

# Latin American bilateral free trade agreements with Asia: Chile and China, Japan and Korea

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# Overview

1. Introduction.
2. A quick overview of bilateral and regional agreements.
3. Case study: the FTAs between Chile and China, Japan and Korea.
4. Looking ahead: FTAs and LAC farm exports to China and East Asia.

# Introduction

- Why are free trade agreements worth examining in the context of this conference? Because:
- China has become an engine of growth for LAC region due to the growth in import demand.
- For several LAC countries, China is now principal export destination: Argentina, Brazil, Chile, Peru and Cuba.
- Interestingly, China has yet to become a major destination for Central America, Ecuador and Mexico
- Regional agreements (Mercosur, the Central America Agreement, the Andean Group), have perhaps reached a limit of expanding intra-regional trade to attain scale economies.
- For agriculture there is a natural weakness in growth of internal demand, especially outside Brazil and Mexico, making progress in the region's agri-food sector dependent on exports.

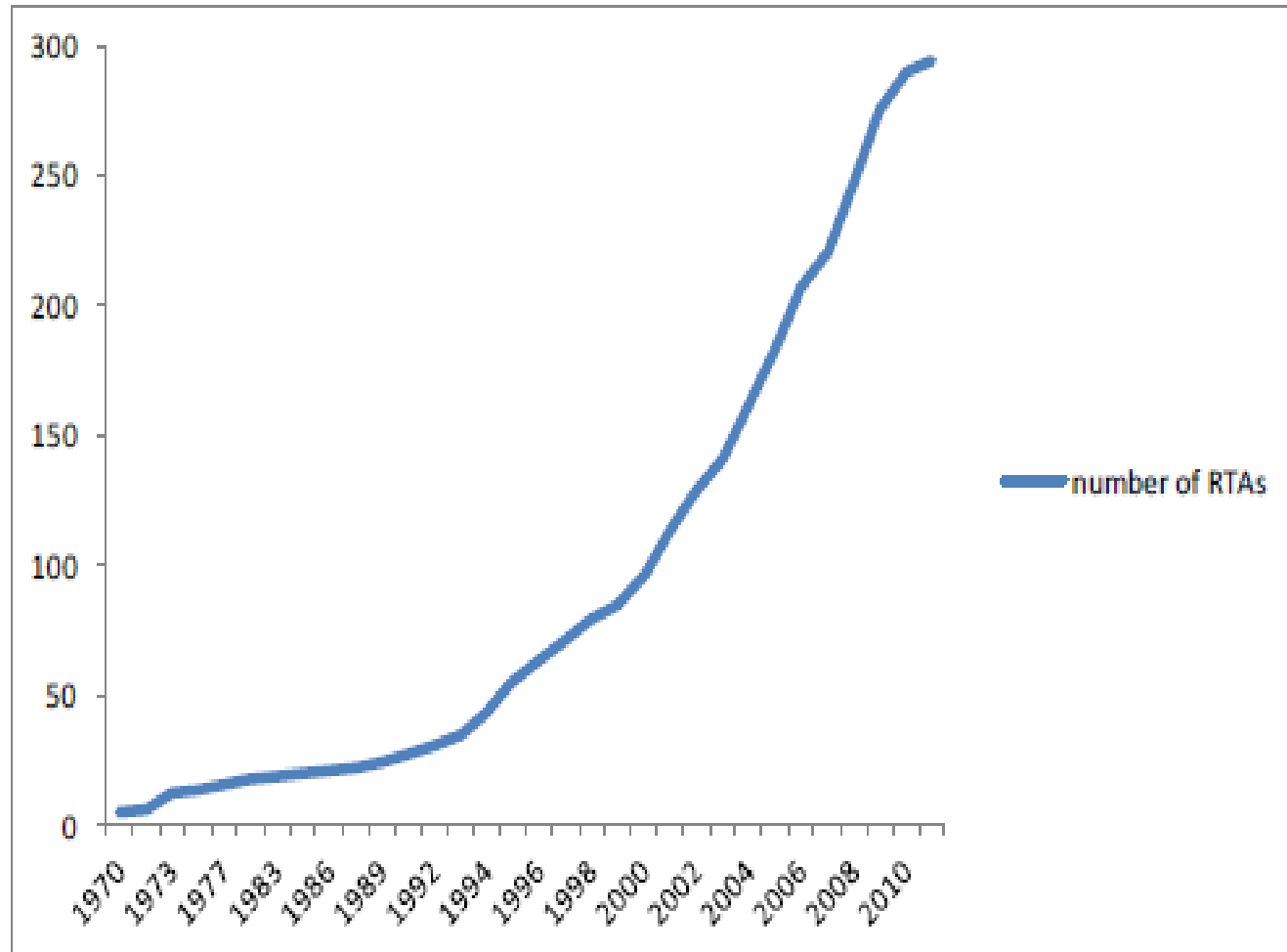
- China's growing demand for raw materials has been key to spurring trade with LAC, and LACs demand for its manufactures has grown due to China's competitiveness
- China has implemented in recent years bilateral agreements with Chile, Costa Rica, and Peru.
- Only part of this expansion of trade between China and LAC is due to FTAs

- Two reasons to anticipate an increase in non-commodity agricultural exports from LAC to China.
  - the growth in the Chinese economy overall and in consumer incomes, leading to higher consumption of higher-income-elasticity goods, such as fresh fruit and dairy.
  - the FTAs that China has signed incorporate declining tariffs in these goods over five-year and ten-year horizons. Exports of these products will grow as tariffs diminish, eventually entering duty free.

# Overview of the recent growth in the number of bilateral and regional agreements

- Diverging opinions regarding the merits of FTAs.
- LAC region has been notably active in FTAs, both within the region and more recently with countries outside.
- 3<sup>rd</sup> section has detail of specific FTAs between Chile and China, Japan and Korea. Chile is the only LAC country with China FTA for several years, since 2005. (Costa Rica and Peru have signed FTAs w/ China recently.)
- Lessons from Chile's FTAs helpful for other LAC.
- Trade flows between Chile and Asian trading partners, evolution of export shares by destination and product.

The cumulative number of bilateral and regional trade agreements since 1970.



*Source:* OECD Secretariat calculation from WTO database.

- Notifications to GATT of FTAs increased sharply since 2000, linked to the lack of progress in developing multi-lateral agreements (Doha) under the WTO.
- FTAs notified to the WTO. between geographically close countries, but expansion to FTAs across continents, a number of north-south, in addition to south-south FTAs.
- FTAs developing between diverse economies and populations, mixing large and small countries, and developed and developing economies. FTA growth has offered a much higher degree of economic integration and therefore a reduction of the influence of protectionist measures on trade.
- LAC has been very active in FTAs, within the region and beyond. Chile, Mexico, Peru and Mercosur have led the way.
- In contrast to the previous emphasis on regional agreements, both analytically and in practice, bilaterals have propagated more quickly, perhaps a reflection of the difficulties of negotiating common external tariffs and a perception of the disappointing performance of past regional agreements. (The EU agreement is a different animal, with common trade policy, currency and free factor mobility.)



- FTAs part of the so-called “spaghetti bowl” criticized by Bhagwati and colleagues.
- Continuation of regional integration agreements (RIA), in the not-too-distant past held in suspicion by trade economists, although elicited high expectations among policy makers.
- Economists and policy makers had different counter-factual scenarios in mind to compare gains and losses.
- Policy makers thinking in terms of the gains from trade with neighbors Usually with cultural affinity. Their counterfactual scenario not based on multilateral desire but on probability of no agreement at all with potential trading partners.
- Moreover, politicians saw other gains from integration: promote bargaining power of a block.
- Security might be enhanced by further interlocking economies and therefore making conflicts more costly. EU is an obvious case of this latter concern, but Mercosur and the Central American Agreement could also be viewed in this light.
- Furthermore, trade agreements could serve as a commitment mechanism to avoid policy reversals in domestic economic reforms.

## Bilateral and LAC regional trade agreements and date signed

Country pair	Date		
Chile-Canada	1996		
Chile-Mercosur	1996		
Chile-Mexico	1998		
Chile-Peru	1998		
Cent. America-Chile	1999	NAFTA	1992
Chile-EFTA	2002	Mexico-Bolivia	1994
Chile-EU	2002	Mexico-Colombia	1994
Chile-Korea	2003	Mexico-Costa Rica	1994
Chile-US	2003	Mexico-Peru	1995
<b>Chile-China</b>	2005	Mexico-Nicaragua	1997
Chile-New Zealand-Singapore-Brunei (P4)	2005	Mexico-EFTA	2000
Chile-Japan	2007	Mexico-EU	2000
Chile-Australia	2009	Mexico-Israel	2000
Chile-Turkey	2009	Mexico-Northern Triangle	2001
		Mexico-Uruguay	2003
		Mexico-Japan	2004
Country pair	Date		
		Peru-Thailand	2005
Mercosur-Bolivia	1998	Peru-Mercosur (ACE59)	2005
Mercosur-Canada ( ACE59)	2004	Peru-US	2006
		Peru-Singapore	2008
CAFTA-DR	2004	Peru-Canada	2009
Colombia-US	2006	<b>Peru-China</b>	2009
Panama –Singapore	2006	Peru-Korea	2011
<b>Costa Rica - China</b>	2010		

Australia-Singapore	2003
Australia-Thailand	2004
Australia-US	2007
COMESA	1995
EU-South Africa	2000
EAC	2002
<b>China-Hong Kong</b>	2003
EU-Egypt	2004
ECOWAS	2005
Korea-Singapore	2006
Japan-Thailand	2007
<b>China-New Zealand</b>	2009
New Zealand-Singapore	2001
New Zealand-Thailand	2005
SADC	2004
Turkey-EFTA	1992
Turkey-Egypt	2007
US-Morocco	2005

Special features of the FTA's between Chile and China, Japan and Korea, focusing on agricultural and agro-processed products

- Chile only LAC country with FTAs with all three Asian countries, operational for several years.
- Mexico has FTA with Japan for several years. Peru signed FTA with China in 2009, implemented 2010, Peru with Korea (August 2011). Costa Rica FTA with China August 2011.

## Total agro-food exports from Chile, and export shares to principal partners (%), 1998-2008, FAOSTAT

Year	Total Ag-food trade billion US\$	Year-to-year change in %	China	Japan	Korea	USA	E.U.	Canada	LAC	ROW
1998	2.77		2.7	7.6	0.1	26.1	21.5	<b>2.0</b>	<b>32.7</b>	7.3
1999	2.73	-1	2.3	5.6	0.4	28.1	23.3	<b>2.1</b>	<b>29.8</b>	8.3
2000	2.78	2	1.9	6.4	0.5	30.5	22.3	<b>2.0</b>	<b>28.9</b>	7.4
2001	3.11	12	1.9	6.3	0.3	27.1	22.3	<b>2.0</b>	<b>33.4</b>	6.8
2003	3.60	16	2.3	6.1	<b>1.4</b>	<b>31.3</b>	<b>26.6</b>	<b>1.9</b>	<b>22.9</b>	7.5
2004	4.21	17	2.4	7.6	<b>1.9</b>	<b>26.0</b>	<b>27.4</b>	<b>2.1</b>	<b>24.5</b>	8.2
2005	4.68	11	<b>2.4</b>	8.4	<b>2.3</b>	<b>25.1</b>	<b>26.2</b>	<b>2.3</b>	<b>24.8</b>	8.3
2006	5.23	12	<b>3.0</b>	6.8	<b>2.5</b>	<b>25.6</b>	<b>26.0</b>	<b>2.5</b>	<b>25.4</b>	8.2
2007	7.49	43	<b>2.9</b>	<b>5.4</b>	<b>3.0</b>	<b>25.1</b>	<b>30.2</b>	<b>2.8</b>	<b>22.1</b>	8.5
2008	7.47	-0.3	<b>3.0</b>	<b>4.7</b>	<b>2.4</b>	<b>22.1</b>	<b>27.8</b>	<b>2.6</b>	<b>28.5</b>	8.9

Source: Authors' calculations based on FAOSTAT. *Excludes* fisheries, fishmeal and aquaculture, and forestry products. These products would add between 50 and 70 percent to the total export values shown here. Mineral exports would add much more. Note 2002 missing in FAO database.

Figures in bold indicate FTAs with Chile and the years in which trade treaties are in effect.

## Total agro-food-forestry exports from Chile, and export shares to principal partners (%), 1998-2008, ODEPA

Year	Total Ag-food trade billion US\$	Year-to-year change %	China	Japan	Korea	USA	E.U.	Canada	LAC	ROW
1998	4.33		3.7	10.5	1.2	29.5	24.1	<b>1.3</b>	<b>22.6</b>	7.1
1999	4.72	8.95	1.2	9.1	2.6	31.9	23.2	<b>1.3</b>	<b>20.5</b>	10.2
2000	4.98	5.42	3.6	9.5	2.0	29.7	24.2	<b>1.4</b>	<b>21.7</b>	7.9
2001	4.79	-3.84	5.9	9.4	1.7	30.4	22.1	<b>1.5</b>	<b>23.5</b>	5.5
2002	5.18	8.35	5.4	8.1	2.1	33.5	21.8	<b>1.7</b>	<b>20.9</b>	6.5
2003	5.94	14.49	4.4	8.2	<b>2.4</b>	<b>32.8</b>	<b>24.5</b>	<b>1.9</b>	<b>18.6</b>	7.2
2004	7.51	26.59	5.2	8.2	<b>2.5</b>	<b>32.1</b>	<b>24.1</b>	<b>1.9</b>	<b>19.1</b>	6.9
2005	8.04	7.03	<b>5.2</b>	8.3	<b>2.9</b>	<b>30.5</b>	<b>23.9</b>	<b>1.8</b>	<b>20.8</b>	6.6
2006	8.90	10.63	<b>5.0</b>	7.6	<b>3.1</b>	<b>30.5</b>	<b>23.7</b>	<b>1.9</b>	<b>21.1</b>	7.1
2007	11.01	23.74	<b>7.8</b>	<b>7.0</b>	<b>3.9</b>	<b>24.3</b>	<b>25.6</b>	<b>1.8</b>	<b>20.8</b>	8.9
2008	12.76	15.87	<b>7.3</b>	<b>6.7</b>	<b>4.0</b>	<b>22.3</b>	<b>26.8</b>	<b>1.9</b>	<b>24.2</b>	6.8
2009	10.81	-15.24	<b>10.0</b>	<b>6.6</b>	<b>4.2</b>	<b>24.4</b>	<b>24.6</b>	<b>2.3</b>	<b>21.6</b>	6.4
2010	12.32	13.89	<b>8.5</b>	<b>6.7</b>	<b>4.3</b>	<b>23.1</b>	<b>26.2</b>	<b>2.3</b>	<b>22.0</b>	6.9

Source: Authors' calculations based on data de ODEPA. *Excludes* fisheries, fishmeal and aquaculture products, but includes forestry products. Figures in bold indicate FTAs with Chile and years in which trade treaties are in effect <sup>14</sup>

## Implementation Schedule of tariff reductions for Chilean exports to Korea, beginning 2004

Category	Number of tariff lines	% of tariff lines	2009 export value US\$ millions	% of 2009 export value
Immediate (2004)	6,938	90	1,201	41.2
7 years (2011)	59	0.8	1,507	51.7
9 years	6	0.1	-	0
10 years	361	4.7	202	6.9
16 years	7	0.1	-	0
DDA	302	3.9	4	0.1
Exceptions	32	0.4	0.1	0
Total	7705	100	2,915	100

# Ag exports to Korea

- Tariff reductions began in 2004, gradually converging to zero values in 16 years.
- Contrast between ag products and fisheries in liberalization period is striking.
- Fresh fruits subject to long tariff-reduction periods: pears to 16 years, grapes, apples, apricots and strawberries to 10 years, cherries and peaches to 7.
- Fishery from Chile classified for immediate removal of duties.
- Aside from forestry products Korea's MFN regime protectionist, with tariffs on sometimes > 100%.
- Several meat products, citrus, etc., classified "DDA"- excluded until Doha Round. Hindsight: DDA category mistake.
- Exports of fruits and meats from Chile to Korea were subject to stringent SPS regulations, modeled on international conventions: WTO for SPS, Codex for food products, the CIPF code on phytosanitary convention, and the OIE for animal products.



- Trading partners accept SPS standards, under WTO.
- Chilean exporters have made considerable investments to meet international standards, applicable to others.
- Export composition - some Chile products (meats and fresh fruits) more susceptible to stringent SPS than countries exporting soy and wheat. (copper and forestry immune).
- For Chile the FTA with Korea contributed to increased trade flows, but not to a significant diversification of exportables – at least so far. Contributed to expansion in number of products exported and number of Chilean firms exporting to Korea.
- Investment in the development of better business relations and contacts for future marketing opportunities for both countries.
- Korea manufacturing zero tariff for most exports.
- For Chile, potential gain for ag and food, but Korea maintains some quotas and long tariff-reduction schedule, and DDA (no progress in the Doha Round).

# FTA with Japan

- Signed in 2007, following negotiations that began in 2005. But before negotiations began both countries had undertaken studies to evaluate potential economic impacts of a possible agreement and to identify sensitive areas and negotiating strategies.
- Prior to the FTA, Japanese exports to Chile faced the 6 percent uniform MFN tariff (against average effective rate of 1.8%), disadvantaging the country relative to countries with previously-sign trade agreement, including the United States, the EU, Canada, Mexico, Korea, and Mercosur.. Japan tariff disadvantage disappeared under the FTA in 2007.

# Chile – Japan FTA on agr.

- - Beef -initial quota of 1300 tons with a tariff preference of 10%,quota increases to 4,000 tons in the 5th year with a tariff preference of 20%.
- - For offals - initial quota of 600 tons with 10% preference, increasing in five years to 750 tons with 40% preference.
- - Pork - initial quota of 32,000 tons, increasing to 60,000 tons at the 5th year with a tariff preference of 50%.
- - Bottled wine - initial tariff of 12%, falling to 10.4% in 2010 and reaching zero in 2017-2019.
- - Tomato paste - initial quota of 3,700 tons increasing to 5,000 in the 5th years with a zero tariff.
- - Table grapes - initial tariff of 17% sees a range of tariffs between 5.7 to 12.8% in 2010, reaching a zero tariff during 2017-2022.
- Et cetera

## Chile exports to and imports from Japan (million US\$), 2004 to 2009.

	2004	2005	2006	2007	2008	2009	2009 January to June	2010
Merchandise exports	3,733	4,592	6,374	7,235	7,292	4,687	1,941	3,175
copper	1,838	2,073	3,909	4,518	4,266	2,573	890	2,073
pulp	63	40	51	66	70	46	18	19
others	1,831	2,479	2,414	2,650	2,956	2,068	1,032	1,083
Mechandise imports	803	1,021	1,15	1,614	2,656	1,355	584	1,371
Trade balance	2,930	3,571	5,224	5,621	4,636	3,332	1,357	1,804

# Non-tariff questions

- The treaty opens the possibility of future renegotiations to accelerate the reduction schedule.
- Export subsidies are prohibited for both countries.
- A bilateral safeguard approved for temporary suspension of imports when there is a perceived risk of serious disruption due to rapid increase in imports.
- Rules of origin for imports to Japan are established based on three criteria: (i) fully domestic production, (ii) change in the tariff category, and (iii) value of the regional content.
- Such rules monitored by a specialized agency, representing both government and producers associations.
- Accord on process principles: Customs valuation and technical norms, channels for cooperation, a process for harmonization of procedures, and a Working Group to examine SPS conditions.

# FTA with China

- Signed in 2005, in force in October 2006, China's first bilateral trade agreement.
- Since, China has signed others FTAs, specifically in the LAC region with Peru in 2009 and Costa Rica in 2010.
- 3 areas: trade in goods, services, and a protocol on investments (FDI). Gradual tariff reduction calendars of 1, 5 or 10 years.
- “Exclusions” for sensitive products, 3% of Chile's exports and 1% of its imports from China (counting tariff lines).
- In 2007 China was Chile's 3<sup>rd</sup> largest destination; in 2010 China was single most important source of export revenues.
- Notably, during the recent economic downturn in 2009 Chilean exports to China grew by 20.6%, in contrast to a decline in Chile's exports to the rest of the world, including countries with which Chile had FTAs. The Chinese market helped Chile as a buffer during the crisis. China has become Chile's second most important single source of imports since 2008.

- As a proportion of Chile's total exports of agro-food products since 2007 exports to China increased from 5% to between 8.5 to 10% in 2010. Exports to China had a higher growth rate than other FTA partners.
- High concentration in forestry products, which represents between 52 and 56% of all agro-food-forestry exports to China, followed by fruits and wine (approximately 5 to 7% each). The slower growth of Chile's ag and food exports to China (relative to minerals and forestry) is consistent with the slower schedule of tariff reductions for sensitive products resulting the market access negotiations with China.

- Some sensitive products included salmon, table grapes and apples, which reach duty free status only after 10 years. Other sensitive products included exports of poultry, pork, plums, fresh peaches and nectarines, canned peaches, cherries, tomato paste, frozen shrimp. China resisted a rapid opening to these products, but they will eventually enter duty free into an enormous market.
- On the impact of the Chile-China FTA, (different from Korea and Japan), is the role of exchange rates. China has pegged the RMB to the dollar, effectively allowing the peso to strengthen as dollar devalues. Chile's exports to China have become relatively more expensive, both in terms of competition with Chinese domestic producers and in terms of competition from other countries with currencies that have not appreciated.



- Chile's agreements with China, Japan and Korea are also similar with respect to the degree of restrictiveness remaining on market access for agricultural products.
- Chile's agreement with the European Union on the other hand is much more complicated and demanding regarding farm exports from Chile, although similarly straightforward and more relaxed on the industrial products side.
- For Chilean exports to the EU of agricultural and food products, the tariff regime remains far more complex and restrictive.
- More than a third of farm imports from Chile, the EU agreement commits to no final removal of tariffs, ever. Meats enter under a tight set of import quotas, which, while expanding, began at a low base. For nine lines goods tariff concessions are only 50%

## Looking ahead: FTAs and LAC farm exports to China and East Asia

- China has become a major trading partner and the most important destination for primary products, minerals, forestry and agriculture, exported by Brazil and Chile. It is the second most important destination for exports of basic commodities from Peru, Venezuela and Cuba. (Costa Rica is a special case, exporting manufactures to China.)
- Considering the rapid economic growth of China, and its large population, the recent trends in growing import demand for natural-resource products are likely to continue.
- Although growing at a lower rate, markets in Japan and Korea also offer attractive opportunities for commodity exports from the LAC region.

- FTAs are a marketing tool for countries, promoting market penetration by lowering import barriers. Agreements are an attractive option to overcome the highly restrictive current trade regime for agricultural-based imports in Japan and Korea.
- Although with relatively lower protection, China still applies significant restrictions to imports on important agricultural products in which the LAC region is competitive. In China, grains and forestry products currently enter at relatively low import duties, but other products such as meats, dairy products, fresh and processed fruits, and others goods still face high levels of protection.
- The competitiveness of LAC exports in East Asian markets might face the threat of weak dollar relative to Latin American currencies.

- The Chinese currency effectively follows the US dollar, and to the extent that Japan and Korea are devaluing their currencies relative to LAC countries, exporters will be (and some already are) squeezed between falling revenues from tradables and constant or increasing production costs of nontradables.
- The currencies of Brazil, Chile and Colombia have recently appreciated against the dollar and exporters are complaining. For example, the Brazilian real has increased 9.5% against the dollar in the last 12 months.
- The government of Brazil has expressed concern that there is little to do except to try to lower interest rates and to restrain capital inflows via other means as well, such as a tax on short-term capital movements.
- Chile faces weak dollar and increasing wages for ag labor due to greater demand from fast-growing economy more generally. Harvest wages rose 20% in pesos over last year (34% in US\$).

- Some international commodity prices (grains), have increased in dollars compensating for the exchange rate appreciation, but this is not generally the case of non-commodities. A weakening dollar particularly against LAC currencies is a possible scenario for the next few years.
- The potential expansion in farm-related exports from South America to East Asia a possible “vent-for-surplus” case: exports allow for a fuller use of economic resources than in closed, domestic trade.
- Some South American countries possess a surplus capacity, in the form of land and climate, for the production of both commodities and some niche products.
- And future growth in the domestic demand for these farms goods is likely to be limited in middle-income countries.
- FTAs a role in generating greater effective demand for the output of these surplus resources.
- Exports of many commodities can increase without raising domestic prices consumption.

- The LAC region, however, is not East Asia's only potential supplies.
- China and Australia and New Zealand, and the ten economies in ASEAN are negotiating trade accords to reduce barriers overall, but importantly from LAC's perspective to open China's markets to agricultural exporters with a geographic advantage.

- If such agreements come on line in the near future, some Latin American countries could be put at a disadvantage, although the effect would depend on their product mixes.
- Soybeans and wheat from LAC are unlikely to be impacted, but other fish and food products could.
- Moving forward on FTAs between LAC and East Asia would not merely forestall the potential loss of competitive position in terms of prices, it would also accelerate in the case of non-commodities the experimentation, the contacts and training, the cultivation of the value chain, and the learning-by-doing required for successful marketing.

- Does greater trade with East Asia require better regional coordination among LAC countries? Multinational companies do this as part of their business. What is the role of the public sector in such coordination? This question is to be addressed as part of this Workshop.
- Trans Pacific Partnership (TPP) initiative, an expansion of the Pacific-4 group of Brunei, Singapore, New Zealand and Chile.
- The Trans Pacific Strategic Accord began with a group of relatively small countries in 2006, but expanded between 2007 and 2010 to include Australia, the United States, Malaysia, Peru and Vietnam, eventually becoming the TPP negotiating group.
- Possible new members include Canada, Japan, the Philippines, South Korea, and Taiwan. Note that China remains outside the group.



- The TTP partnership aims at establishing a free trade zone uniting many countries in Asia and the Americas, most of which have bilateral FTAs within the group. While bilaterals remain in effect, negotiations are ongoing over a wide and ambitious range of topics, including market access, government procurement, environmental issues, services, the financial sector and telecommunications.
- The web of already-established FTAs among so many of the current negotiating group provides a base, at least with respect to market access, on which a much more extensive agreement might be reached. The question remains regarding the best way the rest of South America, beyond Peru and Chile, could take advantage of the ongoing initiative.

- In addition, one observes that China, Japan and Korea are growing more commercially integrated with ASEAN countries and Australia and New Zealand, and eventually India, all exporters in potential competition with LAC.
- This development might prompt a certain sense of urgency on the part of Latin American countries to not “miss the boat” with respect to large and lucrative markets, particularly in agricultural products.
- Chile and Peru’s fruit and vegetable ag especially sensitive to high-income growth. (Demand growth from EU and USA limited.)
- FTAs with large Asian economies would not offer a dramatic benefit to some LAC exporters of basic commodities, such as grains, forestry and minerals.
- FTAs do offer at least some minor benefits to all, and major benefits to exporters of non commodities.