

Sustainability Impact Assessment in Support of the Negotiations for the Modernisation of the Trade Part of the Association Agreement with Chile

Final Report

Draft, March 2019

EXECUTIVE SUMMARY

1. When it entered into force in 2003, the original EU-Chile Association Agreement was a path-breaking agreement, providing for deep liberalisation of goods trade, WTO-plus rules in areas such as sanitary and phytosanitary standards, broad liberalisation commitments on trade in services and foreign direct investment, commitments on government procurement and intellectual property, including mutual protection of geographical indications, trade facilitation, and innovative institutional provisions. Evaluations of the impact of the original Agreement suggest that it worked powerfully to support bilateral trade at a time when Chile was highly active in entering into FTAs with other parties, and thus avoided putting EU suppliers at a competitive disadvantage in the Chilean market; EU services exporters benefited in particular. However, with the passage of time and the evolution of the EU's FTA approach, the original Agreement now lags in important areas and still leaves some room for liberalisation in traditional areas. Therefore, Chile and the EU agreed to enter into negotiations for a modernisation of the Agreement. These negotiations started in November 2017 and are currently ongoing.

2. This is the draft final report for the Trade Sustainability Impact Assessment (SIA) in support of the negotiations to modernise the trade pillar of the existing EU-Chile Association Agreement. The report presents findings of the potential economic, social, human rights and environmental impacts (the four "sustainability pillars") stemming from provisions in the modernised Agreement or being a consequence of removing or reducing remaining barriers to bilateral trade and investment between the EU and Chile. The report also provides a number of recommendations, derived from the analysis, on issues to be incorporated into the modernised Agreement and mitigating measures. Furthermore, it describes the methodology used and, in a separate appendix, a summary of the consultation activities and contributions received from stakeholders in Chile and the EU. The research for the report was undertaken by a team of researchers from BKP Development Research & Consulting and the Catholic University of Valparaiso's Centro Vincular under a contract with the European Commission's DG Trade, over the period April to December 2018.

3. The modernised Agreement is found to likely make a modest further contribution to the bilateral economic relationship, building on the original Agreement. Given the relatively small expected incremental economic impacts, it is unlikely to raise sustainability concerns overall (i.e. for Chile and the EU as a whole). Nevertheless, effects in particular sectors, areas, or for groups of people could not be excluded. These have been assessed in a number of horizontal analyses (the impact on SMEs, women and rural communities), sector analyses (covering dairy, mining, construction, tourism and hospitality services, communication and business services, and wholesale and retail trade) and case studies (olive oil, salmon farming, the lithium batteries value chain, renewable energy, competition, and subsidies). The findings of these analyses support the conclusion that the modernised Agreement's overall impacts will be limited, while offering the opportunity to ensure that the benefits from liberalised bilateral trade are widely shared and are sustainable.

Sustainability issues – overall findings

4. From an **economic** perspective and based on the quantitative analysis stemming from the Commission's CGE simulations, the modernisation of the Agreement does not raise sustainability concerns in terms of the scale of the impacts and adjustment pressures. The impact for the EU is negligible, both at the aggregate economy level and at the sectoral level; in Chile, the impact would be noticeable for the most affected sectors but would similarly be of a scale that would raise only minimal concerns from a sustainability perspective. The impact of the modernised Agreement on participation in *global value chains* is expected to be slightly positive, and no sustainability concerns from an economic perspective have been identified to date regarding *intellectual property rights*, the impact of the Agreement on *specific regions and countries* (including LDCs and the EU's Outermost Regions) or the *administration of rules of origin*. Finally, the modernisation of the Agreement is expected to strengthen the legal framework in the Parties to combat *corruption and money-laundering* which is expected to have beneficial economic and social effects. The modernisation could also reinforce existing domestic rules and procedures on *good regulatory practices and transparency*, thereby strengthening good governance.

5. With regard to the potential **social** impacts, the modernised Agreement again is expected to have very limited effects in the EU, following from the low economic effects, and also small effects in Chile at the economy-wide level, with some slightly more pronounced effects in some sectors:

- *Employment and wage* effects are estimated to be negligible in the EU, and small in Chile, where the modernised Agreement is expected (under the ambitious scenario) to lead to sectoral employment changes ranging from an increase of 2.2% in the vegetable oil sector to a decrease in machinery by about 2.9%,¹ as well as a limited increase in real wages. Unskilled workers (wage increase of 0.5%) are expected to benefit more than skilled workers (0.3%), which would indicate a small decrease in income inequality.
- Expected effects of the modernised Agreement on *consumers* are limited but positive. Consumer price changes are marginal (the CGE model estimates a price increase in the EU of 0.01% and up to 0.09% in Chile), and the modernised Agreement's provisions should ensure an appropriate level of quality and safety of products and services on one hand, as well as their variety, availability and accessibility to consumers, on the other.
- Due to the limited economic effects, the impacts on *public policies and social protection*, as well as – to the extent that data is available – on the *informal economy* are expected to be very limited.
- With regard to *rights at work and job quality*, the modernised Agreement could play a supportive role, e.g. through the trade and sustainable development (TSD) Chapter, commitments related to health and safety at work, labour inspection and decent

¹ Note that overall employment effects cannot be assessed by the CGE model as total employment is held constant based on the model's assumptions.

working conditions, promotion of decent work and effective implementation of ratified ILO conventions.

- *Corporate social responsibility (CSR)/Responsible Business Conduct (RBC)* practices could benefit if the modernised Agreement provides a strengthened framework for EU-Chile co-operation and encourages the uptake of CSR/RBC practices by enterprises from both Parties.
- Finally, the ongoing negotiations between the EU and Chile (and later on, the implementation of the modernised Agreement) provide an opportunity for exchange of information and good practice in *dialogue with civil society* realised by both Parties, comparison of experience and recommendations for further improvement.

6. The overall effect of the modernised Agreement on **human rights** as a consequence of economic changes induced by the Agreement is expected to be minor, both in the EU and in Chile. However, following a screening and scoping exercise the impacts on the following human rights have been examined in more detail:

- Although the *right to the highest attainable standard of physical and mental health and access to essential medicines* is a domestic matter, it could potentially be affected in Chile by the modernised Agreement, depending on the exact provisions of the Agreement and the actions of the Chilean government; this impact would have to be re-investigated once the final text of the Agreement is available. Although existing problems in Chile with regard to the right to health, in particular in the industrial “zones of sacrifice,”² are not caused by the modernised Agreement, it is difficult to exclude the possibility that it might lead to increased economic activity in sectors that are situated in these areas. In the EU, the right to health is not likely to be affected.
- The modernised Agreement’s impact on the *right to adequate food* is expected to be marginal, both in the EU and Chile. It is also not likely that the Chilean food labelling regime would have to be amended in the future due to the Agreement, as it does not discriminate against imports.
- As a result of the modernised Agreement, the *right to work* in Chile is expected to be affected in a limited way through creation/loss of jobs in different sectors. The specific Chapter on TSD and the provisions on trade and gender that are envisaged in the modernised Agreement are expected to have a minor but structurally positive impact on the right to work and labour rights in the long run. Labour rights of some vulnerable population groups, e.g. women or migrant workers could be potentially affected positively through increase in employment in the sectors that employ a comparatively high share of migrant workers.

7. The analysis also indicates that overall **environmental** impacts will be modest, given the scale of the economic impacts. The following issues have been considered:

- The overall effect of the modernised Agreement on *greenhouse gas (GHG) emissions* is expected to be limited. The CGE model simulations show an increase in emissions where the Agreement is leading to an increase in production (e.g. vegetables, fruits, nuts; and oilseeds, vegetable oils and fats in Chile; motor vehicles and transport; and machinery in the EU), and vice versa. Furthermore, the reduction of trade barriers in the modernised Agreement is expected to provide improved opportunities for trade in low-carbon goods and services as well as in strengthening the existing Chilean regulatory framework.
- The modernised Agreement might lead to changes in *transport* emissions in Chile, both in terms of absolute levels of transport activities and modal shift. Changes in bilateral trade may also impact trade related transport emissions. The modernised Agreement could result in an uptake of more stringent fuel quality standards, improvement of the transport policy framework and increase in European investments in Chilean transport infrastructure.

² Name applied in Chilean public discourse for areas where the growth of economic activities has arguably been to the detriment of environmental conditions and consequential damages including on human health (see Hervé et al. 2012).

- In *energy*, the Agreement modernisation could expand opportunities both in Chile and the EU to import technical solutions that help the further growth of renewable energy.
- The ex-ante study concluded that the modernised Agreement is unlikely to have an effect on the level of *air quality* in Europe and only a minor impact in Chile. The SIA analysis confirms these earlier conclusions but also identifies that significant differences may occur between regions and cities.
- With regard to *land use*, the analysis aimed to identify whether the expected growth in agricultural output in Chile can be achieved without expansion of agricultural area, e.g. through increased yield. This analysis was inconclusive.
- *Biodiversity* is unlikely to be affected as a consequence of the economic changes induced by the modernised Agreement. However, the Agreement could provide an opportunity to address certain existing issues regarding the impact of economic activity on biodiversity.
- Regarding *water quality and resources*, the expected increase in overall agricultural activity as well as certain industrial activity such as copper mining also gives reasons for environmental concern in terms of nitrogen run-off from farming and discharge of contaminated water from mining activities. While on average the impact of the modernised Agreement seems small, the localised impact may still be significant.
- The modernisation of the Agreement could induce an increase of *waste*, in particular in the utility and construction sectors. To ensure that further growth in the amounts of waste is avoided, a combination of efforts to decouple economic growth from waste production and improved waste management and control could be pursued.

Specific recommendations to address each of these environmental issues are included in section 4.4.

8. The analysis of **horizontal issues** has resulted in the following findings:

- The impact of the modernised Agreement on **SMEs** is expected to be slightly positive.
- The Agreement's impact on **women** is expected to vary, depending on the role considered. First, women as *workers* are expected to benefit in absolute terms. However, sectors which employ more men are expected to grow the most (e.g. agriculture, fishing and utility, including construction). Second, a large part of *women-led enterprises* operates in sectors – such as trade, hotels and restaurants and agriculture – for which the CGE model estimates a limited increase in output (notably in Chile) and in bilateral trade. Third, the impact on women in their roles as *traders*, notably in Chile, is estimated to be limited but positive.
- The modernised Agreement's effects on **rural communities** (in Chile) are expected to be positive but small overall. They will be unevenly distributed across the country, depending on which particular economic activities dominate a given region.

Impacts at sector level and case studies

9. A number of sectors and topics were selected for more in-depth analyses based on their economic importance, the anticipated impact of the modernised Agreement on them, and the level of importance accorded to them by stakeholders and negotiators. The findings can be summarised as follows:

- **Dairy:** The existing Agreement provides for a limited liberalisation of some dairy products. Further liberalisation under the modernised Agreement would increase bilateral trade significantly – exports by the EU to Chile by 40%, and exports by Chile to the EU by 76%, although from a much lower level – but total exports and output of the sector only change marginally. Accordingly, employment and other social effects, as well as environmental and human rights effects in the sector are expected to be negligible. The expansion of geographical indications (GI) to dairy products is not expected to have a major impact in Chile, despite fears by Chilean dairy stakeholders, as Chile currently uses mostly generic names.
- **Mining:** Although tariffs were fully liberalised already under the existing Agreement (including the downstream sectors), this sector is highly important for Chile in terms

of export revenues, value chain participation, and linkages to other sectors within Chile (including services, equipment maintenance, engineering, and R&D). The economic impact (changes in bilateral and total trade, as well as output) of the modernised Agreement as estimated in the CGE simulations is negligible in both the EU and Chile. Nevertheless, the modernised Agreement has the potential to contribute to addressing the outstanding issues in the sector, such as the accidents at work through measures contemplated in the future TSD Chapter and especially its provisions regarding measures and policies on health and safety at work, as well as labour inspection, facilitated by the exchange of best practices and cooperation.

- **Construction:** This sector has a high prevalence of SMEs, features some social and labour issues provisions on investment and public procurement, and is likely to be impacted by a modernised Agreement through these provisions. According to the CGE simulations in the ambitious scenario, the modernised Agreement could lead to an increase in sector output in Chile by 1.1% and, flowing from this, an increase in sectoral employment ranging from 0.6% (unskilled labour) to 0.8% (skilled labour). Furthermore, the modernised Agreement has the potential to contribute to addressing labour rights issues in the sector through strengthened labour provisions in the TSD Chapter.
- **Tourism and hospitality services and wholesale and retail trade** are two important sectors from a labour and gender perspective and raise a number of social issues, such as a high degree of informality, child labour, etc. They are also considered jointly in the CGE simulations (in the “other services” sector), according to which the modernised Agreement is expected to have only a negligible effect in the EU. For Chile, a small decrease in employment of unskilled workers in the sector is anticipated, and no change for skilled workers. These changes would lead to also marginal changes in the other sustainability dimensions, for example, a minor impact on the right to an adequate standard of living of the unskilled workers in Chile.
- **Communication and business services:** Bilateral trade in this sector promises to increase due to the modernised Agreement. Changes in total sector output are marginally positive in the EU and slightly more positive in Chile, at 0.14% and 0.26% in the conservative and ambitious scenarios, respectively. Employment effects in the EU are negligible; in Chile, a small contraction of unskilled labour is estimated – 0.15% in the conservative scenario and 0.29% in the ambitious one – as well as a marginal decrease in employment of skilled labour (less than 0.1%). Overall, the anticipated effects flowing from enhanced trade under the modernised Agreement are expected to be limited.

10. The findings of the various case studies can be summarised as follows:

- **Olive oil:** The modernised Agreement is expected to add impetus to the already growing olive oil industry in Chile – according to the estimates, output for the Chilean olive oil sector would increase by 5.9%, with the ensuring positive social and human rights effects in Chile. Nevertheless, the magnitude of the economic effects on bilateral trade is relatively small: e.g. the total value of Chilean exports is expected to increase by USD 2.8 million, and the total (negative) welfare effect for EU producers is negligible: olive oil farmers in the EU are unlikely to be affected given the small relative scale of the changes in imports from Chile in relation to the size of the market. Another effect is that the modernised Agreement could lead more strongly than is already the case in Chile (because of an already growing olive sector as well as growth in other sectors) to increase pressure on land and water use, thereby also potentially negatively affecting the right to a clean environment and the right to water.
- **Salmon farming:** The impact of the modernised Agreement on salmon exports from Chile is likely to be minimal: a further liberalisation of tariffs on fresh and frozen salmon is not possible, and even a full liberalisation of market access for smoked salmon would unlikely lead to a major rise in smoked salmon exports from Chile, given that the existing quota has not always been filled. The modernised Agreement could, depending on the final text e.g. of the TSD Chapter, lead to regulatory changes, or changes in the implementation and enforcement of regulations, which could enhance the sustainability of salmon farming in Chile.

- **Lithium batteries value chain:** Chile is the EU's main supplier of lithium, which is an important input for the EU automotive industry (development of car batteries). The existing Agreement sets a zero-tariff on trade in lithium products between the EU and Chile, and hence there is no scope for further liberalisation in a modernised Agreement in this regard. However, the governance features of the modernised Agreement could potentially help the development of two-way supply chain relationships as well as address a number of risks in the lithium batteries value chain associated with increased costs due to transportation, loss of part of the value, time delays, relinquished control on quality and limitations on design options. These risks could be dealt with through the simplification of technical measures and trade facilitation measures in the modernised Agreement. Finally, lithium mining can have a number of social, human rights and environmental impacts. To address these, the modernised Agreement's Chapters on TSD and Energy and Raw Materials (ERM) could include clear and enforceable criteria on sustainable development and promote EU company focus on CSR/RBC downstream in the lithium value chain to demand also CSR/RBC upstream from Chilean raw material (i.e. lithium) producers.
- **Renewable energy:** Chile is one of the largest markets for renewable energy in South America and EU equipment and energy companies play an important role. The modernised Agreement has the potential to strengthen the cooperation between the EU and Chile in the area of Energy and Raw Materials and TSD. Exchanges of best practices with respect to solar- and wind-energy, where the EU has ample experience, research cooperation as well as a stronger involvement of EU companies in providing equipment, necessary flanking services, and sharing necessary technologies could be enhanced to help Chile realise its renewable energy ambitions.
- **Competition:** Given the expected limited economic impact of the Agreement's modernisation, even at sectorial levels, no changes in market structure are expected to be caused in the EU or Chile. Nevertheless, competition issues are part of the negotiations, and the provisions in the modernised Agreement could have a direct impact on the competition regime and, accordingly, competition in Chile or the EU. Based on the existing textual proposals, however, because competition issues continue to be considered as domestic issues, and also because provisions on competition continue to be excluded from the Agreement's dispute settlement provisions, the impact of the modernisation of the Agreement on competition, including on mergers and acquisitions, is expected to be negligible.
- **Subsidies and state aid:** In the absence of major anticipated economic effects of the modernisation of the Agreement (which would also apply to the availability of government revenues needed to finance such subsidies), any potential effect of the modernised Agreement on the Parties' subsidy practices would have to come from provisions in the Agreement itself. Based on the proposed texts, no major impact on subsidies practices is expected. Although the modernised Agreement would establish a consultation mechanism on subsidies between the Parties, and subject certain subsidies to conditions, these disciplines would affect only a limited share of subsidies granted. WTO rules would remain the main instrument to deal with subsidies and countervailing measures.

Recommendations

11. Derived from the analysis, two types of recommendations have been prepared and are presented throughout the study: recommendations to be considered in the negotiations on the modernisation of the EU-Chile Agreement, i.e. primarily suggestions of issues to be addressed in the modernised Agreement; and recommendations on measures to ensure the benefits or mitigate the potential adverse effects of the modernised Agreement.

12. An overview of these recommendations is provided in Table 45 and 47 in Chapter 8. These do not repeat all recommendations made throughout the study – in particular all recommendations derived from the sector and case study analysis – but do address all areas of recommendations. A list of all recommendations with references to the respective sections in this report is presented in Appendix D.