SOUTH AFRICAN INSTITUTE OF INTERNATIONAL AFFAIRS

Development through Trade Programme

Trade Reform in Southern Africa: Vision 2014?

Working paper

THE POLITICAL ECONOMY OF TRADE POLICY REFORM: CHILE, 1974-2005

The Political Economy of Trade Policy Reform: Chile, 1974-2005

by Sebastián Herreros

Counsellor: Chilean WTO Mission

Note: This is a working paper. It may not be cited, referenced, or used for further research until such time as it has been published. However, the author welcomes comments, which may be sent to sebastian.herreros@misionchileomc.ch.

The Political Economy of Trade Policy Reform: Chile, 1974-2005

Sebastián Herreros

1. Introduction

Chile is widely seen today as an example of a country that has successfully liberalized its economy, both internally and externally. In the area of trade policy, this process started with the radical reforms undertaken in the mid 1970s. While the broad thrust of Chilean trade policy shows substantial continuity over the last three decades, there have been significant changes in the relative emphasis of that policy. Between 1973 and 1989 it was based almost exclusively on unilateral opening (along with participation in multilateral negotiations), whereas since 1990 it has evolved towards a "multi-track" approach. The latter combines further unilateral opening with the maintenance of the commitment to multilateralism and a growing emphasis on bilateral and regional negotiations. This paper attempts to explain the evolution of Chilean trade policy since the mid 1970s, in the context of a political economy analysis. This will include the economic rationale for the reforms, as well as the role played by foreign policy considerations, international actors, ideology, and interest groups.

The structure of this essay is as follows. After this introduction, Section 2 briefly reviews Chile's economic policies during the import-substitution stage. Sections 3 and 4 examine the trade and complementary reforms implemented during the period of military rule (1973-89) and under democracy (1990 to the present). Section 5 looks at the impact of these reforms on the overall performance of the Chilean economy. Section 6 identifies the main challenges Chile faces in order to continue benefiting from its integration into the world economy. Finally, in Section 7 some conclusions are drawn, including on the relevance of the Chilean case for other developing countries.

2. The import-substitution stage

The Great Depression of the 1930s had such a negative impact on the Chilean economy[1] that it caused a radical change in its development pattern: from an outward-oriented economy, heavily dependent on mineral exports (nitrate and later copper), to an inward-oriented one, with its focus on industrialization. This shift was reinforced by the scarcity of imported goods caused by the Second World War (Meller 1996). Over the next decades, Chile resorted to a host of tools in order to promote

[1] Compared with the average of the 1927-29 period, in 1932 Chile's GDP had fallen by 38.3%, its exports by 78.3%, its imports by 83.5%, and its per-capita GDP by 42% (Meller 1996).

industrialization, such as exchange controls, multiple exchange rates, high import tariffs, export taxes, import licenses, import quotas, import prohibitions, credit rationing and different types of subsidies. This was often done at the expense of the agricultural and mining sectors, which were subject to high taxes and fixed prices.

The United Nations Economic Commission for Latin America (ECLAC), created in 1948 and headquartered in Chile's capital Santiago, was very influential in spreading the paradigm of industrialization through import-substitution across the region. The best known exponent of this "development from within" paradigm in the Latin American context was the Argentinean economist Raul Prebisch (who was also ECLAC's Executive Secretary from 1950 to 1963).

Fontaine (1993) labeled Chile's socio-economic model prior to 1973 "the redistributive State" and argued that the country was during this period a typical case of a rent-seeking society. From a distributive point of view, the model had a clear pro-urban bias. It favored urban consumers through capped prices for basic agricultural products. Import-substitution policies also favored industrial entrepreneurs and workers, especially those unionized, who were also urban dwellers. This pattern was consistent with the political landscape during most of the import-substitution period, characterized by a small electorate dominated by urban voters.

In Chile, the import-substitution model delivered only modest growth (an average of 3.8% a year between 1940 and 1970). It was also characterized by high inflation, chronic fiscal deficits, frequent balance of payments crises and an overgrown public sector. While the share of manufacturing in GDP climbed from 13% in 1925 to about 25% in 1970, large segments of Chilean industry were internationally uncompetitive. Import-substitution was especially unsuitable for a country like Chile with a small internal market. Moreover, it led to the stagnation of the agricultural sector and discouraged exports (Eyzaguirre, Marcel, Rodríguez and Tokman 2005).

The evidence suggests that the "easy stage" of import-substitution was over in Chile by the mid-1950s (De la Cuadra and Hachette 1988; Stallings and Brock 1993). However, the overall model was by and large maintained since then by successive administrations of different political sign[2]. This is explained in good measure by the fact that most entrepreneurs either adhered to or acquiesced with the concept of a "mixed economy", in which the State has an entrepreneurial role and also promotes economic activity (Valdés 1995). This was obviously especially the case of industrial entrepreneurs who benefited most directly from import-substitution policies. As Fontaine argues, the model enjoyed a significant "social consensus" during the 1940s and 1950s (Fontaine 1993).

The social consensus gradually began to unravel towards the end of the 1950s, as a consequence of two big trends: a massive increase in the electorate, with the entry

[2] Populist (Ibáñez, 1952-58), Conservative (Alessandri, 1958-64), Christian Democrat (Frei, 1964-70). Several, largely unsuccessful, attempts to reform the trade regime were made in 1956, 1959-61 and 1968-70 (De la Cuadra and Hachette 1988).

of previously disenfranchised segments such as women and illiterate peasants[3], and a deceleration of economic growth due to the numerous distortions produced by the import-substitution model (Fontaine 1993).[4] The result was that, at the same time that large, poor and mostly rural segments of society entered the political game for the first time, the capacity of the system to deliver on their demands was drastically reduced. This led to a radicalization of the social and political process, especially in the late 1960s, which in turn brought about a hardening of positions by the entrepreneurial movement and the increased unity between its different components.

In particular, the process of Agrarian Reform launched under President Frei Montalva´s Christian-Democrat administration (1964-70) sparked a process of defensive organization across the different entities representing the entrepreneurial sector (agriculture, industry, mining, commerce). These left their considerable differences aside and formed a common bloc aimed at the defense of private property (Valdés 1995).

In 1970 Salvador Allende, from the Socialist Party, took office as President, having obtained only 36% of the votes in the elections that year. He was backed by the Popular Unity leftwing coalition, whose economic program aimed at a massive collectivization of the means of production. Under President Allende the number and magnitude of distortions in the trade regime (as in the whole economy) grew enormously. The following is a brief summary of the situation at the time of the 1973 military *coup* (Meller 1994):

- Import tariffs ranged from 0 to 750%, with an average of 105%.
- 50% of tariff lines had tariff rates above 80%, while only 4% had tariff rates below 25%.
- However, import taxes were only 26% of import value in 1971, as a result of widespread exemptions and special regimes.
- For more than 60% of imports there was a 90-day, non-interest bearing prior deposit of 10,000% of the imported goods' CIF value.
- Almost 50% of tariff lines required the Central Bank's approval for importing the goods.
- There were 8 official exchange rates, with a 1,000% differential between the maximum and the minimum.

This system of protection did not obey to any specific development objective. The disorganization prevalent not just in trade policy but in economic policy as a whole led to the stagnation of manufacturing production, the disappearance of economic growth, and a severe contraction of the fledgling non-traditional export

[3] Until the early 1950s, the electorate accounted for only 10% of the population. Women were allowed to vote in 1950 and the illiterate population only in 1970. As a result of these and other electoral reforms, the electorate grew from 1.28 million in 1957 to 3.24 million in 1969.

[4] Between 1950 and 1970, Chile's per capita GDP grew at a yearly average of 1.4%, compared with an average of 3.1% for the group of developing countries with a comparable income level, and with a 3.3% for the industrialized countries (Fontaine 1993).

sector (Agosin 1999). When in September 1973 the military staged the *coup* that put an end to President Allende's "Socialist experiment", Chile was in the middle of an economic (and political) crisis of enormous proportions. Serious economic mismanagement had brought about hyperinflation (606% in 1973), a massive fiscal deficit (21% of GDP) and crippled the productive apparatus (Dornbusch and Edwards 1994).

Before proceeding to the reforms of the military regime, it is worth mentioning that, for all its shortcomings, the import-substitution model had some positive aspects. For example, during the 1960s the State promoted research and the creation of human capital in the areas of forestry, fishery and agriculture, all of which would later become leading exporting clusters. The action of the State was also instrumental in developing the physical and telecommunications infrastructure essential for the subsequent export boom (Meller 1996, Agosin 1999).

3. The reforms of the military government

3.1. Introduction

When it seized power in September 1973, the military junta led by General Augusto Pinochet had no definite government project (Valdes 1995), let alone an economic blueprint. However, it quickly chose a long-term "foundational" scheme over a "restoration" one. The political implication of this choice was that the military saw themselves as leading a transformation project for Chilean society, rather than restoring order and providing the bridge to a civilian administration. According to the military government's Declaration of Principles of March 1974, what was required were "profound and prolonged actions to change Chilean mentality" (Valdés 1995).

Although the junta's leaders were all strongly anti communist, the military's nationalistic tendencies connected well with a protectionist view in economic matters (Fontaine 1993). Lacking themselves both experience in government and technical expertise in economics, the military resorted to a group of young, liberal economists who had been secretly working since 1972 in an alternative economic program, in anticipation of Allende's overthrow. The military approached this group partly because of its image of technical competence and partly because of the seriousness of the economic crisis facing the country. Here a brief digression is in order, because that group of economists, who would later come to be known as the "Chicago Boys", would play a central role in the implantation of a free market model in Chile.[5]

Most of the "Chicago Boys" were alumni of the Catholic University's Economics Department. All of them followed graduate studies in Economics at the University of Chicago under a cooperation program between both universities that ran from 1956 to 1964. This program, known as the Chile Project, was funded by the government of the United States through its International Cooperation Administration (later known as the Agency for International Development, AID). It was deliberately

[5] An excellent reference on the Chicago Boys is Valdés (1995).

conceived as a means to counter the influence in Chile of the structuralist views then prevalent both in ECLAC and in the national university (the University of Chile). Most Chicago Boys returned to academic life in the Catholic University's Economics Department, which they eventually came to dominate. They also gradually began venturing in debates on economic policy, at the same time as Chilean politics became increasingly polarized.

The group was characterized by a strong *esprit de corps* and by heavily ideological views on social life. All Chicago Boys shared an absolute belief in economic science –in its neoclassical stream- as the best provider of answers to most questions concerning the organization of society. Consequently, they dismissed the role of other social sciences. They also criticized openly not just democratic politics but actually the very notion of politics, which they saw as inherently corrupt and obstructing market forces (Valdés 1995). This discourse, which made them natural allies of the military, stood oddly with the stated aim of building a "free society" through the reforms of the military government.

During roughly the first two years of the military regime, the Chicago Boys had to struggle for influence. Not all members of the economic team shared their radical views. In fact, many favored a more gradualist and less ambitious approach, aimed mainly at correcting the imbalances created under Allende. In the words of the then Finance Minister Jorge Cauas, speaking in July 1974, the goal was to create "a modern, mixed economy".

The massive balance of payments crisis of 1975 provided the opportunity for the Chicago Boys to secure the backing of General Augusto Pinochet, with their proposals for a radical adjustment program. From then onwards, they embarked on an ambitious process of reforms, ultimately aimed at transforming Chile into a truly market-driven economy. The main elements of their platform were liberalization, deregulation and privatization. The Ministry of Finance took on the lead role, especially after December 1976, with the appointment as Finance Minister of Sergio De Castro, widely seen as the Chicago Boys' natural leader.

3.2. The first trade reform: 1974-1979

Liberalization of the trade regime was essential for the success of the new strategy. The first reform took place in parallel with an adjustment program aimed at bringing down inflation (Meller 1996) and was quite radical. By the time it was completed, in 1979, "...the Chilean import regime could be considered one of the most open in the world. There were no quantitative restrictions, no prohibitions, no anti-dumping or countervailing duties, no subsidies on exports, and a uniform nominal tariff of 10% for all imports except for automobiles…" (De la Cuadra and Hachette 1988).

This sweeping reform was implemented in three stages. In the first, from early 1974 to mid 1975, all quotas and official approvals for imports were eliminated, all quantitative restrictions were replaced by tariffs, and the different exchange rates were unified. The simple tariff average was cut from 105% to 57%, although some tariffs still reached 120%. An export promotion agency, ProChile, was set up in 1974, first within the Ministry of Economy and after 1979 under the Ministry of Foreign Affairs. During the second stage, from mid 1975 to mid 1977, tariffs were further reduced to a range from 10% to 35%. During the third and final stage, from December 1977 to June 1979, tariffs were reduced on a monthly basis to reach the uniform level of 10% for all products (except automobiles).

The flat tariff, which became the centerpiece of Chilean trade policy since 1979, presents several advantages. First, from an economic point of view, it is consistent with the principle of neutrality, or equal treatment to all sectors. The new economic team was of the view that by ostensibly granting the same level of protection to all sectors, the undisturbed market forces would determine the most efficient allocation of economic resources. Second, from a political economy point of view, it minimizes the incentives for lobbying. And third, it simplifies customs administration enormously.

The new strategy resulted in Chile's withdrawal from the Andean Pact in 1976.[6] The decision was based both on discrepancies with that bloc's restrictive treatment of foreign investment and on Chile's unwillingness to maintain the high protection levels demanded by the bloc's common external tariff.

The radical character of the first trade reform (as well as of the ones implemented in many other areas) can only be understood within its historical context. Firstly, the economic crisis facing the country was of such magnitude that it provided the right environment for radical reforms. Secondly, the military junta exercised absolute political control. All political parties were outlawed. The National Congress was closed. Left-wing parties were violently repressed, with many of their leaders and members killed, tortured or exiled. The power of labor unions was drastically reduced. Business leaders, most of whom supported the overthrow of Allende, were initially very enthusiastic about the military regime and supported the removal of quantitative restrictions and the early tariff cuts (Stallings and Brock 1993)[7]. Those entrepreneurs who felt negatively affected by the reforms were not heeded. The military granted the economic team isolation from any interest group pressure (ibid.). In short, the ideologically-driven Chicago Boys were given the space to implement their policies in almost laboratory-like conditions.

In the multilateral sphere, Chile also broke new ground. As a result of the Tokyo Round of 1973-79, the country bound its entire tariff universe, the first GATT member to do so. All tariffs were bound at a flat 35%. The Chilean example of a ceiling binding for the whole tariff universe would be followed by a number of

[6] The Andean Pact (now Andean Community), created in 1969, is an integration scheme comprising trade and other policies. Its other members at the time Chile abandoned it were Peru, Bolivia, Colombia, Ecuador and Venezuela.

[7] This may have had to do with the high tariff level at the beginning of the reform, which meant that the early reductions were only eliminating redundant protection (Meller 1994).

developing countries, especially in Latin America, a decade and a half later in the Uruguay Round.

3.3. Investment and labor-market reforms

The economic authorities considered it very important to attract foreign investment so that it could flow to the sectors where Chile had comparative advantage, in the context of the new open-economy model. Liberalization of the foreign investment regime was therefore another of the early reforms of the military government. It was explicitly aimed at restoring foreign investors' confidence after the difficulties of the 1970-73 period.

The Foreign Investment Statute, which entered into force in 1974, was instrumental in opening up Chile's foreign investment regime. This instrument, still in force, is the main channel through which foreign direct investment (FDI) enters the country. Under its provisions, the foreign investor signs a legally binding contract with the State of Chile for the transfer of capital or other forms of investment and receives a number of specific guarantees and rights. The contract cannot be modified unilaterally by the State or by subsequent changes in the law. However, investors may, at any time, request the amendment of the contract to increase the amount of the investment, change its purpose or assign its rights to another foreign investor.

The Foreign Investment Statute guarantees non-discriminatory and non-discretionary treatment of foreign investors. Therefore, foreign investors enjoy the same rights and guarantees as local ones. It also guarantees investors the right to repatriate capital one year after its entry and to remit profits at any time.[8] Once all relevant taxes have been paid, investors are assured access to freely convertible foreign currency without any limits on the amount, for both capital and profit remittances. The repatriation of all capital invested is devoid of any tax, duty or charge up to the amount of the originally materialized investment. Only capital gains over that amount are subject to the general regulations contained in the tax code. The Foreign Investment Statute allows investors to lock in the tax regime prevailing at the time an investment is made.

The new Constitution adopted in 1980 guaranteed everybody the right to carry out any economic activity that is not contrary to morals, public order or national security, and is in compliance with the relevant laws. It also established that no arbitrary discrimination may be accorded by the State and its agencies in economic matters.

[8] Chile's Foreign Investment Committee argues that in practice the one-year capital lock-in has not represented a restraint since most productive projects --in areas such as mining, forestry, fishing and infrastructure-- require more than a one-year start-up period (see www.cinver.cl).

Labor market reforms pointed in the same direction as the overall shift in economic policy. Along with the loss of power experienced by labor unions, regulations were made more flexible so as to facilitate the firing of personnel, and there was a reduction in employer-financed pension charges and more generally in non-wage labor costs (Meller 1996). Labor market reforms also included the removal of entry barriers to some occupations, such as port workers (Fontaine 1993). However, not all labor-market reforms were in the direction of increased flexibility: a system of wage indexation was put in place in 1973 and retained until 1982.

3.4. The 1982 crisis and the populist interlude

Chile's access to international capital markets improved towards the mid 1970s. Starting in 1976, limitations on international capital movements were systematically eliminated, ending with the complete liberalization of international capital flows in 1981.

By the end of the 1970s, there was already talk of the "Chilean miracle" (Meller 1996). Average GDP growth was around 8% a year between 1976 and 1981. Exports grew from US$ 1.3 billion in 1973 to US$ 4.7 billion in 1980. However, the strong real appreciation of the peso since 1976, along with the reactivation of growth from 1977 onwards and continuing tariff liberalization, led to a big surge of imports and the emergence of unsustainable current account deficits, financed by private foreign capital.

In 1979 the Chilean authorities fixed the exchange rate in an effort to fight inflation. As inflation came down slowly, this brought about a real overvaluation of the Chilean peso, fostered by large capital inflows. This in turn led to a loss of competitiveness for both exporting and import-competing sectors. The tradable sectors of the economy contracted, while the non tradable ones expanded.

The way in which the domestic financial markets were liberalized aggravated the situation. The 1975 reforms included the privatization of banks, the elimination of ceilings on interest rates, the reduction of the compulsory reserve requirements applicable to banks, and the elimination of all restrictions on credit. At the same time, barriers to entry into banking and financial activities were sharply reduced. Moreover, there was no prudential regulation of the banks and other financial institutions. As a result, the financial sector grew enormously, financial operations replaced real investments, and interest rates soared from highly negative levels to extremely high levels in real terms (Agosin 1999). This hit both the exporting and import-competing sectors, already affected by the real overvaluation of the Peso.

When the debt crisis arrived in 1982, the Chilean economy experienced an almost complete collapse. Gross Domestic Product dropped by 14.1%, while official unemployment reached 26% (Meller 1996). As foreign capital dried up, the authorities reacted to the need to generate current account surpluses to service the external debt by successive devaluations that continued well into that decade. The Chicago Boys fell from grace and were replaced by new economic authorities with more heterodox views.

Between 1982 and early 1985 Chile experienced a populist interlude. The government adopted a number of unorthodox measures. Among the most visible was the intervention of a large part of the banking system in January 1983, effectively rescuing those banks from bankruptcy. Moreover, the Central Bank, which would only become autonomous from government in 1989, purchased risky portfolios and set a preferential exchange rate for debts in dollars, thereby sheltering those debtors at least partially from the devaluation of the Peso.

In the area of trade, there was a partial reversal of the previous reform. Tariffs were raised to 20% in March 1983 and to 35% (the maximum level bound in the Tokyo Round) in September 1984.[9] In addition, temporary tariff surcharges were authorized in 1982 for sectors in special difficulty (mostly industrial ones), and a mechanism to compensate for external price instability -the "price band system"- was put in place in 1984 for wheat, sugar and vegetable oil. However, the flat tariff policy remained in place and there was no recourse to quantitative restrictions.

The tariff increases were aimed at generating additional fiscal revenue at a time when the international price of copper was low, but they were also a response to mounting social pressures. After 1982 opposition groups, although formally proscribed, began organizing massive rallies to protest against the deteriorated economic and social situation, and in favor of a return to democracy. Against a widespread perception of economic failure, the military were first forced to negotiate with the opposition. The survival not just of the Chilean free market experiment but even of the military regime itself were seriously put into question (Fontaine 1993). Moreover, the measures adopted in favor of the financial sector were resented by other entrepreneurs, who were experiencing massive bankruptcies. These business sectors thus became much more vocal than in the past, demanding more active government action to encourage economic recovery (Stallings and Brock 1993, Campero 1992, Valdés 1995). Increased tariff protection was part of the government's answer.

It is worth noting that, even at this moment of near economic collapse, the exporting sector opposed the tariff increases. By 1984 the main business associations had come to be dominated by exporters. These included the National Agricultural Society (where the traditional grain producers were gradually replaced by export-oriented fruit entrepreneurs), the National Mining Society (a traditional export sector in Chile), and the National Chamber of Commerce (dominated by importers). Opposition to free trade was led by some segments of the manufacturers' lobby *Sociedad de Fomento Fabril* (SOFOFA) and by representatives of small and medium enterprises (Fontaine 1993).

[9] Jara (2005) presents evidence in the sense that, had it not been for the Tokyo Round binding, tariffs would have been increased beyond 35%.

In 1982-83 the Chilean economy faced both internal and external disequilibria. The internal disequilibrium had to do with the very high unemployment rates and the deterioration in workers' wages. The external one had to do with the scarcity of foreign exchange due to the heavy burden of servicing the external debt.[10] After some hesitation, the authorities chose to reduce the external imbalance even at the cost of aggravating the internal one. The political logic behind this decision seems to have been that the military could control domestic unrest by sending soldiers into the streets, but had no leverage to prevent multilateral financial institutions and international banks from cutting the provision of credit to the country. It was therefore decided to "invest in reputation" by following a non confrontational strategy vis-à-vis foreign creditors (Meller 1996).

Since 1983 Chile entered into several adjustment programs with the International Monetary Fund. The Fund identified substantial reduction of the external debt as Chile's most urgent priority. To that effect it prescribed a quick reduction in the current account deficit, to be achieved through restrictive monetary and fiscal policies. The IMF also prescribed a strategy of growth based on the expansion of exports, whose proceedings would allow an orderly servicing of the debt (Meller 1996).

3.5. The second trade reform

The reversal of the trade opening of the 1970s was short-lived. Once the external disequilibrium was reduced, and against the background of the IMF prescriptions, a new economic team led by Hernán Büchi launched the second trade reform in 1985. There was a drastic initial reduction in tariffs from 35% to 20% in just four months, with a further reduction to 15% in January 1988. These tariff reductions were supported by the majority of Chile's business associations, thereby reflecting the ascendancy of a free trade constituency within Chile's business sector.

A key difference with the first reform was the continuous real depreciation of the peso that took place from 1982 to the end of that decade, compensating for the tariff reductions and improving the competitiveness of both exporting and import-competing sectors. This was made possible by the abolition in 1982 of the mechanism of automatic wage indexation according to inflation that had been put in place in 1973 and by the high unemployment levels due to the crisis. In particular, the de-indexation of wages resulted in a fall of nearly 20% in real wages between 1981 and 1987 (Meller 1996), thereby countering the effect of the successive nominal devaluations on the price level.

Another main component within the Chilean government's strategy of export-driven growth was the creation since the mid 1980s of several mechanisms aimed at promoting exports. The most important are described below.

---

[10] Between 1982 and 1987, Chile's external debt was bigger than its gross domestic product and four times higher than its exports (Meller 1996).

The general drawback, introduced in 1988, allows all exporters to be reimbursed for import duties paid on imports incorporated or consumed in the production of exported goods. The simplified drawback, introduced in 1985, was targeted at "non traditional" exports (less than US$ 7.5 million a year at the time). It established a simplified refund equivalent to a percentage of the value of a company's exports of a given product (3, 5 or 10%), depending on the country's total exports of that product (the higher the country's total exported value, the smaller the refund in percentage terms). This mechanism, which benefited mostly industrial products, could on some occasions have an export subsidy component, as there was no link between the refund and the imported content of exported items (Agosin 1999). Both drawback programs are still in force, although the simplified drawback was modified and reduced as a result of Chile's commitments under the WTO Agreement on Subsidies and Countervailing Measures.

The Automotive Statute, which entered into force in 1985, allowed the exemption of customs duties on imports of vehicles for assembly in Chile, to the extent that they were offset by exports of domestic components of an equivalent value, within a period of 12 months following the importation. This provision was among the types of practices prohibited by the WTO Agreement on Trade-Related Investment Measures and was eliminated in 2003.

Starting in 1987, and with a view to promoting technological innovation and stimulating the purchase of capital goods, Chile also allowed for the deferred payment of import duties on imports of capital goods for up to seven years.[11] Moreover, there could be a partial or total remission of the amount due on the deferred import duties if the company concerned had used the capital goods to produce exports. These debt reductions amounted in effect to export subsidies, and were therefore phased out gradually starting in 1998.

ProChile, the State's export-promotion agency, also began to play a more active role in the 1980s. Its main activities include disseminating information on foreign markets, promoting Chilean exports through generic publicity and participation in international fairs, and working to resolve administrative problems faced by exporters through its network of offices abroad.

In short, Chilean trade policy, as indeed the management of the whole economy, presented during most of the 1980s a much more pragmatic, less orthodox character than prior to the 1982 crisis. This was reflected in the deliberate efforts made to preserve a high (i.e. depreciated) real exchange rate, as well as in the granting of different types of export incentives and of product-specific, contingent protection via surcharges. In the words of a sympathetic observer, the key to the success of Chile's economic policies in the second half of the eighties rested in their "pragmatic orthodoxy" (Fontaine 1993). This stands in contrast with has been termed "the naïve

[11] Purchasers of Chilean-made capital goods were entitled to a tax credit equivalent to 73% of the customs duty on the net invoice value of the goods.

phase" of reforms, from 1974 up to the 1982 crisis (Valdés 1995, Eyzaguirre, Marcel, Rodríguez and Tokman 2005).

3.6. The trade reforms of the military: overall assessment

Chile was an early reformer. It began implementing autonomously most of the "Washington Consensus" reforms a decade before the debt crisis gave the IMF and World Bank the leverage to push those reforms in other Latin American countries. Moreover, as it has been widely noted, its reforms predated the "neoliberal revolutions" of Thatcher in the United Kingdom and Reagan in the United States.

During the period of military rule Chile experienced two separate trade reforms, with one interlude (and partial reverse) in between. The first reform was more ambitious than the second one, but less successful. The lack of coherence between trade and macroeconomic policies, as well as the lack of sound regulation in the financial sector, led to economic collapse and a brief reversal. Moreover, an important part of the existing manufacturing capacity in 1974 was destroyed, rather than being re-oriented towards the exporting sector. Agosin (1999) argues that probably a more depreciated exchange rate and lower real interest rates would have helped a smoother transition for the manufacturing industry. Many entrepreneurs, used to decades of import substitution and government-fixed prices, struggled to make the right decisions in the context of a rapidly liberalized economy. However, the first reform was instrumental in eliminating the strong anti export bias of the economy before 1973, and in re-directing resources towards the country's sectors of comparative advantage.

The second reform was much more successful than the first one in promoting export-led growth and the diversification of Chilean exports away from copper. Between 1985 and 1990, exports grew at an average 16.9% per year (Meller 1993). They benefited from a favorable exchange rate, a much more activist trade policy, the existence of substantial spare capacity in the form of a vast pool of unemployed or underemployed labor, and very favorable terms of trade between late 1987 and 1992. Agosin (1999) argues that the simplified drawback program was instrumental in increasing both the number of exported industrial products and the value of those exports.

A few figures illustrate how successful the trade reforms of the 1970s and 1980s (and other associated economic reforms) were in inducing export growth. Exports climbed from US$ 1,100 million in 1970 (16% of GDP) to US$ 8,300 million in 1990 (34% of GDP). An important diversification also took place: the share of copper in Chilean exports fell from 80% in 1970 to less than 45% in 1990, although they continue to be overwhelmingly concentrated on natural resources. Export success stories such as wine, salmon and fruit date to the second half of the eighties, along with the emergence of a new generation of Chilean entrepreneurs with a global outlook. In sum, the reforms of the 1970s and 1980s laid the foundations for the export-led growth that Chile has experienced almost without interruption since the mid eighties.

In contrast with its good external performance, Chile's growth record in the 1973-89 period was quite poor: at an average of 3.7%, it was even below the 3.8% average of the import-substitution stage. Chile presented also a very erratic growth pattern, including two major recessions, in 1975 (drop in GDP of 12.9%) and 1982 (drop in GDP of 14.1%), but also two periods of average GDP growth above 6% (1976-81 and 1985-89). Over the sixteen years of military rule, investment accounted for less than 16% of GDP (Valdés 1995). Moreover, there was an important element of de-industrialization (Agosin 1999).

The reforms under the military had a big social cost. Unemployment was at double-digits during practically the whole period of military rule, topping at 31.3% in 1983 and staying at effective levels above 20% between 1982 and 1985. Real wages fell by about 20% between 1981 and 1987 (Meller 1996). Many social indicators worsened markedly. [12]. Poverty reached 45% of the population in 1987, several years after the collapse of 1982-83. Income inequality also increased significantly.[13]

The pain from the adjustment process of the 1980s was far from evenly spread. On the one hand, the severe contraction of per capita social spending hit especially hard the poorest and most vulnerable segments of society, which rely disproportionately on the public provision of health, education, housing and -ultimately- a social safety net. On the other hand, the economic authorities strayed from laissez faire on several occasions to subsidize privileged, mostly upper income, groups. Meller (1996) illustrates this by pointing out that while 600,000 people received an unemployment subsidy equivalent to 1.5% of GDP, less than 10,000 debtors in dollars received support equivalent to 3% of GDP. A further 400,000 unemployed did not receive any unemployment subsidies.

The handling of macroeconomic policy during the years of military rule is also widely seen as deficient, especially in the 1974 to 1985 period (Eyzaguirre, Marcel, Rodríguez and Tokman 2005, Agosin 1999, Meller 1996). This is particularly evident in the failure to bring inflation down to single-digit levels.

4. Trade reforms under democratic rule: 1990-2005

4.1. Overview

[12] There were some exceptions. For example, during the 1980s Chile achieved one of the lowest infant mortality rates in Latin America (0.84%). This probably responded to some extent to the efforts made by the military regime to target some social programs at the most vulnerable groups (Meller 1996).

[13] There are no comparable figures on income inequality at the national level before 1987. However, there are older series based on occupation polls conducted by the University of Chile in the Greater Santiago area. These show that the Gini coefficient, which measures income inequality, climbed from a value of 0.476 in the 1958-63 period to a maximum of 0.570 in 1987-90.

After winning the December 1989 elections, Patricio Aylwin took office in March 1990 as Chile's first democratically elected President after almost 17 years of military rule.[14] The broad centre-left coalition he led, the Concertación, has been in power without interruption until today, winning the Presidential elections of 1993, 1999 and 2005, as well as all parliamentary and municipal elections.[15]

The successive democratic governments have faced the challenge of both achieving dynamic economic growth and spreading its benefits more evenly across society. This was a major challenge, considering the enormous social frustration accumulated during both the closed-economy period and the military regime (Eyzaguirre, Marcel, Rodríguez and Tokman 2005).

The new economic authorities –most of them trained in the United States- chose to stick to the market-economy, outward-oriented model. This had to do with a number of factors. First, the economy had been growing by more than 6% a year between 1985 and 1989, with exports growing even faster and unemployment finally coming back to a single-digit figure. Second, by the early 1990s there was widespread and vocal support for the model among Chile's business sectors, which made even a partial reversal almost inconceivable. Third, the main parties in the new ruling coalition, and their technocratic elites, had gone through their own processes of reassessing the role of markets during the 1970s and 1980s. These processes are briefly discussed below.

For many leaders of the Chilean left, the experience of exile meant firsthand exposure to European social democracy at work (as well as to the failure of "real socialism" in the Soviet Union, Eastern Europe and elsewhere). This led to their gradual reappraisal of the role of markets in economic life, and to the emergence of a "renewed" faction within the Socialist Party. This faction has become very influential since the late 1980s and has provided a large number of authorities and technical *cadres* in all the Concertación governments. The other main centre-left party in the coalition, the Party for Democracy, was created only in 1989 and therefore did not carry the heavy historical baggage of the Socialist Party. It quickly adopted a social democratic approach in economic matters.

The (originally) main partner in the Concertación coalition, the Christian Democratic Party, was historically not as hostile to markets as the left parties. However, its roots are not liberal either, as they are heavily influenced by

[14] The Constitution that entered into force in 1980 envisaged a referendum in 1988 on the continuity of the military regime for a further 8 years. Following the victory of the "No" option with nearly 55% of the votes, presidential elections took place in December 1989. These were won by the Concertación's candidate, Patricio Aylwin of the Christian Democratic Party, over the right-wing candidate Hernán Büchi (who had served as Finance Minister between 1985 and 1989).

[15] Arguably the main strength of the Concertación has been its broad character. It includes forces such as Socialists, Social Democrats and Christian Democrats that, while all in opposition to the Pinochet regime, were in opposite camps during the Allende period. This inclusiveness has provided successive administrations with a broad base of popular support and legitimacy.

corporativism and the Catholic Church's Social Doctrine. Its shift towards a more market-friendly approach was spearheaded by CIEPLAN, a mostly economic think-tank created in 1976.[16] CIEPLAN grouped a number of Chilean economists, most of them associated with the Christian Democratic Party and with graduate studies in prestigious US universities. Their research provided a critique of the military government's economic policies that was both analytically rigorous and grounded on standard economic theory. CIEPLAN thus greatly influenced the Concertación's government program in the late 1980s, and after 1990 many of its best known academics have occupied top economic posts in the successive democratic administrations.

Under the Concertación governments, some of the structural reforms initiated by the military regime have been modified, but not repudiated. For example, some changes to labor laws were introduced in 1991, restricting the grounds for firing employees, increasing the compensation that firms had to pay to lay off employees, and restricting employers' recourse to lockouts. While these and other changes marked a break with the authoritarian regime, they did not amount to a major alteration of the labor-market regime.

Chilean trade policy under the Concertación administrations can be described as following a "multi-track" or "lateral" approach (Sáez and Valdés 1999). The policy of unilateral opening that became a distinctive feature of the military regime has not only been maintained, but actually deepened. At the same time, the country has been an active player at the multilateral level, both during the Uruguay Round and in the current Doha Round. Finally, a new –and growing- emphasis on bilateral and regional agreements was added. This "lateral" strategy is based on the concept of "open regionalism" –another ECLAC creation[17]-, "...which seeks to ensure that no trade agreement limits the freedom [of Chile] to negotiate further agreements or creates more obstacles *vis-à-vis* other trading partners" (WTO 1997). Mirroring these changes, the Foreign Ministry –through its specialized Trade Directorate- has assumed a leadership role in trade negotiations.

Although the focus of this paper is on autonomous trade liberalization, free trade agreements have become such a prominent feature of Chile's trade policy since 1990 that it is relevant to look at the causes of this trend. Several forces were at play (see Box 1).

There has been a substantial degree of continuity between the trade policies of the successive democratic administrations. However, it is possible to distinguish three phases in it, which broadly coincide with the stints of Presidents Aylwin (1990-1994), Frei (1994-2000) and Lagos (2000-2006).

4.2. The Aylwin administration (1990-94)

[16] See www.cieplan.cl

[17] See ECLAC (1994).

The most important trade measure adopted by President Aylwin's administration was to lower Chile's applied Most Favored Nation (MFN) tariff from a uniform 15% to a uniform 11% in June 1991. This was intended to ease the tendency towards appreciation of the Chilean Peso resulting from increased capital inflows (Jara 2005). The Government's tariff reduction plan was approved by unanimity in Congress.

The newly democratic Chile chose neither to return to the Andean Pact (later renamed Andean Community) nor to join the new Common Market of the South (MERCOSUR), created in 1991.[18] This decision responded to several reasons. First, at the time several members of both blocs were still experiencing important levels of macroeconomic instability. Second, both groups are customs unions with common external tariffs that differ from Chile in that they are not uniform and are on average higher than Chile's. Third, joining either group would have meant for Chile surrendering its autonomy in trade policy (and trade negotiations). Instead, Chile obtained "associated member" status in both groups. This independent-minded policy has attracted criticism within the South American region. However, it has proved beneficial, as it has allowed Chile both to go faster with its own reforms and to exploit opportunities that would not have been available to it as a member of one of the two main integration schemes in the region. Chile's FTAs with the European Union, Korea and China are clear examples.[19]

During the Aylwin administration Chile negotiated its first free trade agreement, with Mexico in 1991. At Chile's request, the agreement provided for the elimination of tariffs on almost all products. Therefore, it represented a significant departure from the traditional approach in the Latin American region, based on partial product coverage and tariff reduction rather than elimination. However, its scope was limited to trade in goods. The agreement with Mexico was followed in 1993 by two others, along the same lines, with Venezuela and Colombia.

[18] MERCOSUR's current members are Argentina, Brazil, Paraguay and Uruguay. Venezuela, which withdrew from the Andean Community in 2006, is in negotiations to become a full MERCOSUR member.

[19] The argument can be summed up as "the advantage of being single (and small)". Chile is an economy small enough not to threaten the viability of any productive sectors in its FTA partners (even in agriculture). This is obviously not the case with MERCOSUR, for example, which contains agricultural powerhouses such as Brazil and Argentina.

Box 1: The roots of Chilean trade regionalism since 1990

Chile's steady move into bilateral and regional trade agreements since 1990 responded to a number of factors. By the early 1990s there was a certain consensus among the economists associated with the incoming Concertación coalition that it was time to move beyond an exclusive focus on unilateral opening (Butelmann and Meller 1993, Agosin 1993, Velasco and Tokman 1993, Ffrench-Davis 1996). The substantial unilateral opening of the 1970s and 1980s had allowed the Chilean economy to reap substantial efficiency gains. However, the open trade regime that Chile already had in the early 1990s meant that the additional efficiency gains from further unilateral opening would be much smaller.

A second element was the desire to promote exports with higher value-added, reflected in the discussions about a "second exporting phase". To achieve this, improved access to foreign markets for more sophisticated products was required. This could not be obtained via unilateral opening. Therefore, a new strategy incorporating some element of reciprocity appeared necessary.

Third, the world economy had by the early 1990s moved clearly towards regional agreements, with the Canada-USA Free Trade Agreement (later NAFTA), the Single Market project in the European Union, and the creation of APEC and MERCOSUR. This trend provided an additional, defensive rationale for a small country like Chile to either join or negotiate FTAs with the main blocs. The substantial geographical diversification of Chilean exports made this argument especially compelling.

Fourth, during most of President Aylwin's administration there was uncertainty about the outcome of the Uruguay Round. Therefore, Chile -as many other countries- took some form of "insurance policy" in the form of bilateral agreements (Valdés and Sáez 1999).

Fifth, the Uruguay Round did not achieve as much liberalisation as Chile expected in several areas, such as agriculture. Indeed, Chile acknowledges that the liberalisation that can be achieved at the multilateral level is necessarily limited. Therefore, the country has negotiated faster and more comprehensive liberalisation with countries that were prepared to do so. A clear example is the elimination of antidumping duties in the Chile-Canada and Chile-EFTA FTAs, something that is inconceivable in the WTO. Moreover, multilateral liberalisation is not a continuous process. The launch and conclusion of every trade round are difficult processes, highly dependent on the political and economic conditions in the major trading powers. A small country like Chile, highly dependent on exports, cannot simply "wait until the next round" –or even until a round in progress is completed- while its competitors are negotiating preferential deals in all its most important markets. Furthermore, Chile's experiment with bilateralism has neither stopped unilateral liberalisation nor resulted in a lack of attention to the multilateral sphere.

Sixth, Chile's flat and relatively low tariff ensured that bilateral agreements would not create significant trade diversion (Velasco and Tokman 1993). One of the reasons behind the decision to unilaterally reduce the MFN tariff between 1999 and 2003 was to further reduce the scope for trade diversion caused by free trade agreements.

Finally, the re-democratisation process that took place across Latin America in the 1980s and early 1990s, coupled with increased convergence in economic policies along market-based lines, created the conditions for a renewal of the integration drive. Within the region, integration agreements have often had an important political logic. For Chile this is particularly clear about its relations with its neighbours: Argentina, Peru and Bolivia. These have traditionally been characterised by tensions (two wars with both Peru and Bolivia in the XIX century, a near-war situation with Argentina as late as 1978). Chile has seen a reinforced institutionalised integration with its neighbours, including trade but going well beyond it, as a means to promote peaceful and co-operative relations.

The new democratic administration was very keen to reassure international investors about its intention of keeping unaltered the liberal economic policies implemented by the military government. This was a key factor behind the strong priority Chile gave from the early 1990s to either joining NAFTA or negotiating a bilateral FTA with the United States. Arguably the importance of this motivation fell over time, as successive democratic administrations proved their commitment to a liberal economic model.

The end of the Aylwin administration coincided with the conclusion of the Uruguay Round. Chile committed to reduce its bound MFN tariff from 35% to 25% for practically all products by 2000, in fulfillment of the agreed cuts for developing countries[20]. In addition, Chile made commitments in several service sectors within the context of the GATS[21]. Those commitments essentially bound the policy framework in place at the time (WTO 2003).

Summarizing, the main objective of Chilean trade policy during the first post-Pinochet democratic administration was twofold. First, to send a clear message of continuity with the fundamentals of the "Chilean model" to economic agents both in Chile and abroad. And second, to put the country again in the Latin American map after a long period of diplomatic isolation. The first goal was achieved by locking in – and in the case of tariffs, deepening- the country's openness levels to trade and foreign direct investment. This was done both unilaterally and multilaterally (through Uruguay Round commitments). The second goal, which had at least as much to do with foreign policy as with trade, was pursued through the negotiation of bilateral agreements.

4.3. The Frei administration (1994-2000)

During the administration of President Eduardo Frei Ruiz-Tagle, Chile continued to extend its net of bilateral and regional agreements in Latin America, while at the same time it began venturing further a field. In 1994 it joined APEC and was invited to join NAFTA. This offer was never to materialize, however, due to the Clinton Administration's lack of "Fast Track" authority. New FTAs were added with Ecuador (1994), MERCOSUR (1996), Canada (1997) and Peru (1998). The FTA with Canada, Chile's first free trade agreement with a developed country, was also the first in which the country undertook commitments in areas such as services and investment. Both parties also agreed not to apply antidumping duties to each other.

In the multilateral front, Chile advanced its Uruguay Round bound tariff reduction schedule from 2000 to 1996, as a result of commitments in APEC. It also

[20] Wheat, wheat flour, sugar, vegetable oils and dairy products were bound at 31.5%. The sugar bound tariff was raised in 2001 to 98%. This product is subject to the price band system, created in the 1980s. The price band provides for a higher tariff the lower the international price. In 1999-2000, very low international sugar prices resulted in Chile's tariffs for that product exceeding largely the bound level, which led to the decision to re-negotiate that level upwards in the WTO.

[21] The sectors are business services, leasing and rental services, telecommunications, financial services, tourism and travel related services, and auxiliary air transport services.

publicly and continuously supported the launch of a new round of multilateral trade negotiations in the WTO.

Two important events took place in domestic trade policy. First, a law was passed in 1998 providing for a further reduction of five percentage points in Chile's applied Most Favored Nation (MFN) tariff, from 11% to 6%, to be implemented uniformly in the same number of years. The rationale for this decision was twofold: to improve the competitiveness of the economy in general and to reduce the room for trade diversion that could arise as the result of the country's various free trade agreements. This tariff reduction was more controversial than the one of 1991, as the first effects of the Asian crisis had begun to be felt, including increased flows of cheap imported manufactures (Jara 2005, Silva 1999). This was compounded by increased agricultural imports from MERCOSUR following the 1996 agreement and which hit Chile's politically influential import-competing agricultural sector.

In this context, to make possible the approval in Congress of the tariff reduction plan, the Government committed to introduce draft legislation allowing the application of safeguard measures. This legislation, which entered into force in May 1999, is stricter than the WTO's Agreement on Safeguards. For example, it only allows for safeguard measures to last one year, renewable for up to one additional year, instead of the "four plus four" years allowed by the WTO. The effectiveness of the general safeguards regime as a protection tool is further eroded by provisions in several of Chile's free trade agreements that set strict conditions for safeguards to be applied to FTA partners.

4.4. The Lagos administration (2000-2006)

During the administration of President Ricardo Lagos, the implementation of the unilateral tariff reduction plan approved in 1998 was concluded. Also during the 2000-2006 period Chile modified several trade-related laws (such as on customs procedures, trade-related investment measures in the automotive sector, and protection of intellectual property rights) pursuant to Uruguay Round commitments. In the multilateral sphere, Chile supported enthusiastically the launch of the WTO's Doha Round in 2001, and has been an active participant in it. However, the most prominent feature of Chilean trade policy during this period was the conclusion of free trade agreements with several of the world's "mega markets": the European Union (November 2002), Korea (February 2003), the United States (June 2003) and China (November 2005).[22]

An ambitious reform was undertaken with the entry into force of the Government Procurement Law in 2003. The law sets out the principles of public procurement for all governmental and other public institutions, including regional governments and municipalities, but excluding public works and state-owned

[22] Under the current administration of President Michelle Bachelet, an FTA with Japan entered into force in September 2007.

enterprises. Its objectives are to achieve maximum transparency in public procurement, to allow savings for the State and to promote the use of e-commerce. It makes public tendering compulsory for all contracts exceeding US$ 62.000 (as of May 2007). The law does not provide for different treatment of national and foreign goods, services, or suppliers. The law also establishes a tribunal for public procurement, which deals with infringements of procurement procedures, including for public works (WTO 2003).

In the area of trade facilitation, Chile has been continuously streamlining its import procedures since 1997, inter alia through the introduction of an electronic processing and payment system. Imports are usually cleared the same day they arrive at port (WTO 2003).

5. Impact of the reforms

5.1. Protection levels

Chile's bound tariff rate since the end of the Uruguay Round is a flat 25%, with a handful of exceptions in Agriculture (see footnote 20). As a result of its last unilateral tariff reduction, Chile's applied MFN tariff has been a flat 6% since 1 January 2003, again with roughly the same exceptions as for the bound rate. Taking into account Free Trade Agreements, the country's average applied tariff level is much lower, at around 2% (and going down). This reflects the fact that the countries with which Chile has subscribed such agreements account for 79.4% of the country's trade (as well as for 76.6% of the world's product).[23] Chile maintains only one multilateral tariff-rate quota, for sugar, although it has negotiated some others under bilateral agreements, usually for sensitive agricultural products.

Except for a handful of import-competing agricultural commodities (sugar, wheat and wheat flour, dairy and poultry), the tariff level has almost ceased to be a relevant variable. Today productive sectors in Chile (both exporters and those competing with imports) tend to care more about the exchange rate level than about the tariff level. Trade remedies are also used very scarcely, with the exception of safeguards for the agricultural commodities already mentioned.

Chile also follows a general policy of no permanent exceptions in its free trade agreements. Sensitivities are dealt with through longer tariff phase-out periods. The only exceptions respond to reciprocity considerations (that is, when a partner in an FTA permanently excludes items of exporting interest to Chile from tariff elimination). Chile also maintains the policy that its FTAs must have the widest thematic coverage possible, including trade in services, investment, government procurement and other "second generation" areas. It has accordingly been expanding and updating its network of FTAs within Latin America, which originally covered only trade in goods.

[23] See the website of the Ministry of Foreign Affairs' Economic Directorate, at www.direcon.cl

5.2. Trade and investment performance

Chile's total merchandise trade reached a record US$ 95.000 million in 2006, explained by exports of US$ 59.000 and imports of US$ 36.000 million. Its ratio of merchandise trade to GDP was 63.4% in 2005, and 76.4% if trade in services is also considered (World Bank 2007). Chile's trade is geographically well diversified. In the case of exports, in 2006 Asia absorbed 34%, the European Union (EU-25) 27%, the NAFTA countries 22%, and Latin America 13%. In the case of imports, 34% came from Latin America, 20% from both Asia and the NAFTA countries, and 15% from the EU-25.

While in 1975 Chile exported 200 products by 200 companies to 50 destinations, in 2004 it exported 5,238 products by 6,636 companies to 171 destinations.[24] Despite this successful diversification effort, Chile remains highly dependent on copper exports. Copper's share in total exports, after being brought down to around 40% in the 1990s, has rebounded strongly in the last years, reaching nearly 55% in 2006. This reflects the currently very high international price, caused among other factors by soaring demand in China.

Foreign direct investment has also played a crucial role in fostering Chile's integration with the world economy. The Chilean FDI regime accords National Treatment to foreign investors with only a few sectoral exceptions (international land transport, maritime cabotage, fisheries, and radio and print media).

Chile's FDI stock reached 64.6% of GDP in 2005, up from just 30% in 1990. By comparison, in 2005, the average world figure was 22.7%, and 27% for developing countries (UNCTAD 2006). For the past ten years, the ratio of FDI to GDP has averaged 6-8%, higher than the OECD average and any other Latin American country.

Between 1974 and 2005, gross materialized FDI in Chile totaled US$ 78.1 billion. It is worth noting that 89% of this amount entered the country after 1990. This suggests that foreign investors have rewarded the increased political, social and macroeconomic stability that has characterized the country since regaining democracy. In recent years, foreign investment has increasingly been taking place not just to supply the Chilean market but also other markets, especially within Latin America, taking advantage of Chile's network of free trade agreements.[25]

In terms of composition, between 1974 and 2005, the mining sector was the main receptor of FDI, accounting for 33.1% of grows inflows under the Foreign Investment Statute. It was followed by Services (19.6%), Utilities (19.2%), Manufacturing (12.7%) and Transport and Communications (11.6%). Since 1990 the share of mining in total FDI has decreased (it represented 47% until that year) and other sectors have expanded, notably Transport and Communications and Utilities.

[24] ProChile (Chile's export promotion agency). See its English-language website at http://www.chileinfo.com/index.php?accion=info_comercial

[25] Chile's Foreign Investment Committee. See www.cinver.cl (available in English).

This was mainly the result of privatizations in the energy and telecommunications sectors and of increased competition following the deregulation of mobile and long-distance telephone services. An infrastructure concessions program, launched in 1995, opened the way for the participation of private capital, mostly from abroad, in the construction and operation of roads and airports. Water privatizations and a concessions program for water treatment services have also attracted important FDI inflows in recent years.[26]

A large number of multinational companies currently have operations in Chile. These include Pernod Ricard, Fonterra, Tiger Oats, Nestlé, Unilever, Philip Morris, Chiquita and Dole in the agribusiness sector, Alcatel, Packard Bell, Telefónica, Ericsson, IBM, Microsoft, Yahoo!, Reuters, Motorola, Hewlett-Packard, Cisco, Sun Microsystems, INTEL and Unisys in information and communication technologies, Vivendi and Alstom in construction and infrastructure, L'Oreal, Sanofi-Aventis, Siemens, Bayer, Philips, Shell Petroleum Co., 3M, Procter and Gamble, Caterpillar, General Electric, Merck and Pfizer in industry, Total and Endesa in electricity, gas and water, Crédit Lyonnais, AXA, Deutsche Bank, Allianz, ABN Amro, ING, UBS, HSBC, JP Morgan Chase and Citigroup in financial services, BHP-Billiton, Anglo American, Sumitomo, Rio Tinto and Phelps Dodge in mining, and Sodexho, TNT Express, P&O Nedlloyd and ABB in other services.[27]

Chile has also become an active foreign investor, especially within South America. It is estimated that between 1990 and 2006 Chilean investment abroad exceeded US$ 38 billion, with Argentina, Brazil, Peru and Colombia accounting for 80% of the total. However, there are registered Chilean investments in countries as far as Spain, Australia, Croatia or the United Arab Emirates. Most Chilean FDI concentrates on energy, forestry, manufacturing and a wide variety of services (especially financial and retail services, but also other emerging sectors such as engineering, information technology and even air transport[28]). [29]

5.3. The services sector[30]

Services are the most important sector of the Chilean economy in terms of contribution to GDP and employment (52.7% and 62.8% respectively in 2002). Conditions for foreign participation in Chile' services sector are far more liberal than implied by its GATS commitments. Foreign participation in Chile's services sector is substantial, especially in financial services and telecommunications.

State involvement in the provision of commercial services is limited. The State retains ownership of one bank (BancoEstado), the postal and railway services, and one public television channel. It also owns major seaports and airports; however, these

[26] Chile's Foreign Investment Committee. See www.cinver.cl (available in English).
[27] Chile's Foreign Investment Committee. See www.cinver.cl (available in English).
[28] LAN Peru, a subsidiary of LAN Chile, Chile's largest air carrier, is itself Peru's largest air carrier.
[29] Ministry of Foreign Affairs' Economic Directorate. See http://www.direcon.cl
[30] This section is based on WTO (2003).

have been increasingly given in concession to private operators. State involvement in any of these sectors does not preclude private participation.

Since the early 1990s, Chile's telecommunications sector has been fully privatized. There is substantial presence of foreign companies in the sector.

Equity caps only exist in the maritime transport sector, where more than 50% of the capital of a shipping company must be owned by Chileans. Maritime cabotage is also reserved by law for Chilean enterprises. There are also limits on the proportion of foreigners allowed to work in a company established in Chile: according to the Chilean labor code, foreign natural persons cannot make up more than 15% of the total staff employed in Chile. This provision does not apply to highly specialized personnel with skills that cannot be procured in Chile.

Chile's banking system includes a large number of foreign-owned or controlled banks. Foreign banks incorporated in Chile and branch offices are allowed to undertake the same range of activities as national banks and are subject to the same regulations. However, foreign financial services providers that wish to establish a commercial presence in Chile must obtain authorization from the Superintendence of Banks and Financial Institutions (in the case of banking services) and from the Superintendence of Securities and Insurance (in the case of insurance services). Authorization depends on market conditions and national interest.

Chile's air transport policy is based on the principles of open skies, free competition between airlines, and freedom of price-setting. Chilean and foreign airline companies are allowed to supply commercial air transport services both domestically and internationally. However, by law the participation of foreign companies is allowed only on the basis of reciprocity.

Chile's airports are state-owned, but their construction and administration, including the provision of terrestrial auxiliary services, has been given in concession to private enterprises. With the exception of traffic control, the State is not involved in the provision of air transport or auxiliary services.

5.4. Macroeconomic and growth performance

Chile shows a strong growth record in the last 20 years. Even accounting for the 1998-2003 slowdown, its GDP grew at an average of 5.8% between 1987 and 2006, the fastest rate in Latin America. Agosin (1999) argues that Chile since the mid 1980s is a case of export-led growth rather than one of "growth-induced exports". He identifies export expansion and growth in investment as the Chilean economy's twin engines of growth in this period.[31]

[31] Agosin identifies two main channels through which exports induce growth in a small and developing economy such as Chile's. First, they potentially represent –unlike the domestic market- a

In spite of being a very open economy, Chile is today less vulnerable to external shocks than it historically was. This is explained in large part by its solid macroeconomic performance since 1990. Inflation, still at 26% in 1990, was brought down to single-digit levels by 1995. The Central Bank, made autonomous towards the end of the military regime in 1989, adopted in the early 1990s an inflation-targeting policy, with a target band of 2 to 4%. Inflation levels have been within this band in all years since 1999. In other words, Chile presents since the late 1990s inflation levels comparable to those in OECD countries.[32] The consolidated net public debt (central government and Central Bank) represented less than 6% of GDP in 2004, down from nearly 34% of GDP in 1990 (OECD 2005).

In 1999 the Central Bank abandoned the policy of targeting the nominal exchange rate that had been pursuing since 1984 and let the Peso float freely. In so doing, it has allowed the exchange rate to play a greater role in the stabilization of activity in response to external shocks.

Fiscal policy has assumed a counter-cyclical stance since the introduction in 2001 of the structural surplus rule. This rule stipulates that the calculation of the annual budget should produce a surplus of 1% of GDP, assuming a level of activity consistent with the economy's trend output growth. In so doing it allows an expansionary fiscal policy in periods of low economic activity, without interfering with the country's monetary policy or raising the risk perception of foreign investors[33]. The responsibility for estimating the values of the two key variables in this calculation -the economy's trend output growth and the medium term copper price- has been delegated to expert panels, therefore reducing the risk of political interference (OECD 2005).

During most of the 1990s Chile maintained some capital controls. These were a response to the great abundance of foreign capital the country experienced during most of that decade, and to the desire to prevent such inflows from inducing an excessive appreciation of the Peso. The authorities therefore put in place measures to discourage inflows of short-term capital[34], while continuing to welcome FDI (Agosin 1999). The development of hedging instruments together with the increased maturity of the Chilean financial system and the credibility of its macroeconomic policies made it possible to eliminate these restrictions in 2001 (WTO 2003).

While in the past copper prices had a big effect on the country's macroeconomic stability, this effect has been moderated since the creation of the Copper Stabilization Fund. This fund was set up in 1986 in the context of a structural

nearly infinite source of demand. Second, they promote technological change by financing imports of capital goods, which tend not to be produced domestically.

[32] The expected inflation rate for 2007 is around 6%, responding –among other factors- to increased energy costs.

[33] Ministry of Finance's website, at www.minhda.cl

[34] FDI was required to remain in Chile for at least one year and a non-interest bearing reserve on short term external credit was imposed.

adjustment program with the World Bank. It allows the Chilean State (the only shareholder of CODELCO, the world's largest copper producer) to maintain a stable spending pattern in spite of fluctuations in copper's international price. It does so by providing for the collection of surpluses in times of high prices and their withdrawal when prices are lower.

5.5 Employment performance

Unemployment was at double-digits during practically the whole period of military rule. Although there are no comparable figures available for the national unemployment rate before 1986, the series compiled by the University of Chile on unemployment in Greater Santiago since 1960 provides a good proxy.[35] It shows that unemployment reached particularly high levels following the recession of 1975 (over 16% in that year and 1976) and especially the one of 1982 (exceeding 22% in that year and 1983). Moreover, the figures for the 1980s substantially underestimate the extent of the problem, as they exclude the emergency employment programs put in place after 1982 and that essentially amounted to masked unemployment.

By comparison, the national unemployment series available since 1986 shows a brighter picture. The unemployment rate finally reached a single-digit level in 1988 (9.7%) as a result of economic recovery in the second half of the 1980s. It continued to gradually decrease in a context of high and sustained growth, reaching its lowest level (an average of 6.3%) in the 1996 to 1998 period. It rebounded again in 1999, the only year since 1983 in which the Chilean economy has experienced negative growth (-0.7%). This took place in the wake of the Asian and Russian crises and in a context of high interest rates that choked economic activity. Unemployment remained at 9 to 10% levels until 2005, finally beginning to ease off towards the end of that year. The average for the first half of 2007 was 6.8%, suggesting that the economy is finally close to the levels of the mid 1990s.

5.6 Poverty reduction performance

Since regaining democracy, Chile has experienced a massive reduction in poverty, from 38.6% of the population in 1990 to 13.7% in 2006 (14% in urban areas and 12.3% in rural areas). Extreme poverty (i.e. destitution) has been reduced from 13% in 1990 to 3.2% in 2006[36]. This record is unparalleled in Latin America. Poverty reduction has been matched by improvements in social indicators, including enrolment

[35] It is worth noting, however, that the unemployment rate in the Greater Santiago area tends to be above the national figure in "bad years" and below it in years of high economic activity. This is probably because Santiago concentrates a disproportionate share of Chile's industry and other activities, such as construction, that are very sensitive to the economic cycle.

[36] The poverty line used in Chile corresponds to twice the cost of a basic food basket. In 2006, it was equivalent to about US$ 90 per person per month in urban areas (US$ 60 in rural areas). Destitution is defined as income below the cost of one basic food basket. For more details on the methodology used and the evolution of poverty since 1990, consult the Planning Ministry's website: http://www.mideplan.cl/final/categoria.php?secid=25&catid=124

in primary education, youth literacy, infant mortality and life expectancy, with these indicators reaching levels close to those in advanced economies. According to the OECD, infant mortality, which stood at 78 children per 1,000 live births in 1970, had fallen to 17 children by 1990 and 7.6 by 2004. Life expectancy at birth has also risen steadily and in 2004 stood at 78 years.

It is widely recognized that strong and sustained economic growth, complemented by much increased social spending in areas such as health and education, has played a key role in the above achievements. It is also broadly accepted that the openness of the Chilean economy has contributed strongly to the country's robust economic performance. It can therefore be argued that this openness has also helped to reduce poverty and to otherwise improve social indicators.

6. Challenges ahead

> *"As in previous years, **Chile**, ranked 27th, leads the rankings in Latin America and the Caribbean. Chile's position reflects not only solid institutions – already operating at levels of transparency and openness above those of the EU on average – but also the presence of efficient markets that are relatively free of distortions. The state has played a supportive role in the creation of a credible, stable regulatory regime. Extremely competent macroeconomic management has been a critical element in creating the conditions for rapid growth and sustained efforts to reduce poverty. The resources generated by Chile's virtuous fiscal policy have gone to finance investment in infrastructure and, increasingly, education and public health. Given Chile's strong competitive position, the authorities will have to focus attention on upgrading the capacity of the labor force with a view to rapidly narrowing the skills gap with respect to Finland, Ireland and New Zealand, the relevant comparator group for Chile."* (The Global Competitiveness Report 2006-2007, World Economic Forum)

Chile is now an upper-middle income country. Its per-capita gross national income, of US$ 5.870 in 2005 (US$ 11.470 in Purchasing Power Parity terms), exceeds those of all Latin American countries except Argentina, is similar to the levels in Russia and South Africa, but lower than in all OECD countries except Mexico and Turkey. Notwithstanding two decades of rapid growth, per capita incomes are still less than half the OECD average.[37]

Today Chile shows much improved social indicators and a solid record of macroeconomic stability, with low inflation, a fiscal surplus and a strong reserve position. It has the lowest country risk in its region, and along with Mexico, is the only sovereign borrower in Latin America to enjoy an investment-grade credit rating. Chile is widely considered the freest economy in Latin America and the Caribbean.[38]

[37] World Bank (2007).

[38] Chile ranked 11th among 162 countries according to the 2007 Index of Economic Freedom, published jointly by the US-based Heritage Foundation and The Wall Street Journal. As on previous occasions, it ranked first in Latin America and the Caribbean. See http://www.heritage.org/index/countries.cfm

Moreover, it is widely considered to have transparent institutions and a generally effective regulatory framework.[39]

Arguably Chile's main challenge over the coming decade will be to cross the development threshold, catching up with the lower-rung members of the OECD. This will imply, as the OECD itself has put it, "lifting the economy's growth potential" (OECD 2005).[40]

With an average applied tariff level around 2% (and going down), little gains can be expected from new unilateral tariff reductions, except to simplify customs procedures. Chile should, however, take the opportunity of the current Doha Round negotiations at the WTO to undertake binding commitments that reflect more closely its current openness levels. This means binding its tariffs at a level much closer to the current applied MFN level, and assuming both deeper and broader commitments in services. Chile has also made important progress on several "second generation" reforms, such as on government procurement, competition policy, services, investment and intellectual property.

Chile is a clear example that natural resources are not necessarily a curse. However, doubts remain as to whether "more of the same" will be enough to cross the development threshold, and if so, when. In particular, it has been pointed out that there are countries with natural resource endowments similar to Chile's, but with a more abundant and cheaper workforce, and closer to the world's big "centers of consumption". The vulnerability of comparative advantages based on exhaustible natural resources has also been highlighted, as well as the catching-up effect as other developing countries undertake the same reforms in which Chile was a pioneer (Eyzaguirre, Marcel, Rodríguez and Tokman 2005). Chile also has a low research and development intensity by international standards (0.7% of GDP, about one-third of the OECD average). And despite the significant progress made since 1990, especially in terms of coverage, Chile's educational performance remains poor in comparison with OECD countries (OECD 2005).

Against this background, it has been argued that Chile must embrace more aggressively "the knowledge economy", while maintaining its specialization in the natural resource areas where it has comparative advantage. The preconditions for this qualitative jump are already in place: the rule of law, macroeconomic and institutional stability, a market-based economy (including quite liberal trade and investment regimes), reasonably good public infrastructure, a well-regulated -and expanding- capital market, and notable improvements in educational coverage (Eyzaguirre, Marcel, Rodríguez and Tokman 2005; OCDE 2005).

[39] In 2006 Chile was ranked best in its region in Transparency International's Corruption Perceptions Index (and twentieth overall). See http://www.transparency.org/policy_research/surveys_indices
[40] Last May, the OECD formally invited Chile to start negotiations conducive to full membership.

A prerequisite to fully benefit from the knowledge economy is to develop the country's human capital. In policy terms, this requires improving the quality of education (especially in the public system, which caters for the majority of the population) and fostering innovation (Eyzaguirre, Marcel, Rodríguez and Tokman 2005; OCDE 2005). In the microeconomic area, it will be important to improve access to capital for small and medium enterprises and start-ups, as well as finding ways of increasing the very low participation rate of women in the labor force (for example, through the expanded availability of childcare and pre-school education).[41] Other challenges ahead are improving environmental standards, so that Chilean products are not discriminated against by governments or customers in developed country markets, and securing stable and diversified energy sources.[42] Neither of these challenges is directly related to trade policy.

Despite Chile's success with poverty reduction, its income distribution has shown little improvement from the maximum levels it reached towards the end of the military rule period. Today it remains very unequal even by world standards. This issue has become increasingly prominent in the public debate, as the latter gradually shifts from how to eradicate extreme poverty to how to ensure a fair distribution of the fruits of economic growth. Therefore, another major challenge for the political sustainability of the "Chilean model" is bringing these persistently high levels of income inequality closer to OECD levels.[43]

Summing up, Chile's economic references in the coming years will be those developed countries that have been able to prosper by adding value to mostly natural resource-intensive exports (Australia, Canada, New Zealand) and those that, being relatively small economies, have succeeded by adopting the right policies in areas such as education, innovation and fostering entrepreneurship (Ireland, Scandinavia).

7. Conclusion

For an outside observer, if there is one common thread in Chile's trade policy over the last three decades, it is a consistent commitment to trade liberalization. Aside from a brief policy reversal right after the economy's near-collapse in the early eighties, both the rightwing Pinochet dictatorship and the successive centre-left democratic

[41] At 40.9% in 2005, Chile's labor force participation rate for women is well below the world's average (57.9%), and is lower than that of any region except for the Middle East, North Africa and South Asia (World Bank 2007). This very low figure probably responds to a host of reasons, including not just inadequate coverage of childcare and pre-school education, but also entrenched cultural patterns. Chile is widely seen as Latin America's most socially conservative country.

[42] Chile is highly dependent on foreign energy sources (oil and natural gas). In recent years it has experienced growing difficulties to secure an adequate and stable supply, especially from neighboring countries. This in turn puts a question mark on the Chilean economy's growth prospects.

[43] Although high even by Latin American standards, Chile's income inequality levels are reduced significantly when State transfers to the poorest segments of society are considered. In 2006, the income ratio between the richest 10% of the population and the poorest 10% fell from 31.3 times to 12.1 times when such transfers were considered (Ministry of Planning, www.mideplan.cl).

administrations led by the Concertación have pursued freer trade almost relentlessly. All avenues have been explored: unilateral liberalization (in the second half of the seventies, in the second half of the eighties, in the early nineties and again in the late nineties), multilateral commitments in the GATT/WTO, and most visibly now, free trade agreements since the early nineties. Chile has experimented with both "big bang" reforms under dictatorial rule and gradualist reforms in democracy (see Annex 1 for a chronology of Chile's trade and investment reforms).

How did this come to pass? It certainly was not a foregone conclusion in September 1973. There was no reason to expect that the military, once in power, would preside over a period of such radical economic reform. Countless other military dictatorships in Latin America and elsewhere chose to leave the import-substitution model essentially in place, or at most to just tinker with it.

In the Chilean case, it was a very specific set of circumstances that allowed events to happen the way they did. The seriousness of the country's crisis in 1973 provided the conditions for radical reform. But equally crucial was the symbiosis that took place between the military's "national re-foundation" project and the ideological vision of the Chicago Boys. The military gave the Chicago Boys a free hand to implement their preferred policies. Equally importantly, they carried on with the reforms in spite of the high social cost, buying time for them to finally begin to pay off from the mid eighties. In a "normal politics" situation, it is very likely that the social and economic cost of the reforms (including trade liberalization) would have been considered excessive, and the reforms abandoned or at least partially reversed.

The result was that, by the time the country regained democracy, the open economy model had been showing positive results for half a decade, both in terms of growth and employment. An influential "free trade constituency" had emerged among entrepreneurs, made up -among others- of exporters in booming sectors such as salmon, wine and agro-industry in general, as well as of Chilean firms interested in investing in other Latin American countries. In short, there was no turning back the clock.

The military government was responsible for implanting the market economy model in Chile, and for convincing entrepreneurs of its virtues. However, it failed in one crucial aspect: gaining popular support for the model.[44] This task was left for the future democratic administrations. The process was remarkably quick. As one author sympathetic with the military government observed in the early 1990s, the free market model only began to be accepted by the Chilean population at large under democratic conditions (Fontaine 1993). Writing only two years later, Valdés asserted that the opening-up of the economy to foreign competition and export orientation had "become articles of faith for Chilean society in general" (Valdés 1995).

[44] Fontaine (1993) provides data supporting this view, based on polls conducted in 1988 in Chile's capital Santiago. Just as an example, according to those polls, 54.8% of Santiago's population favored income redistribution policies as the best means to eradicating poverty, against only 37.6% who privileged economic growth.

Chile experienced an average growth rate of 6.4% during the first three years of President Aylwin's administration, coupled with falling inflation, rising investment and a fall in unemployment. This good performance in the critical first years of democracy probably explains in good part why the market economy model quickly began to legitimize itself among the wider population. Another, very important part of the explanation lies with the more "social democratic" nature of the new social compact. After 1990, long-repressed social demands were met through policies such as the introduction of a minimum wage and of an unemployment benefit scheme, as well as through increased social spending in the areas of public health and education, long neglected by the military. In this way, a basic social protection net was created (in some cases, reconstructed). Finally, the search for consensus further reinforced the legitimacy of economic policies among the wider population. In sum, democracy allowed "a social pact between government, business sectors, and workers" (Valdés 1995, p 254).

Against the predictions of many supporters of the military government (including some prominent Chicago Boys), democracy has not only proved not to be a problem for the working of the open economy model: it has actually reinforced it. The overall performance of the Chilean economy improved dramatically since 1990, in a context of political and social stability, coupled with greater policy coherence, better macroeconomic management and a strengthened regulatory framework. This has of course been greatly facilitated by the near consensus that exists across the Chilean political spectrum on the fundamentals of a market-based, outward-oriented economy.

A number of lessons can be distilled from the rich experience Chile has accumulated in over thirty years of trade-related reforms. While some of them are more specific to the Chilean context than others, all of them have some level of applicability to other developing country situations. Following are some of the most important.

When launching a trade reform, it is important to eliminate quantitative restrictions first, as Chile did in the first stage of its reform between 1974 and 1975. This is so because quantitative restrictions are the most distorting kind of trade barriers, as they inhibit response to price signals –and therefore the reallocation of resources- more than tariffs. Anyway, this particular recommendation has lost most of its relevance, as the vast majority of developing countries have by now committed under WTO rules not to maintain quantitative restrictions.

More importantly, the near-collapse of the Chilean economy in 1982 illustrates the importance of policy coherence. Specifically, governments should try to avoid real exchange rate appreciation while simultaneously reducing tariff protection, so as to avoid a "double whammy" effect on exporting and import-competing sectors. The 1982 crisis also points at the importance of proceeding cautiously when opening the capital account, and of putting in place a sound regulatory framework for the financial sector before doing so.

The Chilean experience also shows the importance of macroeconomic stability, including low inflation, to allow economic agents to assess adequately where to channel resources in response to price –including trade- liberalization. High inflation and macroeconomic stability in the first years of reforms made it difficult for economic operators to assess the comparative competitiveness of different industrial sectors. Investment into Chile's sectors of comparative advantage picked up significantly in the second half of the 1980s, and especially from 1990 onward, in the context of increased macroeconomic stability and lower inflation.

In terms of timing, the Chilean experience suggests that a gradual approach to trade reform can work as well as a "big bang" one. Actually, the second reform under the military government, in the second half of the 1980s, delivered better results than the first, in spite of being less ambitious. However, an assessment of the relative merits of each approach will necessarily depend on the circumstances. For example, Chile arguably needed some sort of "big bang" to kick-start reforms in the highly distorted economic environment prevailing right after the military coup. In contrast, all subsequent trade reforms took place in a much less distorted environment, therefore allowing for more gradualism and fine tuning. Moreover, a large part of the explanation why the first reform ended in collapse had to do with inadequate policies in other areas and a general lack of policy coherence, rather than with the depth of trade reform per se.

Chile's experience with an essentially flat tariff structure has been largely positive. While being an extreme case, the Chilean experience points at the benefits of a simple tariff structure that avoids large tariff dispersion. These benefits accrue through a less distorted allocation of economic resources, more transparency and predictability for economic operators, less incentives for lobbying, and a simplified customs administration. Moreover, the low and uniform tariff has allowed Chile to negotiate bilaterally with different partners, by reducing substantially the scope for both trade diversion and incoherence among the different agreements.

Chile's successful second trade reform highlights the benefits of pragmatism, as shown in the use of different types of export incentives –including some export subsidies- and of targeted temporary protection. It is worth recalling, however, that some of those export incentives are no longer legal under WTO rules. Increasingly intrusive multilateral rules mean that developing countries have less "policy space" now than in the 1980s.

In this new international context of reduced policy space, the role the State can play in fostering exports through WTO-consistent, horizontal mechanisms becomes even more important. In particular, the experience of ProChile highlights the benefits of an active export-promotion agency in gathering and disseminating information on foreign markets and in encouraging small and medium enterprises to associate and cooperate to explore those markets.

The most importance lesson that can be drawn from the Chilean experience is one that has already been mentioned: democracy is in no way intrinsically detrimental to trade reform or to economic growth in developing countries. Ultimately, trade reforms –indeed, any reforms- need political legitimacy if they are to be preserved in the long run. The specific type of export model Chile developed under the military, based on low wages and an aggressive exploitation of the country's natural resources, could not be sustained indefinitely. For is part, the massive inflow of foreign investment since 1990 strongly suggests that investors put a premium on stability, not just economic but also political and social. At the same time, it cannot be ignored that trade policy-making under democratic politics has been greatly facilitated in Chile by the country's near consensus on the benefits of free trade.

References

Agosin, Manuel. "Beneficios y costos potenciales para Chile de los acuerdos de libre comercio". Estudios Públicos, 52 (primavera 1993).

Agosin, Manuel. "Comercio y crecimiento en Chile" (also published in English as "Trade and growth in Chile"). CEPAL Review 68, August 1999. Available in http://www.eclac.cl/publicaciones/xml/3/20203/agosin_i.pdf

Butelmann, Andrea and Meller, Patricio. "Tópicos centrales en una estrategia comercial chilena para la década de los 90". En Butelmann, Andrea and Patricio Meller (eds.), Estrategia comercial chilena para la década del 90. CIEPLAN, Santiago de Chile, 1993.

Campero, Guillermo. "Entrepreneurs under the Military Regime". In Drake, Paul W. and Iván Jaksic, The Struggle for Democracy in Chile. University of Nebraska Press, 1992.

De la Cuadra, Sergio and Hachette, Dominique. The Timing and Sequencing of a Trade Liberalization Policy: The Case of Chile. Documento de Trabajo Nº113, Instituto de Economía Pontificia Universidad Católica de Chile, 1988.

Dornbusch, Rudiger and Edwards, Sebastián. "Exchange Rate Policy and Trade Strategy". In Bosworth, Barry P., Dornbusch, Rudiger and Raúl Labán (eds.), The Chilean Economy. Policy Lessons and Challenges. The Brookings Institution, 1994.

ECLAC (United Nations Economic Commission for Latin America and the Caribbean). Open regionalism in Latin America and the Caribbean. Santiago, 1994.

Eyzaguirre, Nicolás; Marcel, Mario; Rodríguez, Jorge and Tokman, Marcelo. "Hacia la economía del conocimiento: El camino para crecer con equidad en el largo plazo". Estudios Públicos, 97 (verano 2005).

Fontaine, Juan Andrés. "Transición económica y política en Chile: 1970-1990". Estudios Públicos, 50 (otoño 1993).

Ffrench-Davis, Ricardo. Comentarios, in "Panel: ¿Son el NAFTA y el MERCOSUR el camino hacia la integración del Hemisferio?". In Lipsey, Richard G., and Patricio Meller. NAFTA y MERCOSUR. Un diálogo canadiense-latinoamericano. CIEPLAN/DOLMEN, 1996.

Jara, Alejandro. "Las Virtudes de la Promiscuidad (La apertura comercial de Chile)". In Estevadeordal, Antoni y Torrent, Ramón (eds.), Regionalismo Global: Los Dilemas para América Latina. Fundación CIDOB , Barcelona, 2005.

Labán, Raúl and Meller, Patricio. "Trade Strategy Alternatives for a Small Country: The Chilean Case", in Lipsey, Richard and Meller, Patricio (eds.),Western Hemisphere Trade Integration. Macmillan Press, 1997.

Meller, Patricio. "Economía Política de la Apertura Comercial Chilena". Serie Reformas de Política Pública, ECLAC, 1993.

Meller, Patricio. "The Chilean Trade Liberalization and Export Expansion Process 1974-90". In Helleiner, Gerald (ed.), Trade Policy and Industrialization in Turbulent Times. 1994.

Meller, Patricio. Un siglo de economía política chilena (1890-1990). Editorial Andrés Bello, Santiago, 1996.

OECD (Organization for Economic Cooperation and Development). Economic Survey of Chile, 2005. OECD Policy Brief. Paris, 2005.

Sáez, Raúl E. "Estrategia comercial chilena: ¿Qué hacer en los noventa?". Colección Estudios CIEPLAN Nº40, marzo 1995.

Sáez, Sebastián and Valdés, Juan Gabriel. "Chile y su política comercial "lateral"" (also published in English as "Chile and its "lateral" trade policy"). CEPAL Review 67, April 1999.
Available at http://www.eclac.cl/publicaciones/xml/5/19935/saezvaldes.pdf

Silva, Verónica. "Política comercial y relación público-privada en Chile durante los noventa". Unpublished draft, 1999.

Stallings, Barbara and Brock, Philip. "The Political Economy of Economic Adjustment: Chile, 1973-90". In Bates, R. and Krueger, A. (eds.), Political and Economic Interactions in Economic Policy Reform. 1993.

UNCTAD (United Nations Conference on Trade and Development). World Investment Report 2006 - FDI from Developing and Transition Economies: Implications for Development. Geneva, 2006.
Available at http://www.unctad.org/en/docs/wir2006annexes_en.pdf

Valdés, Juan Gabriel. Pinochet's economists. The Chicago School in Chile. Cambridge University Press, 1995.

Velasco, Andrés and Tokman, Marcelo. "Opciones para la política comercial chilena en los 90". Estudios Públicos, 52 (primavera 1993), 53-99.

World Bank. World Development Indicators 2007. Washington, DC, 2007.

World Economic Forum. The Global Competitiveness Report 2006-2007. Geneva, 2006.
Available at http://www.weforum.org/en/fp/gcr_2006-07_highlights/index.htm

World Trade Organization. Trade Policy Review Chile 1997. Geneva, 1997.

World Trade Organization. Trade Policy Review Chile 2003. Geneva, 2003.

Annex 1
Chronology of Chile's trade and investment reforms, 1974-2003

Year/period	Event
1974	The Foreign Investment Statute enters into force: liberalization of the FDI regime
1974-75	First stage of the first trade reform: quantitative restrictions are eliminated, the different exchange rates are unified, tariffs are reduced from an average of 105% to an average of 57%
1975-77	Second stage of the first trade reform: tariffs are reduced to a range from 10% to 35%
1976-81	Elimination of capital controls
1977-79	Third stage of the first trade reform: tariffs are reduced to a flat 10% (except for automobiles)
1979	Tokyo Round: Chile binds all its tariffs at 35%
1982	Debt crisis and near-collapse of the economy
1983-84	Partial reversal of trade reforms: tariffs are raised to 20% (March 1983) and then to 35% (September 1984)
1985-88	Second trade reform: tariffs are reduced to 30% (March 1985), then to 20% (June 1985) and finally to 15% (January 1988)
1991	Unilateral tariff reduction, from 15% to 11%
1991	Capital controls are introduced (on short term capitals)
1991 to the present	Negotiation of several free trade agreements
1994	Uruguay Round: Chile binds practically all its tariffs at 25%[45] and undertakes some commitments on Services
1999-2003	Unilateral tariff reduction, from 11% to 6%
2001	Capital controls are eliminated

[45] Wheat, wheat flour, sugar, vegetable oils and dairy products were bound at 31.5%. The sugar bound tariff was raised in 2001 to 98%.