# Latin America's first free trade agreement

In a world whose present evolution is primarily conditioned by the challenges of far-reaching economic transformation, increasing interdependence and globalization, regional cooperation becomes a decisive and determining element for spurring development and assuring the well-being of nations.

Trade and cooperation will be the fundamental elements in economic blocs in which comparative advantages will enable countries to meet the challenges of world economic competition. Mexico is already diversifying its trade with Europe, the Pacific Rim countries, North America and, of course, Latin America. The most outstanding example of this is the Economic Complementation Agreement (ECA) between Mexico and Chile, signed on the 22nd of September of 1991.

While the agreement is significant for several reasons, its relevance and novelty lie in two basic points: 1) the ECA is the first free trade agreement signed by two Latin American nations, and 2) Mexico and Chile have taken an enormous and important step toward the integration of the continent. The presidents of the two countries, Carlos Salinas de Gortari of Mexico and Patricio Aylwin of Chile, stated in their joint communiqué that "regional coordination, unity, and integration have the highest priority on the short and the medium term political agenda."

Furthermore, the ECA is responding to global needs insofar as globalization of markets is what mankind is striving toward. This agreement thus signifies one of the most important political acts of the last few years in Latin America for the cause of regional coordination. We have finally left behind 150 years of talking about integration without doing anything about it.

A good overview of the importance of the agreement was provided by Gert Rosenthal, the Executive Secretary of CEPAL. Prior to the signing of the ECA he had warned about the risk of creating a new economic division in Latin America: a gap between the countries who might integrate and those who can't even afford to think about it. Rosenthal pointed out that "the negotiations that Mexico is now engaged in over a North American free trade area do not exclude the possibility of negotiating similar agreements with other Latin American countries at the same time. By extension, the postulates of the Initiative for the Americas and increasing Latin American integration are not mutually exclusive; rather, they are complementary."

## The fine print of the Santiago Agreement

According to information given out by the Ministry of Commerce and Industrial Development, the Santiago Agreement, signed for Mexico by Minister of Trade Jaime Serra Puche and for Chile by Minister of Finance Alejandro Foxley, will increase bilateral trade by some 233%; from U.S. $150 million to U.S. $500 million over the next five years.

The program reduces tariffs, starting on the first of January this year, and will conclude in 1998 when all tariffs on bilateral trade will be eliminated. The Ministry of Trade and Industrial Development made public that as of January 1992 the maximum tariff for goods traded will be 10%; in 1993 it will go down to 7.5%; in 1994 to 5%; and, in 1995, to 2.5%. By 1996 trade will be totally tariff free.

The tariff reduction program puts the branches of commerce on two different time tables: 1) that for the majority of goods, which will be tariff-free by 1996; and 2) a shorter list of products such as petrochemicals, glass, ceramics and wood among others, which will not be completely tariff-free until 1998. Non tariff barriers will likewise be done away with starting next year.

The main Mexican products exported to Chile are, in order of importance: motor vehicles, railroad cars, petrochemicals, typewriters, tyres, synthetic fibers (polyester), and photographic film. Chile exports to Mexico fish meal, beans, iron, fruit, textiles, wood, and furniture, among other items. The Ministry of Trade pointed out that for Chile the ECA represents access to a market of approximately 15 million people. However, Chilean sources estimate that their exports to Mexico will soon have access to a market of nearly 90 million consumers.

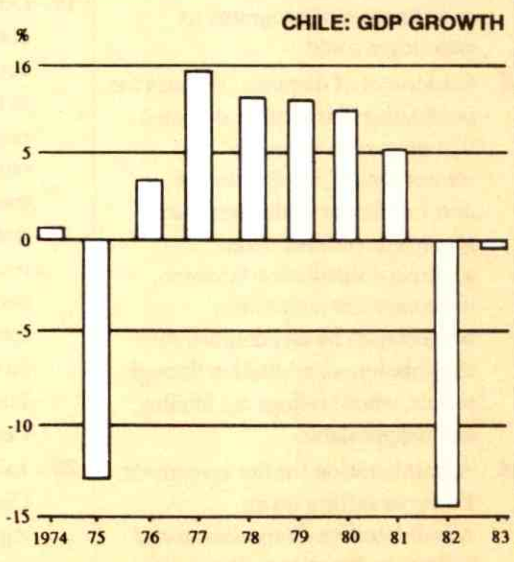
Furthermore, Andrés Velasco, head of the Chilean Office for the Coordination of International Finance, explained that the ECA complies with the parameters set by the Latin American Association for Development and Integration, which means that it does not have to be approved by the legislative branch. He also stated that the trade agreement contains safeguard clauses in case excessive imports of a particular product might have negative effects. In these cases a surtax mechanism would be put into effect to make the imported product more expensive.

There are also mechanisms to prevent unfair trading practices; government procurement will be regulated so that it does not set up barriers to global trade, and clear operational rules will be drawn up for settling disputes through a governmental commission which will issue its rulings within 35 days.

### Chapters

1. Objective. Establishes the aims of the agreement: increase bilateral trade, promote investment and cooperation between the two nations.
2. Liberalization program. Stipulates tariff reduction aims and the elimination of non-tariff barriers. Specifies how to treat products that are excepted from the terms of the agreement. Defines duties and restrictions on imports. In this section goods are classified according to category:
   a) The vast majority of products that are now subject to tariffs: for these goods all non-tariff barriers will be eliminated as soon as the ECA comes into force and tariff reduction programs are set up, initially with a maximum common tariff of 10% to be reduced to zero by the 1st of January 1996.
   b) Goods of special temporary interest for both nations, such as petrochemicals, textiles, glass, ceramics, meat, poultry, eggs, tobacco and wood. The tariff reduction program starts out with a common maximum tariff of 10%; this will start to go down as of 1994 and will reach zero on the 1st of January, 1998.
   c) Goods for which no tariff reduction program has been agreed on, for example certain fixed agricultural prices in Chile, oil and oil by-products, and key Mexican agricultural products of no interest in Chile.
3. Origin. Sets up rules of origin applicable to any bilateral trade under the auspices of the ECA. The basis is the existing rule of the Latin American Association for Development and Integration. Some flexibility is allowed for differential requirements by sector and to sectors and their modification over time.
4. The motor vehicle sector. Makes possible the liberalization of bilateral trade in motor vehicles and parts, beginning in 1996. For Chile this means the possibility of exporting vehicles to Mexico restriction-free.
5. Safeguard clauses. Two possibilities are imagined: balance of payment problems, and significant harm to similar or directly competitive goods. The ECA allows for temporary application of surtaxes on a non-discriminatory basis. When balance of payments problems come up the application of the surtax cannot be selective.
6. Unfair trading practices. Each country's laws will be applied in such cases. Consultations will facilitate enquiries in the case of subsidy or dumping problems.
7. Domestic taxation. Commits both parties to tax exports from the other country the same way that domestic goods are taxed.

**Chile is, perhaps, the country in best shape in Latin America, having avoided several crises in the past. For example, in 1973, before the military coup, inflation was close to 700%, the public-sector deficit was 25% of GDP, and there was a ten-fold difference between the black-market and official exchange rates. Structural changes were introduced at that time. They consisted of opening up the economy to more and greater market orientation. The plan was similar to Mexico's: cutting subsidies, public-sector spending and tariffs, as well as deregulation and privatization. However, in 1982, Chile went through a serious problem in the area of banking, one which would have grave repercussions. Chile's subsequent experiences teach us a lesson. We cannot ignore the external phenomena which affect our system. Nor can the commercial banking system ignore the risks inherent in micro- and macroeconomic activity. Healthy and prudent —in one word, orthodox— bank intermediation is an essential requisite for the health and growth of developing economies.**




Source: Department of Economic Research, Banamex. Based on data from the Banco Central de Chile.

8. Government procurement. An attempt was made to prevent government procurement from becoming a barrier to trade. This subject may be negotiated starting in 1993. The idea is to define the coverage and clarify the procedures regulating each country's government purchases. It is especially important for Chile to clarify its procedures in the future.
9. Investments. Encourages investment and joint ventures; grants the best possible treatment to capital from the other country.
10. Sea and air transport. Seeks to set up unrestricted sea and air transport for both freight and passenger services.
11. Other services. Opens up the possibility of including trade in other services in the agreement.
12. Other standardization. Commits both parties to standardize rules and regulations when necessary in order to perfect the ECA.
13. Economic cooperation. Coordinates programs, fairs, seminars, exhibitions, and the exchange of information.
14. Encouragement of trade. As in the above chapter, stipulates the coordination of programs to encourage trade.
15. Settlement of disputes. Defines the mechanism for settling disputes that may arise from the interpretation, application or non-fulfillment of the agreement. It consists of three stages: a) direct consultation between, the competent authorities; b) mediation by an administrative commission; c) arbitration through panels, whose rulings are binding and unappealable.
16. Administration for the agreement. Foresees setting up an Administrative Commission and defines its functions. These are: evaluating how the ECA is functioning and proposing modifications; mediation, appointing arbitrators and proposing changes; establishing procedures for the application of safeguards; following up on price policies and practices in key sectors of the economy of both nations; and setting up mechanisms to assure the active participation of the private sector. The commission will be governmental with representatives from each countries' respective ministries.
17. Duration. Establishes that the Economic Complementation Agreement will be of indefinite duration.
18. Repeal (revocation of the agreement). Establishes that the country that wishes to end the agreement must notify the other country 180 days before it officially notifies the Latin American Association for Development and Integration. Likewise, from that time on all rights and duties acquired shall cease, except for those to do with imports which shall remain in force for another year.
19. Other stipulations. Includes the commitment on the part of the two countries to grant proper protection to intellectual and industrial property rights, and to keep each other mutually informed of foreign trade rules, regulations, and statistics. In addition, this chapter recommends that there be coordinated action in international forums and that the private sectors have recourse to the Inter-American Trade Arbitration Commission to settle disputes.
20. Joining the ECA. The Mexico-Chile Economic Concertation Agreement is open to other nations belonging to the Latin American Association for Development and Integration, subject to negotiation.
21. Temporary stipulations. States that the agreement will be formalized with the Latin American Association for Development and Integration and that all other agreements that Chile and Mexico previously signed within the framework of the Association will be null and void.

### Anti-drug trafficking agreement

On another tack, but within the general framework of bilateral cooperation, on the 2nd of October the governments of Mexico and Chile signed an agreement in which they commit to fight drug trafficking and drug addiction. Drugs threaten the security and other national interest of both. The agreement signed contains four sections: prevention and reduction of the demand for narcotics and psycho-tropic substances; control of supply; suppression of illegal trafficking; treatment and rehabilitation.

The agreement was careful to establish Mexican and Chilean respect for the principles of self-determination, non-intervention, equality before the law, and respect for territorial integrity.

It was also agreed to beef up anti-drug trafficking and drug-rehabilitation budgets according to each country's economic resources. The production, importing, exporting, and sale of inputs, chemicals and chemical raw materials used in the production of drugs will also be regulated.

To guarantee compliance with this agreement a committee composed of representatives from the two countries will be established. Its basic function will be to recommend to the two governments the most efficient means of cooperatively achieving their goals

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