

TECHNICAL AND INSTITUTIONAL STRENGTHENING PROGRAM IN SUPPORT OF
CHILEAN MEMBERSHIP IN GLOBAL INTEGRATION AGREEMENTS

(TC-96-02-13-8-CH)

EXECUTIVE SUMMARY

BENEFICIARY: Republic of Chile

EXECUTING AGENCY: Ministry of Finance

MIF FACILITY: Technical Cooperation Facility (Facility I)

OBJECTIVES: The general objective of the program is to help Chile become a player in the global economy through membership in different economic integration and trade agreements.

Specifically, the program will boost the country's technical and institutional capacity to negotiate membership in economic integration and trade agreements with trading blocs and groups such as the Asian Pacific Economic Community (APEC), the European Union (EU), the Southern Cone Common Market (MERCOSUR), and the North American Free Trade Agreement (NAFTA), on terms that are consistent with the rules and regulations of the World Trade Organization. The program will also offer the private sector new market opportunities for business and investment.

DESCRIPTION: In its capacity as the program executing unit, the Ministry of Finance, through its International Unit, will hire senior specialists to develop the practical expertise that is needed to negotiate and implement the APEC, NAFTA, MERCOSUR, and EU agreements, provide information to the public, and coordinate activities with the private sector.

FINANCING:

Modality:	Nonreimbursable
MIF:	US\$ 944,875
Beneficiary:	<u>US\$ 944,875</u>
Total:	US\$1,889,750

DISBURSEMENTS:

Execution period:	18 months
Disbursement period:	24 months

**FEASIBILITY AND
RISK:**

Sufficient qualified personnel, technical experts, materials, and financial resources are available in the country to make the program a success, and there is an ample supply of specialists on the international market.

The interests of the private sector will be represented mainly through business associations, which will coordinate the concerns of the different groups involved in the integration program planned by the government.

**THE BANK'S
STRATEGY IN THE
COUNTRY:**

One objective of the Bank's strategy is to provide broader support for projects in which the private sector plays a prominent role and for projects to promote regional integration. The project will directly target that objective, by making use of the Bank's technical expertise and experience to establish a suitable institutional and regulatory framework for the process of integration.

**ENVIRONMENTAL
CLASSIFICATION:**

The Environment Committee classified this as a Category II operation.

PROJECT TEAM:

Ramón Figueroa, Project Team Leader (COF/CCH); Carlos Sepúlveda, (INT/ITD); and María Eugenia Luna de Nepote-Cit (LEG/REL)

I. COUNTRY ELIGIBILITY

- 1.1 On October 6, 1993, the Donor's Committee declared Chile eligible for financing under all facilities of the Multilateral Investment Fund.

II. BACKGROUND

- 2.1 In recent years, most countries of Latin America have transformed their economies once ravaged by over-indebtedness, stagflation, and protectionism into open, competitive markets. Between 1990 and 1993, per capita GDP in the region rose at an average annual rate of 4.3% compared with an annual decline of 8.9% from 1981 to 1990, while exports swelled from US\$78 billion to US\$133 billion.
- 2.2 In the mid-1970s, Chile embarked on a trade liberalization and structural adjustment program that brought about rapid growth, burgeoning export volume, and higher productivity by the end of the decade. In the aftermath of the debt crisis that erupted in 1982, the economic authorities again focused attention on improving export performance, which was considered the cornerstone of the development model. This strategy, which hinged on the unilateral phasing out of tariffs, a stronger currency, and safeguards for foreign investors, has borne fruit over the last 10 years. Economic growth has been steady, export diversification has resulted in higher export earnings, inflation has declined, and unemployment and extreme poverty have been systematically reduced.
- 2.3 The moral of the Chilean experience is that trade can serve as an engine of growth for the countries of Latin America, in much the same way as it has benefited the countries of Asia. However, for export growth to continue at its present rate, it will be necessary to find more export markets and to increase added value and the quality of exports.
- 2.4 Although a unilateral lowering of tariffs is bound to lead to greater efficiency, competitiveness, and technological development, in itself it is not enough to change a small country into a truly competitive exporter. Trade agreements are the pillars of export growth and sustainable development since they open new and more diversified markets for freer trade.
- 2.5 Aware that trade is a vital to the success of the country's development strategy, the Chilean authorities have entered into a significant number of preferential trade agreements with other Latin American countries (i.e. Mexico, Argentina, Colombia, and Venezuela) since 1990. Chile's adhesion to the Asian Pacific Economic Community in the Pacific Rim was recently approved and negotiations are now under way on Chile's membership in the North

American Free Trade Agreement (NAFTA) and the Southern Cone Common Market (MERCOSUR), and on its participation in the European Union (EU).

- 2.6 The trade agreements offer the private sector a golden opportunity to penetrate new markets through the elimination of barriers to the international mobility of factors of production. Chile will have to develop an appropriate institutional, macroeconomic, and regulatory framework so that its private sector can maximize the opportunities issuing from these regional and nonregional trade integration agreements.
- 2.7 Accordingly, national teams will have to increase their technical expertise and institutional capabilities rapidly in order to address the process of integration efficiently from the time of negotiations. This expertise and these capabilities concern mainly: (i) terms and technical, legal, and financial mechanisms in the treaties and instruments governing groups of countries with which Chile wishes to have preferential trade agreements; (ii) impact of these conditions and mechanisms on its current and potential trade relations, including branches of production and geographic areas that may be adversely affected; (iii) an assessment of potential conflicts between Chilean legislation and institutional arrangements and future agreements with these groups; and (iv) identifying international arrangements that will be needed for the functional integration of the national productive apparatus.
- 2.8 Given the magnitude of the challenge and its significance, Chile has decided set up a special program to help the process of integration along in an effort to bolster institutional capacity in this area. Although the country has qualified high-level technical expertise, support will be required from the Bank, which has technical units that specialize in economic integration and has been providing steadfast support for such efforts in the Region.

III. PROGRAM

A. Objectives of the program

- 3.1 The general objective of the program is to help Chile become a player in the global economy through membership in different economic and trade integration agreements.
- 3.2 Specifically, the program will boost the country's technical and institutional capacity to join economic integration or trade agreements with trading blocs or groups such as APEC, the European Union, MERCOSUR, and NAFTA, on terms that are consistent with the rules and regulations of the World Trade Organization. The private

sector will also be offered new opportunities for business and investment.

B. Description of the economy

- 3.3 In its capacity as the program executing unit, the Ministry of Finance, through its International Unit, will hire senior specialists to develop the practical expertise that is needed to negotiate and implement the APEC, NAFTA, MERCOSUR, and EU agreements, provide information to the public, and coordinate activities with the private sector.

C. Components

- 3.4 Six components that would be financed in part by the MIF have been identified to achieve the objective of the program. These components cover areas assigned priority by the Chilean government:
1. Adapting the procedures used by the National Customs Service to the requirements of economic integration under new trade agreements (US\$345,600; MIF US\$215,600)
- 3.5 Chile's membership in or association with APEC, NAFTA, MERCOSUR, and EU will require substantial changes in the administration, management, and organization of the National Customs Service (SNA) stemming from the need to apply different areas of specialization to goods from countries that are signatory to these agreements. Accordingly, it will be necessary to modernize and streamline procedures for customs administration and management.
- 3.6 The component is designed to modernize the procedures for inspection, expediting, and valuation of customs operations and treatment of separate harmonized tariffs for purposes of membership in new trade agreements. The following benefits are expected:
- a. proposals for new regulations, manuals, and procedures for inspection and expediting of customs operations, in accordance with the trade agreements;
 - b. proposals for new regulations, manuals, and procedures for customs valuations, in accordance with the agreements;
 - c. proposals for new regulations, manuals, and procedures for harmonized customs tariffs; and
 - d. practical training for SNA staff in the application of the new procedures.

2. Making economic and financial regulations consistent with integration agreements (US\$375,000; MIF US\$98,000)
- 3.7 In light of the diverse legal and regulatory impact that participation in new agreements will have, an accurate picture of the type of changes will be needed in order to prepare legal regulations that are consistent with the agreements under negotiation.
- 3.8 The component is designed to evaluate changes in economic and financial regulations that are needed in the short term as part of the integration process. This component is expected to produce the following results:
 - a. identification of areas in which national regulations conflict with the regulations governing economic integration agreements;
 - b. proposals for changes in legislation and economic regulations to expedite the process of integration;
 - c. identification of areas of major conflict in financial and accounting regulations in the process of economic integration; and
 - d. proposal for changes that are needed in financial and accounting legislation to expedite the process of integration.
3. Adapting government procurement procedures to the requirements of the new trade agreements (US\$232,650; MIF US\$144,650)
- 3.9 In Chile, there is no standard system of procurement for the public sector. Procurement is done through a decentralized system based on principles of transparency, efficiency, and nondiscrimination at the national and international level. Public services and State-owned companies must observe these principles although there is no standardized system of procurement for goods and services. Some trade agreements (i.e. APEC, NAFTA, WTO) may contain rules for government procurement that conflict with national legislation. Consequently, national regulations that are not fully harmonized to these rules will hamper the procurement process making it more costly for public enterprises and government institutions.
- 3.10 The component is designed to introduce procedures for procurement in the public sector that are consistent with World Trade Organization rules and those established under trade agreements to which Chile is considering becoming a party. It is expected to produce the following results:
 - a. proposals for procurement procedures for the public sector; and
 - b. a feasibility study on electronic systems for public sector procurement.

4. Trade in services (US\$299,700; MIF US\$241,700)

- 3.11 Trade in services has grown significantly in recent years and the market for highly sophisticated services (i.e. computer services, business management, financial engineering) is expected to grow even faster in the short term.
- 3.12 Serious flaws that may be attributable to inadequate regulation and little or no information of the kind that is needed for economic agents to make informed decisions on trade hampers the development of the services market. This problem is expected to be exacerbated still further if steps are not taken to correct these market imperfections during negotiations on membership in the new agreements.
- 3.13 Under this component, a suitable regulatory framework and a statistical information system will be established to overcome the shortcomings noted. The component is expected to produce the following results:
- a. proposals for new regulations governing trade in services;
 - b. list of distortions and barriers in other countries adversely affecting trade in services that could be corrected or changed through negotiation under economic or trade agreements; and
 - c. proposal for a system of statistical information in trade in services with the help of the private sector.

5. Nontariff barriers (US\$149,200; MIF US\$95,200)

- 3.14 In recent years tariffs and quotas have been rapidly eliminated only to be replaced by other types of restrictions which are commonly known as nontariff barriers. Countries that are members of APEC, EU, MERCOSUR, and NAFTA, as well as Chile, all have nontariff barriers of one kind or another for certain imports. At the same time, these integration arrangements have agreements, schedules, and other mechanisms to deal with restrictions between the members themselves or with nonmember countries. Full and systematic information in this area and of the alternatives that are available to eliminate these restriction or mitigate their impact through negotiation are indispensable for Chile to take full advantage of regional integration agreements.
- 3.15 The country's political authorities will be given additional technical expertise on the kinds of nontariff barriers used by Chile's trading partners under the new agreements. The component is expected to produce the following results:
- a. a pamphlet will be prepared in conjunction with the private sector, identifying major nontariff barriers addressed under

these agreements and recommendations on how to mitigate their effects or negotiate their elimination.

- 3.16 Private groups with ties to the export sector such as the Association of Manufacturing Exporters, the Association for Business Development, the Federation of Business and Industry, will provide counterpart resources for research although this would not rule out involvement by public sector groups such as the Chilean Export Promotion Office. This idea is for the private sector to become involved with this issue in order to have access to pertinent information.

6. Evaluation of the anticipated effects of trade agreements with certain integration systems (US\$163,725; MIF US\$99,725)

- 3.17 The benefits and costs of these integration agreements will vary from one sector to another. The effects of joining a large trade bloc need to be analyzed in advance in the case of a country with a small economy.
- 3.18 The basic objective of this component is to identify the costs and benefits to Chile of membership in various trade groups, with an assessment of the anticipated impact that the unrestricted import of goods and services from member countries would have on specific branches of production, certain areas of the labor market, and some regions. It will focus on the magnitude and extent of tariff reductions and the pace at which they are to be eliminated.
- 3.19 The analysis of the results could furnish important criteria that would be used to establish a tariff reduction policy that is consistent with Chile's basic development strategy. Amongst the sectors that would be studied are agricultural production and agribusiness, textiles and garment making, and chemicals and machine tools. The component is expected to result in:
- a. an analysis of the anticipated impact of trade agreements on selected sectors of the economy and recommendations on tariff elimination policies, to be drawn up on the basis of information workshops and feedback.

D. Cost and financing

- 3.20 It is estimated that the overall cost of the program will be US\$1,889,750, which will be financed as follows: (i) up to the equivalent of US\$944,875 in nonreimbursable funding from the MIF (Facility I) to pay for advisory services by senior international specialists; and (ii) up to the equivalent of US\$944,875 in local counterpart funding from the Ministry of Finance to defray the cost of personnel, advisory services, and goods and services for the project. In view of the nature of the local contribution, the executing agency will be required to itemize in its progress

reports all expenses for personnel and for goods and services under the program that are charged to local counterpart funding.

BUDGET PROGRAM			
	FINANCING		
	MIF	LOCAL	TOTAL
1. Technical team	0	137,100	137,100
2. Activities	919,875	696,000	1,615,875
A. Modernization of SNA	215,600	130,000	345,600
B. Harmonization of laws	98,000	277,000	375,000
C. Government procurement	144,650	88,000	232,650
D. Trade in services	241,700	58,000	299,700
E. Nontariff barriers	95,200	54,000	149,200
F. Impact of agreements	99,725	64,000	163,725
G. Development of program	25,000	25,000	25,000
3. Logistical support (equipment leaks, etc.)	0	86,775	86,775
4. Contingencies	25,000	25,000	50,000
TOTAL	944,875	944,875	1,889,750
Percentage	0.50	0.50	1.0

E. Execution

- 3.21 The program will be carried out by the Ministry of Finance's International Unit. MIF funding will be used to cover the cost of consulting services for specific activities to assist with Chilean integration into trade blocs.
- 3.22 The program will be administered by a general coordinator and three experts who will each be in charge of two projects. They will be assisted by two secretaries and an administrative assistant.
- 3.23 The expected duration of the program is as follows: 18 months for execution, and 24 months for disbursement.

F. Conditions precedent to the first disbursement

- 3.24 The following conditions must be met: (i) overall coordination and technical teams must be established; (ii) a work plan must be submitted; (iii) the terms of reference for all consulting services must be acceptable to the program administrator; and (iv) semiannual projections of expenses by program activity and source of financing must be prepared.

G. Other conditions

- 3.25 The executing agency will open a special account for MIF funds, and will keep accounting records fully justifying the use of the counterpart resources. Local counterpart expenses charged against existing resources will be assessed at market value.

IV. PROCUREMENT AND DISBURSEMENT

- 4.1 The procurement of goods and services will be carried out in accordance with the standards and procedures of the Bank and the MIF. A revolving fund will be set up in an amount equivalent to 10% of the MIF contribution.
- 4.2 The project financial statements will be audited by the Auditor General of the Republic.

V. FEASIBILITY AND RISKS

- 5.1 Qualified personnel, technical and administrative expertise, materials, and financial resources are available in the country to ensure the success of the program. In addition, there is an ample supply of specialists on the international market.
- 5.2 Business associations will be involved in the program, to represent the interests of the private sector and to minimize the likelihood of the negotiations becoming bogged down.

VI. COMPLIANCE WITH PROJECT ELIGIBILITY CRITERIA

- 6.1 General project eligibility criteria. The financing provided by the Bank is consistent with the MIF objectives of attracting private investment and promoting the private sector as an engine of economic growth and social development in the country.
- 6.2 Project eligibility criteria under the Technical Cooperation Facility. In light of the importance of trade agreements for the development of the export sector, the proposal satisfies the criteria under the Technical Cooperation Facility (Article 3, Section 2, of the Agreement Establishing the Multilateral Investment Fund), whereby advisory services to assist governments with plans that are part of a comprehensive reform program geared towards strengthening the investment climate are eligible for financing. Useful lessons in negotiating membership in trade agreements in the region are one potential benefit of this project.

VII. CONSISTENCY WITH THE BANK'S COUNTRY STRATEGY

- 7.1 Amongst its objectives, the Bank's strategy purports to broaden support for projects with major private sector involvement and projects aimed at regional integration. The present project directly underpins this strategy since the Bank's technical assistance and experience will be used to establish a suitable institutional and regulatory framework that will ensure the success of the process of regional integration.

VIII. AVAILABILITY OF MIF RESOURCES

- 8.1 **Financing modality.** The project will be financed with a donation based on the following considerations: (i) on October 6, 1993, the Donors Committee declared Chile eligible for all modalities of MIF financing; (ii) Chile meets the eligibility criteria for grant funds at the national level, as set out in article 3, section 5(b), of the country eligibility memorandum; and (iii) the proposed project would have a significant impact on the flow of investment funds, as required by Article 3, Section 5(a) of the MIF Agreement, insofar as one of its objectives is to create a climate conducive to local and international private investment. The validity of these criteria was confirmed at a meeting of the Donors Committee on March 30, 1994 (MIF/GN-23).

IX. EVALUATION AND FOLLOW-UP

- 9.1 **Reports.** (i) An initial report will be prepared 60 days after startup of the program, and (ii) semiannual reports will be submitted 30 days after the end of each six-month period.
- 9.2 A final report giving an overview of the effectiveness of the program will be due three months after the program is concluded. This report will be prepared in accordance with terms of reference agreed on with the Bank six months prior to completion of the program.

MIF FACILITY I - CHILE
TECHNICAL AND INSTITUTIONAL STRENGTHENING PROGRAM
IN SUPPORT OF CHILEAN MEMBERSHIP IN GLOBAL INTEGRATION AGREEMENTS

MATRIX OF PROGRAM RESULTS

The <u>general objective</u> of the program is to help Chile become a player in the global economy through membership in different economic integration and trade agreements.		
The <u>specific objective</u> of the program is to boost the country's technical and institutional capacity to negotiate membership in economic integration and trade agreements with trading blocs and groups.		
Subprograms	Activities	Expected results
A. Modernization of the National Customs Service (SNA)	The SNA has modernized its procedures for inspection, expediting, and valuation of customs operations and treatment of separate harmonized tariffs for purposes of membership in new trade and economic agreements.	At month 18 of the project, the SNA will have a full package of proposed changes in procedures for inspection, expediting, and valuation of customs operations and treatment of separate harmonized tariffs. Personnel concerned (300 employees) will have received the necessary training to <u>initiate</u> the process of change.
B. Making legal, accounting, and financial regulations consistent	An evaluation has been done of the changes in legal and financial regulations that are needed as part of the integration process.	At month 18 of the project, the country will have a full package of proposed legal, financial, and accounting changes that are needed for harmonization with requirements under integration agreements.
C. Making operating policies and standards for government procurement consistent	A series of proposed standards (drafts) to make public sector procurement procedures consistent with those of the principal economic and trade agreements of which Chile is, or hopes to become, a member.	The new government procurement procedures will be available within 12 months.
D. Strengthening of trade in services	The country has a trade in services system that is based on efficient regulation and relevant market and institutional information, that is operative in the context of the economic and trade agreements of which Chile is, or hopes to become, a member.	At month 12 of the project, Chile will have a full package of proposed reforms (draft version) of present regulations governing trade in services and a proposed market information system, with the help of the private sector.
E. Identifying and reducing nontariff barriers	Chile has increased the body of information available for identifying noncommercial barriers.	At month 12 of the project, Chile will have the results of studies identifying the principal nontariff barriers.
F. Evaluation of the anticipated effects of trade agreements	Expected impact of trade agreements evaluated in terms of benefits and costs.	At month 12 of the project, an evaluation will have been done of alternatives to elimination of tariffs for various trade agreements, in light of the magnitude, scope, and pace of tariff reductions.

PROPOSED RESOLUTION

CHILE. NON REIMBURSABLE TECHNICAL COOPERATION FOR A TECHNICAL AND
INSTITUTIONAL STRENGTHENING PROGRAM TO SUPPORT THE ACCESS OF CHILE
TO INTEGRATION AGREEMENTS

The Donors Committee of the Multilateral Investment Fund

RESOLVES:

1. That the President of the Inter-American Development Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Multilateral Investment Fund, to enter into such agreements as may be necessary with the República de Chile and to take such additional measures as may be pertinent for the execution of the plan of operations referred to in Document MIF/AT- with respect to a technical cooperation for a technical and institutional strengthening program to support the access of Chile to integration agreements.
2. That up to the amount of US\$944,875 is authorized for the purpose of this resolution, chargeable to resources of the Technical Cooperation Facility of the Multilateral Investment Fund.
3. That the above-mentioned sum is to be provided on a nonreimbursable basis.