

“U.S.-Chile Free Trade Agreement: Building on Success”

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First, I'd like to thank Roger Noriega and the American Enterprise Institute for their leadership on the issues highlighted here today, including the U.S. relationship with Latin America and the importance of free trade and the rule of law in securing progress in that relationship.

The U.S.-Chile FTA is in many ways a tremendous success. I am planning to split my time more or less evenly between a paean to the FTA's success and a focused criticism of the Chilean government's failure to implement the agreement in one particular area.

Those of you who woke up in a sunny mood and wish not to be disturbed by bad news can take a break at my half-way mark, and those of you who woke up grumpy and want to stay that way can take their seven-minute break about now.

First the good news. The agreement has succeeded marvelously as a tool to drive commerce, growth, and jobs; as an example to other countries with regard to the efficacy of free trade as a policy; and in terms of its ability to enhance the U.S. partnership with Chile across a variety of fields.

The agreement was implemented on January 1, 2004 — a little over two years ago. U.S. exports to Chile surged by 33% in 2004 and by an additional 43% in 2005. The cumulative rise in U.S. exports to Chile was over 90% over two years. In other words, U.S. exports have almost doubled in two years. As a point of reference, U.S. exports overall rose 23% in that same period.

The results for Chilean exports have been similarly impressive, with Chilean exports to the United States rising by 80% over two years. In other words, the positive results in trade have been quite balanced. It's worth pointing out that Chile is undergoing a huge export boom based in large degree on commodity sales to Asia, with Chilean exports to China and other countries growing even faster than their exports to the United States. U.S. capital goods imports are helping to make that boom possible.

Now, we all expected this agreement to be a success, but the huge explosion in trade has caught many people in this city by surprise. The U.S. International Trade Commission (ITC) had forecast total export growth of 18-52% for the first 12 years of the agreement's implementation.

Compare that estimate with the real results. The rise in U.S. exports to Chile over just two years was five times the low end of this range of estimates and twice the amount suggested by the high estimate. And to reiterate, the ITC foresaw these gains over a period of 12 years, not two.

Some individual companies can point to even more astonishing gains. For example, Caterpillar was one company that worked hard to secure approval of the agreement — and it has won some amazing benefits.

Exports of Caterpillar-type equipment from Illinois, site of the company's headquarters, rose dramatically over the first two years of implementation of the FTA. Sales of front-end shovel loaders rose from under \$10 million to nearly \$40 million over two years — a four-fold rise. Sales of off-road dump trucks — which generally means the huge dump trucks used in mining — rose from \$40 million to \$200 million over the two years in question — a five fold rise.

Let me draw two quick conclusions from these results.

First, the ITC needs a new model. I'm joking, but only a bit. Even allowing for the high price of copper, which has been a huge stimulus to the Chilean economy, the static and hyper-conservative model used by the ITC is by any measure a failure when it comes to calculating the benefits of FTAs.

There is a real political risk that arises from the exaggerated conservatism of the ITC's economic modeling. If the ITC consistently low balls its estimates for FTAs' economic impact, making the case to the Congress for these agreements' approval will become more and more difficult.

And second, you should never bet against the animal spirits of American entrepreneurs ... or Chilean entrepreneurs ... or entrepreneurs anywhere. More generally, tariffs around the globe are generally much lower today than they were in the immediate post-WWII era, but modern FTAs have disciplines that go far beyond cutting tariffs — they cover economic growth sectors ranging from services to government procurement to investment. Time and again these new FTAs are showing an ability to bring big benefits to workers across the breadth U.S. economy — and the same for our partners.

Against this backdrop of general success, I would like to spend a few minutes providing some details on the major disappointment of this agreement — namely, the Chilean government's failure to implement the intellectual property provisions of the agreement.

To quote Secretary of State Condoleezza Rice, IP is the mother's milk of the 21st century economy. Not just in the United States but around the globe, the innovative industries are at the core of our economic progress — creating high-paying jobs, enhancing our competitiveness. And they deliver the goods — whether the “goods” in question are entertainment in the form of a good movie — business tools in the form of software — or life saving medicines in the form of pharmaceuticals.

While counterfeit and pirated goods are a problem in Chile as they are in many countries — including the United States — the particular problem in Chile is in the pharmaceutical sector.

If you'll bear with me a moment, I'll tell you about the two central challenges that the pharmaceutical industry faces around the world — problems that pose a direct threat to the value of their intellectual property. These problems raise questions about whether or not research in life-saving medicines will continue to be economically viable.

For the pharmaceutical industry, the product is a molecule and a set of test data that shows the molecule's efficacy and safety. Developing these molecules and data requires hundreds of millions of dollars of investment and many years of intensive research. Because the act of filing for a patent obligates a firm to reveal these data to a government agency, it is understandable that firms will seek legal tools to protect the fruits of their investigations.

This is what we mean by data protection, or protection of the data that shows the medicine's efficacy and safety. Indeed, if data of this sort isn't intellectual property that needs to be protected, then what is?

The pharmaceutical industry faces a second and related challenge known as linkage. Basically, firms that have received a patent from the Patent Office want to avoid a situation in which the health ministry can grant marketing approval for a copy of their product to a third party.

In other words, they want their patent to mean something. You don't have to be an IP lawyer to see that your patent means nothing if the health ministry doesn't pay any attention to the question of who holds the patent when they decide whether or not to approve a firm's request for permission to market a drug.

Failure to enforce this linkage between patent ownership and marketing approval makes a mockery of the patent system. It undermines the very premise of investing in the laborious and expensive research that generates new, life-saving medicines.

So, with that primer on data protection and linkage, let me read to you the text of the Chile-United States Free Trade Agreement on this subject.

“With respect to pharmaceutical products that are subject to a patent, each Party shall not grant marketing approval to any third party prior to the expiration of the patent term, unless by consent or acquiescence of the patent owner.”

Again, you don't have to be an IP lawyer to understand that. The text is clear. I can tell you that the U.S. pharmaceutical industry greeted this text in the agreement with great satisfaction. Consequently, the industry worked hard to make the case for the FTA's approval by the U.S. Congress.

To give some specific examples, Merck has two products protected by patents in Chile — Stocrin, an HIV/AIDS drug, and Vytorin, an anti-cholesterol drug that combines a Merck product with a product created by Shering-Plough.

In both of these cases, the Chilean Institute of Public Health issued marketing approvals for copy products manufactured by other companies — companies that do not face the burden of underwriting a massive R&D program to discover and test new medicines before bringing them to market.

In the case of Stocrin, the Chilean courts refused to issue an injunction after the copy was approved for marketing. One of these marketing approvals was issued late last year under the Lagos government, and the other just a few weeks ago — since the Bachelet government took office.

This company is not alone. Others have brought these difficulties to my attention as well, and, more importantly, to the attention of the Office of the U.S. Trade Representative. In its annual Special 301 report on intellectual property rights around the world, the USTR announced in April that it will conduct an Out-of-Cycle Review to monitor progress on IPR issues in Chile. This signals a special and heightened level of concern about the situation in Chile.

After commenting on the data protection and linkage problems I have mentioned, the report says: “The United States is very concerned that Chile continues to grant marketing approval via sanitary approvals to unauthorized copies of patent-infringing pharmaceutical products.”

A skeptic might ask: Can’t all of these difficulties be minimized and disregarded as limited to a single industry? Doesn’t this add up to an asterisk on an otherwise very successful agreement?

I would contend that the answer is no. This refusal to abide by the clear terms of the FTA represents a dangerous aberration from the *rule of law*, respect for which has been the key factor differentiating Chile from many of its neighbors in Latin America and the Caribbean.

For Chile is truly a nation of laws. When I lived in Chile in the early 1990s, I recall seeing copies of new laws for sale on newsstands in downtown Santiago. And yes, people were buying them. U.S. firms have invested over \$10 billion in Chile, 40% more than they have invested in mighty India with its billion capitalists. They have done so because Chileans have allowed so little daylight between the letter of the law and its implementation. This respect for the rule of law is the best and most effective investment-promotion program you could possibly devise.

Chile’s track record has been very good. In the words of one pharmaceutical industry executive, “it never occurred to me that the Chileans would not implement the agreement.”

The precedent here is incredibly important. The positive results I cited at the beginning of my remarks bear eloquent witness to the potential of FTAs to bring benefits to the United States and to our friends in Latin America and the Caribbean.

Now, if law-abiding Chile fails to adhere to the terms of our bilateral agreement, how can we expect other countries to do so? What about Guatemala, where the Congress has witnessed tough fights about intellectual property rights? What about the Dominican Republic, where overt instances of IP theft such as broadcast piracy have been a problem through the years?

And what about Peru and Colombia, with which we have FTAs pending? The Chamber is leading a business coalition seeking Congressional approval of these agreements. How can we secure their passage if the toxic idea takes hold in the Congress that foreign governments simply can’t be trusted to uphold their trade agreements?

Worst of all, Chile’s potential as country on the path toward a high level of economic development will be frustrated if this problem is not taken seriously. At a time when other Latin American governments are nationalizing natural resources — or in one instance, nationalizing a billion dollars worth of U.S. investment — respect for the rule of law and for property, including intellectual property, is critical.

For wealth is made, not found, and development can never come about unless property is respected. I hope that Chile will take the higher path toward development and growth. Thank you.