of trade facilitation can be narrowly focused, such as customs harmonization and mutual recognition of product standards, or could be quite far-reaching, as with cooperation in enforcing national competition policies and deregulation of key domestic markets (deep integration).

<sup>15</sup> One of the major reasons that MERCOSUR was interested in having Chile join the Southern Cone trade bloc was to facilitate access to Chile’s ports and from there the markets of the Asia-Pacific. A manifest of this interest of MERCOSUR is Titles XII and XIV of the Chile-MERCOSUR Agreement, which, among others,

investments, trade remedies (safeguards, antidumping and compensatory rights) norms and standards (sanitary and phytosanitary measures), trade-related issues (competition policy, intellectual property rights, government procurements), institutional issues (transparency, dispute settlement), labor and environmental issues. In addition, the Government of Chile considers the participation of its citizens (the civil society), to be fundamental to the formulation of State policy (Silva 2001).

Open/new/deep regionalism has a variety of implications for the new dimensions of market access: the issue of market access has now to be approached in a broader manner than what prevailed earlier. It is necessary to embrace the continuum of trade, investment and competition policies that impede the international contestability of markets. Whether the economies benefit from a particular FTA depends on the scope and coverage of its provisions and the nature of the enforcement mechanism. As a consequence, trade policy today is typically far more complex to describe, negotiate or implement than the earlier ones. The bilateral and multilateral agreements of recent “generation” that have been signed by Chile precisely have this character of “intrusion” to the areas previously considered solely as domestic issues.

Chile has incorporated these new areas into the accords it ties with its partners, although not all of Chile’s potential trading partners are interested in going beyond the dimensions achieved in the WTO. For instance, the current treaty with Canada incorporates the highest rights and obligations so far in FTAs signed by Chile with respect to services and investment, but it does not incorporate such aspects as intellectual property rights, technical standards, sanitary and phytosanitary measures, and government procurement.<sup>16</sup> On the other hand, the treaty with Mexico incorporates such aspects.<sup>17</sup> Chile and Canada considered that the WTO rules, together with their own respective legislation, already addressed these matters satisfactorily (Jara 2001).

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obliges the signatory countries to execute a protocol on physical integration, with a goal of establishing a bi-oceanic corridor from the Atlantic to the Pacific (O’keefe 1998).

<sup>16</sup> Even in the case of Chile/Canada FTA, cross-border financial services are excluded from the commitments on services. The same exclusion of financial services also applies to the Chile/Central American FTA.

<sup>17</sup> In contrast to NAFTA, in Chile/Mexico FTA, there are no chapters on financial services and government procurements. However both governments made specific commitments in Article 20-08 to begin negotiating these chapters before the determined dates. Both governments have also committed themselves to negotiating the elimination of antidumping duties on imports. According to the declaration of the Second Vice-Ministers Meeting of Chile/Mexico FTA November 2000, a series of meetings has been sustained between the two parties to advance in these areas ([www.direcon.cl](http://www.direcon.cl)). Chile is not a member of the WTO Agreement on Government Procurement.

Therefore, Chilean strategy has been comprehensive in most areas but selective in some cases. By selecting the areas that are important to individual countries, Chile and its trade partners not only address the access problems of each trade route, but also keep a realistic agenda in light of the lack of interest of some countries to go beyond the rules set by the WTO. Individual institutional and other weaknesses should also be taken into account (Sáez and Valdés 1999). Chile also has several “sensitive” sectors to which the government considers it appropriate to apply differential treatment or a protracted schedule for their liberalization. In addition to several agricultural products, financial services are often regarded as “sensitive” areas. Given the limited human and financial resources that developing countries like Chile have available for trade negotiations, it is not always wise of these countries to “spread thin” among simultaneous negotiations in distinct areas on different geographical fronts.

The costs of having a myriad of agreements derive basically from the problems in achieving coherence and convergence, in coordinating negotiators efforts, and in monitoring the negotiation and implementation processes, and in using effectively the dispute settlement mechanisms. There is also a serious problem that decision makers of the private sector must encounter with respect to a complex, and often conflictive, business prospect that results from various negotiations. At the same time, the multiplicity of negotiation areas requires the availability of highly capable professionals. Also, the incorporation in this process of interrelated, multiple negotiation areas calls for participation and articulation of government officials from various ministries and departments and their coordinated efforts with other economic agents particularly of the private sector (Jara 2001). However, the costs of multiplicity would be less insofar as the agreements with diverse trade partners converge in terms of tariff structures, liberalization timeframes and similarities in norms and disciplines. There also exist economies of scale in the learning process of government officials and the business community with respect to negotiations and benefits and costs involved in those agreements.



### **III-4. Chilean Regionalism: A “Stepping Stone” towards Multilateralism?**

A question often posed on the relationship between regionalism and multilateralism is whether the former is a “stepping stone or a “stumbling block” towards the achievement of the latter. A central concern surrounding regional integration schemes, therefore, has been not only the consistency of regional trade agreements (RTAs) with the GATT/WTO commitments to global trade liberalization, but also the broadening and deepening of RTA concessions which go further than those made in the GATT/WTO.

In several cases, the regional process may be faster to produce substantial progress toward further trade liberalization. RTAs may facilitate liberalization in areas that are too complex to be negotiated successfully in the WTO or too difficult to enforce in that setting (Krugman 1993). For instance, for activities that are presently highly protected (e.g., government procurement, anti-dumping measures and some services), liberalization in a regional context may be more feasible than through global liberalization. The same observation might apply to highly technical areas, such as industrial standards, where intensive negotiations are required. Once formed and implemented, regional agreements, in these areas might also serve as blueprints for future multilateral liberalization (Hoekman, Schiff and Winters 1998).

The proponents of regionalism argue that RTAs adopt a “WTO-plus” approach by accepting higher levels of obligations in certain areas than in multilateral agreements, thereby laying the foundations for multilateral progress in those areas (Sampson 1996; Blandford 1995). Countries in a regional agreement tend to have a strong incentive to widen the initial coverage of the agreement in order to increase the gains of cooperation. Participants may be better off by introducing new targets and issues in the agreement (López and Matutes 1998). This might occur in such areas as in trade in services, investment, intellectual property rights, factor mobility, rules of origin, competition policy, anti-dumping and safeguards, sanitary and phytosanitary regulations, etc. Purely economic factors can be combined with political or security issues as well.

The country’s main forum for multilateral economic cooperation is the WTO. The Chilean authorities recognize this organization as an indispensable organ for pursuing the interests of the country, much more than just a tool to mend the failures of unilateral openness. The membership of Chile and major trading partners to the WTO

provides a homogeneous normative framework that would reduce diversity and lessen the need to design bilateral disciplines in some cases. Due to Chile's high dependence on foreign trade, it is in the interest of the country for clear, WTO-based procedures to exist. Such procedures are followed by the other member countries, and provide a guarantee that the rest of the world is working toward a greater liberalization of trade. WTO is a vital organ in the areas of dispute and controversy resolution (DIRECON 2000). In fact, Chile has appealed to the Dispute Settlement Body numerous times, both at the consulting level and at the highest level of the panel.

Another Chilean persuasion in support of multilateralism is that outcomes of multilateral negotiations provide a minimum level of commitments and a reference framework. In particular, the Uruguay Round has considerably elevated the "floor" and the breadth of such reference. The Chilean authorities think that deeper and stronger disciplines and commitments in many areas which go beyond the traditional "border" restrictions, together with a strategy of "single undertaking", facilitates results that would deepen even more some specific areas in bilateral negotiations. Conversely, the NAFTA and the similar agreements signed by Mexico, and to a lesser extent by Chile, possibly contribute, in a complementary manner, to clarifying the structure and focus of the disciplines and procedures of more "modern" WTO (Jara 2001). The bilateral agreements signed by Chile are intended to fill in the gaps that still remain after the implementation of unilateral tariff reductions and multilateral negotiations through the WTO. From this perspective, Chilean bilateral and plurilateral trade agreements have been essential complements to the existence of WTO and other standard trade liberalization schemes.

The WTO is not free of limitations and imperfections, however. The Uruguay Round, while enabling countries like Chile to strengthen its links with the rest of the world, also manifested the weaknesses of the multilateral nature of the organization.<sup>18</sup> Moreover, the results of the Uruguay Round have fallen short of the expectations held

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<sup>18</sup> The negotiations were long and complicated, originally intended to end in December 1990 but instead going on for several more years. The fate of the GATT, which first developed its multilateral trade system in the late 1940's, was uncertain. Such uncertainty prompted the major powers to look elsewhere. The United States began to promote an active policy of bilateral trade negotiations (Israel, 1985; Canada, 1989; NAFTA, 1992), the European Union signed the Maastricht Treaty and continued to grow, APEC became the main economic forum for the region, and Latin America began to concentrate on MERCOSUR.

by Chile. The issue of market access of agricultural products is still unsatisfactory, and the international trade scene is still susceptible to arbitrary and hidden barriers to trade.

Moreover, Sáez (2001) argues that the multilateral system contains certain principles that could inhibit the negotiation capacity of a small country like Chile. In effect, the MFN clause, which is the pillar of the WTO system, can be a limiting factor for a small country; not being a large producer of a good at the world level might signify a scarce negotiation power or maneuverability in certain sectors. For these reasons, Chile negotiated *bilaterally* the liberalization of the automotive sector towards the Mexican market in a more favorable condition. The rules of origin in Chile-Mexico FTA are simpler than those of NAFTA (see Chapter III of this paper), and since 1996 this trade is totally liberalized without any restriction. As a result, Chilean car exports to Mexico jumped from US\$ 21,480 in 1996 to US\$ 22 million in 1997 and to US\$ 41 million in 1998. The elimination of these barriers would not have been possible for Chile in a multilateral negotiation, given that the country is not an influential supplier of the good in question at the international level.

Chile is a founding member of the WTO, having joined at the Marrakech Agreement in 1995 after the approval of the national Congress. As such, it has had to implement the agreements concluded during the Uruguay Round and restructure its internal legislation. To comply with the WTO commitments, three export subsidy programs are now being phased out within the period allowed by the Agreement on Subsidies. One such program related to the automotive sector.<sup>19</sup> Another program was designed to allow duty-free entry for capital goods insofar as they were used for export purposes. The third program provided for the “simplified” system of refunds of 10% of the value of exports.<sup>20</sup>

The Chilean negotiation positions at the multilateral forum have been guided by several principles. First and foremost is the need for transparency in the negotiations so

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<sup>19</sup> More precisely, Chile did not meet the deadline of January 1, 2000 for eliminating the measures in the automotive sector that are inconsistent with the measures of local content and trade balancing of the TRIMS agreement. On December 29, 1999, the Chilean authorities requested an extension in its deadline until May 31, 2000. In July 2000, the authorities requested and was granted an additional “informal” extension until December 31, 2000.

<sup>20</sup> The simplified duty drawback system, established in 1985, entitled the exporter to a 10%, 5% or 3% rebate on the FOB value, depending on the total value of goods exported. Starting on January 1<sup>st</sup> 1999, reimbursement of indirect taxes on inputs incorporated into exported goods has been eliminated, and the 10% rebate on the FOB value of exports not exceeding US\$ 10.5 million has been reduced to 9%, according to the five-year plan,

that the WTO members can have an active participation in a comprehensive, integral decision-making process. Second, the member countries should stick to the “standstill” principle, which will later keep them from making internal decisions that reduce market access. And third, Chile wants the negotiation results to be compiled as a “single undertaking”, in a way that nothing is decided until everything is decided. This way, the interests of all the member countries in different negotiating sectors can be considered adequately. Furthermore, the forthcoming negotiations should take into account Special and Differentiated treatment for developing countries when the negotiated matters are those that could exceed these countries’ capacity to implement them. Prior to the Doha Ministerial Meeting, Chile insisted that the next multilateral negotiations should not last more than three years, with a mid-term ministerial revision (DIRECON 2000).<sup>21</sup>

As in the WTO conference in Seattle in 1999, during the Ministerial Conference in Doha in 2001, the Chilean authorities expressed interests in initiating a broad negotiation agenda, whose contents should include especially the following issues: i) an ambitious and credible mandate on agriculture as a central issue of the agenda; ii) a firm treatment of antidumping rights; and iii) environmental measures in the multilateral rules and disciplines that would preserve the balance between sustainable development and free trade (WTO 2001a). In addition, in the preparation for the Conference, the Government made a series of proposals in areas such as: i) agriculture as participating member of the Cairns Group; ii) revision of antidumping mechanisms; iii) trade in services; iv) fishery subsidies; and v) a reformulation of dispute settlement mechanisms.

Although the outcomes at the IV Ministerial Meeting in November 2001, in Doha, Qatar, fell short of Chilean government’s expectations in some areas, the Doha declaration contains texts that might have important ramifications for the country. The authorities think that it is important to have the WTO member countries committed in agriculture to comprehensive negotiations aimed at substantial improvements in market access and reductions of all forms of export subsidies and trade-distorting domestic

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reducing 1 percentage point per year, down to 6% in the year 2002, and then all rebate rates will be fused to a single 3% in the year 2003. This system cannot be used in conjunction with the regular drawback.

<sup>21</sup> Chile has been an active participant at the WTO forums. In the area of services, for instance, together with Australia and New Zealand, the country has brought forward a proposal on its liberalization. Also, it is interesting to note that Chile, on its own, made a proposal on WTO negotiation in trade services, by way of the so-called “clusters” approach. The objective of this idea was to respond to the fact that supply of one service requires supply of other related-services. This way, a restriction in one service can affect others in a kind of

support. Aside from the ongoing negotiations on agriculture, there will be negotiations on fisheries and anti-dumping laws (as part not only of Subsidies and Countervailing Measures but also of environment), two areas that are of great importance to Chile. The inclusion of a text on the reduction and elimination of tariffs, including tariff peaks and tariff escalation, as well as non-tariff barriers, without *a priori* exclusions of any sector, was another achievement. The stated objectives were achieved without making “sacrifices” in other areas such as environment, government procurement, and dispute settlement, because the Chilean position basically coincided with that of the developed countries (www.direcon.cl, El Mercurio November 17, 2001).

Meanwhile, possible progress in future negotiations in new areas such as competition policy, investment or electronic commerce might should facilitate the country’s bilateral negotiations in those areas. These are the areas in which Chile is inclined to assume greater commitments of liberalization.

#### **IV. Comprehensiveness of Chilean FTAs**

The “comprehensiveness” can be looked at two ways: i) by how “wide” the FTA in question is in terms of number of negotiation areas involved (i.e., the inclusion of border as well as non-border issues); and ii) how “deep” the disciplines and modalities are within one negotiation sector (e.g., the “negative” vs. “positive” approach of negotiation in the sector of trade in services). In this chapter, several negotiation areas are examined to address the second aspect of comprehensiveness.

##### **IV-1. Reduction of Tariffs and Non-Tariff Measures**

Within the realm of unilateral decisions, Chile has been employing an aggressive reduction in the general tariff rate as part of the country’s trade policy. In 1991, the majority party of the Chilean Congress (the Democratic Coalition) promoted the reduction of the general tariff on imports from 15% to 11%. This was followed in 1998 by the approval of a scheme to reduce the tariff by one percent every year, starting in

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“production supply-chain” of services. For example, trade in forestry should benefit in liberalization if the

1999, until a rate of 6% is reached in 2003. At present, Chile's applied MFN tariff is 8% across-the-board. The drop in nominal tariffs, coupled with tariff structures for those countries that Chile has trade agreements, means that once the tariff reduction process is completed in 2003, the average effective tariff will be 3% to 4%. In terms of liberalization, this new tariff structure will place Chile on a level similar to Belgium, France, Spain and Italy (Chile Foreign Investment Committee, 2001).

Also, as a result of the Uruguay Round, Chile reduced its bound rate from 35% to 25% for most products and to 31.5% for some agricultural products, such as dairy products, wheat and wheat flour, oilseeds and oleaginous fruit.<sup>22</sup> Chilean "bound" rates are generally lower than those of other Latin American countries (ECLAC 2001).<sup>23</sup>

As a result of bilateral efforts, many countries that are involved in trade with Chile face a lower rate than that of the general tariff. Discrepancies in the effective and general tariff rates appear due to agreements signed primarily with countries within the hemisphere. Table 6 shows how the effective tariff rate on Chilean imports has changed at the turn of the year. These variations between the rates for January 2001 and the month before exist because of the aforementioned reduction of the general tariff by 1%, plus further reductions resulting from the individual PTAs that Chile has signed with its trade partners. While most countries experienced a drop in the tariff that they face, there are some exceptions, most notably Ecuador and Mexico. These irregularities occur due to changes in the composition of relevant imports, mostly related to the seasonal phenomena of Chilean trade. Despite these specific cases of increasing tariffs, the overall tendency toward a lower total tariff rate should continue until reaching a rate of 5.5% at the end of 2001 (Cámara de Comercio de Santiago 2001b).

As expected, Chile's method of using numerous FTAs has been received with mixed reviews. Many agree that all lateral reductions in trade barriers are beneficial, be they multi-, uni-, bi-, or plurilateral. In this sense, all types of "lateral" initiatives should be supported because they are important opportunities in trade. However, some argue

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connected services such as transport, engineering services, etc. were to be also liberalized (DIRECON 2000).

<sup>22</sup> Chile applies a price band system for a certain number of agricultural products, namely sugar, wheat, wheat flour, and vegetable oils. Under this system, in cases of imports carrying costs under the floor value, specific additional tariffs are applied to the general ad-valorem duty in order to equalize such value. If import costs exceed the ceiling price, tariff reductions are applied to the general ad-valorem duty to prevent exceeding that value level.

that the prevailing system turns the general tariff into a highly differentiated one, resulting in reduced protection for some sectors, while others enjoy levels much greater

**Table 6: Effective Tariffs on Chilean Imports by Country and Region**

	December 2000	January 2001
Argentina	3.5%	2.4%
Bolivia	2.5%	2.3%
Brazil	4.7%	3.8%
Colombia	1.4%	0.9%
Ecuador	0.1%	4.9%
Mexico	0.2%	0.3%
Paraguay	5.1%	6.1%
Peru	3.0%	2.5%
Uruguay	5.4%	3.7%
Venezuela	5.2%	4.7%
Australia	8.9%	7.9%
Canada	1.6%	1.0%
China, People's Republic of (PRC)	8.0%	7.7%
France	6.3%	7.6%
Germany	8.9%	7.9%
Hong Kong, China	9.0%	8.0%
Italy	8.7%	7.9%
Japan	8.8%	7.9%
Korea, Republic of	8.8%	8.0%
Nigeria	9.0%	8.0%
Spain	8.4%	7.6%
Taiwan, Province of China	7.4%	7.0%
United Kingdom	8.8%	7.7%
United States of America	7.8%	7.0%
<b>TOTAL</b>	<b>6.4%</b>	<b>5.9%</b>
MERCOSUR	4.0%	2.9%
Latin America	3.3%	2.7%
NAFTA	5.8%	5.7%
Europe	8.2%	7.7%
Asia	8.3%	7.7%

Source: Cámara de Comercio de Santiago

<sup>23</sup> Recently on August 22, 2001, Chile notified the WTO to raise the bound rate on sugar from 31.5% to 98%. In accordance with Article XXVIII of the GATT, the country offered compensations to its principle sugar suppliers, such as Argentina, Guatemala and Brazil (DIRECON 2001, www.direcon.cl).

than the current general tariff. Such critics propose a uniform tariff reduction ruled by the government, which would supposedly improve Chile's linkages to the global economy. On the other hand, Agosin (1997), for instance, argues that Chile should reduce tariffs to zero on imported capital goods and inputs not produced in the country, and that there is no urgency to reduce tariffs on consumer good imports. In effect, the myriad of FTAs has made the country's tariff reduction process not only "comprehensive" but also "complex".

Contrary to the typical message of FTAs, under which preferential tariff reduction is welfare inferior to non-preferential tariff reduction, Wonnacott and Wonnacott (1981) argue that FTAs could produce more gains thanks to improved market access to trading partners. If a country were to negotiate FTAs with all of its trade partners, it would end up with zero effective tariffs on all imports, or free trade, despite the legal existence of positive MFN tariffs. Chile follows such a strategy of sequentially negotiating bilateral FTAs with all of its significant trade partners. This sequencing of FTAs, titled "additive regionalism" recently by Harrison, Rutherford and Tarr (2001), may produce gains that are significantly larger than unilateral free trade. Critics of Chile's additive regionalism strategy (e.g., Donoso and Hachette 1996) argue that agreements with South American countries are unlikely to be beneficial for Chile, and that it is not worthwhile delaying the benefits of unilateral and multilateral liberalization to pursue these agreements. They suggest that agreements worth pursuing are its major trading partners (i.e., the EU, the United States and Japan).

Advocates of regionalism, such as Butelmann and Meller (1995), on the other hand, consider that additive regionalism would progressively reduce trade diversion costs for Chile, lower the effective average tariff of the country and provide significant improved market access in partner countries. Moreover, they argue that Chile should unilaterally lower its external tariff while simultaneously pursuing additive regionalism to further reduce trade diversion costs. Harrison, Rutherford and Tarr (2001) find that this strategy is likely to provide Chile with gains many multiples of the static gains from unilateral free trade. Meller (1996) argues that given the proliferation of FTAs, the best strategy for a small country like Chile is to enjoy preferential market access in such a manner that the small country can play the "hub and spoke game".



Excluding health, sanitary and phytosanitary measures and concerns to public morals and national security, import quotas and other quantitative restrictions, as well as licensing, surveillance mechanisms, and cartels are prohibited as non-tariff measures (NTMs) in Chile. There are neither export licenses nor controls on exports required in the country. The only exception is the prohibition of the importation of used motor vehicles excluding certain public utility vehicles.

On the other hand, the Government of Chile claims that its exports face real and potential NTMs placed by trading partners. According to the Ministry of Economy, as of the year 2000 the country faced 220 non-tariff measures that were identifiable and significant in 14 countries. Those countries that figure with a high frequency are Argentina and Brazil, followed by the United States, the European Union and Mexico (Cámara de Comercio de Santiago 2001a). Though the norms on non-trade barriers are clearly established in the WTO framework, they are not easy to detect and even harder to eliminate. The bilateral or plurilateral route of negotiation can be thought to be a more effective way to address the issue of NTMs that are often specific to the market condition of the country/region in question.

## **IV-2. Trade in Services**

Trade in services occurs in many different areas, involving all economic activity that is not represented by tangible goods. Key sectors in this type of trade include transportation, telecommunications, financial services, publicity, consulting, energy, entertainment, and tourism. Most services are not affected by tariffs, but instead are susceptible to laws, norms, and disciplines that discriminate against foreign services or service providers.

Services liberalization is a relatively new topic, negotiations for which had started in the early 1990's and culminated in the General Agreement on Trade in Services (GATS). GATS came into force on January 1, 1995 and Chile is a founding member of the agreement. As for the Western Hemisphere, the strongest push for liberalization began in 1994, when NAFTA came into force. In the hemisphere, fourteen

sub-regional agreements on trade in services have been made since then (see Table 7).<sup>24</sup> Such dynamism in the services area shows an increased interest of the countries in the matter, as well as an acknowledgement that such growth is indispensable for economic development.

Chile's relatively open service trade regime is in contrast to its relatively limited GATS commitments. In particular, Chile maintains a "horizontal" limitation, applying to all sectors in its GATS schedule, under which authorization for foreign investment in services industries may be contingent on a number of factors including employment generation, use of local inputs and competition. Chile has made WTO commitments on most basic telecommunications services, by adopting the Fourth Protocol to the GATS on Basic Telecommunications, which makes commitments in domestic and international long distance, and adopted the reference paper on regulatory commitments. The country also signed the Fifth Protocol to the GATS on Financial Services, thus making market access and national treatment commitments in banking, insurance and other financial services.<sup>25</sup> With regards to air transport services, both passenger and freight, Chile aims to implement an open skies policy through bilateral agreements (APEC 2001).

It should be stressed that all of the fourteen subregional arrangements in trade in services go well beyond those defined at the multilateral level in their objectives (including GATS), the type of disciplines, and the scope of liberalization (Table 7). According to Stephenson (2001b: 24), the negotiating posture of Latin American countries at the GATS has been rather cautious, while that at the regional level in the area of services liberalization has been strongly pro-active. "All of these agreements go beyond the GATS in either developing deeper disciplines, or providing for greater liberalization and market access opportunities for service providers, or enhancing transparency – or a combination of all three. Two sub-regional agreements even posit

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<sup>24</sup> The other trade and integration arrangements contain no provisions specific to services or to the liberalization of trade in services, although definitions on services are set out in the annex to the CARICOM. The Chile/MERCOSUR and Bolivia/MERCOSUR agreements include a short chapter on services, with a few provisions.

<sup>25</sup> However, during the 1997 WTO financial services negotiations, Chile made commitments neither for asset management services, including the management of mutual funds or pension funds, nor for financial information services. Chile also reserved the right to apply economic needs and national interest tests to the licensing of foreign financial service suppliers. In practice, however, Chile has allowed foreign banks to establish as branches or subsidiaries and to provide the same range of services that domestic banks are allowed.

the complete removal of all restrictions affecting services and service providers falling within their arrangement, while other agreements posit an effective standstill or prohibition on the adoption of any new restrictive measures. A few agreements even set out the unconditional application of both MFN and national treatment”.

A major difference between the WTO and the subregional negotiations on trade in services is that the former follows the “bottom-up” (positive-list) approach while the latter, the “top-down” (negative-list) approach (Prieto and Stephenson 1998; Stephenson 2001b). The former method was agreed on and applied during the Uruguay Round and is established at the multilateral level under GATS. Points of emphasis include the creation of commitments in market access and treatment of foreign providers in specific service sectors. Periodic rounds of negotiations serve to add liberalization in sectors not originally considered. MERCOSUR, with its Protocol of Montevideo on Trade in Services (December 1997), also follows this approach, pushing for common markets in specific timeframes. MERCOSUR hopes for a higher level of services liberalization, as does GATS, but is also working toward the complete elimination of all barriers affecting trade in services, whatever the sector.

Chile is more involved in the latter “top-down” approach, which was first pioneered in NAFTA. This method commits the members involved to liberalizing all forms of discriminatory treatment faced by all service sectors, excluding certain sectors and measures that are clearly stated in accompanying reservations. The Chile-Mexico sub-regional agreement uses this approach, as do the Chile-Canada and Chile-Central America agreements. None of the NAFTA-type agreements contain schedule modification procedures because schedules of commitments are not addressed by the agreements in the first place.<sup>26</sup>

Another differentiating element is an article on *local presence* that is contained in the agreements signed by Chile with Mexico and Canada as well as in NAFTA, the Group of 3 (Colombia, Mexico and Venezuela), Mexico’s bilateral agreements with Bolivia, Costa Rica, and Nicaragua, and the Central American/Dominican Republic

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Providers of securities and asset management services have also been allowed to establish 100% owned subsidiaries in the country (USTR, Foreign Trade Barriers, 2001).

<sup>26</sup> It is reported that there is still no consensus regarding which approach should be adopted in FTAA. Business representatives from the 34 member countries are split over the issue. Some U.S. civil society and labor groups oppose using a negative-list approach because they believe it later may limit public social policies if exceptions for particular sectors are not built into the agreement.

agreement. This article prohibits any party of a given agreement to require a foreign service provider to establish itself locally in order to supply a traded service. This “right of non-establishment” is harmonized within these NAFTA-type agreements.

When dealing with *principles* on trade in services, the agreements signed in the Western Hemisphere are rather homogeneous, and those signed by Chile are no exception. Except for the CARICOM Protocol II, all fourteen sub-regional agreements contain obligations in both Most-Favored-Nation (MFN) treatment and National Treatment. Such uniformity stresses the importance of these two principles in trade in services. Those agreements following the NAFTA model treat them as unconditional principles. One more relevant principle to service trade is *transparency*, which is mentioned in all of the agreements. Such articles require the publication of measures relevant to trade in services, and in some cases the notification of said measures. The NAFTA-type agreements go further, sometimes requiring the notification of changes in existing laws and proposals for such change. In the case of Canada-Chile FTA, both governments agree to monitor the ongoing implementation process and to seek further opportunities for liberalization following implementation (WTO 1997).

The *coverage* of service sectors is also comprehensive in all of the agreements concluded in the Western Hemisphere, containing substantive provisions on trade in services, with very few specific exceptions, although country-specific exceptions can be made for certain service sectors; these exceptions are stated in a list of reservations to a given agreement.<sup>27</sup>

With regard to the rules and disciplines in trade in services, there are also some areas that are uniform in many of the agreements. *Domestic regulation* is one of them; while GATS recognizes the need for WTO members to regulate their services to achieve national objectives, it stipulates that these regulations must be transparent and run with due process. Laws governing services must not be more obstructive to trade than necessary, and members must explain the objectives upon request, allowing trade partners to comment upon them. MERCOSUR follows a similar provision. Neither NAFTA nor the NAFTA-type agreements contain an article on domestic regulation *per se* in their chapter on trade in services. Instead, these agreements contain a version of

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<sup>27</sup> The exceptions are generally confined to air transport services (routing), and services that are carried out in the exercise of government functions on a non-competitive basis.

the GATS provision that is more narrowly focused and applies only to the licensing and certification of professional service suppliers.

The *mutual recognition* of licenses and certificates is also an area of convergence in rules and disciplines, allowing service providers to consider different aspects of allowing other WTO members their accession to the agreements. *Quantitative restrictions* is another, which deals with non-discriminatory measures that, in the case of the NAFTA-type agreements, may be added or removed via negotiations and notifications. None of the agreements contain provisions in *subsidy* disciplines, while all allow member countries to deny the benefits of the agreement to services that are under its juridical power.

The possibility for general *safeguard* action with respect to services is not contained in the trade and integration agreements of the Western Hemisphere, though it is found in the GATS. None of the agreements signed by Chile contain an article on general safeguard action. Some of the other agreements, however, do contain such an article or allow for future regulation to be developed.<sup>28</sup> On the other hand, general provisions on *dispute settlement* for services are contained in all of the agreements. The Chile/Canada agreement contains additional provisions on dispute settlement in the chapter on Temporary Entry of Business Persons.

When viewing all of the sub-regional agreements made in the trade in services, there are also some areas of divergence. However, within the scope of the agreements involving Chile, these areas are consistent, and very often different from the rest of the agreements. Furthermore, these areas tend to be similar to those of NAFTA, which proves the foundational relationship between this agreement and those signed by Chile. They include a “*standard of treatment*” clause that requires members to provide service providers of other member countries the better treatment afforded by the principles of MFN and National Treatment. None of the other agreements deal with such provision.

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<sup>28</sup> However, safeguard action in the case of balance-of-payments difficulties is foreseen in most agreements including NAFTA, the Group of 3, Andean Community and Central America with the Dominican Republic. The bilateral treaties signed by Mexico with Bolivia, Costa Rica and Nicaragua specify that procedures for the establishment of disciplines on safeguards will be developed.

**Table7: Summary of Areas Relevant to Trade in Services**

AGREEMENT	PRINCIPLES				
	MFN Treatment	National Treatment	Transparency	No Local Presence	
<b>Chile-Canada</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	
<b>Chile-Central America</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	
<b>Chile-Mexico</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	
Andean Community	Yes	Yes	Yes	No	
GATS	Yes	Yes	Yes	No	
MERCOSUR	Yes	Yes	Yes	No	
CARICOM	No	Yes	Yes	No	
NAFTA	Yes	Yes	Yes	Yes	
Group of Three	Yes	Yes	Yes	Yes	
Bolivia-Mexico	Yes	Yes	Yes	Yes	
Costa Rica-Mexico	Yes	Yes	Yes	Yes	
Central America-Dom. Republic	Yes	Yes	Yes	Yes	
CARICOM-Dom. Republic	Yes	Yes	Yes	Yes	
Mexico-Nicaragua	Yes	Yes	Yes	Yes	
Mexico-Northern Triangle	Yes	Yes	Yes	Yes	
AGREEMENT	RULES AND DISCIPLINES (AREAS OF CONVERGENCE)				
	Domestic Regulations	Recognition	Quantitative Restrictions	Subsidy Disciplines	Denial of Benefits
<b>Chile-Canada</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>	<b>Yes</b>
<b>Chile-Central America</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>	<b>Yes</b>
<b>Chile-Mexico</b>	<b>Yes</b>	<b>Yes</b>	<b>Yes</b>	<b>No</b>	<b>Yes</b>
Andean Community	Yes	Yes	Yes	No	Yes
GATS	Yes	Yes	Yes	Future	Yes
MERCOSUR	Yes	Yes	Yes	Future	Yes
CARICOM	Yes	Yes	Not Specified	No	Yes
NAFTA	Yes	Yes	Yes	No	Yes
Group of Three	Yes	Yes	Yes	No	Yes
Bolivia-Mexico	Yes	Yes	Yes	No	Yes
Costa Rica-Mexico	Yes	Yes	Yes	No	Yes
Central America-Dom. Republic	Yes	Reference: GATS	Yes	No	Yes
CARICOM-Dom. Republic	Yes	Yes	Yes	No	Yes
Mexico-Nicaragua	Yes	Yes	Yes	No	Yes
Mexico-Northern Triangle	Yes	Yes	Yes	No	Yes
ARGEMENT	RULES AND DISCIPLINES (AREAS OF DIVERGENCE)				
	Standard of Treatment	Treatment of Investment	Monopoly Disciplines	General Safeguards	Modification of Schedules
<b>Chile-Canada</b>	<b>Yes</b>	<b>Separate Chapter</b>	<b>Yes</b>	<b>No</b>	<b>---</b>
<b>Chile-Central America</b>	<b>Yes</b>	<b>Bilateral Agreement</b>	<b>Yes</b>	<b>No</b>	<b>---</b>
<b>Chile-Mexico</b>	<b>Yes</b>	<b>Separate Chapter</b>	<b>Yes</b>	<b>No</b>	<b>---</b>
Andean Community	No	Decisions 439 and 291	Separate Decision	No	---
GATS	No	Within GATS	Yes	Future	Yes
MERCOSUR	No	Separate Protocols	Separate Protocol	No	Yes
CARICOM	No	Within Protocol II	Separate Protocol	Yes	Not Specified
NAFTA	Yes	Separate Chapter	Yes	No	---
Group of Three	No	Separate Chapter	Yes	No	---
Bolivia-Mexico	No	Separate Chapter	No	Future	---
Costa Rica-Mexico	No	Separate Chapter	Future	Future	---
Central America-Dom. Republic	No	Separate Chapter	Yes	Future	---
CARICOM-Dom. Republic	No	Separate Chapter	Yes	No	---
Mexico-Nicaragua	No	Separate Chapter	Future	Future	---
Mexico-Northern Triangle	No	Separate Chapter	No	Future	---

Source: Extracted from Stephenson (2001a), "Multilateral and Regional Services Liberalization by Latin America and the Caribbean", OAS, Washington D.C.

The treaties that Chile has agreed to also consistently set out disciplines on *monopoly* service providers, ensuring that monopoly suppliers do not abuse their position in the market, or perform actions inconsistent with the WTO guidelines assumed by a member. State-owned enterprises are also included in these advanced agreements.

Many agreements have provisions that deal with the relationship between services and investment. While GATS and MERCOSUR include these within the agreement, NAFTA and the NAFTA-type models including the ones involving Chile set out the rules and disciplines in investment in a separate chapter. These provisions allow for the entry of investments from member countries, implementing country-specific exceptions when necessary. The agreement between Chile and Central America has the unique characteristic of bilateralism, containing bilateral investment treaties for between each Central American country and Chile.

### **IV-3. Investment**

The past decade saw a marked increase in bilateral and regional agreements dealing with investment. This increase was accompanied by a strong growth in the flow of portfolio investment and foreign direct investment (FDI), particularly in Latin America and the Caribbean. During the 1990's, FDI inflows to the region increased from US\$ 8.9 billion in 1990 to US\$ 93.5 billion in 1999, an almost 1000 percent jump. In the case of Chile, the FDI flowing into the country sat at US\$ 9 billion in 1999 (see Table 4).<sup>29</sup>

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<sup>29</sup> In Chile, foreign investment can be made through two mechanisms, the Foreign Investment Statute, Decree Law 600, and Chapter XIV of the Compendium of Foreign Exchange Regulations of the Chilean Central Bank. The former establishes a special regime of foreign investment through which the investor opts to submit a foreign investment application and after the authorization of investment enter into contract with the Chilean State under the provisions of Decree Law 600, which grants special conditions for the investor, such as the right to transfer their capital and the net profits repatriation to other countries, the guarantee of non discrimination against the foreign investments and the companies participating therein and tax stability. The latter, on the other hand, establishes a general mechanism of registration of foreign investment and loans. This allows the free entry, use and exit of investment flows which only consist of freely convertible foreign exchange. The Central Bank may not screen or otherwise reject the foreign investment. In addition, there has been a substantial amount of foreign investment inflow through the modality of American Depository Receipts (ADRs), which amounted to US\$ 10,263 million during 1990 and June 2001, in comparison to US\$ 41,825 million and US\$ 5,110 million under DL 600 and Chapter XIV, respectively, in the same period ([www.foreigninvestment.cl](http://www.foreigninvestment.cl)).

Throughout the decade, more than seventy bilateral investment treaties (BITs) have been signed within the hemisphere. While most of these agreements deal with standards of treatment of investment and investors, the laws and regulations of the host state regarding the admission of investments, and dispute settling mechanisms, several agreements go beyond this scope by including a right of establishment and a list of reservations. This is in contrast to a general exception, which deals with entire sets of obligations instead of being a country-specific list. NAFTA and the Group of 3 FTA follow this new approach, as do a handful of bilateral agreements. The Chile-Mexico and Chile-Canada FTAs are part of this handful, allowing the agreements to incorporate a market access component to the protection element. These agreements do not attract investment on their own, but instead complement the determinants of FDI flows.

During the 1990s, Chile has negotiated a large number of BITs that are officially called Investment Promotion and Protection Agreements (IPPAs) and/or Agreements on Double Taxation with almost all countries in the Western Hemisphere (Table 8). The country is also currently negotiating or has negotiated IPPAs with a large number of countries in other parts of the world including the APEC economies. With respect to APEC, IPPAs with Australia, China, Republic of Korea, Malaysia, and the Philippines have been in force, while the ones with Indonesia, New Zealand, and Vietnam are awaiting ratification. Those under negotiation are Singapore, Thailand and Russia (APEC 2001). Japan has not entered into a BIT with Chile. In the case of Mexico and Canada, Investment Chapter of the Free Trade Agreement guarantees those rights and stipulates corresponding obligations. In recent years, Chile has implemented an active policy in Double Taxation Treaties, signing agreements with some APEC's economies, among others, Mexico, Canada and Peru.

The principles that have led the development of Chile's investment regime in the 1990s are said to be the following: i) National Treatment; ii) MFN; iii) no performance requirement; iv) no restrictions on the appointment of senior management and directors; and v) a possibility of resolving disputes by international arbitration. Those remaining measures which may still restrict such general principles are found in the sectors or sub-sectors of privatization, aboriginal affairs, oceanfront land ownership, telecommunications, transport networks and services, radio communication and submarine cables, fisheries, government services (APEC 2001). Several additional



issues are incorporated in some of the agreements that deal with newly discussed components of trade. For example, there are provisions in the Chile-Canada FTA that prevent investment activity from harming domestic health, safety, and environmental concerns.

A key characteristic of a BIT is its definition of investment, which makes up its substantive scope. Most agreements involving the countries in the hemisphere adopt a “broad, open-ended, asset-based” definition of investment.<sup>30</sup> For instance, in the Chile-Canada and Chile-Mexico agreements, the definition encompasses portfolio as well as direct investment, including loans to enterprises. However, some agreements try to avoid specific monetary and speculative flows that are not related to investments. The Chile-Canada FTA is one of them, excluding “real estate or other property, tangible or intangible, not acquired in the expectation or used for the purpose of economic benefit or other business purposes.” (Robert 2001).<sup>31</sup> As for which investors are covered by an agreement, both bilateral FTAs signed by Chile consider the place of incorporation of a company to determine its nationality, as do NAFTA and the Group of 3. Other agreements use the location of the management or seat of the company, or the nationality of the people controlling the company, as the criteria for investor coverage.

When it comes to general standards of treatment, almost all the agreements incorporate provisions on fair and equitable treatment. Such standard is unrelated to the domestic laws of member countries, and is usually combined with the principle of full protection and security or that of nondiscrimination. The Chile-Canada FTA provides for disciplines on non-discriminatory treatment through national treatment and MFN clauses. In addition, this FTA carefully limits the conditions for expropriation and guarantees investors of both parties fair and adequate compensation if an expropriation were ever to occur; it insures that the interests of investors are protected when a host country expropriates their investment. It also allows investors to take advantage of

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<sup>30</sup> There are some exceptions to this rule; for instance, CARICOM’s Protocol II does not define investment, while Decision 291 of the Andean Community covers only foreign direct investment.

<sup>31</sup> One of the difficult areas in negotiation relating to the definition of investment between Chile and Canada was the encaje policy of Chile. This policy required that a certain percentage of foreign loan funds must be placed in non-interest-bearing account at the Central Bank of Chile for one year. This policy also applied to foreign borrowings by Chilean funds. The Chilean authorities argued that the objective of this policy was to regulate speculative capital inflows. Other countries including Canada, however, argued that this raised total cost of business and could discourage foreign direct investment. The deposit requirement was reduced from 30% to 10% in June 1998 and to zero two months later. The encaje system was later abandoned in 2001.

investor-state dispute settlement provisions that offer access to expedient international arbitration procedures.<sup>32</sup>

**Table 8: Chile's Bilateral Investment Treaties**

(as of September 2001)

<b>Latin America</b>		<b>Europe</b>	
Argentina	In Force since February 27, 1995*	Austria	In Force since November 17, 2000
Bolivia	In Force since July 21, 1999	Belgium	In Force since August 5, 1999
Brazil	Approved by Congress on December 14, 1994	Croatia	In Force since July 31, 1996
Colombia	Signed on January 25, 2000	Czech Republic	In Force since December 2, 1996
Costa Rica	Signed on July 11, 1996	Denmark	In Force since November 30, 1995
Cuba	In force since September 30, 2000	Finland	In Force since June 14, 1996
Ecuador	In Force since February 21, 1996	France	In Force since December 5, 1994
El Salvador	In Force since November 18, 1999	Germany	In Force since June 18, 1999
Dominican Republic	Signed on November 28, 2000	Greece	Signed on July 10, 1996
Guatemala	Approved by Congress on September, 2001	Hungary	Signed on March 10, 1997
Honduras	Approved by Congress on September, 2001	Italy	In Force since June 23, 1995
Nicaragua	Approved by Congress on September, 2001	The Netherlands	Signed on November 30, 1998
Panama	In Force since December 21, 1999	Norway	In Force since November 4, 1994
Paraguay	In Force since September 16, 1997	Poland	In Force since September 9, 2000
Peru	In force since August 11, 2001	Portugal	In Force since February 24, 1998
Uruguay	In Force since April 22, 1999	Romania	In Force since August 27, 1997
Venezuela	In Force since May 17, 1994	Spain	In Force since April 27, 1994
		Sweden	In Force since February 13, 1996
		Switzerland	Signed on September 24, 1999
		Turkey	Signed on August 21, 1998
		Ukraine	In Force since August 29, 1997
		United Kingdom	In Force since June 23, 1997
<b>Asia, Pacific Islands and the Middle East</b>		<b>Africa</b>	
Australia	In Force since November 18, 1999	South Africa	Signed on November 11, 1998
China	In Force since October 14, 1995	Egypt	Signed on August 5, 1999
Indonesia	Signed on April 7, 1999	Tunisia	Signed on October 23, 1998
Korea, Rep.	In Force since November 18, 1999		
Lebanon	Signed on October 13, 1999		
Malaysia	In Force since August 4, 1995		
New Zealand	Signed on July 22, 1999		
Philippines	In Force since November 6, 1997		
Vietnam	Signed on September 16, 1999		

Source: Chilean Foreign Investment Committee ([www.foreigninvestment.cl](http://www.foreigninvestment.cl)).

\*Signed treaties need to be ratified by Congress before they can be in force. Treaties are in force in Chile after they are published in the Government's Official Registry of laws and decrees.

<sup>32</sup> The most controversial arrangement of this type is Chapter 11 of NAFTA (more details see Chapter IV of this paper). This chapter provides a broad set of investor protection and investment liberalization rights to foreign investors, and obligations for governments. It contains an investor-state dispute settlement process, which has been strongly criticized by civil society groups. The investor-state arbitration process is initiated directly by the foreign investor against the host government, with little information and transparency provided to the public (IISD and WWF, 2001). The results of the process are binding on both participants, and there are limited opportunities to appeal or review a decision. As of April 2001, there were 17 such cases that have been initiated.

As mentioned earlier, the Chile-Canada and Chile-Mexico agreements add a right of “establishment” factor to this standard, and they require national treatment and MFN treatment. Most NAFTA-type agreements grant investments and investors the better of national and MFN treatment.<sup>33</sup> Most agreements also contain exceptions to the rule, such as treatment at federal and sub-federal levels in NAFTA. The Chile-Canada and Chile-Mexico agreements likewise have a general exception for taxation treaties, which covers not only the investment chapter but also the entire agreement (Robert 2001).

In addition, the NAFTA-type agreements prohibit performance requirements for both goods and services. Most bilateral agreements, however, do not address the issue. Once again, the Chile-Canada and Chile-Mexico agreements are special in that they prohibit requirements in levels of local content, purchase of local goods and services, foreign exchange balancing, domestic sales, export percentages, technology transfer, and supplier exclusivity as conditions for “establishment, acquisition, expansion, management, conduct, or operation of a covered investment.” Some of these areas are also prohibited from subsidies or investments.

The general dispute settlement mechanisms present in the FTAs signed in the region are also used to solve investment disputes between member countries. However, in those cases when an investment instrument is used, there usually exists a reference to a specific institutional arbitration mechanism, be it under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) or the United Nations Commission on International Trade Law (UNCITRAL). In any case, most agreements urge investors and host countries to solve the dispute by themselves via consultations and negotiations. They may require a certain elapsed period before the dispute can be brought to arbitration, or allow the investor to bring disputes to local courts of the host state. In Chile’s investment agreements, the foreign investor is guaranteed of the right to submit a claim before the local courts or before international tribunals, the latter being ICSID or UNCITRAL.

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<sup>33</sup> In contrast, The Andean Community and CARICOM do not include an MFN provision.

#### **IV-4. Rules of Origin (RO)**

Chile does not apply non-preferential rules of origin but its network of rules of origin (RO) schemes is complex. Chile is a signatory to ALADI since 1981, and applies the specific scheme of origin contained in Resolution 78. Bilateral agreements signed afterwards by Chile are in accordance with this resolution, including ECAs with Colombia, Venezuela, Ecuador and Peru. An association trade agreement with MERCOSUR, effective as of October 1, 1996, contains a special set of RO. Both the FTAs with Canada (1997) and Mexico (1998) contain a set of specific RO.

More specifically, the RO requirements of the ALADI outlined in Resolution 78 are relatively simple and their applications in distinct agreements signed within the ALADI framework introduce uniformity (Jara 2001). Generally, in order for any good to enjoy any ALADI preferential tariff arrangement, the product must either originate or be made with inputs that originate within the territory of the signatory countries. A good that has foreign inputs will be also accorded preferential treatment if it is sufficiently transformed within the territory of a member country so as to achieve a new tariff classification heading under the ALADI's harmonized tariff schedule (NALDISA). When a new tariff heading classification is not achieved, the good will still receive preferential tariff treatment if the total CIF value of the foreign inputs does not represent 50% of the FOB price of the final product (Resolution 78, Annexes 1 and 2).

Meanwhile, the RO requirements between Chile and MERCOSUR are more detailed than those found in ALADI or even in the MERCOSUR agreement itself (Title III, Article 13, Annex 13), because mainly of Chile's association, not a full membership, in MERCOSUR. This means that Chile does not observe MERCOSUR's Common External Tariff (CET) system but applies its own duties on all goods coming from the outside world, which in most cases are lower than those applied by MERCOSUR. This associate membership, in turn, calls for a RO scheme that prohibits third parties to use Chile as a conduit for getting their foreign products into MERCOSUR and avoid paying the higher MERCOSUR CET.

Under these RO provisions, goods that are made wholly from products native to Chile or MERCOSUR enjoy intraregional free trade treatment. Those goods that do not originate in Chile or MERCOSUR and have not undergone a substantial transformation within the region with a new classification under NALDISA may still qualify for the

benefits, though no more than 40% of the FOB value of the final product can reflect the CIF value of non-regional inputs.

The RO requirements in the Chile/Canada agreement (under Chapter D and Annex D-01) includes a liberal 35% regional content requirement when the transaction value method is employed, or 25% when the net cost method is used for a large number of manufactured goods for a duty-free treatment between the two countries. Therefore, the ROs in the agreement with Canada are more flexible for all products except in agriculture, textiles, clothing, footwear, and plastics and chemicals. The rules stipulate also *de minimis* exceptions.<sup>34</sup> The RO for these exempt products have been relaxed on a transitional basis. Flexibility is added to the rules of origin by allowing change of tariff classification at the sub-tariff level and by reducing the value of regional content. In comparison, the minimal regional content requirements in the NAFTA are either 60% or 50% respectively. The RO requirements in the Chile-Mexico agreement (under Chapter 4, Annex 4-03) are similar to those of NAFTA, and incorporate the concepts of transaction value (50%) and net cost methodologies (40%) in determining the regional content requirement of goods, as well as *de minimis* exceptions. In this FTA, the *minimis* threshold is 8%, instead of the 9% level in the Chile/Canada FTA. Both agreements have special provisions for the automotive sector.

In sum, in the old agreements signed by the countries in the hemisphere, mostly under the ALADI framework, there is a general rule applied across-the-board based on a change in tariff classification at the heading level or, alternatively, a regional value-added rule of at least 50% of the FOB export value. However, in the new generation agreements, mostly those that follow the NAFTA model of RO, these general rules are accompanied by additional product-specific rules negotiated at the 6-digit level of the Harmonized System. The regional content provisions in the Chilean FTAs with Mexico and Canada are, however, less stringent than those of NAFTA. The RO rules governing the MERCOSUR and MERCOSUR bilateral agreements with its associate members

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<sup>34</sup> Under the *minimis* provisions, a good shall be considered to be an originating good if the value of all non-originating materials used in the production of the good that do not undergo an applicable change in tariff classification is not more than 9% of the transaction value of the good, adjusted to a F.O.B. basis, or, if the transaction value of the good is unacceptable under Article 1 of the Customs Valuation Code, the value of all such non-originating materials is not more than 9 % of the total cost of the good. However, these provisions do not apply to all product groups.

(i.e., Chile and Bolivia), as well as the Central American Common Market's ROs, can be considered intermediate models between the above-mentioned two models.

The proliferation of complex ROs could be considered as a step backwards from the simpler arrangements which are common in the ALADI agreements (Devlin and Estevadeordal, 2001). The diversity of RO in the agreements concluded by Chile can be an obstacle to their coherent application and the optimum choice of suppliers. The Chilean authorities are aware of this risk, and for this reason they have endeavored to ensure that rules of origin are as uniform as specific as possible.

#### **IV-5. Antidumping and Safeguards**

The regulations governing the rules and procedures in antidumping and countervailing cases in Chile are the WTO Agreements<sup>35</sup> and Law 19,612 and its Regulation Decree No. 575. These measures can only be imposed for one year. In 1999 the Congress approved Law 19,612 that modifies a previous one (Law 18,525), allowing the country to impose safeguard measures according to Article XIX of GATT. It could be used if a specific product is being imported in such increased quantities and conditions as to cause or threaten to cause "serious damage" to the domestic industry. Safeguards shall be applied for one year, renewable only for one additional year. This law is not only in compliance with the Agreement on Safeguards of the WTO and does not use all the provisions contemplated by this organization (APEC 2001: 84), but is also more exigent in that the WTO safeguards are permitted for a period of four years and are renewable for an additional four years.

The tariff surcharges mentioned in Law 18,525 can be applied when there is a complaint that growing imports with distorted prices are affecting domestic production and causing serious injury. This measure too could only be imposed for one year, the surcharge plus the applied tariff cannot exceed the bound tariff rates, and it is applied on an MFN basis. This surcharge does not constitute a safeguard in the sense of Article XIX of GATT 1994, since it cannot exceed the bound rate (WTO 1997: 23).

Antidumping investigation cases affecting countries of the Western Hemisphere are many. The United States and Brazil are the leading targets of these investigations in

the region, accounting for 63% of the cases initiated against FTAA countries between 1987 and the first semester of 2000. The countries in a second tier were Argentina, Canada, Mexico and Venezuela (about 30% of the cases), followed by other 12 countries (share of 7%). The distribution by users of antidumping had a similar profile. During the period, Chile initiated 5 cases against FTAA countries (in comparison to 7 cases with the rest of the world), while the country was the target of 16 cases initiated by FTAA countries (none from the rest of the world) (Tavares, Macario and Steinfatt 2001).

Most regional agreements in the Western Hemisphere allow the use of antidumping measures among their members according to WTO rules. Chapter Nineteen of NAFTA contains a dispute settlement mechanism on antidumping and countervailing duties, providing for binding binational panel reviews of cases for goods of member countries and changes to existing laws of the parties. In the case of CARICOM, for example, these rules have been explicitly included in the Protocol VIII that was signed in March 2000. The member countries of MERCOSUR are expected eventually to eliminate antidumping.

At the world level, there are only four regional trade agreements in which the member countries have abolished antidumping measures among themselves and the Canada-Chile FTA (1996) is one of them.<sup>35</sup> For each good, the anti-dumping exemption comes in effect when the tariffs on that good have reached zero in both countries, or after six years, whichever is earlier. This initiative might have resulted from a high possibility that implementing an EU-style elimination of safety valves would be costly for partners such as Canada and Chile which still have a low level of economic integration; the bilateral trade flows represent roughly 1.5% for Chile and less than 0.1% for Canada. “The experience of particular integration agreements, including the free trade area between Canada and Chile (and possibly that between Chile and Mexico) with the replacement of safeguards for antidumping might provide further insights into additional parameters that might be needed to be taken into account when balancing the

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<sup>35</sup> They are: the Agreement on Implementation of Article VI of the GATT 1994, the Agreement on Subsidies and Countervailing Duties, Article VI of GATT 1994, and the WTO Agriculture Agreement.

<sup>36</sup> The other three agreements are: the European Union (EU), the European Economic Area (EEA), that came into force in 1994 by the treaty signed between EU and the European Free Trade Association (EFTA), and the Closer Economic Relations Agreement (CER) between Australia and New Zealand.

costs and benefits of different institutional alternatives to protect domestic producers from import competition” (Tavares, Macario and Steinfatt 2001: 30).

The elimination of antidumping is replaced by a special transitional safeguard. Chapter F (Article F-02) of the Canada-Chile agreement provides special rules for safeguard actions during the transition period and states that “each Party retains its rights and obligations under Article XIX of the GATT 1994 and the Agreement on Safeguards of the WTO Agreement except those regarding compensation or retaliation and exclusion from an action to the extent that such rights or obligations are inconsistent with this Article”. The FTA with Mexico and the ECA with Peru also stipulate conditions that limit the use of global safeguards of the WTO for reciprocal trade. The ECA agreements with Venezuela, Bolivia, Ecuador, and Cuba have dispositions on safeguards that are based on the ALADI rules. A safeguard regime was also adopted with MERCOSUR in 1999.

It is interesting to note that Chile/Mexico FTA in Article 20-08 (b) stipulates that both countries would start, within one year after its entry in effect, negotiations on reciprocal elimination of antidumping rights, as is practiced in Chile/Canada agreement. In the case of Chile’s FTA with Central America, antidumping and unfair trade practices do not have specific provisions. While it confirms the rights and obligations in conformity with the WTO norms, the agreement only specifies that the member countries are committed to promote reforms in the framework of WTO or FTAA so that these measures would not become hidden trade barriers, and that the member countries will establish a work program on this area two years after the entry in effect of the FTA. In contrast, the agreement provides detailed provisions on safeguards, bilateral and global. This absence of antidumping rules can be also interpreted another manifestation of the Chilean authorities’ desire to deal with the issue of antidumping more decisively in the WTO framework.

#### **IV-6. Standards and Conformance**

In order to guarantee free flows of goods and services and to give non-discriminatory treatment between national and foreign products, as well as to use international standards, most agreements include standards, technical regulations and conformity assessment procedures. Chile’s policy on this are based on: i) non-interference with the



free operation of markets and freedom of trade; ii) non-discriminatory treatment between domestic and foreign products and between foreign products; iii) the use of international standards as a basis for national standards, when possible; and iv) transparency (APEC 2001). Chile has 2,265 voluntary standards, 76% of which are based on international standards.<sup>37</sup>

There are two approaches to categorizing the treatment of standards in the Western Hemisphere. There is the objective of *harmonization* on the one hand, and the objective of *compatibility* on the other. Harmonization requires the countries in question to have identical policies, as well as common physical standards and technical regulations. Also, it requires a permanent institutional mechanism to oversee the coordination of such standards. Compatibility is a different approach in that all it requires is that the standards used by member countries do not create barriers to trade. Such goal can be achieved by making the standards more identical, by promoting the integrity of the interfaces, or recognizing their equivalency. Such recognition in trade qualifications allows the countries to use the traded goods and services in similar ways.

In general, those integration arrangements present in customs unions set out harmonization as their overriding policy objective, while those integration arrangements found in FTAs emphasize a compatibility approach (see Table 9). This contrast can be seen, for instance, between MERCOSUR, which declares a commitment to gradually harmonize existing national standards, and NAFTA, which mandates its members to “make compatible of a specific standard or conformity assessment procedure” ([www.sice.oas.org/standards](http://www.sice.oas.org/standards)).

Although all of the bilateral FTAs of the hemisphere explicitly consider standards in their provisions, they can be broken into two groups: The first consists of five ECAs signed by Chile with Mexico (1992), Bolivia, Venezuela, Colombia and Ecuador, which do not contain explicit disciplines on standards but rather a general article or chapter promoting economic cooperation in this area (Stephenson 1998). The agreements with Colombia and Ecuador, however, go further to admonish the member

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<sup>37</sup> The preparation of standards is carried out in accordance with the Code of Good Practice of the TBT Agreement criteria. Once standards have been approved by the National Standardization Institute (INN) Council, they are usually given official status, though remaining voluntary, by the relevant Ministry by means of Decrees or Resolutions. INN standards are usually based on international standards such as ISO (International Organization for Standardization), IEC (International Electrotechnical Commission) and

countries to follow the principles of the MFN treatment, notification and exchange of information, and to utilize international standards when elaborating national ones (see Table 9). Furthermore, these two treaties set out the goal of trying to achieve compatibility as between parties on standards, and to seek mutual recognition of their certification system and laboratory testing results.<sup>38</sup>

The second category of agreements consists of the two signed by Mexico, with Bolivia and Costa Rica. In these agreements, the parties reaffirm their rights and obligations under the TBT Agreement of the WTO, such as MFN treatment, national treatment, transparency and notification, establishment of enquiry points, and use of international standards. The stated policy objective in these two agreements is to bring about compatibility. Similar to the NAFTA approach, the benefits of mutual recognition of conformity assessment systems and procedures are recognized, while conformity assessment bodies are to be accredited or recognized on equally favorable terms (Stephenson 1998).

With respect to Chile, a compatibility approach has been present also with MERCOSUR. The agreement confirms the rights and obligations under the TBT Agreement, though it does not contain detailed provisions on standards. The parties strive for compatibility in the area of standards. The less ambitious nature of commitments can be explained by the fact that as an associate member of MERCOSUR, Chile tries to retain relative sovereignty on the matter of standards. The Chile-Mexico agreement is guided by provisions and disciplines in Chapter 8 of the FTA that are similar to those of the WTO TBT Agreement.

In some cases, Chile's commitments include disciplines that extend beyond TBT Agreement provisions in areas such as transparency, equivalence, mutual recognition, and risk assessment. In addition, Chile's FTAs with Canada and Mexico include provisions on technical norms in the telecommunication sector.<sup>39</sup>

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CODEX. For example, the INN participates as a member in eight ISO Technical Committees and as an observer in 135 ISO of these committees.

<sup>38</sup> Standards and technical regulations set out specific characteristics of a product - such as its size, shape, design, functions and performance, or the way it is labeled or packaged. The difference between a standard and a technical regulation lies in compliance. While conformity with standards is voluntary, technical regulations are by nature mandatory. Conformity assessment procedures are technical procedures - such as testing, verification, inspection and certification - which confirm that products fulfil the requirements laid down in regulations and standards.

<sup>39</sup> Standards-related measures relate to attachment of terminal or other equipment to public telecommunications transport networks.

**Table 9: Comparison of Policy Objectives Towards Standards in the Western Hemisphere**

	Standards	Technical Regulations	Conformity Assessment Procedures	Certification
Andean Group	Harmonize	Harmonize	Follow International Guidelines	Harmonize Criteria for Certification
MERCOSUR	Harmonize <sup>a</sup>	Harmonize	--	--
CACM	Harmonize	--	--	--
CARICOM	Harmonize	--	--	--
NAFTA	Promote Compatibility	Make Compatible	Make Compatible Seek Mutual Recognition	Seek to Approve or Grant Licenses on Equal Terms
Group of Three	Promote Compatibility	Make Compatible	Make Compatible Seek Mutual Recognition	Seek to Approve or Grant Licenses on Equal Terms
Mexico-Bolivia	Promote Compatibility	Make Compatible	Make Compatible Seek Mutual Recognition	Seek to Approve or Grant Licenses on Equal Terms
Mexico-Costa Rica	Make Compatible	Make Compatible	Make Compatible Seek Mutual Recognition	Seek to Approve or Grant Licenses on Equal Terms
Chile-Colombia	Promote Compatibility	--	Seek Mutual Recognition	Seek Mutual Recognition
Chile-Ecuador	Promote Compatibility	--	Seek Mutual Recognition	Seek Mutual Recognition
Chile-MERCOSUR	Identify Areas for Compatibility	Identify Areas for Compatibility	Seek Mutual Recognition	--

Source: Organization of American States, 1998

<sup>a</sup> These objectives are not explicitly set out in the MERCOSUR Treaty but are followed in practice

Chile and MERCOSUR have also established a Working Group on Technical Regulations in three sectors: pharmaceuticals, cosmetics, and foods. In the negotiations of an FTA with Central America, a special chapter on this subject was also included. Ongoing negotiations of an FTA with the United States, the European Union and the EFTA also contemplate this topic to be included (APEC 2001). In this way, “a common multilateral basis is being reinforced in subregional arrangements, which would seem to make the adoption of such disciplines by the FTAA an easy matter” (Stephenson 1998).

## V. Chile and the United States FTA

As mentioned, earlier, the strategy of multiple FTAs involves benefits and costs. The costs and needs of coordination associated with the myriad of FTAs, however, can be lessened when they are structured in a similar manner. In practice, this has been

happening as trade partners also apply the multilateral commitments. Meanwhile, the Chilean government seeks to incorporate elements of the NAFTA model, particularly those related to services and investment, into the forthcoming Chile/US FTA as a further step of consolidation of the NAFTA model.

### **V-1. The Implication of Chile/US FTA for the Free Trade of the Americas (FTAA)**

The imminent Chile/US FTA is widely viewed as a model case for the FTAA. As the USTR (2001) suggests, this FTA demonstrates the commitment of the United States to free trade throughout the Western Hemisphere and sets the stage for further trade liberalization in the region. Conversely, the FTAA is likely to bring with it a convergence process among various FTAs that exist in the hemisphere under the NAFTA model (Sáez 2001). From this perspective, Chile is already anticipating the task of normative harmonization in the FTAA. More importantly, the Chilean government believes that the Chile-United States agreement could provide an impetus to the FTAA negotiations since the country's objectives insofar as FTAA and the United States are concerned are similar: to open up markets, establish trade and investment norms and regulations, and implement an efficient and practical conflict-resolution mechanism ([www.direcon.cl/usaantec2.htm](http://www.direcon.cl/usaantec2.htm)).

Despite the adoption by both countries of the NAFTA as a prototype of negotiations, each country obviously tries to conserve and protect national interests. The ongoing negotiation process examined in this chapter highlights the difficulties encountered and conflictive areas. Though market access problems in the traditional sense still remain important, issues of "new" and "deep" regionalism are increasingly becoming key elements of negotiation.

### **V-2. Negotiation Process and Problem Areas**

Chile and the United States initiated negotiations for an FTA in December 6, 2000. Since that date, ten rounds of negotiation have taken place. The negotiations are expected to conclude in the mid 2002. The economic implications of the FTA for Chile are obvious because the United States is Chile's top trading partner, though Chile is

currently ranked 32<sup>nd</sup> in the US imports. Strong interests on the part of the United States reflect their desire to use this agreement as a platform to consolidate the NAFTA process within the hemisphere as in the form of FTAA.

The complexity and the degree of comprehensiveness of ensuing negotiations can be appreciated by looking at what issues are being negotiated between the world economic giant and a small but emerging economy. In the sphere of trade of goods, market access, rules of origin and customs procedures are the major issues. In the area of trade remedies, safeguards, anti-dumping and compensatory rights are being negotiated. Sanitary and phytosanitary issues, technical specifications and standards, are the major negotiation areas with respect to norms and standards. In trade in services and investment, practically all areas are covered including the treatment of transport, telecommunications, advertising and consulting services. It is important to note that financial services as well as electronic commerce, and business visas are being separately discussed/negotiated. Other trade-related issues cover competition policy, intellectual property rights, and government procurement. As a comprehensive FTA, institutional aspects such as transparency and dispute settlement are also included. Furthermore, labor and environmental issues are also addressed. While all the above-mentioned standards and disciplines should be consistent with those of the WTO, the Chilean government aspires to go much further. "One of the merits of a bilateral agreement is that it allows for a much more in-depth analysis of certain topics than is possible in a scenario in which there are more than 140 members, such as the WTO" ([www.direcon.cl/usaantec.2htm](http://www.direcon.cl/usaantec.2htm)).

In spite of many rounds of negotiations, both countries are still at odds over the extent of the initial tariff cut.<sup>40</sup> Chile has argued for an ambitious schedule that would cut tariffs to zero on 85% of trade as soon as the FTA goes into effect. Under the Chilean plan, tariffs on the remaining 15% would be phased out over five or ten years.

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<sup>40</sup> The original proposal of the United States was to immediately eliminate US tariffs on two-thirds of imported Chilean products as soon as the FTA takes effect. On the other hand, the Chilean officials argue that this proposal is not sufficient; this is slightly more than the volume of Chilean products that already enter the US market duty-free under the unilateral tariff preferences or the MFN rate. The U.S. proposal divided the remaining third of Chilean exports to the U.S. into three baskets: one which contains goods eligible for a short-term tariff phase-out; another that would be eligible for a long-term tariff phase-out; and a third which would consist of sensitive products for which tariff reduction has yet to be decided. In contrast, Chile offered a proposal with three groups that would benefit from immediate phase-out, five and ten year phase-outs, and a group of sensitive products that would be to be decided. The majority of items that the United States placed for

On the other hand, the United States envisages a much more modest schedule, with an immediate zero tariff applied to just over half of trade. The United States is not necessarily advocating or excluding a phase-in that is longer than ten years.<sup>41</sup> Although the two sides seem to have settled for three tariff phase-out phases “immediately” upon agreement, after four and eight years, they will yet have to divide products among those “baskets”. More importantly, negotiators have yet to decide how to deal with products in a “fourth basket”, which on the U.S. side includes key Chilean agricultural products sensitive for U.S. producers (Inside U.S. Trade 2001c; 2001d; 2001k; 2001f).<sup>42</sup>

Agriculture is a sensitive area for both countries. Chile is known to have assumed the position that it will not insist on U.S. elimination of domestic support as part of the agreement, but that it pushes for a deal to enable it to maintain the price-band system of tariffs on some of its own sensitive agricultural commodities, including sugar, vegetable oil, and wheat (Inside U.S. Trade 2001d). Removal of the price band is a top priority for many U.S. agricultural groups, who are pressing the issue more as a precedent for other agreements, such as the FTAA, than for its actual market access (Inside U.S. Trade 2002). Both countries will likely explore transitional tariff-quotas based on the model of NAFTA for certain agricultural products. Under NAFTA, the sugar tariff-rate quota establishes a quota for duty-free access with built-in progressive reductions for the over-quota tariff. The foregoing is a good example of potential benefits of a bilateral FTA in which a particular concern of a small country (Chile’s price-band scheme) can be crossed against another concern of a larger trade partner (domestic support program of the United States). This kind of give/and take situation is most unlikely to happen in a multilateral negotiation forum.

In the area of investment, both parties have not reached an agreement on the extent to which the U.S.-Chile FTA should reflect broad investor protections that are included in the NAFTA. Business groups in the United States call for investment provisions modeled after the NAFTA (specifically provisions under Chapter 11) to be included in the FTAA and bilateral agreements with Chile and Singapore. The major

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immediate tariff elimination are already at zero tariff, which means that the U.S. basket would add actually as little as 2% of current trade to that category.

<sup>41</sup> In the NAFTA, the most sensitive category has a fifteen year phase-out period, in addition to the “immediate” “five” and “ten” year categories.

<sup>42</sup> The U.S. proposal was reportedly to have included some key Chilean exports like wine and salmon on the U.S. “sensitive” list.

issues include guarantees of non-discriminatory and fair and equitable treatment, protections against government actions that amount to expropriation of investment, and provisions allowing investors to sue host governments for damages at arbitration panels. U.S. environmental, labor and consumer NGOs are concerned that investment rules could undermine a government's ability to act in the public interest. Their biggest concern is over the prospect that private investors would be given direct access to investor-state dispute settlement to challenge government non-compliance with FTAs. Governments can be required to pay the investor monetary damages if the investor's complaint is upheld in an arbitration panel (U.S. Inside Trade 2001a; 2001j).<sup>43</sup> The Bush administration will have to formulate a position on this issue if it wants to put forward modified NAFTA investment-language in the U.S.-Chile FTA.

It seems that in the negotiations to date the United States is advocating a "product-specific" approach to preferential rules of origin in the FTAA, the Chile FTA and the Singapore FTA. This approach requires negotiators to establish for each product or product sector, the degree of working or processing necessary within the parties of the agreement to transform non-originating component materials into originating goods eligible for preferential tariff treatment. As discussed earlier, the NAFTA predominantly adopts a product specific "tariff shift" approach, whereby the degree of working or processing is represented by a specified change in HS system tariff classification for each product or sector. This approach is contrasted with rules of origin based on a single generally applicable rule, such as a single uniformly applied "tariff shift" standard or a "regional value contest" test that has been applied by Chile as in MERCOSUR. The United States thinks that the former approach not only provides more certainty and transparency, but also compensates for a deficiency of the HS tariff nomenclature in which a shift does not necessarily reflect a particular transformation for a product (USTR, Federal Register; May 4, 2001).

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<sup>43</sup> The longstanding effort of Canada and Mexico to clarify Chapter 11 not only calls for a more transparent arbitration process, but also to seek to limit how expropriation prohibitions and guarantees of fair and equitable treatment can be used to limit governments' legitimate regulatory authority, especially on environmental matters. The Canadian authorities, for example, have argued that expropriation of investment, which requires compensation, is different from interference with an investment, which does not. Furthermore, Canada argues that the obligations of Chapter 11 should in no way be read to unduly restrict the governments' ability to legislate for the public good, for instance, where the environment or the health of their citizens are involved.

Regarding services, the U.S. and Chile are reported to have agreed to a negative list approach<sup>44</sup> and the two sides have exchanged a list of reservations of service sectors that they do not want to liberalize through the FTA process. Negotiations include financial services and temporary entry of services personnel. In the former, which is a “sensitive” area, one of the most difficult areas so far has been insurance and asset-management for Chile’s privatized pension system. It has been reported that the U.S. mutual fund firms and other financial companies are seeking to compete with Chilean firms in handling pension investments and wish to phase out all restrictions on where these funds can be invested. American firms want the Chilean rules changed so that Chileans will have the choice to select an American firm to handle the voluntary part of the investments (savings of additional funds). In addition, they desire to be able to be hired by AFPs (Pension Fund Administrators) to administer individual accounts in the mandatory portion (i.e., a mandatory savings program through employers that is administered by private Chilean financial firms). Currently, only 20% of the funds in the mandatory system can be invested abroad. On insurance business, U.S. firms are interested in being able to operate as branches, where Chile currently allows only operation through wholly owned subsidiaries or in joint venture with Chilean partners. In addition, American firms are pushing Chile to adopt “best practices” in regulating insurance to ensure transparency and speed up the introduction of new products into the market (Inside U.S. Trade 2001i).

The United States government is reportedly resisting Chile’s demand for expedited temporary entry for services personnel because this deal would set a precedent for regional Latin American agreements. Though it is certain that the United States seeks to have Chile as a model for other countries’ trade liberalization in many service sectors, it would not like to accede to Chile’s request for liberalization in the cross-border movement of services personnel, fearing that it could serve as a precedent for the FTAA (Inside U.S. Trade 2002). Chile presses for the same treatment provided in the Chile/Canada agreement, that calls for expedited visa procedures for personnel in specified services without work authorization.

The U.S. telecommunications industry is also pushing for the Chile/U.S. FTA to

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<sup>44</sup> The United States advocates the negative-list approach in FTAs, arguing that though it is ambitious, it provides countries with flexibility to deal with domestic sensitivities by scheduling reservations.



serve as model and incorporate WTO-plus commitments. The United States wants Chile to accept procedures that make it easier for competing telcom firms to tap into existing lines or lease them. In addition, the United States also wants Chile to commit to private ownership of the telecommunications industry. Although the Chilean industry is already privatized, the agreement would serve as a template for other countries, which still maintain government control over basic telephone service. In the express delivery service industry, the United States is pushing for text that will prevent the Chilean postal service from subsidizing competitive express delivery service in Chile or giving such a service other unfair advantages, although the Chilean postal service does not at present have an express delivery service. This U.S. interest originates from the desire to press for similar language with other countries in the FTAA (Inside U.S. Trade 2002).

On government procurement, both sides agreed to exchange offer lists on what types of projects will be opened to bidding from foreign firms. Issues remaining in this area include, among others, whether foreign companies can bid on federal, state or local projects, and the extent to which bidding would be open to some aspects of defense contracts. A clear understanding on differential treatments in accordance with the level of governments is an important issue in the forthcoming FTAA.

The U.S. has expressed interest in handling electronic commerce in both the Chilean and Singaporean FTA. The latest WTO ministerial declarations asked countries to work until 2003 on the institutional arrangement for discussing future rules applicable to e-commerce and, in the meantime, refrain from imposing duties on e-commerce transactions. As of November, before talks in Miami, the United States had not yet tabled a proposal for handling labor and environment issues (Inside U.S. Trade 2001b).<sup>45</sup> Chile is supposedly objecting to the enforcement of labor and environmental provisions through trade sanctions.

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<sup>45</sup> The Office of USTR has sought comment on the draft environmental review of the proposed U.S.- Chile FTA (the draft review is available [www.ustr.gov/environmnet/environmental.shtml](http://www.ustr.gov/environmnet/environmental.shtml)). The Office of USTR requested public comments regarding the scope of the environmental review, including the potential environmental effects that might arise from the Chile agreement and the potential implications for environmental laws and regulations. The final review will be made publicly available on the conclusion of the agreement negotiations.

## **VI. Conclusions**

The Chilean conception of open regionalism is elusive in that it is a regionalism that facilitates economic transactions in a region, in a broad sense, without diverting trade or investment from the rest of the world and thus without putting at risk the thrust of the multilateral system. The Chilean open regionalism does not embody as principle the extension of concessions on an unconditional MFN basis. Rather, a basic requirement for the Chilean version is that over time the dynamics of FTAs lead to reductions in the external barriers against non-members. In addition, the Chilean open regionalism places a strong emphasis on the reduction of transaction costs through the harmonization or non-discriminatory application of trade rules, domestic regulations and standards and via the building of physical infrastructure. Another embodied criterion for assessing the “openness” might be whether or not the bilateral or plurilateral FTAs go beyond the existing coverage of the WTO, and have a “GATT/WTO plus” focus in areas that are already subject to the WTO disciplines.

The Chilean trade strategy in the 1990s has evolved around negotiating, signing and implementing several NAFTA-like FTAs (“second generation” FTAs) that cover a vast range of sectors. Therefore, these second generation FTAs are “wide” in terms not only of the geographic coverage that extends to countries and regions not necessarily geographically contiguous, but also the number of sectors negotiated and incorporated. The breadth of topics is very distinct from those contained in the earlier ones (“first generation” ALADI-ECAs) that deal principally with tariff and non-tariff barriers across national borders. The second generation FTAs also introduce new approaches to older issues, such as rules of origin, contingent measures for imports, and dispute settlements. The comprehensive coverage of sectors reflects in part the change from the “old” Latin American regionalism, based on import substitution, to a new regionalism, driven by market forces, rather than fiat, the forces of globalization in markets of products, capital, labor and technology.

These FTAs are also “deep” in many negotiation areas, especially in services and investment. Due to the foundational resemblance to the NAFTA, the nature and scope of the Chilean FTAs have become quite similar to those of other arrangements that exist in the Western Hemisphere. In some important aspects, these NAFTA-like

agreements adopt a “GATT/WTO-plus” focus. This way, a common multilateral basis is being reinforced and built-on in regional arrangements. This reinforcement building-on process, in turn, could facilitate the adoption of such disciplines in the FTAA. The negotiation on the Chile/United States FTA up to now clearly shows this process of reinforcement. In a sense, Chile is already anticipating the task of normative harmonization within the hemisphere.

For instance, in the area of trade in services, the Chilean FTAs and other FTAs in the hemisphere go beyond the GATS in either developing deeper disciplines, or providing for greater liberalization and market access opportunities for service providers, and/or enhancing transparency. The “negative-list” approach and the “right of non-establishment” are harmonized within these NAFTA-type agreements. These FTAs apply a “*standard of treatment*” clause that requires members to provide service providers of other member countries the better treatment afforded by the principles of MFN and National Treatment.

The similarity between Chilean FTAs and other FTAs in the Western Hemisphere can be also observed in the area of investment. Most NAFTA-type agreements grant investments and investors the better of national and MFN treatment. Most agreements also contain exceptions to the rule, such as treatment at federal and sub-federal levels as in NAFTA. Furthermore, the NAFTA-type agreements prohibit performance requirements. In addition, the Chile/Canada FTA limits the conditions for expropriation and guarantees investors of both parties compensation if an expropriation were ever to occur.

A rather unique feature among regional trade agreements, even at the world level, is found in the Chile/Canada agreement, in which both countries negotiated a mutual exemption from the application of antidumping. Elimination of the right to impose antidumping duties was an issue to which the Canadians, as well as the Mexicans, gave a high priority within the NAFTA, but they were unsuccessful in securing in the face of U.S. opposition.

With respect to rules of origin, in the old agreements signed by the countries in the hemisphere, mostly under the ALADI framework, there is a general rule applied across-the-board based on a change in tariff classification at the heading level or, alternatively, a certain threshold of regional value-added in the FOB export value. In

contrast, in the new generation agreements, mostly those that follow the NAFTA model of rules of origin, these general rules are accompanied by additional product-specific rules negotiated at a determined level of the Harmonized System. Admittedly, the complexity of rules of origin makes it difficult to produce a convergence process among the Chilean and other FTAs.

Although Chile's attempts to incorporate new areas into the agreements are clear, there is no fixed "package" of sector coverage. For instance, while the current FTA with Canada incorporates the highest rights and obligations so far in FTAs signed by Chile with respect to services and investment, it does not incorporate such aspects as intellectual property rights, technical standards, sanitary and phytosanitary measures, and government procurement. On the other hand, the Chile/Mexico FTA incorporates such aspects. Chile and Canada considered that the WTO rules, together with their own respective legislation, already addressed these matters satisfactorily. By selecting the areas that are important to individual countries, the country tries to establish a realistic agenda in light of the lack of interest to go beyond the WTO rules. Both agreements, as well as Chile/Central American FTA, explicitly exclude cross-border financial services from their liberalization commitments, though the agreement with Mexico calls for specific commitments to begin negotiations before a determined date. Chile and its FTA partners have other "sensitive" items, and depending on the trade partner, the basket of products for a differential treatment on liberalization differs accordingly. In this sense, the Chilean strategy has been selective.

Meanwhile, Chile considered that the WTO rules, together with its own respective legislation, already address the matters satisfactorily and that it is more preferable to strengthen the multilateral framework for these areas. The issue of antidumping, intellectual property rights and the standards and conformance, might be a case in this respect. In the case of the latter, the ECAs signed by Chile do not contain explicit disciplines on standards but rather a general article that promote economic cooperation. The agreement with MERCOSUR does not contain detailed provisions on standards, though it confirms the rights and obligations under the TBT Agreement of the WTO. Provisions and disciplines of the second generation Chilean FTAs are also similar to those of the WTO TBT Agreement.

The multiplicity of current FTAs whose “width” and “depth” are not yet uniform across trade partners and between “generations” can be significant costs to a small country like Chile, making the convergence process among FTAs more difficult and at the same time raising levels of protection and transaction costs. Obviously, the type of convergence that may be necessary between FTAs depends on the depth of the agreements themselves: the convergence by way of tariff reductions, conformance and standards, etc, might be easier to achieve, while convergence in other policy instruments, such as services, investment, competition, rules of origin, antidumping and safeguards, government procurement, movement of labor, environment etc. might be a more difficult task. However, given the strong NAFTA focus as a basis, it would be easier for the Chilean FTAs, the existent as well as forthcoming, to harmonize the plethora of agreements, based on a common set of NAFTA standards and regulations and similar liberalization time frames.

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