

STUDY REPORT ON THE JAPAN-CHILE FREE TRADE AGREEMENT

JUNE, 2001

JAPAN-CHILE FREE TRADE AGREEMENT
STUDY GROUP

JAPAN EXTERNAL TRADE ORGANIZATION (JETRO)

FOREWORD

This report brings together the views of the members of the Japan-Chile Free Trade Agreement Study Group set up by the Japan External Trade Organization (JETRO).

When the then Chilean Minister of Foreign Affairs, Juan Gabriel Valdes, visited Japan in November 1999, he proposed to the Chairman of JETRO that a joint study be made for a free trade agreement (FTA) between the two countries. In response to this proposal and a subsequent request by the then Undersecretary for International Economic Relations of the Ministry of Foreign Affairs, Alejandra Jara, in February 2000, JETRO established the Japan-Chile Free Trade Agreement Study Group in May 2000. In Chile, a study group was established in May the same year by the Ministry of Foreign Affairs' General Directorate of International Economic Affairs (DIRECON).

The Japan-Chile Free Trade Agreement Study Group was comprised of academics and leading figures from industry, and met on eight occasions. The issues discussed at these meetings included the current situation of trade and investment between Japan and Chile, economic liberalization and international trade policy in Chile, the potential for investment in Chile, the expansion of trade, investment and services as a result of a Japan-Chile FTA, the conformity of an FTA with the General Agreement of Tariffs and Trade (GATT) and World Trade Organization (WTO), the impacts of a Japan-Chile FTA on domestic industry, users and consumers, matters other than market access expected to be incorporated into a Japan-Chile FTA such as trade in services, intellectual property rights, competition policies, government procurement practices and dispute settlement, and the overall assessment of a Japan-Chile FTA. The conclusion of the report is that an FTA between Japan and Chile would provide an effective means of further strengthening economic relations between the two countries, and that maximum efforts should be made to conclude a Japan-Chile FTA as soon as possible.

A variety of views were expressed by the members of the study group, details of which are given separately in "Materials of the Japan-Chile Free Trade Agreement Study Group : Members' Reports."

A final point worth mentioning is that in addition to twice inviting non-member speakers, the study group also had representatives of government and business organizations present at meetings as observers.

Shintaro Oishi
Chairman
The Japan-Chile Free Trade Agreement Study Group

**Members of the Japan-Chile
Free Trade Agreement Study Group**

1. Members

Chairman

SHINTARO OISHI Senior Executive Director
Japan Design Foundation
(Former Executive Vice President of JETRO)

Vice Chairman

AKIO HOSONO Professor
Research Institute of Economics and Business
Kobe University

Members

SHIGEO OBARA Managing Director
Mitsubishi Research Institute, Inc.

MITSUHIRO KAGAMI Exective Vice President
Institute of Developing Economies(IDE)
JETRO

MICHIO KAMENO Vice Chairman
Customs Duty Committee
Japan Mining Industry Association

MASAYUKI KAWASHIMA Special Coordinator for Latin America
Planning and Coordination Department
JETRO
(Note:succeeded Masaru Inoue,former Special
Coordinator for Latin America,on 30 June,2000)

FUKUNARI KIMURA Professor
Faculty of Economics
Keio University

KAZUO SATO Counselor
Mitsui & Co.,Ltd.

TSUYOSHI TAKAHASHI Representative
Inter-American Development Bank
Office in Japan

SHINJI HATTORI Professor
Faculty of Economics
Toyo University

KOJI WANAKA Deputy General Manager
Government and Industrial Affairs
Honda Motor Co.,Ltd.

2. Non-Member Lecturers

TAKAO SUAMI(5th meeting) Professor
Faculty of Law
Waseda University

SATORU TAIRA(8th meeting) Professor
Faculty of Law
Osaka City University

3. Observers

Ministry of Economy, Trade and Industry

TETSUHIRO HOSONO (Director, Trade Policy Division,
Trade Policy Bureau)

(Note:succeeded Toshio Matsunaga,former Director of Genaral Affairs
Division and Trade Policy Plannning Office,International Trade Policy
Bureau, on July 14,2000)

MOTOHISA SUZUKI (Director, Latin America and Caribbean Office,
Trade Policy Bureau)

KAORU HONJYO (Director, Mineral and Natural Resources Division,
Natural Resouces and Fuel Department,
Agency for Natural Resources and Energy)

(Note:succeeded Keiichi Goto,former Director of Mining Division,
Agency for Natural Resources and Energyon September 19,2000)

Ministry of Foreign Affairs

NORITERU FUKUSHIMA (Director, First Latin America and Caribbean
Division, Latin America and Caribbean
Affairs Bureau)

Ministry of Finance

KUNIO MIKURIYA (Director, Research Division,
Customs and Tariff Bureau)

Ministry of Agriculture, Forestry and Fisheries

TORU TAKAHASHI (Director, International Trade Policy Coordination
Division, General Food Policy Bureau)

Japan Federation of Economic Organization

SATOSHI MUKUTA (Manager, Trade & Investment Policy Group,
International Economic Affairs Bureau)

The Japan Chamber of Commerce & Industry

KAZUO SHIROZA (Deputy General Manager, International Division)

4. Secretariat

Overseas Research Department, JETRO

CONTENTS

1. Intensifying discussion on free trade agreements
2. Chile's importance as Japan's partner in an FTA
 - (1) The "Chilean model" of economic development with higher foresight
 - (2) Free and open trade policies
 - (3) IT Leader in Latin America
 - (4) Business partner across the Pacific
3. Current situation of trade and investment between Japan and Chile
 - (1) Trade between Japan and Chile
 - (2) Current situation of foreign direct investment between Japan and Chile
 - (3) Trade in services
4. Effects and impacts expected from an FTA between Japan and Chile
 - (1) Analysis based on an econometric model
 - (2) Effects on major products among Japan's exports to Chile
 - (3) Effects and impacts of increased imports from Chile to Japan
 - (4) Promoting investment
 - (5) Expanding trade in services
5. Wanted a comprehensive FTA
 - (1) Trade in goods
 - (2) Trade in services
 - (3) Investment
 - (4) Intellectual property rights
 - (5) Governmental procurement practices
 - (6) Competition policies
 - (7) Anti-dumping measures
 - (8) Standards and certification
 - (9) Electronic commerce
 - (10) Dispute settlement
6. Measures to achieve closer economic relations other than an FTA
 - (1) Venues for international dialogues
 - (2) Improvement of basic infrastructure related to economic activity
 - (3) Inter-industry partnerships
 - (4) Promoting mutual understanding
 - (5) Expanded grassroots interaction
 - (6) Free movement of people
 - (7) Activities to promote trade and investment
7. Conclusion : A comprehensive FTA should be concluded as soon as possible

1. Intensifying discussion on free trade agreements

In recent years, discussion on the subject of free trade agreements (FTAs) has intensified in Japan. The following four factors have contributed to the upsurge of interest in FTAs:

(a) Among all the regional trade agreements in the world that have been notified to the World Trade Organization (WTO), some 120 are already in force. Of the world's 30 largest economies, only three countries and one area, namely Japan, People's Republic of China (including Hong Kong), Republic of Korea, and Taiwan, have not concluded some type of regional trade agreement.

(b) It has been increasingly acknowledged that FTAs do not contradict the WTO framework based as it is on multilateralism, but actually complement that framework.

(c) In some cases, FTAs have been able to work out rules that govern international business even when such rule making has been rather difficult in the sphere of WTO. This perception has promoted the view that such agreements can help raise the WTO obligations to a higher level (GATT/WTO-Plus).

(d) Disadvantages and foregone economic losses that may derive from not participating in FTAs have become increasingly apparent to Japan. These potential disadvantages and demerits are apparent in Japanese business in Mexico that, who is a party to free trade agreements with the United States and Canada (North America Free Trade Agreement) and also with the European Union.

In light of these factors, some significant steps have been taken to promote FTAs in Japan. Japan External Trade Organization (JETRO) published the findings of the Committee for Closer Economic Relations between Japan and Mexico in April 2000. The following month, the Institute of Developing Economies-JETRO released the findings of the 21st Century Japan-Korea Economic Relations Study Team. Both sets of findings strongly supported FTAs. In July 2000 the Japan Federation of Economic Organizations (Keidanren), a private-sector group, issued its own proposal, an "Urgent Call for Active Promotion of Free Trade Agreements." In September 2000 a joint study group, established by the governments of Japan and Singapore to look into the prospects for an FTA, released its report. The following month the heads of the two countries agreed to begin negotiations aimed at establishing a "Japan-Singapore Economic Agreement for a New Age Partnership." These negotiations are now underway.

Other countries, including Australia and Canada, have also expressed an interest in creating new frameworks for economic relations with Japan.

2. Chile's importance as Japan's partner in an FTA

As an FTA partner of Japan, Chile has the following excellent credentials among Latin American countries:

(1) The "Chilean model" of economic development with higher foresight

Chile was among the first countries in the Latin American region to implement and/or adopt economic policies based on competition and market principles, creating an economic system that has come to be known as the "Chilean model." Specifically, Chile's domestic economic policies have focused on macroeconomic reforms, fiscal stability, the overhauling of the national pension fund system, privatization of state-owned enterprises, capital market reforms, and the revision of labor laws. Efforts have also been made to reduce government intervention in economic activity, increase the saving rate, and strengthen the competitiveness of domestic industry. As a result of these measures and efforts, Chile's industrial base has been rapidly restructured; its mining, forestry, and fishery sectors, among others, have been more competitive; and new efforts are being made to promote other competitive industries, electric power generation and distribution and wine industries, as illustrative cases.

By concluding an FTA with Chile, Japan will be able to apply the lessons of Chile's economic reforms to the ongoing structural reforms in Japan.

(2) Free and open trade policies

The government of Chile has simultaneously promoted free trade via three different routes—unilateral, bilateral, and multilateral. Unilaterally, Chile has taken steps to reduce its import tariffs. The government of Chile employs a uniform tariff rate, whereby the same percentage is assessed on all the products. Since 1999, that rate has been declining by one percentage point per year. The current tariff rate stands at 8%; it will decrease to 6% in 2003. Because of multiple FTAs and regional preferences that the country enjoys, its actual average tariff rate is 5.5%—2.5 percentage points lower than the current uniform rate. By contrast, the WTO's "bound" tariff rate, for products other than wheat, flour, cooking oil, dairy products, and sugar (for which the rate is 31.5%), is a uniform 25%.

The government of Chile, advocating multilateralism as the principle for trade liberalization, regards the WTO framework as the working principle for free trade and has strongly committed itself to that framework. Chile is one of the few developing countries to pledge unwavering support to the WTO's General Agreement on Trade in Services (GATS) and Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Chile has also concluded free trade agreements with 16 countries (agreements with 11 of these already in

effect, and an agreement with five Central American countries pending for approval). The country proclaims that bilateral trade liberalization is a process that is complementary to multilateral efforts.

Chile has constructed a network of FTAs covering virtually the whole of Latin America. Its agreement with Mexico is a wide-ranging, NAFTA-style pact, while Chile and Mexico are the only two countries in Latin America to have concluded this type of agreement. Chile has also entered into a NAFTA-style free trade agreement with Canada. In early December 2000 Chile began negotiations on a bilateral free trade agreement with the United States, which is also basically envisioned as a NAFTA-style pact. Since the proposed agreement is intended to incorporate rules governing electronic commerce, it would actually extend beyond NAFTA's domain.

Chile's FTA network is expanding beyond the Americas (Western Hemisphere). In April 2000 Chile began negotiations on an FTA with the European Union, and similar negotiations are underway with the Republic of Korea. Efforts are also made to work out free trade agreements with the European Free Trade Association (EFTA), as well as with countries such as New Zealand, Australia, and Singapore. Chile, along with Mexico, is an hub for free trade agreements in the Americas, and is poised to solidify its position as a hub for free trade agreements on the Pacific rim.

By pursuing free and open trade policies, Chile has developed economic and industrial structures that are highly accessible to world markets and are highly export-oriented. By building on a foundation of open economic structures, Chile is aiming to become the Singapore of Latin America. When measured as percentages of total imports and exports in gross domestic product (GDP), the openness of Chilean economy becomes clear: Chile's total imports amount to 24.6% of its GDP, which is about 2.5 times higher than the comparable figures for Argentina, Brazil and Peru. Chile's total exports, meanwhile, account for 27.2 % of GDP--nearly three times higher than the figures for the other three countries.

(3) IT Leader in Latin America

At present, although there are significant disparities in diffusion rates of information technology (IT) between Latin America and the developed nations, Chile stands out from the other Latin American nations in this regard. For example, according to data collected by the International Telecommunication Union (ITU), as of December 1999 there were 6.66 personal computers, 15.05 cellular telephones, and 4.16 Internet users for every 100 habitants in Chile. Among the 17 major Latin American countries with a population of at least 5 million, Chile ranks at the top in each of these categories.

IT connectivity: Personal computers, cellular telephones,
and Internet users in major Latin American countries

	Number of computers	Number of Internet users	Number of cellular telephones
Chile	6.66	4.16	15.05
Argentina	4.92	2.46	12.12
Brazil	3.63	2.08	8.95
Mexico	4.42	2.57	7.94

Note: The figures shown are per 100 habitants.

Source: International Telecommunication Union (ITU)

Chile is also home to IT-related businesses, including one of Latin America's top software makers, which exports banking software and other products to the rest of the region. This firm has developed a software for pension fund system and is rapidly building on its successes. Meanwhile, the administration of President Ricardo Lagos is actively promoting the realization of a "digital" economy.

(4) Business partner across the Pacific

Chile is a trading nation that faces Japan across the Pacific Ocean. Chile regards Japan as a base for gaining access to the markets of Asia; Japan regards Chile as one of the gateways to Latin America. Chile, the first South American country to join the Asia-Pacific Economic Cooperation (APEC), is scheduled to serve as the forum's chair for its Ministerial meeting in 2004.

According to a report published in 2000 by the Institute for Development Management, Chile ranks 26th in the world in competitiveness, just below Malaysia and higher than any other country in Latin America, including Brazil (34th) and Mexico (36th). Japan's ranking was 17th. Chile has a law-abiding citizenry and respects global standards. From Japan's point of view, the Chilean national character is a key factor what makes Chileans an excellent business partner.

3. Current situation of trade and investment between Japan and Chile

(1) Trade between Japan and Chile

Trade between Japan and Chile is complementary, with Japan exporting industrial products and importing mining, agricultural, forestry, and marine products. The trade balance is strongly in Chile's favor: Japan continually imports more than it exports. The only countries in Latin America that register a trade surplus with Japan are Chile and Brazil, and of the two, trade balance is much more favorable for Chile.

Chile is Latin America's second largest exporter of goods to Japan. Japan, in turn, is the second largest importer of Chilean goods, after the United States.

(a) Japan's exports to and imports from Chile

Japan's exports to Chile in 1999 totaled US\$ 549 million, a 39.1% decline from the previous year, while imports from Chile for 1999 amounted to US\$2.51 billion, an increase of 5.3% over the previous year. The total combined value of imports and exports peaked US\$ 4.10 billion in 1995, when imports from Chile totaled a record of \$3.19 billion. Exports to Chile reached a peak of \$1.07 billion in 1997. Over the years, Japan has continually recorded a trade deficit with Chile. During the five years from 1995 to 1999 the value of imports from Chile was an average 3.26 times greater than that of exports to Chile.

Japan's exports to and imports from Chile (unit: US\$ million)

Year	Exports (FOB)	% increase/decrease	Imports (CIF)	% increase/decrease	Balance
1994	936	16.9	2,161	19.1	-1,225
1995	915	-2.3	3,188	47.5	-2,273
1996	843	-7.8	2,781	-12.8	-1,938
1997	1,066	26.4	2,989	7.5	-1,923
1998	901	-15.5	2,382	-20.3	-1,481
1999	549	-39.1	2,508	5.3	-1,959

Source: Ministry of Finance. Prepared by JETRO

(b) Exports and imports by sector

Japan's exports to Chile in 1999 covered various sectors, the most important being transportation equipment, which accounted for 55.8% of all Japan's exports to Chile that year. Among the other sectors, general machinery accounted for 11.7%, electrical machinery for 8.5%, and tire inner tubes for 8.2% of all exports. Japan's imports from Chile were dominated by mining products, with non-ferrous metals comprising 34.7% of all imports from Chile for 1999. Among other sectors, marine products accounted for 26.0%, wood products for 8.9%, and semi-manufactured copper for 7.1%.

While Chile is Japan's 11th largest source for imports of agricultural, forestry, and fishery products, it only provides 2.1% of all such imports. Nevertheless, Chile is an important supplier of a number of specific food products: Chile is Japan's second largest source of imported frozen Pacific salmon, its second largest source of frozen trout, its largest source of grapes, and its largest source of fish meal. Chile is also an important source of mining products to Japan—its largest source of copper ore and molybdenum ore and its third largest source of iron pellets. In the area of wood products, Chile is Japan's third largest supplier of wood chips and its fourth largest supplier of pulp and recycled paper.

Chile is also Japan's top supplier of copper ingots as classified within the category of metal products.

(c) Chile's ranking in terms of exports to and imports from Japan

Within Japan's overall imports and exports, Chile ranks 49th accounting for a 0.1% share of all Japanese exports in 1999. As a supplier of imports, however, Chile ranks 25th, with a 0.8% share. Although Chile's share of trade with Japan is relatively small with respect to the rest of the world, it accounts for 2.8% of Japan's exports, making Chile the sixth largest recipient of Japanese exports among Latin American countries, after Panama, Mexico, Brazil, Puerto Rico, and Argentina. As a supplier of imports, Chile ranks second in the region behind Brazil, with a 26.0% share. Thus, Chile is one of Japan's vital trading partners in Latin America.

(d) Japan's ranking in terms of exports to and imports from Chile

Within Chile's overall imports and exports, Japan is second only to the United States, with a 14.4% share of all Chilean exports in 1999. As a supplier of imports, Japan ranks fifth, with a 4.2% share, behind the United States, Argentina, Brazil, and China.

(2) Current situation of foreign direct investment between Japan and Chile

(a) Japan ranks seventh in foreign direct investment in Chile

The total accumulated foreign direct investment (FDI) in Chile (based on disbursement), from 1974 through 1999, undertaken in accordance with the law governing foreign direct investment (Parliament Ordinance 600), reached US \$40.837 billion. FDI from Japan accounted for US\$ 1.378 billion, or 3.4% of this total, the seventh highest share.

The largest amount of direct investment in Chile from Japan—US\$1.031 billion, or 74.8% of the total—was directed to the mining sector, followed by manufacturing, which totaled \$185.29 million, and services industries, which amounted to \$115.46 million.

FDI in Chile in accordance with the Parliament Ordinance 600
(based on disbursement) (unit: \$1,000)

Sector	Investment from Japan	Share of total	Total foreign investment	Japan's share
Agriculture	4,051	0.3%	226,046	1.8%
Construction	1,000	0.1%	929,236	0.1%
Electricity, gas, water systems	0	0.0%	6,905,327	0.0%
Manufacturing	185,294	13.4%	5,583,494	3.3%
Mining	1,031,258	74.8%	14,875,420	6.9%

Marine industries	7,858	0.6%	171,738	1.2%
Service industries	115,457	8.4%	9,757,806	1.2%
Timber	28,355	2.0%	238,327	11.9%
Transport and communications	4,946	0.4%	2,149,940	0.2%
Totals	1,378,222	100.0%	40,837,334	3.4%

Source: Chile Foreign Investment Committee

(b) Major investment projects in Chile by Japanese enterprises

Among major investment projects in Chile by Japanese businesses is one in which copper smelters and trading firms have formed a group to engage in capital participation in five large-scale copper mines, including La Escondida. In other major projects, a trading company has established an investment firm in Chile and invested in an iron mine developed by the CAP group, a Chilean conglomerate. In the forestry sector, paper producers and trading firms have formed groups, established three local corporations, and are operating a plantation business. In the marine industry, a fishing firm operates trawlers, cultivates and processes salmon and trout, and purchases marine products. In the area of automobile sales, Japanese firms have set up four local distributorships in Chile. In the financial services sector, a Japanese bank has opened a local office in Chile.

(c) Investment in Japan by Chilean enterprises

To date, investment in Japan by Chilean businesses has been limited to the establishment of representative offices in Japan.

(3) Trade in services

(a) Size of trade in services of the two countries

According to the IMF, Japan's export trade in services in 1998 amounted to US \$62.4 billion, while its imports in services for the year totaled US \$111.8 billion. Japan's exports of services accounted for slightly over 5% of the world total, while its imports of services represented a little less than 10% of the world total.

Chile's exports in services for 1998 amounted to \$4.1 billion, while its imports in services totaled \$4.2 billion, each accounting for approximately 0.3% of the respective world total.

(b) Trade in services between Japan and other Latin American countries except Brazil and Mexico

The only statistics available on Japan's bilateral trade in services with countries in Latin America are those with Brazil and Mexico. The data with Chile is lumped together with "other Latin American countries," that excludes Brazil and Mexico.

Japan's services exports to "other Latin American countries" in 1999 totaled ¥329.3 billion, or 4.8% of the total for exports in services to the entire world. Japan's imports in services from "other Latin American countries" for the same year totaled ¥775.6 billion, or 5.9% of all imports in services from the entire world. A breakdown of all exports in services in 1999 reveals that exports in the transportation sector accounted for the largest share (7.2%) of the total--of which 11.0% was accounted for by marine transport-related exports--followed by exports in the construction (6.8%) and financial services (5.8%) sectors. A breakdown of imports in services for the year indicates that the transportation sector represented the largest share (19.0%) of the total, of which marine transport-related imports accounting for 30.0%. The significant position of transport-related services in both imports and exports seems to apply to trade in services between Japan and Chile.

(c) Trade in services between Chile and Japan

Since trade in services occupies a relatively low priority for both Japan and Chile, it is likely that trade in services between the two will continue to play a limited role for both. Japan's exports in services to and imports in services from Brazil account for a mere 0.68% and 0.36% of the respective totals, while exports in services to and imports in services from Mexico account for 0.61% and 0.26% of the respective totals. Chile's share of services exports of the United States is 0.56%, while its share of US services imports is 0.50%.

4. Effects and impacts expected from an FTA between Japan and Chile

(1) Analysis based on an econometric model

(a) Expansion of trade resulting from the abolition of tariffs (static effects)

According to the econometric model (see note) that calculates the degree of trade creation due to an immediate elimination of tariffs, Japan's exports to Chile would increase by 58.7% and imports from Chile by 10.6%. The net result would reduce Japan's trade deficit with Chile by 12.3%.

Japan's exports would be expected to increase in each sector, with exports of transportation equipment rising by 61.8% and exports of electronic products increasing by 84.5%. Because import tariff rates are already relatively low, among Japan's imports from Chile, mining products would only increase by 0.1%, with timber and wood products also increasing by 0.1% and metals and

metal products increasing by 3.0%. On the high end, imports of fruits and vegetables would rise by 45.2%, imports of fish by 34.4%, and imports of food, drink, and tobacco by 33.6%.

(b) Projected trade-creation with higher productivity incorporated (dynamic effects)

In view of dynamic effects that the conclusion of an FTA between Japan and Chile is expected to produce, under the assumption that Chile's productivity in all sectors other than services will increase by 10%, and that other conditions are kept unchanged from calculations for static effects as set forth in(a) above, the estimate suggests that exports from Japan to Chile would increase 34.7% and imports from Chile by 33.1%. This in turn would cause Japan's trade deficit with Chile to increase 32.4%. The total value of Chile's exports would increase 26.4%, while the total value of its imports would decrease 7.4%, leading to an enormous 2,454% projected increase in Chile's trade surplus.

Note: The econometric model applied in both (a) and (b) above employs 1995 as the base year and is based on the premises of perfect competition (maximized profits, maximized utility), perfect capital mobility (balanced current-accounts), and numeraire for capital costs. A database created by Purdue University has been used to calculate tariffs, with numeric values included to account for import quota, anti-dumping duties, and non-tariff barriers. Chile's tariff rate is about 11% for virtually anything outside the service sector, while Japan's rates are 8.81% for vegetables, fruit, and nuts, 6.96% for fish, 4.65% for prepared food, drinks, and tobacco, 0.01% for mining products, and 0.02% for timber and wood products.

(2) Effects on major products among Japan's exports to Chile

The effects of a Japan- Chile FTA on Japan's exports to Chile can be interpreted as the removal of disadvantages caused by the absence of such an agreement. Specifically, the disadvantages to Japan's exports of automobiles, super-sized tires, audio and video equipment, and industrial and plant businesses would be either totally or partially erased by the conclusion of an FTA. Moreover, as noted above, in the event that no such agreement is concluded, a uniform 8% import tariff will be applied to these products in 2001.

(a) Automobiles

Japanese-brand autos accounted for 37.6% of all car sales in Chile in 1999, while South Korean-brand cars represented a 30.7% share. Because Japanese cars must compete with more competitively priced Korean cars, Japan's auto exports to Chile are expected to dramatically decline in the future, once Chile concludes an FTA with the Republic of Korea. In the opinions of general

manager of a local Japan-based distributor, Japan's market share, which currently exceeds 30% including even commercial vehicles, can be expected to fall to less than 10%. Should that happen, it will have a severe impact on automobile-related financial and service businesses, including those Japanese firms in Chile that provide parts.

(b) Super-sized tires

Chile, the largest copper-producing nation in the world, hosts numerous giant mines. One Japanese tire maker and one tire maker in Europe supply the super-sized tires with which the huge dump trucks that work Chile's giant mines are equipped. The two companies are in competition, and each commands approximately 50% of the market. In the event that Chile succeeds in concluding an FTA with the European Union, Japanese-made tires will be placed at a clear disadvantage, since they will continue to be subjected to import tariffs while European-made tires will not, and the Japanese maker will certainly have to forfeit its market share. In addition, since the Japanese maker produces super-sized tires at only one factory in Japan, it would not be able to shift production to a site in another country with which Chile has an FTA.

(c) Audio and visual device equipment

Because Chile's market favors lower-priced goods, Japanese manufacturers have had a difficult time securing a reasonable market share for the high-quality audio and visual device products produced in Japan. In Chile, Japanese manufacturers sell products primarily made in Asia, the United States, and Mexico, and they are currently struggling to maintain market shares. It is feared that, after Chile concludes an FTA with the Republic of Korea, the market will be largely taken over by Korean products, which will be more competitively priced. In addition, in the event that Chile succeeds in concluding an FTA with the European Union, products from Europe can also be expected to enter the market.

(d) Industrial plants

Japanese firms have posted positive results in Chile with sulfuric acid plants and electric power plants. But if Chile should conclude an FTA with the United States and the European Union, Japanese firms will be placed at a marked disadvantage in terms of price competition.

(3) Effects and impacts of increased imports from Chile to Japan

If import tariffs are eliminated as a result of an FTA, both users and consumers of these imported will benefit from the reduced cost of the goods. Furthermore, an influx of more competitively priced imported goods into the market will

generate more vigorous competition, forcing domestic producers to improve productivity, as they will be confronted with both lower import prices and greater quantities of imports.

Those who might face a negative impact from a Japan-Chile FTA include producers of marine products (salmon, trout, and sea urchin), producers of agricultural products and processed goods (grapes and apple juice), and copper smelters.

(a) Marine products (salmon, trout, and sea urchin)

A surge in imports of cultivated salmon and trout from Chile in the 1990s resulted in lower domestic wholesale prices for these products, ultimately reducing the number of Japanese business entities involved in cultivating salmon and trout by two-thirds and causing Japan's domestic production of salmon and trout to decline by half. Japan's markets for salmon and trout are already nearly saturated, and further increases in imports could intensify price reductions. If, in addition, import tariffs (3.5%) are cut, it would deal a further blow to domestic producers of cultivated salmon and trout—firms that, on average, are not turning a profit even under current conditions.

With regard to sea urchin, although domestic products have enjoyed a reputation as much higher in quality in comparison to imported products, the consumption of high-quality goods has been declining amid a trend toward austerity during economic hard times. The consumption of less expensive products such as those served at cut-rate price *sushi* shops has been increasing, and imports of sea urchin, for use in these establishments and the like, have been increasing as well. If the import tariff on sea urchin (7%) were to be abolished, imports can be expected to increase even more rapidly. In any case, fishing for sea urchin in Japan is carried out by extremely small-scale operations that rely on diving and other such traditional methods.

(b) Agricultural products and processed goods (grapes and apple juice)

As a result of the declining consumption of grapes, due partly to increasing diversification by consumers among other fruits, the volume of grapes imports remained fairly stable throughout the 1990s, when domestic production declined. Under these circumstances, if the import tariff (8.7% from November to February, 17.5% from March to October) were eliminated, imports from Chile would increase and put strong pressure on domestic production.

Japan's imports of apple juice increased in the 1990s, reaching a volume nearly four times as great as that of domestically produced apple juice. Approximately 10% of these imports came from Chile. Under these circumstances, if the import tariff on apple juice (19.7%) were eliminated, imports would increase even more, causing domestic production of fresh apples and supply for juice production to

decline further, and this could have a negative impact on demand and supply adjustment by utilizing fresh apples used to make juice.

(c) Copper

Virtually all the copper ore used by domestic producers of copper ingots comes from overseas, and Chile is the largest source for imported raw copper, providing 42% of all imports. Demand for copper ingots has leveled off, and its imports have declined in volume in recent years in the face of increased domestic production. In 1999, the largest share, 48%, of copper ingots imports originated from Chile. Prices used in copper ingots transactions in Japan are based on the London Metals Exchange quotations, plus the destination-specific premiums, as well as import tariffs and domestic costs. If an FTA were concluded between Japan and Chile and the current 3% import tariff on copper ingots were eliminated, it would encourage copper ingot imports from Chile. In response, domestic smelters, in an effort to maintain their domestic sales, would probably lower their prices to match the reduced price of Chilean ingots resulting from the elimination of the import tariff. This would cut into their earnings, possibly harming their corporate operation base. Should this occur, it would also have an impact on the stability of imports of copper ore from Chile. Furthermore, it could lead to a decline in imports of copper ingots from countries other than Chile.

The advantages that might arise from the elimination of import tariffs due to an FTA between Japan and Chile, benefiting primarily users and consumers, are listed below:

(i) Lower costs

The elimination of tariffs on agricultural and marine products from Chile would result in lower wholesale prices, benefiting, among others, the food service industry, manufacturers of processed foods, and retail businesses.

The elimination of tariffs on copper ingots would enable users to procure this product at a lower cost. Copper ingots are used in electrical wiring, automobile parts, and household appliances, as well as in electronic devices such as mobile telephone terminals. It is an essential material for the information technology sector, in which Japanese business are seeking rapid expansion.

(ii) Possibility of development of new products and creation of new business modality

The availability of a wide variety of imported marine products, such as salmon, trout, and sea urchin, at wholesale prices lower than the domestically produced products, has contributed to the creation of a business mode in Japan. The appearance of cut-rate price *sushi* shops is a case in point. Moreover, it is

widely believed that if the food service industry can succeed in procuring materials at lower costs and it then becomes easier to add new items to the menus, this will help increase customer satisfaction, and this will also make it easier for manufacturers of processed foods to develop new products.

With regard to agricultural products, the harvest seasons in Japan and Chile are quite different, so imported goods can supplement the supply of domestic goods when the latter are unavailable. In this way, the firms involved can look forward to more potential business opportunities all year long. At the same time, as a secondary effect, demand for the agricultural products in question including the domestic products can increase.

(iii) Greater selection of products for consumers

If imported marine products, together with domestic products, are made more freely available to consumers, this will provide consumers with a greater selection of products. The reason why it has become possible to eat salmon and trout fresh and raw is that these products are provided from producers of scrupulous feeding and sanitary practices. In addition, among fresh agricultural products, the most promising in imports are those “niche” market products that would compensate for the relatively high shipping costs of these products. This, in turn, will result in a wider product selection for consumers of not only marine products but agricultural products as well.

As for above mentioned (ii) and (iii), the majority of the study group members are convinced of the advantages to users and consumers of an FTA between Japan and Chile, but some members emphasized that the advantages arising from elimination of import tariffs had already been realized while Japan’s imports from Chile had increased, and therefore lower tariffs resulting from an FTA could produce very limitedly such advantages for the future.

Thus, in considering the potential value of an FTA between Japan and Chile, it is necessary to take into account not only the viewpoints of domestic producers but also those of users and consumers. Such an agreement is expected to produce a variety of results in relation to Japan’s imports from Chile.

With regard to highly sensitive goods, one possible approach would be to treat them as exceptional goods not subject to reduced tariffs, as long as this does not violate the conditions for “substantially all the trade” stipulated in Article 24 of the GATT. In addition, it would be possible to devise interim measures for use in principle a 10-year transition period to cover some of the sensitive goods not treated as exceptions. In such cases, the domestic producers involved would have to increase their productivity and profitability over the course of the transition period in order to be able to survive without protective tariffs. This is the opinion of majority of the study group members, but some committee members strongly emphasized that consideration should be given to making

agricultural, forest and marine products exempt from an FTA, based on the conviction that the removal of import tariffs on these products would have an especially severe impact, and insisted on the need for conformity with negotiations on agricultural products within the WTO framework, and attention devoted to the “multi-functionality” of agriculture. The importance to secure a stable supply of mineral resources was also pointed out.

(4) Promoting investment

FDI in Chile by Japanese businesses has been primarily aimed at the development of natural resources. The conclusion of an FTA, however, would offer advantages that could motivate businesses to seek new forms of investment.

Possible new venues for investment include supporting industries that cater to Chile’s major industries, such as the mining, forestry, and fishery industries; value-adding industries, which process the secondary mining, marine, or timber products; the development of South American markets such as Mercosur, in cooperation with Chilean businesses; and infrastructure-related concession businesses.

Chile is Latin America’s leading investing country, and Japanese corporations should consider incorporating Chilean businesses into their global production and sales networks. Joining forces with Chilean businesses through FDI would enable Japanese businesses to take advantage of Chilean experience and expertise when they deal with Latin American countries other than Chile. If, for example, a Japanese business decides to invest in the development of a promising new copper mine in Argentina, it would be able to effectively utilize the experience and technological prowess of its Chilean counterparts. The sophistication and superiority of Chilean businesses could also provide advantages in dealing with the privatization of state-owned industries and the acquisition of infrastructure concession businesses in other Latin American countries besides Chile.

Although there has been virtually no investment in Japan by Chilean businesses to date, they are interested in Asian markets. Chile is a potential supplier of a variety of the natural resources required by many Asian countries. In addition, the fact that Chile is engaged in FTA negotiations with the Republic of Korea and is considering FTAs with other Asia-Pacific countries, such as Singapore, suggests that Chile’s interest in Asian markets will magnify in the future. A pulp manufacturer or a supplier of food products, for example, might set up a marketing operation based in Asia. In such a case, from the standpoint of generating more FDI in Japan, efforts would be needed to encourage the company to choose a site in Japan as its Asian location. It would be an effective business strategy to set up a base in Japan, hire Japanese

employees who are well acquainted with Asian markets, and then proceed to develop a new market. It would also be possible for Chile's copper mining producers to establish their own local corporations in Japan and utilize them to reinforce their marketing efforts.

(5) Expanding trade in services

As the global economy becomes increasingly oriented toward services, the availability of efficient and low-cost services has become an essential factor for competitiveness in many kinds of economic activities. For this reason, trade in services between Japan and Chile can be expected to increase. If Japan and Chile were to conclude an FTA, trade between the two countries would be expected to increase, and this would be accompanied by some increase in transport services and other such private-sector services. Furthermore, recent developments in information technology and electronic commerce are not only bridging the physical distance between the two countries but will also contribute to increased trade in services.

5. Wanted a comprehensive FTA

Chile's free trade agreements with Canada and Mexico, modeled on NAFTA, are comprehensive in nature, addressing not only the liberalization of trade in goods but also trade in services, investments, intellectual property rights, government procurement, standards and certification, and dispute settlement. In December 2000, Chile began negotiations with the United States on a free trade agreement that is expected to cover electronic commerce as well.

The prospective agreement with Singapore for which the government of Japan has entered into negotiations, officially titled the "Japan-Singapore Economic Agreement for a New Age Partnership," is expected to be an extremely comprehensive agreement addressing the disposition of customs and other trade-related procedures by electronic means, as well as services, investments, free movement of people, competition policies, financial services, telecommunication services including electronic commerce, and dispute settlement.

Amid the ongoing progress of economic globalization, it is not enough to simply liberalize trade in goods. The volume and speed of capital movement is now greater, while trade in services is becoming increasingly important. Especially, the diffusion of the Internet is astonishing, and e-commerce, which is creating new business modalities, is very likely to increase drastically. It is essential that rules be formulated to govern new businesses that exist outside the realm of trade in goods, both to promote their healthy development and to ensure fairness in their transactions. At the same time, this will also improve the business environment in the countries that are parties to an FTA. For example,

although Chile is a leading country in forming a network of FTAs, it is not a party to the WTO agreement on government procurement practices, to which Japan is a party. Therefore, if a set of rules covering government procurement practices that conform to the WTO agreement were to be included in an FTA between Japan and Chile, this would have the effect of elevating the level of Chile's of government procurement system. Thus, a free trade agreement between Japan and Chile should be comprehensive. Specifically, it should include the following areas:

(1) Trade in goods

It is necessary to ensure that the reduction or elimination of tariffs will be in conformity with the condition of coverage of "substantially all the trade," as stipulated in Article 24 of the GATT/WTO agreement.

If a Japan-Chile FTA is formed, it will be necessary to conceive measures to prevent "transit" exports 'via Chile' by neighboring countries. Its free trade agreements, by eliminating or reducing import tariffs on products from neighboring countries, such as Argentina, Bolivia, Peru and Brazil, makes it possible for products to be transported by land and such products might subsequently be exported to Japan. In order to address this situation, it will be essential to enact detailed rules of origin.

At the same time, efforts should also be made to improve trade-related procedures so as to lower transaction costs, such as simplifying customs procedures and making them more efficient, speeding up quarantine procedures, and conducting other trade-related procedures by electronic means.

(2) Trade in services

At present, trade in services between Japan and Chile is relatively limited, but given the increasing share of economic activity occupied by services, trade in services between our two countries is expected to rapidly expand in the future. Though the two countries are separated by a great geographical distance, rapid progress in information technology and, especially, the amazingly rapid spread of the Internet, have made communications between our two countries much easier, effectively bridging the physical distance.

It will be necessary to ensure that trade in services is conducted in conformity with the condition of "substantial sectorial coverage" which is stipulated in Article 5 of the GATS agreement.

(3) Investment

The mere existence of FTA is likely to encourage investment, but the real psychological effect on investment activity (the demonstration effect) starts to

emerge when negotiations on an FTA begin. In order to foster a positive impact, it will be necessary to establish highly disciplined rules for investment. On top of the existing investment protection, obligations on investment liberalization, prohibition of performance requirements, and venues for the dispute settlement should all be included in the agreement. In particular, in order to facilitate new investments by foreign firms that have no experience in setting up a local corporation in the country with which an FTA has been concluded, it is important to incorporate, the pre-establishment most favored nation (MFN) treatment and national treatment (NT) as basic principles in the chapter of investment in the FTA.

(4) Intellectual property rights

Under the WTO framework the issues and various aspects of intellectual property rights is governed by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Because both Japan and Chile belong to the WTO and are automatically parties to the TRIPS Agreement, any FTA between them must address intellectual property rights in a manner that goes beyond the TRIPS Agreement, or its provisions will be meaningless. It has been pointed out that the TRIPS Agreement, which was drafted around 1990, has already fallen behind developments in the rapidly changing area of intellectual property rights. In order to create a system that provides a high level of protection for intellectual property rights, it will be necessary to get an accurate grasp of the TRIPS Agreement's inadequacies under current conditions with respect to "copyrights" and the like, and to ensure that the FTA properly addresses those areas.

(5) Government procurement practices

Chile is not a party to the WTO convention on government procurement practices, but the government of Chile opens the contract process to the public and make public the government procurements through the Internet in order to secure the principle of transparency and nondiscrimination. On the other hand, Japan is a party. These two countries should deliberate on establishment of the same level of liberalization stipulated in the WTO convention on government procurement practices, and application of the same principles set forth in the WTO convention.

(6) Competition policies

It is necessary to enlarge the reduction and/or abolition of trade barriers with appropriate policies on competition. The only effective way to deal with acts aimed at restraining competition within a country that is a partner in an FTA is through cooperation between the authorities in both countries charged with protecting competition. Competition policies are not addressed by current WTO agreements, and for this reason, such policies must be addressed in an FTA

between Japan and Chile. Specifically, the first priority should be to achieve harmony between the countries participating in FTA with respect to laws and policies related to competition; the second priority should be to ensure cooperation between the respective authorities in each country through discussions and exchanges of information. When one of the two countries has laws that are more advanced in this area than the other, exchanges of information can offer a comparison that will highlight inadequacies in the laws of the latter country, paving the way for the revision of such laws. This will have the effect of speeding up the process of harmonizing policies and laws dealing with competition.

(7) Anti-dumping measures

Within the world economy, there have been instances where anti-dumping penalties have been applied arbitrarily or for protectionist reasons. In light of this, model rules concerning the imposition of anti-dumping duties should be formulated and included in an FTA between Japan and Chile. The rules stipulating mutual rejection of the levying of such penalties within the anti-dumping measures included in Chile's free trade agreement with Canada should also be studied. These ideas opposing the activation of anti-dumping measures may help end the misuse of these measures.

(8) Standards and certification

In order to ensure that systems of standards and certification do not pose needless obstacles to trade, in accordance with the directives set forth in the WTO Agreement on Technical Barriers to Trade (TBT Agreement), efforts should be made to adjust both Japan's and Chile's systems to ensure that they conform to international standards. Furthermore, it is desirable that consideration also be given to the possibility of mutual recognition arrangements in sectors where this is deemed appropriate, based on the volume of trade in goods subject to both countries' systems of standards and certification, as well as on an analysis of such factors as costs associated with standards and certification in the respective sector and the degree of technical parity between the two countries with respect to systems of standards and certification.

(9) Electronic commerce

Due to surging e-commerce profits and its increasing use, its importance to both the Japanese and Chilean economies has increased, with electronic commerce becoming a pivotal business and trade sector. The growing importance of electronic commerce has been accompanied by a growing need to protect the privacy of information about individuals, to ensure that electronic contracts and signatures can be used safely, and to guard against computer crimes. Developing a common set of rules to address these concerns will not

only help improve market functions but will also make facilitate new business expansion. With this in mind, Japan and Chile should harmonize their rules governing electronic commerce as part of an FTA. The inclusion of such rules in a Japan-Chile FTA can also contribute to the establishment of global standards for electronic commerce.

(10) Dispute settlement

Intra-governmental procedures should be established to handle the resolution of any disputes that arise over differing interpretations or the application of an FTA between Japan and Chile. At the same time, mechanisms should be created to ensure that disputes involving businesses in the two countries are to be resolved swiftly, harmoniously, and fairly. In addition, both countries should make efforts to promote the use of non-judicial dispute settlement mechanisms to provide mediation or arbitration services within their legal systems.

6. Measures to achieve closer economic relations other than an FTA

Measures to achieve closer economic relations between Japan and Chile should include not only the conclusion of an FTA but also cooperation in international dialogues, the improvement of basic infrastructure related to economic activity, the formation of inter-industry partnerships, the promotion of mutual understanding, expanded grassroots interaction, and activities to promote trade and investment.

(1) Venues for international dialogues

The venue for global dialogue related to trade is the WTO. The Asia-Pacific Economic Cooperation (APEC) is a venue for inter-regional dialogue related to promotion of trade and investment, and the East Asia Latin America Forum (EALAF) is also an inter-regional venue for dialogue related to government, economics, and culture. The EALAF, comprising 13 Asian nations (including Japan), two nations in Oceania, and 12 Latin American nations (including Chile), held its first conference of foreign ministers in Santiago in late March of 2001.

(2) Improvement of basic infrastructure related to economic activity

In addition to FTAs and agreements concerning investments, taxation agreements offer another framework for inter-governmental efforts to help provide and improve an environment for business. Taxation agreements primarily prevent both double taxation and tax evasion, but consideration should also be given to introducing a system of preliminary consultations regarding tax obligations.

At the policy level, Japan's Ministry of Economy and Industry (formerly the Ministry of International Trade and Industry) holds dialogues on trade policy with Chile's Ministry of Economy, and the foreign ministries of the two countries hold policy dialogue as well. Relatively vigorous dialogues also take place at cabinet-level meetings.

It is also important to promote interaction and to cultivate personnel to take charge of new economic relationships. One way to do this is for Japan and Chile to act in concert to promote greater progress in South-South cooperation, so as to provide intellectual support for the formulation of policy in the field of economics. There is considerable room for cooperation between Japan and Chile on policies aimed at cultivating supporting industries, educating entrepreneurs, and encouraging small business development.

At present, the Japan International Cooperation Agency (JICA) is carrying out a comprehensive survey in order to come up with a plan for regional development and investment promotion in Chile. In addition, a study group on Latin America's natural resources, entitled "Latin America Natural Resources Forum," is being held under the leadership of the Ministry of Foreign Affairs. It is hoped that the findings of these activities will be utilized to help private industry create new business strategies.

(3) Inter-industry partnerships

The most important framework for inter-industry partnerships is the Japan-Chile Business Committee, which holds regular meetings nearly every year. Another such organization is the Japan-Chile Subcommittee of the Japan-Latin America Twenty-First Century Committee for the Pacific Basin, which convenes meetings of persons of wisdom from both countries.

The Chile-Japan Chamber of Commerce and Industry, consisted mainly of Japan-based businesses, has been in existence in Chile for some time. These private-sector frameworks should compile suggestions and proposals regarding factors that either prevent or encourage business between Japan and Chile, along with suggested improvements; the improvement of mutually complementary systems (for quantitative expansion of trade and investment); and the creation of systems for horizontal specialization (for substantive expansion of trade and investment). In Japan, the Japan-Chile Association offers cultural exchange activities and works to promote friendly relations between the two countries.

(4) Promoting mutual understanding

The exchange of information is essential for promoting mutual understanding. In both countries, information needs to be made available through Japanese-

language and Spanish-language publications and Web sites, and improvements are needed in the presentation of information. It is also important to promote tourism, so campaigns to attract tourists should be held in both countries and information on tourism should be made available.

In the realm of communications, a video-equipped telephone has been installed that connect the Chilean embassy in Tokyo with Santiago, and this is made available to businesses for meetings, negotiations, and the like. This new form of communication effectively bridges the distance between the two countries.

(5) Expanded grassroots interaction

While only about 2,000 Chilean citizens claim Japanese ancestry, social interaction among Chileans of Japanese ancestry and Japanese citizens who are long-term residents of Chile is important from the standpoint of promoting mutual understanding. More academic conferences, joint research projects, university partnerships, and other such forms of cultural and academic interaction are desirable. The United Nation Economic Commission for Latin America and the Caribbean is located in Santiago, and efforts should be made to cooperate and coordinate activities with its staffs.

A sister-city relationship has been established between the city of Tenri in Japan and the city of La Serena in Chile. If progress can be made in arranging working holiday-style exchanges of young people, as well as exchanges involving non-governmental organizations and non-profit organizations, this will further enhance the prospects for interaction at the local community level in the future.

(6) Free movement of people

Human interaction is essential to efforts to promote mutual understanding and achieve grassroots interaction, above mentioned, apart from achieving closer economic relations. In order to make it easier for people to come and go freely between Japan and Chile, both should study the possibilities for simplifying and speeding up the procedures required to obtain a visa between the two.

(7) Activities to promote trade and investment

Activities aimed at promoting trade and investment between Japan and Chile are mainly conducted in Japanese side by JETRO and in Chilean side by ProChile -- the Chilean foreign ministry's bureau for the promotion of exports. Their activities consist primarily of holding seminars to present and disseminate information, dispatching and receiving trade missions, and dispatching and receiving experts. It is important for the two organizations to cooperate in these activities and to carry them out in accordance with previously prepared mid-term schedules. Consideration should be given to having these two organizations cooperate further on the establishment and

execution of a system of commercial and economic laws. Moreover, the two should not only cooperate with one another, they should also coordinate their efforts with those of organizations in Japan such as JICA, the Japan Overseas Development Corporation, and the Association for Overseas Technical Scholarship, and organizations in Chile such as the Chilean Economic Agency (CORFO).

7. Conclusion: A comprehensive FTA should be concluded as soon as possible

Having duly considered the significance advantages and disadvantages of an FTA between Japan and Chile, and having adequately considered the potential impact on Japan's specific domestic industries, the multi-functionality of agriculture, and the need to secure a stable supply of natural resources, we conclude that the maximum effort should be made to conclude an FTA between Japan and Chile as soon as possible.

The FTA to be concluded between Japan and Chile should be comprehensive, addressing not only market access but also investments, services, government procurement, standards and certification, and competition policies. In this way, it will not only promote bilateral trade but also promote mutual investment flows and encourage businesses from the two countries to cooperate in developing markets in third countries. In addition, as spill-over effects of the FTA, Japan and Chile will enter into an even closer and more multi-level economic relationship. Besides, by concluding a forward-looking FTA demonstrating that both nations regard free trade as a matter of national policy, Japan and Chile will be contributing to the liberalization of trade and investment throughout the world.