United States General Accounting Office

GAO

Testimony

Before the Subcommittees on International Economic Policy and Trade and on Western Hemisphere Affairs, Committee on Foreign Affairs, House of Representatives

For Release on Delivery
Expected at
2 p.m., EDT
Wednesday
July 1, 1992

CHILEAN TRADE

Factors Affecting U.S. Trade With and Investment in Chile

Statement of Allan I. Mendelowitz, Director
International Trade and Finance Issues
General Government Division

054805/147007

GAO/T-GGD-92-58

CHILEAN TRADE
FACTORS AFFECTING U.S. TRADE WITH AND INVESTMENT IN CHILE

SUMMARY OF STATEMENT BY ALLAN I. MENDELOWITZ
DIRECTOR, INTERNATIONAL TRADE AND FINANCE ISSUES
GENERAL GOVERNMENT DIVISION

The subject of this testimony is the conditions affecting U.S. trade with and investment in Chile.

Since the mid-1970s, Chile has led all other Latin American countries in its efforts to create a market-oriented economy. Its key market reforms have been the elimination of nontariff barriers to trade, the adoption of a flat import tariff rate of 11 percent, the liberalization of its foreign investment regime, and privatization of many government-owned companies. Chile has also 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, (2) establishing a specific time frame for approving foreign investment applications, and (3) lowering the fixed tax rate on investor profits.

Concerns that reduce the attractiveness of Chile as a place for U.S. companies to invest include Chile's requirement 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 the lack of a tax treaty between the United States and Chile. Specific factors that may affect U.S. investment in Chile's mining sector include the ease with which an established mining claim may be challenged and a lack of adequate infrastructure to support additional mining operations, including insufficient ports and electricity in northern Chile.

Although most U.S. and Chilean agricultural production is noncompetitive because of different growing seasons, some U.S. agricultural growers are concerned about increased imports from Chile. In addition, a few trade barriers exist to agricultural trade between the United States and Chile, including a Chilean variable import levy on certain agricultural products and preferential tariffs on certain products imported from selected Latin American countries. In addition, grapes marketed in the United States between April 20 and August 15 have to meet quality standards for U.S. number 1 table grade.

The U.S. government has taken steps to promote trade with and investment in Chile. For example, several U.S. government agencies are currently providing assistance to U.S. companies. In addition, the Enterprise for the Americas Initiative established the framework for U.S.-Chilean free trade negotiations.

Mr. Chairman and Members of the Subcommittees:

I am pleased to be here today to testify about our report on the conditions affecting trade with and investment in Chile.[1]

Our report, which was issued on June 12, was prepared at the request of the Chairman of the Subcommittee on International Economic Policy and Trade, House Committee on Foreign Affairs. For the report, 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 both 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

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.

---

[1] Chilean Trade: Factors Affecting U.S. Trade and Investment (GAO/GGD-92-106, June 12, 1992).

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. Copper products overall accounted for 45.7 percent of total Chilean exports in 1990. However, 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 approximately $8 billion. In 1991, Chile was the world's 53rd largest exporter and 54th largest importer.

In 1991, bilateral trade between the United States and Chile 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. In 1991, however, Japan replaced the United States as Chile's main export market.

The United States is Chile's largest single foreign investor. In the period from 1974 to 1990, U.S. investment in Chile under that country's foreign investment statute totaled approximately $2.5 billion, which represented about 40 percent of such foreign investment in Chile during that period.

Living conditions in Chile are among the best in Latin America. 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.

After more than a decade and a half of military rule, Chile returned to democratic government in 1989 with the election of President Patricio Aylwin. Confidence in the stability of Chile's political environment is evidenced by large foreign direct investment flows of more than $2.6 billion in the years following the return to democratically elected government.

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. Between 1973 and 1979, Chile gradually reduced import tariffs to 10 percent from a range of 0 to 750 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 from 15 percent to a flat 11 percent for all imports except some luxury items.

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.

The Chilean government also plans to further liberalize foreign investment by shortening the capital repatriation period to 1 year, setting specific time frames for approving foreign investment applications, and lowering the corporate tax rate.

Nevertheless, U.S. companies we spoke with have expressed concerns about several policies that affect foreign investments, such as the requirement that for 1 year, companies retain in deposits at Chile's Central Bank 20 percent of capital borrowed from foreign sources. In addition, because there is no tax treaty between Chile and the United States, profits of U.S companies operating in Chile are subject to taxation by both the Chilean and U.S. governments.

FACTORS AFFECTING U.S. INVESTMENT IN CHILE'S MINING SECTOR

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.

On May 5, 1992, the Chilean government passed a law allowing the state-owned copper company, CODELCO, to enter into joint ventures with foreign investors. The new law will grant companies access to known copper reserves and will allow them to bypass the costly and time-consuming exploration phase. In 1990, CODELCO produced about 75 percent of Chile's copper and owned about 25 percent of the mining properties.

U.S. companies we spoke with are concerned that companies with established mining operations must often incur significant administrative and litigation cost in defending their property rights. They stated that companies or individuals frequently filed claims challenging the property rights of established mining operations. These claims were 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. In addition, many of the companies told us that Chile's ports need to be expanded and its electricity, water, and road services need to be improved.

U.S.-CHILEAN AGRICULTURAL TRADE

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. Chile has become the second largest supplier after Mexico of fruit and vegetable exports to the United States. Chile sells approximately 40 percent of its agricultural exports to the United States. (See app. I for an overview of Chilean agricultural exports to the United States, 1990 and 1991.)

Although the United States is a major agricultural exporter, it sells few agricultural commodities to Chile. This situation is not surprising given Chile's relatively small population. However, because the United States accounts for only about 11 percent of Chile's agricultural imports, or $66.3 million out of a total of $667.9 million in 1991, there may be opportunities for expanded U.S. agricultural exports. (See app. II for the value of U.S.-Chilean agricultural trade, 1990-1991.)

Most of Chile's major fruit exports to the United States do not compete with U.S. agriculture, but rather complement domestic production. 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. However, some U.S. growers we spoke with are concerned that the increase of fresh fruits and vegetable imports from Chile 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.

Certain import trade barriers exist in Chile's agricultural sector. For example, 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.

U.S. exports are also hindered by preferential tariffs that Chile grants to some products from selected Latin American countries. These 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.

On the other hand, Chilean growers and agricultural officials consider U.S. "marketing order requirements" a major barrier to Chilean agricultural exports. Grapes marketed in the United States between April 20 and August 15 are subject to a marketing order requirement that stipulates a quality standard of U.S. number 1 table grade. 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.

U.S. EFFORTS TO PROMOTE TRADE WITH AND INVESTMENT IN CHILE

The United States supports trade with and investment in Chile through the programs of several trade-related agencies such as the Overseas Private Investment Corporation, the U.S. Export-Import Bank, the Trade and Development Program, and the Department of Agriculture.

In June 1990, the U.S. Administration launched the Enterprise for the Americas Initiative (EAI), a program that set the stage for negotiations for a U.S.-Chilean free trade agreement. The United States and Chile signed a bilateral framework agreement on trade and investment in October 1990. 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 tariffs on trade between the two countries. While United States-Chile trade is fairly small compared to overall U.S. trade, U.S. and Chilean government officials told us that a U.S.-Chilean free trade agreement is important because it would send a signal to other Latin American countries that they will be rewarded for economic reform and market liberalization. They noted that if the United States fails to reach a free trade agreement with Chile, other countries in the region will question the U.S.' commitment to forge closer economic ties with them.

Chile's lack of a comprehensive environmental policy may affect potential U.S.-Chilean free trade negotiations. According to the U.S. embassy, Chile lacks laws in several environmental areas, and laws in other areas are only sporadically enforced. To counteract this problem, the present Chilean government established 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.

- - - - -

Mr. Chairman and Members of the Subcommittees, this concludes my prepared statement. I will be happy to try to answer any questions you may have.

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.

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.