Chile 2002, WORTH KNOWING!

Summary: Chile's economy continues to perform better than average in relation to the rest of Latin America. GDP forecast for 2002 and 2003 is 3.1% and 6%, respectively. Credit worthiness is the highest in Latin America and continues to rise. Investment opportunities exist in the resource sector, all other export-oriented industries (wines, salmon farming, pulp and paper, fish meal, etc…) and tourism infrastructure. Government-sponsored incentives exist for investment in technology industries. Guarantees for foreign investors are among the highest in the world, as are governance and transparency standards. Commitment to free trade is solid with the lowest average tariffs in Latin America. Chile has refrained from imposing safeguards on imported steel following US imposition of safeguards for this industry. Cooperation between private and public sectors has increased with a clear agenda to be implemented. Negotiations on FTA with the US continue. Negotiations with the EU have been successfully concluded. Asia-Pacific focus is expected to regain its importance (35% of Chilean exports are destined there) after negotiations with the US conclude. Chile is a natural choice as gateway for investment and trade in the rest of South America and offers an enviable level of social and political stability. The social agenda and infrastructure development offer opportunities for foreign investors in housing, education, health, roads, port facilities and other. Government priorities focus on reducing poverty and unemployment, human resource development, and law enforcement and security.

- Chile's GDP is expected to grow at 3.1% this year with an optimistic forecast for 2003 of 6.0%. Expenditure has been below 1990's levels. Growth is the result of increased volumes of exports

-Chile's export-led economy has shown significant resilience by successfully emerging from the Asian crisis, the US recession, 09/11, and the Argentine crisis. .

-There is good reason for optimism that **the FTA's with the US will be signed in the near future.**

-An important step has been taken by **successfully concluding a FTA and political agreement with the EU.** These steps will no doubt solidify Chile's export economy:

From the Wall Street Journal, Monday, April 29, 2002

Chile, EU, Reach Trade Accord: Chile heralded a trade accord with the European Union on Friday as a model for its neighbors to follow and a sign of confidence that Chile is immune to financial and political turmoil plaguing Latin America. After three years of talks, Chile and the 15-member EU struck a political and trade deal in Brussels on Friday. The pact frees most of the US$ 7.2 billion trade between Chile and the EU, including contentious areas like fish and wine. "It is an example of the kind of free-trade agreements we will see in the 21st century," said Chile's President Ricardo Lagos

-Exports in 2002 will reach US$ 18 billion and US$ 21 billion in 2003. Copper the most important export, has seen low world prices, as have other exports commodities. Recovery of these commodity markets would significantly increase Chile's GDP.

-Investment in infrastructure has increased through public bidding projects. Upgraded port facilities in the North will be the conduit for Bolivian natural gas exports to distant destinations. Roads, irrigation projects and the construction of modern prison facilities also account for the increase in infrastructure investment.

-The **Argentine crisis, has marginally affected Chilean companies** investing in or exporting to, that country (power, supermarkets, agricultural products, etc.), but, together with other market factors, it has added downward pressures on the Peso, resulting in the steady devaluation of the latter in relation to the US dollar (P 480 = US$ 1in May 2001, P 720 = US$ 1 in November 2001). At present the exchange rate has stabilized at about P 660 = US$1, which better reflects the economic realties behind the value of the peso. The exchange rate for 2003 is expected to be P 675 = US$1. Devaluation has stimulated exports but business is mindful of the need to increase productivity and competitiveness.

Economic Forecast, Chile 2002

% Variation	Central Bank	IMF	Manufacturer's Alliance
GDP	3.3	3.0	3.1
Expenditure growth	4.1	--	.7
Inflation	3.0	3.3	3.5
Exports (US$ billion)	18.3	--	17.5
Imports	16.8	--	16.8
Trade Balance (US bill)	1.5	--	.75
Current account, %GDP	-1.0	-2.0	-1.9
Exchange rate US$	--	--	675 P/US
Copper average price/lb	.72/US	--	.68/US

Source: SOFOFA (Chilean Manufacturers" Alliance)

-Chile's sound **macro indicators remain impressive and its credit worthiness, the highest in Latin America, continues to rise**. A Treasury bond offer of US$ 800 million was priced at 116 basis points of US Treasury bond, which reflects the soundness of the Chilean economy.

-Santiago, the capital city has been chosen for several years in a row, as the best city in Latin America for business.

-Chile's private pension model has impacted positively on capital markets and continues to perform admirably (between 7-10%/year), **making it one of the best, if not the best model for pension fund development.** This model has been instituted in a number of countries in Latin America, Eastern Europe and, in a modified version, in Hong Kong. Steve Forbes, a guest of Universidad Gabriela Mistral and PBEC Chile, spoke last August before 500 business leaders and academics, praising the Chilean model and its advantages to serve as an alternative to the present US pension system.

-The important mining sector reflects the confidence foreign investors have in Chile. Noranda of Canada has established its main office in Santiago to manage the company's world copper mining operations, safe for Canada. Placer Dome of Canada, also established its Latin American center of operations in Santiago. In addition, European, North American and some Asian investors in the wine industry (through joint ventures), in banking, in the salmon and wood products, among others, confirm Chile's advantage and promise.

-Chile's trade balance has remained stable with a positive balance forecasted for 2002 at US$ 1.6 billion.

-Chile's commitment to free trade remains unchanged. A strong supporter of tariff reduction in APEC, Chile was the first economy to lower *unilaterally* its tariffs in 1974 to 11% across the board. Tariffs have been set at 7% for this year and will be lowered to 6% in 2003.

-Chile continues to pressure economic partners and international organizations to ensure that trade impediments do not distort global trade and investment flows. **This commitment has been fully endorsed by the present left-of-center governing coalition**. The concerns of the private sector in this sense have been channeled through, among others, PBEC's Anti-Dumping committee who, last October in Shanghai's MTM developed a set of specific recommendations endorsed by PBEC's Board and forwarded to the WTO and the governments of the 20 APEC economies.

-In spite of the very real danger of permanent damage to the local steel industry of the US government announced safeguards on imported steel (from 8 to 30%), Chile will not apply its own set of safeguards to imported steel. This demonstrates that, in spite of the risks, political pressures do not easily outweigh the commitment to the WTO and the strictest adherence to free trade principles.

-PBEC Chile Vice-President, Jorge Perez, representative of the Chilean steel industry, maintains that the Chilean steel industry is efficient but faces huge challenges from countries that unfairly protect and/or subsidize steel exports. Safeguards in the US and other countries may understandably buy time for local steel industries, but at the same time, seriously damage industry **in a free market as Chile's, which relies solely on competitiveness and adjustment to world markets, assuming the concept of a leveled-playing field will eventually be respected.**

-Chile has signed FTA's with Canada, Mexico, Mercosur, Colombia, Peru, Ecuador, Venezuela and the Central American Union. Negotiations are under way with Korea. Negotiations have been undertaken with Japan, India, and New Zealand, among others. Considering the 6% tariffs for 2003 and the number of FTA's Chile has signed with a number of countries, **Chile's average tariffs will probably be the lowest in the world, bordering 3.6%**

-A pro-growth agenda has been developed through extensive consultation and negotiation between PBEC Chile member, SOFOFA (Manufacturers' Alliance) and the government.

-The mutually supported **private/public agenda seeks to solve the microeconomic impediments to investment and employment in key economic sectors, and to improve the overall competitiveness of the Chilean economy.**

-The private/public cooperation is illustrative of the **new perspectives on economic development, which entails a mutually beneficial accommodation in the face of significant challenges presented by globalization.**

-This agenda, which is demonstrative of **why Chile has the enviable position of being the most stable and secure country for investment and business in Latin America,** contains proposed reforms in a number of areas:

- the regulatory environment to favor competitiveness;
- the bankruptcy law, to ensure rapid re-utilization of capital assets;
- the regulatory system in the telecommunication sector as it affects rates, conflict resolution, and transparency;
- the fisheries regulation system, to enhance species protection goals, and increase efficiency among small and large companies;
- the power generation and delivery sector, to ensure supply, control costs, and increase competition
- the development of a modern and efficient dispute mediation and settlement system that will include tax-related issues to lower costs to individual companies;
- the pollution control system in the national capital region;
- an incentive system to increase research and development activity through better utilization of local expertise, and protection of intellectual property rights through patents;
- exposure to the world of the Internet in all ambits and increase the use of electronic signature in business transactions, open up the public bidding system, and the use of payment through the Internet;
- the tax system to accommodate tax credits for reinvested profits, review the allowable amortization period of assets, eliminate the Armed forces tax exemption on imports to ensure a leveled playing field for local companies, and create incentives for investments in third countries where Chile is used as a platform;

- the development of a mature and functional risk capital market, improve competition in the capital market sector; and modernize and simplify the operations of the financial sector;
- the public sector, especially as it refers increases in efficiency in education and health, and a review of social policies to make them more effective in fighting poverty;
- the more efficient operation of the justice system;
- the development of better employment and training policies, safety net programs to protect against unemployment, and greater flexibility in labor relations;
- simplifying paper work and procedures throughout the public service and increase efficiency in turn around times, and increase the number of government services available on-line;
- improving and overhauling the entire export facilitation system.

-Ten priority areas have been identified:

1) Reform of the capital markets, increased access to credit to SME's, greater private/public cooperation for infrastructure investment;
2) Completion of FTA's with the US and the EU, and a implement an incentive program for investment in technology;
3) Reduce employment seasonality through wage subsidies and training, and the implementation of an unemployment insurance program;
4) Increased investment levels and user protection in the power generation and distribution sector, in water purification and treatment, in telecommunications and in the fisheries;
5) Simplify a list of 120 administrative government procedures, and 50 at the municipal level, and better coordination of the government's modernization agenda;
6) Implementation of reforms in the health sector;
7) Increased access and quality of post secondary education, through scholarship and student loan programs;
8) War on drugs in 88 urban districts, increased citizen protection and implementation of police prevention programs;
9) Implementation of gender and ethnic anti-discrimination policies and programs;
10) Increased access to basic housing for lower incomes sectors.

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