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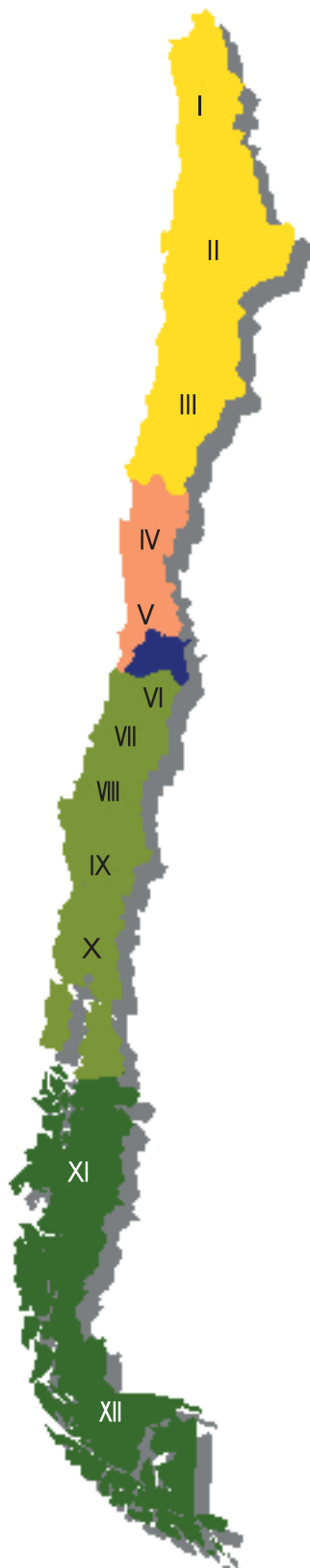
MINISTRY OF ECONOMY,
DEVELOPMENT AND
RECONSTRUCITON



JAPAN INTERNATIONAL
COOPERATION AGENCY
(JICA)



CHILEAN ECONOMIC
DEVELOPMENT AGENCY
(CORFO)



EPIE

FINAL REPORT

Volume 1 Analysis

THE STUDY FOR PROMOTION
OF INVESTMENTS AND EXPORTS
FOR THE BALANCED
ECONOMIC DEVELOPMENT
IN THE REPUBLIC OF CHILE

October 2001

INTERNATIONAL DEVELOPMENT CENTER OF JAPAN
UNICO INTERNATIONAL CORPORATION

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**JAPAN INTERNATIONAL COOPERATION AGENCY (JICA)
MINISTRY OF ECONOMY, DEVELOPMENT AND RECONSTRUCTION
CHILEAN ECONOMIC DEVELOPMENT AGENCY (CORFO)**

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Preface

In response to a request from the Government of the Republic of Chile, the Government of Japan decided to conduct a “Study for Promotion of Investments and Exports for the Balanced Economic Development in the Republic of Chile (EPIE)” and entrusted the study to the Japan International Cooperation Agency (JICA).

JICA selected and dispatched a study team headed by Dr. Norimichi Toyomane of the International Development Center of Japan to Chile between March 2000 and August 2001. In addition, JICA set up an advisory committee headed by Dr. Akio Hosono, Professor of Kobe University, between March 2000 and August 2001, which examined the study from specialist and technical points of view.

The team held discussions with the officials concerned of the Government of Chile and other people concerned both in the private and public sectors, and conducted extensive field surveys not only in Chile but also in Bolivia, Argentina, Brazil, Mexico, Japan, South Korea and China. Upon returning to Japan, the team prepared this final report.

I hope that this report will contribute to the promotion of export and investment and further to the balanced economic development of Chile.

Finally, I wish to express my sincere appreciation to the officials concerned of the Government of Chile for their close cooperation extended to the study.

October 2001

A handwritten signature in black ink, consisting of stylized Japanese characters, likely reading '川上隆弘' (Kawakami Takao).

Takao Kawakami
President

Japan International Cooperation Agency

Letter of Transmittal

The Study for Promotion of Investments and Exports for the Balanced Economic Development in the Republic of Chile (EPIE) began in March 2000 and has completed in October 2001, in accordance with the Scope of Work signed by the Ministry of Economy, Development and Reconstruction, Government of Chile, and the Japan International Cooperation Agency (JICA).

The Study has two main objectives: 1) to formulate new strategies for promoting investments and exports for five geographic zones in Chile; and 2) to formulate short-term action plans to realize the strategies. As the Scope of Work emphasizes, the Study has investigated Chile's new possibilities particularly in the global framework of MERCOSUR and APEC. Viewed in this framework, Chile has emerged as a country that has a strong potential to become an international "gateway" between Asia and South America. The five strategies that the Study proposes to promote export and investment are all formulated around this central concept.

In formulating the strategies, the Study has closely looked into the five zones for potentials and constraints. This regionalized approach has been very appropriate since Chile is a country with highly diverse regional characteristics. Furthermore, given the over-concentration of population and economy in the Metropolitan Region, the national capital, this regional approach has a particular importance in alleviating the imbalance.

Combining the international framework and the regional approach, the Study has produced a unique outcome. This Final Report details the results of the work conducted by the JICA Study Team during the one and a half years.

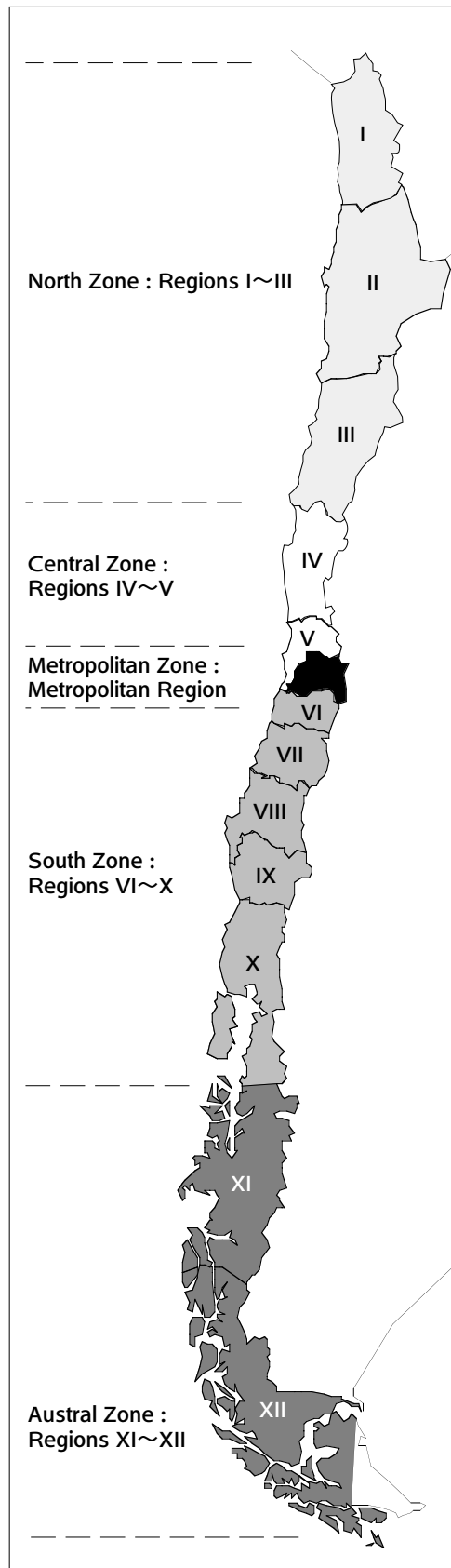
A 20-member consultant team of the International Development Center of Japan (IDCJ) and UNICO International Corporation was entrusted by JICA to carry out the Study. This JICA Study Team has worked in very close cooperation with the Ministry of Economy, Development and Reconstruction and CORFO (Corporación de Fomento de Producción). The Team has also greatly benefited from strong collaboration extended by hundreds of organizations and people, both in and outside of Chile. Without their contributions, this Study could never have achieved its goal. On behalf of the JICA Study Team, I would like to express my deepest gratitude for the wholehearted support given by them.

I strongly believe that Chile will play a larger role in the international arena in the future and hope this Study will stimulate various efforts to this end.

October 2001



Norimichi Toyomane
Team Leader



Map 1 Chile and Five Zones

Exchange Rates

US\$ 1 = 550 Peso
(as of August 2000)

US\$ 1 = 660 Peso
(as of July 2001)

GLOSSARY ENGLISH/SPANISH

El presente miniglosario adjunto al Informe Final del Estudio para la Promoción de Inversiones y Exportaciones y un Desarrollo Económico Equilibrado de las Regiones de Chile (EPIE) sólo intenta constituir una pequeña ayuda lingüística bilingüe y conceptual, en algunos casos. No se trata en ningún caso de una recopilación completa o de una guía, sino simplemente de una contribución en el marco del estudio que el equipo de JICA llevó a cabo con el fin de uniformar terminología y, por ende, evitar confusiones.

La lista terminológica que se presenta se basa en los temas tratados a lo largo de estos meses de estudio, especialmente en los viajes y entrevistas en las regiones de Chile. Así, gran parte de los términos fueron incluidos porque en algún momento ofrecieron alguna dificultad de traducción o se prestaron para confusión, o bien porque el significado del concepto en cuestión no era evidente para todos los participantes. Cabe mencionar que las diferencias culturales entre las partes pudieron ser una de las barreras de comunicación, de modo que se han definido términos que algunos consideran obvios, sin embargo, no lo eran para todos.

Con todas las limitaciones que el glosario que se presenta a continuación pueda tener, espero que preste ayuda a los lectores del Informe.

* * * * *

The current mini-glossary enclosed to the Final Report of the Study for Promotion of Investment and Exports for the Balanced Economic Development in the Republic of Chile just intends to be a small linguistic bilingual contribution as well as a conceptual contribution, in some cases. This is not a comprehensive guide, but rather a simple help in the framework of the Study this JICA's team has carried out, in order to standardize the terminology and avoid confusions.

The terminological list presented is based on the issues we have been dealing with all along these months, especially during the trips and the interviews to the regions of Chile. Thus, most of the terms were included since they offered some difficulties when they had to be translated or because they were somehow confusing, or even because the concept we were discussing was not clear to all the parties involved. We must say that some cultural differences may have caused some communication troubles, so that some terms may seem obvious to some people, but not to everybody.

Notwithstanding the limitations this work certainly has, we hope that it will help the readers of this report as well as the development of the Study.

A - **artisanal fisherman** pescador artesanal
- **artisanal fishing** pesca artesanal: Actividad pesquera extractiva realizada por personas naturales que en forma personal, directa y habitual trabajan como pescadores artesanales (...). [Decreto 430/91 MINECOM, D.O. 92. ene. 21]

B - **business** negocio, transacción, operación; la actividad económica, la economía, comercio e industria
- **business environment** (see also investment environment) ambiente de negocios

C - **capital intensive** con gran intensidad de capital, con uso intensivo de capital: se aplica, en general, a una industria que exige mucho capital, en contraposición a las necesidades de otro factor de producción, a saber, el trabajo, o mano de obra. [Diccionario de dificultades del inglés, segunda edición, corregida y aumentada, Barcelona, Editorial Juventud, Alfonso Torrents del Prats, 1989.]

- **cluster** complejo productivo integrado; conglomerado industrial [Cabe señalar que el término “cluster” es de uso cada vez más frecuente en contextos de lengua española.]

- **company** (see also firm, enterprise, business) empresa, negocio [Cabe señalar que la palabra “compañía” es igualmente válida, en rigor, para referirse a una empresa, sin embargo, su uso mucho menos frecuente y más impreciso la hace poco recomendable en español.]

- **concession (≠ privatization)** concesión (de obras públicas)/ también Sistema de concesiones o Programa de concesiones : sistema de explotación de obras y servicios públicos o fiscales en los que el Estado invita a participar al sector privado nacional o internacional en los procesos de inversión, mantención y uso; así, éste financia obras económicamente rentables y luego recupera su inversión a través del cobro directo de una tarifa a los usuarios. De esta manera el Estado libera recursos públicos para destinarlos a proyectos con mayor valor estratégico o de gran rentabilidad social. [Definición basada en la publicación *Infraestructura Pública y Programa General de Concesiones*, de la Coordinación General de Concesiones del Ministerio de Obras Públicas, 1998]

- **corporate strategy** estrategia empresarial

- **corporation** sociedad anónima, sociedad de capital, sociedad por acciones

- **customer (≠ client)** cliente, usuario, consumidor

D - **differentiation** diferenciación: se aplica dentro de un sector industrial para señalar que cada productor vende un producto cuyas características son tan particulares que éste se distingue de los de la competencia. [The MIT Dictionary of Modern Economics, Third Edition, Cambridge Massachusetts]

- **distribution** (see also logistics) distribución, conductos de distribución: transporte de mercancías a través de los canales de comercialización hasta su destino final.
- **diversification** diversificación: acción o práctica de fabricar variados productos, invertir en variados títulos mobiliarios, vender variadas mercancías, etc. de manera que un fracaso o una depresión en alguno de los rubros no resulte desastrosa para todos. [Websters Encyclopedic Unabridged Dictionary of the English Language, New York, Random House, 1989.]

E - **economies of scale** economías de escala: reducción en el costo promedio de un producto, a largo plazo, como resultado de un rendimiento creciente (...). [The MIT Dictionary of Modern Economics, Third Edition, Cambridge Massachusetts]

- **enterprise** (see also company, firm, business) empresa

- **environmental impact** impacto ambiental: alteración positiva o negativa de la calidad ambiental, provocada o inducida por cualquier acción del hombre. Es un juicio de valor sobre un efecto ambiental. [CONICYT, 1988. Principios para una política ambiental]

la modificación de la condición y características originales de un área silvestre causada directa o indirectamente por la acción humana. [Ley 18. 362. Crea un sistema nacional de áreas silvestres protegidas del Estado. D.O. 84. dic. 27]

la alteración del medio ambiente provocada directa o indirectamente por un proyecto o actividad en un área determinada. [Ley 19.300. Bases medio ambiente. D.O. 9 marzo 94]

- **externalities** externalidades: se suele entender por externalidades los efectos externos de las economías y las deseconomías externas, los efectos indirectos o derivados. Las externalidades conllevan una interdependencia de las funciones productivas y de los servicios. [The MIT Dictionary of Modern Economics, Third Edition, Cambridge, Massachusetts]

F - **farm worker** campesino

- **firm** (see also company, enterprise, business) empresa [Cabe señalar que la palabra “firma” es válida para referirse a una empresa, aunque, a menudo, este término apunta más bien a la razón social de una institución commercial; con todo, es de mucho mayor profusión en inglés, de modo que se recomienda emplear otra terminología en español. Comentario basado en el Diccionario de dificultades del inglés, segunda edición, corregida y aumentada, Barcelona, Editorial Juventud, Alfonso Torrents del Prats]

- **fringe benefits** beneficios sociales, beneficios extrasalariales; prestaciones suplementarias

G - **gateway** puerta/puerto de entrada/salida, paso, vía: para los efectos del presente estudio se quiere destacar la función de Chile como puerto de salida hacia Asia desde diversos países del Cono Sur y también como puerto de entrada a Sudamérica, no sólo a Chile, desde el continente asiático. No obstante el papel de puerto internacional que se le presenta a Chile no se limita al transporte y la infraestructura que pueda proporcionar, sino que va más allá; se trata de convertir al país en un centro de actividades múltiples que cuente con servicios e instituciones públicas adecuadas, a saber, servicios financieros, sistemas de información, servicios legales, políticas públicas transparentes, seguridad nacional y ciudadana, un alto nivel de educación, eventos sociales y culturales atractivos, así como un turismo de alto nivel.

I - **import-substitution** (industrialization) sustitución de importaciones: se trata de una de las principales estrategias de desarrollo escogidas por los países en desarrollo en los años de la postguerra. Se pensaba que una política de industrialización era la mejor estrategia para alcanzar el progreso económico. La sustitución de las importaciones mediante el establecimiento de una industria nacional amparada en aranceles y cuotas sería lo más apropiado. La fabricación de bienes industriales sería el comienzo de este camino para luego continuar con los bienes de capital. Se esperaba reemplazar las importaciones, lo cual fomentaría el crecimiento interno; el costo de tal estrategia estaría cubierto por los países más avanzados, los que proporcionarían bienes de consumo manufacturados.[The MIT Dictionary of Modern Economics, Third Edition, Cambridge, Massachusetts]

- **integrated pest management (IPM)** manejo integrado: término empleado en la producción agrícola; en la conversión desde un sistema convencional, éste es el paso previo a la producción orgánica, pues consiste en la producción agrícola con un uso reducido de fertilizantes, pesticidas y sustancias químicas sintéticas.

- **inter-firm cooperation** cooperación entre empresas

- **(to) investigate** fiscalizar, velar por el cumplimiento de las leyes o normas; supervisar

- **investment environment** (see also business environment) ambiente de inversión

K - **know-how** conocimientos, preparación, preparación técnica, técnica, método, método de fabricación, procedimiento industrial

L - **labor-intensive production** producción que exige mucha mano de obra: concepto que se contrapone al de *capital-intensive* e indica que una actividad

económica determinada exige el empleo de una proporción importante de mano de obra en comparación con las inversiones de capital necesarias. [Diccionario de dificultades del inglés, segunda edición, corregida y aumentada, Barcelona, Editorial Juventud, Alfonso Torrents del Prats, 1989]

- ***laissez faire*** liberalismo, política de no interferir: doctrina según la cual las decisiones de los individuos encausan mejor los asuntos económicos de una sociedad que la autoridad colectiva, hasta el punto de excluirla virtualmente. Esta idea se sustenta en los escritos de los fisiócratas, sin embargo sus fundamentos analíticos yacen en la obra de Adam Smith y su escuela clásica. [The MIT Dictionary of Modern Economics, Third Edition, Cambridge, Massachusetts]
- **logistics** (see also distribution) logística: término de origen militar, también empleado en el ámbito de la infraestructura pública y privada y el comercio internacional así como la planificación estratégica de la distribución de bienes para referirse al traslado de recursos o mercancías al destino requerido a través de medios óptimos y de un sistema complementario con el fin de alcanzar el objetivo propuesto.

M - **macro-region** macroregión: para los efectos del presente estudio se entenderá por macroregión un área geográfica internacional, es decir que incluye unidades territoriales* de distintos países, con intereses y proyectos económicos y geopolíticos comunes, de modo que puede ser considerada como una unidad económicamente interdependiente. El objetivo de tal agrupación es aprovechar las ventajas del intrarregionalismo como forma de integración económica y comercial.

- **management** administración, gerencia, dirección, gestión, gestión administrativa, manejo.
- **manufactured goods** bienes/productos manufacturados.

N - **natural resource-based industry** industria intensiva en recursos naturales

- **non-natural resource-based industry** industria no intensiva en recursos naturales

P - **phytosanitary** fitosanitario: perteneciente o relativo a la prevención y curación de las enfermedades de las plantas. [Cabe mencionar que el Servicio Agrícola y Ganadero (SAG) no se rige por una definición oficial de este término, de modo

* Se entiende por unidades territoriales lo siguiente: provincias, en el caso de Argentina; departamentos en los casos de Bolivia, Perú y Paraguay; regiones, en el caso de Chile y; estados en el caso de Brasil.

que nos atendremos a la que proporciona el Diccionario de la Real Academia de la Lengua Española, en su edición de 1992]

- **privatization** (\neq concession) privatización: transferencia o venta de una empresa o actividad pública o fiscal al sector privado. A diferencia de la entrega de una empresa en concesión, caso en el que el bien de uso público sigue perteneciendo al Estado, la privatización implica traspasar un porcentaje o la totalidad del bien en cuestión al sector privado para su explotación, junto con los derechos que esto implique dentro de la ley. [Definición general, redactada para los fines del presente estudio, basada en el uso del término por parte de las autoridades chilenas]
- **profitability** rentabilidad
- **prospective mission** misión prospectiva: grupo de especialistas enviados a terreno a realizar un conjunto de análisis y estudios con el fin de explorar o predecir el futuro en una determinada materia, especialmente en el ámbito de las inversiones [Definición basada en el Diccionario de la Lengua Española de la Real Academia de la Lengua]

S

- **seasonal unemployment** desempleo estacional: desempleo que resulta del modelo de trabajo estacional en ciertas industrias. Los sectores agrícola, turístico y de la construcción han sido tradicionalmente afectados por este modelo de empleo. Este es un elemento del desempleo estructural.[The MIT Dictionary of Modern Economics, Third Edition, Cambridge Massachusetts]
- **seasonal worker** trabajador de estación, temporero.
- **segmentation** segmentación: división del mercado en segmentos, es decir, en grupos de consumidores o usuarios que comparten características especiales y exigencias comunes.
- **service industry** industria de servicios
- **SME (small-and-medium-sized enterprise)** pequeña y mediana empresa (PYME): la CORFO define las pequeñas empresas como aquellas que tienen entre 5 y 49 empleados y cuyas ventas anuales están en un rango de 2401 a 25.000 Unidades de Fomento (UF); mientras que las empresas medianas son aquellas que tienen entre 50 y 199 empleados y cuyas ventas anuales van de 25.001 a 100. 000 UF.
- **structural unemployment** desempleo estructural: es el resultado de la existencia y el desajuste, a la vez, del desempleo, por una parte, y la disponibilidad de plazas de trabajo, por otra. Quienes se encuentran desempleados no poseen las habilidades requeridas o no viven en el lugar correcto para llenar las vacantes. [The MIT Dictionary of Modern Economics, Third Edition, Cambridge, Massachusetts]

- **supporting industries** industrias de proveedores de insumos; industrias de proveedores de servicios; servicios subcontratados

[Cabe señalar que el término “supporting industries” comprende tanto a los proveedores de insumos como a los proveedores de servicios, en inglés, mientras que en español es necesario especificar de qué tipo de proveedor se trata, a qué tipo de servicio de apoyo nos estamos refiriendo].

T - **training** (of workers) capacitación

U - **unskilled labor** mano de obra no calificada

V - **value-added** valor agregado

- **venture capital** capital de riesgo: como fuente de financiamiento de una empresa, conjunto de medios que constituyen el patrimonio neto y que, por lo tanto, están plenamente al riesgo de gestión. El capital de riesgo se compone de inversiones iniciales y sucesivas de capital (comprendidas las eventuales reservas de sobreprecio de emisión) y del autofinanciamiento generado en el curso de la gestión. El capital de riesgo, o capital propio, se contrapone al capital de préstamo. [Glosario de términos financieros. CEPAL, Sede subregional de México, 1996]

- **vocational education** formación técnica, adiestramiento profesional; instrucción práctica; capacitación: enseñanza profesional de grado inferior al universitario, destinada a preparar al alumno para ingresar en determinada profesión o mejorar la situación de trabajadores ya empleados. [Glosario internacional para el traductor inglés-castellano/castellano-inglés, tercera edición revisada y aumentada, Santiago de Chile, Editorial Universitaria, Marina Orellana]

Z - **zone** zona: para fines prácticos del presente estudio se ha dividido el país en zonas geográficas. Cada una de ellas comprende varias regiones, excepto la Zona Metropolitana que corresponde exactamente a la Región Metropolitana. Las zonas geográficas de Chile en este caso son las siguientes: Zona Norte, incluye las regiones I, II y III; la Zona Central, incluye las regiones IV y V; la Zona Sur, incluye las regiones VI, VII, VIII, IX y X; y la Zona Austral, incluye las regiones XI y XII; además de la Zona Metropolitana.

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IN THE REPUBLIC OF CHILE**

FINAL REPORT

Volume 1: Analysis

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INTRODUCTION

The Government of the Republic of Chile in 1998 requested the Government of Japan to conduct technical cooperation on the *Study for Promotion of Investments and Exports for the Balanced Economic Development in the Republic of Chile* ("the Study"). The Japanese government decided to implement the Study and had the Japan International Development Agency (JICA), the official agency responsible for the implementation of the technical cooperation programs of the Japanese government, undertake the Study in close cooperation with the authorities concerned of the Chilean government. The implementation arrangements for the Study were agreed upon between the Ministry of Economy, Development and Reconstruction and JICA, and signed by respective representatives on July 29, 1999 (see Appendix). The Study started in March 2000 and was completed in September 2001.

STUDY OBJECTIVES

The Study has the following objectives:

- 1 To formulate new strategies and policies for each of the five geographical zones of Chile to develop and promote investments and exports, especially between Asia and South America in the framework of MERCOSUR and APEC;
- 2 To formulate short-term action plans to the year 2006; and
- 3 To pursue technology transfer in the course of the Study.

STUDY AREA

The Study covered the whole national territory of Chile. Analysis and formulation of strategies, however, was based on the five geographical zones (Map 1):

North Zone	Regions I, II, III
Central Zone	Regions IV, V
Metropolitan Zone	Metropolitan Region
South Zone	Regions VI, VII, VIII, IX, X
Austral Zone	Regions XI, XII

In formulating strategies and policies, the Study focused on three zones: North, Central and South. For each of the three zones, one region was selected as the model for which the short-term action plan would be developed. The model regions were:

Region I	North Zone
Region V	Central Zone
Region X	South Zone

BACKGROUND

Chile has consistently pursued a policy of economic liberalization and openness since the mid-1970s. As a result, Chilean has significantly diversified its export commodities and destinations. Foreign direct investment phenomenally increased during the 1990s.

In spite of these achievements, Chile is now faced with new challenges:

- (1) Chile's export is highly dependent on natural resources, particularly mineral products. This "monocultural" structure could not be sustained over the very long run. Chile should diversify its economy while its mineral resources last and sell in relatively good terms.
- (2) Conventional opportunities for foreign direct investment may be depleting in Chile. It has to find out new, dynamic sectors to receive a new wave of investment.
- (3) Asia will be a major market as well as a major source of investment for Chile. Chile needs strategy to approach Asia, particularly China.
- (4) A stronger Asia-South America linkage can transform Chile into the "gateway to and from Asia" serving South American neighbors in general and MERCOSUR members in particular. Chile has to break its "insular" characteristics by improving infrastructure crossing its borders.
- (5) Chile can play a unique role as a commercial service center on the South American continent; thanks to its liberal economic policies Chile can provide a very favorable and conducive business environment unfound in the region.

Those international changes will certainly affect Chile, but the effects will differ significantly among its sub-national regions because of their very diverse characteristics. Traditionally Chilean economy has centered on Santiago and its environs. The strong drive for concentration and regional disparities is still in full force and will surely accelerate if no effective counter-actions are taken in the face of economic globalization. Widening regional disparities represents a serious obstacle to national unity particularly when a new policy in favor of administrative decentralization is being pursued.

Given this background, a study is useful which aims at a more balanced development of the Regions by strengthening their export capacity and by promoting investment, both making the most of the local advantages the Regions can offer.

APPROACHES

The JICA Study Team adopted the following approaches to the Study:

From Top Down. The Study places Chile in the global and long-term perspective to see where its future opportunities are.

From Bottom Up. To feel the pulse of the real business world, the Study conducts extensive interviews with firms in Chile, Japan and other countries.

Be Systematic and Comprehensive. Statistics are thoroughly analyzed; all the 13 Regions are systematically surveyed with the same agenda.

Be Concrete. The Study identifies concrete "priority sectors and products" and develops concrete action plans to promote them. It also provides concrete priorities for infrastructure development.

Chile-Japan Collaboration. As a Chile-Japan cooperation project, the Study will be carried out with a close collaboration between the CORFO tem and the JICA team.

SCOPE OF THE STUDY AND WORK FLOW

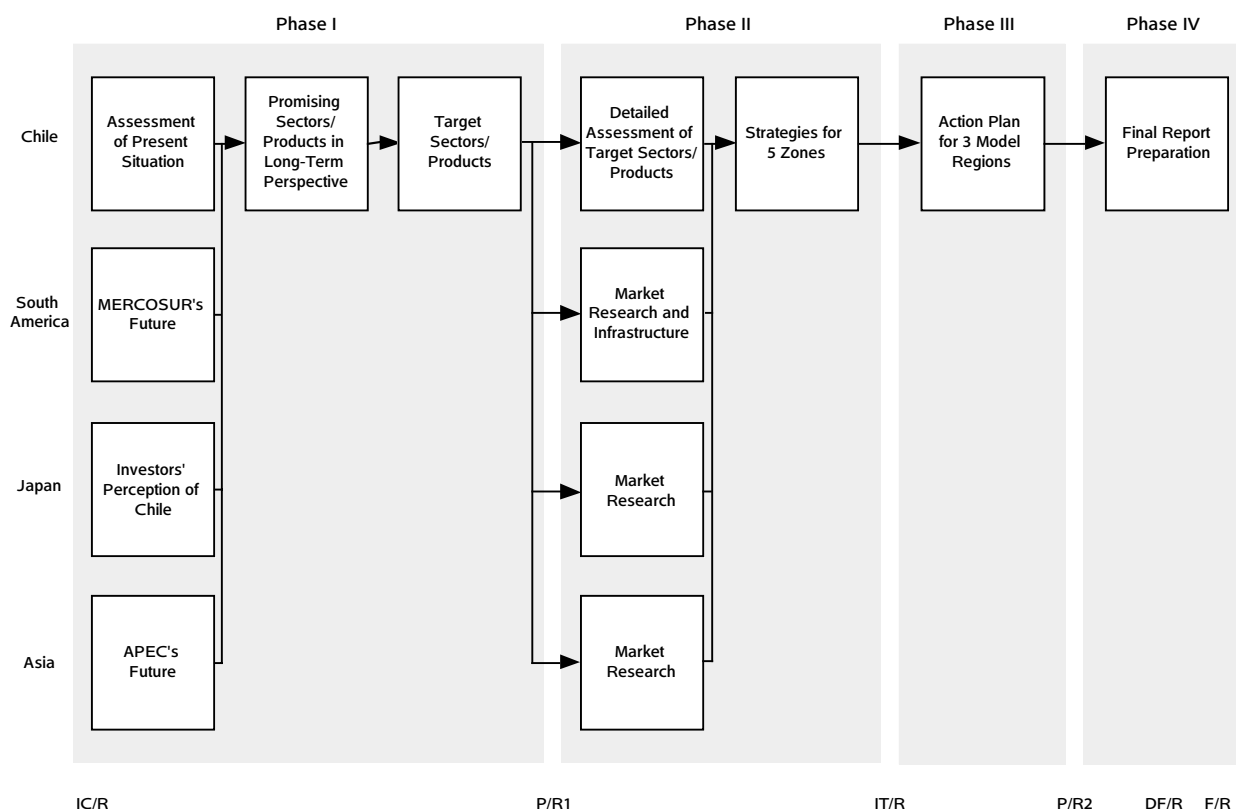
The Study was implemented in four phases:

Phase I: Assessment of the Present Situation [March 2000-August 2000]

Phase II: Development of New Strategies and Policies for the Five Geographical Zones [October 2000-January 2001]

Phase III: Formulation of Short-Term Action Plans [February 2001-May 2001]

Phase IV: Preparation of the Final Report [June 2001-September 2001]



1 RECOMMENDATIONS

The objective of the EPIE Project is to develop zone-specific strategies and action plans for the promotion of exports and foreign investment. To develop appropriate strategies and action plans, two criteria have been stressed:

- 1 Long-term view; and
- 2 JICA Study Team's maximum contribution

That is, the JICA Study Team has 1) favored long-term strategic thinking over short-term achievements; and 2) opted to focus on measures by which the Team can maximize the utility of its Japanese perspectives. The results are the following five strategies as highlighted in Volume 2 of this Report:

North Zone: Macro-Region and Gateway
Central Zone: Integrated Gateway
South-Austral Zone: Eco-Region
Solution-Oriented Manufacturing
Information Technology Industry

In formulating the zone- or sector-specific strategies mentioned above, the JICA Study Team has also realized that more general policy recommendations should accompany the above strategies. In this way, it will be easier for the Chilean government to facilitate their implementation. This Chapter will therefore describe some principal recommendations proposed by EPIE for the government to consider.

(It should be noted that the recommendations highlighted below are *not* a summary of the five strategies, but rather are quite separate and are aimed specifically at the Chilean government. In other words, the recommendations are intended to provide a general policy framework within which the five strategies should be pursued.)

To further clarify this point, the recommendations will be classified into four categories:

- 1 To become a global gateway
- 2 To develop industries
- 3 To promote export and investment
- 4 To facilitate implementation

As may be noted, one common theme underlying the recommendations mentioned above is "think of strategy; act on strategy." It is this idea that consistently relates, either directly or indirectly, to the various aspects of export and investment promotion.

1.1 To Become a Global Gateway

There is a high possibility that Chile will become a gateway of global significance. To achieve such status, however, it must focus its attention on both ends of the gateway: South America and Asia.

Recommendation 1 Facilitate regional integration within South America

South America is Chile's natural "turf." Chile's economic future, at least a crucial part of it, will hinge on neighboring South American economies, Argentina in particular. Chile must foster cooperative relations with those countries both at local as well as

national levels. Efforts at the local level to strengthen economic relations with regions in adjacent countries are quite valuable, and should be supported and facilitated by central authorities.

Recommendation 2 Look at Japan in Asia; watch China and South Korea next

For Chile, Japan is the largest Asian trading partner and by far the largest source of investment in Asia. It is without doubt that Chile should keep Japan as its principal Asian partner. Chile should expand and strengthen its economic ties with Japan with all means available. However, South Korea and China are advancing very rapidly in the same direction. Both countries have great potential to become a major importer and investor. In this regard, Chile should develop a thorough and well-defined strategy to approach China, in particular. Not only is its market potential huge but it already shows serious signs of interest to invest abroad. It is even predicted that China will soon catch up with advanced countries in terms of industrial technology. With its near acceptance in the WTO, China will emerge in the global economy as a powerful new player. Chile should approach this country with a careful and consistent strategy.

Recommendation 3 Shift the “iso-transport cost line” eastward

The “iso-transport cost line,” analyzed and presented by the JICA Study Team (Figure 1.1 reproduced here from Chapter 12), demonstrates where Chile’s potential hinterland lies for the gateway concept. The line may be shifted further eastward by improving infrastructure within Chile, across the Andes and in neighboring countries. National priority should therefore be given to projects that foster this purpose, particularly those that directly benefits high-potential areas.

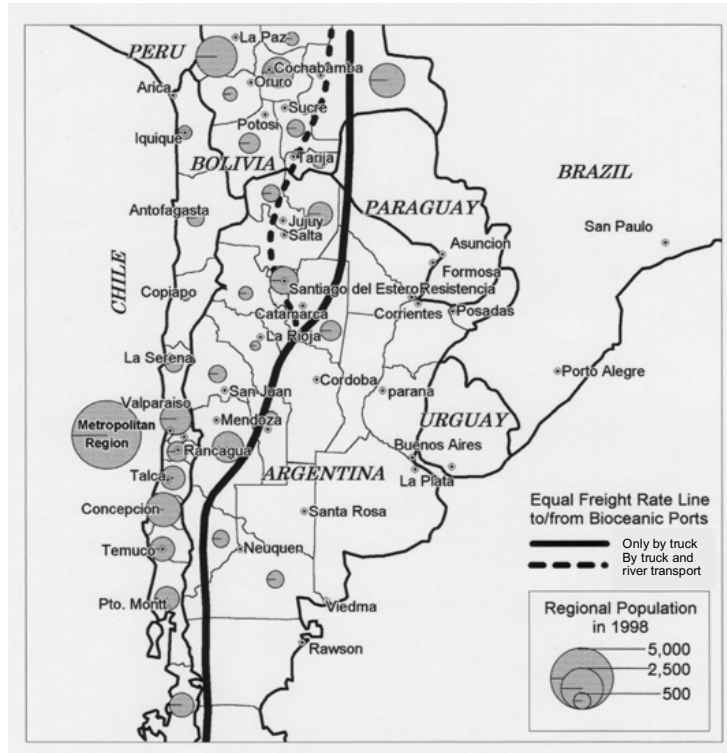


Figure 1.1 Potential Hinterland of Chilean Ports

Source: JICA Study Team

1.2 To Develop Industries

Even though Chile is endowed with an abundance of natural resources, this alone could not sustain high economic growth over an extended period of time. Chile must diversify and strengthen its industries.

Recommendation 4 Focus on SMEs

The central player of future industrial development (as well as export promotion) in Chile should be small- and medium-sized enterprises (SMEs). In terms of production or trade volume, large-scale companies will definitely maintain their leading position though they should be challenged or supported by SMEs. This point especially applies to export promotion.

Recommendation 5 Develop industrial clusters

A few dominant and successful companies in each sub-sector characterize Chile's industrial sector. These companies are almost isolated from others. Except for mining and salmon farming, industrial clusters have hardly been developed. Since the industrial cluster is a very effective way to foster SMEs and improve their competitiveness, its development should be of high priority. The "eco-region" concept, proposed for the South-Austral Zone, is a promising attempt to facilitate such development.

Recommendation 6 Eliminate the "anti-SME" bias

One obstacle for SMEs, however, is a prevalent view against SMEs. The very principle of fair competition upheld by the Chilean government can nurture that bias. Though this principle has generally proved correct in the Chilean context, it has also effectively hampered potential SMEs' rising and competing with the well-established large-scale companies both in Chile and abroad. One possible option to relieve this situation is to provide temporary financial assistance to SMEs under well-defined conditions. If CORFO or ProChile are to be responsible for this operation, their capability to assess the company's potential must be substantially upgraded. It is also evident that SMEs have difficulty in acquiring new technology. Free competition tends to deny SMEs, particularly those in regions, access to new, advanced technology. One way to address this problem is to help make new technology collectively accessible to SMEs, as a form of "infrastructure." One scheme based on this approach is proposed for the salmon farming net workshops in the South Zone.

1.3 To Promote Export and Investment

The essence of the EPIE Project is on how to best promote exports and investment. The key answer appears to be "strategic thinking."

Recommendation 7 Adopt a national strategy

Both in export and investment promotion, Chile's policy has been very open and fair-minded: "no preference; anyone is welcome." As a consequence, Chile treats importing countries equally, gives similar attention to Chilean exporters irrespective of their size, and indicates no preference for sectors or industries in attracting investment from abroad. This "equal treatment, no preference" approach, combined with the free economy principle, is only effective up to a certain point. In the era of global economy

where all countries compete fiercely for market and investment (France is aggressively promoting wine in China; the U.S. is highly active to convince Japanese investors), the Chilean approach is almost certain to lose. In its place, or to complement it, a selective approach is necessary. To be selective, one needs strategy. Chile should adopt a national strategy for export promotion. The same applies to investment promotion. The problem is that there does not exist one Chilean authority that is responsible for the task of strategy making. This administrative void should be filled soon.

Recommendation 8 Select “strategic partners”

Very often, “think strategically” is tantamount to “select and concentrate.” While keeping its open-minded policy as the basis for development, Chile at the same time should identify and select a few economic partners with strategic importance (countries, regions or companies) and concentrate its efforts towards them. A thorough study in this respect is absolutely necessary to make such strategic choices. Research capacity to deal with these aspects, however, seems ill defined both with CORFO and ProChile.

Recommendation 9 Create and disseminate Chile’s image

The image matters in global competition. This is why EPIE action plans repeatedly propose some or other form of image campaign (e.g., “Arica as the gateway to the macro-region,” “Valparaíso as the IT center of Chile,” “Eco-region,” and “Chilean-type solution-oriented manufacturing”). A clear, positive image of Chilean products will enormously help, among others, SME producers and exporters to promote their sales overseas. Likewise, a favorable and attractive image of Chilean cities will be highly instrumental to lure foreign investors. The opposite is also true: a bad reputation would damage Chilean products’ prospects in the world markets. Rampant environmental pollution, for instance, will only tarnish the image of Chile and do tremendous harm to its export. Creating a good image and eliminating a bad reputation will therefore pay off. This is one area where strong initiative and concerted effort by the government are necessary and can be effective.

1.4 To Facilitate Implementation

Strategies and action plans must be put into practice. This final category of recommendations are concerned with their implementation.

Recommendation 10 Utilize the existing organizations and schemes

Some action plans represent quite new ideas to the Chilean public administration. However, it is not recommended to create a new organization or scheme to carry out the action. Rather, it is advisable to mobilize existing agencies, organizations or schemes, with some modification if necessary, to carry out the task.

Recommendation 11 Strengthen coordination

Although Chile’s strength lies in its “system,” it is not totally free from shortcomings. One such flaw is fragmentation. Promotion of export and investment particularly necessitates tight coordination of concerned organizations, both public and private. Among others, CORFO, ProChile, the Foreign Investment Committee and SERNATUR should collaborate closely in this way. Their relationships seem close at the regional level but not sufficiently so at the central level. Since the promotion could never be fully effective with any one organization being left out, the four organizations should

bear a collective responsibility to implement the strategies. One way to guarantee this is to organize a special team of people delegated by the four organizations and make the team carry out specific projects.

Recommendation 12 Implement the strategy and action plans as one “package”

The strategy and action plans proposed by EPIE are so designed that they form one coherent package. Since they are tightly interwoven, any one item, if implemented in isolation from the others, could not have the intended effect. To achieve the maximum result, each action should be implemented together as one “package.” However, this would particularly require the Regional government to have sufficient funds to finance that “package.” The central government should further delegate the financial sources as well as the duties to the Regional governments to promote export and investment and, ultimately, develop the regional economies.

PART 1

**EXPORT AND
INVESTMENT**

2 ANALYSIS OF THE CHILEAN ECONOMY

2.1 Chilean Economy: Past, Present and Future

2.1.1 Geographic Position

Viewed geographically, Chile has both advantages and constraints. The geographical advantages include:

- Rich natural endowment;
- Diversity in climate, topography and environment;
- Opposite season; and
- Long coastal line.

For instance, Chilean copper is highly competitive in the world market because of its abundance and the proximity of the copper deposits to the coast. Copper has thus supported the Chilean economy for decades and still is Chile's mainstay. Another example is fruits, whose export has been steadily increasing due to Chile's unique climatic condition found on the Southern Hemisphere.

On the other hand, Chile has some geographical constraints as well:

- Peripheral location on the globe;
- Small population; and
- Long, linear territory.

Chile's global location, far from any of the world's dynamic economic centers, has undoubtedly been a disadvantage for the country. Its small population translates into a small market and hampers the development of industrial and commercial activities. Chile's unique territorial shape, combined with a scattered population in the periphery, makes it uneconomical to build basic infrastructure across the national land. This further hinders the type of economic development that tightly integrates regions into one dynamic movement.

As demonstrated, the geographical advantages and constraints form the very framework for economic activities and should therefore consistently underlie EPIE's analyses and prescriptions.

2.1.2 Macroeconomic Performance

Overview

In the beginning of the 1980s, Latin American countries faced a severe economic crisis. Chile was no exception and its economy had to undergo major structural changes. However, such changes allowed the country to recover quickly from the crisis and, since 1984, entered a new stage of growth driven by export and investment. With the return to democracy in 1990, the processes of economic liberalization and openness were further strengthened, providing extremely favorable conditions for sustained growth of direct foreign investment. During the same decade, Chilean exports have also expanded and diversified as never before in the country's history.

At the end of 2000 Chile completed 18 consecutive years of positive growth (at a slower rate than previous years but still at positive rate), which is an exceptional performance

in Latin America. As a matter of fact, in the 1990s, Chile became the most dynamic economy in the region:¹

“Chile’s economic performance has been exemplary since the mid-1980s, with an average growth in real GDP per capita of 5.4 percent between 1984 and 1997, one of the highest rates in the world” (Sachs and Larrain 2000).

Indicators

Figure 2.1.1 shows a long-term trend of Chilean GDP (in real terms) between 1960 and 1999. It is clearly seen from the Figure that the 1990s was indeed a period of exceptional economic growth. The 10-year average growth rates were 4.3% (1960s), 2.1% (1970s), 2.7% (1980s) and 6.0% (1990s). The overall average was 4.2% during the four decades.

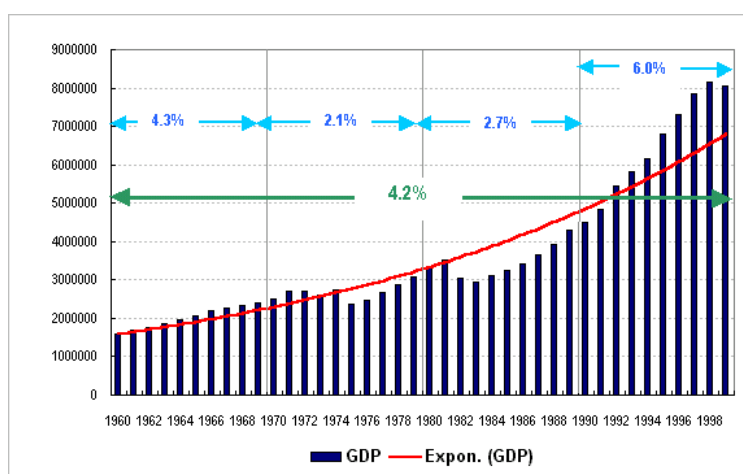


Figure 2.1.1 Real GDP (1960-1999)

Note: In millions of 1986 pesos.

Source: Miguel Torres, data from CIEPLAN/SUBDERE (1994) for period 1960-89 and Banco Central de Chile (1999) for period 1990-1999.

Another important aspect of the Chilean economy is inflation. High inflation was almost an “endemic” characteristic of the economy as seen in Figure 2.1.2. Two-digit inflation was prevalent over 50 years in the 20th century. The hyperinflation (over 500% at one point) during and after the socialist government (1970-1973) had devastating effects. In the past five or six years, the rate has been consistently stabilized at a level lower than 10%.

¹ Chile’s position in Latin America is also outstanding. According to data from ECLAC (2000), while GDP of Latin America as a whole increased 2.5% annually during 1990-1999, Chile’s GDP showed an average of 5.4% growth (in constant 1995 dollars). During the same period, per capita GDP grew 1.3% annually on average for Latin America while it was 4% for Chile, the highest record in the region.

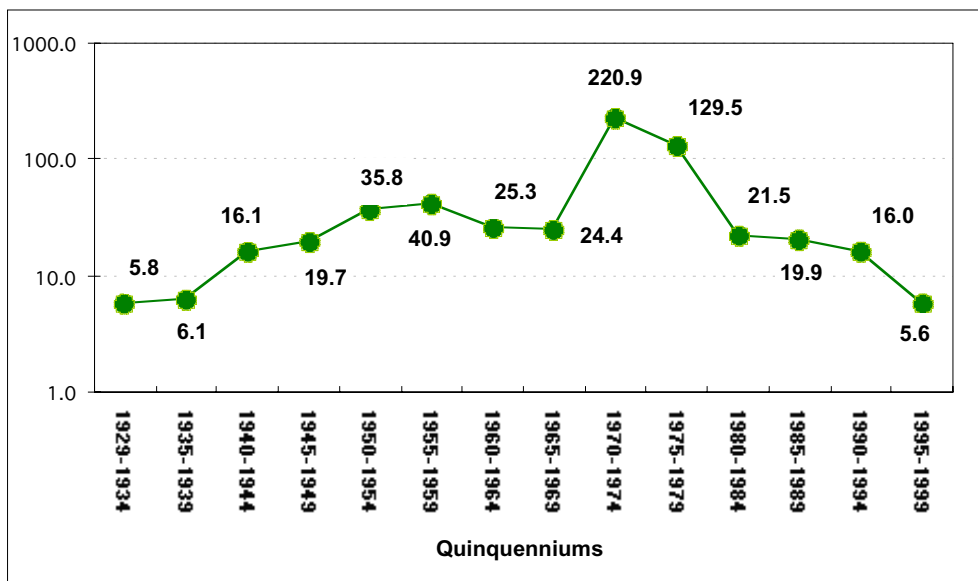


Figure 2.1.2 Inflation (1929-1999)

Note 1: CPI's variation (%) from December to December of each year.

Note 2: CPI base: Dec1998 =100.

Source: Miguel Torres, based on data from INE (1999b).

The outstanding performance during the 1990s was the result of a long process of structural changes. In fact, the period leading to the 1990s since the mid-1970s was unstable, experiencing significant ups and downs:

The First Reform Period (1974-1976) set priority on appeasing the three-digit inflation, inherited from the socialist regime. This period was marked by slow growth, an increase in unemployment, moderate reduction of inflation and significant losses of social welfare.

The Boom Years (1977-1980) experienced, as the result of the stabilizing policy, a significant drop in the inflation rate and a recovery of production, salaries and employment. GDP grew at over 5%. The economic policy during this period, however, sowed the seeds of the coming crisis.

The Debt Crisis (1981-1984) then hit the economy hard. The debt moratorium announced by Mexico in 1982 triggered the region-wide economic crisis. In Chile GDP contracted sharply in 1982 and 1983. Inflation rose again to over 20% and unemployment also reached 20%. However, Chile's recovery was rather swift, a positive effect of structural reforms in the previous eras.

The Beginning of *The Miracle* (1985-1989) started after the Crisis. The structural reforms instituted since the First Reform Period had finally begun to bear fruit. The Chilean economy now stood completely open and liberalized. A stable GDP growth was back, reaching nearly 7% each year.

Then came the phenomenal 1990s, Chile's *Miracle*, boosted by the return to democracy in 1990. It was the consequence of proper macroeconomic management, both internal

and external, aimed at making growth more dynamic or, in other words, stimulating capital formation and export. The *virtuous circles* of “investment-growth” and “export- growth” were clearly at work (Agosin 1999).

2.1.3 Chilean Model

For the “proper macroeconomic management” to be effective, however, the whole institutional environment must also be appropriate and favorable. What enabled Chile to set the virtuous circles in motion was its economic openness and stability. These characteristics are the paramount achievements of the reforms implemented since the 1970s through 90s.²

The Chicago Boys adopted the economic philosophy of *laissez faire*, totally liberalizing the markets while reducing the State’s involvement to the minimum. After a few policy blunders and hard lessons, subsequent policymakers upheld the philosophy and painstakingly instituted a series of reforms to that effect: liberalization of the domestic markets (especially labor and financial markets), opening the Chilean economy to the international market, financial and monetary discipline, privatization of state-owned concerns and infrastructure, and so on. At the same time, the political system also underwent changes and has emerged as a highly professional system marked by transparency and stability. The resulting politico-economic system is widely known as the *Chilean Model*.

The *Chilean Model* represents a system highly conducive to economic development in the era of internationalization. As a matter of fact, Chile is quite unique in the world in that it stands out from the rest not because of its economic might or size but because of its economic system. One of Chile’s most valuable strengths in competing in the world is its *system*.

Competitiveness Ranking: “System” is Chile’s Strength

A good way to grasp this concept is to refer to the rankings compiled and published by various institutions. One such ranking that is highly respected worldwide is IMD’s “*The World Competitiveness Yearbook*.” A look at Chile’s rankings in various sectors or aspects vis-à-vis other countries will reveal reliable hints regarding where Chile’s strength lies. Table 2.1.1 is a summary of a few selected indices for Chile and eight other countries in Latin America and elsewhere (IMD 2000).³

A few observations concerning the Table will follow. First, while six Latin American countries fare poorly in general, Chile stands top among them in most categories; Chile is even ranked higher than Japan in some categories. Second, Chile’s strengths lie in government and national economic management. Third, in relation to the second point above, Chile’s advantages originate from its political and economic “processes” and not from the “products”; compare Japan whose strengths principally come from “what it

² Stallings and Peres (2000) show that Chile is the only country among nine Latin American countries to achieve tangible, positive results out of the reforms on all of the five indicators: investment, productivity, growth, employment and equity.

³ In total 47 countries are assessed in this Yearbook, among which 6 are Latin American (Chile, Argentina, Brazil, Mexico, Colombia, Venezuela). The subject countries are ranked with respect to 290 items in 8 fields.

produces” rather than from “how it produces.” Chile’s economic strength is its stable, reliable, transparent and yet flexible *system*. And fourth, in spite of these favorable assessments, some maintain that there remains much room for Chile to improve its ranking.

Table 2.1.1 National Ranking of Competitiveness

	Chile	Argentina	Brazil	Mexico	Colombia	Venezuela	USA	Singapore	Japan
Total	26	42	34	36	44	46	1	2	17
1. Domestic Economy	40	42	38	35	44	47	1	8	6
2. Internationalization	21	38	34	37	42	47	1	2	27
3. Government	13	35	27	20	39	44	10	1	22
4. Finance	25	39	36	40	45	46	1	10	22
5. Infrastructure	32	37	35	39	41	38	1	13	21
6. Management	22	38	26	33	41	47	1	5	24
7. Science and Technology	32	46	35	44	41	43	1	9	2
8. People	34	38	40	37	44	43	3	5	20
Selected Items									
Attractiveness (manufacturing)	21	35	29	28	42	44	1	2	22
Attractiveness (R&D)	27	43	30	38	44	46	1	8	6
Attractiveness (services & management)	23	40	32	36	44	46	1	3	25
Direct investment stocks abroad	27	26	25	32	35	34	1	15	4
Central government domestic debt (% of GDP)	10	6	28	8	12	5	23	41	38
Computers per capita	34	35	39	36	41	37	1	12	18
Globalization threatens economy?	16	41	36	26	47	45	3	5	35
Political system is well adapted to today’s economic challenges?	16	38	37	33	42	47	10	1	44
Bureaucracy does not hinder business development?	18	38	29	28	44	43	14	1	25
Companies’ financial health does not hinder their ability to compete?	15	42	30	35	45	38	20	7	40
Infrastructure is adequately planned and financed?	27	41	38	36	44	46	10	1	18
A dynamic marketing culture exists?	14	35	12	37	42	47	1	4	30
University education meets the needs of a competitive economy?	7	40	29	37	27	46	6	4	47

Source: IMD (2000)

Mitsubishi Report

The *system* as the core of the *Chilean Model* can be seen in another perspective. The so-called *Mitsubishi Report* succinctly characterizes the Chilean economy in five points (Mitsubishi Research Institute 1996):

- 1 Small market size
- 2 Rich natural resources and industrial structure affected by them
- 3 Diversity and growth of the external trade relations
- 4 Open and liberal economic system
- 5 Open and liberal system governing inward direct investment

It is somewhat remarkable that two out of five points (or characteristics) refer to “system” very explicitly when depicting a national economy. Of course the Report’s basic perspective (or bias) should be taken into account; its purpose was to analyze the future prospect of Japanese investment into Chile. Still this characterization of the Chilean economy seems to be a right one, very appropriately reflecting where its beauty is. Chile’s economy stands out in the world because of its *system*.

Fusing with the World Economy

Chile has striven over the past quarter century to transform its economic system into an open and transparent one free from State interference. For instance, it has gradually lowered import duties and tariffs, sealed a number of free trade agreements, and treated foreign investment equally with domestic investment. Such open-minded actions would only lead the economy to “fuse” with the world economy, leaving no trace of barriers at the borders.

This process of “fusion” seems to be quite a bold strategy for such a small-sized economy as Chile to survive the economic globalization. However, the strategy seems to be working handsomely. Owing to the strategy, as its excellent performance in the 1990s testifies, Chile has already made significant gain in export and foreign direct investment, two principal engines for growth. In the following two sections, Chile’s achievements in terms of export and investment will be briefly reviewed.

2.1.4 Trade

Trade Policy

The size of Chile’s domestic market is not large enough for economies of scales to be effective in its manufacturing sector. The need to diversify markets and exports has forced Chile to pursue a very open and liberal trade policy, thereby providing easy access to external sources and, at the same time, finding new markets for Chilean goods.

Chile’s trade liberalization scheme is the oldest and longest continuously applied program in the region. Chile has implemented three different trade reform programs: a radical scheme in 1974-1979, a more moderate one in 1985-1991 and the present one from 1991 until today. The essential difference between the two previous programs was the effect on the exchange rate. During the first liberalization exercise, the currency appreciated steadily following an initial depreciation. By contrast, in the 1980s, the gradual reduction of tariffs from a maximum rate of 35% (September 1984) to the current level of 11% (June 1991) was accompanied by a sharp real devaluation. It sent positive signals to exporters and, at the same time, more than compensated the slightly negative impact of the tariff reduction on the production of goods that competed with imports. Despite the success of the second program, the de-industrialization process that was spurred on by the first reform was not reversed. Exports remained concentrated in natural resource-intensive product lines. Nevertheless, items involving a higher level of value added gained ground, investment continued to rise and the creation of new production capacity began (ECLAC 1994). The third program’s main characteristic is that it put an end to the unilateral integration and moved forward to the development of negotiated initiatives of integration with different regions and countries. In this phase a persistent revaluation of the peso was combined with negotiated reduction in tariffs.

Free Trade Agreement

Consistent with its newest policy (“open regionalism”), Chile has become the world’s most active promoter of free trade. It has signed free trade agreements with most Latin American countries and Canada. It is currently in negotiations with the EU, the U.S. and South Korea. Initial studies have also finished with Japan. On the multilateral side, Chile is keen to integrate NAFTA and is now in negotiations to integrate the Free Trade Agreement of the Americas (FTAA). It has been a member of APEC since 1994 (Chile will have zero tariffs by 2015) and an associated member of MERCOSUR since 1996.

Export⁴

Chilean exports reached its peak in 1997 at over US\$17 billion. The volume decreased in subsequent years due to the Asian crisis in 1997 but recovered in 2000 reaching US\$18.2 billion (equivalent to about 40% of GDP). Export destinations are fairly balanced: about 40% goes to South and North Americas, 30% to Europe and 30% to Asia. The largest export destination is the U.S. (17% in 2000) followed by Japan (14%). The fastest growing major importer is China. In 2000, its imports from Chile jumped from around US\$600 million to nearly US\$1 billion. China now ranks as the fourth largest export destination accounting for 5.3%.

Need to Diversify Exports

Traditionally, Chilean exports concentrated in a few commodities like copper, woods, pulp, salmon and fruits. Although Chile’s exports have diversified during the last ten years, both in terms of products and markets, there still is a clear dependency on primary products. A look at export data for the last 20 years reveals this. In 1980, Chile’s exports of manufactures added up to 11.3% of the total value of FOB exports of goods; meanwhile primary product exports represented 88.7% of that total. Out of these primary product exports, 40.4% were of refined copper and copper ores. From 1980 on, exports of manufactures increased, but not significantly. In 1997, they represented 15.2% of the total FOB value, while primary products’ share was still large at 84.8%, of which about 40% were of refined copper and copper ores (ECLAC 1998b). Obviously, richness in natural resources has largely determined Chile’s industrial and trade structures.

It is clear that natural resources have been important for Chile’s success in the last two decades, but the question is whether Chile should continue to rely on them to sustain growth over the coming decades. One example of such concern was expressed by the Standard & Poor’s rating released on October 22, 1998. While assigning Chile an A- ranking, the document stated that natural resource dependence was an obstacle to an improvement in this evaluation: “an intense concentration in commodities—with copper representing 40% of total exports—exposes the balance of payments to fluctuations in commodity prices.” Sachs and Larrain (2000) express a similar concern: “it appears unlikely that copper exports could grow for over 20 years at the rates required to support the projected per capita income even in the conservative scenario.” They conclude: “Chile will have to rely on exports other than natural resources in order to attain per capita income in the range of \$17,300 in a conservative scenario or \$22,300 in

⁴ See Section 3.1 below for details.

an optimistic scenario in 2020.”

Dependency on commodity export, as typified by copper, poses some serious problems in the Chilean context. First, as theory tells, an economy well endowed with resources in quantity and quality, coupled with a monopoly of the resources, is susceptible to “Dutch diseases” and rent-seeking behavior, both restraining the economy from development (Meller 1996). Second, an economy highly dependent on commodity export is subject to the volatility of the international commodity prices. Third, the Chilean commodity sector is unlikely to grow faster and absorb additional employment, particularly the highly educated segment.

Statistics for 2000 indicate that “non-traditional” exports are on the rise.⁵ Their value increased 10% over 1999, totaling US\$6.6 billion or about one third of the total export. This trend is heading in the right direction and should continue in this way. However, the need for a new, coherent set of policies is clear to encourage export growth and diversification further (Macario 2000).

2.1.5 Foreign Direct Investment

Investment Policy

Under existing rules, foreign direct investments into Chile have to conform to one of the following: Foreign Investment Law (DL 600) or Central Bank Foreign Exchange Rule Chapter XIV. Most foreign direct investment in Chile has chosen DL 600 as its legal basis. (DL 600 contains provisions regarding legal contracts with the State of Chile that both guarantee the rights of the foreign investor and establish the obligations of the foreign investor.) This regulatory framework for investment, the oldest of its kind in the region, has remained very stable since its promulgation in 1974. True to the economic principle of free and fair competition, it is characterized by openness and fairness: it does not discriminate foreign investors against Chilean investors; it does not pose restrictions on foreign investors except one financial regulation. DL 600 undoubtedly was a decisive factor behind the phenomenal FDI inflows in recent years (ECLAC 1998a).

Foreign Direct Investment⁶

Indeed, despite the fact that its economy remains smaller than those of other major Latin American countries, Chile has become one of the most favored destinations of foreign investment flows in Latin American and the Caribbean. The annual average inflow of FDI into Chile increased phenomenally from US\$530 million in the 1980s to US\$1.7 billion during the first half of the 1990s and to over US\$5 billion during 1997 and 1998.

The recipient sectors, however, have been limited to a few. According to statistics of the Foreign Investment Committee, the mining sector, chiefly copper and gold, received nearly 50% of FDI inflows during 1974-1996. The manufacturing sector received 22% of total FDI in 1974-1989 but the share declined to 16% in 1990-1996. By

⁵ “Non-traditional” export refers to, among other things, mineral-based manufactured goods (e.g., table salt), agro-based manufactured goods (e.g., juice, raisin, perfume), manufactured goods (e.g., vessels, transmissions, leather clothing, radios), agriculture and fishery products (e.g., seeds, fish fillet, frozen fish) and chemical materials (e.g., polypropylene, methanol).

⁶ See Section 3.2 for details.

contrast, the service sector increased its share from 28% to 35% in the same periods. Given the great mining potential of Chile, the tendency for FDI flows has been to go into new projects rather than acquisitions of existing enterprises. However, this is changing; with the sweeping progress of privatization, nearly 40% of FDI went to mergers and acquisitions in 1997. As a result, the service sector came to account for more than 50% of FDI flows, especially in the areas of electric power, telecommunications and financial services. Further in 1999, Chile doubled its annual FDI inflows (an all-time record US\$9.2 billion), largely as a consequence of the purchase of Enersis and Endesa-Chile by the Spanish electricity corporation, Endesa-España (US\$3.6 billion).

Companies based in the U.S. and Canada have traditionally been the chief source of FDI, primarily in large-scale mining projects. FDI from these countries grew from 53% of the total in 1974-1989 to 59% in 1990-1996. This structure changed in 1997 when Spain accounted for 31% of FDI, mostly in the service sector (electricity). This trend continued until 1999.

End of Expansion?

After 1999 recorded an all-time high of US\$9.2 billion, foreign direct investment in 2000 plunged to US\$3.7 billion, a 62% drop. Is this a temporary trough unavoidable in the economic cycle? Or is this a telltale sign of the end of expansion?

Sachs and Larrain (2000) directed Chilean people's attention to this crucial issue by warning them against a possible downfall. There has been a wide range of arguments since then. Among others, Moguillansky (1999) maintains that at the end of the 1990s Chile finished an investment cycle in the main export sectors, noticeably mining and natural resource processing. She attributes this depletion to the lack of an investment strategy and to the excessive concentration of capital in a few sectors. She also urges the necessity of an efficient strategy to foster new, dynamic sectors that will keep the virtuous circles in motion.

Some agree with this view. They observe that the early 1990s will never repeat themselves when multinational companies rushed to make huge investments in principal sectors. Neither will return, they predict, the heyday of telecommunications, power and financial services when they enjoyed sizable inflows. They further point out that return on investment is no longer as high as in the early 1990s and, to begin with, many Chilean corporations are already in the hands of overseas concerns. The era of investment expansion is over.

Others disagree. They think that the drop was temporary, caused by the postponement of large-scale investment projects. They also point out that portfolio investment is maintaining a high level, indicating that investors' confidence remains with Chile. They predict that foreign investment will bounce back in 2001.

In EPIE's view, it is unmistakably clear that Chile should have a strategy to foster new sectors to receive investment. This is exactly the main proposition underlying the strategies and action plans throughout this Report. However, Chile needs another perspective to look at the issue when exploring new investment possibilities. It is the

spatial or regional perspective. Historically in Chile, industries and investments have heavily concentrated in one particular location: Santiago. If we simple-mindedly explore new investment opportunities without taking this fact into consideration, that effort will only reinforce the prevailing undercurrent and further aggravate the negative effects of over-concentration. Our effort to promote investment in unconventional sectors should therefore be keenly aware of this pitfall. To prove this, the next section will look at Chile from the regional perspective.

2.1.6 Regional Perspective

Chile is composed of 13 Regions. The Regions are administrative branches of the State and have no autonomy. The *Intendente*, the head of Region, is appointed by the President and is not elected by popular vote. However, the Regions are far from uniform. Different historical background and difficulty in transportation nurtured and preserved distinct characteristics of each Region. Chile's 13 Regions are as diverse as the six continents on the earth.

Viewed from the Regions, a very different picture emerges of the country. Chile has two characteristics regarding this respect:

- 1 Concentration of population and economic activity in the Metropolitan Region
- 2 Disparities and imbalance between the Regions

Concentration

The Metropolitan Region accounts for 40% of Chile's population and nearly half of GDP (Figures 2.1.3 and 2.1.4). It also accounts for a substantial share of export and foreign investment (Figures 2.1.5 and 2.1.6).

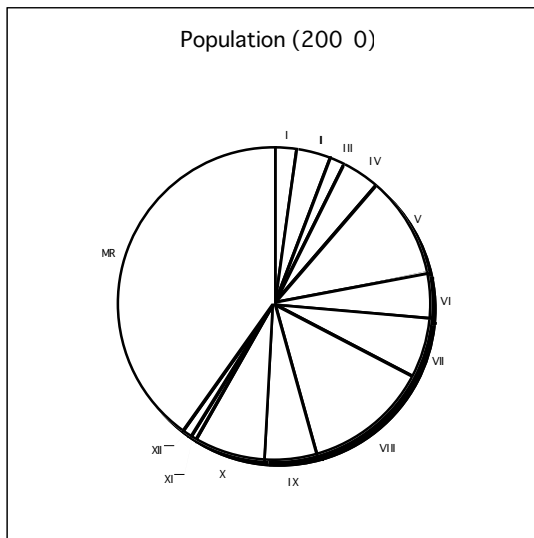


Figure 2.1.3 Population

Source: Data from INE (1999a)

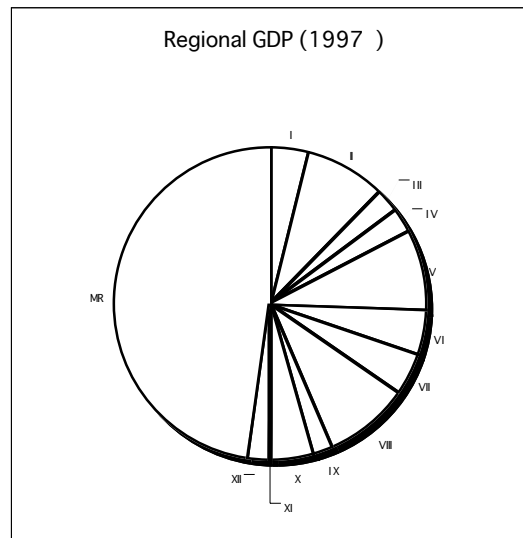


Figure 2.1.4 Regional GDP

Source: Data from Banco Central de Chile (1999)

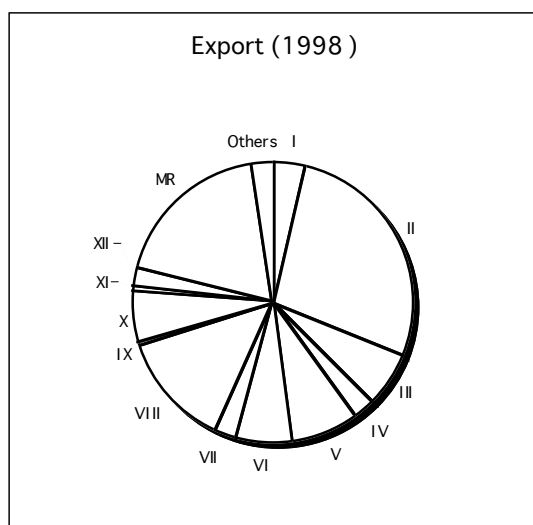


Figure 2.1.5 Export

Source: Data from ProChile

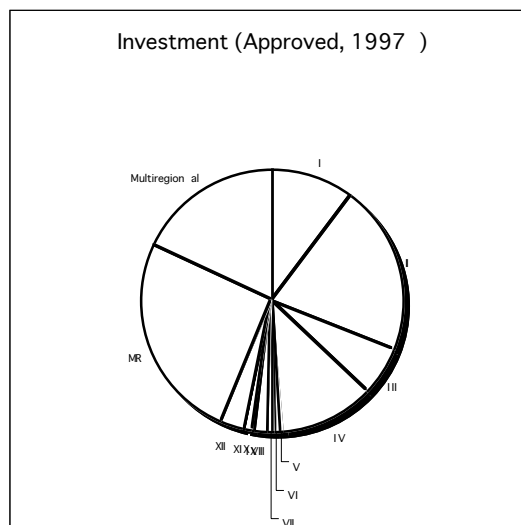


Figure 2.1.6 Foreign Investment

Source: Data from Foreign Investment Committee

Concentration of population and economic activity can mean efficiency in production, distribution and consumption because it creates economies of scale, various externalities and saving on transportation costs. On the other hand, “excessive” concentration induces inefficiency, negative externalities (e.g., environmental problems), and a polarized economic structure that entails inequality vis-à-vis the rest of the country. The case of Chile may be judged as an “excessive” level of concentration.

Income Distribution

Interpersonal distribution of income in Chile is fairly unequal. According to the results of the CASEN Survey of 1998, while the richest 10% accounted for 41% of income, the poorest 10% accounted for only 1.2%. When compared to a previous CASEN Survey conducted in 1987, it is apparent that the picture did not change much over the time.

Income distribution is also unequal among the Regions. Using per capita GDP as a proxy of personal income, we can see a wide interregional variation (Figure 2.1.7).

It is true that the remarkable economic growth during the 1980s and 1990s has improved the level of personal income. The CASEN Surveys also reveal that poverty incidence decreased from 45% in 1987 to 22% in 1998. Extreme poverty was reduced from 17% to 6%. This reduction occurred across the Regions but the rate differed among them. As demonstrated in Figure 2.1.8, levels of poverty reduced more quickly in the Metropolitan Region and in Regions I, II and V.

Comparing Figures 2.1.7 and 2.1.8, we can notice two points about regional disparities in Chile:

- 1 Poverty incidence does not quite relate to the level of per capita GDP; and
- 2 Rate of poverty reduction does not correlate with the level of per capita GDP either.

These two points suggest that there exist some groups of the population who are not yet

fully integrated in the modern economic sector. This finding should underlie various attempts to overcome the interregional economic imbalance.

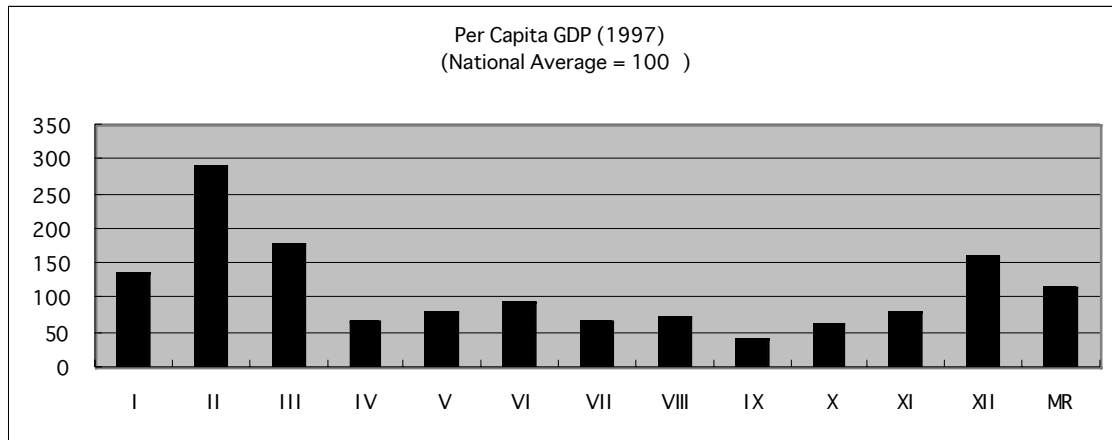


Figure 2.1.7 Per Capita GDP by Region

Source: Data from Banco Central de Chile (1999)

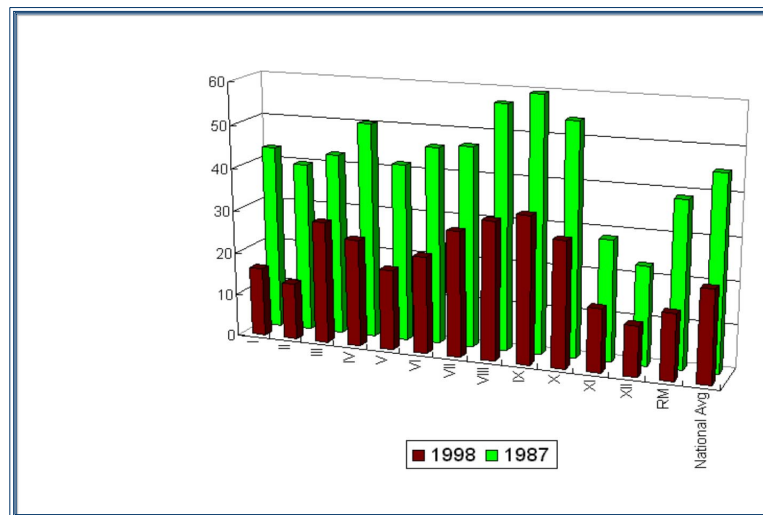


Figure 2.1.8 Poverty Incidence by Region (1987 and 1998)

Source: Data from CASEN Survey 1987 and 1998

Towards a More Balanced Regional Development

To rectify the “excessive” concentration in Santiago and reduce the disparities among the Regions, the government has introduced various measures to focus more on regional perspectives. Among them, three notable undertakings are 1) **Estrategia Regional de Desarrollo** by MIDEPLAN/SERPLAC, 2) **TodoChile** by CORFO, and 3) **New Exporters Project** by ProChile.

MIDEPLAN in conjunction with SERPLAC has prepared *Estrategia Regional de Desarrollo* (Regional Strategy for Development) for each of the 13 Regions. The Strategy identifies Region’s potentials and aspirations, sets priorities, and prescribes

actions for the medium term (1996-2000). The 13 Strategies were referred to by EPIE when the JICA Study Team selected possible strategies for the three model Zones.

TodoChile is a comprehensive program, spearheaded by CORFO, to direct more investment to the Regions outside Santiago. In the program, each Region identifies products or sectors that have a comparative advantage, develops an attractive investment promotion package, and provides financial and technical support to the prospective investors. Authorized in 1998, the program made a good headway: 36 investment projects (US\$21 million) were materialized in 1999 alone out of 56 approved plans. Year 2000 saw an even stronger surge, with investment commitment reaching US\$100 million. The program is also unique providing one-year training to high-ranking officials in the Regional government to familiarize them with business and investment.

The New Exporters Project, introduced by ProChile in 2001, attempts to identify and support those SMEs that have high potential to become consistent exporters. The Project aims at transforming 1,000 such high-caliber SMEs nationwide into full-fledged exporters by 2005. Though it does not explicitly refer to the regional dimension, the Project has clear, positive regional implications. This is demonstrated in the fact that the enterprises in the Regions are primarily SMEs.

EPIE shares exactly the same perspective and orientation regarding these three undertakings.

2.1.7 Remaining Issues

Although Chile has achieved enormous economic success in the last decade, there still are pending issues that will arise in the future. "Growth with equity" as stressed by Ffrench-Davis (1999) succinctly summarizes this entire array of issues. Equity here should be both interpersonal and interregional. To sum up this introductory Section, I will repeat only four issues:

- 1 Chile needs a vision.**
- 2 Chile needs to diversify exports.**
- 3 Chile needs to attract investment in new sectors.**
- 4 Chile needs to de-polarize.**

How? Part of the answers will be elaborated in this Report.

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2.2 Chile in the World Setting

2.2.1 MERCOSUR: Achievements and Its Benefits to Chile

(1) Achievement of MERCOSUR

a. Establishment of MERCOSUR

The Southern Common Market (hereinafter called MERCOSUR) was established under the Treaty of Asunción, signed in March 1991 by Brazil, Argentina, Paraguay and Uruguay. The Treaty of Asunción was aimed at the establishment of a common market among the four countries with free circulation of goods, services, capital and workers from January 1995. The Treaty of Asunción has been formally amended once, in the Additional Protocol of Treaty of Asunción, known as Protocol of Ouro Preto, signed in December 1994.

b. Organizational Structure of MERCOSUR

According to the above Protocol of Ouro Preto, the institutional structure of MERCOSUR was established as follows (Article 1):

- Council of the Common Market (consisting of Ministers of Foreign Affairs and Ministers of Economy)
- Common Market Group
- MERCOSUR Trade Commission
- Joint Parliamentary Commission
- Economic and Social Consultative Forum
- MERCOSUR Administrative Secretariat

The first three bodies are decision-making bodies. The Trade Commission has a number of Technical Committees under it to deliberate on technical matters.¹ The Ad Hoc Group has discussed some sensitive issues like services, institutional issues, external relations and sugar.

Also, to advance MERCOSUR's status from a customs union to a common market, various Working Sub-Groups have been established under the Common Market Group.² In addition to the above functions, some regional common issues such as science and technology and tourism have been discussed at the Specialized Meetings of the Common Market Group.

One big difference between MERCOSUR and EU is that the former lacks tools to finance less developed regions and countries among the members. To complement this shortcoming, the Technical Cooperation Committee has been established under the Common Market Group.

¹ TC1=Tariff Nomenclature and Classification of Merchandize; TC2=Customs Affairs; TC3=Trade Norms and Disciplines; TC4=Public Policies That Distort Competitiveness; TC5=Defense of Competition; TC6=Unfair Trade Practices and Safeguards; TC7=Defense of Consumers; TC8=Non-Tariff Measures and Restrictions; TC9=Automotive Sector; and TC10=Textile Sector.

² WSG-01=Communications; WSG02=Mining; WSG03=Technical Rules; WGG04=Finance; WSG05=Transport and Investment; WSG06=Environment; WSG07=Manufacturing; WSG08=Agriculture; WSG09=Energy; WSG10=Labor, Employment and Social Security.

Thanks to the various and serious efforts made by those Groups and Committees in the past five years as well as to each member country's efforts of structural reform and open economic policy, MERCOSUR is consolidating itself and becoming a hot spot that world investors are watching.

c. Chile's Joining MERCOSUR

Chile joined MERCOSUR as associate member in 1996. After the Treaty of Asunción was signed, Chilean exporters looked into neighboring markets carefully and started to increase exports to Argentina significantly beginning in 1992. It can be said that MERCOSUR has opened significant trade opportunities for Chile. This can be seen clearly from the trade figures for 1990 and for today.

Table 2.2.1 Exports from Chile

	1989	1990	1991	1992
Brazil	523	487	448	451
Argentina	110	114	157	462

Source: IMF, IFS

d. Trade Performance of Chile

Chile's trade figures after the formal establishment of MERCOSUR with major trading partners indicate the following trend. With Brazil and Argentina, no significant change can be observed. However, trade balance with Argentina is worsening. Market watchers say that MERCOSUR's consolidation process has been a natural one up to now and this worsening trend is part of the process. From now on, however, conscious efforts are needed to consolidate it further. Leaving this process solely to market forces has obvious limitations.

Traditionally, Chile keeps a well-balanced regional trade breakdown (1/3 to the Western Hemisphere, 1/3 to Asia, 1/3 to Europe). In addition, Chile has tried to keep reasonable trade balance with major trade partners. However, trade balances in recent years shows a growing deficit with some countries. Chile should reconsider its trade policy seriously with those negative balance countries--USA, Mexico, Argentina, Germany and Italy. It should also consider seriously exploring new markets such as Asian countries.

(2) MERCOSUR: Its Consolidation Process and Benefits to Chile

This section will analyze in some detail the ways of consolidation and some remaining limitations of MERCOSUR. Since some of MERCOSUR's limitations can actually mean certain advantages to Chile, they will be analyzed from that viewpoint, too.

Table 2.2.2 Main Trading Partners of Chile

Export (F.O.B.) from Chile		Unit: US\$ million			
Country	1993	1994	1995	1996	1997
US	1,655	2,012	2,375	2,559	2,711
Japan	1,502	1,976	2,906	2,496	2,676
UK	554	523	1,076	887	1,062
South Korea	413	584	897	864	990
Brazil	407	605	1,057	935	957
Taiwan	408	539	703	629	786
Argentina	589	637	586	701	781
Germany	487	582	837	742	747
Italy	330	359	609	475	500
Netherlands	260	346	438	394	423
Total incl.others	9,415	11,644	16,447	15,396	17,025
Imports of Chile (C.I.F.)		Unit: US\$ million			
Country	1993	1994	1995	1996	1997
US	2,477	2,638	3,793	4,110	4,333
Argentina	581	955	1,385	1,634	1,837
Brazil	1,060	1,000	1,195	1,066	1,243
Japan	883	1,007	1,013	950	1,076
Mexico	210	264	601	927	1,055
Germany	620	555	790	730	843
China	301	363	498	636	721
Italy	336	351	509	551	700
Spain	278	341	445	530	621
South Korea	343	333	528	557	589
France	346	363	446	582	502
Total incl.others	10,869	11,501	15,348	17,353	18,888
Trade Balance for Chile					
Country	1993	1994	1995	1996	1997
US	-822	-626	-1,418	-1,551	-1,622
Argentina	8	-318	-799	-933	-1,056
Brazil	-653	-395	-138	-131	-286
Japan	619	969	1,893	1,546	1,600
South Korea	70	251	369	307	401
Germany	-133	27	47	12	-96
Italy	-6	8	100	-76	-200

Source: EIU Country Profile Chile 1999-2000

a. Institutional Mechanism

Like APEC, MERCOSUR's members and associate members do not have obligation to accept decisions made by CMC, MTC, etc. In other words, their consolidation is based purely on the best effort principle. This will entail the following limitations:

Lack of an institutional approach and compulsory requirement of decisions by the MERCOSUR Council, Trade Commission, etc. will inevitably cause delay in consolidation. As many observers have noted, MERCOSUR lacks an institutional

approach. Each member and associate member country has assigned responsible government departments and organizations that work for the Working Sub-Groups, Technical Committees, etc. Since those Groups or Committees do not report to the MERCOSUR Administrative Agency, any party interested in their activities and performances should refer to individual countries for information, not to the MERCOSUR Administrative Agency. This will naturally slow down the consolidation efforts.

However, considering the military regimes long persistent in the region and lack of any consolidation efforts until the mid-1980s, it seems a natural choice for the member countries to adopt the best effort basis for their cooperative activities. In fact, Argentine and Brazilian Ministries of Foreign Affairs, which are responsible for MERCOSUR negotiations, are of opinion that it will take 10 to 15 more years to complete consolidation of MERCOSUR. At the same time, both governments maintain that the consolidation of MERCOSUR and Latin American countries is a clear priority over FTAA, which is scheduled to start technical negotiations in 2005.

Thus, its lack of an institutional approach hampers MERCOSUR's consolidation. However, one positive point has resulted from this: transparency has dramatically increased due to the MERCOSUR initiative. This has clearly worked for the benefit of Chile.

b. Lack of Financing Tool

The member and associate member countries, in principle, share the policy of a small government and efficient public sector accounts management. As a consequence, financing the sub-national region's development in MERCOSUR countries has become difficult with scarce funds though demand is high and necessity evident. This problem was discussed during the re-launching meeting of MERCOSUR held in Buenos Aires on June 30, 2000. One option is to utilize Fonplata (*Fondo de Desarrollo de Cuenca de Rio de La Plata*). This issue will be studied further in a Working Sub-Group.

c. Treatment of Sensitive Issues Such As Free Trade Zone

To build MERCOSUR's firm basis, member and associate member countries have not yet touched upon sensitive issues such as free trade zones. However, to further and deepen its consolidation, they should no longer avoid such touchy issues. Brazil has recently proposed that only one free trade zone be established in each member and associate member country. If this is so decided, then Chile will face another very sensitive issue regarding which city can survive as *the* free trade zone. This issue is pending for further study by a Working Sub-Group. Its decision must be clear on how to treat free trade zones and in-bond transactions in order to facilitate the consolidation of MERCOSUR.

d. Harmonization of Macroeconomic Targets

To achieve further consolidation as a common market similar to the EU, member and associate member countries should pursue the consolidation of macroeconomic performance. The first step would be to establish macroeconomic targets and harmonize statistical data systems. A significant progress was made in December 2000

when the member countries agreed to take steps to set common macroeconomic targets by 2005. According to the agreement, they will first publicize each country's macroeconomic targets in 2001 and, as the second step, harmonize their targets during 2002-05. Brazil has proposed the development of a common currency in MERCOSUR. Whether or not they will have a common currency, a convergence of macroeconomic performances will bring a real benefit to Chile. In the past, when a currency turmoil happened elsewhere in Latin America, Chile suffered heavily simply because it is a Latin American country. This will cease to happen once their macroeconomic performances are harmonized.

e. Lack of MERCOSUR Common Standards

Member and associate member countries have their own different infrastructures of metrology and standards. So far they have developed their standards based on the ISO/IEC standards. However, it would be difficult for them to achieve perfect compliance with the ISO/IEC standards. Instead they might consider jointly adopting the MERCOSUR standards, similar to the ASEAN standards, to facilitate intra-region trade procedures. The MERCOSUR standards could be based on the concept of ISO/IEC standards but should respect the region's specific conditions and characteristics.

The issue of MERCOSUR common standards was also among the agenda for the re-launch meeting of MERCOSUR on June 30, 2000. Both the Chilean public and private sectors should be encouraged to cooperate to take advantage of this movement, which clearly will benefit Chile. Government initiatives alone, however, will not be enough to develop the standards and conformance infrastructure. It is necessary and encouraged for the private sector to participate in the effort.

f. Lack of Private Sector Participation

The driving force of the region's economy is the private sector in general and SME (small- and medium-sized enterprises) in particular. In MERCOSUR, however, their involvement has been minimal. Those who lead MERCOSUR consolidation, like APEC, have been the governments. As some observers point out, the private sector's participation should be strongly encouraged to facilitate further consolidation.

If the private sector actively participates in the MERCOSUR processes, it will reveal a number of problems that block trade. For example, credit risk of importers has not been discussed in MERCOSUR. If the importer's risk or basic data are not available in MERCOSUR, an aggressive export promotion policy will hardly be effective. This is a type of market failure. Some schemes can cope with this such as credit guaranty or trade insurance or a type of information bank on trading companies.

In view of the MERCOSUR countries' needs to diversify their trade partners and political linkages from the traditional West to the emerging East, Chile's full membership in APEC can become a very valuable asset. Its experiences in dealing with APEC, particularly Asian countries, and their business circles may render Chile some superior position in MERCOSUR.

2.2.2 APEC: Achievements and Its Benefits to Chile

APEC started its consolidation efforts from the Bogor meeting in 1994, followed by the Osaka meeting in 1995. The main aim of APEC is to establish free trade among the members (by 2010 for developed countries and by 2020 for developing countries). A comparison of working groups of APEC and MERCOSUR shows that APEC's activities concentrate more on trade and related issues.

(1) Organizational Structure and Achievements of APEC

APEC's most important organization is CTI (Committee on Trade and Investment), which was established in 1993 by the Declaration and APEC Trade & Investment Framework. CTI functions as the decision-making tool for the liberalization and facilitation of trade and investment among APEC member countries.

There are several sub-committees, such as Sub-Committee on Standards and Conformance and Sub-Committee on Customs Procedures, and some experts groups like Investment Experts Group and Intellectual Property Rights Experts Group that study specific issues.

CTI (Committee on Trade and Investment) also has some sub-groups that study such issues as tariff and non-tariff measures, services, competition policy, government procurement, deregulation, rules of origin, dispute mediation and mobility of people.

During 1999, CTI focused its work in the following areas. The CTI:

- Implemented and improved the Collective Action Plan which will significantly lower costs and reduce barriers to the movement of goods and service;
- Undertook a review of CAP implementation since 1996 as a parallel exercise to the self-review undertaken by member economies of their Individual Action Plans;
- Completed a review of its structure and adopted a number of measures to streamline the work processed within the Committee to achieve cost-effective use of resources while ensuring that assigned tasks and objectives are completed in a timely fashion;
- Facilitated the technical discussions to carry forward work in the non-tariff elements of Early Voluntary Sectoral Liberalization (EVSL);
- Managed the implementation of the project on "Communicating the Impact of Liberalization" which involved the development of effective communication strategies to build community understanding and support for liberalization; and
- Undertook a survey of APEC's trade facilitation achievement to-date and produced a package of highlights which was presented to Leaders.³

As noted above, APEC's achievements are mainly in elaborating a Collective Action Plan, leading it to Early Voluntary Sectoral Liberalization. Obviously, facilitation of communication and transparency of rules are other major achievements.

³ This paragraph is taken from "Update of Activities within APEC" (February 2000) by APEC Secretariat, Singapore.

(2) Benefits to Chile

a. Comparison of Major Regions' Trade Performance in the World

Table 2.2.3 shows the major economic regions' trade performances. One notable finding is the high rate (72%) of intra-regional ("within region") trade of APEC. If we exclude NAFTA countries (USA, Canada and Mexico) from APEC, the rate of intra-regional trade further increases to 98%. This clearly indicates that to join APEC and respect the Collective Action Plan is a good trade promotion policy.

When looking at the percentage share of the region's external trade, we can recognize the importance to MERCOSUR of the issue of common external tariff. Actually, this issue becomes a burning spot as Chile tries to gain full membership of MERCOSUR. By contrast this concern does not exist in APEC since APEC is working towards a free trade area, rather than a customs union.

Table 2.2.3 Comparison of Regions' Trade Performance

	Total Trade (A) (Export+Import)	Trade within the Region (B) (Export+Import)	B/A	Motivation on Harmonization
APEC	453	326	72%	High
APEC-NAFTA	232	228	98%	High
EU (15)	418	256	61%	High
NAFTA	222	98	44%	Still low
ASEAN (9)	72	45	63%	High
MERCOSUR	18	4	22%	Still low

Unit: US\$ billion

	Export to outside Region	Import from outside Region	Common External Tariff
APEC	27%	29%	
APEC-NAFTA	6%	Almost 0%	
EU (15)	39%	38%	
NAFTA	51%	60%	Will work
ASEAN (9)	76%	81%	Will work
MERCOSUR	76%	79%	Will work

Source: WTO Annual Report 1998

b. Benefits to Chile

Chile is currently negotiating a free trade agreement with the Republic of Korea and Japan. As shown in Table 2.2.2 above, Chile is showing good trade performance vis-à-vis Japan, South Korea, Taiwan, etc. However, exports to the Asian region are concentrated in the mining sector. Real diversification is advisable and should be pursued soon. Viewed in this context, APEC's most valuable benefit for Chile is that Chile can concentrate its effort on trade promotion, without paying attention to the impact of common external tariff. It is exactly here that this EPIE Study can make a contribution discovering concrete ways that Chile may penetrate APEC markets.

2.2.3 Free Trade Agreements: Achievements and Their Benefits to Chile

(1) Signed Free Trade Agreements

Chile has signed the free trade agreements as listed in Table 2.2.4. As shown in the list, a number of free bi-lateral and bi-regional agreements were signed in the 1990s.

Table 2.2.4 Regional Trade Agreements in the Americas in the 1990s

Agreement	Signed	Year in Force
Chile-Mexico (1)	1989	1990
Chile-Venezuela	1993	1994
Chile-Bolivia(2)	1993	1993
Chile Colombia	1993	1994
Chile-Ecuador	1994	1995
Chile-MERCOSUR	1996	1996
Chile-Canada	1996	1997
Caribbean Community (CARICOM)	1989	1990
Central America Common Market	1990	1993
CARICOM-Venezuela	1992	1993
NAFTA	1992	1994
MERCOSUR	1991	1995
Bolivia-Mexico	1994	1995
Andean Community	1988	1996
Bolivia-MERCOSUR	1996	1997
Mexico-EU	1999	2000
Mexico-Israel		

Note: (1) Two countries revised substantially and upgraded this agreement, signed and entered into force in 1998.

Source: INTAL, "The FTAA, Some Longer Term Issues" and various sources.

Also, the following free trade agreements are under negotiation.

- Chile-CCM (Central America)
- Chile-Panama
- Chile-European Union
- Chile-South Korea
- Chile-U.S.

In addition, free trade agreement negotiations are underway in many other parts of the region and elsewhere. The following list indicates the extensiveness of this effort:

**Table 2.2.5 On-going Free Trade Agreement Negotiations in Americas
(excluding Chile)**

FTAA	Mexico-Panama
Andean Community-Brazil	Mexico-Trinidad & Tobago
Andean Community-Panama	Mexico-Uruguay
CACM-Panama	Mexico-Singapore
Costa Rica-Trinidad & Tobago	MERCOSUR-EU
Mexico-Belize	CARICOM-EU
Mexico-Ecuador	

Source: INTAL, "The FTAA, Some Longer Term Issues" and various sources.

(2) Benefits to Chile

As widely known, a free trade agreement allows that both countries may increase trade due to lower tariff rates. Additionally, the agreement may increase personal communications and transparency of both economies with a solid trade database and clear rules. As apparent from the past trends in Latin America, the unweighted average tariff rates have been drastically reduced promoting mutual trade. In this way, the free trade agreement obviously benefits Chile.

**Table 2.2.6 Tariff Structure in Latin America, 1985-97
(unweighted averages)**

Country	1985	1991	1994	1997
Argentina	39.3	14.2	15.4	14.1
Bolivia	22.7	9.2	9.7	9.6
Brazil	55.1	20.4	9.7	14.9
Chile	30.0	11.0	11.0	11.0
Colombia	46.5	16.4	11.3	11.4
Ecuador	58.7	16.6	11.0	9.9
Mexico	33.6	12.6	12.4	13.7
Paraguay	18.7	13.6	7.3	10.0
Peru	64.4	16.2	15.6	13.1
Uruguay	35.9	21.3	13.6	10.1
Venezuela	31.6	15.1	11.3	11.5

Note: Chile's uniform tariff is set at 8% since January 1, 2001.
It will be reduced further to 6% by 2003.

Source: INTAL, The FTAA, Some Longer Term Issues.

However, real benefits from the free trade agreement will be gained only through a long-term commitment to solve obstacles on both sides. In the case of MERCOSUR, Brazil predicts that it will take 10 to 13 years for the free trade agreement to completely consolidate. APEC has set the goal to achieve free trade in 2020 (in the case of developing countries). A concrete strategy should be established today, aimed at gaining the real benefits from these free trade agreements. In doing so, it is first necessary to recognize where improvement is needed in the short, medium and long term. With its long history and accumulated experiences of free trade agreements with different parts of the world, Chile is clearly a leader of the application and development of the free trade agreement.

2.2.4 Chile as the "Gateway" to and from Asia and the Pacific

(1) Two Meanings of "Gateway"

There seem to exist two distinct meanings of "gateway." One is the "gateway to pass through"; the other is the "gateway as the initial destination."

In its usual sense, particularly in the Chilean context, "gateway" means a corridor which goods and people pass through. Their destinations are somewhere else rather than Chile itself. They come and go because it is the shortest path. As a "gateway,"

Chile's job is to assure them a short, safe and smooth passage over its territory. In turn, they do not have much concern for Chile while they are in transit. This is what the first meaning mentioned above implies.

The second meaning has slightly different implications. People and goods come to the "gateway" because it is their first destination. From there, they will further continue their journeys to another destination. The difference is that they come to the "gateway" for some reasons, not just to pass through. The reasons may vary: some come to find a buyer; others are lured by the place itself, by its history or culture; still others may look for opportunities. People and goods are in transit. But they are in no hurry because this *is* their destination. Some may not even know where their next destinations are. The "gateway" becomes a place where people and goods converge, stay and radiate.

(2) Chile as the "Gateway to Pass Through"

To some extent Chile has already achieved its status as the "gateway to pass through." Much effort is being done to promote this status further in anticipation of increased cargoes (typically in bulk) traveling through Chile. Without doubt, this direction or strategy is justifiable.

However, since these transit operations are largely dictated by pure economic calculations, the economic hinterland Chile can claim over South America as this type of "gateway" should have natural boundaries or watersheds. A realistic hypothesis is that Chile can serve as the "gateway" of this type only for the *western half* of the area demarcated by the Pacific coast on the western side and the rivers of *La Plata*, *Parana* and *Paraguay* and, further down, the Atlantic coast on the eastern side (Figure 2.2.1). This hypothesis is based on two simple assumptions that, first, cargoes will take the shorter path to the shipping port and, second, river transportation on *Río Paraguay* and *Río Parana* is a viable option. As is easily understood, this hypothesis is still optimistic in the sense that it tacitly assumes that the Andes can be crossed anywhere and the costs of trans-Andes freight are the same as the costs of land transportation in the plain.

The purpose to show this hypothetical (and simplistic) hinterland for the Chilean "gateway" is twofold. One is to clearly indicate where latent opportunities are. The second purpose is to guide efforts to focus on the right target. In fact, there remains much that may be done to promote Chile as even the "gateway to pass through." Obvious tasks are to improve trans-Andes transportation, to build modern and sophisticated logistic systems, and to deepen ties with the regions on the other side of the Andes. It will be a ten-year goal for Chile to become the full-fledged "gateway" of this type.

(Later in this Report, the economic hinterland of Chilean ports will be analyzed with real data and shown in Figure 12.5.2 in Chapter 12. The figure indicates that the above hypothesis is rather correct.)



Figure 2.2.1 Chile’s Hypothetical Hinterland as the “Gateway to Pass Through”

(3) Chile as the “Gateway as the Initial Destination”

As the JICA Study Team believes, Chile has yet to become this type of “gateway.” It is arguable whether Chile should aspire for such status too but, according to the JICA Study Team, Chile has every reason to pursue it as a second-stage goal. With this type of “gateway,” there would be no well-defined hinterland. Figure 2.2.2 depicts this schematically.

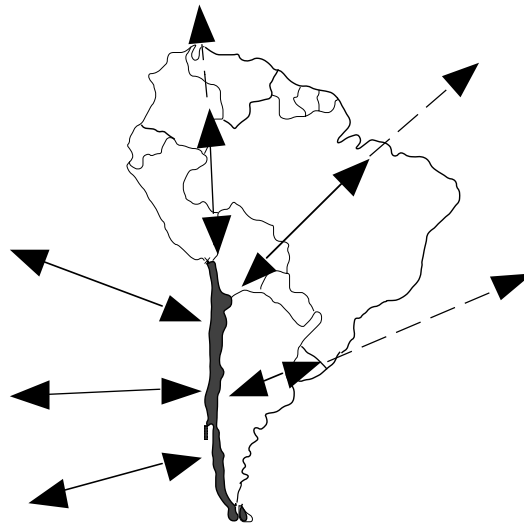


Figure 2.2.2 Chile as the “Gateway as the Initial Destination”

If Chile is able to become the “gateway as the initial destination,” it will greatly depend on the extent to which Latin American economies have matured as a whole. Take Singapore for example. When it gained independence in the 1960s, its port was little more than a local harbor at the gate of the Strait of Malacca. However, its indisputably

superb location worked wonderfully to push this tiny city-state to climb the economic ladder as Japan and other Asian countries grew, much dependent on trade. It became a typical “gateway to pass through.” After a while, Singapore started to transform itself from a mere port town to a regional commercial and financial center. This ambitious plan, supported by the government’s vision and firm commitment to it, again worked wonderfully. Singapore today well exemplifies the “gateway as the initial destination.” One point should be noted, however. Singapore’s success has depended to a great extent on neighboring countries’ growth and prosperity. If Chile can also seek a similar status on the South American continent, the economies in the region must be similarly stable and prosperous and, more importantly, interdependent. Considering this, the “gateway as the initial destination” might be a target to be appropriately set in a 10- to 20-year range or possibly longer.

The main reason that this option is worth pursuing is that the concept seems to have much broader and deeper implications for the country than appears at first glance. It is not a concept referring to “transportation,” “logistics” or “economics”; rather, it is a concept directly concerned with the country’s “character” or “identity.” If Chile succeeds in achieving such status, this will definitely become part of its national identity.

2.2.5 Chile as the “Commercial Service Center” for South America

(1) Possibility as a Commercial Service Center

In order that a country serves as a commercial service center for the region, it must be able to offer the following fundamental services and functions:

- a) Flexible and smooth transportation infrastructure, including roads, railways, seaports, airports, etc. for international transportation plus customs clearance system;
- b) Safe warehouses and other logistic infrastructure for smooth distribution;
- c) Modern telecommunications system;
- d) Stable supply of energy, water, etc.;
- e) Stable financial system;
- f) Internationally-recognized quality control system, including ISO9000, ISO14000, Products Certificate System and its supportive metrology system, which could be led to MRA (Mutual Recognition Agreement) with major trading partners;
- g) Well-talented and -trained people to support the above functions; and
- h) World’s recognition of the country and its people, infrastructure and culture as the commercial service center of the region.

Regarding these requirements, Chile’s current position is as follows:

a. Flexible and smooth transportation infrastructure

One recent incident well exemplifies the general condition of transportation infrastructure in Chile. Due to heavy snowfall, the Cristo Redentor Passage at the Chile-Argentina border has been closed for over ten days. A Brazilian newspaper reports that the economic loss incurred by the Brazilian and Argentine freights stranded

at the pass is estimated at over US\$5 million.⁴ Though Chile and Argentina have been cooperating to open and improve border crossing passes, much remains to be done.⁵ If Chile is to become a commercial service center in South America; this aspect definitely needs to be upgraded to world standards.

b. Safe warehouses and other logistic infrastructure for smooth distribution

This aspect will be elaborated in detail in Chapter 11 of this Report.

c. Modern telecommunications system

Due to the aggressive privatization drive in Chile, this aspect could be ranked among the top in Latin America.

d. Stable supply of energy, water, etc.

The same applies to this aspect as applies to the telecommunications sector. It may also be mentioned that MERCOSUR has been instrumental in securing a stable supply of electricity and natural gas from Argentina to Chile.

e. Stable financial system

The Chilean financial system is very stable. Deregulation has been pursued very aggressively, allowing the Chilean financial system to enjoy the first rank credibility in Latin America. To become a financial center of the region, however, Chile is debilitated due to its small market size. This point will be analyzed in the following section.

f. Internationally-recognized quality control system, including ISO9000, ISO14000 and Products Certificate System

To enjoy the real benefit of free trade agreements, it is necessary to simultaneously promote mutual recognition agreements to avoid duplicating customs inspection. Regarding this point, there remain many aspects to be improved. This subject will be dealt with in Chapter 9, Industrial Standards, of this Report.

(2) Possibility as a Financial Center

Theoretically speaking, a financial center (as a special case of a commercial service center) must satisfy all the following qualifications:

- World-level settlement capacity (both trade-related and capital payments);
- World-level custody (and confidentiality of the financial markets);
- World-level derivatives market;
- World-level credit analysis and loan loss provision guidelines;
- World-level investment banking skills; and
- World-level database on borrowers, bond issuers, etc. including rating information.

Past efforts implemented by Chilean authorities have worked favorably for Chile's

⁴ *Gazeta Mercantil*, July 11, 2000.

⁵ A 1997 agreement between Chile and Argentina specifies 40 crossings to be opened and improved. The Cristo Redentor pass is among the highest priorities.

aspiration. Taking advantage of extensive privatization, for instance, some infrastructure-related companies (telecommunications and electricity) have been listed at the New York Stock Exchange. Generally, foreign investors highly appreciate Chile's qualifications listed above and, as a consequence, foreign direct investments (including re-investment of dividends) and portfolio investments through bonds and shares have become Chile's very important sources of balance of payment. Chile now enjoys a good reputation as a very reliable borrower in the world financial market.

In fact, concerned people have long cherished the concept of Chile (or Santiago in that matter) as a financial center. A 1998 document prepared by the Chilean Banks Association (*Asociación de Bancos*) studies its feasibility and makes strategic recommendations to materialize the concept⁶ (its basic strategy: to consolidate the Chilean financial market to other Latin American countries'--MERCOSUR's in particular--that are compatible with the concept). The recommendations have been at best slow to be carried out, however.

In spite of the respectable performances and good reputation, Chile's qualifications as a regional financial center are still far from perfect. Sections below will scrutinize them one by one.

a. Settlement (trade-related and capital payments)

Chile is behind other countries in this area. For instance, the Central Bank of Brazil has completed a two-year study on the settlement system (Electronic Payment System) with technical support from the Bank of Japan, Bundesbank, the Bank of England, the Federal Reserve Bank of the U.S.A., BIS, Euroclear, Cedel and N.Y. Chips. *Bolsa de Valores de Futuro* (in Sao Paulo) will start its operation in February 2001. The *Superintendencia de Valores* of Chile is of opinion that it would be useful to become a part of this system. In other words, Brazil is a clear forerunner in Latin America in this field.

b. Custody (and Confidentiality of Financial Markets)

Custody service is strongly correlated to the volume of settlement. It is not possible to develop the custody function alone independent of the settlement service. The current volume of settlement in Chile may not warrant the full development of custody.

c. Derivatives

Derivatives (as this name suggests) are also much related to the volumes of trade and capital market transactions. Chile's limited size of financial transactions could be an obstacle to the development of a derivatives market.

d. Credit analysis and loan loss provision guidelines

In this regard, Chile is recognized as being the top rank in Latin America.

⁶ "Santiago: Centro Financiero Internacional—Elementos para un Plan estratégico," October 1998.

e. Investment banking skills

Again in this field (along with credit analysis skills), Chile is further advanced than other Latin American countries. *Bolsa de Valores de Santiago* is now studying the possibility of a high yield bond-equity fund of small- and medium-size companies. Securitization is also popular. The limited size of financial transactions, however, will again prove an obstacle. To be a major player in investment banking, a certain size of transactions are essential.

f. Database on borrowers, bond issuers, etc. including rating information

Chile's trade activities are the most dynamic in Latin America in terms of trade ratio against GDP. Also, Chile traditionally maintains a good reputation regarding its credibility of information and is highly respected by other Latin American countries. If Chile could compile and offer Latin American-wide comprehensive data on exporters, importers and bond issuers, then it is certain that investors, banks, exporters and importers throughout the world would appreciate and purchase the data. It is expected that such data may also be used to develop appropriate SME-supporting financial tools, such as the credit guaranty scheme and the credit insurance scheme. Regarding this aspect, a recent program initiated by MITI of Japan to establish a nationwide databank on SMEs will be of a good reference.⁷

2.2.6 World Economy and Chile: Where Are the Opportunities?

(1) Where Chile's Markets Are

Having reviewed the global environment on the one hand as well as conducted interviews with Chilean, Japanese and several other countries' companies both in Chile and abroad on the other, the JICA Study Team has summarized its preliminary view on where Chile's future markets are (Table 2.2.6). The Table is self-explanatory and may require no further elaboration.

Table 2.2.6 Chile's Future Markets

	MERC OSUR	Latin America (excl. MERCOSUR)	North America and Europe	Japan and South Korea	Other Asian countries
Natural Resources (including agricultural produce and fishery products)	○	○	●	●	◎
Natural Resource-Based Manufactured Products	○	○	●	●	○
Non-Natural Resource-Based Manufactured Products	◎	◎			
Services	○	○			
Tourism	○		○		

Legend: ● Already major market; should be explored further for new possibilities
 ◎ Already medium-size market; should be promoted further
 ○ Emerging market

⁷ Visit a website for this program at: <<http://partner.sme.ne.jp/index.html>>. About 1,500 SMEs have already registered in this website providing their business information and seeking business opportunities worldwide.

(2) Gateway

Chile's serving as the "gateway to pass through" is an option involving brilliant possibilities. However, realistically speaking, Chile's hinterland may be largely confined to the areas along the eastern side of the Andes. Even within this limited area, various new possibilities remain untapped and various tasks remain to be completed. This "gateway" possibility may be fully realized in 10 years.

One key to this success is Argentina's cooperation particularly regarding the trans-Andes transportation routes. A recent move by the Argentine government to improve the 200-km road sections linking to *Paso de Jama* in the Andes is a very welcomed initiative. Other countries also believe bi-oceanic corridors to be of highest priority. Brazil is calling a Latin American Infrastructure Consolidation Summit towards the end of August 2000, whose outcome should be closely monitored.

Turning to the commodities that are transported through the "gateway," one should note the massive Chilean investments directed towards Argentina since the early 1990s. Sectors vary from manufacturing to service and real estate to agriculture and wood/paper. This is an indication that economic integration of Chile and Argentina (and of MERCOSUR) is quietly and irreversibly underway. Such integration will only enhance Chile's chance to function as the "gateway" as more commodities attempt to cross the borders freely seeking the market and an outlet to markets abroad.

Chile's second-stage, long-range goal might be the "gateway as the initial destination." This concept suggests that Chile is itself the destination for the people and goods. As Latin American economies develop and mature, possibilities will increase that this far-reaching concept is realized. Chile's identity as a nation should ultimately underlie this concept. Its strength in "systems" will surely be the integral element of the second-stage "gateway" concept.

(3) Financial Center

Chile's advantages lie mostly in its financial market that is much advanced and stable compared to other Latin American countries. Chile has significantly deregulated outgoing transactions and incoming transactions are well controlled by highly talented monetary authorities. On the other hand, its primary disadvantage is its limited size of transactions. In spite of this limitation and rather taking advantage instead of the favorable conditions and its positive international recognition as a low-risk country, Chile may advance in several directions:

Offshore market

A typical example of the offshore market is Panama – no investment regulation is posed or no income tax is levied on foreigners. As a matter of fact, Chile has already taken up this option. The offshore market was opened in Chile in March 2000 based on *Ley de Bolsas Offshore* (Law on Offshore Securities Market).

High yield bond and equities to small- and medium-size enterprises through the Investment Fund

This scheme will be designed to lure foreign capital into Chile to finance SMEs with

risk money. Since SME development appears as one strategic subject in the Chilean context of export and investment promotion, this scheme deserves further study.

Latin America Database

If Chile can systematically accumulate trade- and investment-related companies' data throughout Latin America, it will give Chile a huge potential to become *the* highly credible financial information center of Latin America. The data could be sold to trading companies, investors, banks, fund managers of investment funds, monetary authorities, etc. Such data are indispensable for risk analysis when developing any new financial schemes (e.g., credit guaranty scheme, trade insurance mechanism). The database could be easily self-sustained considering the large demand unmet in the region and beyond.

(4) From the Present to the Future

The *Mitsubishi Report* cited earlier found that Japanese direct investment in Latin America has been concentrated in Brazil and Mexico. The main reason for this is market size: "Japanese companies have invested in Mexico because of its vicinity with the USA . . . and in Brazil mainly to take advantage of its large domestic market." Interviews conducted by a JICA team member with major Japanese companies located in Mexico and Brazil also confirm this reasoning. However, many of the interviewees unanimously pointed out where Chile's possibility is: they share a view that Chile may become a suitable investment destination *when* Chilean and Argentine markets are integrated.

As this view suggests, Chile's position in the world economy could show a few drastic shifts in the long run as the global economic framework constantly adjusts itself to the rapidly changing world. The shifts and changes are hard to foresee. Yet one thing can be said for sure: a Chilean strategy for investment and export promotion *must try* to foresee the changes, however dim and faint in the distant future.

Such an effort is worth noting realized by Corvalán Quiróz. In his 1999 publication, he observes that Chile's economic growth for the next 10 to 15 years can be visualized as one which will go through a combination of deepening of the primary exporter model with modernization and expansion of the manufacturing and service exporting base.⁸

A general conclusion of this section might be this: Chile has a good potential to serve as a global gateway. However, to tap that potential, Chile should direct its strategic attention to both ends of the gateway: Asia and South America. On the Asian side, where large markets for Chilean primary commodities already exist, efforts are further needed to expand the markets while attracting investors. On the South American side, where new markets for Chilean products may be emerging, Chile should pursue to deepen its economic relations with the neighboring countries. Tighter relations with South American economies, particularly with Argentina, will strengthen Chile's position as the gateway. This will in turn become highly instrumental to lure Asian investment.

⁸ Alejandro Corvalán Quiróz. 1999. *Una mirada regional al cambio de década y sus proyecciones al siglo xxi*. Programa de Economía del Trabajo, PET-V Región/For Nacional de Desarrollo Productivo. (Valparaíso).