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The Internationalization of Chilean Agriculture: Implications of the United States-Chile Free Trade Agreement

Lindsay M. Faine

Notes

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INTRODUCTION

The United States-Chile Free Trade Agreement (U.S.-Chile FTA) has finally arisen from the negotiation table. Countries have been waiting in line to finalize free trade agreements with the heralded country of the south. While many Chileans have been enjoying the benefits of the fast-growing economy, others have taken to the streets to protest against Chile's internationalization and the crisis they believe is just around the corner. This crisis is the expression of a continuous imbalance between rural agriculture and the agricultural export market, and between agricultural economic growth and human-oriented rural development.[1] Peasant farmers, *campesinos,* face increasing difficulties in remaining competitive, and the working conditions of rural wage laborers continue to be precarious.[2] Although poverty has decreased significantly since the return to democracy in 1990, the gap between the rich and poor continues to be pronounced.[3]

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1. *See generally* David E. Hojman, *Introduction, in* NEO-LIBERAL AGRICULTURE IN RURAL CHILE (David E. Hojman ed., 1990) (discussing the dramatic changes in Chilean agriculture and rural society since the 1973 military coup).
2. *Id.*
3. MICHAEL DUQUETTE, BUILDING NEW DEMOCRACIES: ECONOMIC AND SOCIAL REFORM IN BRAZIL, CHILE, AND MEXICO 187 (1999).

Chile's neoliberal policies trace back to the fall of Salvador Allende.[4] Before this period, Chile was a relatively closed economy where agriculture contributed less than five percent to Chile's overall exports.[5] By the 1990s, Chile had become one of the most open economies in the world in which agriculture generated about thirty percent of overall exports.[6] Chile has attempted to make this transition under a 'growth with equity' development strategy.[7] However, the government has failed to tackle the negative social consequences of market liberalization on the rural countryside, where *campesinos* derive their livelihood from grain, wheat flour, sugar, and edible vegetable oil ("traditional agriculture").[8] Instead, the government has furthered Chile's deep integration into world markets through free trade agreements.[9] However, the resolution of the agrarian question in Chile cannot be left to free market forces alone. Rather, the state must actively intervene to mitigate the effects of trade liberalization on the rural population.[10] The state needs to facilitate local initiatives to spread the benefits of growth and modernization, especially to those marginalized during the authoritarian rule from 1973 to 1989.[11] Although Chile's increased market access offers great opportunities for growth, this also exacerbates inequality and dependency.[12]

This Note seeks to understand Chile's trade liberalization policy as it relates to agriculture. Part I of this Note introduces the basics of free trade analysis and the effects of protectionist

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4. *See infra* note 36 and accompanying text.

5. *See* Patricio Silva, *State Subsidiarity in the Chilean Countryside, in* NEO-LIBERAL AGRICULTURE IN RURAL CHILE 2 (David E. Hojman ed. 1990).

6. *Id.*

7. *See* Rafael X. Zahralddin-Aravena, *Chile and Singapore: The Individual and the Collective, A Comparison,* 12 EMORY INT'L L. REV. 739, 739-41 (1998); Cristóbal Kay, *The Agrarian Policy of the Aylwin Government: Continuity or Change?, in* CHANGE IN THE CHILEAN COUNTRYSIDE 27 (David E. Hojman ed., 1993) [hereinafter CHILEAN COUNTRYSIDE]. The discourse in the new government was reconciliation and commitment to a social market economy. *See id.*

8. CHILEAN COUNTRYSIDE, *supra* note 7, at 27.

9. *See generally* Mark P. Sullivan, *Chile: Political and Economic Conditions and U.S. Relations,* Congressional Research Service Report for Congress (Aug. 5, 2003), *available at* http://fpc.state.gov/documents/organization/23586.pdf (discussing the background for the Chile–United States FTA).

10. *See generally,* ALAN WINTERS, TRADE AND POVERTY: IS THERE A CONNECTION?, (World Trade Organization Working Paper), *at* www.wto.org/english/news_e/pressOO_e/pov3_e.pdf (June 13, 2000).

11. *See infra* Part II.

12. RICARDO FRENCH-DAVIS, REFORMING THE REFORMS IN LATIN AMERICA 2 (2000).

measures on trade. Part II provides a historical background of Chile's economic and agricultural reform and summarizes Chile's agricultural economy and the safeguards Chile has imposed to protect that economy. Part III describes Chile's free trade agreement with the United States and its likely effect on Chile's agricultural economy. Part IV analyzes the potential effects of the U.S.-Chile FTA on Chilean agriculture. Part V suggests strategies to reposition the theme of "Human Development" as a fundamental proposition for the coming years, using market liberalization as a resource to achieve it, and not as an obstacle for sustainable development. This Note concludes that Chile, as a model country of trade liberalization, must take positive steps to support traditional agriculturists throughout the transition in order to promote human development on a worldwide level.

I. FREE TRADE BASICS

Economists analyze trade liberalization by considering both short and long-term effects as well as weighing the social and private costs of adjustment.[13] Long-term effects are the most important for successful free trade agreements.[14] The most important long-term gains include increased competition, stimulus to investment and more efficient use of economic resources.[15] The short-term effects of creating a free trade agreement are measured in terms of trade creation and trade diversion.[16] Trade creation occurs when lower-cost imports from one trading partner replace domestic production from the other.[17] The idea is that trade creation causes efficiency gains for each country

13. WINTERS, *supra* note 10, at 59. "Trade liberalization is generally held to have long-run benefits, but it more or less requires adjustment in a country's output bundle to achieve them. If adjustment is costly, liberalization could lead to periods of decline and/or poverty before things get better." *Id.*

14. *Id.* at 58-59.

15. *See id.*

16. Dr. Richard L. Bernal, *Regional Trade Arrangements and the Establishment of a Free Trade Area of the Americas,* 27 LAW & POL'Y INT'L BUS. 945, 949 (1996) (describing how regional trade agreements can discriminate against nonmembers).

17. The theory of comparative advantage says that a country will export the product in which it has the greater advantage, and import the commodity in which its advantage is less. JOHN H. JACKSON ET AL., LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 8 (1995). For example, if the United States can produce wheat more cheaply than Chile, the United States will have a comparative advantage in wheat and therefore will export the wheat to Chile. *Id.* at 9.

because each country will shift from a higher-cost domestic source product to a lower-cost foreign product.[18] Each country will eventually begin to specialize in producing those items in which they have a comparative advantage.[19] Trade diversion occurs when lower-cost imports from a third party are prevented from entering a signatory country because of tariffs[20] or non-tariff barriers,[21] and are replaced by higher-cost imports from a signatory country.[22] Economists argue that protectionist measures are the leading cause of trade diversion.[23]

Protectionism in agriculture has been pervasive.[24] The instability of the agricultural market forced all countries to consider agriculture as an exception to trade liberalization.[25] Countries invoked quantitative restrictions,[26] export subsidies,[27] and domestic subsidies[28] in order to protect their domestic agricultural sector from the fluctuation in the international market.[29] While many international trade agreements have sought to reduce protectionist measures in favor of free trade, countries have been slow in removing such restrictions.[30]

Proponents of protectionist measures argue that the agricultural sector should be treated differently because of self-sufficiency, exceptional price instability, and preservation of the rural way of life.[31] Moreover, smaller countries are unable to subsidize their farmers to the same extent as larger, industrial-

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18. *Id.*
19. *Id.*
20. A tariff is a tax imposed at the border on imported goods. *Id.* at 373.
21. There are hundreds of non-tariff barriers (NTBs), such as quotas, subsidies, quality standards, and health and safety regulations. *Id.* at 378.
22. MICHAEL J. TREBILCOCK & ROBERT HOWSE, THE REGULATION OF INTERNATIONAL TRADE 130 (1999).
23. *See generally,* JACKSON ET AL., *supra* note 17, at 372–435 (discussing the effects of tariffs, quotas, and NTBs).
24. TREBILCOCK & HOWSE, *supra* note 22, at 246. "Protectionism has been pervasive in the agricultural sector in Canada, the United States, the EU and Japan." *Id.*
25. *Id.*
26. A quantitative restriction, or quota, is the most commonly used NTB. JACKSON ET AL., *supra* note 17, at 376. "A quota specifies the quantity of a specific product that a country will allow to be imported during a specific time period." *Id.*
27. "The export subsidy. . . is paid to an industry only on products that are exported." *Id.* at 758.
28. "The domestic subsidy is granted to an industry on all of its production of a product, regardless of whether that product is exported." *Id.* at 757.
29. TREBILCOCK & HOWSE, *supra* note 22, at 246-51.
30. *Id.* at 246.
31. *Id.* at 252-254.

ized countries.[32] The basic argument against agricultural protection is that it distorts the functioning of free trade.[33] Critics argue that it misallocates resources by shifting resources toward less efficient producers who are favored by protectionist measures and away from producers that are more efficient.[34] On a domestic level, the argument follows that protectionist measures lead to higher-cost imports, thereby forcing domestic consumers to pay a higher price for their products.[35]

II. THE CHILEAN EXPERIMENT

A. THE AGRARIAN REFORM – FROM SOCIALISM TO DICTATORSHIP TO DEMOCRACY

When Salvador Allende became president of Chile in 1970, he faced an unstable situation in the country.[36] In the countryside, there were constant clashes between *campesinos* and large

32. For example, the United States introduced the 2002 Farm Bill that increases support to United States farmers by $190 billion over the next ten years. *See* The Farm Security and Rural Investment Act of 2002, Pub. L. No. 107-171, 116 Stat. 134 (codified as amended in scattered sections of 7 U.S.C.); 2002 Farm Bill Regulations—Marketing Assistance Loans and Loan Deficiency Payments for Peanuts, Pulse Crops, Wheat, Feed Grains, Soy Beans, and other Oil Seeds, 67 Fed Reg. 63506 (Oct. 11, 2002) (to be codified at 7 C.F.R. pt. 1421). Smaller countries, like Chile, do not have the budget to support all farmers to that extent. *See* Eduardo Olivares & Luis Mendoza, *Parte TLC y Proyectan Aumento de 10% en Exportaciones a EE.UU. en 2004* [*Free Trade Agreement Projects 10% Increase in Exports to the United States in 2004*], LA TERCERA, Jan. 2, 2004, at 20.

33. TREBILCOCK & HOWSE , *supra* note 22, at 254 (stating that the fundamental issue is whether any of the reasons in favor of trade protection necessitate measures that radically distort world trade and cost non-farm households thousands of dollars in both higher food prices and in taxes that pay for farm subsidies).

34. *Id.*

35. *Id.* The author discusses the possibility of stabilizing farmer's incomes directly, through income averaging techniques or income insurance, rather than forcing consumers to pay higher prices. *Id. But see* John S. Markle, *Slaying the Sacred Cow: Looking for Consensus in the Reformation of World Agriculture Trade,* 68 N.D. L. REV. 607, 619-620 (1992) (arguing that while direct income is economically wise, it may be politically impossible). The author argues that direct income support converts cheap government programs into an expensive support system for farmers. *Id.*

36. PAMELA CONSTABLE & ARTURO VALENZUELA, A NATION OF ENEMIES: CHILE UNDER PINOCHET (W.W. Norton & Company 1991). In 1970, Salvador Allende, a Socialist Senator, overcame the Christian Democrat Eduardo Frei with a thirty-six percent plurality. *Id.* at 23. "Unfazed by his slim mandate and lack of majority support in the Congress, he launched ambitious plans to nationalize copper mines, take over factories and banks, accelerate land reform, and raise living standards. He was convinced that the sluggish, inefficient economy could be stimulated without leading to inflation." *Id.* at 24.

landowners.[37] Allende recognized the existence of class conflict and advocated for the exercise of state power on behalf of the weaker class.[38] By 1973, the government had expropriated over 4000 farms and the large land estates had ceased to exist.[39] This reform promoted unionization of the rural *campesinos*.[40] However, on September 11, 1973, General Augusto Pinochet Ugarte launched a coup d'etat against the Allende administration.[41] This day marked the beginning of seventeen years of dictatorship, a critical turning point for Chile's financial market and social and political unrest.[42]

While other Latin American countries were suffering the same political upheaval,[43] General Pinochet began a major project of trade liberalization one year after announcing himself President of Chile.[44] At the same time, the United States was campaigning against communism and socialism,[45] thereby giving the Pinochet administration the additional strength needed

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37. *Id.* at 24-25.

38. *See* Harry P. Díaz, *Proletarianisation and Marginality: The Modernisation of Chilean Agriculture, in* NEO-LIBERAL AGRICULTURE IN RURAL CHILE 132 (David E. Hojman ed., 1990) (describing the military's first step to reverse the process of Allende's agrarian reform by ending expropriations and redistributing expropriated land to various groups, including the former owners).

39. WILLIAM C. THIESENHUSEN, BROKEN PROMISES: AGRARIAN REFORM AND THE LATIN AMERICAN CAMPESINO 103-04 (1995) (stating that Allende expropriated as many farms in his first year as the previous President did in his entire six-year term).

40. *See infra* notes 73-76 and accompanying text.

41. Hojman, *supra* note 1, at 1 (describing the 1973 military coup as the mark of dramatic change for Chilean agriculture and rural society).

42. *See generally* CONSTABLE & VALENZUELA, *supra* note 36 for a vivid description of Pinochet's dictatorship.

43. *Id.* Almost every country in Latin America experienced a military takeover during the 1970s and 1980s. *Id.*

44. DEMETRIS PAPAGEORGIOU ET AL., LIBERALIZING FOREIGN TRADE: ARGENTINA, CHILE, AND URUGUAY 177 (1991).

> However, unlike many countries in similar circumstances, Chile went on to mount a major and most ambitious project of trade liberalization between 1974 and 1979, which unified exchange rates, eliminated import prohibitions, export quotas, all tariff exemptions, and on-tariff barriers, and reduced a tariff schedule widely dispersed around an average of 90 percent to a flat 10 percent.

Id.

45. CONSTABLE & VALENZUELA, *supra* note 36, at 22-39. Upon Allende taking office, the United States mounted a "two-track operation" to rid Chile of socialist rule: "while diplomats waged an overt political crusade, the CIA spent up to one million dollars on propaganda and other operations aimed at creating financial and political panic." *Id.* at 23.

to promote a pure free-market model.[46] The United States took advantage of this opportunity and sent young economic theorists to Chile to experiment with the growing economy.[47] These students, commonly known as the "Chicago Boys", arrived in Chile hoping to stabilize the distorted exchange rates and to standardize the varying rates on numerous products.[48]

The trade liberalization project proved successful in many respects, with the gradual elimination of protectionist measures in favor of more liberal policies.[49] Nevertheless, the 1980s saw stagnation in the forward-moving Chilean economy as well as for all of Latin America.[50] Consequently, the United States transitioned their economic focus to Eastern Asia, where fast-growing markets were more appetizing than the struggling markets in Latin America.[51] In reaction to Chile's slow market, the Chilean administration implemented measures to protect their domestic agriculture by increasing tariffs.[52]

Fortunately, the stagnation of the 1980s did not defeat Chile. In 1989, the dictatorship ended, and a democratically elected government took office in 1990.[53] "Neoliberalism with a human face" has characterized the economic policy since the

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46. *See id.* at 168.

47. PHILIP KING, INTERNATIONAL ECONOMICS AND INTERNATIONAL ECONOMIC POLICY 191 (2000) ("Chile con Chicago" is perhaps the best known, and extreme, example, where the University of Chicago virtually adopted the Catholic University of Santiago as a training ground for future Chilean economists. What these technocrats began in the 1980s has largely changed the face of the economic policy environment of the emerging markets in this last decade.").

48. CONSTABLE & VALENZUELA, *supra* note 36, at 168-71. These economic theorists sought to experiment with the free-market principle, sharply in contrast to the Marxist theory for underdevelopment that prevailed at the time. *Id.* at 168.

49. PAPAGEORGIOU, *supra* note 44, at 177-79. *See also,* Hojman, *supra* note 1, at 1 ("The land reforms carried out during the 1960s and early 1970s were reversed and some expropriated estates returned to their previous owners.").

50. CARMEN ZECHNER, EXPANDING NAFTA: ECONOMIC EFFECTS ON CHILE OF FREE TRADE WITH THE UNITED STATES 12 (2002) ("The 1980s have been labeled the lost decade for Latin America. The term 'lost decade' refers to the stagnation and decline of real GDP (gross domestic product) and per capita income recorded in Latin America during the 1980s.").

51. *Id.*

52. *See* Díaz, *supra* note 38, at 132 (stating that in reaction to the economic crisis, Chile increased tariffs and incorporated more pragmatism in subsequent neoliberal policies); *See* discussion *infra* pp. 17-22 regarding the Chilean price band system. The government set up a state fund to finance the minimum support prices for some key products and the government established a few technical assistance programs for those *campesinos* considered viable. The aim was to bring about an increase in yields so as to make the traditional farm sector more competitive. THIESENHUSEN, *supra* note 39.

53. *See* CONSTABLE & VALENZUELA, *supra* note 36, at 296-320.

democratic transition.[54] The new administration continued to promote the neoliberal[55] model but attempted to implement better social policies.[56] Nevertheless, the administration still emphasized greater market liberalization with a focus on agricultural exports and failed to undertake any substantial social initiatives that might be favorable to the rural *campesinos*.[57] Moreover, the country used its new democratically elected government and its unique geographical location to regain the interest of the Northern Hemisphere.[58]

In the search to amplify its exportation markets, Chile has been very committed to the subscription of trade agreements.[59] Chile's active and open trade policy has led to economic agreements with all the Andean countries in 1995,[60] to membership in MERCOSUR in 1996,[61] and to free trade agreements with Canada in 1997, Mexico in 1998, and both the European Union and Central America in 2002.[62] These trade agreements gave rise to a seven percent increase in Chile's gross domestic product annually.[63] This dramatic increase and Chile's new ap-

54. CHILEAN COUNTRYSIDE, *supra* note 7.

55. Neoliberal is a term often used in Latin America to describe a variation of the capitalist, free market policy. *See* DUQUETTE, *supra* note 3, at 125.

56. *Id.* The government encouraged cooperative forms of organization among smallholders of property in order to obtain credit, marketing, and technical assistance. *Id.*

57. *Id.* (describing the new government's fear of launching any fundamental policy proposals that might resurrect the Allende years).

58. ANDRÉS BIANCHI, TOWARDS A CHILE-UNITED STATES FREE TRADE AGREEMENT (2002), *available at* http://www.chileusafta.com/press_news_indiv.html?news_id=3cc471041c210744_7201 ("Due to its openness and relatively small size, Chile is linked more directly than many other countries to economic developments around the world. However, rather than view this fact with fear, Chile has embraced it as an opportunity.").

59. *Id.*

60. The Andean Pact, which formally changed its name to the Andean Community in 1997, is made up of Bolivia, Colombia, Ecuador, Peru, Venezuela and Chile. DUQUETTE, *supra* note 3, at 138 (stating that Chile was part of the Andean Pact but withdrew in 1976 in order to increase foreign investment).

61. *See id.* at 166-71. Mercado Común del Sur (MERCOSUR) is a free market zone designed to integrate the economies of the southern cone of Latin America in order to create increased bargaining power against other trading blocs. *Id.* When Chile began negotiating with MERCOSUR, the officials promised that additional resources would be provided to rural *campesinos* in order to help protect their livelihood. *Id.* In addition, measures that protected traditional agriculture were still allowed. *Id.*

62. BIANCHI, *supra* note 58. The result of these trade agreements led Chile from "a net external debtor of nearly $15 billion in 1987 to being a net external creditor of $8.5 billion in 2001". *Id.*

63. *Id.* The Chilean economy suffered in 1999 due to the Asian economic crisis

proach to market liberalization provoked the United States to view Chile with respect and as a model for other developing countries in Latin America.[64]

B. CAMPESINOS V. GLOBALIZATION: THE PLIGHT OF THE TRADITIONAL FARMER

Chile has a population of approximately fifteen million and a Gross Domestic Product (GDP) of $156 billion.[65] Chile is comprised of thirteen regions, numbering from I in the north to XII in the south and Santiago, Chile's capital.[66] The principal agricultural regions are III to X because regions I and II are primarily desert, and XI and XII comprise much of the Patagonian region.[67] The Andes mountain range, the Coastal mountain range, and the valleys that lie in the center of the country characterize the other eight regions.[68] Chile's total arable land is 2.65% and permanent crops total .42%.[69] Thus, only a relatively small portion of the total land in Chile is suitable for agricultural use.[70] Wheat, sugar and edible vegetable oils, known as Chile's traditional agriculture, characterize region VII, while the regions IV through VI, collectively known as the Central Valley region, are dedicated primarily to the fruit sector.[71]

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but rebounded in 2000. Sullivan, *supra* note 9, at 4.

64. Directorate General for Trade of the European Commission, *Bilateral Trade Relations-Chile,* (Oct. 2002), *at* http://www.europa.eu.int/comm/trade/ bilateral/chile/index_en.htm. "Chile is widely recognised as having the most open, stable and liberalised economy in Latin America . . . It is not for nothing that the World Economic Forum has rated the Chilean economy as the most competitive in Latin America." *Id. See also* HOUSE WAYS AND MEANS COMM., SUBCOMMITTEE ON TRADE, 108TH CONG., STATEMENT ON HOW THE UNITED STATES–CHILE FREE TRADE AGREEMENT SERVES THE INTERESTS OF UNITED STATES COMMERCE, *at* http://ways andmeans.house.gov/media/pdf/chile/hr2738docbenefitschileFTA.pdf [hereinafter HOUSE WAYS AND MEANS] (describing Chile as one of the world's fastest growing economies and as having a thriving democracy).

65. CENTRAL INTELLIGENCE AGENCY, THE WORLD FACT BOOK (2003), *at* http://www.cia.gov/cia/publications/factbook/geos/ci.html (last visited Jan. 21, 2004) [hereinafter WORLD FACT BOOK].

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. Paulina De Los Reyes, *The Rural Poor: Survival Strategies and Living Conditions among the Rural Population in the Seventh Region, in* NEO-LIBERAL AGRICULTURE IN RURAL CHILE 146 (David E. Hojman ed., 1990). "The peasants are located primarily in areas of low agricultural return, for example, in isolated hilly areas near the Andes or in dry coastal regions." *Id.*

71. *Id.* at 146 (stating that a large share of the rural population resides in region VII).

1. Domestic Agricultural Market

Campesinos that dedicate themselves to traditional agriculture "are located in areas of low agricultural return."[72] While many of these traditional agriculturists have suffered from poverty for generations, the marginalization reached under the Pinochet administration was unprecedented.[73] The *campesinos* felt the deterioration of production conditions, the reversal of Allende's land reform, and the consequent marginalization of hundreds of thousands of families, high unemployment, and the substitution of permanent work by seasonal employment.[74] Since the return to democracy, however, *campesinos* have increased production levels through advanced technologies.[75] They are no longer defined as a structurally backward or stagnant sector.[76] Nonetheless, *campesinos* continue to suffer from poverty.[77] The poverty of today, however, was not created by the same factors as that of the early 1960s and 1970s.[78] Today, some argue that the poverty is a result of a neoliberal model that is unable to integrate most of the rural population into the market in a meaningful way that could contribute to improved living conditions.[79]

Chile's tariff system has tried to protect the *campesinos* by dissuading foreign countries from trying to export agricultural products at a rate lower than the *campesinos* are able to produce. All agricultural products have a uniform import tariff that dropped to six percent in 2003 with the exception of se-

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72. *Id.*

73. *Id.* at 147. Rural *campesinos* represent the bottom quintile in the Chilean economy. *Id.* During the Pinochet administration, the land that had been given to them by the Frei and Allende governments was taken away and returned to many large landowners or used by the government to promote international investment. *Id.*

74. *Id.* at 146.

75. Díaz, *supra* note 38, at 131 (stating that recent agricultural modernization has been the product of a new style of development imposed by the Pinochet Administration). The agricultural modernization consists of the "efficient allocation of resources through the market, private property and private enterprise." *Id.*

76. *Id.* at 127.

77. De Los Reyes, *supra* note 70, at 146.

78. Díaz, *supra* note 38, at 127.

79. *Id. See* James Langman, *Free Trade a Dilemma for Chile; Success for Some Means Loss for Others,* WASH. TIMES, (June 17, 2003) (stating that the U.S.–Chile FTA will mean greater opportunity for some in Chile, such as for the successful export producers). "But for the more than 200,000 farmers in southern Chile who specialize in [traditional agricultural products such as] wheat, dairy products, beef and [sugar] beets produced mainly for the domestic market free trade with the United States. spells impending disaster." *Id.*

lected grains, wheat flour, sugar, and edible vegetable oils.[80] These products are protected by a price band system, which is determined annually with reference to both domestic and international conditions.[81] The price band contains a floor price and a ceiling price.[82] If a country exports a product to Chile at a price lower than the floor price, the Chilean government adds a tariff to raise the price equal to the floor price.[83] If a country exports a product at a price higher than the set price ceiling, the Chilean government will lower the price to equal the ceiling price.[84] This policy is designed to shield domestic producers from fluctuating world prices and to encourage farmers to adopt better farm management practices.[85] Proponents of the system contend that relevant economic, social, and labor reasons coupled with food security justify its functioning.[86] For over twenty years, the farmers and their respective industries have counted on the certainty of a minimum price of production.[87] Moreover, yields of some crops increased substantially so that they are now similar to those achieved by advanced countries with highly developed and subsidized agriculture, such as the United States and countries in the European Union.[88] On the other hand, critics argue that the price band is protectionist; it does not guarantee that the associated costs will be equally distributed between

80. Sullivan, *supra* note 9, at 5.

81. RECOPILACIÓN DE LEYES Y REGLAMENTOS [COMPILATION OF LAWS AND REGULATIONS] Law No. 18.525 at art. 12 as amended by Law No. 19.897 (Chile), *available at* http://www.odepa.gob.cl/noticiasweb/jsp/imprime2.jsp [hereinafter Amended Band Law].

82. *Id.*

83. *Id.*

84. *Id.*

85. Jaime Campos Quiroga, *Las Bandas de Precios, un Mecanismo de Seguridad y Confianza Para los Productores* [*Price Bands, a Mechanism of Security and Confidence for Producers*], July 1, 2003, *available at* http://www.agroamigo.cl/contenido/estadistica/est_banda.htm [hereinafter *Security and Confidence*] (describing that for economic, social, labor, strategic and food security reasons the price band has been justified. For the last twenty years, farmers have been able to produce with the certainty of receiving a minimum price for their products).

86. *Id. See also* Hojman, *supra* note 1, at 4 (stating that the price band has "led to output increases [and] significant result[s] in terms of local employment trends"). Proponents of price stabilization argue that people in farming is a social good in itself. TREBILCOCK & HOWSE, *supra* note 22, at 253-54. One assumption is that without family farming, the countryside would be saturated with polluting industries or replaced by commercial towns. *Id.* Even urbanites argue that maintaining the beauty of the countryside is an important social factor that should be considered. *Id.* at 254.

87. *Id.* at 253.

88. Sullivan, *supra* note 9, at 4.

the producer and the consumer and it inhibits the Chilean economy from successful integration in the international market and therefore affects the development of the export sector.[89]

Many of Chile's trading partners have also condemned the price band system because they found it to be nontransparent, unforeseeable, and discretionary.[90] For instance, in 2002, Argentina filed a case with the World Trade Organization[91] (WTO), claiming that Chile violated its obligations under the Agreement on Agriculture[92] (AoA). Under the AoA, Chile's bound tariff rate for wheat, wheat flour, and edible vegetable oils was 31.5%.[93] Argentina argued that Chile's price band system did not maintain the tariff within this range.[94] Argentina looked to Article 4:2[95] of the AoA, essentially arguing that the

89. Jaime Gatica, *La Banda de Precios del Azúcar [Sugar Price Band]*, June 19, 2002 *at* http://www.expansiva.cl/columnas/detalle/tpl?idcolumna=06192002121731 [hereinafter *Sugar Price Band*]. *See also* TREBILCOCK & HOWSE, *supra* note 22, at 254 (asking whether price distortions necessitate measures that increase food prices and taxes for non-farm households in order to pay for farm subsidies). Critics that argue against price stabilization through subsidies believe that the income of farmers could be stabilized through income averaging techniques or income insurance. *Id.*

90. WTO Appellate Body Report on *Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R para. 71 (Sept. 23, 2002), at www.wto.org [hereinafter *Price Band Panel Report*].

91. After World War II, many governments pushed for a multilateral discipline in international trade in order to compete against the trade protection imposed by major trading nations. BHARGIRATH LAL DAS, THE WORLD TRADE ORGANISATION: A GUIDE TO THE FRAMEWORK FOR INTERNATIONAL TRADE 3 (1999) (describing the need to expand international trade in order to ensure development and growth). In 1986, the Uruguay Round on Multilateral Trade Negotiations began, which resulted in a comprehensive set of agreements including the Agreement on Agriculture, purporting to eliminate protectionist measures. *Id.* at 6. In the same process, the World Trade Organization (WTO) emerged as the administrator on the implementation of the Uruguay Round agreements and provided a framework for the enforcement of these rights and obligations. *Id.* at 3.

92. The Agreement on Agriculture is designed to open up countries' borders to agricultural products by reducing the import restrictions that countries have maintained to protect their agriculture. WTO Agreement on Agriculture, Apr. 15, 1995, *available at* http://www.wto.org/english/docs_e/14-ag.pdf [hereinafter Agreement on Agriculture]. The AoA sets out an implementation period for the reduction of agricultural protection for each country, dependent upon their level of development. *Id.* LAL DAS, *supra* note 91, at 240 (showing a typical schedule of a Member and an analysis of their reduction requirements).

93. Raj Bhala & David A. Gantz, *WTO Case Review 2002,* 20 ARIZ. J. INT'L & COMP. L. 143, 221-22 (2003) (discussing Chile's Price Band System which drew the "ire of Argentina"). The applied most-favored nation rate was only eight percent. *Id.* at 222.

94. *Price Band Panel Report*, *supra* note 90.

95. Agreement on Agriculture, *supra* note 92, art. 4:2. Article 4:2 provides that "[m]embers shall not maintain, resort to, or revert to any measures of the kind

price band system was similar to a "variable import lev[y] and [to a] minimum import price", both of which are prohibited.[96] The WTO Panel, agreeing with Argentina, held that the additional duties that Chile imposed on wheat and edible vegetable oils violated the AoA.[97] The Appellate Body, agreeing in part with the Panel, gave Chile fourteen months to modify their price band system.[98]

In response to the WTO's decision, Chile undertook to modify their system of price bands.[99] On August 6, 2003, Chile supplemented Law No. 19.897 with Article 12 of Law No. 18.525, which went into effect on September 25, 2003.[100] The new law sets a fixed floor value and a fixed ceiling value until 2007.[101] From 2008, both the floor and the ceiling will be reduced 1.5% annually until 2014.[102] In the case of sugar, after 2007, the fixed values will be reduced two percent annually from 2008 until 2011 and then six percent annually from 2012 to 2014.[103] Overall, the new law is transparent, foreseeable, and nondiscretionary because exporting countries will be able to determine the exact tariff that will be placed upon its product.[104]

2. *Agricultural-Export Markets*

Chile's fresh fruit exports grew fifteen-fold between 1974 and 1992,[105] providing Chile with a comparative advantage in

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which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 and Annex 5." *Id.* The AoA footnotes different measures that are included under Article 4, including "quantitative import restrictions, variable import levies, minimum import prices, discretionary import licensing, non-tariff measures maintained through state-trading enterprises, [and] voluntary export restraints". *Id.* at n.1.

96. *Price Band Panel Report*, *supra* note 90, para. 73.

97. *Id.*

98. *See id.*

99. Amended Band Law, *supra* note 81.

100. *Id.*

101. *Id.* art. 1, para. 3.

102. *Id.* art. 1, para. 4.

103. *Id.*

104. *See supra* note 81.

105. GABRIEL G. CASABURI, DYNAMIC AGROINDUSTRIAL CLUSTERS: THE POLITICAL ECONOMY OF COMPETITIVE SECTORS IN ARGENTINA AND CHILE 32 (1999) (describing the significant growth in fruit exports pursuant to a strong policy and business strategy as well as based on favorable natural conditions); *see also* Manuel R. Agosín, *Free Trade Agreements for Chile: Potential Benefits and Costs*, 4 TRANSNAT'L L. & CONTEMP. PROBS. 21, 25 (1994) (stating that fruit and vegetable exports to the United States are greater in volume than those to other trading partners).

trade liberalization.[106] The rapid growth has allowed the fruit industry to take over land that was previously dedicated to traditional agriculture in the Central Valley.[107] This growth was encouraged by the generous government subsidies and fiscal incentives that mainly benefited large corporations.[108] A few middle-sized and capitalized small farms also grew rapidly because of international borrowing.[109] Many regions in the north and south of Chile also tried to accommodate the needs of the fruit industry, but the land does not benefit from the privileged agroecological situation enjoyed by Chile's Central Valley.[110] Unfortunately, Chile's fruit market has not escaped without difficulties. Due to competition from other nations, the Chilean fruit industry faces saturation that can only be cured through greater diversity in both market and product.[111]

Also included in Chile's agrarian reform was the development of the agroindustrial sector. The agroindustry exhibits the specific traits most associated with recent Chilean economic success: export growth in a natural-resource related sector.[112]

106. In 1779, David Ricardo documented the theory of comparative advantage. MIKE MOORE, A WORLD WITHOUT WALLS: FREEDOM, DEVELOPMENT, FREE TRADE AND GLOBAL GOVERNANCE 52 (2003). His theory suggested that specialization of a group, rather than just an individual, was the basis for economic success. *Id.*

107. CASABURI, *supra* note 105, at 32-33.

108. *Id.* at 33-36 (analyzing the reasons why Chile's government subsidized the fruit market in order to ensure its success). Corporación de Fomento de la Producción (CORFO) designed a plan to promote investment in the fruit sector. *Id.* at 35-36. The plan studied the foreign markets to determine the public demands in the fruit sector while building the basic infrastructure for developing the industry. *Id* at 36. CORFO also provided credit to those farmers and facilities that chose to grow and export the types of fruit that the study had determined to be the most profitable. *Id.*

109. THIESENHUSEN, *supra* note 39, at 111. The large growth created many jobs in agriculture but the rural peasants did not benefit from the increased agricultural activity. *Id.* at 112.

110. CASABURI, *supra* note 105, at 31. The Central Valley surrounds Santiago, Chile's capital, which is home to nearly six million people. *Id.* at 33-34. This location provides the fruit industry with reduced transportation costs, access to the hub of economic activity in Chile and rich soil. *Id.* at 31-34. Moreover, "the relative physical isolation of the Valley . . . means that it benefits from the lack of widespread plant diseases that affect competing fruit-production regions." *Id.* at 31.

111. *Id.* at 38 (noting that countries such as South Africa and Argentina are reestablishing themselves and trying to recover market shares that were lost to Chile in previous years). *See also* CHILEAN COUNTRYSIDE, *supra* note 7, at 28 (describing the need to open up new export markets because Chilean fruit was reaching its limit).

112. THIESENHUSEN, *supra* note 39, at 112 ("This sustained agro-export growth is the success story of the neo-liberal economic strategy and has garnered widespread admiration for the Chilean policy model.").

The agroindustrial hotbed is located in the northern central region of Chile,[113] near the Central Valley. Networks of small producers who supply to large firms producing fruit, vegetables, wine, and dairy products for local and export markets characterize the sector.[114] Forty-three percent of Chilean agriculture goes to the agroindustrial sector, thereby having a major effect on the structure and conduct of farming.[115] While just thirty years ago this sector did not export, state intervention helped the agroindustrial sector achieve twenty percent of total processed natural resource-related exports.[116] Nonetheless, this sector also exhibits the same dwindling presence of smaller agroindustrial firms as is prevalent in the export of primary agricultural products.[117] Between 1975 and 1995, investment in smaller agroindustrial firms decreased while many larger firms showed double-digit annual growth in investments.[118] For example, Chile's largest agroindustrial firm, IANSA, produced sugar from sugar beets grown by small and medium farmers for thirty-five years.[119] However, in 1985, the company privatized and moved largely into the export of tomato paste.[120] IANSA's change in emphasis largely affected the sugar beet producers in the south because of the number of contracts being formed with medium and large fruit farmers.[121]

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113. XIMENA MILICEVIC ET AL., LINKAGE IMPACTS OF FARMING WITH AGROINDUSTRIAL CONTRACTS: THE CASE OF TOMATOES IN CHILE, 3 (May 1999), *available at* www.rlc.fao.org/prior/desrural/pdf/milicevl.pdf (stating that the agroindustry began mainly with the grapes, sugar beets, and apples but expanded to include other fruit and vegetables by the 1990s).

114. Paola Perez-Alemán, *Learning, Adjustment and Economic Development: Transforming Firms, The State and Associations in Chile*, 28 WORLD DEV. 41, 42 (2000) (describing the new dynamic between private firms and the government in order to encourage new standards of product quality and upgrade productive capabilities).

115. MILICEVIC ET AL., *supra* note 113, at 1 (stating that approximately twenty-five percent of farmers in Chile have contracts with agroindustrial firms). "[T]his implies that up to now the center of gravity of agroindustry are the medium—not the smaller farms." *Id.*

116. *Id.*

117. Martine Dirven, *Local Agroindustry Survival Difficulties in a Globalizing World, Illustrated by Examples from the Chilean Milk Industry* (Aug. 2, 1999), *at* http://www.redcapa.org/Downloads/mdirven2.doc ("The number of small agroindustrial firms fell from 1,381 in 1980, to 1065 in 1990, to 1005 in 1995 while the number of larger agroindustrial firms increased steadily from 318, to 445, to 505.").

118. *Id.*

119. MILICEVIC ET AL., *supra* note 113, at 3.

120. *Id.*

121. *Id.* at 10-11. *See* Agriculture Online, *Chile's Iansa Plans Layoffs in Restructuring,* (Oct. 6, 2003) *at* http://www.agriculture.com/worldwide (stating that

III. BILATERAL FREE TRADE AND AGRICULTURE

International indicators show that Chile has an open, competitive, transparent and disciplined economy.[122] The economic stability, political transparency, and the relative ease of doing business in Chile highlights the institutional stability, the legal certainty for investors, the quality of the political economy, and a solid financial system; factors consistent with the macroeconomic rigor needed to compete in the world market.[123] All of these factors reflect the low risk that a country confronts when dealing with Chile's economy, despite the recessive international scene, the drought in external financial sources, and with the economic crisis of its neighbors.[124] The national indicators explain why Chile is able to negotiate free trade agreements with both the United States and the European Union simultaneously.[125] Chile believes that both negotiations have come at a decisive moment to deepen their export sector, and through this, promote investment, employment and modernization of their productive system.[126]

The U.S.-Chile FTA, signed on June 6, 2003,[127] culminates negotiations that began in 1990.[128] Prior to the late 1990s, the United States was highly competitive in the Chilean market.[129] Subsequently, Chile became a party to numerous free trade

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Chilean sugar producer IANSA has begun a restructuring program that includes reducing its workforce by fifteen percent to increase the company's productivity and competitiveness). "The corporate reshuffle is part of a plan to raise sugar production to 100 tons per year from the current 76 tons by 2014 when a price band that protects local sugar producers from cheaper imports will be removed." *Id.*

122. Evgenia V. Sorokina, *Chile's Free Trade Agreements: Can Their Benefits Survive Chile's Continuing Controls On Foreign Capital,* 18 AM. U. INT'L L. REV. 1217, 1219 (2003) (describing Chile as the most attractive emerging market in South America because of economic stability, political transparency, and relative ease of doing business).

123. *Id.*

124. *Id.* at 1218-19.

125. *Id.* at 1218.

126. *Id.* at 1218-19 (describing the Chilean government's hopes to reverse the economic slowdown by signing agreements with the European Union and the United States). Skeptics of the U.S.-Chile FTA suggest that the benefits may be exaggerated unless Chile can reduce their costs of production because of high shipment costs from Chile to the European Union or the United States. *Id.* at 1231–1232.

127. Trade Agreement, June 6, 2003, U.S.-Chile, 42 I.L.M. 1026, *available at* http://www.ustr.gov/new/fta/Chile/final.pdf [hereinafter U.S.-Chile FTA].

128. Agreement Concerning a United States-Chile Council on Trade and Investment, Oct. 1, 1990, U.S.-Chile, 29 I.L.M. 1404. The preamble refers to the U.S. Enterprise for the Americas Initiative and the intention to establish a mechanism for encouraging free trade. *Id.* at 1405.

129. HOUSE WAYS AND MEANS, *supra* note 64, at 1.

agreements, providing preferential market access for its new partners.[130] From 1989 until 2000, the United States ran a small trade surplus with Chile but exports fell drastically between 2001 and 2002. This, in turn, left the United States with an approximate deficit of U.S. $1.2 billion.[131]

Chapter three of the U.S.-Chile FTA deals with agriculture.[132] The main impact on agriculture is the phased-in reduction and eventual elimination of tariffs on all agricultural products.[133] However, because the FTA contains few restrictions with respect to domestic support measures, its overall liberalizing effect is quite modest for the United States.[134] Article 3.16 does prohibit, however, export subsidies on agricultural goods moving from one FTA partner to the other.[135] It should be noted that this does not prohibit either Chile or the United States from reacting to export subsidies from other countries. Under the FTA, approximately seventy-five percent of U.S. agricultural products will enter Chile without tariffs within four years and 100 percent will enter duty-free within twelve years.[136] In order for the United States to gain such preferential access, Chile has committed to phase out its price band system over the twelve-year transition period.[137] In agreeing to its elimination, Chile went further than required under the WTO Agreement on Agriculture.[138]

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130. *Id.*

131. Sullivan, *supra* note 9, at 7. The United States was still subject to the six percent uniform tariff while other countries that had already completed trade agreements with Chile were exporting products without being subject to any tariff. *Id.* at 5.

132. *See* U.S.-Chile FTA, *supra* note 127, art. 3.

133. *See id.*

134. *See id.*

135. U.S.-Chile FTA, *supra* note 127, art. 3:16 ("Where an exporting Party considers that a non-Party is exporting an agricultural good to the territory of the other Party with the benefit of export subsidies, the importing Party shall, on written request of the exporting Party, consult with the exporting Party with a view to agreeing on specific measures that the importing Party may adopt to counter the effect of such subsidized imports.").

136. *See The United States and Chile Free Trade Agreement, May 2003 Fact Sheet, at* http://www.fas.usda.gov.info/factshets/ChileFTA/overall.html (last visited Sept. 24, 2003).

137. *Id.* (describing the benefits that United States' farmers, ranchers, food processors and businesses will receive with new access to Chile's new market of fifteen million consumers).

138. *See supra* notes 93-98 and accompanying text.

IV. EVALUATION OF CHILE'S TRADE LIBERALIZATION

A. SHORT-TERM CONSEQUENCES

1. Trade Creation

In order for a free trade agreement to be successful short-term, the agreement must lead to greater trade creation than trade diversion and increase the economic well-being of each signatory country.[139] In the case of the U.S.-Chile FTA, the reduction of trade barriers increases the imports from the other party, not only affecting domestic production but also imports from other countries.[140] For example, the U.S. wheat and sugar market—while not necessarily more efficient than Chile's traditional agriculture, but highly subsidized—will enter Chile at a lower cost than is possible for Chilean wheat and sugar farmers.[141] Chile's decision to eliminate the price band system, but to allow export subsidies from the United States, supports the oversupplied wheat market in the United States, thus creating another export market.[142] In return, Chile will increase exports of fruit and agroindustrial products to the United States because of the comparative advantage that Chile maintains in these sectors.[143]

Trade creation is not beneficial for all sectors. Proponents of free trade argue that trade creation is almost always economically beneficial overall because it occurs only when the price of the import in question is lower than the domestic cost of producing the same good.[144] Therefore, trade creation allows the domestic economy to obtain the good at a lower cost than would be possible without trade.[145] Liberalization of Chile's sugar and wheat sector has the potential for substantially reducing sugar and wheat prices in Chile, which historically has held its domestic prices above world prices through the price band system.[146] The trade off, critics argue, is the complete de-

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139. *See supra* note 13 and accompanying text.
140. *See supra* notes 133-38 and accompanying text.
141. *See supra* note 32 and accompanying text.
142. *See supra* note 32 and accompanying text.
143. *See supra* note 106 and accompanying text.
144. *See supra* note 17 and accompanying text.
145. *See supra* note 17 and accompanying text.
146. *See supra* notes 81-84 and accompanying text.

struction of the domestic sector that cannot produce at such low levels.[147] As a result, Chile potentially faces substantial rural worker displacement through the adjustment to liberalized agriculture markets and production.[148] Unfortunately, trade creation does not only occur when the domestic cost of producing the good is lower than the domestic cost of production.[149] For instance, the export subsidies from the United States create the appearance of a lower-cost good, thereby entering Chile at a lower price.[150] In actuality, both countries produce traditional agriculture at relatively the same cost.[151] Due to the relative size of the United States as compared to Chile, the government is able to provide domestic support at greater levels than Chile.[152]

2. Trade Diversion

Trade diversion, the term used to describe the displacement of imports from other countries, is less likely to be beneficial to the importing country. As an illustration, suppose that before the Chile-EU Association Agreement went into effect, Chile imported a particular product from the United States and not the European Union.[153] However, after the Association Agreement went into effect, because of the reduction of tariffs on the EU goods, Chile imported the same product from the European Union and not the United States.[154] Even though the U.S. price was lower for Chilean purchasers, the reduction of tariffs favors the European Union product.[155] Until January 1, 2004, the Chilean market rejected U.S. products that could easily be obtained from other markets, because they were subject to the six percent uniform import tariff.[156] This trade diversion had dramatic effects on U.S. exports to Chile,[157] and therefore gave the United States the last-minute urgency needed to complete the U.S.-Chile FTA.[158]

147. *See supra* Part II.B.
148. *See supra* note 1.
149. *See supra* note 79 and accompanying text.
150. *See supra* note 135 and accompanying text.
151. *See supra* note 75-76 and accompanying text.
152. *See supra* note 65 and accompanying text.
153. *See supra* notes 20-23 and accompanying text.
154. *See supra* notes 20-23 and accompanying text.
155. *See supra* notes 20-23 and accompanying text.
156. *See supra* note 131.
157. Olivares & Mendoza, *supra* note 32, at 20.
158. *See supra* notes 129-30 and accompanying text.

Meanwhile, Chile was feeling the same effects from the North American Free Trade Agreement (NAFTA) between the United States, Mexico, and Canada.[159] Since both Chile and Mexico maintain a comparative advantage in the fruit and vegetable market, Mexican goods were entering the U.S. market without being subject to tariffs.[160] Meanwhile, Chilean products, even though produced at a lower cost than the Mexican goods, were subject to a small tariff.[161] Thus, in the short term, both the United States and Chile will likely benefit from trade creation overall, but certain sectors will be devastated by the inevitable trade diversion that will result from the U.S.-Chile FTA.

B. LONG-TERM CONSEQUENCES

Long-term effects are the most important factor for successful free trade agreements but often more difficult to predict.[162] The most important long-term gains include increased competition, stimulus to investment, and more efficient use of economic resources, while negative long-term effects include displacement and increased government support.[163] Chilean promoters of the U.S.-Chile FTA believe the free trade agreement will complement their economic reforms, creating a shock of productivity in work and capital.[164] Proponents also believe the stimulus to investment will benefit all Chileans because of the privatized social security system that is based on savings and investment, rather than taxes and spending.[165] However, trade analysts

159. *See supra* note 50 and accompanying text.

160. *See supra* note 106 and accompanying text. *See generally* MAGDALENA BARROS, FROM MAIZE TO MELONS: STRUGGLES AND STRATEGIES OF SMALL MEXICAN FARMERS (2000) (describing the struggles that Mexican agriculture has undergone since the North American Free Trade Agreement and measures being taken by small farmers to cope with the drastic transition).

161. *See supra* note 111 (discussing Chile's need to open up new markets to the fruit industry).

162. *See supra* note 13 and accompanying text (discussing the costs of adjustment both short and long-term).

163. *See supra* note 15 and accompanying text.

164. *See supra* note 126 and accompanying text.

165. José Piñera & Aaron Lukas, *Chile Takes a Bold Step Toward Freer Trade,* WALL ST. J., Jan. 15, 1999, at A11, *available at* http://www.freetrade.org/pubs/articles/al-1-15-99.html (describing the benefit that Chileans receive from free trade because of their market-invested retirement funds). In 1980, Chile created Chile's Pension Savings Account system. *Id.* The authors argue that the private pension system influenced the first democratically elected government after Pino-

must weigh the long-term effects against the social costs of adjustment.[166] The weaknesses in this reasoning arise from the small number of Chileans that benefit from the privatized pension system.[167] While only those in the formal economy are able to benefit from a shock in productivity, not all formal jobs provide access to the system.[168] Moreover, since many *campesinos* are not part of the formal economy, they are likely to be affected negatively by the elimination of the price band system and likewise will not see any of the benefits from increased foreign investment.

1. Increased Competition

Critics argue that the price band inhibits competition and therefore does not guarantee, in the long term, that the associated costs will be equally distributed between the producer and the consumer.[169] This conclusion is based on historical analysis that shows that price bands are far from being a mechanism that stabilizes prices, but rather function as a protectionist system, financed by consumers.[170] This is the difference between the net benefits, meaning the overall effects for the entire country, and the distributional effects, defined as the effects that protectionist measures have on certain sectors of the country. This protection has cost Chilean consumers about U.S. $1.7 billion, with the greatest damage being suffered by the poorest sectors.[171] To illustrate this point, one need only look at the percentage of income that families allocate to the purchase of goods made from wheat, sugar, and oil.[172] The poorest twenty percent allocates almost sixteen percent of its income to the purchase of those goods, while the richest twenty percent allocates only 3.8%.[173] Despite the fact that spending on those goods in absolute terms is higher in the richest quintile, as a percentage of income the poorest are most affected by the high product price created by the price band.[174]

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chet to continue opening the economy. *Id.*

166. *See supra* note 13 and accompanying text.
167. *See supra* note 165.
168. *See supra* note 13 and accompanying text.
169. *See supra* note 88 and accompanying text.
170. *See supra* notes 34-35 and accompanying text.
171. *See supra* note 74 and accompanying text.
172. *See* De Los Reyes, *supra* note 70, at 148.
173. *Id.*
174. *Id.*

Instead, critics claim that in the long term, the sugar price band guarantees that the major beneficiary will be the only sugar refining company in the country, IANSA, and that the consumers will be disadvantaged.[175] Under the old price band system, when the international price is below the fixed floor value, the government adds a tax specifically designed to lift the price to meet the floor level.[176] Arguably, this situation benefits IANSA because they internally produce sugar.[177] The argument follows that the consumers are prejudiced because instead of paying the lower international price, they must pay the higher internal price.[178]

Both the U.S.-Chile FTA and the WTO have forced Chile to eliminate the price band system.[179] Proponents of the elimination believe that it will increase competition against major refining companies, such as IANSA, thereby reducing the monopolistic pricing of the goods for consumers.[180] It follows that rural *campesinos* will be better off because they will not be paying as much for basic products.[181] This argument fails to address two issues. First, if competition increases, IANSA will likely be forced out of the market or at least will have to increase its productivity, which generally means laying off workers.[182] In addition, IANSA had been dedicated to contracting with small and medium size farmers.[183] The decrease in IANSA's output level will likely force the company to eliminate the contracts it has maintained with small farmers and, instead, contract with medium or large farmers who produce at a greater efficiency level or, in the alternative, completely move into the fruit and vegetable market.[184]

Secondly, most rural *campesinos* survive from their own crop production and the crop production of other *campesinos*.[185] Increased competition from the United States will decrease profitability, which will likely decrease their production level to a minimum, if anything, and force *campesinos* to put more money

175. *See supra* notes 118-20 and accompanying text.
176. *See supra* notes 82-84 and accompanying text.
177. *See supra* note 118 and accompanying text.
178. *See supra* note 89 and accompanying text.
179. *See supra* notes 97-98, 137 and accompanying text.
180. *See supra* note 35 and accompanying text.
181. *See supra* note 35 and accompanying text.
182. *See supra* notes 119-20 and accompanying text.
183. *See supra* notes 119-20 and accompanying text.
184. *See supra* notes 119-20 and accompanying text.
185. *See supra* notes 73-76 and accompanying text.

into basic products.[186] For example, if the internal prices fall as a result of elimination of the price band system, domestic production of sugar and wheat will fall in response to lower prices and *campesinos* will be forced to purchase these products from the market rather than surviving from their own production of sugar and wheat.[187] Overall, *campesinos* will possibly be worse off.

2. Investment

The U.S.-Chile FTA is concerned not only with free trade, but also with investment. Investment adds to national savings and helps to expand productive capacity.[188] Price stability is necessary in order to attract foreign direct investment in a region.[189] The agroindustrial sector will likely attract the majority of foreign direct investment because it is characteristic of Chile's neoliberal policies initiated in 1974.[190] The successful supply of exports, however, requires substantially more than just changes in market strategy in order to induce investment, even when a comparative advantage presently exists in a market.[191] The State has played a key role in improving capacity for the fruit market and the agroindustrial sector in order to attract foreign investors and has continued to do so.[192] Chile's dramatic entrance on the international market shows the difference the state can play in attracting investment and stabilizing the market.[193] The Chilean government projects that the U.S.-Chile FTA will double the exports from Chile to the United States.[194] Given that one-third of external investments in Chile come from the United States, the large growth in exports will provoke an even greater injection of U.S. investment because of the accelerated increase in Chile's GDP.[195] *Campesinos,* however, have not received the same investment by the government and therefore have been unable to draw foreign direct investment.[196] The in-

186. *See supra* notes 73-76 and accompanying text.
187. *See supra* notes 73-76 and accompanying text.
188. *See supra* note 165 and accompanying text.
189. *See supra* notes 31, 118 and accompanying text.
190. *See supra* note 112 and accompanying text.
191. *See supra* note 106 and accompanying text.
192. *See supra* note 106 and accompanying text.
193. *See supra* note 106 and accompanying text.
194. Olivares & Mendoza, *supra* note 32, at 20.
195. *Id.*
196. *See supra* notes 108-09 and accompanying text (discussing the large investment the Chilean government put into the export market rather than the do-

crease in agricultural exportation lies solely within the fruit and agroindustrial sector and does not include traditional agricultural products.[197] Therefore, they will likely face a continued loss of current domestic and foreign investors because of the forthcoming price instability in the traditional agricultural market.[198] Unless the state can work to promote stability in the region, any small investors that the more viable *campesinos* have today will likely put their investment in a more stable market, such as the fruit sector.[199]

Unfortunately, the Chilean government does not have the budget to support all industries while maintaining and increasing involvement in the fruit and agro-industrial markets.[200] Instead, the government would have to use some of the resources gained from the agricultural export market to help secure the domestic traditional *campesinos*.[201] However, this may not be enough given the substantial subsidies distributed to United States farmers in the same sector.[202]

3. Use of Resources

Chile's unique geographical location provides Chilean farmers with both benefits and disadvantages.[203] Most benefits belong to the fruit farmers because of the specialized climate that prevents widespread land disease and the close proximity to Santiago and Chile's principal ports.[204] The *campesinos* are left with the disadvantage of low agricultural return because of the marginalized land used for the growth of traditional agriculture.[205] Within the Central Valley region, the benefits will be concentrated largely in the hands of capitalist fruit farmers and agroindustries.[206] The fruit export boom encourages land concentration as large companies buy land from the *campesinos*.[207] Academics have suggested that *campesinos* should switch production to a different agricultural crop or move into the forest

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mestic market).

197. *See supra* notes 108-09 and accompanying text.
198. *See supra* notes 115-18 and accompanying text.
199. *See supra* notes 115-18 and accompanying text.
200. *See supra* note 65 and accompanying text.
201. *See supra* notes 105-11 and accompanying text.
202. *See supra* note 32 and accompanying text.
203. *See supra* notes 58, 67-72 and accompanying text.
204. *See supra* note 110 and accompanying text.
205. *See supra* note 71 and accompanying text.
206. *See supra* notes 105-21 and accompanying text.
207. *See supra* note 107 and accompanying text.

industry.[208] However, few viable alternative agricultural crops actually exist for *campesinos* who wish to discontinue producing traditional agriculture.[209]

A possible alternative would be to dedicate more of the Central Valley to increase the production of fruit and move the agroindustries to the southern regions where agriculture may no longer be a viable alternative. Overall, this would promote an efficient use of resources. *Campesinos* may be able to augment their income by renting their land and taking off-farm employment or working in the agroindustries. Since the agroindustry requires special resources and knowledge that the average *campesino* does not possess, it is unlikely that the *campesinos* will be able to move into the agroindustry alone.[210] They would need additional education in order to switch production, which they are often unable to afford or obtain in the southern regions.[211] The government and private agroindustries are unlikely to invest in the *campesinos* in order to support them throughout this transition.[212]

C. FAILURES OF FREE MARKET FORCES

Proponents of the price band system and critics of the U.S.-Chile FTA argue that the negative short and long-term effects on traditional agriculture should outweigh the benefits on other sectors.[213] They argue that to analyze trade only in economic terms is not sufficient.[214] However, even assuming that it is sufficient, an economic analysis has limitations. The basic analysis of trade creation and trade diversion does not address the economic effects from the displacement of workers, land use, and on the efficient producers that subsidized foreign products will overcome.[215] The Chilean government, like all dominant trade

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208. *See supra* notes 34-35 and accompanying text. Mexican corn farmers were also forced to find alternative employment because they could not compete with the heavy U.S. subsidies. Hugh Dellios, *10 years later, NAFTA Harvest Falls Short: Rural Mexicans Left out of Boom*, CHI. TRIB., Dec. 14, 2003, at 1.

209. *See supra* note 110 and accompanying text.

210. *See supra* note 110 and accompanying text.

211. *See supra* notes 71-72 and accompanying text.

212. *See supra* note 108 and accompanying text.

213. *See supra* note 85 and accompanying text.

214. *See supra* note 85 and accompanying text.

215. JOHN MADELEY, HUNGRY FOR TRADE 51 (2000).

> Positive trade liberalization effects may eventually relieve the poor, but in the short/medium term the whole adjustment process may be more harmful than helpful. . . . In order to benefit, the poor need to enjoy trade-induced

policies, tends to support companies that trade, and in practice, these are mostly larger companies, rather than small enterprises.[216] While the wheat and sugar farmers in the south have supported the domestic markets for many years, the government has put resources into improving the fruit sector.[217] In turn, large-scale fruit producers bought out small basic food crop farmers who could not afford to invest in the new crops, leaving them with marginal land.[218] Without the price band system to protect the traditional agriculture, 200,000 farmers will be left without their livelihood and will be forced to move from their land.[219] Chile's market reform represents not only an important economic change in Chile's agricultural sector, but also a critical policy shift from "food security" to "food access." Politically, this represents a drastic change in Chile's agricultural policy. In Chile, the production of sugar, wheat and vegetable oils is not only an economic activity, but is also a cultural one that has strong roots in the nation's political history. Therefore, Chile's agreement to liberalize its agricultural sector, particularly the traditional agriculture sector, is a bold economic and political move.

The agro-export model in Chile has had, and will continue to have, an uneven impact on regions and farmers.[220] The boom in fruit exports is concentrated largely in the Central Valley region.[221] The employment effect of fruit production has been positive, as it is much more labor-intensive than traditional agriculture, which it has partially replaced.[222] Meanwhile, the net employment effect on traditional agriculturists will likely be negative, thereby accelerating displacement of workers from the southern region.[223] Even if the *campesinos* were able to change into a different agrarian sector, small farmers are not likely to

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> price reductions for consumer goods, as well as reduced input and increased output prices which they face as producers . . . . [T]he poor may experience increased income risks in the short run when they switch from producing subsistence-local goods to producing tradable goods. Given the imperfect working of credit markets, these risks may considerably worsen conditions for the poor.

Id.

216. *See supra* note 107 and accompanying text.
217. *See supra* note 107 and accompanying text.
218. *See supra* note 107 and accompanying text.
219. *See supra* note 75 and accompanying text.
220. *See supra* notes 105-21 and accompanying text.
221. *See supra* note 105 and accompanying text.
222. *See supra* note 105 and accompanying text.
223. *See supra* note 109 and accompanying text.

induce foreign investment or contract with the agroindustrial sector.[224] The result is 200,000 workers and their families without a viable livelihood that are forced to either survive off a parcel of their land while selling the rest to large agroindustrial firms or selling all of their land and migrating to the capital, which is already home to six million habitants.[225]

Displacement can exacerbate inequalities. For example, many *campesinos* will be forced to leave their traditional agricultural practices.[226] The loss of their practices will force them to find alternative work either in the southern region or in the Central Valley region. Chile's urban population will likely increase over the next few years due to the inability of the *campesinos* to compete with U.S. imports. Meanwhile, the rural population growth will likely remain stagnant, ending centuries of traditional agriculture and indigenous culture in Chile.[227] Chile's essential task will be to create enough industrial jobs to absorb dislocated rural workers while also modernizing its agricultural sector with adequate technology to encourage the adjustment from traditional agriculture to exportable crops, where possible.

V. STRATEGIES TO REPOSITION THE THEME OF HUMAN DEVELOPMENT, USING TRADE LIBERALIZATION AS A RESOURCE RATHER THAN AN OBSTACLE

The dilemma facing Chile is ultimately whether the government should abandon *campesinos* completely to market forces or, on the contrary, whether it should launch a major development program that would radically strengthen *campesino* agriculture.[228] The latter option does not seem feasible at present, as it would entail reviving the agrarian reform issue, requiring huge transfers of economic resources to *campesinos* as well as a series of domestic protection measures.[229] These pro-*campesino* programs would mean abandoning much of the remaining neoliberal traces in government policy as well as partially reversing Chile's opening to world markets.[230] Chile

224. *See supra* note 117 and accompanying text.
225. *See supra* note 115 and accompanying text.
226. *See supra* note 79 and accompanying text.
227. *See supra* Part II.
228. *See supra* Part III.
229. *See supra* Part II.
230. *See supra* Part II.

would not be willing to take such drastic measures and it would not be good for Chile as a whole.[231] The most viable choice for the government, in order to promote at least minimal "growth with equity", is to help ease the economic and social adjustment in the traditional agriculture sector.[232] The costs to the government of these adjustments will depend on structural reforms, maintenance of the phase-out period for the price band system, the use of exceptions as stated in the U.S.-Chile FTA, and the availability of adjustment assistance.

The Chilean government needs to intervene in the economy in order to rectify the limitations and inequities of the free-market neoliberal economic system imposed by the "Chicago Boys."[233] As the Chilean Executive Branch and Congressional representatives from different parties sign the free trade agreements, there is a general understanding that financial resources will be needed to strengthen the competitiveness of the traditional agriculture sector.[234] For example, when the Economic Complementation Agreement was signed between Chile and MERCOSUR, the Executive Branch promised a gradual increase in the budget of the agricultural sector for the 1997-2001 period.[235] These monies were to be allocated mainly to areas like development of irrigation, soil recovery, forestry development, sanitary improvement, development of new markets, agricultural research and innovation.[236] To date, *campesinos* have not seen the fruits of this promise to facilitate their transition to different activities.[237] State intervention would aid *campesinos* in the transition from cereal production to a sustainable, alternative source of income, such as direct payments, thereby mitigating the harsh effects that are inexorable.[238] Without this support, rural unemployment will inevitably increase and a significant portion of arable land will be fallowed or put to unproductive uses.[239]

The Agreement on Agriculture reformed the agricultural

231. *See supra* notes 105-21 and accompanying text (describing the potential benefits to the agricultural-export market).

232. *See supra* notes 105-11 and accompanying text (discussing the government aid to the fruit industry).

233. *See supra* notes 47-48 and accompanying text.

234. *See supra* note 54 and accompanying text.

235. *See supra* note 61 and accompanying text.

236. *See supra* note 61 and accompanying text.

237. *See supra* note 61 and accompanying text.

238. *See supra* note 108 and accompanying text (describing how the fruit sector benefited from state aid in research and technology development).

239. *See supra* note 105 and accompanying text.

sector in international trade.[240] One key issue was the choice of economic instruments that are decoupled from agricultural production.[241] This is necessary because of the drastic government intervention in agriculture in most industrialized countries, which has led to substantial increases in the output of agricultural products.[242] This dramatic increase in agricultural output has forced countries to use border measures aggressively, such as the Chilean price band system.[243] Direct income payments can be an alternative means of raising farm incomes in Chile, as well as for other developed and industrial countries.[244] Direct income payments help to transition the farmers, stabilize incomes and promote social assistance measures without affecting the price of the consumer.[245] These payments provide transfers indirectly to producers, and include research and development.[246] Direct income payments are considered better than export subsidies because they do not promote greater production or trade diversion.[247] Instead, they guarantee a minimum income that may relieve poverty and facilitate mobility within agriculture and to other sectors.[248]

While direct payments are only a short-term solution, they will assist *campesinos* throughout the price band phase-out period. It is also important for Chile to ensure that the reduction of tariffs for traditional agriculture follows the phase-out period in order to minimize the social problems that will arise. Moreover, Chile must be willing to enforce the provisions that eliminate export subsidies[249] against the United States while also using the safeguards[250] that were established against the sharp

240. *See supra* note 92 and accompanying text.

241. *See supra* note 92 and accompanying text.

242. *See supra* note 32 (describing the measures that the United States has taken in order to protect their farmers).

243. *See supra* note 85 and accompanying text.

244. *See supra* note 35 and accompanying text.

245. *See supra* note 35 and accompanying text.

246. *See supra* note 35 and accompanying text.

247. *See supra* note 35 and accompanying text.

248. *See supra* note 35 and accompanying text.

249. *See supra* note 135 and accompanying text.

250. *See* U.S.-Chile FTA, *supra* note 127. The safeguard measure applies to all commodities that do not have specific tariff-rate quotas to protect against import surges during tariff phase-out, such as the phase-out of the price band system. *Id.* art. 8.1. The chapter eight safeguard measures suspends further tariff reductions and can re-establish a rate not less than the Most Favored Nation (MFN) rate. *Id.* An injured party can apply to initiate a safeguard measure, which can be maintained for no longer than three years or until the termination of the transition period. *Id.* art. 8.2.

increases in traditional agricultural imports that will negatively affect the *campesinos* during their transitional period. Ultimately, adjustment costs will likely not outweigh the benefits of trade liberalization. Ideally, adjustment costs will be short-term and the benefits of free trade will continue to grow and increasingly benefit all sectors of Chilean society. In order for Chile to successfully integrate its economy in the world market, the government must implement a strategy to enhance the competitiveness of the traditional agriculture sector without postponing conversion to other activities such as fruit and agroindustrial production.

CONCLUSION

Chile's agrarian transformation will likely lead to overall growth of the Chilean economy. Neoliberals claim that this achievement is due to the market reforms introduced by the Pinochet government. Unfortunately, they tend to ignore or downplay the high social costs of this transformation, such as the increase in rural poverty and the rising inequality among Chilean citizens. Government policy has failed so far to reduce the technological gap between capitalist farms and *campesinos.* On the contrary, the gap has widened. While Chile continues to deepen its integration into the world market, the size of the farm and its level of capitalization are going to become even more important as new economies favor larger enterprises. The question is whether the general increase in trade will substantially overtake these negative effects. Chile will have to refine policies further at the national level in order to increase the speed of the supply-side response so that the welfare gains from the new liberalism can be felt by a wider section of the community, including those most adversely affected by the free trade agreements. Otherwise, as has already been seen through protesting farmers, there is a danger of losing fragile public support for the internationalization of Chilean agriculture and the further integration of Chile's economy in the world market.