

## Chile and its “lateral” trade policy

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This article looks at the bases, objectives and results of the “lateral” trade policy adopted by Chile in the 1990s. In particular, it seeks to give a clearer idea of the role of bilateral agreements and to incorporate into the discussion the empirical evidence observed in the case of Chile. It concludes that the criticisms levelled at this policy, especially by those who advocate unilateral trade openness rather than other options, are based on an incomplete analysis of basic international trade theory. It is therefore argued that the economic concepts taken into account in evaluating the economic and political rationality of this strategy must be expanded to acknowledge the complementarity of the available options and to incorporate the analysis of game theory, the existence of economies of scale, the transaction costs existing in the functioning of international markets, and foreign policy elements. Through this multidimensional strategy, Chile has sought to overcome various problems and to stimulate the areas of its economy which have been most dynamic in the 1990s: exports of products with greater added value, services and capital. By traditional standards of appraisal, the results obtained do not reflect any negative impacts but they do show positive effects.

# I

## Introduction

Chile has been one of the Latin American countries which has promoted one of the most active policies of bilateral trade agreements during the 1990s, based on both foreign policy and economic considerations. This experience differs from the integration policies promoted from the 1960s onwards in three respects: i) it is based on the signing of broad free trade agreements within the framework of an outward-looking development policy rather than the creation of common markets or customs unions; ii) with varying degrees of success, the agreements have stimulated the inclusion of the different dimensions of trade, thus reflecting the greater complexity of the international economic relations of today, and iii) the efforts to conclude agreements are not limited to the countries of the region, although these are given priority (especially in the case of the members of the Latin American Integration Association (ALADI): efforts have also been made to progress in integration with the United States and Canada, the Asia-Pacific economies, and the European Union. This is an acknowledgement of the geographical diversification of Chile's economic links.

This policy has not been free from criticisms based on various arguments, especially in the area of trade policies. In the context of the discussions on the proposal to reduce tariffs from 11% to 6% over a period of five years, which was approved by Congress, however, a group of economists of various political beliefs argued in favour of the proposal for a uniform tariff reduction presented by the government, pointing out that this would correct serious distortions in the prevailing tariff scheme and allow the country to improve its linkages with the international economy and adding that the signing of a considerable number of trade agreements had caused the uniform 11% tariff to develop in practice into a highly

differentiated tariff resulting in negative effective protection for some sectors and a level of protection considerably greater than 11% for others (*El Mercurio*, 1998).

This discussion is similar to that which took place in the early 1990s about the type of trade policy that the United States Government should follow in order to promote greater trade openness. Lawrence Summers, the present Under-Secretary of the Treasury of the United States, stated with respect to this dispute that there should be unquestionable support for all lateral reductions in trade barriers, whether they be multi-, uni-, tri- or pluri-lateral (Frankel, 1997). By that he meant that the discussion was not particularly relevant: what was important was to take advantage of the trade opportunities that presented themselves, and in that respect all "lateral" initiatives were good.

There are two important aspects underlying the public debate in Chile: i) a sufficiently representative number of economists reject differentiated tariffs and their effects, and ii) a policy of unilateral openness is to be preferred over other options.

The purpose of the present paper is to set forth the bases and objectives of the "lateral" trade policy followed by Chile since 1990. In order to do this, we will analyse the aspect of unilateral openness, explaining the justification for the policy options followed since the restoration of democracy in Chile.<sup>1</sup> In particular, an effort will be made to clarify the role that bilateral agreements have played and still play in the trade policy of the governments of the Democratic Coalition, so as to further a better understanding of the objectives pursued, which are at once economic and political, and to incorporate into the discussion the empirical information applicable to the Chilean case which has been accumulated so far in this respect.

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<sup>1</sup> For an analysis of the period of President Patricio Aylwin, see Sáez, Salazar and Vicuña, 1995.

## II

### The role of economic agreements and trade policy options

The main conclusions that economic theory offers on trade policy hold that unilateral openness is the best policy for a small country like Chile, since it helps to ensure better resource allocation and hence maximizes the well-being of the community as a whole. It has been recognized by economists of different political persuasions that the unilateral openness policy applied by Chile since the mid-1970s has helped to achieve rapid growth of its exports, both traditional and non-traditional, while at the same time stimulating greater diversification in terms of products and market destinations.<sup>2</sup> An equally important factor was the role played by the State in the 1960s and 1970s in establishing incentives of different types which helped to reduce the risks of exporting and thus helped to create an endogenous trade development process.<sup>3</sup>

The governments of the Democratic Coalition have recognized the validity of this argument and have promoted and enhanced the unilateral openness process. Thus, in 1991 tariffs were reduced on an across-the-board basis from 15% to 11%, and Congress recently approved a further reduction of 5 percentage points over a period of five years. As a result, the uniform tariff applicable to imports from the countries with which Chile has not signed free trade agreements will be only 6%: the lowest level in the last four decades.<sup>4</sup>

However, the Democratic Coalition has made still further efforts to secure greater openness in areas

that affect trade from other dimensions: in particular, in the telecommunications sector it has promoted broad deregulation and introduced greater competition, and in financial matters it has expanded the available field of business while at the same time improving the supervision of banks, insurance companies and securities. The private sector has begun to invest in the public infrastructure. Finally, the process of privatization of public enterprises has continued, with special attention to ensuring transparency and protection of the interests of the State in this process. In such an important area as intellectual property rights, in 1991 Chile became the first Latin American country to grant protection for pharmaceutical products. The government has also ratified important international treaties such as the Paris Convention (in 1991) and the international agreement for the protection of plant varieties (in 1996). In the area of foreign investment, it has signed numerous agreements for the promotion and protection of investments, thus giving a clear sign of the stability of its policies.

In short, the process of greater openness promoted by the governments of the Democratic Coalition cannot be evaluated solely in the light of the traditional trade parameters (tariff reduction and elimination of non-tariff measures), but must also be understood in the context of the whole set of elements making up the new dimensions of trade policy.

<sup>2</sup> See, for example, Wisecarver (ed.), 1992, and Meller, 1996.

<sup>3</sup> See the comments by Meller, 1996, and the studies by Sáez (1994a and b).

<sup>4</sup> It should be added that the Chilean trade regime is marked by the absence of non-tariff barriers and other types of additional protection mechanisms (except for a very limited number of agricultural products). If we take into account the agreements already in force, then the tariff rate will be substantially lower.

### III

## The role of economic agreements

### 1. What role has been played by the international economic agreements negotiated by Chile?

The international multilateral, plurilateral and bilateral economic agreements have complemented and completed the process of unilateral openness in the aspects in which this process cannot of itself intervene or take decisions.

This assertion may be examined in the light of the specific case of a "minor" non-traditional export product: fresh and frozen scallops. In the late 1980s, after substantial investments in the north-central area of Chile, the export of such shellfish began to be developed, with 60% to 70% of the exports going to the French market. In 1993, however, the French Government decided that scallops from Chile (and other areas) were not the same as the French ones, and it imposed a labelling and marketing regulation whereby only scallops of the species *Pecten* could be sold as "*coquille Saint-Jacques*". All others, including the Chilean product, must be sold as "*pétoncle*", which French consumers associated with a product of lower quality and price. This "scientific" classification artificially affected the conditions of competition, giving rise to a concealed form of protection of the French product, which maintained its position in the market, while adversely affecting the Chilean product.

After the failure of diplomatic approaches and private-sector efforts, the Chilean Government resorted to the Dispute Settlement Body of the World Trade Organization (WTO), on the grounds that this regulation was a form of arbitrary discrimination which sought to protect French producers.

Although the case was finally settled through direct negotiations which corrected this distortion, the existence of this obligatory, independent and binding machinery provided for in the WTO promoted a satisfactory solution which the diplomatic approaches of a small country had not been able to secure. Obviously, this is not the only example of such a situation; mention may also be made of the restrictions on fresh apples imposed by the European Economic Commu-

nity in 1993 and the restrictions on exports of tobacco imposed by the United States in 1993, both of which were settled in the context of the former General Agreement on Tariffs and Trade (GATT).<sup>5</sup>

### 2. What lessons may be drawn from these experiences?

The first lesson is that international trade does not take place in a vacuum: the possibilities of taking full advantage of its benefits do not depend only on the domestic policies adopted by a country, but also, and fundamentally, on those adopted by its trading partners.

The second lesson is that one of the main functions of international agreements is to correct market failures that unilateral openness cannot correct itself. They are designed to reduce the transaction costs faced by private agents when taking investment decisions. The economic literature defines transaction costs as the costs of measuring the value of the attributes of the goods which are being traded and the costs of protecting rights and monitoring and enforcing agreements.<sup>6</sup> In the opinion of Coase (1988), without the concept of transaction costs, which is largely absent from current economic theory, it is impossible to understand the functioning of the economic system, usefully analyse many of its problems, or establish a basis for policy formulation.

International economic relations suffer, among other problems, from asymmetrical information; market flaws and uncertainty (such as lack of knowledge of market conditions and of laws which affect trade and the stability of mutual trade); lack of transparency; and the existence of permanent incentives to depart from certain patterns of behaviour (as for example through the proliferation of protectionist pressures). All these problems increase the cost of operating in international markets.

<sup>5</sup> It must be admitted that the solutions reached do not fully satisfy the aspirations of Chile, but they have allowed the economically acceptable continuation of these activities

<sup>6</sup> For other definitions, see Dixit, 1996.

Agreements have two essential functions. Firstly, they contribute to mutual trade openness which makes it possible to take advantage of the benefits of trade. In this context, game theory provides the economic bases for agreeing on trade openness between countries. This case is a simple example of the application of the prisoner's dilemma: the ideal world for a country A is to cause country B to dismantle its trade barriers, while maintaining its own barriers, but finally both country A and country B decide to maintain their respective barriers, which is the worst possible result for both of them in terms of well-being. Trade negotiations of all types open up opportunities for ongoing co-operation once countries have identified their preferred joint strategies, but in order to construct this trading space mechanisms are needed to identify and punish "fraud".

Secondly, agreements are designed to reduce the transaction costs of international economic relations, especially in view of their current multidimensional nature, since they provide a set of rules applicable to the members which ensure stability, stimulate transparency through specific obligations, and ensure the fulfillment of the rules through binding instruments

which reduce the incentives to depart from them. Charles Kindleberger has described this latter function as the provision of international-level public services because these are a necessary "good" for the stability of commercial transactions and if they did not exist this would bring us to a situation similar to that experienced by the world in the 1930s.

We thus see that international agreements promote trade through at least two mechanisms: i) the elimination and regulation of trade barriers through the provision of a framework for co-operation, and ii) the reduction of transaction costs. Both these aspects, as well as those of a political nature, are usually ignored in the public debate in Chile on the rationality of the government's strategy with regard to trade agreements. As Coase (1988) notes, it is necessary to introduce explicit positive transaction costs into economic analysis in order to be able to study the world as it actually exists.

But if we already have the WTO, which is a multilateral institution with over 130 member countries, then what is the point of negotiating bilateral economic agreements? The answer to this question involves not only economic but also political elements.

## IV

### The multilateral trade system

From the point of view of Chile, the multilateral trade system represented by the WTO is the international economic negotiation forum par excellence, since most of Chile's main trading partners participate in it.<sup>7</sup> In this case, not being a member of the WTO is simply not a viable alternative. Negotiations in this environment represent the best possible option for Chile and offer the greatest benefits because they are at a multilateral level, do not involve trade diversion, and reduce the transaction costs with a broad group of trading partners operating under common rules: Chile benefits from the economic concessions exchanged among the members of WTO regardless of their size and relative weight and their level of development. However, this institution also has a number

of limitations and imperfections, and some of the latter stem from its own multilateral nature.

The last round of multilateral negotiations, and the most important in this century, was the Uruguay Round of GATT (ECLAC, 1994). This round, which concluded in December 1993, enabled over 120 countries to arrive at an ambitious set of agreements, thanks to which Chile's links with the rest of the world have been further strengthened, and gave a strong boost to the rights and duties laid down in the system, especially non-discrimination, national treatment and the most-favoured-nation clause.

However, the negotiations were highly complex—the longest in the history of GATT—and often involved great difficulties. Indeed, they were originally supposed to have ended in December 1990, but this did not occur and between 1990 and 1993 there was great uncertainty about what was really going to happen to the multilateral trade system which had

<sup>7</sup> The absence of the Chinese People's Republic and Russia is a serious defect which needs to be corrected as quickly as possible.

TABLE 1

**Main regional agreements, 1957-1996<sup>a</sup>**

Africa/Middle East		Europe	Americas	Asia-Pacific
1957		1957 - Rome Treaty		
1960		1960 - European Free Trade Association (EFTA)	Latin American Free Trade Association (ALALC)	
1965			1969 - Andean Pact	Australia-New Zealand
1970				
1975	Economic Community of West African States			1978 - Association of South-East Asian Nations (ASEAN)
1980	South African Conference		Latin American Integration Association (ALADI)	
1985	1989 - Arab Union of the Maghreb		1988 - USA-Canada Agreement	1985-1987 - ASEAN expands
1990-1996	1991 - Economic Community of Africa	1991 - European Economic Area (EFTA + EU) 1993 - Maastricht Treaty	1991 - MERCOSUR 1992 - NAFTA 1996 - the Andean Pact becomes the Andean Community	1992 - South-East Asian Regional Association 1993 - Asia-Pacific Economic Council (APEC)

Source: Frankel (1997).

<sup>a</sup> This is not a complete list.

TABLE 2

**Regional agreements notified to the World Trade Organization by its members**  
*(Number of members notifying agreements)*

1957-1990	1991	1992	1993	1994	1995	1996	1997	1991-1997
30	1	9	7	3	7	14	20	61

Source: WTO.

been developed around GATT since 1948. Academics of different schools of thought wrote books warning of the trade wars that were likely to break out between the United States, Japan and the European Union (Thurow, 1991; Krugman, 1996; Bhagwati, 1991).

Furthermore, in this highly uncertain situation, the United States made a significant turnaround in its trade policy, embarking on an active policy of bilateral trade negotiations (Israel, 1985; Canada, 1989, and NAFTA, 1992). Leaving behind the approach taken since the Second World War, the European Union negotiated and signed the Maastricht Treaty (1992), the most important since the Rome Treaty, and continued to incorporate new members (Frankel, 1997) into what some authors called "Fortress

Europe". It is worth recalling that the Asia-Pacific Economic Council (APEC) consolidated its position as a regional economic forum for the Asia-Pacific region in those years, especially in 1993 (tables 1 and 2). It has been estimated that 90% of the members of WTO belong to some kind of regional agreement (Lawrence, 1996).

In Latin America, MERCOSUR has become the main economic integration initiative, with the biggest scope, and has had considerable effects on trade in the hemisphere, especially that of Chile, extending beyond exclusively economic aspects.

The results of the Uruguay Round were highly significant, strengthening and clarifying rights and obligations in a significant number of aspects, securing the incorporation of the agricultural and textiles

and clothing sectors into the multilateral rules, and establishing the first multilateral agreement on trade in services and on trade-related aspects of intellectual property. The WTO has provided a serious juridical framework for the settlement of disputes.<sup>8</sup> Indeed, from the time when the WTO came into being up to 27 July 1998, 141 consultations had been requested under the Understanding Governing the Settlement of Disputes. It must be admitted, however, that it has not been possible to make all the progress hoped for by countries like Chile—for example, with regard to access to markets for agricultural products or the dismantling of the trade-distorting Multifibre Agreement—and there are still extensive possibilities for the application of arbitrary and concealed trade restrictions, as well as gaps in terms of trade discipline.

Thus, the speed and depth of the trade openness that can be achieved at the multilateral level are limited, although their strengthening and enhancement continue to be one of Chile's priorities.

Within this world situation at the beginning of the 1990s, in which there was a considerable likelihood of entering on a period of international economic "disorder", with conflicts between the economic powers and the formation of exclusive economic blocs (NAFTA, the European Union, the Asia-Pacific area, MERCOSUR, etc.), and the lower leadership capacity of the United States in trade matters was evident, Chile sought a way of "protecting" and deepening the development scheme adopted over the last two decades, marked by economic openness and growth led by external trade. This, together with foreign policy considerations, explains why Chile

seeks international economic agreements as a complement to its policy of unilateral openness.

This was acknowledged by the WTO itself in its report on Chilean trade policy prepared in September 1997, in which it said that Chile's present interest in regionalism stems from a clear determination not to be left out of the preferential systems which are being formed, which would cause it to lose markets, but its proclaimed intention of making further unilateral tariff reductions is proof that at the same time it maintains its commitment to apply free trade policies based on the most-favoured-nation principle.<sup>9</sup>

Chile has made the greatest efforts, and has insistently sought opportunities for negotiations, with the countries or groups of countries with which it trades most extensively (the United States, MERCOSUR, the Asia-Pacific area and the European Union) and which are also those which have undertaken integration processes with highly significant economic repercussions;<sup>10</sup> it has also tried to ensure and expand the trading possibilities of its production sector and to avoid being excluded from international trade or trying to protect itself from it.

Fortunately, the most pessimistic scenarios have not so far materialized: in 1990-1996, international trade grew by an average of 6% per year, while the world GDP grew by only 1.5%, but Chile's exports increased by 11%. Moreover, studies by the Organization for Economic Cooperation and Development (OECD) and the WTO itself have recognized that the spread of regional agreements has been a complement to multilateral trade openness, or at least has not affected it adversely.<sup>11</sup>

<sup>8</sup> See, *inter alia*, Jackson (1997) and Petersman (1997).

<sup>9</sup> See the summary and conclusions in WTO (1997).

<sup>10</sup> Thus, although the trade gains from the entry of Chile into NAFTA or from a bilateral agreement are estimated to be only small, no estimate has been made of the impact of the fact that countries whose exports compete with those of Chile may obtain preferential access to that market, as occurs, of course, with the countries forming part of the corresponding group and also those

enjoying preferences granted under the Generalized System of Preferences (GSP) to which Chilean exports do not have access. Something similar could also occur in the case of an agreement between MERCOSUR and the European Union or between the latter and South Africa.

<sup>11</sup> Partly because rounds of negotiations have taken place at least once every decade in the context of the multilateral trade system. See OECD (1995) and WTO (1995).



# V

## The existing bilateral agreements and their effects

In order to analyse the bases underlying the "lateral" trade policy that Chile has followed it is necessary to address four different but inter-related questions: What type of agreements should be negotiated? With which countries should Chile negotiate? What are the objectives pursued? And what appraisal may be made of the agreements?

In answering these questions, it should be noted that the agreements which have been negotiated do not solve all the problems faced. Nor are they perfect. In many aspects they have been unsatisfactory, and an effort has been made to correct this with new proposals for improving and deepening them. The present agreements have indeed progressed in the direction of promoting free trade, however (table 3).

### 1. What type of agreements should be negotiated?

Economic theory does not give a completely satisfactory or unambiguous answer to this question. Dornbusch (1993) says that "In the area of trade policy a good dose of common sense must fill the gap left by an absence of hard theory that might otherwise set the guideposts". In this sense, there are criteria on what trade agreements should *not* do: i) they should not divert trade (a criterion already expressed by Jacob Viner in 1950) and ii) they should maintain the volume of trade of their members with regard to the rest of the world and increase the volume of trade among their members (Kemp and Wan's theorem), that is to say, they should not create additional trade barriers with respect to third countries: this rule ensures that the agreements are reflected in an increase in overall social well-being.

A second aspect which is not addressed by economic theory is what the content of the negotiations should be. When Viner (1950) wrote his study distinguishing between the effects of creation and diversion of trade (which has served as a guide for the research since then) the agreements to which he referred were fundamentally in respect of tariffs and, to

a lesser extent, non-tariff measures (quotas, licenses, contingents, prohibitions, etc.). In the present context, however, the agenda for the negotiations is much broader and more complex and refers to the need to negotiate "all aspects affecting trade". In this context, since the Tokyo Round of GATT in 1974-1979 there has been a clear tendency to address new aspects of trade: technical barriers, government purchases, anti-dumping duties, subsidies and countervailing duties. The Rome Treaty, NAFTA and the results of the Uruguay Round represented a step forward by incorporating new issues such as services, intellectual property, and some aspects of investments. The pressure to incorporate matters relating to the environment and labour rights has been less successful, although these matters are very much present in the current trade agenda.

Chile has recognized this multidimensional aspect by promoting the incorporation of most of the aspects relating to trade in the negotiations which it carries out, but it has done so with a good deal of realism. Thus, the current treaty with Canada incorporates the highest rights and duties so far registered in free-trade agreements signed by Chile in respect of services and investments, but it does not incorporate such aspects as intellectual property, technical standards, sanitary and phytosanitary measures, government purchases, etc., because when negotiating the agreement both countries considered that the WTO rules, together with their own respective legislations, already addressed these matters satisfactorily.

On the other hand, the Treaty recently negotiated with Mexico does incorporate these aspects, because in the bilateral relations with that country these questions are important (the current problems of access to Mexico are connected with matters of this type, such as technical standards).

The realism with which this strategy has been approached also takes into account the fact that not all Chile's potential trading partners are interested in going beyond what was achieved in WTO regarding the incorporation of all dimensions of trade, or else



TABLE 3

**Chile: Status of bilateral agreements**

Agreement	Status	Coverage
With Canada	Came into force: 5 July 1997 Tariff elimination programmes under way as scheduled; process will be completed in 2014 Opening of negotiations on financial services scheduled for 1999.	Trade in goods, services and investments.
With Mexico (ECA No. 17) <sup>a</sup>	Came into force: 1 January 1992 Tariff elimination programme completed. The new treaty, incorporating new areas, will be submitted to Congress shortly. Opening of negotiations on financial services, anti-dumping measures and government purchases scheduled for 1999.	Trade in goods. New treaty: services, investments, intellectual property, technical obstacles. Sanitary and phyto-sanitary measures. Air transport.
With Venezuela (ECA No. 23)	Came into force: 1 July 1993 Tariff elimination programme to be completed by 1 January 1999.	Trade in goods. Treaty envisages an undertaking to expand trade in services.
With Colombia (ECA No. 24)	Came into force: 1 January 1994 Tariff elimination programme to be completed by 1 January 1999.	Trade in goods. Negotiations have been begun to incorporate trade in services and investments.
With Ecuador (ECA No. 32)	Came into force: 1 January 1995 Tariff elimination programme to be completed by 1 January 2000.	Trade in goods. Treaty envisages an undertaking to expand trade in services.
With Peru (ECA No. 38)	Came into force: 1 July 1998 Tariff elimination programme under way; to be completed by 1 January 2012.	Trade in goods. Treaty envisages an undertaking to expand trade in services.
With MERCOSUR (ECA No. 35)	Came into force: 1 October 1996 Tariff elimination programme under way; to be completed by 1 January 2014. Participation in institutional structure of MERCOSUR.	Trade in goods. Physical integration. Undertaking to negotiate on trade in services.
With Bolivia (ECA No. 22)	Came into force: 6 April 1993.	Partial-Scope Agreement covering a specific number of products. It is proposed to expand this agreement to incorporate more products.

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

they are simply not in a position to do so, because of institutional or other weaknesses.

## 2. With which countries should Chile negotiate?

Economic theory has not been able to formulate a simple rule or recommendation, in terms of social well-being, regarding the countries that should be chosen as partners in a bilateral agreement (Srinivasan, Whalley and Wooton, 1993). For example, it is considered that the main trading partner of a country is a natural candidate, but Chile has various “main trad-

ing partners”, depending on the form of aggregation used. It is also claimed that a country should negotiate with others that have a similar pattern of exports or imports, as a means of modifying the terms of trade in its favour, but this is not very feasible for Chile. Geography plays a very important role in selecting a trading partner: the most recent empirical information indicates that two countries which have a common frontier trade 82% more than two similar countries which are not immediate neighbours. These estimates also show that a 1% increase in distance reduces trade by 0.6%, all other things being equal (Frankel, 1997).

The political dimension, which is recognized in the economic literature as an important factor for explaining the formation of regional agreements, has naturally been present in the case of Chile. Thus, Foreign Minister Insulza has said that “the economic complementation and integration agreements which we have promoted in recent years, although mainly concerned with trade, can also have implications as regards increasing the security of Chile in our regional environment”. These words are also backed up by the results of empirical studies which estimate “security externalities”: there are higher levels of trade between countries which are strategic allies than between those which are, or consider themselves to be, adversaries (Mansfield, 1993).

The composition of Chile’s trade with Latin America, which favours the export of goods with higher added value, services and investments, together with the cultural and historical links that exist (also recognized in the economic literature as determinants of trade)<sup>12</sup> and the political dimension already referred to, explain the priority which Chile has given to the Latin American region in its trade policy.

### 3. What are the objectives that have been pursued?

#### a) *Market access*

The policy of negotiating international economic agreements has been aimed primarily at opening external markets in order to ensure the best possible development of Chile’s exports. Obviously, unilateral openness is not necessarily reflected in openness of the markets of Chile’s trading partners. For example, it does not necessarily have any effect on their customs practices or the way they adopt and administer technical barriers, nor does it eliminate the restrictive practices applied by countries through the adoption of anti-dumping measures. Through agreements, however, it is possible to achieve preferential, assured and predictable openness which facilitates the development of export projects.

#### b) *Ensuring access conditions and stability for exports*

Latin America has been marked by unstable economic conditions and trade policies. In the 1990s, however, there has been a noteworthy increase in

trade openness in all dimensions of trade. It has been possible to safeguard these conditions through bilateral agreements. The following three examples illustrate this point. Since 1997, because of its external financial difficulties, Brazil has been applying restrictions on its imports which it also extended to Chile, Bolivia and the rest of its MERCOSUR partners, but two of these measures –the restriction on credits to finance imports and the application of non-automatic import licences– have been applied to Chile, Bolivia and the other MERCOSUR members on special terms which, although not eliminating their application, have nevertheless permitted the partial maintenance of the trade flows in question. For its part, Mexico raised its tariffs for WTO members after 1993, but not for Chile. Finally, Colombia recently wanted to impose restrictions that would have affected some Chilean textile exports within the framework of WTO, but because of its bilateral agreement with Chile it did not do so. There are some cases –for example, in connection with MERCOSUR– which it has not yet been possible to settle satisfactorily, but the framework for settling them does exist.

#### c) *Eliminating trade barriers that it would be hard to remove in any other way*

The multinational trade system has certain rules regarding negotiations which can inhibit the bargaining power of small countries like Chile. Thus, for example, the most-favoured-nation clause, which is a pillar of the system whereby Chile has benefitted from conditions of greater openness negotiated by other countries, is also to some extent a limiting factor: as Chile, in some cases, is not an important world-level producer of certain goods, its scope for bargaining is narrow (the “major supplier” and “substantial interest” rule).

This may be illustrated with a concrete example. There are currently three companies that assemble motor vehicles in Chile: General Motors, Peugeot and Renault (the latter firm also produces some parts and components). The agreement between Chile and Mexico opens up the export of vehicles to that market on favourable conditions, outside the provisions of its motor industry legislation: the rules of origin are much simpler than those of NAFTA, and since 1996 trade between these two countries has been completely free. Chilean exports of vehicles to Mexico increased from US\$ 7,500 in 1995 to US\$ 105,000 in 1996, US\$ 33 million in 1997, and US\$ 29 million in the

<sup>12</sup> See the estimates in Frankel, 1997.

first half of 1998. The elimination of these barriers would not have been possible for Chile in a multilateral negotiation, because Chile is not a major producer in the world market. Bilateral negotiation, however, stimulated exports in a way that unilateral openness could not have achieved.

d) *Progressing in all dimensions of trade*

The Uruguay Round negotiations sought to incorporate a significant number of new dimensions into the multilateral rules which had been in force since the creation of GATT in 1947. Although the results have been very noteworthy, there are nevertheless a number of weak points. The complexity which is added to trade negotiations by the incorporation of more dimensions, many of them of a sensitive nature, strengthens the idea that there might be better prospects of satisfactorily settling these kinds of difficulties on a bilateral basis.

Consequently, a first objective is to promote and protect Chile's investments abroad, the exports of services normally associated with them, and also those which are not associated with investments. Thus, for example, within the framework of these agreements it has been possible to further and consolidate measures to ensure that Chilean shipowners can have unrestricted access to bilateral freight, as well as to cargos to and from third countries, in the area of maritime transport. Recently, within the context of the negotiations on the new treaty with Mexico, the indirect restriction on the transport of vehicles, which benefitted Mexican shipowners, was eliminated, so that Chileans and Mexicans are now subject to the same conditions. This controversy had dragged on since 1991.

Another important issue for Chile is the possibility of eliminating the application of anti-dumping duties. This objective, which is very difficult to attain at the multilateral level, was achieved in the negotiations with Canada, and it is hoped to do the same with Mexico in the near future. Such advances represent an example for the hemispheric trade negotiations which are currently under way.

e) *Protecting and stabilizing market access*

The existence of programmes of unilateral preferences which discriminate against some exports; the implementation of NAFTA (or the negotiation of bilateral agreements by the United States) in countries whose exports compete with those of Chile in the

United States market; the negotiation of agreements between the European Union and MERCOSUR or South Africa, and indeed the formation of MERCOSUR itself, are events which could be very unfavourable for Chilean exports, because of their effects in terms of trade diversion or loss of competitiveness in those markets. Chile seeks to avoid such effects by maintaining at least the same conditions of access as those enjoyed by its most direct competitors.

f) *Promoting exports of manufactures and services*

The composition of Chile's trade with the Latin American countries is different from that of its trade with the rest of the world. Chile's exports to the region include products of greater added value and more stable prices, and the bilateral agreements make it possible to take advantage of the economies of scale offered by a broader market and to incorporate more employment, technology and innovation, which are central elements in economic development, provided that the rules of origin are simple and are aimed at the creation and not the diversion of trade.

Another of the features of Chile's links with the region is the importance of exports of services. The complexity of negotiations in this field is significantly reduced when a smaller number of countries are involved.

#### 4. What appraisal may be made of the agreements?

In order to answer this question it is necessary first of all to highlight the fact that preferential access to markets totalling almost 500 million persons has resulted in the expansion and diversification of Chile's exports (table 4).

These agreements operate in macroeconomic and international economic environments which are a reality that must be taken into account but whose effects the agreements are designed to relieve. At the beginning of the 1990s, the growth prospects for the countries of the region appeared to be very promising, but since 1994 they have suffered from various problems which have affected their macroeconomic performance. We may recall, for example, the so-called "tequila effect" of the Mexican crisis, the adjustment problems of the Brazilian and Argentine economies, and the political and economic instability which have prevailed in recent years in Colombia, Venezuela and Ecuador.

TABLE 4

**Chile: Trade and investment, by agreements signed or on negotiating agenda**  
(Millions of dollars)

Year	Andean Commu- nity <sup>a</sup>	MERCOSUR <sup>b</sup>	Mexico	Canada	United States	Central America <sup>c</sup>	Asia- Pacific area <sup>d</sup>	European Union	Total
Exports of goods									
1990	304.6	652.0	57.7	56.2	1 469.2	12.9	2 159.8	3 279.8	8 580.3
1993	566.8	1 089.2	130.8	61.1	1 655.2	54.4	2 839.7	2 544.5	9 416.2
1997	1 118.8	1 863.1	376.3	131.0	2 710.5	96.9	5 629.0	4 146.6	17 024.8
Imports of goods									
1990	506.3	1 124.0	100.8	224.3	1 373.4	4.4	915.4	1 882.4	7 023.4
1993	454.7	1 761.0	209.7	203.1	2 477.4	19.4	1 853.8	2 312.3	10 629.6
1997	914.2	3 193.2	1 076.2	432.5	4 332.6	79.7	2 905.3	3 957.0	18 111.6
Foreign Direct Investment <sup>e</sup>									
1990	1.5	6.1	-	252.9	270.9	-	56.7	328.7	1 320.4
1993	7.5	59.3	0.4	480.5	623.7	-	97.6	193.2	1 729.8
1997	26.6	94.7	9.9	678.8	913.4	-	181.8	2 181.0	5 041.2
Chilean direct investment <sup>f</sup>									
1990	-	13.9	-	-	-	-	-	-	15.9
1993	55.3	616.1	2.5	-	-	-	-	-	2 795.1
1997	1 014.7	3 545.8	18.0	-	75	-	30	-	4 730.9

Source: Prepared on the basis of data from the Department of Economic Studies of DIRECON.

<sup>a</sup> Chile has some form of Economic Complementation Agreement (ECA) with all the member countries of this group (see table 3).

<sup>b</sup> Comprises figures for 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 economies, excepting the United States, Canada and Mexico.

<sup>e</sup> Investment made under D.L. 600. Does not include figures for investment made under Chap. XIV, which is a mode of investment frequently used by countries from the Latin American region.

<sup>f</sup> Investment officially detected.

This, together with the evolution of the relative exchange rates of Chile and these countries, explains on the one hand why Chile has not been able to take advantage of all the new options. On the other hand, however, it means that when this situation, which has not been linked to the Asian crisis but to the economic reforms undertaken, has been overcome, Chile will have a context of trade preferences which it will be able to use to advantage.

The present Asian crisis also gives some indications of how trade with the countries of that region has behaved. Thus, exports to the countries with which there are trade agreements grew by 8% in the first six months of 1998, although total exports to the Asia-Pacific area fell by 11.4%. Obviously, this growth cannot be attributed entirely to the existence of the agreements, but largely to the way the crisis has hit and the composition of trade with these partners.<sup>13</sup> However, the dynamism of this trade does in-

dicate the importance of having a privileged relationship in these markets.

The evaluations of Chile's agreements with MERCOSUR, Mexico, Colombia and Venezuela (see Meller and Donoso, 1998, and Meller and Misraji, 1998) give grounds for optimism. If we look at the effects in terms of trade diversion and creation, which is the criterion used for measuring the impact of the agreements on well-being, the figures indicate that the amount of trade diversion was very small but the creation of trade was very significant in some sectors. As noted earlier, this criterion is limited because it concentrates on the effects of eliminating tariff barriers but does not take account of other dimensions of trade included in these agreements.<sup>14</sup> In particular, it cannot measure the reduction in transaction costs deriving from the greater certainty and transparency of the trade regimes prevailing in these markets or the expansion in trade linked with the process of outward-oriented investment.

<sup>13</sup> It should be recalled that exports of copper and of the fisheries sector had the greatest incidence in the reduction in the amounts

exported, because of the effect of the drop in international prices.

TABLE 5

**Chile: Estimate of gains in well-being from trade agreements**  
(As percentages of GDP)

Product coverage	MERCOSUR	NAFTA	NAFTA and MERCOSUR	NAFTA, MERCOSUR, and European Union	NAFTA, MERCOSUR, European Union and rest of South America	Canada and Mexico, MERCOSUR, European Union and rest of South America
No exceptions	-0.43	1.04	1.48	5.24	8.4	8.16
With exceptions	-0.43	1.04	1.48	2.02	2.48	0.44
With exceptions and 6% tariff	0.35	1.70	2.01	2.29	2.66	0.87
Agricultural products excluded only in agreement with European Union	-0.43	1.04	1.48	2.02	5.48	3.90
Agricultural products excluded only in agreement with European Union, and 6% tariff	0.35	1.70	2.01	2.29	5.71	4.44

Source: Harrison, Rutherford and Tarr (1997).

Another criterion used by economic theory for evaluating trade agreements (Kemp and Wan, 1976) is the following: when trade among the members of an agreement expands and their trade with the rest of the world either remains constant or increases (i.e., no obstacles are created for the trade of third countries) there is a clear increase in well-being both for the members of the agreement and for the non-members. If we look at what happened before the Asian crisis in Chile's trade with its trading partners and with the rest of the world, we see that in global terms Chile's trade has continued to expand, both with the countries with which it has signed agreements and with the rest of the world.<sup>15</sup>

With regard to the composition of Chilean exports, the studies indicate that the agreements have promoted or at least maintained exports of goods with high levels of added value. This has been one of the main concerns of the governments of the Democratic Coalition. But the increase in exports of high added value has also been accompanied by an increase in traditional Chilean exports and exports of agricultural products which, in some cases, were not being exported because of the various barriers affecting their possibilities of access to foreign markets (for example, phytosanitary barriers).

<sup>14</sup> Nor does it consider questions such as the existence of economies of scale (Pomfret, 1997).

<sup>15</sup> It should be repeated once again that this conclusion concerns trade as a whole; it does not pretend to be a generalization at the sectoral level, where the situation may be different. For a

Estimation of the economic impact of a trade agreement is an extremely complex exercise from the technical point of view, and the results obtained depend very much on the assumptions taken as the basis of the calculations.

Harrison, Rutherford and Tarr (1997) have evaluated the various trade policy options open to Chile and their impact on social well-being as measured in terms of a percentage of annual GDP (table 5). The options correspond to an "additive" strategy, that is to say, one which takes account of the effect on social well-being of the incorporation of new agreements. The possibilities evaluated in the table are: agreement with MERCOSUR; agreement with NAFTA; NAFTA plus MERCOSUR; NAFTA plus MERCOSUR and the European Union; NAFTA plus MERCOSUR, the European Union and the rest of South America; and finally, agreements with Canada and Mexico plus MERCOSUR, the European Union and the rest of South America. These authors also examine the impact these policy options would have if certain products are excluded (such as sensitive agricultural products) and if the most-favoured-nation tariff is reduced from 11% to 6%.

The main conclusions to be drawn from table 5 may be summarized as follows: the best option is to include all products in the agreements –i.e., that there should be no exclusions– which is the policy that Chile has been applying. The best strategy is to sign agreements with as many trading partners as possible in order to avoid the costs arising from trade diver-



sion; it might be said that this backs up the strategy of open regionalism supported by the Government of Chile. In a situation like that described, excluding the United States does not have a significant impact on well-being. When the possibility of excluding certain products is considered, however, the presence or absence of the United States becomes very important.

## VI

### Conclusions

In this article we have examined the bases, objectives and results of the "lateral" trade policy adopted by Chile since the beginning of the 1990s. The criticisms which have been levelled at this strategy are based on a limited analysis of the theoretical bases of international trade. In this paper we argue that in order to evaluate the economic and political rationality of this strategy it is important to broaden the economic concepts by acknowledging the complementarity that exists between the available options and incorporating into the analysis game theory, the existence of economies

Finally, the table indicates that if only the agreement with the European Union excludes agricultural products, the effect on well-being is greater than in the option in which all the agreements exclude this type of products, because of the importance that non-cereal agricultural products have for Chile in a bilateral agreement with the United States.

of scale, the transaction costs involved in the functioning of international markets, and also foreign policy elements.

The aim of this multidimensional strategy has been to overcome the problems referred to earlier and to stimulate the most dynamic economic activities of the Chilean economy during the 1990s: exports of goods with higher added value, services and capital.

Using traditional parameters of appraisal, the results obtained have not shown any negative effects but they have registered clear positive effects.

(Original: Spanish)

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