CHILEAN TRADE

Factors Affecting U.S. Trade and Investment

GAO

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The Honorable Sam Gejdenson
Chairman, Subcommittee on International
Economic Policy and Trade
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

As requested, we examined the conditions affecting U.S. trade with and investment in Chile. More specifically, we obtained information on (1) Chile's trade and investment policies and U.S. concerns about these policies, (2) the specific factors that may affect U.S. investment in Chile's mining industry and agricultural trade with Chile, and (3) U.S. government efforts to promote trade with and investment in Chile.

Background

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Chilean Trade: Factors Affecting U.S. Trade and Investment

Since the mid-1970s, Chile has moved further and faster than any other Latin American country towards free market reform and trade liberalization. Between 1983 and 1990, Chile's economy grew at an average annual real rate of 5.6 percent. With a population of 13 million, Chile's gross domestic product was $26 billion in 1990, or $1,967 per capita, compared with $2,156 per capita for Latin America as a whole.

Mining is Chile's leading industry and greatest earner of foreign exchange. Copper products account for almost all of Chile's mineral exports. Chile is the world's leading producer of copper, accounting for about 19 percent of the world's production and approximately 23 percent of the world's reserves. According to the Bureau of Mines, world demand for copper is expected to increase about 2.7 percent per year between 1990 and the year 2000, even though the use of fiber optics in the telecommunications industry has affected some traditional copper uses.

Copper products overall accounted for 45.7 percent of total Chilean exports in 1990. Chile's reliance on copper exports has diminished substantially since the mid-1970s, when copper constituted 70 percent of its exports. Conversely, agricultural, fishery, and forestry products account for a greater percentage of Chile's export revenues than they did in the mid-1970s.

Between 1985 and 1991, Chile's export earnings increased from $3.8 billion to $9 billion. Its imports increased from about $3 billion to about $8 billion.

Also, in 1991, Chile was the world's 53rd largest exporter and 54th largest importer.

Bilateral trade between the United States and Chile has also increased. In 1991, trade between the two countries reached approximately $3.1 billion. The United States is one of Chile's principal trading partners. According to the Chilean government, in 1991, the United States accounted for approximately 20 percent of Chile's total imports and 18 percent of its total exports. Also, in 1991, Japan replaced the United States as Chile's main export market.

The amount of U.S. foreign investment in Chile is substantial. The United States is Chile's largest single foreign investor. Between 1974 and 1990, U.S. investment reached approximately $2.5 billion in Chile, which represents about 40 percent of foreign investment during that period.

Living conditions in Chile are among the best in Latin America. According to a recent report by the Inter-American Development Bank, access to water, sewage facilities, and electricity is high. However, the number of families living in poverty is estimated to be as high as 50 percent, and the rural population, which is about 20 percent in Chile, has a notably lower standard of living than the urban population. Chile's literacy rate is about 95 percent.

Some trade analysts have attributed Chile's current political stability to several factors, including its democratic government and its broad political consensus. Confidence in Chile's political environment is evidenced by large foreign direct investment flows of more than $2.6 billion in the years following the newly elected government. (Chile's president, Patricio Aylwin, was elected in 1989.)

Results in Brief

Since the mid-1970s, Chile has led all other Latin American countries in its efforts to create a market-oriented economy. Two of its key market reforms have been the elimination of nontariff barriers to trade and the adoption of a flat import tariff rate of 11 percent. Another key reform has been the liberalization of its foreign investment regime. The basic principles governing Chile's investment climate are nondiscriminatory treatment of foreign investors, free access to the foreign exchange market and economic sectors, and minimal state regulation and intervention. Another prime element of Chile's economic reform has been the reduction of its foreign debt. Since the mid-1980s, Chile has reduced its total external debt by about 16 percent.

The Chilean government is considering several investment reforms to further improve the investment climate, including (1) allowing companies to repatriate capital after 1 year instead of the current 3 years (profits are allowed to be freely transferred out of Chile), (2) establishing a specific time frame for approving foreign investment applications, and (3) lowering the fixed tax rate on investor profits.

U.S. companies have expressed concerns about Chile's requirement, adopted in June 1991, that all investors put 20 percent of capital borrowed from foreign sources in non-interest-bearing accounts in Chile's Central Bank for 1 year and Chile's lack of a tax treaty with the United States, which results in double taxation. (App. I provides further information on Chile's trade and investment environment and on U.S. concerns.)

Specific factors that may affect U.S. trade with and investment in Chile involve the mining and agricultural sectors. U.S. companies we spoke with told us that they are concerned that companies or individuals frequently file claims challenging the property rights of established mining companies. The U.S. companies also cited a lack of ports and electricity in northern Chile as factors that may adversely affect investments in Chile's mining sector. (App. II contains further material on U.S. trade with and investment in Chile's mining sector.)

A few trade barriers exist to agricultural trade between the United States and Chile, including a Chilean variable import levy on certain agricultural products, preferential tariffs on certain products from selected Latin American countries, and U.S. marketing order requirements.[1] Although most U.S. and Chilean agricultural production is noncompetitive because of different growing seasons, some U.S. agricultural growers are concerned about increased Chilean exports. (Further information on U.S. trade with Chile's agriculture sector is in app. III.)

The U.S. government has taken steps to promote trade with and investment in Chile. For example, the Bush Administration's Enterprise for the Americas Initiative (EAI) established the framework for U.S.-Chilean

[1]Marketing orders are marketing plans designed by growers and handlers in a particular industry to collectively work out solutions to supply and demand problems that growers and handlers are unable to resolve individually. Once voted in by the industry and approved by the Secretary of Agriculture, marketing orders are issued as federal regulations and have the force and effect of law.

free trade negotiations. However, Chile's lack of a comprehensive environmental policy may affect these negotiations.

Several U.S. government agencies, such as the Overseas Private Investment Corporation (OPIC) and the U.S. Trade Development Program are currently providing assistance to U.S. companies interested in trade with and investment in Chile. (U.S. efforts to promote trade with and investment in Chile are discussed further in app. IV.)

Scope and Methodology

To accomplish our objectives, we obtained information on Chile's trade and investment policies from officials in the U.S. Departments of Commerce, State, Agriculture, and the Interior; from the Office of the U.S. Trade Representative; the International Trade Commission; the Chilean embassy in Washington, D.C.; the Chilean Ministry of Finance; the Chilean Foreign Investment Committee; and Chile's Export Bureau. Information in this report on Chilean legal matters does not reflect our independent analysis of the matters but rather is a synopsis of what Chilean and U.S. government officials provided to us.

To explore specific factors that may affect U.S. investment in Chile's mining industry and trade with Chile's agricultural sector, we met with seven U.S. companies and three non-U.S. companies investing in Chile's mining sector, several U.S. agricultural growers, and one large U.S. bank. In addition, we interviewed officials from Chile's state-owned copper company, the Chilean Copper Commission, and the Chilean Ministries of Agriculture and Fisheries. We also met with representatives from several industry groups and policy institutions in Chile and the United States with extensive knowledge of these two industries, a major mining trade association, and a copper labor union. We used figures provided by the Central Bank of Chile for the value of Chilean exports to the United States.

Finally, we obtained information on U.S. government efforts to promote trade with and investment in Chile from officials at the Department of Commerce's International Trade Administration, OPIC, the U.S. Export-Import Bank, the International Bank for Reconstruction and Development, and the Inter-American Development Bank.

Appendixes V and VI contain a map of Chile and selective economic activities in Chile, respectively.

We did our work from February through May 1992 in accordance with generally accepted government auditing standards.

We discussed our report with officials from the U.S. Embassy in Chile and the Chilean embassy in the United States, and they generally agreed with the information presented. We incorporated their comments in this report where appropriate.

As agreed with the Committee, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretaries of State, Commerce, Agriculture, and the Interior; the U.S. Trade Representative; and other interested congressional committees. We will also make copies available to others upon request.

Please contact me on (202) 275-4812 if you or your staff have any questions concerning this report. The major contributors to this report are listed in appendix VII.

Sincerely yours,

Allan I. Mendelowitz

Allan I. Mendelowitz, Director
International Trade and Finance Issues

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Abbreviations

ALADI	Latin American Association for Integration
D.L.	Decree Law
EAI	Enterprise for the Americas Initiative
IADB	Inter-American Development Bank
OPIC	Overseas Private Investment Corporation

Chile's Trade and Investment Environment

Beginning in the mid-1970s, Chile's military regime instituted sweeping reforms to revitalize the economy by liberalizing its trade and investment policies. These reforms included reducing tariff and nontariff barriers, privatizing state enterprises, instituting nondiscriminatory foreign investment policies, and reducing foreign debt. The Chilean government also plans to further liberalize foreign investment by shortening the capital repatriation period, setting specific time frames for approving foreign investment applications, and lowering the corporate tax rate to further liberalize the economic environment.

Nevertheless, U.S. companies have expressed concerns about several policies that affect foreign investments, such as the requirement that for 1 year, companies retain in Chile's Central Bank 20 percent of capital borrowed from foreign sources, and the lack of a tax treaty between the United States and Chile.

Reduction of Trade Barriers and Privatization of State Enterprises

Between 1973 and 1979, Chile gradually reduced import tariffs from a range of 0 to 750 percent to a uniform import tariff of 10 percent. Although tariffs rose again briefly in the mid-1980s, they settled at 15 percent in 1988. In June 1991 Chile lowered the uniform ad valorem tariff rate[1] from 15 percent to a flat 11 percent for all imports except some luxury items, such as liquor and automobiles, which are subject to the 11 percent tariff plus additional taxes.

The government also phased out import licensing and removed import quotas on most foreign products. In addition, Chile removed price controls and deregulated the financial sector. Finally, since the mid-1970s, Chile has privatized over 460 companies, including Chile's chemical, sugar, and national aviation companies.

Nondiscriminatory Foreign Investment Policies

The basic principles governing foreign investment in Chile are equal treatment of foreign and national investors ("national" treatment), free access to the foreign exchange market and economic sectors, and minimal state regulation of and intervention in business activities. Foreign investment is permitted in all sectors except those industries affecting national security. There are no restrictions on foreign ownership of local enterprises or on foreign participation in joint ventures.

[1]An ad valorem rate is an import duty rate expressed as a percentage of the imported commodity's value.

The principal mechanisms governing foreign direct investment in Chile are Chile's foreign investment statute—Decree Law 600 (D.L. 600)—and the Central Bank's Foreign Exchange Regulations that govern debt-for-equity swaps under chapter XIX. In addition, some foreign direct investment enters Chile through the private foreign exchange market, commonly referred to as the "parallel market."

Foreign Investment Statute

The foreign investment statute, adopted in 1974 and referred to as Decree Law 600, requires the government and the foreign investor to sign a written contract. According to the Executive Vice President of Chile's Foreign Investment Committee, the terms of the contract cannot be unilaterally changed by the Chilean government. D.L. 600 is the basic legislation governing foreign investment and the principal regime governing investments by foreign investors. In 1991, Chile received direct investments of about $1.1 billion under D.L. 600. Since 1985, Chile has received a total of $4.7 billion through D.L. 600, as shown in table I.1.

Table I.1: Foreign Direct Investment Under D.L. 600

U.S. dollars in millions

Year	Investment
1985	$ 138
1986	184
1987	497
1988	787
1989	898
1990	1,132
1991	1,096
Total	**$4,732**

Sources: Trade and Investment Between Chile and the United States, Embassy of Chile to the United States (Washington, D.C., August 1991), p.18, and Chile's Foreign Investment Committee.

Although there are no limits on repatriation of profits, capital cannot be repatriated until after 3 years. In addition, under D.L. 600, foreign investors can choose one of three tax options for computing required income taxes. They may opt for a flat income tax rate of 49.5 percent for a period of 10 years, or a 40-percent fixed rate plus a variable rate for a period of 10 years. They can also choose to receive the same tax rate as domestic companies, which pay a variable rate. Since 1990, domestic companies have been taxed at 35 percent. Prior to that time, they paid a lower rate.

According to the Chilean embassy in Washington, D.C., most foreign investors have chosen the same tax rate as domestic companies.

A Foreign Investment Committee, which includes the ministers of the Economy, Finance, and Foreign Affairs, authorizes foreign direct investment coming into Chile under D.L. 600. The foreign investor signs a contract with the Chilean government. The contract specifies the investor's rights, such as the right to remit profits and capital, to hold assets indefinitely, to receive national treatment, and to participate in any form of investment. Chilean government officials emphasize that the Foreign Investment Committee acts as a registration office that benefits the foreign investor by enabling the investor to sign a contract guaranteeing the conditions under which the investment will take place.

Debt-for-Equity Swaps

In May 1985, the Chilean Central Bank created a process to swap Chilean foreign-currency-denominated debt held by foreign institutions for equity in Chilean companies. Chilean debt, like much debt of Latin American countries, sells in the secondary market at a discount from its face value. Chapter XIX allows foreign companies and individuals to purchase Chilean debt from foreign bank creditors wishing to reduce their exposure in Chilean debt and then use it to invest in Chile. The Chilean Central Bank redeems the debt in pesos (the Chilean currency) at close to its face value. A foreign investor then invests the proceeds in a new or ongoing venture in Chile. Capital invested under chapter XIX may be repatriated after 10 years and profits after 4 years.

During the mid-1980s, Chilean debt traded at 30-70 percent of face value. Between 1985 and 1990, U.S. companies invested $1.4 billion through chapter XIX. However, since 1988, the value of Chile's debt on the secondary market has climbed from 55 percent to over 90 percent, rendering chapter XIX investments relatively unattractive financially. As shown in table I.2, investments under chapter XIX decreased significantly in 1990 and 1991.

Table I.2: Foreign Direct Investment From Debt-for-Equity Swaps

U.S. dollars in millions

Year	Investment
1985	$ 32
1986	213
1987	707
1988	885
1989	1,321
1990	418
1991	11
Total	**$3,587**

Sources: Trade and Investment Between Chile and the United States, and the Chilean embassy in the United States.

Unregulated Foreign Investment

Foreign direct investment is also possible without the approval of a government committee or the Central Bank. Foreign investors can bring capital into Chile and exchange it for pesos through foreign exchange dealers or private banks, referred to as the "parallel market." Such investors do not sign a contract with the Foreign Investment Committee and therefore do not have the guarantees granted to investments coming in under D.L. 600. For example, when investors take their money out of Chile, they must again exchange their pesos for foreign currency through these exchange dealers. If Chile experiences a foreign currency shortage, investors may have difficulty exchanging their pesos for foreign currency. Several officials in Chile told us that only small companies use the parallel market and that most of these have been companies in the service industry.

Reduction of Foreign Debt

Since 1985, using several debt conversion programs, including chapter XIX, Chile has reduced its external debt by 16 percent, from almost $21 billion in 1985 to $17 billion by March 1992. (See table I.3.)

Table I.3: Chile's External Debt, 1985-March 1992

U.S. dollars in millions

Year	External debt
1985	$20,529
1986	20,829
1987	20,660
1988	18,960
1989	17,520
1990	18,576
1991	17,360
1992 (March)	17,268

Source: Chilean Central Bank

In October 1990, Chile reached a favorable debt rescheduling agreement with its creditor banks, postponing half of Chile's repayments until 1991 through 1993.

Since 1985, Chile has reduced its debt to commercial banks by approximately $10.3 billion, or about 70 percent. Chile's debt-servicing burden is now at a level comparable to countries that have normal access to private international capital markets. In 1990, its foreign debt service burden stood at 22.7 percent of its foreign exchange earnings from exports of goods and nonfinancial services, the second lowest debt service ratio in Latin America after Venezuela. In addition, in 1992, the value of Chile's debt on the secondary market was selling for over 90 cents on the dollar, a higher rate than that of any other major developing debtor country that has restructured its commercial debt. In contrast, in 1985, Chilean debt sold for 30 cents on the dollar.

Planned Investment-Related Reforms

The Chilean government is planning to liberalize D.L. 600 by allowing capital repatriation after 1 year instead of 3, by establishing a specific time frame for approving foreign investment applications, and by lowering the corporate tax rate.

The Chilean administration is considering allowing foreign investors to repatriate capital after 1 year instead of the current 3 years. A top official from the Chilean Ministry of Finance recently explained that the restriction was initially meant for long-term investments, such as those in the mining and energy sectors. He noted that investments are now going into areas such as the service sector, where investments might be for shorter terms and where there is concern about the 3-year restriction.

This official also stated that the Chilean government is considering establishing a deadline for approving a foreign investor's application to do business in Chile. If the Foreign Investment Committee has not replied to an investor's application within the allotted period, the application would be considered automatically approved.

Finally, the Chilean administration is thinking about lowering the fixed tax rate applied to investors' profits under D.L. 600 from 49.5 percent to an effective rate of 42 percent.

Concerns of U.S. Companies

Representatives from several U.S. companies told us that they have several concerns regarding investment in Chile. These concerns include Chile's capital reserve requirement and Chile's lack of a tax treaty with the United States.

Reserve Requirement on Foreign Borrowed Capital

In June 1991, Chile imposed a capital reserve requirement, known as the "encaje," on all foreign borrowed capital entering the country, when short-term foreign capital inflows threatened to overheat the Chilean economy and put upward pressure on the value of the peso. Chile's high real interest rates, compared with relatively lower international interest rates, stimulated an inflow of short-term foreign capital beginning in late 1990.

The encaje requires all investors to post a cash reserve of 20 percent of the total capital obtained from foreign-source loans brought into Chile. The reserve amount is deposited with the Chilean Central Bank for 1 year in a non-interest-bearing account. The reserve requirement applies regardless of whether the capital enters for short-or long-term use. As an alternative to holding 20 percent of their investment in the Chilean Central Bank, investors have the option of paying a tax equal to the interest forgone on the 20 percent of their investment or purchasing the equivalent amount of Chilean Central Bank bonds.

Officials from two U.S. firms we spoke with stated that while the "encaje" does not impose a significant financial burden on their companies, it "sends the wrong signal" to foreign investors. They noted that investors coming in under D.L. 600 are supposed to have a guarantee that their contract will not be unilaterally changed by the Chilean government. Several companies stated their belief that the encaje effectively changes their contracts and violates the spirit of Chile's foreign investment policy. One company representative questioned whether the Chilean government, which instituted the encaje in response to pressures on the domestic economy, might in the future impose other burdens on foreign investors to improve the domestic economy.

Lack of a Tax Treaty

Because there is no tax treaty between Chile and the United States, profits of U.S. companies operating in Chile are taxed by both the Chilean and U.S. governments. According to a U.S. State Department official, the United States approached the Chilean administration regarding a possible tax treaty that would eliminate double taxation. However, according to this official, the Chilean government is not interested in negotiating a tax treaty unless it is in the context of negotiations for a U.S.-Chilean free trade agreement.

Factors Affecting U.S. Investment in Chile's Mining Sector

On May 5, 1992, the Chilean government passed a law allowing the state-owned copper company to enter into joint ventures with foreign investors. This measure could further increase foreign investment in Chile's mining industry.

However, U.S. companies we spoke with are concerned that companies with established mining operations must often incur significant administrative and litigation costs in defending their property rights. In addition, U.S. companies noted that Chile's ports need to be expanded and its electricity, water, and road services improved.

Since 1982, more than half of all foreign investment in Chile has been concentrated in its mining industry. U.S. companies are a major source of this investment. In addition, according to a representative of a major mining equipment company, U.S. companies expect to export approximately $250 million in mining equipment to Chile between 1992 and 1995.

Proposal for Joint Ventures Between Chile and Foreign Investors

According to a U.S. embassy official in Chile, President Aylwin signed legislation in May 1992 that allows Chile's state-owned copper corporation, CODELCO, to enter into joint ventures with foreign investors. Chile has 23 percent of the world's copper reserves. In 1990, CODELCO produced about 75 percent of Chile's copper and owned about 25 percent of the mining properties. The intent of the new law is to alleviate CODELCO's financial and production problems by providing the copper company with money and technology from foreign investors.

In addition, the new law authorizes CODELCO to transfer small- and medium-sized mines to ENAMI, Chile's state-owned smelter company. ENAMI, unlike CODELCO, has legal authority to sell outright its properties, and it is expected that CODELCO will pass many small and medium mining properties to ENAMI, which then may sell them to private mining concerns.

Representatives from three of the U.S. companies we spoke with stated that they believe the joint venture reform will benefit foreign investors. According to a U.S. embassy official in Chile, the new law will grant companies access to known copper reserves and will allow them to bypass the costly and time-consuming exploration phase. A few U.S. companies told us that they might be interested in working with CODELCO on future projects.

Concerns Raised by U.S. Companies

The views of the representatives from the U.S. companies we interviewed regarding challenges to property that is already claimed and Chile's infrastructure are discussed in the following sections.

Challenges to Property Rights

The major concern cited by U.S. companies investing in Chile's mining sector is that companies or individuals frequently file claims challenging the property rights of established mining companies. These claims are generally filed when property was incorrectly surveyed, the survey permit contained clerical mistakes, or the permit was improperly submitted to the courts. This practice, referred to as "over-staking," can result in significant administrative and litigation costs for the company with the original property claim.

A small group of Chilean investors challenged one large U.S. company on the grounds that the company's surveyor report for a site already under development was improperly filed. The investors' challenge was based on the fact that the U.S. company had submitted the wrong copy of the surveying document. According to representatives from the U.S. company, they negotiated a settlement to avoid a time-consuming and costly judicial process.

Representatives from another U.S. company told us that they abandoned one of their mining projects because of the amount of money they were spending on legal fees to defend their claim. This company spent about $1.5 million over 3 years to try and resolve the problem. According to these representatives, 37 concession claims were stacked against their existing claim on the basis of one typographical error in their paperwork.

In addition, the views of U.S. companies were substantiated through discussion with two non-U.S. companies investing in Chile's mining industry. For example, a representative from a Canadian company told us that his company had been in court 15-20 times in the past 10 years to defend its property claims. He stated that these property disputes are quite common, time-consuming, and disruptive.

Although most of the companies we met with in Chile stated that challenges to property are a concern for investors, all except one U.S. company said that they would not abandon their mining operations in Chile because of over-staking. They noted, however, that in order to protect their property, their company lawyers spend a great deal of time ensuring that the company's property rights documents are filed properly.

Officials from the Ministry of Mines acknowledged that over-staking is a problem. They noted that the Ministry of Mines is trying to improve its record-keeping efforts for property claims. They told us that the Ministry is developing a computerized data base that will help prevent additional claims from being filed on property that has already been claimed and is under development.

Needed Improvements in Infrastructure

In addition, many of the companies we spoke with stated that Chile's ports need to be expanded, and its electricity, water, and road services need to be improved.

Six U.S. companies noted that the increase in foreign investment in mining and other industries has caused congestion in many of Chile's ports and that the ports need to be enlarged or new ones built. Some mining companies have built their own ports, although doing so has created an additional financial burden for these companies. Others are planning to build ports for future projects.

In addition, many company officials told us that electricity and water services are inadequate in the northern area of Chile where many of the mines are located. They stated that water is critical to mining because it is used in the chemical processing stage of mineral extraction. Several companies are considering building their own power plants because the supply of electricity is not large enough to support their projects. In addition, a few companies we spoke with have built or are planning to build their own water systems. Furthermore, representatives from several companies told us that the secondary roads in the mining areas need to be improved.

United States-Chile Agricultural Trade

Certain import trade barriers exist in Chile's agricultural sector. For example, Chile imposes a variable import levy on selected agricultural products. On the other hand, Chilean growers and agricultural officials consider U.S. marketing order requirements a major barrier to Chilean agricultural exports.

The principal Chilean fruit exports to the United States generally complement U.S. production. However, spokespeople for the U.S. agricultural industry are concerned that increased exports from Chile could adversely affect U.S. producers.

Trade Barriers to Agricultural Trade Between the United States and Chile

In the agricultural sector, Chile's main trade barrier to U.S. agricultural exports is a price band on four products. U.S. exports are also hindered by preferential tariffs that Chile grants to some products from selected Latin American countries.

Price Bands

The Office of the U.S. Trade Representative considers agricultural price bands a major barrier to trade with Chile. According to Chilean agricultural officials, wheat, wheat flour, oilseeds, and sugar are currently subject to a price support mechanism known as a "price band." Under the mechanism, the Chilean government imposes a variable import levy in addition to the flat 11-percent tariff rate on imports of these commodities when their price falls below the minimum price set by the Chilean government. The minimum price is based on the price of the commodity over a prior period of 60 months. Chilean officials argue that the price bands are necessary to protect domestic farmers from the effects of international price fluctuations. The U.S. government, however, opposes Chile's reliance on price bands because they limit the competitiveness of U.S. wheat and oilseed exports to Chile.

Preferential Tariffs

Chile grants preferential tariffs to certain products from other Latin American countries belonging to the Latin American Association for Integration (ALADI). ALADI member countries receive as much as 30- to 50-percent reductions on tariffs on their exports to Chile. Although these preferential tariffs affect only 6 percent of Chilean imports, they have a direct impact on potential U.S. exports of cotton and oilseed products. For example, many Chilean importers prefer high-quality U.S. cotton and oilseed products to similar imports from Latin American countries.

However, these U.S. products are subject to full tariff rates and therefore are not as competitive as imports from ALADI countries.

U.S. Marketing Orders

Grapes marketed in the United States between April 20 and August 15 are subject to a marketing order requirement of U.S. number 1 table grade. Chile has complained that whereas quality inspection for U.S. grapes is done at the point of origin, Chilean grapes are inspected upon entry into the United States. Chilean growers argue that the marketing order's implementation is discriminatory and represents a nontariff barrier, because the Chilean fruit cannot always meet number 1 table grade standards after a 14-day boat trip to the United States. An official with the U.S. Agricultural Marketing Service explained that to ensure that grapes meet table grade 1 standards upon entering interstate commerce, they inspect and certify Chilean grapes on arrival in the United States. According to this official, the condition of Chilean grapes at their point of origin, 14 days before they arrive in the United States, is not an issue.

Principal Chilean Agricultural Exports to the United States

Fresh fruits are Chile's principal agricultural exports to the United States. Table grapes are the leading Chilean fruit export, accounting for more than half the value of Chilean agricultural exports to the United States in 1991. Other major Chilean fruit exports include peaches, nectarines, plums, and pears. Processed agricultural products, such as apple juice, are becoming increasingly important exports to the United States, as Chile's fruit and vegetable processing industry expands and develops. Chile's reinstatement to the Generalized System of Preferences and the elimination of customs duties on some of these products have provided excellent opportunities for growth.[1] Chile has also enjoyed considerable success promoting its wine exports to the United States. It is now the third largest supplier of wine to the United States, replacing Germany and following Italy and France. Table III.1 shows Chile's major agricultural exports to the United States in 1990 and 1991.

[1]The Generalized System of Preferences is a program whereby the United States and certain other industrialized countries grant duty-free entry of imports from developing countries that are eligible for benefits.

Table III.1: Major Chilean Agricultural Exports to the United States, 1990 and 1991

U.S. dollars in millions

Commodities	1990	1991
Table grapes	$264.4	$342.3
Peaches & nectarines	41.5	47.8
Apple Juice	13.3	41.4
Plums	24.7	28.2
Pears	11.2	19.6
Wine	14.1	18.9
Others	156.1	169.7
Total	**$525.3**	**$667.9**

Source: Central Bank of Chile.

Chile has become the second major supplier after Mexico of U.S. fruit and vegetable imports. Chile sells approximately 40 percent of its agricultural exports to the United States. Table III.2 shows the value of U.S.-Chilean agricultural trade in 1990 and 1991.

Table III.2: Value of U.S.-Chilean Agricultural Trade, 1990-1991

U.S. dollars in millions

Trade	1990	1991
U.S. imports from Chile	$525.3	$667.9
Chilean imports from the United States	40.5	66.3

Source: Central Bank of Chile.

Although the United States is a major agricultural exporter, it sells few agricultural commodities to Chile. This situation is not surprising given Chile's modest population. However, because the United States accounts for only about 11 percent of Chile's agricultural imports, there may be opportunities for expanded U.S. agricultural exports.

Most of Chile's major fruit exports to the United States do not compete with U.S. agriculture, but rather complement domestic production. The fruit industry has become a major element of Chile's economic growth. Chilean fruit exporters have taken advantage of a growing season that coincides with the Northern Hemisphere winter to develop valuable markets in the United States.

U.S. Growers Concerned About Increased Chilean Exports

Some U.S. growers are concerned about the influx of fresh fruit and vegetable imports from Chile. A spokesman for a major growers' organization noted that fresh fruit exports to the United States have risen dramatically in recent years and are expected to continue to increase by as much as 40 percent over the next few years. He cautioned that such an increase could adversely affect U.S. producers, particularly in the case of fruits such as apples that have a long shelf life and are marketed throughout the year. He also remarked that although Chilean fruit and vegetable production is complementary to U.S. production, prices decrease when Chilean exports overlap with domestic production during the beginning or end of the season.

On the other hand, another representative of a major growers' organization explained that Chilean fruit is not a significant source of competition for domestic producers if these fruits enter the U.S. market primarily during the off season. A spokesman for a growers' organization also noted that U.S. distributors benefit from Chilean imports because such imports enter the market when there is no domestic production.

U.S. Efforts to Promote Trade With and Investment in Chile

The United States has promoted trade with and investment in Chile through several mechanisms aimed at encouraging liberalization efforts in developing countries. President Bush's Enterprise for the Americas Initiative (EAI) set the stage for negotiations for a U.S.-Chilean free trade agreement. The Chilean government believes a free trade agreement with the United States is the most important component of EAI. However, Chile's environmental policy may have an impact on free trade negotiations. In addition, several U.S. trade-related agencies support trade and investment relations with Chile.

Enterprise for the Americas Initiative

In June 1990, the U.S. administration launched the Enterprise for the Americas Initiative, a program designed to strengthen Latin America and Caribbean economies through increased trade and investment, and through the reduction of official debt to the United States. As part of the trade component of EAI, the administration announced a willingness to enter into free trade agreements with Latin American countries. Recognizing that some countries may not be ready to negotiate a comprehensive free trade agreement, President Bush invited interested parties to negotiate bilateral framework agreements with the United States.

The United States and Chile signed a bilateral framework agreement on trade and investment in October 1990. The U.S.-Chilean framework agreement set up a U.S.-Chilean trade and investment council to develop the basis for a future free trade agreement.

To help encourage investment reform in Latin American and Caribbean countries, EAI proposed a new lending program in the Inter-American Development Bank (IADB) to support reforms in the investment sector. Chile received the IADB's first investment sector loan, for $150 million, in June 1991.[1]

EAI also proposes to reduce official bilateral debt owed to the U.S. government. Chile was the first country to sign an agreement to reduce a part of its official debt. Chile's Public Law 480 debt has been reduced by 40

[1]The Inter-American Development Bank has 15 loans outstanding to Chile for a total of $1.7 billion. Of this amount, $600 million has been disbursed, and $1.1 billion is available for disbursement. Most of the IADB's recent loans to Chile are for its social sector, including loans for road improvement, science and technology development, health improvements, and labor training. Prior loans were disbursed for upgrading water, sewage, and electricity facilities.

percent, to $23 million.[2] In addition, in February 1992, Chile signed an agreement with the United States to establish an EAI Environmental Fund. The interest on the remaining portion of this debt would be paid in local currency and placed in this Fund to be used for environmental conservation activities.

Benefits of a U.S.-Chilean Free Trade Agreement

The Chilean government strongly believes that establishing a free trade agreement with the United States is the most important component of EAI. In May 1992, during the Chilean President's visit to the United States, the U.S. President designated Chile as the next country with which the United States will negotiate a free trade agreement.

A U.S.-Chilean free trade agreement should lower or eliminate trade tariffs between the two countries. For the top 10 Chilean exports to the United States, U.S. import tariffs are generally low on those that are unprocessed, such as fruits, copper, and fish. U.S. import tariffs are generally higher on processed products and on higher valued goods. (See table IV.1.)

Table IV.1: U.S. Tariff Rates on Selected Chilean Imports, 1991

Commodity	Tariff rate[a] (Percent)
Fruit, nuts (not including oil nuts) fresh or dried	1.8
Copper	0.6
Gold	8.8
Fish, fresh, chilled, or frozen	0.4
Vegetables, roots and tubers, prepared or preserved	13.6
Inorganic chemical elements, oxides, halogen salts	3.0
Fruit, vegetable juices unfermented	21.5
Women/girls, coats, capes etc., textile fabric, not knit	18.0
Crude vegetable materials, not elsewhere specified	0.9
Wood, simply worked wood, and railway sleepers of wood	1.6

[a]This is a calculated average tariff rate for a 3-digit Standard International Trade Classification commodity group.

Source: Compiled from official statistics of the U.S. Department of Commerce, National Institute of Health Census data file.

In addition, an official at the Chilean embassy in the United States noted that the Chilean government hopes that a free trade agreement with the

[2]Public Law 480, also known as "Food for Peace," authorizes the distribution of U.S. food surpluses to developing countries.

United States will demonstrate to the international community that Chile is committed to free trade and to a democratic government.

Further, U.S. and Chilean government officials stated that a U.S.-Chilean free trade agreement would send a signal to other Latin American countries that they will be rewarded for economic reform, market liberalization, and democratization. Several U.S. and Chilean government officials noted that if the United States fails to sign an agreement with Chile, other countries in the region will question the U.S.' commitment to forge closer economic ties with them.

Chile's Environmental Policy May Affect Free Trade Negotiations

According to officials in the U.S. embassy in Chile and the Office of the U.S. Trade Representative, the lack of a comprehensive environmental policy may affect U.S.-Chilean free trade negotiations. An official with the U.S. embassy in Chile noted that Chile lacks laws in several environmental areas and that laws in other areas are only sporadically enforced. According to the U.S. embassy, many of these laws are unknown or ignored. To counteract this problem, the present Chilean government has focused its attention on environmental policy. The Chilean government considers the establishment of a more comprehensive environmental policy a government priority. The Chilean administration recently took steps to this end by establishing a National Environmental Commission. One of the Commission's main tasks is to create an overall environmental regulatory framework that will synthesize more than 2,000 Chilean laws that bear on the environment. Some of these laws, such as those that deal with water and air quality, are patterned after U.S. standards.

Chile's National Environmental Commission has found that Chile lacks regulations in several problem areas, including the management of toxic wastes and integrated river basins. Furthermore, the Commission has found that investors are not required by law to submit environmental impact statements before initiating a project. However, a private environmental consultant in Chile noted that, in practice, investors must submit an environmental impact statement to various ministries in order to receive land, air, and health permits necessary for project approval. He noted, nevertheless, that most foreign investors comply with their home country standards, which are generally more stringent than those in Chile. He explained that investors believe it is best to install environmentally safe technology at the beginning of their project rather than to make costly changes when their project is already underway.

Drafting a comprehensive Chilean environmental law is expected to be a long process and will require building a consensus among many governmental agencies and the private sector. A comprehensive law is not expected to be presented to the Chilean Congress this year. In the interim, the Chilean government may attempt to fill some of the regulatory vacuum with presidential decrees, which do not require congressional approval, to address specific concerns. The Chilean President has issued one such decree, which limits sulfur dioxide emissions.

Other U.S. Efforts

The United States has supported trade with and investment in Chile through several trade-related agencies. For example, since 1990 the Overseas Private Investment Corporation (OPIC) has granted political risk insurance to six projects in Chile. Two projects were in the mining sector, one each in forestry and in fisheries, and two in the banking sector. OPIC officials noted that because several companies experienced expropriation in Chile in the 1970s, some companies are now wary of investing in Chile without political risk insurance. This wariness is particularly true for companies investing in the natural resource area. Natural resources often are a sensitive area for most countries and are the first to be expropriated in the event of political change.

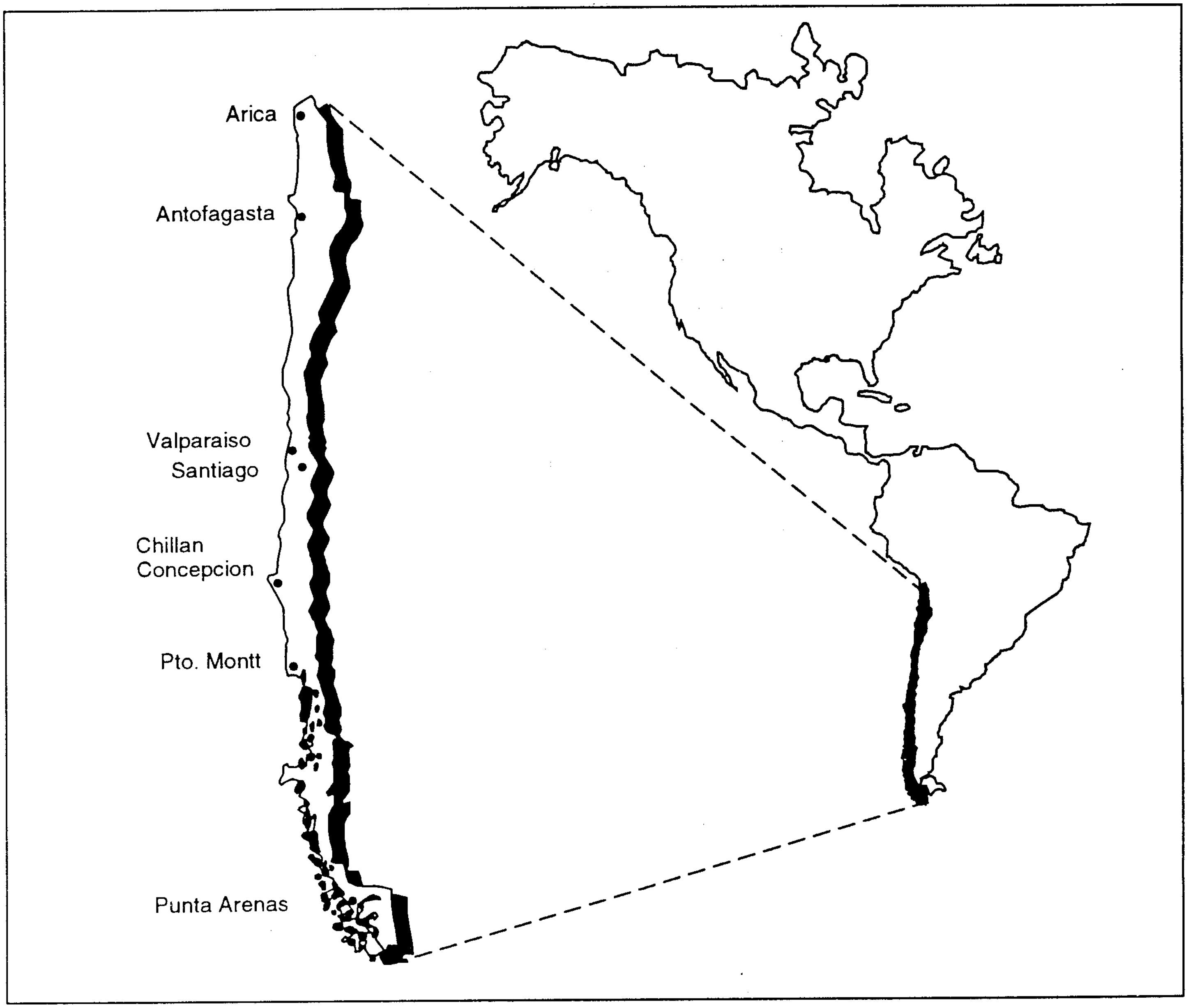
OPIC also issues loans and loan guaranties to U.S. companies investing overseas. Recently, however, because of the favorable economic and political conditions in Chile, companies that have viable projects have been able to secure commercial loans from U.S. banks or from Chilean banks. Therefore, they have not needed OPIC loans or guarantees. According to an OPIC official, OPIC's purpose is to help "needy" developing countries, and Chile no longer fits this description.

The U.S. Export-Import Bank offers a variety of export financing programs to assist U.S. exporters. These include loans, loan guaranties, and credit insurance programs. In 1991, the Export-Import Bank did not provide direct loans to support U.S exports to Chile. However, the Bank did provide $7.4 million in loan guaranties and $3.4 million in credit insurance.

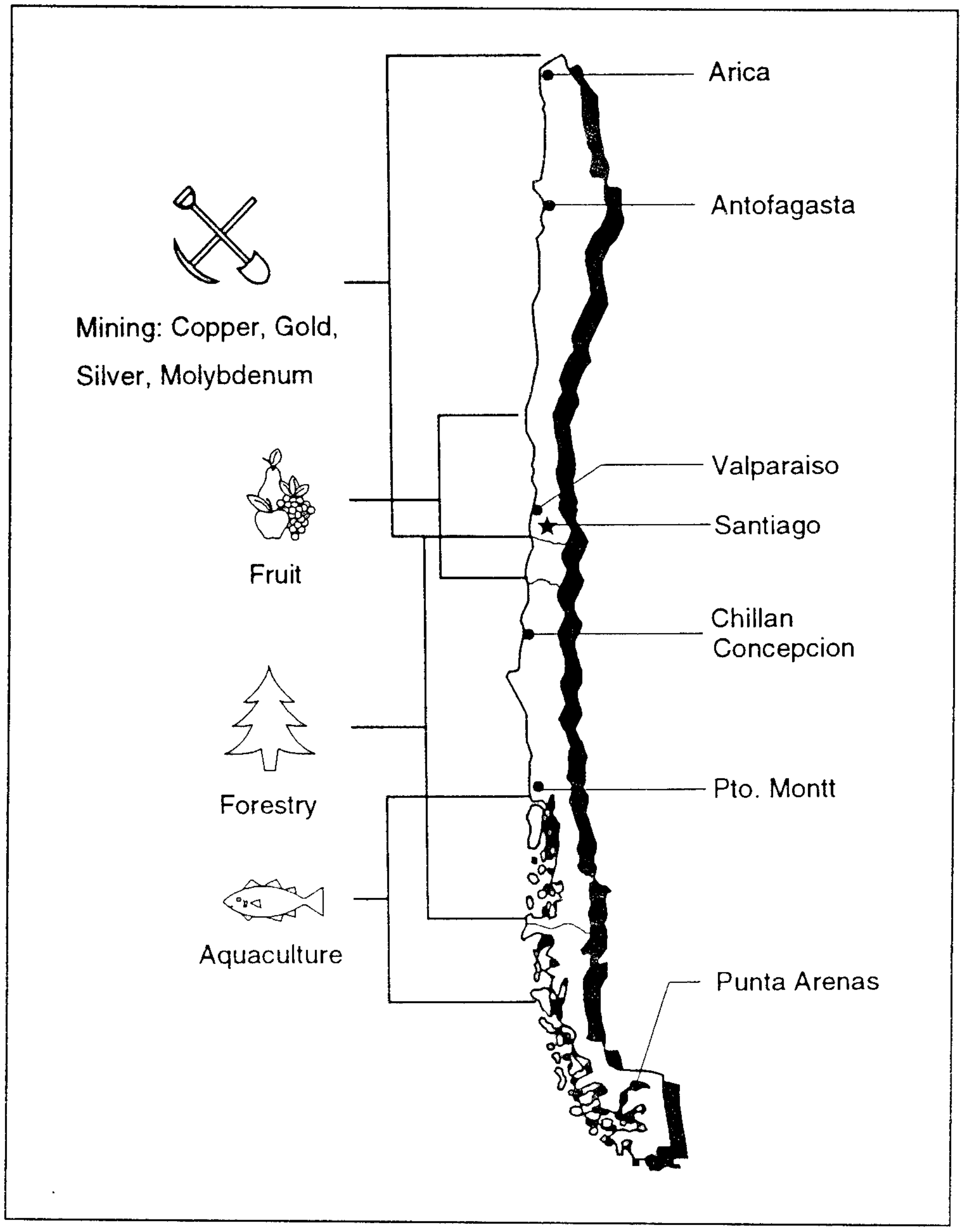
In 1991, the Trade Development Program approved $2.450 million in grants to Chile to pay for feasibility projects in such fields as environment, health care, and energy. The Trade Development Program is currently funding a total of 12 feasibility projects in Chile.

Other agencies that work to promote exports to Chile include the Agriculture Department's Foreign Agricultural Service, which promotes the export of agricultural commodities and food products in Chile, and the Commerce Department's U.S. and Foreign Commercial Service, which conducts a trade promotion program.

Location of Chile



Selective Economic Activities in Chile



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