



Ex-ante Study of a Possible Modernisation of the EU-Chile Association Agreement

Executive Summary

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Major Changes in EU-Chile Trade Flows since the Entry into Force of the Association Agreement

1. The economic relationship between the European Union (EU) and the Republic of Chile is an important one for both partners, albeit one affected by the 2007-08 global financial crisis and economic conditions in Chile. In absolute terms, bilateral trade of all goods has grown for both parties between 2003 and 2015 (9% annual nominal rate of EU's exports to Chile and 2% of EU's imports from Chile), with a marked difference for EU's imports from Chile between 2003-2007 (24% annual nominal increase) and 2007-2015 (4% decrease). During the same period, bilateral trade in agricultural and food products has also grown (14% annual nominal rate of EU's exports to Chile and 5% of EU's imports from Chile), with a much greater increase in EU's exports between 2009-2015 than between 2003-2009 (19% versus 7% annual nominal increase) and a much lower increase in EU's imports between 2007-2015 than between 2003-2007 (2% versus 12% annual nominal increase). However, in relative terms, when compared with trade with the rest of the world, there is a clear erosion in bilateral trade since 2003 in favour of third parties. The picture for agricultural and food products is more nuanced, with Chile's exports improving in relative terms until 2009 and deteriorating thereafter, and EU's exports deteriorating until 2008 and improving since 2014.
2. In absolute terms, bilateral trade in all services has grown at a similar rate between 2004 and 2014 for both parties (7% of annual nominal rate) with a much lower increase in EU's exports between 2007-2012 than between 2004-2007 (3% versus 24% annual nominal increase) and a decrease in EU's imports between 2008-2012 (3% annual nominal decrease), which contrasts with an overall increase between 2004-2008 (18% annual nominal increase). In relative terms, EU's exports of all services to Chile and, to a lesser extent, EU's imports of all services have both improved relative to other suppliers.
3. The Association Agreement appears to have had no consistent effect on EU-Chile investment flows, and the composition of these flows into Chile has remained rather stable, with copper mining receiving approximately 45% of all inflows and financial services and retail divvying up the rest. For public procurement, Chilean firms have not benefitted particularly from the EU procurement market, with a single Chilean winner of all EU bids from 2009 to 2015. From the Chilean side, an analysis of winners of Chilean tenders from 2009 to 2016 shows a similar result, with foreign bidders making up 0.001% of all successful bids. Increased liberalisation of public procurement is not expected to alter these trends substantially, given difficulties in transportation costs and administrative discretion in Chile.

A Review of Previous Studies Shows that Chile Generally Benefits from More Open Trade

4. A review of previous studies assessing Chile's free trade agreements (FTAs) shows that Chile has largely benefited from more open trade. In general, deeper trade integration with the EU has led to gains in Chile's key macroeconomic variables (welfare, gross domestic product, consumption, and capital stock) in the range of 0.2% to 1.8%. Its gains in trade are twice as large, ranging from 1% to 3%. Wages and wage bills of unskilled labour generally increase by more than those of skilled labour, but not by more than 1%. The few studies on the effects of the EU-Chile Association Agreement for the EU point to very small effects, which reflect the small market size of Chile and the size of its trade in comparison to the EUs. In these studies, total EU trade typically grows by less than 0.1%. The EU unskilled labour wage bill declines by 0.1%, as a result of losses in unskilled labour-intensive EU sectors.

The Importance of Agricultural and Food Product Trade between the EU and Chile

5. In 2015, agricultural and food products reached 35% of the total value of EU imports from Chile, but only accounted for about 6% of the total value of EU exports to Chile. EU imports of agricultural and food products from Chile are concentrated in a few categories, such as edible fruits and nuts, beverages, and fish and seafood. In contrast, EU agricultural and food exports to Chile are more diversified, including beverages, waste from food, edible preparations, preparations of vegetables and fruits, oilseeds and oleaginous fruits and preparations of cereals. Since 2010, EU agricultural and food imports from Chile have stabilized at EUR 3.0 billion while EU agricultural and food exports to Chile have continued to grow, reaching EUR 0.5 billion in 2015.
6. Market access for Chilean agricultural and food exports to the EU has improved thanks to the Association Agreement, mainly by gradually opening import quotas and reducing barriers for about 400 tariff lines (or 17% of the total) in key agricultural and food products. There are still some 500 tariff lines (or 21% of the total) of agricultural and food products that are excluded from this gradual import liberalisation. In addition to its traditional exports, Chile has further export potential to the EU, but only under a progressive or complete liberalisation schedule for beef, pork and poultry meats, olive oil, fruit juices, and some specific dairy and fishery products. Tariff rate quotas granted by the EU that have not been fully utilized for beef and pork meats since 2013, and for poultry products and garlic since 2014, are mainly due to Chile's better opportunities and fewer uncertainties in third markets. Despite Chile's low tariffs applied to imports of agricultural and food products from the EU, market access for some specific EU's agricultural and food exports, such as exports of beef, and fresh fruits and vegetables, has been denied due to sanitary and phytosanitary-related issues and other specific requirements. The potential for EU exports to Chile are concentrated in fruits and vegetables for the Chilean off-season marketing period, as well as beef and pork meat products, in addition to current exports.

The Advantages of a Single Investment Chapter

7. A comparative examination of existing international treaties on investment signed by the EU, its Member States and Chile, in particular the bilateral international treaties (BITs) signed between individual EU Member States and Chile, leads to two major conclusions. First, the number of discrepancies among these BITs is sufficient to suggest that replacing these individual BITs with a single EU-wide comprehensive investment chapter within a modernised Association Agreement is appealing for providing similar opportunities to investors from both EU Member States in Chile and Chile in EU Member States. Second, an EU-wide investment chapter in a modernised EU-Chile Association Agreement would bring the additional advantage of extending investment protection to those two EU Member States that have signed a BIT with Chile but that is still not in force (Hungary and the Netherlands), and to those ten EU Member States that have not yet signed a BIT with Chile (Bulgaria, Cyprus, Estonia, Ireland, Latvia, Lithuania, Luxembourg, Malta, Slovakia and Slovenia).
8. The identification of EU and Chilean barriers to investment shows that these measures are few and tend to be concentrated in the sub-sectors of transport, culture, audio-visual, and communications.

Room for Improvement in Public Procurement

9. Although Chile is not a member but an observer of the Agreement on Government Procurement (GPA) of the World Trade Organisation, the 2002 EU-Chile Association Agreement applies the complete 1994 GPA framework to the procurement practices of the two parties for issues such as coverage, national

treatment, transparency, contract award procedures, contract award criteria, technical specifications, regulatory safeguards, bid challenges, and technical cooperation.

10. However, comparing the legal frameworks of the existing EU-Chile Association Agreement with more recent agreements concluded separately by the EU and Chile shows that some market access, regulatory, language and information barriers to public procurement still exist. On the one hand, Chile could improve the procurement for public works and the access to the legal framework, guidelines, procurement statistics, case law and other related documents by using other languages than Spanish. It also could ease restrictions in the qualification of suppliers that presently affect their access to the public procurement market. On the other hand, the EU could clarify important developments of the Court of Justice of the European Union (CJEU) case law with respect to public procurement, notably with respect to land development agreements, in such a way that they can be understood by third parties, and further promote a greater use of its advanced online procurement system (TED), which will be mandatory to all contracting authorities by October 2018. In a modernisation of the EU-Chile Association Agreement, both parties could also aim to achieve a more comprehensive coverage of procurement from state-owned enterprises and entities with special or exclusive rights.

The Costs and Benefits of Reducing Trade Barriers in Goods, Services, Investment and Procurement

11. According to the computable general equilibrium (CGE) simulation results provided by DG Trade for trade liberalisation in goods and services, percentage gains in gross domestic product are 0.001% in a conservative scenario and 0.002% in an ambitious one for the EU, and 0.09% and 0.175% for Chile in the two respective scenarios, by 2025. The growth in total exports respectively amounts to 0.011% and 0.024% for the EU, and 0.151% and 0.209% for Chile, while growth in bilateral exports amounts respectively to 9.91% and 21.46% for the EU, and 0.72% and 1.60% for Chile, in 2025. The largest increases in the EU's exports to Chile are generally found in the trade of goods belonging to the manufactured sub-sectors, whereas the largest increases in Chile's exports to the EU are found in the agricultural and food sub-sectors. Within the agricultural and food sub-sectors, the largest increases in Chile's exports are found in dairy products, followed by oilseeds, vegetable oils and fats.
12. In terms of investment flows, the existing literature uniformly finds a positive effect of investment clauses or investment treaties on foreign direct investment (FDI). Based on previous empirical research, a modernisation of the Association Agreement could generate an approximate increase of 25% in European FDI inflows to Chile in the following years. However, this number is tempered by the fact that the size of the Chilean market is small and the largest EU economies have already been linked to Chile via investment protection treaties for the past twenty years. In contrast, a modernisation of the Association Agreement could lead to a modest increase of approximately 2% or 3% in FDI inflows to the EU from Chile. If the modernisation of the Association Agreement could result in more certainty in investor dispute mechanisms and in the investment climate, it is possible that gains to Chile could result in a doubling of Chilean FDI into the EU.
13. Quantitative evidence on the effects of liberalising public procurement to foreign bidders under a trade agreement, either on overall volumes of procurement or on welfare, is scarce. Given this lack of empirical evidence, it is more instructive to examine sub-sectors where the EU and Chilean firms may benefit from opportunities in a modernisation of the Association Agreement. The health sub-sector, especially medical equipment and consulting services, may remain a potential source of contracting for EU firms, with the advantage that tenders for such procurement may be available to small- and medium-sized suppliers. Public procurements for equipment, infrastructure, and associated services may prove

to be an opportunity for EU firms. A high demand in Chile for consulting and professional services will also continue to be an area where EU firms may have a decided comparative advantage.

Employment and Labour Market in the EU and Chile Expected to see Limited Impacts

14. Overall, the CGE simulation results show very small changes in the Chilean labour market, and negligible changes in the case of the EU, as a result of an expanded Agreement. A limited regressive decrease in the purchasing power of household income is predicted in Chile, while a progressive, albeit negligible, decrease is predicted for the case of the EU. As for labour income in Chile, real wages increase on average in the two alternative scenarios between 0.35% in the conservative scenario and 0.61% in the ambitious scenario for unskilled workers and between 0.19% and 0.37% for skilled workers. This positive effect in both scenarios is also pro-gender. Among sub-sectors the pro-gender bias of the modernisation of the Agreement is particularly noticeable, as in almost all sectors the increases for unskilled workers are higher for women than for men. In the case of the EU, the effects are close to zero, with a slight pro-skill bias and gender neutral effects. As for inequality, there are no changes in the EU and a slight increase in the share of income captured by the highest quintile in Chile.

Increased Opportunities for Small and Medium Enterprises in both the EU and Chile

15. Empirical research shows that SMEs with greater participation in international markets tend to report higher turnover and growth, and are more productive than their counterparts; these same SMEs are likely to be most affected by the modernisation of the Agreement. In the EU, there is large SME participation in total employment in the sub-sectors that are forecasted to expand by the CGE simulation scenarios although, the impact of the modernisation is expected to be negligible. In Chile, the three sub-sectors with the highest increase in export values (fruits, vegetables, and nuts, beverages and tobacco, and other food products) are also the sub-sectors with the highest participation of SMEs in 2014 Chilean exports to the EU. Additionally, it is also important to note that a moderate export increase is also predicted in the ambitious scenario for recreational and other services, a sector that alone accounts for half of the number of SMEs existing in the country, and whose internationalization the Chilean government has tried to incentivize in recent years. This points to an important opportunity to increase Chilean SME exports to the EU brought about by the modernisation of the Association Agreement.

Consumer Welfare Should Increase in the EU and Chile, but Some Groups Could Remain Vulnerable

16. In each scenario of the CGE simulation results provided by DG Trade, both conservative and ambitious, overall aggregate consumption is expected to increase substantially for both the EU and Chile over the long term. Further, overall changes in aggregate consumer economic welfare could increase by more than EUR 268 million, over the long term, in both the EU and Chile. In large part, these results are due to overall changes in consumer prices and labour incomes, but does not consider less quantifiable factors, such as a greater choice of quality products. Nonetheless, there are cultural and socio-economic differences between the EU and Chile that could result in some segments of society being more negatively affected than some others by the modernisation of the EU-Chile Association Agreement, such as low-income earners and young single parents.

The Modernisation of the EU-Chile Association Agreement Could Create New Trade Patterns for Rest of the World

17. In addition to enhanced trade and investment relations between the EU and Chile, the modernisation of the EU-Chile Association Agreement could also carry implications for economic interactions with the

rest of the world. This includes the changes in trade dynamics between the EU and Chile with third countries as well as those between third countries themselves. The shape of these new trade patterns is mainly influenced by current trade agreements signed by the EU and Chile with other third parties, current trade agreements among third countries themselves, and the current composition of trade between both the EU and Chile with third countries. Overall, the EU and Chile's top trading partners (e.g., China, the United States, and Japan) are expected to be among the most affected by the modernisation of the EU-Chile Association Agreement.

There is Potential for the Modernisation of the Association Agreement to Reinforce Labour Standards

18. Quantitative and qualitative studies have suggested that increasing trade volumes can be associated with the weakening of labour rights, especially in developing countries, but that the adoption of trade-based labour clauses has helped in some cases to mitigate erosion of labour protection. Studies also show that positive externalities for labour can arise from their inclusion. Following the pattern established by the “new generation” of EU agreements, this would mark an improvement over the existing Agreement.

Limited Environmental Impacts are Expected, but Greater Cooperation Opportunities Could Arise

19. The environmental effects of the changes in trade and sectoral composition in the conservative and ambitious scenarios are likely to be limited in the EU and Chile. Without mitigating action, CO₂ emissions are likely to increase somewhat in both regions due to scale and technical effects, as well as a projected increase in transportation. While policies to mitigate CO₂ emissions in the EU are well-developed, Chile's policy framework is still under development. Estimates indicate that increases in CO₂ emissions related to international transport are likely to be more important than those due to domestic emissions. Other environmental issues that may require attention are potential increased pressures on water, land and related impacts on biodiversity that may be associated with the projected expansion of Chile's agricultural sector linked to increased export opportunities in both scenarios.
20. The modernisation of the EU-Chile Association Agreement also offers opportunities for the EU and Chile to strengthen their cooperation on technical and policy cooperation in key environmental areas, including CO₂ emissions in international transport, the conservation of biodiversity under the Convention of Biological Diversity, and sustainable production and consumption (where deeper trade integration may help stimulating the adoption of greener technologies). In the past decade, European companies have already become major investors in renewable energy projects in Chile. A comprehensive investment chapter could harness this trend. Other areas where increased cooperation could prove beneficial would include energy efficiency, efficiency in irrigation/water distribution, and efficiency in the application of fertilisers and pesticides. While not strictly speaking an environmental issue, the modernised Agreement would also provide opportunities to improve animal welfare in Chile.

Studies Show that Increased Trade Could Positively Affect Human Rights Protection

21. The few studies that directly examine the effects of trade on human rights conclude that trade can generally have a positive effect on human rights practices, such as lower measures of state repression of human rights and greater respect for civil liberties. In particular, an increase in exports can be associated with a lower level of human rights abuses. Studies also show that one third of states improve their practices in preparation for signing a free trade agreement with the EU, and states that belong to FTAs with enforceable standards are more likely to improve their human rights practices over time than states that do not belong to agreements with social clauses. In sum, both quantitative and qualitative studies show tendencies for an overall positive relationship between trade and human rights protections.

However, Increased Trade Could also Increase the Risk of Exacerbating Some Human Rights Issues

22. Among the current human rights issues in Chile - use of force by police, gender discrimination, the rights and recognition of indigenous peoples, and the rights of sexual minorities - all but two are essentially questions of domestic legislation with no linkage to international trade. Both gender discrimination and the rights and recognition of indigenous peoples are two areas where the intensification of trade and investment with the EU through a modernised Association Agreement could increase the risk of impacting human rights panorama, at least at the margins. Specifically in relation to gender discrimination, the major issue at hand is the equal participation of women in the workforce, and a significant gap in equality of opportunity between men and women, which in turn has an important effect on wage inequality. That said, despite disparities in contracting and utilisation in seasonal employment across genders, the impact of trade on gender inequality would be minimal, and it could also be monitored through labour cooperation mechanisms. As for the rights of indigenous peoples, the impact of the modernised Agreement is likely to be minimal and so is not expected to exacerbate land conflicts.

Chile has made Progress in Complying with Human Rights Standards

Chile has signed and ratified sixteen of eighteen international human rights treaties of the United Nations (UN) and has participated in the Universal Periodic Review by the Human Rights Council of the UN in 2009. The latest of these reviews commend Chile for the work the government continues to do in addressing the human rights violations of past governments, while also recognizing ongoing challenges, such as the rights of women, sexual minorities and indigenous peoples. In terms of labour rights protection, Chile has ratified the core conventions that make up the International Labour Organisation's 1998 Declaration on Fundamental Principles and Rights at Work, but still faces issues in consistently implementing them in domestic labour law and practices. Discrimination against women at the workplace is also still widespread, and in some cases backed by law. Continued engagement by Chile on promotion and protection of human rights in these areas would further minimize any potential risk of negative impacts on human rights from increased trade.

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