CHILE

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Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production and Employment:			
Nominal GDP 2/	71.9	77.1	76.0
Real GDP Growth (pct)	7.2	7.1	4.0
GDP Growth by Sector (pct):			
Fishing	13.0	8.1	5.0
Agriculture	2.6	2.1	1.4
Mining	13.0	8.1	3.0
Manufacturing	11.2	9.5	4.0
Construction	9.4	8.2	3.0
Services	32.3	35.5	18.0
Government	1.7	1.9	1.4
Per Capita GDP (US$) 2/	5,100	5,300	5,100
Labor Force (000s)	5,522	5,380	5,500
Unemployment Rate (pct) 3/	5.5	5.3	6.0
Money and Prices (annual percentage growth):			
Money Supply (M2) 4/	23.4	21.7	20.5
Consumer Price Inflation (pct)	6.6	5.6	4.5
Exchange Rate (Peso/US$)	412	419	465
Balance of Payments and Trade:			
Total Exports FOB 5/	15.4	16.9	15.8
Exports to U.S.	2.6	2.7	2.4
Total Imports CIF	17.4	18.2	19.0
Imports from U.S.	4.1	4.3	4.4
Trade Balance	-2.0	-1.3	-3.2
Balance with U.S.	-1.5	-1.6	-2.0
Current Account Deficit/GDP (pct)	-4.1	-5.2	-7.0
External Public Debt	23.0	26.7	30.0
Debt Service Payments/Exports (pct)	30.9	20.1	24.9
Fiscal Deficit/GDP (pct) 6/	N/A	N/A	N/A
Gold and Foreign Exchange			

Reserves (US$ billions)	15.5	17.8	15.3
Aid from U.S. (US$ millions)	0.3	0.3	0.3
Aid from All Other Sources	N/A	N/A	N/A

1/ 1998 estimates based on monthly data available in November.

2/ The declines in GDP and GDP per capita in 1998 as expressed in U.S. Dollars reflect a significant decrease in the dollar value of the Chilean Peso compared to previous years.

3/ Yearly average.

4/ For 1998, M2 growth through June only.

5/ All figures merchandise trade.

6/ The Government of Chile has run a fiscal surplus for more than a decade.

Source: Central Bank of Chile.

1. General Policy Framework

Chile's economy has grown for more than a decade, but the previous rapid rate of economic expansion is slowing as the country absorbs the double impact of lower commodity prices and shrinking Asian markets. However, foreign investment -- which is relatively long-term oriented -- is still substantial. Copper remains the country's most important export product, accounting for about 36 percent of export earnings in the first nine months of 1998. Exports of fish, forestry products, fresh fruit, and manufactured products are also important. Chile's investment-grade credit rating (reconfirmed in late 1998) is the highest in Latin America (S&P A-, Moody's Baal), and Chilean firms finance investment by borrowing, issuing bonds, and selling stock abroad as well as in Chile. Many Chilean firms have expanded abroad.

The government of Eduardo Frei (1994-present) has continued Chile's emphasis on macroeconomic stability and the economy's export orientation. The government generated fiscal surpluses in each of the years 1988-1997, and it is projected to do so in 1998. The pace of privatization has slowed in the last few years. The independent central bank continued to gradually loosen foreign exchange restrictions on capital flows. The government remains concerned about the potential effects on the exchange rate of rapid foreign currency inflows. As of a result of legislation passed in December 1997, business opportunities for foreign banks in Chile and Chilean banks abroad have been enhanced substantially. Legislation is also now in place for privatizing Chile's ports, water and sewage companies.

The central bank's monetary policy adjusts interest rates to affect domestic spending. In this way, it has gradually reduced inflation while keeping the economy on a path of steady growth. It seeks to stabilize the exchange rate by buying or selling dollars to keep the exchange rate within a preannounced range and by controlling market liquidity.

Indicators for 1998 suggest that real GDP growth will fall short of the government's forecast of 5.0 percent. Inflation will be near the central bank's target of 4.5 percent. Unemployment for the year will average about 6.0 percent; some observers expect the rate to peak in the 8-10 percent range during 1999. Despite enhanced production volume, low world copper prices will mean that the proportional contribution of copper to export earnings will decline marginally over previous years. Chile will likely experience a substantial merchandise trade deficit of some $3.0 billion in 1998 due to the world commodity price decline, weak Asian markets and enhanced imports from Asia. The current account deficit will be on the order of 7.0 percent of GDP. Foreign investment flows continue to be healthy, helping to offset the negative performance of the current account, and although reserves declined through 1998, the balance in October 1998 of $15.3 billion was sufficient to cover some 11 months of imports.

2. Exchange Rate Policies

The central bank made technical modifications to Chile's exchange rate policy in 1998. At the end of 1998, the peso-dollar exchange rate was allowed to fluctuate within a five-percent band on either side of the reference rate. The reference exchange rate moves each day according to changes in the exchange rates of the dollar, mark, and yen. The central bank buys or sells dollars in the official inter-bank market when the peso threatens to move abruptly or outside of the established band. The central bank does this to reduce what it believes are short-term fluctuations. It does not attempt to block long-term trends in the exchange rate, and it has adjusted the reference exchange rate as deemed necessary to reflect such market trends.

Over the last several years, the central bank gradually reduced restrictions on foreign exchange outflows. In 1995, it lifted the requirement that exporters remit some of their foreign currency earnings through the inter-bank market. A legal parallel market operates with rates almost identical to the inter-bank rate. Through much of the past decade, the peso appreciated in real terms against the dollar because of Chile's trade surpluses, strong inflows of foreign capital, and the dollar's weakness on international markets. Since the international market turmoil that began in late 1997, the peso has depreciated against the dollar; as of November 1998, the value of the Chilean Peso was some 9.5 percent lower than its 1997 average rate.

3. Structural Policies

Pricing Policies: The government rarely sets specific prices. Exceptions are urban public transport and some public utilities and port charges. State enterprises generally purchase at the lowest possible price, regardless of the source of the material. U.S. exports enter Chile and compete freely with other imports and Chilean products. Chile's free trade agreements with Mexico, Canada and MERCOSUR give exporters from those countries significant competitive advantages -- virtually all Mexican and Canadian exports enter the Chilean market duty free. Import decisions are typically related to price competitiveness and product availability. (Certain agricultural products are an exception. See section 5.)

Tax Policies: An 18-percent Value-Added Tax (VAT) applies to all sales transactions and accounts for over 40 percent of total tax revenue. There is an 11 percent tariff on virtually all imports originating in countries with which Chile does not have a free trade agreement. Personal income taxes are levied only on income over about $6,000 per year. The top marginal rate is 45 percent on annual income over about $75,000. Profits are taxed at flat rates of 15 percent for retained earnings and 35 percent for distributed profits, with incentives for business donations to educational institutions. Tax evasion is not a serious problem.

Regulatory Policies: Regulation of the Chilean economy is limited. The most heavily regulated areas are utilities, the banking sector, securities markets, and pension funds. No government regulations explicitly limit the market for U.S. exports to Chile (although other government programs, like the price band system for some agricultural commodities described below, displace U.S. exports). In recent years, the government has introduced rules permitting private investment in the construction and operation of public infrastructure projects such as toll roads. Most Chilean ports are administered by a state-owned firm, although legislation is in place to permit private concessions.

4. Debt Management Policies

Due to Chile's vigorous economic growth and careful debt management over the last decade, the magnitude of foreign debt no longer constitutes a major structural problem. As of late-1998, Chile's public and private foreign debt was about $30.1 billion, or around 38 percent of GDP. (In 1985, the debt-to-GDP ratio was 125 percent.) Since the mid-1980s, public sector debt has declined steadily. In 1995, the government and the central bank prepaid over $1.5 billion in debt to the International Monetary Fund (IMF).

5. Significant Barriers to U.S. Exports

Chile has few barriers to U.S. exports and is a member of the WTO. Nevertheless, treatment in some areas, especially agricultural commodities, diverges from international norms. Chile agreed in the GATT Uruguay Round not to raise its tariff rates above 25 percent. Beginning in January 1999, the uniform Chilean tariff rate will decline to 10 percent, and will be reduced by one percentage point per year before reaching a rate of six percent in 2003. The uniform rate applies to all goods except for used goods, which are subject to a 16.5-percent tariff. Chile has free trade agreements which will lead to duty-free trade in most products by the late 1990s with Mexico, Venezuela, Colombia, Ecuador, Peru, Bolivia and the MERCOSUR bloc. Tariffs also are lower than 10 percent for certain products from member countries of the Latin American Integration Association (ALADI) and products imported by diplomats and the Chilean military.

The 18-percent VAT is applied to the CIF value of imported products plus the 10-percent import duty. Duties may be deferred for seven years for capital goods imports purchased as inputs for products to be exported. Duties may be waived on capital goods to be used solely for production of exports. (See section six.) Automobiles are subject to additional taxes based on value and engine size. The engine tax, which is scheduled to be phased out by 1999, applies to vehicles with engines of over 1,500 cc, while the value tax is 85 percent of the CIF value over a certain price level (around $10,000 in 1999). These taxes discourage sales of larger and more expensive vehicles, including most U.S.-made automobiles. Despite these taxes, sales of U.S.-made vehicles are rising.

Another tax that has the effect of discouraging U.S. exports is an excise tax on distilled spirits that competes with domestically produced liquors taxed at lower rates. In late 1997, the legislature passed a law that will gradually modify, but not eliminate, the discriminatory taxation faced by distilled spirits. At the same time, most other imported liquors will eventually face substantially increased tax discrimination. The European Union instigated the formation of a WTO panel to hear a complaint over this discriminatory practice; the U.S. is a third party to the panel.

Import Licenses: According to legislation governing the central bank since 1990, no legal restrictions are imposed on licensing. Import licenses are granted as a routine procedure. Imports of used automobiles and most used car parts are prohibited.

Investment Barriers: Chile's foreign investment statute, Decree Law 600, sets the standard of treatment of foreign investors in the same manner as Chilean investors. Foreign investors using DL 600 sign a contract with the government's Foreign Investment Committee guaranteeing the terms and tax treatment of their investments. These terms include the rights to repatriate profits immediately and capital after one year, to exchange currency at the official inter-bank exchange rate, and to choose between either national tax treatment at 35 percent or a guaranteed rate for the first ten years of an investment at 42 percent. Approval by the Foreign Investment Committee is generally routine, but the committee has rejected some "speculative" investments. In late 1997, the government modified its DL 600 policy to restrict investment entering under the law's provisions to projects worth more than $1 million. In addition, projects of more than $15 million are now routinely vetted with the central bank to identify possible "speculative" flows. Associated external loan financing in excess of the value of direct foreign investment flows cannot enter under the provisions of DL 600 (i.e., to enter free of deposit provisions, foreign loan leveraging cannot exceed a ratio of 1:1).

Investment not entering Chile through DL 600 can enter under Chapter 14 of the Central Bank Regulations. Under Chapter 14, investors can be required to deposit a certain percentage of the value of capital inflows in a non-interest bearing central bank account (known as the "encaje") for as long as two years, or pay an equivalent fee to the central bank; through mid-1998, the rate was 30 percent for one year. Responding to increasing risk premiums charged by creditors and a substantial decline in foreign financial capital flows as a result of the global financial crisis, the central bank reduced the rate to 10 percent in June 1998 and then to zero two months later.

The government says it is not abandoning the encaje, adding that the currently low rates should be viewed as temporary. The purpose of the policy has been to limit short-term speculative investment seeking to take advantage of Chile's high interest rates and thus to help stabilize the value of the Chilean Peso, which had appreciated significantly in previous years. When in effect, the encaje applies to inflows of foreign capital into stock trading, bonds, bank deposits, as well as real estate, none of which in the view of local authorities increases the Chilean economy's productive capacity or improves technology. Exemption is given to stock and ADR purchases used to expand capacity. There is no tax treaty between Chile and the United States, so profits of U.S. companies operating in Chile are taxed by both governments. However, U.S. firms generally can claim credits on their U.S. taxes for taxes paid in Chile. Finally, there is generally a one-year waiting period before any capital can be repatriated abroad.

There are some deviations, both positive and negative, from the nondiscrimination standard. Foreign investors receive better than national treatment on taxation, as they have the option of fixing the tax rate they will pay at 42 percent for ten years or paying the prevailing domestic rate, which is at present lower.

There are also examples of less than national treatment. D.L. 600 allows the central bank to restrict the access of foreign investors to domestic borrowing in an emergency in order to prevent distortion of local financial markets. The central bank has never exercised this power.

Other examples of less than national treatment are certain sectoral restrictions on foreign investment. With few exceptions, fishing in the country's 200-mile Exclusive Economic Zone is reserved for Chilean-flag vessels with majority Chilean ownership. Such vessels also are the only ones allowed to transport by river or sea between two points in Chile ("cabotage") cargo shipments of less than 900 tons or passengers. The automobile and light truck industry is the subject of trade-related investment measures, although U.S. firms are among those helped as well as those harmed. Manufacturers based in the United States and France receive import protection in the form of the taxes noted above, which protect their Chilean production. The manufacturers also receive tax benefits for the use of local inputs and for exporting auto components. Despite these measures, imports make up around 85 percent of the auto market.

Oil and gas deposits are reserved for the state. Private investors are allowed concessions, however, and foreign and domestic nationals are accorded equal treatment.

Services Barriers: Full foreign ownership of radio and television stations is allowed, but the principal officers of the firm must be Chilean. A freeze in force since the early 1980s on the issuance of new bank licenses meant that investors, foreign and domestic, had to acquire existing banks. The government promulgated banking reform legislation in December 1997 that, inter alia, established objective criteria for issuing new bank licenses.

Principal Nontariff Barriers: The main trade remedies available to the Chilean government are surcharges, minimum customs values, countervailing duties, antidumping duties, and import price bands. Chile's most significant nontariff barrier is the import price band system for wheat, wheat flour, vegetable oils, and sugar. When import prices are below a set threshold, surtaxes are levied on top of the across-the-board 10-percent tariff in order to bring import prices up to an average of international prices over previous years. Because of low international wheat prices this year, the price band system imposed import duties as high as 45-50 percent, well above Chile’s WTO bound rate of 31.5 percent.

The government may apply country-specific duties on products that it determines to have received subsidies from exporting countries and on products that it determines to have been dumped at below-market prices. Some industry sources have claimed that surtaxes occasionally have been applied to agricultural imports without reasonable evidence of subsidies or dumping. In the past, these duties have been applied to items such as Argentine wheat flour and Chinese-made shoes. As of late 1998, none are in effect.

Animal Health and Phytosanitary Requirements: Chile has been slow to recognize pest-free areas in the United States that would facilitate the export of many U.S. fruits and vegetables to Chile. Most of Chile’s regulations are unpublished, and when promulgating changes in its regulations, Chile does not allow the public a period for comment on the proposed rule. Most import permits are issued on a case-by-case basis, thereby lending to uncertainty and possible discriminatory treatment. Procedures and tolerances for testing imported chicken for the presence of salmonella present such a severe commercial risk that local importers are reluctant to import such products. Chile's unique beef grading and labeling requirements deter the importation of beef cuts from the United States.

Government Procurement Practices: The government buys locally produced goods only when the conditions of sale (price, delivery times, etc.) are equal to or better than those for equivalent imports. In practice, given that many categories of products are not manufactured in Chile, purchasing decisions by most state-owned companies are made among competing imports. Requests for public and private bids are published in the local newspapers.

6. Export Subsidies Policies

With minor exceptions, the government does not provide exporters with direct or indirect support such as preferential financing. It does, however, offer a few nonmarket incentives to exporters. For example, paperwork requirements are simplified for nontraditional exporters. The government also provides exporters with quicker returns of VAT paid on inputs than other producers receive. In 1997, alleged Chilean subsidies became the focus of a countervailing duty investigation by the Department of Commerce of Chilean salmon exports to the United States; the Department of Commerce determined that such subsidies were minimal.

The most widely used indirect subsidy for exports is the simplified duty drawback system for nontraditional exports. This system refunds to exporters of certain products a percentage of the value of their exports, rather than refunding the actual duty paid on imported inputs to production (as is the case in Chile's standard drawback program). All Chilean exporters may also defer tariff payments on capital imports for a period of seven years. If the capital goods are used to produce exported products, deferred duties can be reduced by the ratio of export sales to total sales. If all production is exported, the exporter pays no tariff on capital imports.

In 1998, the Chilean Congress replaced earlier forestry sector subsidy legislation with a new law that will be directed mainly toward assisting small farmers. Planting costs will be subsidized by as much as 90 percent for the first 15 hectares and 75 percent for the remainder in the case of small farmers. A maximum of $15 million dollars yearly will be destined for this purpose. Special land tax exemptions will also be part of the program. Under the previous law, the combined subsidy costs incurred during 1997 totaled $7.7 million, down from $15.3 million in 1996. The government paid subsidies totaling $174.6 million from 1974 through 1997.

7. Protection of U.S. Intellectual Property

Chile belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is also a signatory to the Paris Convention, Berne Convention, Rome Convention, Phonograms Convention, Nairobi Treaty, and the Film Register Treaty. In 1998, the U.S. Trade Representative maintained Chile on the “Special 301” Watch List. Although Chile’s IP laws are more advanced than those found in several of its neighbors, shortcomings remain both legally and regarding enforcement, notably in Chile’s failure to approve pending patent applications. Chile has stated its intention to fully meet its TRIPS obligation by the January 1, 2000 deadline.

Chile’s intellectual property regime is generally compatible with international norms, and industry representatives welcome government enforcement efforts. However, continuing deficiencies in patent protection have kept Chile on the “Special 301” Watch List since 1989. Efforts to enforce intellectual property rights in Chilean courts have generally been successful. However, Chile does not have an explicit statute for protecting the design of semiconductors, nor does it have comprehensive trade-secret protection. Contracts may set fees and royalties only as a percentage of sales, and payments for use of trade secrets and proprietary processes are usually limited to 3 percent.

Patents: Although the Industrial Property Law promulgated in September 1991 improved Chile’s protection for patents, it still falls short of international standards. The law provides a patent term of 15 years from the date of grant. (The WTO TRIPS Agreement requires Chile to adopt a 20-year standard by 2000.) The law does not consider plant and animal varieties or surgical methods to be patentable. In addition, the registration procedures required by the Ministry of Health to market new drugs are more onerous for first-to-file firms, which tend to be foreign firms. Finally, payments for use of patents may not exceed 5 percent of sales.

Copyrights: Piracy of video and audio tapes has been subject to criminal penalties since 1985. The government has taken aggressive enforcement measures in recent years, resulting in declining piracy rates. In the mid-1980s, the software piracy rate was estimated to be 90 percent, and now it is currently estimated to be 55 percent. The decline is in part the result of a campaign by U.S. and international industry, with the cooperation of Chile's courts and government, to suppress the use of pirated software. Greater access to authorized dealers and service has also helped to reduce the rate of piracy. Industry sources note that penalties remain low compared with the potential earnings from piracy and that stiffer penalties would help deter potential pirates. Copyright protection is 50 years. U.S. recording industry officials have noted that Chile's copyright law grants producers less favorable treatment vis-à-vis authors than the international norm.

Trademarks: Chilean law provides for the protection of registered trademarks and prioritizes trademark rights according to filing date. Local use of a trademark is not required for registration. Payments for use of trademarks may not exceed one percent of sales.

Impact on U.S. Trade: Although damages are difficult to estimate accurately, most observers believe that the U.S. pharmaceutical industry has suffered most from infringement of its intellectual property rights in Chile. The local association of U.S. research-based pharmaceutical companies estimates that losses in Chile due to piracy were $68 million from 1992-1996. Chile's software developers association estimates that losses due to piracy were $80-100 million in 1998.

8. Worker Rights

a. The Right of Association: Most workers have a right to join unions or to form unions without prior authorization, and around 13 percent of the work force belongs to unions. Government employee associations benefited from legislation in 1995 that gave them the same rights as unions. Reforms to the labor code in 1990 removed significant restrictions on the right to strike. Those reforms require that a labor inspector or notary be present when union members vote for a strike.

b. The Right to Organize and Bargain Collectively: The climate for collective bargaining has improved, though public sector unions still face difficulties. Sector-wide collective bargaining is not allowed. The process for negotiating a formal labor contract is heavily regulated, a vestige of the statist labor policies of the 1960's. However, the law permits (and the Aylwin and Frei governments have encouraged) informal union-management discussions to reach collective agreements outside the regulated bargaining process. These agreements have the same force as formal contracts.

c. Prohibition of Forced or Compulsory Labor: Forced or compulsory labor is prohibited in the constitution and the labor code, and there is no evidence that it is currently practiced.

d. Minimum Age for Employment of Children: Child labor is regulated by law. Children as young as 14 may be legally employed with permission of parents or guardians and in restricted types of labor. Some children are employed in the informal economy, which is more difficult to regulate. In 1998, the government estimated that roughly 50,000 children between the ages of 6 and 14 worked. Most of these children worked in the countryside, and many of them worked with their parents.

e. Acceptable Conditions of Work: Minimum wages, hours of work, and occupational safety and health standards are regulated by law. The legal workweek is 48 hours. The minimum wage, currently around $170 per month, is set by government, management, and union representatives, or by the government if the three groups cannot reach agreement. Lower-paid workers also receive a family subsidy. The minimum wage and wages as a whole have risen steadily over the last several years. As a result, poverty rates have declined dramatically in recent years, from 46 percent of the population in 1987 to 23 percent in 1996. Currently 11 percent of salaried workers earn the minimum wage.

f. Rights in Sectors with U.S. Investment: Labor rights in sectors with U.S. investment are the same as those specified above. U.S. companies are involved in virtually every sector of the Chilean economy and are subject to the same laws that apply to their counterparts from Chile and other countries. There are no special districts where different labor laws apply.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		(1)
Total Manufacturing		743
Food & Kindred Products	141	
Chemicals & Allied Products	385	
Primary & Fabricated Metals	-143	
Industrial Machinery and Equipment	2	
Electric & Electronic Equipment	(1)	
Transportation Equipment	(1)	
Other Manufacturing	203	
Wholesale Trade		437
Banking		639
Finance/Insurance/Real Estate		2,480
Services		218
Other Industries		(1)
TOTAL ALL INDUSTRIES		7,767

(1) Suppressed to avoid disclosing data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.