

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

Interim Report

Draft, October 2018

EXECUTIVE SUMMARY

This draft interim 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 presents findings of the analysis undertaken since the start of the research on 26 April 2018. The SIA comprises an assessment of the 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 an update, compared to the inception report of July 2018, of the methodology used and a schedule for the completion of the study. The draft final report for the study is scheduled to be completed by end December 2018 and will provide recommendations on how to maximise benefits and minimise potential negative effects of the modernised Agreement.

Based on the research undertaken to date, the modernised Agreement is unlikely to raise sustainability concerns overall (i.e. for Chile and the EU as a whole), being a consequence of the limited economic effects expected. Nevertheless, effects in particular sectors, areas, or for groups of people cannot be excluded. These are being analysed in a number of sector and case studies. The interim report includes provisional versions of six selected sectors – construction; communication and business services; mining; tourism and hospitality services; wholesale and retail trade; and dairy – and six thematic case studies – olive oil; salmon farming, lithium batteries value chain; renewable energy; effects on rural communities; and effects on women. Additional case studies will be presented in the draft final report.

Sustainability issues – the overall picture

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 would not be palpably felt, neither at the aggregate economy level nor 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 minimal concerns from a sustainability perspective. A number of areas have been identified where the modernised Agreement could enhance bilateral trade through an update of its provisions. These include trade facilitation for goods, as well as enhancing market access and removing regulatory barriers to public procurement markets. The impact of the modernised Agreement on SMEs as well as 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 third regions (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; this 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. Textual proposals regarding the implementation and monitoring of the Agreement are not yet available, but considering the likely extended scope of the modernised Agreement, it appears prudent to also strengthen the mechanisms to implement, monitor and enforce measures. Preliminary recommendations in this respect are that effective monitoring by non-government bodies – i.e. parliaments and non-state actors/civil society – should be ensured; and that the wider range of issues covered by the Agreement, often of a very technical nature, be reflected in the institutional design of the civil society participation, e.g. by allowing for sub-committees on technical matters and/or by widening the scope of civil society representatives in the monitoring bodies of the modernised Agreement.

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. At this stage of the analysis, the provisional findings are:

- Employment effects are estimated to be negligible in the EU (with the highest employment increase in the oil sector of 0.16% under the ambitious scenario and the most pronounced job reduction of 0.06% in the fruits and vegetables sector under the same scenario), and small in Chile where the modernised Agreement is expected 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% (under the ambitious scenario).¹
- Similarly, the impact on wages is negligible in the EU. A limited increase in real wages in Chile is expected. Unskilled workers (wage increase of 0.5% in the ambitious scenario) are expected to benefit more than skilled workers (0.3%), which would indicate a small decrease in income inequality.
- The analysis aims to assess the modernised FTA's impact on women in their different roles, i.e. as employees, entrepreneurs, traders and consumers. First, regarding their role as employees, based on the CGE simulations employment increases are more likely to occur in sectors which to-date have played a more prominent role in employment of men rather than women (e.g. agriculture, fishing and utility, including construction). This means that while women will benefit from positive impacts of the modernised Agreement on employment levels, further analysis of trends in the sectors will be necessary, including through stakeholder consultations, to estimate to what extent women (compared to men) may enjoy those positive impacts. Second, a large part of women-led enterprises operates, both in the EU and Chile, 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. Given that to-date involvement of the Chilean women-led enterprises in international trade has been rather limited, one should consider more channels through which they may seize

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.

opportunities created by the modernised Agreement. For example, they may benefit from additional demand created on the domestic market, be included in value chains (also those export-oriented) and seek to utilise additional export potential offered by the Agreement. Third, the impact on women in their roles as traders, notably in Chile, may be limited, but positive. In 2017, around 58% of exports realised by the Chilean women-led enterprises were food products, notably fruits, nuts, fish and seafood. The CGE model predicts an increase in the Chilean exports in these products to the EU, as well as increase of their prices, which may also benefit the women-led exporting companies. Fourth, the impact on women as consumers remains to be investigated.

- The effect of the modernised Agreement on the consumer price index is very limited (the CGE model estimates a price increase in the EU of 0.01% and up to 0.09% in Chile). Risks to consumers stemming from an increase of trade in unsafe products could not be identified.
- 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 working conditions, promotion of decent work and effective implementation of ratified ILO conventions. In addition, annual meetings held in that context, tailored workshops and cooperation projects may provide a framework for exchange of best practice and discussion on ways to address common challenges.
- Research into the impact of the modernised FTA on the informal economy and corporate social responsibility is still ongoing and requires the input from stakeholder consultation, foreseen in the next stage of the study.

The overall effect of the modernised Agreement on **human rights** as a consequence from economic changes induced by the Agreement is expected to be minor, both in the EU and in Chile – e.g. the right to an adequate standard of living, the right to a clean environment, the right to water and consequently right to health might be affected to a limited extent, partly positively, and partly negatively. Nevertheless, the screening and scoping exercise has led to the conclusion that the following human rights should be examined in more detail:

- Right to the highest attainable standard of physical and mental health and access to essential medicines: Although the right to health 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. But this impact will have to be investigated when more information on the legal text of the Agreement is available. In the EU, the right to health is not likely to be affected significantly by the modernised Agreement.
- Right to adequate food: Although the impact is not expected to be significant, provisions of the modernised FTA related to the liberalisation of tariffs for remaining goods could potentially marginally affect the right to food of the Chilean population, especially in the agricultural and food sectors where some significant tariff barriers remain.
- Right to work: As a result of the modernised Agreement, the right to work is expected to be affected through creation/loss of jobs in different sectors, thereby leading to either positive or negative minor impacts. Specific chapters on TSD and on trade and gender that are envisaged in the modernised Agreement are expected to have a minor but structural positive impact on the right to work and labour rights in the long run. Higher standards and more focused levels of protection could be introduced through these new provisions to the modernised FTA. Labour rights of migrant workers – a vulnerable population group – could be potentially affected positively through increase in employment in the sectors that employ high number of migrant workers.

The assessment of the modernised Agreement's **environmental** impacts considers the following issues. Overall, the analysis indicates that environmental impacts will be modest given the scale of the economic impacts:

- Greenhouse gas emissions: The overall effect of the modernised FTA is expected to be limited. The CGE model simulations show however changes in GHG emissions especially in the following sectors: An increase in emissions in the sectors vegetables, fruits, nuts; and oilseeds, vegetable oils and fats in Chile and a decrease in these sectors in the EU because of a shift of production and bilateral trade; a decrease of emissions in the sectors oil; motor vehicles and transport; and machinery in Chile and an increase in these sectors in the EU because of a shift of production and bilateral trade; and additionally an increase in emissions in Chile in the sectors plant and animal fibres and other crops; dairy products; beverage and tobacco and utility. Furthermore, the reduction of trade barriers in the modernised FTA is expected to provide improved opportunities for trade in low-carbon goods and services as well as in strengthening the existing Chilean regulatory framework.
- Transport and the use of energy: The modernised Agreement might lead to changes in transport emissions in Chile, both in terms of absolute levels of transport activities and modal shift. The modernised FTA 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. In energy, the FTA modernisation could expand opportunities both in Chile and the EU to import technical solutions that help the further growth of renewable energy.
- Air quality: The ex-ante study concluded that the modernised FTA is unlikely to have an effect on the level of air pollution in Europe and only a minor impact in Chile. Further detailed analysis confirms these earlier conclusions but also identifies that significant differences may occur between regions and cities. Specific provisions could be taken up in the modernised FTA on further improvement of local standards, monitoring and enforcement.
- 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 further environmental concern in terms of nitrogen run-off from farming and discharge of contaminated water from mining activities. Given the local nature of the environmental concerns it is not expected that the modernised FTA will significantly impact these developments. However, being a large importer of both copper and agricultural products from Chile and a large exporter of sustainable products to Chile the EU may wish to include expected results of current policy developments as minimal conditions in procurement rules.
- Further analysis, including through consultations, will be undertaken with regard to the modernised Agreement's impact on land use, biodiversity, and waste and waste management.

Provisional findings from sector and case studies

A number of sector studies provide a deeper examination of the potential impact of the modernised Agreement on the EU and Chilean economies. The selection of the sectors has been based on the economic importance of the sectors, the estimated impact of the Agreement on the sectors, and potential for social, human rights and environmental impacts, and the level of importance accorded to the sector by stakeholders and negotiators. The current status of the analysis can be summarised as follows:

- **Dairy:** The existing Agreement provides for limited liberalisation of some dairy products –for example, milk (incl. powdered milk) and butter are excluded, and for cheese a TRQ with a quota of initially 1,500 tonnes (increasing by 5% per year) – both in the EU and Chile – with an in-quota zero tariff was agreed. Despite the partial liberalisation, Chile has hardly exported any dairy products to the EU (and accordingly has not filled quotas for cheese) whereas EU exports to Chile – especially of cheese and, at a lower level, milk powder and butter - have rapidly increased in recent years. Based on the Commission's CGE simulations, bilateral trade would increase 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.

- **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 FTA 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 provisions on investment and public procurement. 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 by 0.6% (unskilled labour) to 0.8% (skilled labour). The modernised Agreement furthermore has the potential to contribute to addressing labour rights issues and the occurrence of child labour in the sector through strengthened labour provisions in the TSD chapter, especially its provisions regarding effective implementation of the ILO conventions, promotion of decent work, decent working conditions, social dialogue in labour-related matters, Corporate Social Responsibility practices, and responsible supply chain management, as well as through continuation of a policy dialogue on employment and decent work under the cooperation pillar of the Association Agreement.
- **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 (apart from a small increase in exports to Chile). For Chile, a small decrease in employment of unskilled workers in the sector is anticipated under both scenarios (by 0.1% under the conservative one and by 0.2% under the ambitious one), 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. Analysis disaggregating the two sectors has begun and will be included in the next report.
- **Communication and business services:** Bilateral trade in this sector promises to increase due to the modernised Agreement, with the EU gaining in exports under both the conservative and ambitious scenarios (more so in the latter), and Chile also gaining in the ambitious scenario under which the modelling assumptions project some improvement in EU market access. 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 FTA are expected to be limited.

The current status of case study research can be summarised as follows:²

- **Olive oil:** The FTA 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 social human rights effects in

² A separate case study on the modernised Agreement’s impact on women has been prepared but has been summarised under the social impact above.

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 FTA 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 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. Nevertheless, the question remains if provisions in the Agreement could lead to regulatory changes, or changes in the implementation and enforcement of regulations, for salmon farming in Chile. This remains to be explored in full as the research progresses.
- **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 FTA 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 EU-Chile FTA. 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 downstream in the lithium value chain to demand also CSR 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.
- **Effects on rural communities.** Results to date indicate a positive but small economic effect of the modernised Agreement for rural areas, which will however be unevenly distributed across the country, depending on which particular economic activities dominate a given region. This is to be investigated further in the next stage of the analysis.

Study planning

The original planning as presented in the inception report largely remains valid, with the draft final report – the next deliverable under the contract – planned to be submitted by the end of December 2018, and the contract completed by early July 2019. From September to November 2018 the focus of activities will be on stakeholder consultations which could not be effectively undertaken so far due to the holiday period.