

Macroeconomic Situation and Outlook

In 2000, the Chilean economy grew at a rate of 5.4 percent, a welcome recovery after the -1.1 percent negative growth of 1999. The rate of economic growth failed to meet expectations, however, given that growth rates were above 7 percent during the second half of the 1990s; nor was it sufficient to reduce unemployment, which remained at 9.2 percent in 2000, only slightly below the 9.7 percent level of 1999. The inflation rate was 4.5 percent, and should continue to decline slowly to 3 percent, unless petroleum prices continue to rise. In support of this trend, fiscal accounts ended 2000 in balance and aim to achieve a surplus of 1 percent of GDP this year. The current account deficit is also low, at 1.3 percent of GDP, with a stable outlook.

For the coming 12-24 months, domestic demand—particularly domestic consumption—is expected to remain weak, due to the high unemployment rate that is anticipated and to uncertainties about labor and employment legislation. Demand will also be aggravated by the slowdown of the world economy, particularly from the poor showing expected from the United States and Japan, and from high petroleum prices. The expected GDP growth for 2001 and 2002 is being continuously adjusted downward, standing at the moment at 4.4 percent and 4.9 percent, respectively. Several policy adjustments have been set in motion to stimulate recovery; these include a reduction in interest rates, renegotiation of debts by small industries with public sector backing, elimination of taxes on companies' capital gains, and the elimination of remaining restrictions on the influx of foreign capital.

The policy of unilaterally reducing external tariffs by one point per year continues to be applied, so that in 2001 the uniform tariff is 8 percent and should continue to decline by one point per year, to reach 6 percent by the year 2003. Nevertheless, due to the numerous bilateral trade agreements signed by Chile since 1991, the effective average tariff now stands at 5.9 percent, a historically low level. Import tariffs for trade flows from MERCOSUR—a free trade area comprising Argentina, Brazil, Uruguay, and Paraguay and the most important source of Chilean food imports—now range from 2.9 percent to 4 percent. On a parallel track, in 2001, negotiations were initiated with the United States for a free trade agreement (FTA), in line with a desired free trade of the Americas agreement to be reached in 2005, as pledged by the Western Hemisphere presidents at the Quebec Summit in April 2001. Bilateral negotiations are also taking place with the European Union, New Zealand and South Korea.

On the other hand, the difficulties faced by neighboring Argentina and its recent drastic increase in external tariffs, plus the devaluation of the Brazilian currency, are causing serious difficulties for Chilean exports into MERCOSUR, while imports from that trading block into Chile have grown significantly. In this rather unfavorable context, domestic investment remains low and the prospects of a larger influx of foreign capital will be critical to decisions about privatizing more

sectors still in public-sector hands, such as the railroad and urban railway projects.

Food Prices and Consumption

During 2000, consumer prices increased by 4.5 percent, but the increase was greater—7.9 percent—for wholesale prices, mostly in connection with the rise in petroleum prices. On the other hand, food costs at the consumer level remained unchanged (-0.1 percent), as international agricultural prices did not rise in any significant measure, weather conditions in the country made it possible to reach good yields, and domestic demand was weak due to high unemployment. The expectation for 2001 is for food prices to remain stable once more, given a scenario of weak international demand and continued low domestic demand. Wholesale prices should rise further as a result of higher transport costs due to higher petroleum prices. This implies that marketing margins in the food chain will continue to shrink, further stimulating the ongoing concentration of food marketing in the hands of large supermarket chains that can compensate low margins with economies of scale.

Food Processing and Marketing

Multinational supermarket chains in Chile continue to consolidate: the Chilean supermarket chain, AGAS, was recently acquired by the Dutch AHOLD group, under the local Santa Isabel brand, which will now control 12.1 percent of the national market, up from 10.6 percent.

In the food processing industry, there has been outstanding growth in the pork industry—a 73 percent increase in exports between 1999 and 2000, with large investments being planned to expand processing capacity. This contrasts sharply with the stagnation observed in the larger and more traditional export-oriented food processing sector of fruits and vegetables; this decline is due to a halt in the growth of exports of frozen and dried vegetables and fruits and fruit juices, and to a serious reduction in tomato pastes and pulps, which were a major pillar of the horticultural sector. The food-processing sector would benefit from FTAs with the US and the European Union, which would alleviate the existing high tariffs for these higher value-added imports, but such FTAs are not expected to take place in the short-term and will probably be phased in over several years.

One of the most dynamic industries in Chile during the last decade has been the wine-producing sector, which has experienced an important restructuring toward the export business, expanding in both area planted and processing infrastructure, and accompanied by a replacement of traditional varieties and by new joint ventures with foreign firms. Wine exports totaled over US\$592 million in 2000, a 10 percent increase over 1999. Primary markets are North America, England, and Germany. Due to the increases in production and

exports by Chile and competing nations (such as North America, Australia, New Zealand and others), prices for grapes and wine are falling drastically, in what is expected to be the beginning of a declining price trend; this will limit a positive outlook only to the companies that can establish themselves in the premium quality niche. This should also discourage new plantations.

Agricultural Production and Trade

The size of the agricultural sector within national GDP has continued to decline. During the 1980s, the agriculture and forestry sectors fluctuated between 7.3 and 8 percent of total GDP; today, however, they stand at only 5.8 percent. During 2000, the sector grew at 5.2 percent, recovering from the -1.3 percent figure for 1999, but still below the average 5.4 percent growth of the economy as a whole.

Agricultural exports declined by 2.8 percent during 2000, in contrast with a 17 percent growth of forest product exports. These trends mean that by the year 2002, forest exports will surpass agricultural exports, altogether exceeding US\$5 million. The primary export product from the sector is cellulose, with exports of US\$1,113 million in 2000, followed far behind by grapes, with an export value of US\$636 million. In terms of markets, the largest increase in exports took place with respect to the European Union (EU), the most important external market for agricultural and forest products; however, exports to NAFTA represent 55 percent of total exports, as opposed to 20 percent in the case of the EU.

Agricultural and forestry imports grew by 3.9 percent during 2000, as the result of an 18 percent increase in imports of livestock products, mainly dairy products and beef. Imports of cereals, vegetable oil, and oilseeds—all major import products—were lower than in 1999, as domestic production increased in response to higher domestic prices.

The most dynamic activities within the sector were poultry and pork production, for both domestic and expanding export markets, and fruits and wine for export markets. In the coming 12 months, virtually no growth is expected in cereal and annual crops production, while milk production should resume a vigorous growth, and there should be a continuing supply response to favorable market conditions in poultry and pork. Dairy imports should therefore decline in the next couple of years. In the beef sector, the absence of BSE (Bovine Spongiform Encephalopathy) and of foot and mouth disease (FMD) in the country (in fact, Chile is presently the only country of the Southern Cone of Latin America free from FMD), has created expectations for opening an export activity in this type of meat, even though Chile has a net deficit in beef trade.

One of the areas of most vigorous growth in the last decade has been the wine sector, due to new plantations and processing infrastructure developed to satisfy export demand. Yet, as mentioned earlier, the prospects are that the price declines observed this season will remain or perhaps intensify, thus reducing new plantations. At present, the price for lower-quality grapes has fallen by up to 50 percent, and the larger wineries are expected to concentrate produc-

tion in higher-quality products. Nevertheless, production and export growth will continue in the coming years, at about 10 percent per year, mainly as a delayed consequence of the increase in plantations over the past five years: the territory planted with vineyards increased from 53,000 hectares in 1994 to about 90,000 in 2000. Fruit plantations also experienced an increase in the previous five years, although more modest than for vineyards and concentrated in a few species such as apples, almonds, lemons, and avocados; thus, fruit production and exports are expected to continue to increase in the next couple of years.

Food and Agricultural Policy

The major policy issue for farmers is how to protect their activity from unfair foreign competition and from highly unstable world prices, in view of the fact that the instruments used so far, price bands and safeguards, are being challenged by major trading partners, such as the US and MERCOSUR. So far, no new mechanisms have been proposed, and there is little hope that multilateral trade negotiations will achieve reductions in agricultural subsidies abroad or eliminate the distortions that result in very unstable world prices for some of the major agricultural commodities. It is expected that, if trade negotiations move ahead with the US, the existing price band mechanism which until April 2001 was applied to three commodities—wheat, sugar, and oils—will have to be dismantled, leading to a reduction in the area sown to wheat and sugar beets. The band mechanism on oil is in practice not operational, as imports have already shifted to oil mixes, which were not subject to the band mechanism, and prices and production levels have already adjusted to the new scenario. The elimination of the price band on oil has already been announced.

The objective of agricultural policy for the next few years is to promote innovations and quality, production that is more friendly to the environment, and production that is economically viable and sustainable. Among the new policy tools introduced in 2001 are an agricultural insurance scheme designed to insure small farmers against climatic risks and the establishment of an agricultural commodity exchange. There will also be a focus on second-generation financial instruments that can help provide more efficient, stable, and non-distorted agricultural markets. However, a viable financial system for small- and medium-sized farmers is still lacking, as private banking never took an active role with this segment; that role was handled by a public institution, INDAP (Instituto de Desarrollo Agropecuario), which is in serious financial conditions due to the nonrecovery of a high proportion of previous loans, caused by an overly lenient lending policy.

Nonetheless, recent efforts to articulate and promote policies aimed at achieving clean agriculture and safe food production are worth mentioning. The first major step in this direction is the public-private program for Good Agricultural Prices targeted at the fruit-growing sector, which will be certified by the Association of Fruit Exporters. In terms of input markets, important public resources are

being spent on improving irrigation infrastructure and on supporting schemes for the recovery of degraded soils. An important portion of public funding for agriculture is focused on the southern regions, in which traditional import-competing agricultural and livestock activities are mainly found. On another front, measures to protect the favorable phytosanitary status of Chile, naturally isolated from a large number of pests and diseases, are and will continue to be given high priority, because of the importance of keeping and opening strict foreign markets for exports.

Water Resources and Management

Chile is a country with favorable water resources conditions, although they are limited in the northern and central areas, where there are cycles of dry spells and periods of abundant rainfall. Mountain snows are the major reservoirs, yet this potential supply is not adequately used in agriculture because of great inefficiencies in the use of the water. Gravity flow of water for irrigation, used in more than 90 percent of the irrigated area, is of low cost but has no more than 30–40 percent efficiency. Nevertheless, efficiency of the river basins is higher, 70–80 percent, due to the possibility of reutilizing the irrigation water from the upriver flow. Most of it ends up in the ocean, however. In urban centers, only about 20 percent of sewage water is treated for reuse. Aquatic ecosystems present difficulties for conservation because no provisions are made to maintain water flows at the minimum levels required.

The average volume of running water is 928 km³, representing 7.9 percent of the total flow of South America and about 2.1 percent of the world flow. While on average, water availability suitable for human consumption in the planet is 9,500 m³/year/inhabitant, this figure for Chile is 70,000 m³. Agriculture is the main user of fresh water, about 89 percent of the total availability.

Demand for water from all these activities has grown at a rapid rate, and scarcity in the near future is possible unless there are new investments in dams and irrigation infrastructure, as well as incorporation of better practices and more efficient technologies in irrigation. New technologies for development of potable water supplies are necessary, and more hydroelectric plants will also be required. Research on water use, ways of improving efficiency, and technological transfer is scarce; in addition, cultural problems come into play when devising ways to improve water management.

Legislation on water rights was introduced back in 1981, after the end of a long period of land reform, when property rights on land and water were reestablished. The legislation enacted a market system in which water rights are traded freely under a regulatory framework, a very uncommon system in developing countries. For this reason, it has been studied by many countries in the region and by multilateral organizations such as The World Bank. While the studies have not been conclusive as to the effectiveness of such a market, it is widely accepted that the water markets have developed much more actively in those river basins in the country where water scarcity is greater. Water

rights, which were provided free of charge on the basis of historical use, can be traded, transferred, or rented, and there is total freedom in the use of the water under one's right. Nonconsumptive rights have also been defined for those types of use, such as hydroelectric plants, that devolve the water and are obliged to do so, once used for an assigned purpose.

A number of issues dealing with conflicts between sectors, such as those between human consumption needs and the mining industry, a very large sector in Chile, or between indigenous populations and the hydroelectric plants, have also been part of the recent history. A proposal from the Executive Branch has been stalled in Parliament for the past few years, which would modify the law, in order to introduce financial penalties for the non-use of the water; it would also stipulate, if the water had not been used within a given time period, that the rights to it would be returned to the authorities to be reassigned to those who require water. There is strong political opposition to this proposal, particularly from farmer's associations, who consider these proposed changes as a challenge to private property rights.

An estimated US\$420 million has been invested in new large- and medium-sized dams and waterworks over the last decade; most of it (68 percent) was spent on new large works, while the remainder was spent in conservation and improvement of existing works and in medium-sized projects. The government has announced that it plans to invest another US\$320 million in the coming years, with financial support from The World Bank and cost recovery from the beneficiaries. Public funding has also helped to finance smaller projects and financial support has been provided for the introduction of improved irrigation systems at the farm level. This year, for the first time, a hydraulic project will be offered for investment to the private sector, following the policy of concessions to private capital that has already been used in other instances such as highways and ports. The proposed project should provide irrigation to some 3,200 hectares, at a cost of about US\$35 million. Farms that will benefit from this initiative will have to pay for the water, the tariffs to be established on the bases of the flow of water provided and the socioeconomic condition of the users. Other projects, currently in different phases of planning, will follow.

Finally, public financial support, based on contesting projects, is provided to cover part of the costs of projects that introduce modern irrigation schemes in small farms under a policy initiated in 1985. A total of 584 projects have been funded since then, with a total investment of US\$20 million, benefiting 25,000 families and providing 110,000 hectares with certain water availability.

Outlook for 2001–2003

A growth in demand for human use of potable water, from 17.6 m³/second in 1995 to about 27.1 m³/second in 2022, is expected in a highly concentrated area around the two largest and neighboring cities located in central Chile, which depend on a single river. The demand for water resources by the hydroelectric sector during the next 40 years

is expected to increase six times, prompting a need to build some 100 new plants (and not more thanks to the importation of natural gas from neighboring countries), and the demand for industrial and mining uses of water should more than double. Water used for agriculture, which at present irrigates about 1.8 million hectares, will possibly be required for an additional 500,000 hectares. The large increase in demand for water will therefore have to be met by combining resources both from the public and private sectors.

At the macro level, there is a definite need to:

- clearly define a national policy on water that goes beyond the existing policy on irrigation
- implement a river basin integrated management system
- introduce a planning strategy for water resources, and
- seek new sources of usable water such as underground sources, water recycling, and more aggressive reclamation of used waters.

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CHILE

	Units	1997	1998	1999	2000	2001 ^E	2002 ^F
FOOD CONSUMPTION PATTERNS							
Per capita caloric intake	Cal/day	2,835	2,874	2,858	na	na	na
From animal products	Cal/day	620	634	611	na	na	na
From vegetable products	Cal/day	2,215	2,240	2,247	na	na	na
Protein (% of calories)	%	11.0	11.0	11.0	na	na	na
Fat (% of calories)	%	26.0	26.0	26.0	na	na	na
Carbohydrates (% of calories)	%	63.0	63.0	63.0	na	na	na
INCOME AND FOOD PRICES							
Per capita income	US\$/capita	5,149	4,929	4,505	4,603	4,493	na
% of disposable income spent on food	%	27.0	27.0	26.8	27.1	27.0	na
% spent eating out	%	3.7	3.5	3.5	3.5	3.5	na
Food price index	1990=100	206.6	208.0	215.0	204.7	208.2	na
General price index (CPI)	1990=100	200.0	209.4	214.4	221.0	230.2	na
POPULATION							
Total population	Million	14.6	14.7	15.0	15.2	15.4	na
Urban	Million	12.4	12.5	12.8	13.0	13.2	na
Nonurban	Million	2.2	2.2	2.2	2.2	2.2	na
Share of population in the following age groups							
0–4 years	%	10.0	9.8	9.6	9.4	9.3	na
5–14 years	%	19.1	19.1	19.0	19.0	18.8	na
15–19 years	%	8.4	8.4	8.4	8.4	8.5	na
20–44 years	%	39.3	39.1	38.9	38.7	38.5	na
45–64 years	%	16.4	16.6	17.0	17.2	17.7	na
65–79 years	%	5.6	5.7	5.7	5.8	5.9	na
80-over years	%	1.2	1.2	1.2	1.3	1.3	na
Median age of population	Years	27.5	27.8	28.3	30.6	na	na
Female labor force participation	%	35.1	36.1	36.5	35.0	na	na
LIFE EXPECTANCY							
Males	Years	72.3	72.3	72.4	72.6	na	na
Females	Years	78.3	78.3	78.4	78.6	na	na
FOOD INFRASTRUCTURE							
Trade capacity							
Grain exports	1,000 Tons	99	136	137	83	81	na
Grain imports	1,000 Tons	1,304	1,357	2,137	1,936	1,510	na
Total food and agricultural trade	Million US\$	5,982	6,113	6,110	6,113	5,871	na
Total food and agricultural exports	Million US\$	4,663	4,793	4,848	4,820	4,618	na
Perishable products	Million US\$	1,429	1,482	1,547	na	na	na
Fishery exports	Million US\$	1,873	1,673	1,784	1,875	1,909	na
Total food and agricultural imports	Million US\$	1,318	1,321	1,262	1,293	1,253	na
Perishable products	Million US\$	272	283	312	na	na	na
Fishery imports	Million US\$	30	24	na	na	na	na
Port capacity	1,000 Tons	30,917	28,212	na	na	na	na
Road access	Kms	79,077	79,144	79,353	79,520	na	na
Rail access	Kms	5,998	5,998	5,998	5,998	5,998	na
Telecommunications	1,000 Lines	2,693	3,046	3,108	3,365	na	na
Power generation	Gigawatts	32,332	34,886	38,019	39,586	39,900	na
Percent of population with refrigerators	%	54.6	77.8	77.8	77.8	na	na
FOREIGN INVESTMENT IN THE FOOD SECTOR							
Inward FDI in the food sector, total	Million US\$	256.9	88.9	391.4	172.9	85.2	na
From other PECC economies	Million US\$	na	na	na	na	na	na
Outward FDI in the food sector, total	Million US\$	1.4	101.3	20.4	na	na	na
To other PECC economies	Million US\$	0.0	89.6	20.9	na	na	na
ROLE OF AGRICULTURE AND TRADE IN THE ECONOMY							
Agriculture as a share of GDP	%	5.8	5.9	5.9	5.9	5.9	na
Self sufficiency in grains	%	71.2	61.2	56.4	59.4	na	na
Self sufficiency in horticultural products	%	100.0	100.0	100.0	100.0	na	na
POLICY TRANSFERS							
Total transfers (subsidy/tax)	Million US\$	228.2	268.4	131.2	151.6	na	na
Total transfers per capita	US\$/capita	15.6	18.8	na	na	na	na
Macroeconomics Indicators							
GDP growth	%	7.4	3.9	–1.1	5.4	3.7	na
Interest rate	%	6.8	9.6	6.0	5.4	4.5	na
Exchange rate	CLPeso\$/US\$	419.30	460.29	508.78	539.50	599.7	na

na = not available E = estimate F = forecast

Sources:
Business Monitor International
CASEN.
CELADE.
Central Bank.
Direcon.

EFE.
FAO.
IFOP.
INE.
MIDEPLAN.
MOP.
MTT.

ODEPA.
PROCHILE.
SONAPESCA.