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A U.S.-CHILE FREE TRADE AGREEMENT: IGNITING ECONOMIC PROSPERITY IN THE AMERICAS

INTRODUCTION

During a May 13 to 15 visit to Washington by Chilean President Patricio Aylwin, George Bush announced that the United States soon will embark on free trade negotiations with Chile.[1] Although Chile's economy is small and has relatively little impact on the U.S., a free trade agreement (FTA) with Chile would benefit America in a number of ways. It would advance Bush's Enterprise for the Americas Initiative (EAI), which seeks to create a Western Hemisphere free trade zone stretching from Alaska to Antarctica.[2] This would benefit U.S. long-term political and economic interests in the Americas. It also would highlight Chile's leadership in free market reform and encourage the spread of free trade throughout Latin America. A U.S.-Chile FTA also would help sustain Chile's impressive economic growth. And it would bolster Chile's democratic reform program, while demonstrating a strong U.S. commitment to Latin America.

Despite these benefits, the Bush Administration wants to move slowly. The White House announced on May 13 that negotiations with Chile would begin only after the North America Free Trade Agreement (NAFTA) talks with Canada and Mexico are completed. However, Chile, which signed an FTA with Mexico on September 22, 1991, wants to move ahead with the free trade negotiations sooner. Chilean business and government leaders have argued that the U.S. and Chile should launch free trade talks as quickly as possible, rather than waiting for the conclusion of the NAFTA talks.

1 For an in depth analysis of U.S.-Chilean relations, see: Michael G. Wilson, "A U.S. Role in Chile's Democratic and Economic Reforms," Heritage Foundation *Backgrounder* No. 837, June 20, 1991.

2 The EAI was first announced by Bush on June 27, 1990, and has attracted widespread support from hemispheric leaders. Besides creating a free trade zone stretching from Alaska to Antarctica, the EAI seeks to spur regional prosperity and stability by assisting Latin American countries in attracting foreign investment, offering debt relief, and advancing free market solutions to environmental protection.

Chileans have a right to be impatient with the Bush Administration. Bush visited Santiago in December 1990, telling his Chilean hosts that they soon would be the first country in South America to strike a free trade deal with the U.S.[3] But after nineteen months, there has been little action. To get things moving, Bush should:

✘ **Begin free trade talks with Chile as soon as possible.** The Bush Administration should complete free trade talks with Chile by next May, when the Administration loses its special "fast track" negotiating authority from Congress.[4] Waiting to begin talks until after the November presidential elections or until Congress votes on NAFTA, probably sometime next spring, could place a U.S.-Chile free trade pact in jeopardy. First, there is no guarantee that Bush, the FTA's biggest champion, will be re-elected.[5] And second, mounting protectionist sentiment in the U.S. Congress could delay NAFTA indefinitely or even derail it, thereby torpedoing any other free trade pact in the region.

✘ **Make it clear that while Chile is the first country to participate in the Enterprise for the Americas Initiative, others soon will follow.** This will demonstrate a strong U.S. commitment to advancing the EAI and will encourage continued free market reforms throughout the region.

Once the negotiations are underway, a U.S.-Chile FTA should:

✘ **Quickly phase out all tariff and most non-tariff barriers to trade with Chile.**

✘ **Lower all other barriers to international trade and investment.** This should include agreements on such issues as intellectual property rights, fair access to natural resources, removing restrictions on foreign ownership, strong property rights laws, environmental regulations, labor laws, and health standards.

✘ **Provide for periods of adjustment to less competitive industries hardest hit by an FTA.** While it is unlikely that there will be any employment shifts or losses in the U.S. as a result of a U.S.-Chile FTA, small adjustment periods will help minimize not only relocation and retraining costs for some employees, but profit losses for companies involved in the fruit growing, textiles, and mining sectors.

3 Leslie Crawford, "Chile Grows Weary of U.S. Procrastination Over FTA," *The Financial Times*, June 3, 1992, p. 5.

4 Fast track authority was granted to the Bush Administration by Congress in May 1991. Under fast track authority, trade agreements are guaranteed an up-or-down vote by Congress, without nuisance amendments and protectionist tinkering that almost certainly would kill most trade negotiations.

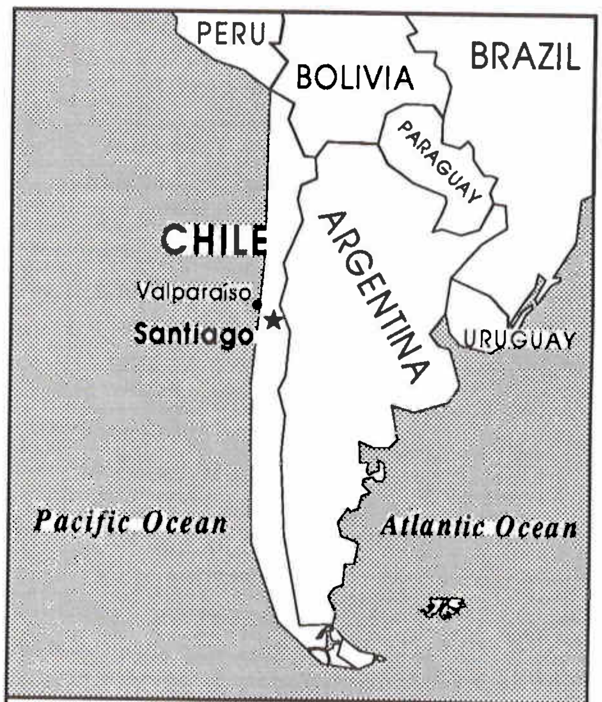
5 Democratic Presidential candidate Bill Clinton, not a strong promoter of free trade, has yet to announce a position with regard to the proposed U.S.-Chile FTA. He has given only tentative support to the NAFTA. Bush, on the other hand, is strongly committed to advancing free trade in the Americas through bilateral agreements and the EAI.

- **Create procedures and mechanisms to resolve potential trade disputes.** Complex environmental and labor laws in the U.S., combined with overlapping jurisdictions of power between state and federal agencies and judicial systems, can create barriers to trade with other countries. These and other types of non-tariff barriers need to be reduced. To do this, the U.S. and Chile should establish a commission to settle rapidly trade disputes over environmental, labor, or health laws that block free trade.

- **Establish "rules of origin."** These are rules that govern the export of goods manufactured with items imported from a country not participating in the free trade agreement. As in all FTAs, these rules will be necessary to prevent other countries from taking advantage of the duty-free provisions in the trade treaty.

CHILE: FROM SOCIALISM TO A FREE MARKET MODEL

Chile is an ideal candidate for a free trade agreement with the U.S. because its economic reforms have been so successful. Chile embarked on its campaign of free market reforms in the mid-1970s. The government of Augusto Pinochet eliminated price controls, reduced tariffs across the board to a flat rate of approximately 10 percent, privatized most of Chile's large state-owned companies, cut back restrictions on foreign investment, and reduced taxes.



Chile: A Model of Free Market Reforms for South America

This economic reform paid off. Since the mid-1980s, the economy grew an average annual rate of 5.7 percent, inflation dropped to 18 percent from 500 percent in 1973,[6] unemployment decreased from 12 percent to approximately 4.5 percent today, average salaries are rising, and exports climbed last year to over 30 per-

6 James R. Whelan, *Out of the Ashes: Life, Death and Transfiguration of Democracy in Chile, 1833-1988* (Washingon, D.C.: Regnery Gateway, 1989), p. 418.

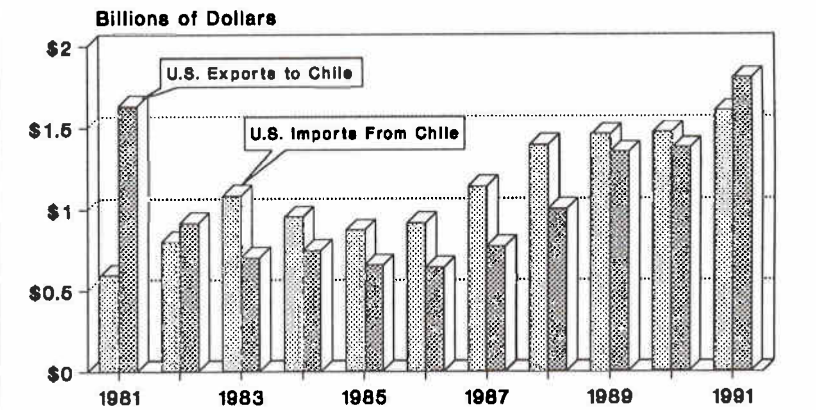
cent of Chile's Gross Domestic Product (GDP).[7] Chilean products are of high quality and compete favorably in world markets. Because foreign investors are offered low taxes, strong legal protection of their investments and property, and favorable rules on taking home profits, they have invested some $6 billion in Chile since 1985. By the mid-1990s, foreigners are expected to commit some $10 billion in new capital to Chile's robust economy.[8]

GROWING U.S.-CHILEAN ECONOMIC TIES

This successful record of free market reforms and Chile's new democratic government is behind the U.S. interest in free trade talks with Chile. Washington and Santiago signed a free trade and investment framework agreement on October 1, 1990, paving the way for a U.S.-Chile FTA. The accord established a joint U.S.-Chile Council on Trade and Investment to monitor bilateral economic ties and to further open markets to both nations. On the Council's agenda are how to: cooperate in the Uruguay Round of multilateral trade negotiations in the General Agreement on Tariffs and Trade (GATT), increase access to each other's markets, protect intellectual property rights, spur foreign investments, and promote the EAI.

Chart 1

U.S. Trade With Chile Since Mid-1980s: Volume Has Grown and Deficit Eliminated



Source: Foreign Trade Technical Department, Central Bank of Chile.

Heritage DataChart

These trade talks come on the heels of ballooning trade between Chile and the U.S. Trade between the two countries has grown without interruption for eight straight years, reaching some $3.4 billion in 1991. The U.S., in fact, is Chile's principal trading partner, accounting for about 20 percent of Chile's total imports and absorbing 17 percent of its exports. Within the past decade, U.S.-Chilean trade doubled in volume.[9]

According to the Central Bank of Chile, Chilean exports to the U.S. in 1991 reached almost $1.6 billion. The composition of these exports, however, has changed over the past ten years. While copper continues to be the main U.S. import, other Chilean goods

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7 See Alejandro Foxley, "The Future of U.S.-Chilean Relations," *Heritage Lecture* No. 323, May 1, 1991.

8 For more information see John F. H. Purcell and Dirk W. Damrau, "Chile: An Investment-Grade Credit," Salomon Brothers, May 1991.

9 "Chile Economic Trends Report," Embassy of the United States, Santiago, Chile, November 1990, p. 19.

such as fresh fruit, seafood, chemical products, and wine have found their way to the American marketplace.

U.S. exports to Chile, America's 35th largest market, totaled approximately $1.8 billion in 1991. This represents an increase of 10 percent from 1990. Chile's imports from the U.S. are heavily weighted toward high-tech equipment, such as computers, and consumer goods.[10]

The U.S. also is the principal foreign investor in Chile's banking, insurance, forestry, mining, light manufacturing, and agricultural industries. As a result of the high returns on foreign investments in Chile, a total of $1.3 billion in foreign investment flowed into Chile in 1990 alone. This amount equaled 5 percent of Chile's GDP, the highest rate of growth in Latin America and six times the average rate for the region.

NINE REASONS FOR A FREE TRADE PACT WITH CHILE

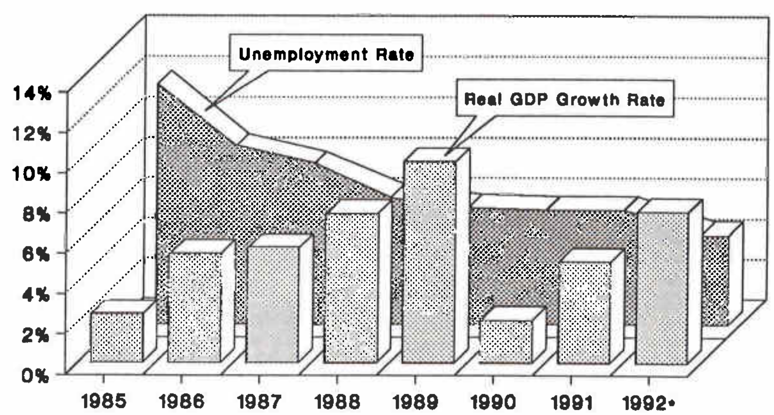
Building on this legacy of expanded free trade is reason enough to begin free trade talks with Chile. But there are other reasons as well—nine, in fact. They are:

Reason #1: Chile's economy is one of the most open and advanced in Latin America and would be the easiest with which to negotiate an FTA.

Chile has moved farther and faster than virtually any other country in Latin America in implementing free market reforms. When Pinochet seized power from the Socialist government of Salvador Allende in September 1973, a bold economic reform program based upon private enterprise and an open market was launched. Following its election in December 1990, the democratic Aylwin government has continued this free market program with great success. For example, Chile has reduced its government-owned enterprises from approximately 500 in the mid-1970s to about 50 today. Moreover, the average tariff rate has dropped from about 105 percent during the Allende years to 11 percent this year. And while Chile's GDP was shrinking by some 12 per-

Chart 2

Chilean Economy Continues to Grow As Unemployment is Cut Sharply



* As of July.

Source: The Embassy of Chile and other sources.

Heritage DataChart

10 For more information on the content and quantity of U.S.-Chile trade, see "Trade and Investment Between Chile and the United States for 1990," Embassy of Chile, August 1991.

cent in the early 1970s, this year it likely will grow by 7.5 percent.[11] Consequently, Chile's economy is one of the fastest growing and most open in the world.

Because of Chile's free market reforms, its economic success story, and its open economy, a U.S.-Chile FTA will be relatively easy to negotiate. Potential disputes over excessive trade barriers, high taxes, unprotected property rights, foreign ownership limitations, profit repatriation, and government subsidized industry will not greatly complicate trade negotiations with Santiago.

Reason #2: Chile's return to democracy would be rewarded and strengthened.

An FTA with Chile will help the Aylwin government's democratic reforms succeed by making Chile economically prosperous and stable. A free trade pact with the U.S., the world's largest economy, will create new and better paying jobs in Chile, thereby lessening political tensions caused by poverty and unemployment. An FTA also will help sustain Chile's impressive economic growth rate.

Reason #3: Bush's Enterprise for the Americas Initiative would be accelerated.

The completion of a U.S.-Chile Free Trade Agreement would accelerate Bush's EAI by encouraging other bilateral and multilateral FTAs throughout the Americas. Such free trade agreements are a major goal of EAI, which was launched by Bush in June 1990. An FTA with Chile would be tangible proof that the Initiative's goals are attainable and that Washington is committed to improving trade ties and promoting economic opportunity in the Americas. If, however, Chile fails to obtain a free trade agreement from the U.S., other countries in Latin America would be discouraged. As Alejandro Foxley, Chile's Finance Minister, put it: "We are impatient to see concrete results from the U.S. president's Enterprise for the Americas Initiative. Middle income countries like Chile are experiencing trade negotiation fatigue."[12]

The EAI cannot advance without a Chilean FTA because Washington needs Santiago's leadership and example to encourage other countries in the region to adopt similar free market economic policies. Chile, moreover, is the only country other than Mexico that is ready today to sign an FTA with the U.S.

Reason #4: Other countries in Latin America would be encouraged to follow Chile's democratic and free market model.

Rapidly concluding an FTA with Chile would encourage other countries in Latin America to imitate Chile's successful economic and democratic reforms. These countries are eager to sign free trade pacts with Washington. They believe that these agreements will attract American investment and boost exports to the U.S. If Chile's reform program is rewarded with an FTA, other Latin American countries will conclude that their reforms also will be rewarded. Already Argentina, Bolivia, Colombia, Costa

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11 "U.S. Market Access in Latin America: Recent Liberalization Measures and Remaining Obstacles," United States International Trade Commission Report No. 2521, June 1992, pp. 5-1 to 5-22.

12 Crawford, *op. cit.*, p. 5.

Rica, El Salvador, Uruguay, and Venezuela are modeling much of their economic reform programs on Chile's. It is especially important that they do so in light of the September 1991 coup in Haiti, the failed February 1992 coup attempt in Venezuela, and the April 1992 military-backed coup in neighboring Peru by President Alberto Fujimori. The momentum toward democracy and free market reforms, first started by Chile, must not be allowed to slow because of setbacks in these troubled nations.

Reason #5: Chile's long-term economic and political stability would be promoted.

An FTA will help institutionalize the free market and democratic advances made in Chile. This would be done by increasing Chilean exports, creating new and better jobs, attracting new foreign investment, and generating increased wealth and economic stability. The more productive the ties between Chile and the world's largest free market democracy, the greater the possibility of long-term success for Chile's free market and democratic revolutions.

Reason #6: There is little opposition from U.S. labor unions.

A free trade agreement with Chile will meet little opposition from organized labor in the U.S. In fact, the AFL-CIO is not all that concerned about an FTA with Chile.[13] The reason: Chilean sales of fruit and seafood to the U.S. require the intensive use of American labor at ports, and thus will create new jobs there. The obstacle in the U.S. for a FTA with Chile, therefore, is not protectionism, but indifference.

Reason #7: There is little competition from Chilean farmers.

Chile's growing seasons are the reverse of those in the U.S. When U.S. produce is coming to market, Chile is in the midst of winter—and thus is not exporting its grapes, peaches, plums, and apples to the U.S. The result: Chile's agricultural exports do not compete directly with American farmers. Lacking competition from Chilean farmers, American farmers and agricultural groups will be less opposed to a free trade pact with Chile than one with Mexico, which has the same growing season as the U.S.[14]

Reason #8: New investment opportunities for U.S. companies in Chile would be created.

Americans already have some $1.5 billion invested in Chile, primarily in mining, financial services, agriculture, forestry, and telecommunications. According to the Commerce Department, U.S. profits on investments in Chile have been more than 40 percent per year for the past four years. Chile offers American investors political stability and a well-educated work force. It already is the fastest growing market in Latin America for such U.S.-produced capital equipment as mining and agricultural machinery. By removing trade barriers and restrictions on investment, a free trade pact would facilitate American investments in Chile.[15]

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13 "U.S.-Chile FTA May be in Works," *The News*, Mexico City, Mexico, May 3, 1992, p. 19.

14 See "Trade and Investment Between Chile and the United States," The Embassy of Chile, Washington, D.C., August 1991.

Reason #9: The economic competitiveness of both countries would be increased.

The competitiveness of U.S. and Chilean companies not only will improve against Pacific Rim nations like Japan, South Korea, and Taiwan, but also against the European Community. American companies will be able to combine their advanced technology and highly skilled labor with Chile's cheaper labor to cut prices on their exported products. The amount of capital available for U.S. and Chilean products will grow as global demand for their products increases and their operations expand.

U.S.-CHILE FREE TRADE AGREEMENT: A KEY TO PROSPERITY IN THE AMERICAS

The Bush Administration must back up its call for free trade negotiations with Chile with concrete and immediate actions. A U.S.-Chile FTA will help consolidate and expand the mutually beneficial relationship that has developed between the two countries. Today, moreover, there is an opportunity to forge a permanent and profitable economic bond between the U.S. and the other countries in the Western Hemisphere. An FTA with Chile will help launch this process.

To spur economic prosperity throughout the Americas, the Bush Administration should:

✘ **Begin free trade talks with Chile as soon as possible.**

The Bush Administration wants to delay free trade talks with Chile until after the NAFTA has been approved by Congress. This is a mistake. It would be far easier to gain congressional approval of a free trade treaty with Chile than one with Mexico. There is less U.S. opposition to free trade with Chile, and American labor unions, which oppose NAFTA, are not as worried about expanded trade with Chile. Thus, a delay in starting negotiations with Chile would only waste time.

The Bush Administration, therefore, should notify Congress immediately of its intention to negotiate a free trade pact with Chile. Under "fast track" rules, free trade talks cannot begin until 60 legislative days after Congress has been notified. Waiting until after the November 3 presidential elections or until Congress votes on NAFTA could jeopardize a U.S.-Chile FTA. For one thing, there is no guarantee that Bush, the FTA's biggest champion, will be re-elected. For another thing, protectionist sentiment in the U.S. Congress could delay NAFTA and ruin chances for any other free trade pact in the region.

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15 See Wilson, *op. cit.*, p. 10.

✘ Make it clear that while Chile is the first country to participate in the Enterprise for the Americas Initiative, others soon will follow.

A free trade agreement with Chile will give new life to the EAI and prove to other Latin American and Caribbean leaders that the EAI is working. Washington should signal to Argentina, Costa Rica, Colombia, and Venezuela that they too will benefit under the EAI program. As soon as these countries are ready, the U.S. will begin free trade talks with them as well.

Once negotiations are underway, a U.S.-Chile FTA should:

✘ Quickly phase out all tariff and most non-tariff barriers to trade with Chile.

Rapidly eliminating U.S. tariffs will greatly benefit Chilean exporters who rely heavily on exports to the U.S. Yet a surge in Chilean exports to the U.S. will not hurt American producers or cost U.S. jobs. The reasons: 1) job losses in one sector will be offset by job gains in others; and 2) there will be few if any job losses in the most vulnerable sectors of the American economy, including mining, textiles, and agriculture, because Chile's growing seasons are opposite of those in the U.S. Since Chilean goods represent only 0.3 percent of overall U.S. imports, even a large increase of Chilean imports would not greatly affect the U.S. job market.

✘ Lower all other barriers to international trade and investment.

Accomplishing this entails reaching agreements on such issues as intellectual property rights, fair access to natural resources, lifting restictions on foreign ownership, strong property rights laws, environmental regulations, labor laws, and health standards. For example, Washington and Santiago should improve Chile's 1991 intellectual property rights laws. One way of doing this would be to lengthen Chile's patent protection of U.S.-manufactured pharmaceuticals from fifteen years to seventeen years. In addition, Chile should follow the lead of Mexico by granting protection for foreign pharmaceutical products that are under development abroad but not yet marketed inside Chile. This way U.S. pharmaceutical manufacturers can be assured that their products will not be copied and sold inside Chile before a patent agreement has ben reached with the government.

✘ Provide for periods of adjustment to less competitive industries hardest hit by an FTA.

After a free trade pact is signed between Washington and Santiago, most tariffs and quotas should be eliminated immediately. However, in certain less competitive sectors, such as fruit growing and textiles, a schedule for phasing out tariffs will have to be established. While it is unlikely that there will be any major employment shifts or losses in the U.S. as a result of a U.S.-Chile FTA, small adjustment periods of less than ten years will help minimize relocation and retraining costs for some employees. These adjustment periods also will reduce profit losses for some companies involved in the fruit growing, textiles, and mining sectors of the American economy.

✘ Create procedures and mechanisms to resolve potential trade disputes.

As trade between countries expands, a number of complicated trade issues arise. One such incident occurred in March 1989 when the U.S. Food and Drug Administration banned Chilean grape imports after two grapes tainted with cyanide were found in Philadelphia. The discovery temporarily brought to a standstill one of Chile's most vital industries. Complex environmental and labor laws in the U.S., combined with overlapping jurisdictions of power between state and federal agencies and judicial systems, also can create barriers to trade with other countries. A U.S.-Chile FTA should therefore establish a commission to settle all trade disputes as rapidly as possible.

✘ Establish "rules of origin."

As with the 1989 U.S.-Canada FTA and NAFTA, a U.S.-Chilean free trade pact likely will include rules of origin. These are laws that govern the export of goods manufactured with items from a country not participating in the free trade agreement. Under the U.S-Canada pact, these content rules were set at 50 percent; rules have yet to be determined in the NAFTA talks. These rules should be aimed at promoting free trade and free market reforms among countries outside of the U.S.-Chile FTA, not discouraging investment in either country or serving as a disguise for "managed trade" between Washington and Santiago. While it is still too early to recommend a specific percentage for the U.S.-Chile content rules, it might be advisable to use the same percentages negotiated under the NAFTA. This would eliminate unnecessary confusion and regulation in linking Chile to North American free trade.

The debate over U.S.-Chilean rules of origin will be much less problematic than during the NAFTA talks with Mexico. It is unlikely that such Asian countries as Japan and South Korea will establish bases of operations in Chile to export products duty free to the U.S. market. The distance involved and transportation costs would be too great and the availability of unemployed or cheap labor in Chile is relatively low compared to other Latin American countries. The debate over rules of origin, however, could heat up if the U.S. uses Chile as a base of operations for re-export to Chile's neighbors, including Argentina and Brazil.

CONCLUSION

The U.S. and Chile both will be winners under a free trade pact. The benefits for the U.S. will be increased markets for American goods; lower priced, better quality products for consumers; more jobs; and a more stable and economically prosperous Latin America. For Chile, the key benefits of an FTA will be more jobs, increased export earnings, more U.S investment, a more competitive economy, and greater political stability resulting from economic growth and prosperity.

Now that countries like Argentina, Chile, Mexico, and Venezuela have the confidence to seek free trade agreements with the U.S., Washington should not lack the confidence or leadership to negotiate these agreements. The Bush Administration can fortify Chile's impressive gains and create strong incentives for free market reform throughout Latin America by signing a free trade pact with Chile. Bush also should enlist Chilean President Patricio Aylwin's help to promote the Enterprise for the Americas Initiative. A U.S.-Chile FTA will be a first, but very important step in this direction. As a model other Latin American countries will surely follow, it will advance President Bush's EAI, and thus create new and vibrant markets throughout the Western Hemisphere for U.S. products. It also will help spread economic prosperity and political stability in the region. Not unimportant, of course, is the fact that an FTA would represent a sign of good faith by the U.S. in the Aylwin Administration.

By contrast, indifference or inaction by Washington could set back progress toward free markets, democracy, and security in the Americas. If the Bush Administration does not take advantage of the current pro-free market and pro-democracy mood in the region, Latin American countries could grow increasingly skeptical of U.S. free trade policy. This could lead to socialist and anti-democratic backlashes throughout the region. In the long run, therefore, Chile's success or failure will help determine whether Latin America remains mired in poverty, debt, drugs, and violence, or joins the U.S., Canada, and Mexico in creating what could become the world's most prosperous and competitive free market—a free trade zone spanning the entire Western Hemisphere.

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