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HANDELSHÖGSKOLAN**

**EXPORT DEVELOPMENT AND FDI UNDER
SHIFTING TRADE POLICY CONDITIONS:
THE CHILEAN WINE INDUSTRY 1990-2012**

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Abstract

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Title: Export development and FDI under shifting trade policy conditions: The Chilean wine industry 1990-2012.

Problem: Throughout the history, the political situation in Chile has been turbulent. It has been, and still is a polarized country, which is reflected in the shifting regimes and the attitudes towards international trade and foreign competition. The trade- and investment policies throughout the years have affected the trade conditions, the investment climate, and the domestic industries. As a result of diversification efforts by the governments of exports and markets, the wine industry has become one of the most important industries for Chile. We study the effects of the political evolution from 1990-2012 on the Chilean wine industry. What led the wine industry to success? Have the trade policies contributed to the growth of the industry or not? In that case, how?

Aim: The aim of this study is to analyze the correlation between Chile's trade policies and the Chilean wine industry during 1990-2012.

Limitations: We have chosen to delimitate our study to FDI and export in the Chilean wine industry, from the 1990's until present time (2012). Furthermore, we do not examine the import; hence solely focus on export and FDI.

Method: This thesis is a quantitative research complemented with qualitative data. A quantitative research is used to find a relationship between two variables, or to investigate a possible phenomenon via quantitative methods. In turn, a qualitative research is a study of a real world phenomenon to get an understanding of a specific problem or question.

Findings: The main findings of the thesis are that trade policy measures during the period 1990-2012 has affected the growth of the Chilean wine industry. Hence, openness and pro-market policies has contributed to an increased inflow of FDI and to a steady increase of Chilean wine export.

Suggestions: A suggestion for further research is to analyze the advantages and disadvantages of further liberalization of the Chilean economy. Hence, if there is a critical point, when openness and liberalization no longer is beneficial to the country and the domestic industries. In this respect it would be interesting to look at the Chilean wine cluster, and discuss the power structure within the industry, and the dependence on foreign investors.

Keywords: *Trade policy development, the Chilean wine industry, growth, export and FDI.*

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1. Introduction

1.1 Background

The history of Latin America, and in this case, the history of Chile has been turbulent. The continent has been subject to brutal colonization, slavery and exploitation of natural resources (Lockhart & Schwartz, 1983). In turn, the colonial experience led to under-development and dependence and was followed by many years of war in the struggle for freedom and independence (Galeano, 1979). Today, nearly two centuries later, no country in the region can be classified as developed (World Bank, 2012) and the poverty and inequality is a regional dilemma, even though some places are worse than others (Bulmer-Thomas, 2003). Naturally this heavy historical heritage has shaped the modern history of Latin America and Chile, where instable public institutions and turmoil have hampered welfare and economic development (Sokoloff & Engerman, 2000).

In modern times, the instability and the shifting attitudes towards international trade and investments of the different regimes have had a direct effect on Chile's position in the world scene. Before the mid-1970's, during the Salvador Allende era, the Chilean economy was highly protected. As a reaction to the failure of the socialist regime of Allende and his party Unidad Popular (UP) in 1970-1973 (de Vylder, 1974), General Augusto Pinochet took the political power in the country with a military coup. He dissolved the parliament and led Chile as a self-appointed dictator from 1973-1989. Pinochet adopted a new development strategy for Chile, which consisted of liberalization and openness (UNCTAD, 2000). However, he governed crucially, tortured and killed people with different political views than his own. After some years the economy faced a downfall and domestic industries that were not able to compete with the new foreign entrants were driven out (Galeano, 1979). Consequently, the number of supporters to the Pinochet regime declined and the dissatisfaction among the people led to his fall. In 1989, Patricio Aylwin of the central-left alliance became the new democratic president. The alliance kept the majority; the following years only new presidents were elected. The Christian democrat Eduardo Frei was elected in 1993 and in 2000 Roberto Lagos from the socialist party won the election. Later, in 2006, the first female president through Chilean history was elected. Michelle Bachelet was also a part of the center-left coalition and became very popular, particularly among the women. As she was not allowed to participate in the election in 2009, Frei once again became the chosen candidate for the center-left alliance. His main rival in the election was Sebastian Piñera of the center-right

alliance, who won with the majority of the votes and still governs as president of Chile today (Gobierno de Chile, 2010). Thus, Chile has been a polarized country when it comes to politics and naturally this affects the trade policy conditions.

Today Chile is a fast growing economy and a stable country characterized by openness to international trade and foreign direct investments (FDI) (WTO, 2009). In comparison with the other Latin American countries, Chile's economic performance is strong and the prosperity is evident. The political stability and the welcoming investment climate have played important roles, leading to a steady increase of FDI (Datamonitor, 2011). However, the innovation output is weak and does not follow the same positive trend. Chile has developed its macroeconomic policy and enhanced international trade and investments but in spite of this the trade policy shows to be increasingly insufficient (Porter, 2011).

The Chilean economy is very dependent on its minerals and the mining sector. The main and most important export product is copper and the trade balance is strongly affected by the demand and the price of the copper in the world market. Nevertheless, lately the Chilean economy has shown to recuperate more rapidly from shocks and fluctuations in copper price, thus, the dependence has diminished. However, through the history, and still today, the mining sector stands for a large share of Chile's GDP and export. Chile has become increasingly important on the world copper market (De Gregorio & Labbé, 2011). In recent years, however, the government has recognized the problematic dilemma of being too dependent on one sector. Hence, diversification of markets and exports has been enhanced in order to perform better economically. As a result, the growth in non-copper exports have increased, for instance exports such as, forestry products, paper and pulp, processed food and vegetables (Berthelon, 2011). Other important export products are fruits, fishery products and wine (WTO, 2012, a). Thus, in the shadow of copper and other minerals the wine market is emerging. Wine has been, and still is, an important product for Chile as nation (Morel-Astorga, 2001). Some even call Chile 'El país del vino', 'The country of the wine' (Del Pozo, 1999). In the last decades, the wine industry has gone through some very important changes when it comes to technological and organizational transformation (Morel-Astorga, 2001) and today the success of the Chilean wine industry is a fact. Therefore, we examine the possible effects of shifting trade policy from 1990-2012, on the wine industry. Has it contributed to the growth and success of the Chilean wine industry, and then, how?

1.2 Purpose

The purpose of this thesis is to get an understanding of how different political governance and trade policies have affected Chile's position in the internationalization process. Hence, we look into FDI and export in the Chilean wine industry and evaluate the connection with the shifting trade policies from 1990 until present time (2012).

1.3 Research Question

Have shifting trade policies affected the growth of the Chilean wine industry, the international trade, and FDI in the Chilean wine industry from 1990 until present time (2012) and in that case, how?

1.4 Sub-Questions

1. How has the export of Chilean wine developed from 1990-2012 and how important is it today?
2. How have foreign direct investments in the Chilean wine industry developed during 1990-2012?
3. How have the trade policies regarding export and foreign direct investment changed with the shifting governments in Chile in the time period post-Pinochet until today?

1.5 Delimitations

There are many interesting sectors in the Chilean economy. However, we have chosen to delimit our study to the export of Chilean wine and FDI in the Chilean wine industry, from the 1990's until present time. The time period 1990-2012 is chosen because it covers the democratization process after the fall of General Pinochet and several different regimes, both left-wing and right-wing. Hence, the timeframe covers political differences and attitudes towards trade and investment. In addition, wine growing does not happen over one night, it requires some years; hence, the longer period of time is convenient. Another limitation we make is that we do not examine the import; hence solely focus on export and FDI.

1.6 Research Design

The introduction chapter provide a background and outline why the subject, Chilean trade policies from 1990–2012 and its effects on the wine industry, has been chosen. The methodology chapter provides information about the research process. In addition, the research approach, planning process and the collection and presentation of data is described. Furthermore, this chapter involves a discussion about the quality of a research and definitions

of the concepts, validity and reliability. The theoretical framework provides basic concepts and theories, necessary for the analysis and the reader's understanding. To get an overview of the Chilean wine industry Porter's value chain analysis is used. Secondly, follows information about trade policy and relevant themes such as promotion and protectionism. Last we present Porter's diamond model for measuring the competitive advantage of nations. In the empirical chapter follows a description of the characteristics and the growth of the Chilean wine industry and its value chain. Thereafter, follows evaluations of the trade policy conditions in Chile from 1990-2012 and the development of wine export and inflow of FDI. Further, we assess the Chilean wine industry in Porter's diamond framework. Later, in the analysis, we use the theoretical framework to analyze our empirical findings. We evaluate to what extent trade policies have affected the Chilean wine industry, the wine export and FDI. We seek the correlation and discuss the role of trade policy in the growth of the Chilean wine industry. In addition, we discuss the value of FDI in the wine industry and the importance of wine export. Last, we draw conclusions and answer our sub-questions and research question, which are presented in the introduction chapter.

2. Methodology

The methodology chapter provides information about the research approach, planning process and the collection and presentation of data. Furthermore, it involves a brief discussion about the quality of a research and the concepts of reliability and validity.

2.1 Research Approach

The research object of this study is export and FDI in the Chilean wine industry. The thesis contains an evaluation of if and how trade policy in Chile from 1990-2012 has affected the international trade and FDI in the wine industry.

The research is built upon theories, which are applied in the empirical findings, the analysis and conclusions. The theories are analytical tools providing an idea about the information that needs to be gathered and how it can be interpreted. However, to accomplish a well-written thesis, it is important to have a multi-approach view. Hence, look at the subject from different points of view and try to leave personal opinions out (Bell, 2005). The theories and definitions of important concepts are outlined in the theoretical chapter. The background data and theories led us to find our subjects of interest and guidance for the problem statement.

2.2 Evaluation of Research Approach and Methods

There are different sorts of studies and the research style depends on the subject and the problem that shall be illuminated (Bell, 2005). The method used in this thesis is quantitative, complemented by qualitative data. A quantitative research is used to find a relationship between two variables, or to investigate a possible phenomenon via quantitative methods. In turn, a qualitative research is a study of a real world phenomenon to get an understanding of, and highlight a specific problem or question. The subject is described and discussed, but the personal interests of the authors are often left out. Hence, this is a quantitative study that is complemented by qualitative research in order to really embrace the subject, interpret our empirical findings and come to accurate conclusions.

The credibility in a quantitative research depends on the collection of data, and the measures that are used to collect it. In qualitative research the level of credibility depends on the researcher/s, and their ability to find reliable sources. Thereby, the authors need to be critical in the research and the use of different sources and instruments (Golafshani, 2003). Thus, throughout our research we have put a lot of emphasis in comparing different data to see whether the fact described is valid and reliable. Therefore we have scrutinized and been critical to where the sources of information come from (the authors or organizations, etc.) and have had in mind that political interests can taint the data.

2.3 Planning Process

As we initiated the project, the focus was to find and collect reliable quantitative and qualitative data for the research, as it is essential to have a good base of knowledge before starting to write. First when the collection of data was considered to be sufficient, we started to formulate the problem, research question and purpose. After this, the focus was to provide a background with necessary basic information, and then outline our chosen methods and theories. The background, method and theoretical framework, was used as a foundation throughout our research, the empirical findings and the analysis. To be effective and to use our time in the best possible way we have critically read through and studied the qualitative material, the statistical sources and revised our accomplishments. Furthermore, our tutor has revised what we have written regularly and we have met up to discuss the outcomes. This way, we got a neutral and critical eye on our work. As we wrote with precision and had it revised at regular intervals, we could stay more effective.

2.4 Collection and Presentation of Data

The study is based upon secondary trustworthy data. Firstly, we collected data about Chile's history, since this directly has affected the country's political climate and the trade policies. Then we continued to collect data about the wine industry, its value chain and how the trade policies in Chile have changed with the shifting regimes from 1990-2012. To achieve the objective with this thesis, we gathered statistical material concerning export and FDI in the wine industry during the chosen time period.

For the analysis of our material, we used helpful theories in the theoretical framework chapter. For this study, Porter's 'Value chain analysis' and his theory 'The competitive advantage of nations' are used. Moreover, the theoretical framework includes relevant terms and facts regarding trade- and investment policy.

2.5 Quality of the Research

To establish a high quality of a research it is of great importance to follow the concepts of *reliability* and *validity*. There are many definitions for these concepts, but we choose to describe reliability as; when different studies about the same subject come to similar conclusions. In other words, when results are shown to be repeatable. This convergence implies trustworthiness and a high degree of reliability. Validity determines how well a study achieves the result that it was intended to measure, thus, if the research questions are answered (Golafshani, 2003). With this in mind, we carefully selected our sources, to achieve high quality.

Research of Chilean trade policy, exports and FDI has been done in earlier studies. However, it seemed that not so thorough research had been done of the wine industry. Naturally, this made the subject interesting, but at the same time we had to consider the risk in writing about it. Hence, we have had to be even more critical and put a lot of focus in finding reliable and valid sources. When referring to official Chilean documents and web sites one should have in consideration that historically Chile has not been governed transparently. The transparency is still questioned, even though new studies show that Chile is the least corrupt country in Latin America and that transparency has been improved in recent years (Aninat, Landregan, Navia, Vial, 2006). Anyhow, this fact has been important to take into account when reading reports and official documents since most of them are written and measured by Chilean authorities.

3. Theoretical Framework

This chapter provides basic concepts and theories necessary for the analysis. To get an overview of the Chilean wine industry Porter's value chain analysis is presented. Secondly, follows information about trade policy and other relevant themes. Last we present Porter's diamond model for measuring the competitive advantage of nations.

3.1 Global value chain

The integration of international economies has been on the rise for a long time. The pace of the globalization is high and one reason for this is the rapid growth of global value chains (GVC) (OECD, 2007). A value chain includes the whole range of production processes and support services of a product or service, from raw material to finished products. All enterprises that supply, produce, process, package, deliver, manage financial services etc. are involved in the value chain (Brown & Laird, 2011). The processes of the value chain can be done everywhere as long as the skills and materials exist to a competitive cost. However, globalization today is more than just products and goods; it has also led to a higher importance of FDI and multinational companies (MNC's). The multinational firms have good knowledge and intellectual properties, which gives profitable advantages in foreign markets. The affiliates from the MNC's become parts of the value chain as they serve and provide other markets as well. As companies wish to be more efficient and competitive on the global market one can argue that the companies are the driving force of the globalization of the value chain (OECD, 2007). Further, the globalization creates opportunities for many countries, especially in terms of spreading of information technologies. This development has created an integrated and cross border value chain that gives the domestic producers an opportunity to gain competitive advantages by learning from the leaders of the chain, which can be either the producers or the buyers (Giuliani, Pietrobelli & Rabellotti, 2005).

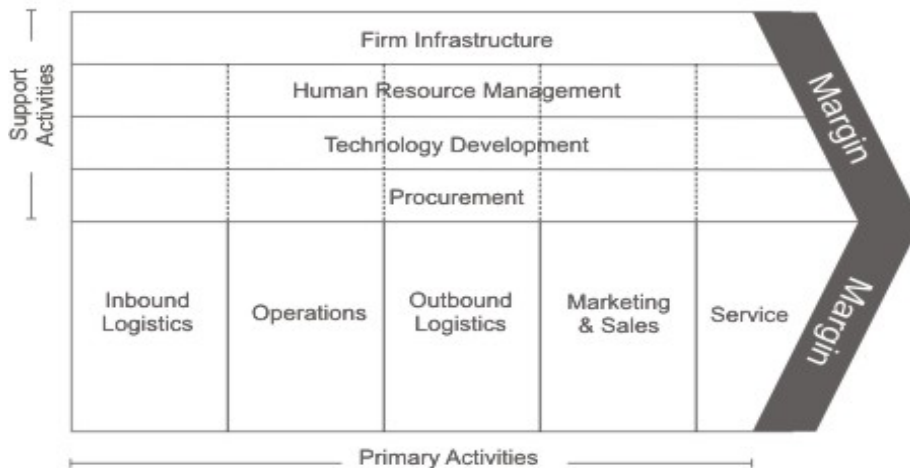
3.1.1 Porter's Value Chain Analysis

Porter divided the value chain into nine categories. All industries perform and manage its activities in one way or another, as the type of activities differs depending on the firm or industry. Further, Porter divided the activities into two larger groups, primary activities and supporting activities. The primary activities are the creation of the product, the marketing, the delivery, and the selling. The supporting activities are those that make the primary activities possible, which are procurement, human resource management, technological development

and infrastructure. Procurement is the acquisition of inputs such as raw material, services, machinery etc. This activity stretches across the whole value chain since all activities use some kind of purchased input. Human resource management considers the activities regarding the employees, for example recruiting, training, development and lay offs. Human resource management also exists through the entire chain, as all activities need human resources. Technological development is as well a big part of the value chain since all activities require some kind of technology. It can be development of a product or improvement of the different activities. Last, the infrastructure is the part that ties the different parts together in a value chain. It encompasses accounting, legal, financing, general management. It is outside the primary and supporting activities but is of high importance for the connection of the various activities in the value chain. The importance of the different activities in each industry varies in terms of competitive advantages but they are present in all and the activities are connected and affect each other. These connections are not only within the firm, but also with suppliers and buyers. Following this, all parts are connected and affect the competitive advantages of a company or industry. Another essential part that influences the competitive advantages is the competitive scope, which shapes the value chain, how companies perform the activities and if and how the activities are shared among the different units.

The competitive scope can be divided in four different categories and one of them is geographic scope that is an issue of a company's international strategy. It is a question of how and where a firm should compete. A global firm needs to decide where and how to spread the different activities. For instance, a company can choose to spread activities downstream, the kind of activities related to the buyer and where they are located, or upstream, activities and support which is not dependent on where the buyers are. Both ways create competitive advantages, for example, in branding and reputation of the firm. Depending on how and where a company decides to locate its different parts of the value chain one can see how they compete internationally. Porter divides this international competition into two dimensions, configuration of the firm's activities worldwide, and coordination, which shows how the different activities are performed in different countries and how they are connected. A company has a lot of options regarding both configuration and coordination for each activity in the value chain. From the choices of strategy the companies can choose many different paths to gain competitive advantages through the value chain. The value chain is important for a company as it determines the global strategy a company should choose (Porter, 1986).

Figure. 1 Porter's Generic Value Chain analysis



Source: Mindtools (2012)

3.2 International trade, Investments and Trade policy

3.2.1 World Trade

The world is getting smaller and the trade between countries is continuously rising, hence, there is a need for negotiations, regulations and trade policies. Trade and investment agreements are made on bilateral, regional and the multilateral level. Multilateral agreements are often discussed and arranged by the World Trade Organization (WTO) and mean more or less, free trade for all. In the internationalization process this is of great importance in order to facilitate trade flows. Regionalism can be defined as a longstanding agreement between a set of nations within the same region. A regional agreement gives the countries preferential trade among each other. Some examples of this are Mercosur and the EU (Bhagwati, 1999). Finally, bilateral agreements are the agreements between two countries (Deardorff, 1998).

On the multilateral level, WTO is the most prominent organization. The WTO was created in 1995 as a result from the Uruguay Round and replaced the former organization General Agreement on Tariffs and Trade (GATT). GATT was created in 1947 and aimed to lower tariffs and to facilitate trade. The WTO has a goal to help producers of goods/services, exporters or importers to perform better in their business. The WTO is the only international organization that is dealing with trade policies among countries. (WTO, 2012 b). It is run by the governments of the member states and the majority of the decisions are made by the organization as a whole. The different agreements and rules of WTO cover goods, services and intellectual property. It also includes tariffs and other trade barriers in order to create a good climate for trade (WTO, 2012 c).

Mercosur is the leading trade bloc in South America and an example of a regional agreement. It was created in 1991 and aims to work as a tariff union and have common market with free trade of services, goods, capital and people (BBC News, 2012). The EU was in 2008 the first and largest trading partner for Mercosur (European Commission, 2010).

3.2.2 Exchange Rate Policy

The choice of an exchange rate policy is one of the most important decisions in macroeconomic policymaking (Calderón & Schmidt-Hebbel, 2008). A country can either have a floating exchange rate or a fixed exchange rate. A floating exchange rate system allows the currency to float freely on the foreign exchange market without intervention to fix the rate of a central bank. In contrast to a fixed-rate system, a floating exchange rate allows a country to independently use monetary policy to reach internal and external balance. Under a floating exchange rate system changes in the exchange rate, called depreciations and appreciations, affect the international trade. For instance, the effect of depreciation is that domestic products get cheaper for foreigners and enhance exports. Thus, the depreciation of a currency lowers the relative price of the country's export and raises the relative price of its import. Following the same reasoning, an appreciation would counteract an increase of exports as it gets more expensive to foreigners. One of the critics to the floating exchange rate system is that the uncertainty of prices as a result of the fluctuating currency might harm international trade and investments (Krugman & Obstfeld, 2009). Nevertheless, a floating exchange rate system has shown to be more sustainable in financially open economies, integrated in the world capital market (Calderón & Schmidt-Hebbel, 2008).

In a fixed exchange rate system a country's currency is pegged to another single currency or a basket of currencies. This kind of exchange rate system is commonly adopted by countries that aim to gain credibility and control the domestic inflation (Calderón & Schmidt-Hebbel, 2008). When a country has a fixed exchange rate, it loses the ability to determine its monetary policy and that way achieve macroeconomic stability. Hence, the value of the domestic currency should match the value of the currency it is pegged to, thus the central bank must be willing to trade currencies at the fixed exchange rate with the actors on the foreign exchange market to maintain a constant exchange rate. However, a country can choose to set a new fixed rate to the reference currency through devaluation or revaluation.

For instance, this is done in situations where the country loses foreign exchange reserves at a rapid pace due to an immense current account deficit (Krugman & Obstfeld, 2009).

3.2.3 Promoting Trade

The commitment and attitude of policymakers is what determines a country's position in the world trade. The export depends on the way in which a country promotes trade or not thus, trade support institutions and enterprises (Brown & Laird, 2011). Today special government agencies are responsible for the promotion of the home country's exports, which often is done through organized promotion activities in other countries. These agencies are also responsible for helping domestic companies (often the small and medium sized), with guidance, to go cross borders (Karamehic & Tsiogka, 2003). Overall well-designed strategies and methods to promote trade are necessities to reach a high level of export. Some methods for the promotion of trade are export *financing*, *subsidies* and *foreign trade zones*. Below, follows a description of the most basic methods.

Export Financing

When it comes to stimulating exports, the financing is a determinate factor (Brown & Laird, 2011). Export financing is a way to enhance a country's exports by giving financial support to exporters. This financial backing aims to make it more profitable to export than to sell the product in the domestic market. This financial assistance can be given in several ways, by tax reliefs, subsidised loans or just direct payments.

Subsidies

Subsidies are described as financial assistance (loans, low-interest loans, direct cash payments and tax breaks etc.) from the government or other public authorities to an actor (Karamehic & Tsiogka, 2003). The effectiveness of subsidies has been discussed as it has shown to create unwanted effects such as weakening competition and instead worked as a hindrance to world trade. Thus, when domestic companies receive such benefits, foreign companies are not able to meet the competition, as they do not receive the same financial assistance. Hence, this kind of financial assistance is not supported by WTO (Kommerskollegium, 2009).

3.2.4 Promoting Investments

Almost every country today has established Investment Promoting Agencies (IPA's) to attract foreign investors. The work of an IPA involves several functions and responsibilities. To attract FDI, a good image of the country is of utmost importance, thus image building is one

of their tasks. *Investor facilitation* and *Investor services* are other functions, which refers to guidance in investment decisions and establishment, provision of information and other help so that companies more easily can start business in the country. To generate investments an IPA seek to find new potential sectors of opportunities and potential investors. Moreover, it aims to improve the investment climate through different supporting activities such as lobbying and surveys of the private sector etc. (Morisset & Andrews-Johnson, 2004).

3.2.5 Protectionism

Protectionism is when a country put up barriers in form of trade regulations, in order to protect domestic firms, products and services, from foreign competition. Protectionism is often seen as a negative action for the long-term economic growth (Kommerskollegium, 2009), thus, free trade of goods and services is often propagated. The main reason for why a country chooses protectionism is the social problems that may arise from foreign competition. Problems that have been discussed are for instance that foreign competition lead to job-losses. Thus, the country tries to protect national securities and valuable domestic resources etc.

A common reason for a country to create barriers is to protect the domestic industries from strong competition. The argument is that companies then can develop and experience economics of scale and take advantages of this, which will have a positive effect on the national income. However, these actions harm the fair competition, and lead to higher prices, inefficiency and a slower innovation pace. Economies that argue for protectionism also mean that it prevents dependency on other big and developed countries. This reason is mainly argued by smaller economies that choose to protect industries that are important for their economy, or that have a special cultural heritage and use it as competitive advantages (Karamehic & Tsiogka, 2003).

3.2.6 Trade Policies of Relevance

Nation-states have through the history discussed the advantages and disadvantages of international competition and free trade. The discussion about promotion or protectionism has led to a wide range of trade policies with different objectives. Hence, implementation of government policies towards international trade is strongly correlated to political views and a determinate factor for what kind of measures that will be used is the power and the interest of the ones who govern (Krugman & Obstfeld, 2009). Further follows a description of the most relevant trade policies for our thesis.

Tariffs

Tariffs are a form of a customs duty on import goods. This is an advantage for the domestic firms since the locally produced goods will have cost advantages against similar imported goods (WTO, 2012 d). Thus, the direct effect of tariffs is to make imported products more expensive. Two different instruments of tariffs are import tariffs and export tariffs. Import tariffs are taxes levied on imports that make it more expensive to import (Krugman & Obstfeld, 2009) and an export tariff is a tariff, which gives a higher price on the exported good. That kind of tariff is often used by developing countries that export low priced natural resources (Karamehic & Tsiogka, 2003). The level of the tariffs normally vary along the value chain and such an escalating structures, where tariffs are lowest on raw material and increases as the good goes up the value chain, are common. A uniform tariff, on the other hand, is an average tariff rate applied on all production stages (Amiti, 2004). Tarr, 2000 argues that a uniform tariff is preferred to a varied tariff structure. If the tariff is uniform, this creates less incentive for certain industries to lobby for protectionism and thus, the level of protection through non-tariff barriers is likely to be lower. However, there are also negative aspects of the application of a uniform tariff. For instance, that it might harm infant and restructuring industries.

Non-Tariffs Barriers

Non-tariffs barriers concern all governmental initiatives except customs duties that restrict or obstruct international business on purpose or not (Kommerskollegium, 2012). These are protectionist measures that often limit the quantity of imported goods, lead to increased price and decreased demand (Karamehic & Tsiogka, 2003).

For instance, ***local content requirements*** are often used by developing countries that aim to change their production industries from solely assembly to production on a more advanced level. It requires that a certain amount of the production of a final good have to be produced in the domestic market. This can for instance be measured in physical units or in terms of the value that is added domestically. Hence, this sort of protection forces companies to use more domestic inputs in their production, which stimulate the domestic industries (Krugman & Obstfeld, 2009). An ***administrative delay*** is a kind of discrimination against foreign products, which aims to delay the selling of a product on the market. Thus, a waiting period is imposed from the products quality controls until they can start to sell the product. Since the timing is

vital when introducing a new product on the market, administrative delays, can lead to very negative effects for companies (Régibeau & Rockett, 2003). Other non-tariff barriers are *technical regulations and standards*. Every country has different regulations and requirements for product standards, which can make it difficult for producers and exporters (WTO, 2012 e). The purpose of regulation is to create common characteristics for the products to facilitate trade. However, it can be used as protectionism when countries use it as a barrier for trade, for example when they have unnecessary expensive controls or different requirements for the markets (Otsuki & Wilson, 2004). In WTO, there is an agreement that works against this, so that the different regulations and standards will not create avoidable obstacles. The agreement additionally involves a right to measure and implement regulation and standards for members, regarding human health, safety and the environment (WTO, 2012 d). Last, *Antidumping* is when a country/company export and sell products to a lower price than on its home market. This ‘dumping’ effect creates ‘unfair’ competition and drives the domestic companies in the export market out of business since the import products are sold at a lower price than the domestic products (WTO, 2012 f). Companies use this instrument and sell products for a loss for instance, when breaking into new markets. ‘Dumping’ is the most common form of price discrimination and is a controversial issue in trade policy, as it is a question about ‘unfairness’ (Krugman & Obstfeld, 2009). The WTO has an anti-dumping agreement, which focuses on how governments neither should or should not react to dumping (WTO, 2012 f).

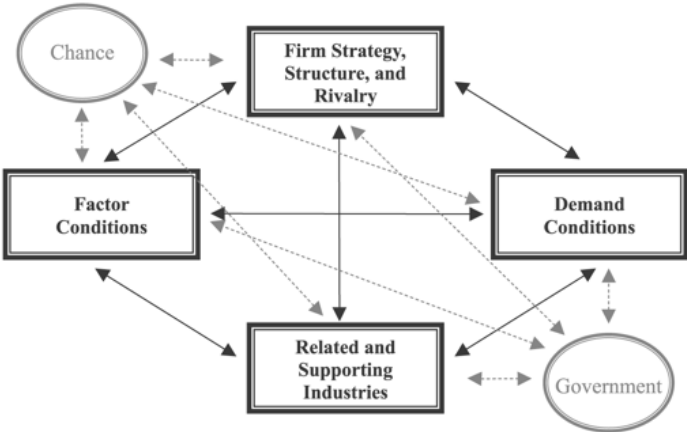
3.3 Porter’s Diamond Model for the Competitive Advantage of Nations

The theory aims to explain why some nations ‘win’ or ‘lose’ in the world trade, and why some succeed in particular industries. The industrial performance depends on the nation and its ‘home base’ environment and is closely related to innovation and constant improvements. In other words, the national environment is what shapes the companies (Grant, 1991). All nations are different, and no country can be competitive in every industry (Porter, 2009). The national characteristics, environment and the economic structure have also shown to be determinant factors for a country’s export development and foreign investments. Hence, trade policies and institutions play key roles for a nation’s competitiveness (Grant, 1991).

In this globalized world, one can believe that the nation’s role has become less important. However, fact is that the role of the nation is more important than ever. Companies today face

many challenges and more intense competition than before. To cope with this global challenge, companies go cross-borders, they strike strategic partnerships; they merge and acquire other firms, collaborate and ally (Porter, 2009). This development has contributed to an increasing importance of MNC's and the competitiveness of an industry or a nation is strongly correlated to these. Thus today the MNC's are more significant when measuring a nation's competitiveness, than its exports (Grant, 1991). The 'Diamond of national advantage' consists of four broad attributes of a nation (Porter, 2009).

Fig. 2 Porter's diamond framework



Source: MBA Knowledge base (2012).

Factor Conditions

Under 'factor conditions', the factors of production, the production processes and how these are related to the competitiveness of the domestic firms, are analyzed. Porter separates the factor conditions into 'basic' and 'advanced', and stipulates that the advanced factors (skills, research facilities, scientific base and infrastructure etc.) weigh heavier than basic factors (local raw material, pool of labor, climate, demographics etc.) as they involve sustained and heavy investment (Grant, 1991). Hence, the competitiveness of a nation depends on the way a country creates, upgrade and develop its factors and at what pace and efficiency this is done. In other words, a competitive nation does not simply possess these factors instead it creates them. Following this, success in a particular industry can be achieved when a nation understands the importance of factor creation (Porter, 2009).

Demand Conditions

The nature of the home market demand for a certain product or industry has shown to be strongly correlated to a nation's competitiveness. Porter stipulates that firms normally are

more sensitive to their closest customers (Grant, 1991). Hence, nations gain competitive advantages in sectors where home market demand is strong. Pressuring domestic demand forces the companies in the industry to respond fast to the needs of the customers, to be innovative, constantly develop, to improve and to invest in new technology. Following this, the characteristics of the domestic buyers are important. Thus, if the buyers are sophisticated and if their needs and demands are more advanced, that is what companies will have to respond to. The fact that domestic demand differs on local levels may sound like a tough challenge. However, by adapting and responding to different customer demands in the home market, one can sometimes foresee global market trends. If demand then grows elsewhere, companies within the industry will be prepared. Additionally, when a firm faces challenges and finds a way to overcome these, they indirectly gain competitive advantages (Porter, 2009).

Related and Supporting Industries

Success in an industry is not possible without the close access and support from related competitive industries. The value chain is extensive, and the presence of developed related industries in a country is essential. Even though a company can benefit from foreign suppliers and products without hampering innovation etc., several competitive advantages can be spotted when working with domestic related and supporting industries, for instance, efficiency, easy access, and lower costs (Porter, 2009). However, the most prominent advantage of the presence of industrial clusters is that it creates a pressure for innovation. Further, communication is facilitated and by having a closer relationship to suppliers they get involved in the innovation process, which will stimulate R&D and upgrading (Porter & Stern, 2001). Porter also highlights the importance of related and supporting industries to be internationally competitive as this puts further pressure on the companies to innovate. Thus, the importance of innovation is obvious. Another competitive advantage is the access to technology and machines for the operations (Porter, 2009).

Firm Strategy, Structure and Rivalry

The characteristics of the companies, the strategies, visions, goals, management and practices and the domestic rivalry within the business sector etc. depend on the country and the national environment (Grant, 1991). There is no pattern or 'winning concept' as every country and industry has their own specific characteristics.

The domestic rivalry is one of the most powerful of all the attributes in the diamond

framework simply because the presence of local rivals contributes to the creation of competitive advantages. Rivalry, both domestic and from outside, puts pressure on innovation, prices and other improvements (Porter, 2009). Porter states that the domestic rivalry is more intense and effective than the competition with foreign actors. It gets more personal and the firms need to find ways to create more sustainable competitive advantages (Grant, 1991). If the local rivalry is highly concentrated, it will be more intense and if it is more intense, the following effects will be even stronger (Porter, 2009).

Government and Chance

As the government shapes the institutional structure and the trade policy, it plays a partial role in the diamond framework. For instance, a government can facilitate an industry's or a company's possibility to grow and become more competitive, through providing an appropriate national environment. Nevertheless, a government can in the same way undertake protectionist behaviour, which in the short term might be beneficial for the economy, but that in the longer term hinder innovation. As mentioned earlier innovation is of great importance when it comes to competitiveness, thus such restrictions damage (Porter, 1990). There is also a *chance* factor. This includes unplanned events, such as economic recessions, price shocks, wars or other intervening actions that affect the national environment (Ankli, 1992).

3.4 Application of the Theoretical Framework

The theoretical framework provides a foundation for answering and analyzing our research questions. The sequence in the theoretical framework is well thought out to provide a guideline for the empirical findings of the thesis. Hence, first there is a description of the value chain of wine, on the basis of Porter's value chain analysis, which gives us a detailed overview of the Chilean wine industry and the different phases of the value chain. This provided us with a foundation for describing the development and the growth of the industry and how trade policies have affected it. Thereafter, we used the macroeconomic and trade policy part of the theoretical chapter, to examine Chile's position in the world trade and its investment climate during 1990-2012. When we had significant knowledge about the characteristics of the wine industry and the shifting regimes and trade policies, it was easier to spot the political changes that might have affected the industry. Finally, we examined the success and competitiveness of the wine industry today through Porter's diamond framework of national competitive advantage. The theoretical chapter has given us a foundation to examine our research question, both from a macroeconomic and a business point of view.

Empirical Findings

The Chilean Wine Industry & Trade Policy

4. The Wine Industry and the Chilean Trade Policy

The empirical chapter provides a description of the characteristics and the growth of the Chilean wine industry and its value chain. Thereafter, follows evaluations of the trade policy conditions in Chile from 1990-2012 and the development of wine export and inflow of FDI. Further, we assess the Chilean wine industry in Porter's diamond framework.

4.1 Wine, The Value Chain

Until the end of the 1980's, the 'Old World' wine countries, France, Italy, Spain, Portugal and Germany mainly controlled the global wine market. During the 1990's, however, they had to give room for new competitive wine producing nations, from the 'New World', the US, Australia, Chile, Argentina and South Africa (Cusmano, Morrison & Rabellotti 2010).

Even though, Chile is said to be among the 'New World' wine nations, the history of winemaking in Chile is long. It all took start during the colonial period, in the mid 16th century when a Spanish conqueror first succeeded to make wine in Chile. During the years of colonialism, wine was made first and foremost for religious purposes. However, in the 18th and 19th century, winemaking in Chile developed when different grapes were imported and technologies were imitated from the French wine industry. Even though wine is a traditional product for Chile, it was not known as a wine-producing nation until the 20th century (Visser & de Langen, 2006). In the last years of the 20th century, the wine industry started to prosper and today Chile is one of the top producing countries (Castaldi, Cholette & Hussain, 2006). In recent years, countries and industries have faced the challenge of globalization and in this development; the GVC has come to play an increasingly important role. To upgrade, and constantly develop skills, technology and products etc. throughout the activities of the value chain is essential to meet the international competition (Ponte & Ewert, 2009). A description of the value chain of wine, from harvest to final product, follows.

Wine production depends on the availability of grapes of quality, thus the environment, the climate, the availability of water, soils and drainage. Suitable conditions when it comes to environment, but also the availability of grape supply at a reasonable cost is therefore the determinate factors for wine production (Overton & Murray, 2011). Chile has a large agricultural area and a variety of soils suitable for fruit- and wine growing. The regions with the highest concentration of wine grape growing farms and vineyards are Maule, Libertador.

B. O'Higgins, Bío Bío and Metropolitan (Fig.1 appendix) (CONICYT, 2007).

Broadly speaking, there are two types of wine markets. On the one hand, there is a large demand for wine as a mass product. Hence, there is a segment of industrial production of wine, which makes it possible to gain advantages of scale and scope and to compete with price and that way, gain higher profits. The product base of wine made on industrial scale is more uniform and holds a lower standard. However, the development in the Chilean wine industry in recent years shows a trend towards more high quality wines and specialization. This segment is associated with some favored valleys and vineyards, which focus on qualitative wine with special characteristics rather than low prices. (Overton & Murray, 2011). This is important, because when the wine producing strategies are different, so are the value chains.

4.1.1 Inbound Logistics

Supply is still based on the availability of quality grapes even though development of new technologies has enabled better production processes and facilitated the grape growing in many ways. Hence, the suppliers and grape growers play a significant role in the value chain. As the grape growing is dependent on climate and other natural factors, the relationship between grape growers and wineries is of a sensitive art. What happens is that the grape farmer harvests the grapes and then the winery in turn chooses the quantity of grapes that are suitable for the wine production. From this, difficulties naturally may arise as the grape grower does not know how much he/she can sell to the winery nor what to do with the grapes that were not suitable for production (Adamo, 2004). To avoid uncertainty, exporting and high quality wineries normally grow their own grapes in order to control the process and the quality of the grapes (Visser, 2004). This is also done as real quality wines should be less treated with chemicals and technology, during the production process (Adamo, 2004). Nevertheless, exporting wineries additionally rely on local or contracted primary producers as a safety if it turns out that more grapes are needed (Visser, 2004). Hence, many wineries find it less risky to invest in an own vineyard than to rely on an outside supplier (Adamo, 2004). For these wineries it is a strategic choice as there are many requirements of the quality of wine for export (Visser, 2004). In comparison to this premium production, wineries operating on the industrial scale do not have the exact same concern. Their focus is on price and not quality, thereby they sometimes buy grapes even from third-party suppliers (Adamo, 2004).

Thus, in this step of the value chain, value can be created through good management, care and control of the vineyard and grapes.

4.1.2 Operations

Production, manufacture and or blending of the wine take place in a winery. However, modern wineries are not only a place for wine production. Today the winery has a broader importance that is to engage the customers through, for instance, cellar sells and wine tours, to show the winemaking processes and build up a brand image. Additionally, it shall be effective and use the resources in a responsible way (Stefanowicz, 2011).

As mentioned earlier, the globalization has contributed to an extensive development of the Chilean wine industry. New market opportunities and intensified demand has led to technological and organizational changes within the industry. Thus, Chile has adopted already existing knowledge and new technologies to transform its wine production processes (Morel-Astorga, 2001). A significant point that changed the winemaking processes in many Chilean wineries was in the beginning of the 1990's, when new international producers invested in the Chilean market. These producers used and invested in new modern technology and practices and brought technology expertise and know-how in marketing, distribution and other commercial aspects (Visser, 2004). One of them, Miguel Torres from Spain introduced small oak barrels for the fermenting in the wine making process. Before that, Chilean wineries fermented the reds in 4000-liter vats. As Chilean wineries had to respond to the market development, and imitate Miguel Torres and other international producers, the quality of Chilean wines significantly improved (Benavente, 2006).

Thus, the value chain of wine production differs, depending on the quality level of the wine. Durable and careful winemaking processes in the winery and age characterize a premium wine, while a table wine can be produced within a shorter period of time, and therefore be distributed or exported faster (Adamo, 2004).

4.1.3 Outbound Logistics, Sales & Marketing

Since the 1990's, the number of Chilean wineries has increased and the Chilean wine industry has gradually turned away from the domestic market to focus more on export markets (Visser, 2004). European countries became, in the 1990's, the main destination for Chilean exports. In

recent years exports to prosperous Asian-Pacific countries have increased (Visser, 2004), in particular to China. Overall, the specific key buyers of Chilean wine today are the US, Canada, the UK, Brazil, Japan, The Netherlands and Denmark etc. (Vinos de Chile, 2012 a).

To sell, not only wine as a product, but also to give a personal touch and an experience for customers and buyers, wines are often sold through the winery itself. However, in general, it is sold to agents and distributors that in turn bring the products to the markets, to local actors such as restaurants and shops, and on the Internet (Orth, Lockshin, & d'Hauteville, 2007). Electronic shopping is an evident modern development, allowing consumers to compare prices and varieties. Many retailers have already entered the electronic markets to follow this development (Lynch, Jr & Ariely, 2000). Smaller sized wineries, however, focus more on direct and local sales, but wine is also sold to intermediaries to reach the larger markets. The commercialization of the wine industry in recent years has led to a trend where wine companies become larger and keep sales and marketing functions in-house. This is often made possible through self-owned subsidiaries in the key markets (Orth, Lockshin, & d'Hauteville, 2007).

Retailers, specifically supermarkets, have with the time gained an important role in the global value chains (Visser & de Langen, 2006). Today, much of the world's wine production is sold through retailers and discount chains (Orth, Lockshin, & d'Hauteville, 2007). This development has led to concentration in the global wine industry, as operating on larger scale brings advantages in production, marketing and distribution etc. Additionally, a successful brand name is of considerable value, and investments in building up an image and a well-known brand is important (Visser & de Langen, 2006).

Hence, to continue the successful development of the Chilean wine exports, collective promotion and marketing efforts are essential (Visser, 2004). The international competition in wines is growing in intensity and Chilean wine producers have been forced to respond with more extensive marketing (Benavente, 2006). The Chilean state has a positive attitude towards promotion and marketing of Chilean wine. For instance, it established the public institution 'ProChile' that provide valuable information to exporting companies of all sectors about export markets and retailers etc., and help the companies to reach their international goals. Along with ProChile, the state provides funding to the organization 'Vinos de Chile',

which plays an important role in the promotion and marketing of Chilean wines (Visser, 2004). Vinos de Chile's mission is to strengthen the image and reputation of Chilean wine, on the international markets. It emphasize the differentiation and the quality of Chilean wine products in order to give the consumers, importers, distributors, restaurant owners, and journalists a positive perception of Chilean wine. This is done through a wide range of activities such as, seminars, wine markets, wine tastings, publications and other promotions. (Vinos de Chile, 2012 b). One important law in respect to wine promotion is, 'denomination of origin' (DO). This is used in almost every wine producing country today and is an instrument used to enhance the quality level of the wines (Benavente, 2006). More specifically it is a set of laws that regulate the origin and the variety of grape and the wine's use (Foster & Spencer, 2002).

Historically, Chile has had problems with its marketing of wine, partly because it is a distant country surrounded by mountains and sea, but also because premium wines have been sold to low prices, which has contributed an unwanted image. The strategy of today is therefore, to make attempts to stimulate export of bottled wine with Denomination of Origin, and decrease the share of bulk wine exports. To increase the export of high quality and reserve wines, and at the same time enhance differentiation of offered wine varieties (Benavente, 2006).

4.1.4 Support Activities

Procurement

The support activities in the GVC are those that make the primary activities possible. Procurement is the acquisition of raw material, services and machinery throughout the cycles of the value chain (Porter, 1986). We have already discussed the availability of the key resource, fresh quality grapes, for the wine production. Other support activities more than the grape stock available locally are bottling, labels, public relations, marketing functions and to a less extent, bottles. Hence, even though the Chilean wine cluster includes the key resource and other important support activities, it is not yet complete. Many supporting products for the wine production need to be imported from foreign suppliers since it is not available in the local market. For instance, this is the case of corks, processing equipment of stainless steel and oak barrels for the fermenting. For the grape growing, fertilizers, pesticides, and other chemical products are imported, together with equipment for the harvesting and filtration (Visser & de Langen, 2006). One difference between Chilean and European wine making is

that irrigation is needed in Chile as springs and summers can be very dry (Morel-Astorga, 2002). Thus, equipment for irrigation is imported. Additionally, tanks, other equipment and accessories are imported for the actual winemaking process (Visser & de Langen, 2006). Together these support industries and activities have indirectly contributed to the development of the Chilean wine industry (Giuliani & Bell, 2004).

Technology Development

Chile has made good progress when it comes to technological development (Visser & de Langen, 2006). Historically, attempts have been made by the governments to promote and spread new technologies in the sector, for instance through technology transfer programs (Morel-Astorga, 2002). The ‘Corporación Chilena del Vino’ (CCV), founded in 1997 is a function of the ‘Corporación de Fomento de la Producción de Chile’ (CORFO) responsible especially for the wine sector (Visser & de Langen, 2006). Some of its tasks are to spread new technologies, educate, provide seminars, and market information to local actors (Corporación Chilena del Vino, 2007 a). ‘Vinos de Chile’ makes similar efforts to promote research and developments of new technology in all phases of the value chain (Vinos de Chile, 2012 c). However, some of the most important technological developments came when foreign investment increased in Chilean market. Fiercer competition triggered local actors to imitate and absorb new technologies and knowledge (Morel-Astorga, 2002). Today, technology and equipment is to a great extent imported, consequently there is a dependence on foreign technology and innovation. To overcome this dependence a joint action is imperative. Chilean wine producers have to enhance their strengths and be prepared to invest, transfer knowledge to each other and to make collective efforts for innovation (Visser, 2004).

Human Resource Management

Traditionally, human resource management in Chile has been characterized by paternalistic structures and the Chilean ‘machismo’ has, very much, affected the mutual relationship between employers and employees (Hojman, 2006). In the last decades, however, work in many vineyards and wineries has become more mechanized. Nevertheless, harvesting and processes of the winemaking is still produced manually at some vineyards and wineries (Morel-Astorga, 2002). Historically, the number of oenologists (wine experts) has been scarce and with their specific and valuable knowledge they have been coveted and have often become independent consultants for many firms (Hojman, 2006). One significant improvement, however, is that the degree of technical professionals with a higher education in

agronomic studies and oenology has increased in the Chilean wine sector. Hence, workers have become more skilled and specialized, a positive development considering that knowledge then accumulate in the companies (Giuliani, 2003). One factor behind this improvement is that all vineyards and wineries today must train its workforce in the different processes, in order to secure a high level of quality of the wine production to meet the competition (Morel-Astorga, 2002). Investments at an institutional level and co-financing has supported research in viticulture and oenology, and thereby, connected universities and research institutes to the wine producers (Giuliani & Bell, 2004). In order to develop the workforce in the wine sector, Vinos de Chile implements activities and projects to educate. In that ambition, the project OTIC Chile Vinos, was started in 2003. It aims to higher the standards in the wine sector partly through development, education and training activities for the workforce of all parts of the value chain. Additionally it provides social scholarships and free education for workers, unemployed and other interested (Vinos de Chile, 2012 c).

In a study made by Giuliani and Bell, (2004) on the Chilean wine cluster Colchagua Valley, it was found that many actors in the cluster turn to external sources of knowledge to enhance development of technological and knowledge-based resources. Thus, it showed that wine producers had established contact with technology transfer institutions and other research institutions. It was shown that international expertise and consultants to a great extent has contributed to knowledge- and technology transfer in the sector and that cooperation between Chilean producers and universities are not yet as extensive as in for instance, Australia and the US (Benavente, 2006). Following this, one main pillar for the development of a cluster is the exchange of knowledge. In this sense, some firms are more open than others. There are some central actors, often exporting companies, with specific knowledge and technology, willing to transfer to other local actors in the cluster. These companies are both linked to external sources of knowledge and hold a high level of expertise within the own firm. Experimentation is often made locally by such companies and is possible because of a good financial situation and knowledge base (Giuliani & Bell, 2004).

Infrastructure

Infrastructure, include the activities that tie the different cycles of the value chain together (Porter, 1986) thus, the flows of both physical products and virtual information. The importance of facilitating these flows in the wine industry has been considered low (Visser,

2004). Nevertheless, the Chilean wine cluster would become more competitive if collective efforts were made to improve the infrastructure, even if it is less important than for example improvements in innovation, education and training etc. (Visser, 2006). Even though, the wine production is clustered in the valleys, the strategic center for the wine business is the capital, Santiago. Wine business associations are established there along with, public institutions that are responsible for the development of the wine sector, research centers and universities (Kunc & Bas, 2009). For instance, Vinos de Chile is located in Santiago and plays an important role in analyzing and proposing new policies, trade agreements and regulations in respect to the wine business (Vinos de Chile, 2012 c). Furthermore, banks and necessary financial services are mainly situated there, together with businesses that make arrangements for export shipping. Moreover, the foreign producers of equipment and technology, and thus the available repair functions are located in Santiago (Crowley, 2000). Naturally, the general management and structure of the wine producing firm depends on the size of the company. In the case of ‘Concha y Toro’, one of the largest exporting wineries in Chile, the headquarter is located in Santiago (Concha y Toro, 2012). When it comes to smaller wineries that focus more on direct and local sales (Orth, Lockshin, & d’Hauteville, 2007) one can assume that functions such as general management, finance and accounting is kept more local. (See the value chain of wine, Fig.2 appendix).

4.2 Trade Policy Conditions and the Effects on Export and FDI

Under the regime of Allende, 1970-1973, the political ambition was not to improve the conditions in an existing society structure but rather to make a revolutionary change and demolish the old social and economic order. Thus, Allende and his party, Unidad Popular (UP) wanted a clear foundation to build up a new Chile and a new economic structure. At that time, Allende described Chile as a capitalist society, too dependent on foreign capital and imperialism and this needed to be changed. It was a sort of a nationalization project (de Vylder, 1974) and hence, the government undertook protectionist measures; import tariffs were highly dispersed and soon averaged 105 percent. Moreover, several other restrictions were implemented such as direct import prohibitions etc. In addition, a distortionary multiple exchange rate system was applied, which consisted of 15 different rates (Lederman, 2005). However, due to different factors, both external and internal, such as inflation, stagnation and divergence within the Chilean left, the strategy of UP did not become as successful as anticipated (de Vylder, 1974). In 1973, the military with General Augusto Pinochet at the

head, overthrew the government and UP. This was the beginning of a new economic restructuring based on a free market concept. Liberalization was the lead word and the state was not going to be a direct market participant anymore (UNCTAD, 2009). A massive privatization program was implemented and a huge number of restrictions and barriers for trade and investments were dissolved. A new exchange rate policy was applied to keep a competitive real exchange rate. In order to stimulate traditional exports as well as non-traditional exports, depreciation of the real exchange rate was achieved in 1973 and was maintained by a crawling exchange rate system until 1978 (Lederman, 2005).

4.2.1 Trade Policy 1990 – 1994

In 1990 the democratically elected Christian democrat, Patricio Aylwin, from the central-left alliance (party *Concertación*) took over the presidency. It was decided that the main elements of the market reforms made under Pinochet's governance, were to be kept and that Chile should continue as an open economy, integrated in the growing world market. Exports were still to be enhanced and import tariffs would be lowered (Edwards & Lederman, 1998). The Aylwin government supported more extensive multilateral trade liberalization, and signed the agreements of the Uruguay round and the General Agreement on Tariffs and Trade (GATT). This resulted in further trade liberalization of for instance services and opened up new markets for Chile's agricultural and industrial products. The agreements also contributed to the lowering of non-tariff barriers and provided a way to solve disputes among trade partners (Weyland, 1999).

In 1991, the *uniform* tariff (a tariff that is uniform in all production stages of the value chain, from raw material to final goods) (Amiti, 2004) was reduced from 15 percent to 11 percent. By this time, capital inflows to Chile had increased, contributing to a pressure of a real exchange rate appreciation. Thus, to maintain control over the real exchange rate, an establishment of exchange controls accompanied the tariff reduction. It was a reserve requirement (for a minimum of 90 days) for short-term capital inflows. This combination of policies, tariff reduction and exchange rate controls, was part of the market-oriented development strategy, aimed to strengthen the opening of the Chilean economy (Lederman, 2005). Further, reductions of the *ad valorem* tariff were also made and the tariff level decreased from 35 to 25 percent on many products, with the exception of some agricultural products, as the system of protectionist price bands established in 1985 was maintained and

hence, the tariff reduction more modest (WTO, 1997). The protectionist price bands aimed to secure more stable internal prices of the agricultural products, so that they were not to be affected by international price volatility (WTO, 2003). Moreover, the government implemented Decree No. 575 in 1993, which consisted in regulations concerning anti-dumping and countervailing duties. However, these measures were according to the WTO not in full compliance with their established guidelines. In parallel with these developments, the government of Aylwin made efforts to create a good perception of the Chilean environment as beneficial, for entrepreneurs and private enterprises (Lederman, 2005).

Even though the new government agreed on the importance of openness and free trade, it disagreed on several other reforms made during the dictatorship. Following this, policies regarding social and redistribution were changed, in order to higher social standards and reduce poverty (Edwards & Lederman, 1998). Additionally, a very important economic policy measure was the establishment of an independent central bank (Lederman, 2005). Considering that one great task for the Aylwin administration was to lower the inflation, the Central bank and its restrictive monetary policy, played an important role. By 1991, the Central Bank had achieved to lower the inflation to 18.7 percent. After this, a more expansionary policy was applied, leading to an increased growth of 7.3 percent in 1991 and 11 percent in 1992. In 1993, however, the economic decision makers had to slow down the expansionary measures to prevent overheating of the economy. In this respect, it is worth to mention that Latin American governments have historically tended to use expansionary policies right before an election in order to win voters and keep the political power. Under the Aylwin government, and the following democratic administrations, manipulation of fiscal policies for political purposes did not happen, which indeed is noteworthy (Weyland, 1999).

In 1991, the government of Aylwin went further with a new trade strategy, consisting in preferential trade agreements (PTA's) (Lederman, 2005). The negotiating of bilateral agreements took start, and some primary targeted trade partners were, Canada, Mexico, Colombia, Venezuela, Ecuador and Mercosur. One priority of the Chilean government was to tie stronger bonds regionally and to improve the trade relations with other Latin American countries. Hence, in addition to the above-mentioned negotiations during the 1990's, agreements under the Latin American Integration Association (LAIA) led to establishment of tariff preferences with Peru and Bolivia (WTO, 1997).

4.2.2 Trade Policy 1994 - 2000

In 1993, Eduardo Frei also from the democratic party *Concertación*, won the election with the majority of the votes and entered office in 1994. The new president wanted to consolidate the opening of the Chilean economy and continued the unilateral liberalization and the negotiation of bilateral economic agreements (Aninat, Landregan, Navi & Vial, 2006). One very important step for Chile was the attaining of full membership in the WTO in 1995 (WTO, 2012 g). In WTO's Trade Policy Review from 1997 it was stated that Chile had liberal trade policies, its main instrument the uniform tariff, was low (11 percent) and it was planned to be reduced even more. Chile approved on eliminating export subsidies by 2003 and agreed on WTO's Most-Favoured-Nation (MFN) principle. The MFN principle signifies that equal opportunities shall be given to all foreign producers and service providers interested in the domestic market (OECD, 2011).

However, during his presidency Chile also became an active member of Asia-Pacific Economic Cooperation (APEC), which indicated an increasing priority to trade with Asian countries. Furthermore, Chile signed an agreement of political and economic cooperation with the European Union. Other free trade agreements (FTA's) were signed, for instance with Canada. Additionally, Chile became an associate member of Mercosur in 1996 (Congreso Nacional Chile, 2012). In this respect, Chile entered cautiously as its commercial policy was different to the policies of the other member countries of Mercosur. Hence, it signed up as an associate member to avoid the same terms as the plain members of Mercosur and could in result keep control of its own tariff policy (Weyland, 1999). In addition, Chile had already struck agreements with Mexico, Ecuador, Venezuela and Colombia etc. All these agreements caused complexities for Chile as a member of WTO as tariffs had been phased out for different goods, during different periods of time, to different trade partners. It was a general concern that Chile's elaborated system of different tariffs would cause unequal treatment of trade partners and increase discrimination. Moreover, it still existed non-tariff policies. On agricultural products, for instance, the price band was still maintained, in the forestry sector production subsidies were used, and in the automotive industry there were local content requirements etc. (WTO, 1997).

In parallel with this liberalization development some started to question the effects of further liberalization. Many voices argued that more import liberalization would lead to job-losses

and a higher unemployment rate, thus harm the welfare. It was also argued that the new international competition and the increase of foreign investors could out-conquer domestic industries and companies that were not competitive enough. The government responded by giving financial support to these sectors, in particular the agricultural, so that technological improvements could be made and the sector could become more competitive. Furthermore, it gave export subsidies and support for technological and organizational development to small and medium sized firms (Weyland, 1999).

In 1999, the government went through with the further reduction of the uniform tariff and lowered it to 10 percent. This was part of a greater plan and a schedule for reductions destined to reach 6 percent in 2003 (Lederman, 2005). Another development made under the Frei administration in 1999, was the transition from a policy of a pegged exchange rate band to a floating exchange rate. The exchange policy before was a crawling band whose reference value was adjusted with respect to the inflation in the preceding month. With reference to this band one could measure the difference between domestic and external inflation. Even though the government aimed to secure a long-term stability of the exchange rate, in favor of the domestic exports, this policy was not sustainable any longer. This was further shown by an appreciation of the currency by 50 percent from 1990-1997. When Chile reached an inflation rate of 3 percent only, in 1999 the decision makers agreed on that, from this point on they would try to maintain the inflation low and stable instead of trying to lower it year after year. A system of a free, floating exchange rate was more appropriate for this new inflation goal (Morandé & Tapia, 2002). A free floating exchange rate gives an economy a better basis to face external shocks and it reduces discretionary behavior of the central bank. The inflation-targeting framework, which also was agreed on in 1999, but came in to force first in 2001, implied that automatic mechanisms would stabilize the inflation so that it would move within a range of 2 to 4 percent (Aninat, Landregan, Navi & Vial, 2006).

4.2.3 Trade Policy 2000 – 2006

In 2000, President Frei was succeeded by Ricardo Lagos, also from the central-left coalition. Lagos made several important reforms concerning social policy, emphasizing human rights, solidarity and health (Congreso Nacional Chile, 2012). On the area of trade policy, Lagos announced the intention of full membership in Mercosur. Nevertheless, this full membership did not become reality since Chile still was allowed to maintain its own external tariff.

Having already concluded FTA's with the other two members (Canada and Mexico) of 'North America Free Trade Agreement' (NAFTA), Lagos commenced negotiations with the US with the goal to strike a trade agreement. In result, the trade agreement came in to force in 2004 (Lederman, 2005). The FTA covers most of the sectors and by a twelve-year period, it is aimed to make all trade with goods free from tariffs and quotas. Moreover, an additional agreement was made with the EU to facilitate trade and investment flows even further. Following this, FTA's were concluded with China, Japan, Panama and a PTA with India (Datamonitor, 2007). Hence, the new government withheld the positive attitude towards multilateral trade and aimed to integrate further in the world market in order to improve market access.

In WTO's trade policy review from 2003, the concern about economic distortion, due to the wide range of trade agreements negotiated by Chile, is expressed. However, as Chile had a low uniform tariff, the concern on how to overcome the distortions, faded in importance during the period. In 2003, the uniform tariff was lowered to 6 percent (Lederman, 2005). Nevertheless, MFN imports declined during the first part of the 2000, seemingly due to the increasing number of PTA's struck by Chile. The price band system for certain agricultural products was still applied for some products (for instance vegetable oils, sugar and wheat) but no antidumping or countervailing measures were undertaken after 2001. The use of non-tariff barriers for trade was limited and regulations and prohibitions for import with respect to the environment or health issues were applied equally for all trade partners. Export subsidies were still distributed, hence, measures were undertaken to bring Chile's practices in line with the guidelines of WTO. During the presidency of Lagos, Chile also went further with the privatization process and established a new competition legislature with the objective to clarify anti-competitive behavior and introduce institutional reforms (WTO, 2003).

When it comes to exchange rate policy, countries that exhibit relatively more exchange rate volatility but less volatile interest rate and reserves are considered to have more flexible regimes. In the case of Chile, an increase in the exchange rate volatility was seen in the first years of the 2000's, but there was also a reduction of volatility in nominal interest rates and reserves. This, if referring to the above-mentioned theory, indicates a positive development towards a more stable macroeconomic environment and a more flexible exchange rate (Morandé & Tapia, 2002). However, the Chilean economy is dependent on its copper export

and it is noteworthy that the mining sector is very volatile by nature. Hence, even though the flexible exchange rate system reduced some impact of shocks, the exchange rate was fluctuating during these years due to a series of external shocks. By 2004, the copper market recovered, leading to an appreciation, which was further consolidated by another appreciation in 2006 (Datamonitor, 2007).

In 2004, the inflation reached 1.1 percent, which is very low in comparison to the historical inflation that during many years was two-numbered in Chile. In fact, during the years after the implementation of the inflation-targeting framework (in 2001), the inflation was maintained at a low level within the band of 2 to 4 percent (Aninat, Landregan, Navi & Vial, 2006).

4.2.4 Trade Policy 2006 – 2010

Michelle Bachelet was the first female president in the history of Chile. She won the election in 2006 over the opposition's candidate Sebastian Piñera and this resulted in the fourth government in row of the central-left alliance and the party *Concertación* (Congreso Nacional Chile, 2012).

Bachelet had an ambition to combine market and equity. In her program she stated that economic development was imperative, but that no one was to be left behind in this development (Wehner, 2009). Hence, she continued the development model of an open market economy and the regional agreements and multilateral trade system continued to play a major role in Chilean trade policy. Trade policies were reformed and adjusted to the agreements of WTO. Thus, import taxes and export subsidies were demolished. The uniform tariff was not lowered further, but maintained at the level of 6 percent (WTO, 2009).

In 2007 the inflation rate started to increase markedly. The reason for the increase was mainly the fluctuating international prices of energy and food, which in turn affected the local price level. As a result, the inflation range could not be held and the inflation increased to a level of 8 percent by the end of the year. Furthermore, this increase was intensified by other unpredicted events, such as bad weather conditions that had an impact on food production and prices and higher costs of energy creation. During 2008, the situation worsened even more. The financial crisis led to a nominal exchange rate appreciation, but the increasing inflation showed no sign of stopping, soon the inflation rate reached 9 percent. In the last quarter of

2008, the impact of the financial crisis was evident and the Central Bank had to act. It finally led to a depreciation of the exchange rate and a tendency of a decreasing inflation rate. Additionally, the fall in price of fuel contributed to the lowering of the inflation (Desormeaux, García, & Soto, 2009).

Chile had participated in the Organization for economic co-operation and development (OECD) since 1993, but only as an observer. To become a full member, the adjustment of certain policies was necessary to reach the standard of other OECD countries. In 2007, it was invited to start the process of becoming a full member and in 2009 Chile was accepted as a full member OECD (Direcon, 2012 a).

4.2.5 Trade Policy 2010 – 2012

2009 became the last year of the center-left coalitions superiority for this time. In 2010, Sebastian Piñera from the center-right coalition '*Coalición por el cambio*', more specifically the right party '*Renovación Nacional*', was elected as Chile's new president (Gobierno de Chile, 2010).

The ministry of foreign affairs of Chile, states that the growth of Chile and the employment among many factors, is very dependent of exports and therefore the external relations will be improved, to gain greater market access. Agreements of economic complementation (AEC's) and FTA's will be enhanced in this ambition (Ministerio de Relaciones Exteriores de Chile, 2012). FTA's with Nicaragua and Vietnam were concluded during 2011. In addition, the negotiation processes of FTA's with Thailand and Trans Pacific Partnership (TPP) proceeds as well as the negotiation of a FTA with China Investments and a partial scope agreement with India, in order to deepen the relationship (See the agreements signed by Chile, Chart. 3 appendix) (Direcon, 2012 b). Focus of the trade policy is to combine the export promotion with an extensive promotion of investments. The policy emphasizes special effort in the spreading of new technologies to all sectors in the domestic market and the establishment of stable regulations in order to increase the competitiveness. In 2010, the uniform tariff was 6 percent, but there are plans on reducing it more which is a sign on the governments willingness to integrate further with the external markets (Ministerio de Relaciones Exteriores de Chile, 2012).

Judging from the modern political development, there has been a general trend towards increased openness in Chile (Lederman, 2005). Today, Chile is more open than ever. The unilateral and multilateral liberalization together with the strategy of FTA's, has positioned Chile in the world economy. Hence, it has reduced the potential political and economic impact of the greater world powers when it comes to commerce. Nevertheless, it has also led to an increasing dependence of international trade (Wehner, 2009). Since the fall of Pinochet the country has experienced a development of political and macroeconomic stability. Exports have been diversified and the improved investment climate attracts foreign investors (ECLAC, 2002).

4.3 Laws and Regulations Concerning the Wine Industry

Decades ago, the Chilean wine industry was highly protected by legislations and barriers for trade. In 1938, the government adopted import restrictions that practically stopped imports of equipment and technology that the Chilean wine industry already then depended on. The protection of the industry hindered competition and growth for many years. During the Pinochet regime, however, the wine industry was deregulated. Prohibitions for the establishment of new vineyards were demolished and governmental controls and limits of wine output were removed. Consequently, the production of wine increased markedly the first years. In contrast, the production decreased from 1982 to 1990, but this was mostly due to changes in the domestic demand and preferences rather than regulatory measures (Crowley, 2000). During the time of the military regime, some countries boycotted import of Chilean wine among those, Sweden, Norway and Canada. First after the restoration of the democracy in 1989/1990 the import of Chilean wine was once again accepted (Morel-Astorga, 2001).

Thus, countries apply different restrictive measures and regulations to imports of alcoholic beverages. It might be taxes, tariffs, technical requirements and sanitary and phytosanitary regulations (government standards to protect health, of humans, plants, and animals) which restrict the access to the foreign markets. Hence, wine products that have been treated with high levels of chemicals and contain high levels of chemical residues can often be restricted by these means. Today, the protection of intellectual property right is very important for the functioning of the multilateral trade system. It protects innovation, processes and technologies etc. from piracy. In Chile, the system Denomination of Origin is used for this purpose. In Chile, tariffs are low; no taxes are applied on wine imports and the wide range of PTA's offer

preferential or duty-free trade of Chilean wine (Foster & Spencer, 2002). Producers in the Chilean wine industry follows a set of oenological practices, that restricts the use of metals, chemicals and other additives in the wine to ensure a pure vinification process and proper preservation and refinement (Almarza, 2011).

To exemplify, two of the main countries of destination of Chilean wine, the US and the UK, have applied different regulations and restrictions for the import of wine. In the case of the US, sales and other taxes vary between the states, but tariffs are low. As Chile, The US participates in the 'World Wine Trade Group' and has agreed on several oenological practices. There are import regulations when it comes to labeling, for instance if it is a blended wine made of a variety of grapes, the percentage of the varieties shall be shown. The US also enjoys several PTA's, facilitating the trade flows of wine. The UK follows the EU profile on trade with alcoholic beverages. The EU countries have agreed on oenological practices, protection of geographical indications, and restrictive technical requirements. All information about the winemaking processes, fact about the vineyard and the winery and year etc., has to be clearly displayed on the label. The wine has to reach the different standards agreed on under EU regulations. Tariffs follow the world standards and are low. In general the tariff on bulk wine is lower than the tariff for bottled wine. Taxes on the other hand, are applied differently of the member countries (Foster & Spencer, 2002).

A challenge for Chile today, is the focus on the Chinese market. Historically, China has been highly protected with a high tariff rate for wine imports. Now, however, China is becoming more market-oriented and has to adjust its tariff levels to the WTO standards. Nevertheless, China is not a transparent country and it is not uncommon that regulated tax rates differ a lot from the tax rate that actually is assessed on the product. Taxes vary depending on port of entry and the industry. A non-tariff barrier that has been even more restricted in recent years is the labeling regulation (Wine Institute, 2010). To conclude, the Chilean wine sector faces intense international competition and the possibility that major export markets will undertake protectionist measures in order to hinder import of Chilean wine (Fischer, 2001).

4.4 Development of Chilean Wine Exports

The growth of Chilean wine export in recent years is an outcome of the effects of various factors. The market-oriented development strategy, initiated by the military regime, the increasing overall openness and the strategy of trade agreements are factors that all have contributed to the increase of trade flows and Chile's integration to the world economy. Another factor has been the willingness of the Chilean state to diversify its export markets, and hence, to enhance and promote the Chilean wine industry (del Pozo, 1999). In fact, between 1990-1999 the export of new products increased markedly due to diversification efforts aimed to decrease the dependence on mineral exports (Berthelon, 2011). Furthermore, it is argued that the stabilized macroeconomic environment and favorable tax policies increased investments in the sector (Benavente, 2006). Change of demand was another main factor for the escalating export-orientation of the wine industry. The domestic consumers demanded less and less wine, preferring substitutes such as soft drinks and pisco (Morel-Astorga, 2001) hence, many Chilean producers had to look towards the international markets. Following this, the changing and increasing foreign demand opened up opportunities for Chile to consolidate its position in export markets such as the US, Canada and Europe, and to get access to new markets, among those Japan and China (del Pozo, 1999). Other reasons for the rapid growth of the Chilean wine industry were droughts, hindering wine production in Spain and Australia, a sanitary crisis in the US and the economic crisis in Europe during the 1980's (Morel-Astorga, 2002). Adding to this, wine consumption and thus, demand increased in markets such as, Denmark and Sweden (Morel-Astorga, 2001). It has also been argued that a reason for the boom of the wine industry in the early years of the 1990's was the depreciation of the peso.

Before the mid-1980's the quality standard of Chilean wine did not reach up to the demand of the consumers in developed countries. Before, the wine export had been directed towards other Latin American countries, where the consumers did not require the same quality (Agosin & Bravo-Ortega, 2009). However, continued liberalization (Agosin, 2001) and the lowering of import tariffs by the Aylwin government (1990-1994) (Edwards & Lederman, 1998) made it possible for Chilean wine producers to import new technology and equipment (Agosin, 2001). Thus, technological development and improvements in the winemaking processes highered the standard of Chilean wine, and the taste was adapted to the foreign customers (Agosin & Bravo-Ortega, 2009). When the Aylwin administration signed the

agreements under the Uruguay round, and GATT new markets for Chile's export of agricultural products opened up. As this also contributed to reduction of non-tariff barriers (Weyland, 1999) it stimulated the rapid growth of the Chilean wine industry and the wine exports in the 1990's (Agosin & Bravo-Ortega, 2009). Another factor that enhanced the growth of export in the first years of the 1990's was the reputation of Chilean wine, as qualitative and good, but still cheap. Nevertheless, this reputation would become an obstacle for increased sales of more expensive wines (del Pozo, 1999). In 1993, the value of Chilean wine export represented 1.3 percent of total exports (UN Comtrade, 2012).

The two first governments (the administrations of Aylwin and Frei) after the restoration of democracy emphasized trade agreements, thus the regional bonds were tightened with Mercosur and different trade agreements were signed with many nations and trade blocs (Lederman, 2005). In addition, Chile became a full member of WTO (WTO, 2012 g) and APEC (Congreso Nacional Chile, 2012), which opened up even more markets for the Chilean wine export (Weyland, 1999). During 1990-1997, the Chilean peso appreciated by 50 percent (Morandé & Tapia, 2002). An appreciation would theoretically counteract an increase of exports as the products get more expensive to foreigners (Krugman & Obstfeldt, 2009). However, when looking at the export development of wine during 1990-1997, the increase in trade quantity of wine export is obvious (UN Comtrade, 2012). President Lagos (2000-2006) continued the multilateral trade strategy. Asia was again prioritized and FTA's were struck with both Japan and China (Datamonitor, 2007). Further reduction of the uniform tariff to 6 percent, and reduction of non-tariff barriers stimulated the increase of trade flows (WTO, 2003). The appreciation of the Chilean peso during his last years of presidency (Datamonitor, 2007) did not seem to have any considerable affect on wine export, as the increase in both trade value and trade quantity was evident also from 2000-2006 (UN Comtrade, 2012). Further, in 2007, during the presidency of Michelle Bachelet, the inflation rate increased markedly, and worsened even more in 2008. The financial crisis led to an appreciation of the real exchange rate. After an intervention by the Central Bank the inflation rate was again lowered and the currency depreciated (Desormeaux, García, & Soto, 2009). In spite of this development, wine exports continued to grow during the period (UN Comtrade, 2012).

In the last two decades, the strategy of Chilean wine producers has been to decrease the export of bulk wine, bottled in the importing country and substitute this with export of already

bottled wines with Denomination of Origin. The price of wine overall depends on the trends in the world market. However, during the 1990's the wine prices in Chile rose by 55 percent and one reason for this may have been the effort made by Chilean winemakers to position Chilean wine as a higher-premium product. Since then, the prices have tended to fall some as the industry has matured, with a small recuperation again in 2003. The initiative taker of the strategy of higher quality wines, and the first mover of Chilean wine exports is considered to be the Spanish wine producer Miguel Torres. He contributed to the start of the export-oriented development and to the spreading of the premium wine strategy, which was imitated by Concha y Toro in 1988 (Agosin & Bravo-Ortega, 2009). Consequently, the Chilean wine production and export was diversified to cover a greater variety of wines, from cheap table wine to premium-quality wine during the period (Morel-Astorga, 2002).

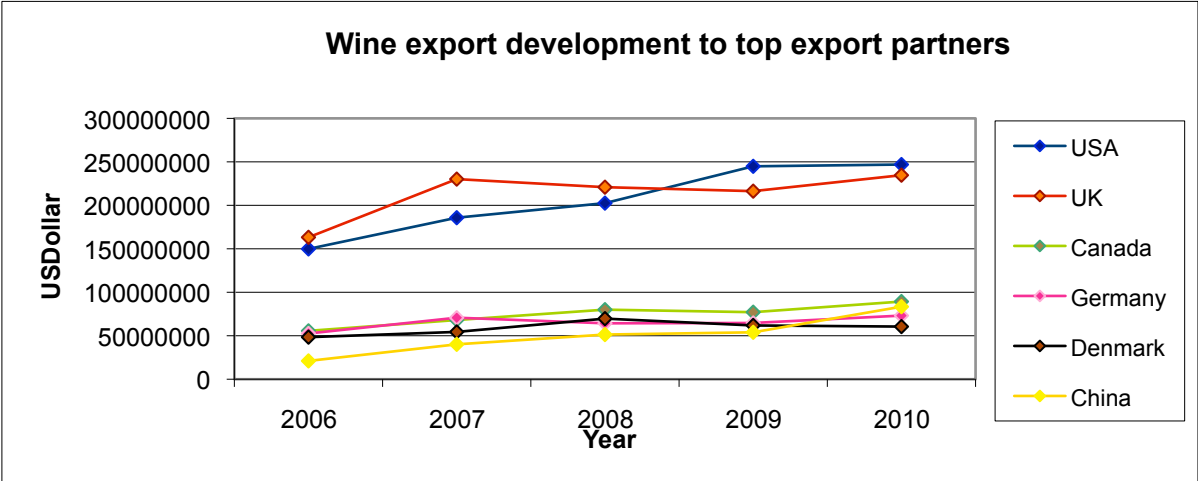
The value of wine export increased from slightly more than 50 million USD in 1990 to a value of approximately 570 million USD in 2000. The positive export rate continued during 2000 (UN Comtrade, 2012) and reached a value of 1710.9 million USD in 2011 (Vinos de Chile, 2012 d). This remarkable development was accompanied by a rise in the relation price/liter, which in 1989 was 1USD/litre and that in the following ten years more than doubled to reach 2.2USD/litre in 1999. Thus, the general price level during the period rose for both bottled- and bulk wine (Morel-Astorga, 2002). In line with the change of strategy to production of more qualitative wines, the export share of bulk (granel) wine decreased and the export share of bottled (embotellado) wine increased (del Pozo, 1999). In 2005, bottled wine with Denomination of Origin accounted for 55 percent of total wine exports and the average price reached almost 3USD/litre (CONICYT, 2007). Today, bottled wine stands for 82,9 percent of total export whereas the percentage of bulk wine export is only 12.7 (Fig.4 appendix) (Vinos de Chile, 2012 d). This shows that the general value of Chilean wine has increased in the international markets. However, even though the export share of bulk wine has decreased in relation to bottled wine, bulk wine export as a category has increased through the years. Earlier, bulk wine was considered a low quality and low priced product. However, in the last decade it has become a new rentable niche for many wine exporters. In other words, high quality wine is today sold also in bulk format. This is argued to be a more economic way of exporting wine, due to lowered transport and distribution costs etc. However, wine exported this way, gives a greater freedom to the buyer or importer to use it, and bottle it the way they want. Some buyers, for instance supermarkets, might put their own

brand on the bottle, but still respect the origin of the wine. Other importers of bulk wine, for example China tend to blend it with their local produced wine so that the final consumer has no idea that he/she is actually drinking Chilean wine (Corporación Chilena del Vino, 2007 b).

By 2006 wine was the fifth most important product for Chilean exports, representing 1.7 percent of total export value. The amount of wine with Denomination of Origin exported was almost doubled from 1998-2006 (CONICYT, 2007). Piñera, the President of Chile today, states that focus during his presidency will be to combine extensive export promotion with extensive promotion of investments. He aims to open up the Chilean economy further and the uniform tariff is planned to be reduced further (Ministerio de Relaciones Exteriores de Chile, 2012). In 2010, Chile had more than 70 exporting wineries and 70 percent of the output was exported to foreign markets. That made Chile the tenth largest wine producer, and the fifth largest wine exporter in the world (Hennicke, 2011). The same year, Chile reached a market share of 8 percent by volume of the global wine market (Mediaside SARL & the Chilean government, 2012). Measured in trade value, wine export counted for approximately 2.2 percent of total exports in 2010 (UN Comtrade, 2012) In 2011 the total value of wine export reached 1710,9 million dollars (Vinos de Chile, 2012 d). The development of export in USD from 2007-2009 was more modest in comparison to the increase from 2010-2011 (UN Comtrade, 2012). This can be explained by the fact that the financial crisis affected the growth of Chilean exports in general and slowed down the increase (Albarran, 2010).

The main destination countries for Chilean wine from 2006-2010 were the US, the UK, Canada, Germany and Denmark. Figure. 3 below show the increase of export to all these countries during the period. Another destination of increasing importance is China, where export of wine, according to the figure also grew during the period (UN Comtrade). As a trade bloc, however, the EU is the main export market. Nevertheless, focus in recent years has been to increase export also to prosperous Asian markets. In consequence China has become a large target market (Fig.5 appendix) (Hennicke, 2011). Some Asian countries, especially Japan became an important export market for Chilean wine during the Asian crisis. But the export to the UK and other European markets also increased during that time (Morel-Astorga, 2002).

Figure. 3 Development of Chilean wine export to top export markets



Source: UN Comtrade (2012)

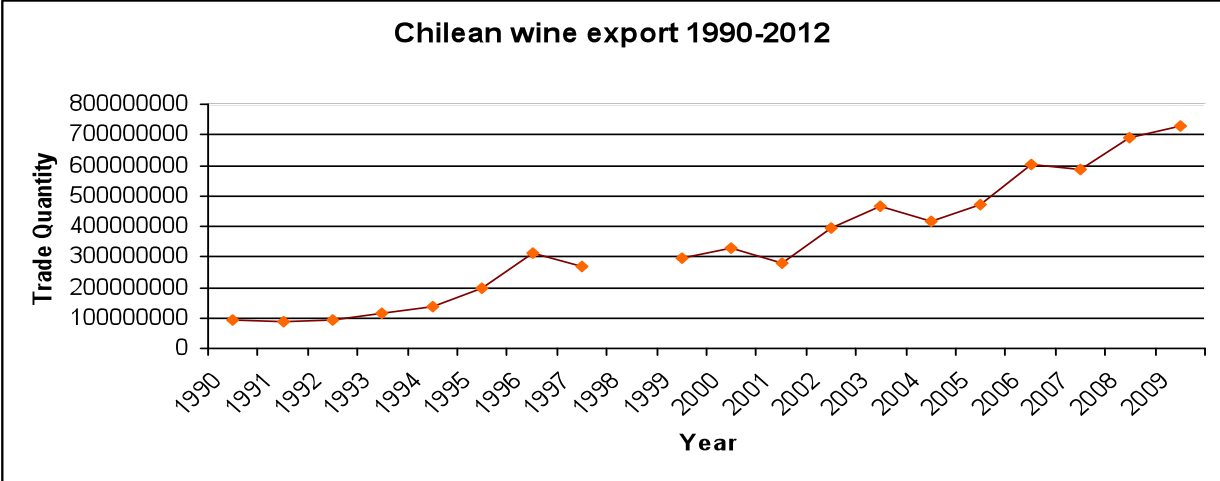
Wine export from Chile flows relatively freely as different trade agreements between Chile and the main trade partners, gives free access or low tariffs, scheduled to be reduced even more. The US duty for Chilean wine exports was in 2011 at a level of 6.3 percent per liter, but will according to the FTA be gradually phased out by 2016. When it comes to the Asian markets, duties have historically been high. For wine export to China the duty was, in 2011, at 11.2 percent, however according to the agreement it will be reduced and reach zero in 2015. In the case of Japan, the duty will be reduced from 15 percent to zero in a period of 12 years (Hennicke, 2011). Chile’s aims to become the leading producer among the ‘New World’ wine producing countries of premium and sustainable wines, in 2020 (Mediaside SARL & the Chilean government, 2012). Below, the growth in trade value and trade quantity of Chilean wine export from 1990-2010 in USD is illustrated.

Figure. 4 Trade Value of Chilean Wine export from 1990-2010 (In USD)



Source: UN Comtrade (2012)

Figure. 5 Trade Quantity of Chilean wine export from 1990-2010 (Netweight, kg)



Source: UN Comtrade (2012) *no estimation in 1999

(See Chart.6, and the export development in Chilean peso, Chart.7 and Fig.8 appendix).

4.5 Foreign Direct Investments in the Chilean Wine Industry

FDI is considered to have both negative and positive effects on a country. For a long time, it has been argued whether it is beneficial to a developing country. Some argue that it is bad since the increased competition in production and labor can crowd out domestic firms. Other mean that the FDI is good and benefit local firms as they bring new technologies and ideas that can be spilled over. Thus, the affect depends and the ways in which the spillover effects are transferred. However, in many cases one can see that FDI has had positive effects, especially in some industries. In the wine industry the visibility of the production is good and hence, imitation and innovation can be spread faster (Kunc & Bas, 2009).

The Chilean wine industry has attracted many foreign investors due to the climate, the low lands, relatively low labor costs, and improved macroeconomic environment. The investors started to come to Chile in the 1980’s and 1990’s and invested in green-field investments, joint ventures or in already existing Chilean companies. The Spanish company, Miguel Torres arrived to Chile in the 1980’s and has had a big influence on the local Chilean wine producers, when it comes to technology, marketing, and export aspects (Visser, 2004). They got influenced and changed the old methods of production using newer technologies. The old tanks were replaced to stainless ones, French and American oak casks started to be used, and new facilities that improved gravity-flow and designs that encouraged tourism were introduced (Kunc & Bas, 2009).

Chile has produced wine for a very long time, but it is mostly in the last decades that the Chilean wine has become so popular, reached higher quality and become a big export product for Chile. This is very much thanks to the technological transfers from FDI. Earlier the foreign investors were few due to the unstable politics and economic climate. However, when the Chilean economy was liberalized and the investment climate stimulated by government support, the amount of FDI increased. The Chilean Economic Development Agency CORFO started the program 'InvestChile' that worked with the promotion of Chile and provided useful information and services for investors. These developments, and the fact that Chile was ranked as the least corrupted country in Latin America attracted many foreign investors in all sectors, including the wine industry (Ricken & Malcotsis, 2011).

Investments through joint venture in the Chilean wine industry counted for 5 million USD from 1974 to 1989. This amount has increased tremendously from 8 million USD between 1990 and 1994 to 38 million USD in 1995 until 1998. Green-field investments and investments in already existing Chilean companies represented a value of 50 million USD between 1974 and 1998. The total sum of FDI during this period was then 101 million USD. 50 percent of this amount came from investors from the US. Seemingly, Chile has been positively affected by foreign investments and their expertise, market knowledge, brand names and economies of scales in terms of logistic costs. The vineyards that had a connection with foreign firms were the first to start exporting to international markets. Further, this development was an example for smaller firms that started to imitate in the ambition to internationalize (Visser & de Langen, 2006).

Chile did an impressive journey from producing not very special wine, to produce high quality wine in less than ten years. In this development, the affect of investments in the Chilean wine industry has been beneficial, especially the large investments from Spain, Italy, the US and France, which gave Chilean vineyards and wineries new facilities and expertise. The technological transfer has been crucial for the success of the Chilean wine industry and the spillover effects from the clusters to local producers created a more sustainable technological improvement. This improved the Chilean wine and increased the demand in the international markets. Chile is today a world exporter and producer of wine and has a well-known name in the wine industry, much thanks to FDI (Ricken & Malcotsis, 2011).

By 2004, there were 265 wineries in the Chilean wine industry and 40 of them had some kind of foreign participation (Bustos, Willington & Peña Torres, 2007). In 2005, there were about 15 multinational firms in the Chilean wine industry. America, is the country that has invested the most, 64.012 million USD from 1974-2001 compared to France that has invested 21.053 million USD during the same period of time. Some multinational firms that are present in Chile are Miguel Torres (Spain), Chateau Larose Trintaudon and Viña de Larose (France), Franciscan State Selection and Kendell Jackson (United States), Mildara Blass (Australia), Viña Selentia S.A. (England and Spain), Odfjell Vineyards S.A. (Norway) etc. (Björk, 2005).

The liberalization, the pro-market policies and the macroeconomic development in Chile seem to be a direct reason for the increase of FDI in general and in the Chilean wine sector (Foreign Investment Committee, 2010 a). Total FDI inflows to Chile increased during the 2000's. In 2008-2009 the inflow of foreign investments slowed down due to the financial crisis, but it recuperated already in 2010 (Euromonitor International, 2012). With extensive networks of FTA's, Chile has become an attractive country for investments (Foreign Investment Committee, 2010 a). In addition to the development and the gained macroeconomic stability, there is a Foreign Direct Investment Committee that provides foreign companies with information and other practical things when investing in Chile (Foreign investment committee, 2010 b). Of course the beneficial climate, the low land and labor cost is a reason for investing in the Chilean wine sector as well, but since the amount of foreign investment in the Chilean wine industry before the liberalization and the economic stabilization, was low (Visser, 2004) one can conclude that the policies in Chile has affected the FDI. Seemingly, this has had an affect on the development of wine export. Foreign investors contributed to the technological and organizational development of Chilean wine producers. Further, it played a key role in shaping the export-oriented strategy, which is widespread in the Chilean wine cluster today (Morel-Astorga, 2001).

4.6 The Competitiveness of the Chilean Wine Industry

In recent years, the wine industry has shifted from relatively localized production and sales to become much more global. Tariffs and trade barriers were decreased and thus, wine producers could afford to sell their products abroad. The more adaptive the wine producers are to internationalization, the stronger competitive advantages they get. Chile has a small population, which provide for a small domestic market with little potential of growth.

However, Chile is positioned well when it comes to wine. With its adaptive and large-scale producers, the production, the export of wine and the ability to attract FDI, Chile has strong competitive advantages (Castaldi, Cholette & Hussain, 2006).

4.6.1 Factor Conditions

Under factor conditions are the characteristics of the factors of production, the production processes and how these are related to the competitiveness of the domestic firms. Porter separates the factors into 'basic' and 'advanced', and stipulates that the advanced factors (skills, research facilities, scientific base and infrastructure etc.) weigh heavier than basic factors (local raw material, pool of labor, climate, demographics etc.) as they involve sustained and heavy investment (Grant, 1991).

Chile is today a democracy and a nation on the rise regarding economic development and international trade. It is a small and oblong country with 17,2 million habitants. (Sveriges Ambassad, 2012) The climate is shifting a lot from north to south and in the central Chile there is hot climate with sun in the summers and rain in the winter. Most of the population lives in the central part of the country (Visser, 2004). When it comes to the wine production, the climate and the terrain are of utmost importance and in that respect Chile has a strong competitive advantage, with its special and rich landscape and low land, perfect for grape growing (Castaldi, Cholette & Hussain, 2006).

Chile has grown a lot since 1990 and between 1990-2007 the average economic growth a year was 5,5 percent. The OECD has also predicted that Chile will be the fastest growing country in OECD 2010-2015. Chile has succeeded better than many other Latin American countries and is now a stable country with developed trade policies, banks and communication networks (Exportrådet, 2012). With a good economic climate and a low labor cost, Chile is an attractive country for FDI when it comes to wine (Castaldi, Cholette & Hussain, 2006). Chile is today an international competitor for premium wine and to continue this development and maintain such a position, it is vital to have the necessary skills and research facilities etc. (Giuliani, 2006).

In 2009, the number of people that studied in university was 876,000, which stands for approximately 5 percent of the total population. The educational system in Chile has been

and still is very questioned since many universities are private and expensive. This naturally creates a hindrance for many habitants to continue to higher studies, and lead to inequality and a lower level of educated people. Even though low levels of educated people is more common in developing countries, knowledge and innovation is often shared within clusters and thus, spillover effects are more important in these countries. When it comes to wine, the education in Chile has improved. The number of educated oenologists was 300 during 1990-2000, which is an increase from the previous decade when it only was 50. This increase of skills and knowledge, has led to a decreasing importance of spillover effects of technology and know-how from foreign companies in the Chilean wine industry (Björk, 2005).

In Chile, there are some major clusters for example, Valle de Colchagua, Casablanca valley, Cachapoal valley and Maipo valley. The whole production of wine in Chile takes place in a territory that covers a third of the nation. The different clusters have different specialties and can through the cluster share innovations and knowledge. For example, some producers focus on white wine, some on red wine, high quality or low cost wine, or both etc. Within the clusters innovation and knowledge develop faster and help the companies to gain competitive advantages. Especially in the wine industry, this is a great advantage since the production is more visible and thus, easier to imitate (Kunc & Bas, 2009).

The factors affect the wine and the competitiveness in different ways, the basic factors are almost always present and directly influence the costs of production, while the advanced factors determines the quality and efficiency and depends on the human resources and their efforts. Both factors are important to gain advantages against the increasing international competition (Heijbroek, 2007).

4.6.2 Demand Conditions

Demand conditions concerns the costumers demands and the ability to meet these needs. The nature of the home market demand for a certain product or industry has shown to be strongly correlated to a nation's competitiveness (Grant, 1991). When it comes to wine, the demand of the consumers shift a lot and it is important to follow new requirements and demands in order to reach out to the costumers. The wine industry in Chile has been really successful the past decades, going through technological renovation in 1980, export boom in 1990 and development of the territories in 2000. As a consequence, Chilean wine has come to reach out

to costumers all over the world (Felzensztein, 2011).

The demand and the factors conditions are connected to each other and the increased demand for Chilean wine in 1990's has contributed to the change in production processes, technology and marketing. Today, Chile exports 70 percent of its wine, as the demand in the domestic market is weak and new substitutes (beer, pisco, soft drinks) have won market shares (Visser, 2004). With 150 destination countries it is vital to keep up with the shifting demands. New habits of the consumers today are that they are smart and that they seek good-value products. Since the financial crisis, it has become more common to socialize and drink at home and the demand for premium wine is expected to rise again. There is also a new segment of trendsetting wine consumers consisting of young people between 21-29 years who drinks more imported wine. Further, with the globalization and the Internet use the youth has become more informed and sophisticated, and thus seek natural organic wine. Additionally the demand for white and rosé wines is on the rise (Felzensztein, 2011).

To meet the costumers new needs and demands, Chile has broadened its export basket when it comes to wine. For instance, almost 2 percent (32 companies) of the vineyards in Chile are working with organic production. The special thing with organic wine is that the standard of the cultivation and the final product are approved by a certification company. Hence, the number of vineyards producing organic wine has increased in the last decade, because of the new trends in demand of the international customers (Cederberg, Gustafsson & Mårtensson, 2008). Furthermore, the increased use of Internet and communications forums has led to a new trend; demand of fair trade products. Internet provides all information about a product and its value chain, thus more people choose to buy wine that is fair trade labeled. Even though, fair trade is still a niche market, it is surely something that companies need to consider in the future (Kleine, 2008).

Overall, Chile has been successful in the internalization process. However, there are still a lot of challenges ahead regarding the wine demand. For instance, there is a change in the focus of export markets. This challenge is the move from export to traditional wine importers such as Europe and the US, to reach the new markets of Asia and Russia where demand for Chilean wine is rising (Visser, 2004).

It is essential for companies to always have the demand factor in mind, to see and respond to the new arising trends in demand in order to gain valuable competitive advantages and keep up with the increasing international competition.

4.6.3 Related and Supporting Industries

Success in an industry is not possible without the close access and support from related competitive industries. The value chain is extensive, and the presence of developed and successful related industries in a country is essential (Porter, 2009).

In the wine industry there are numerous supporting and related industries important for the production of the final product. In Chile, most wineries produce only wine and the supporting products and equipment is often imported from foreign companies. To make and to sell wine, there is a lot of other material and equipment needed except for the grapes. This is what is called the secondary wine production, for example bottles, corkscrews, case corks, processing equipment of stainless steel, chemicals, products for the growing and water supply equipment for the dry summers. In Chile, the availability of these supporting products and activities is weak, thus, the Chilean wine producers mainly rely on imports (Visser & de Langen, 2006).

The influence from FDI in the Chilean wine industry is truly a reason for why Chile's wine industry is up-to-date when it comes to technology. The theme of dependence can of course be discussed, since the competitors may gain competitive advantages over Chile. However, the wine cluster has a lot of support institutions that helps to defend the position of the Chilean wine industry.

The external factors, in the past decades has led Chile's wine industry to the success of wine exports, however, now it is crucial to increase the presence of domestic supporting industries and activities in the cluster. This has to be done in order to meet the present and upcoming challenges of international competition (Visser, 2004). Hence, together the wine industry and the development of supporting industries can strengthen the Chilean wine cluster (Giuliani & Bell, 2004).

4.6.4 Industry Structure, Firm strategy and Rivalry

The characteristics of the companies, the strategies, visions, goals, management and practices and the domestic rivalry within the business sector etc. depend on the country and the national

environment (Grant, 1991) The wine industry constantly meets new challenges when it comes to demand and supply and the companies need to be prepared for these in order to survive. A big change in the industry was in 1990, when there was a shift from supply driven production to market-oriented wine production and new business models. Not everyone was prepared for this shift but the adaptive companies from the ‘New World’ countries were, and they grew from this while more traditionally wine countries decreased their sales (Heijbroek, 2007).

The wine cluster in Chile is less fragmented than the same industry in certain European countries. Nevertheless, it is more fragmented than the wine industries in Australia and the US. The structure and the liberalization of the Chilean economy have attracted foreign companies to make investments in the Chilean wine industry. Hence, when it comes to suppliers in the Chilean wine industry most of them are foreign firms, that once were attracted to the growing Chilean wine industry and the many local firms that imported foreign products (Björk, 2005). The different segments in the Chilean wine industry are still wine, sparkling wine, Vermouth and Fortified wine. The still wine segment is the largest sector representing 71.4 percent. The second biggest is the sparkling wine representing almost 26 percent (Datamonitor, 2004).

Regarding the firms strategies they differ. When it comes to wine companies, they can choose to produce premium wine, organic wine, red- white- and rosé wine, low cost wine etc. Many choose to export their own wine and others to sell their wine to exporting companies (Visser, 2004). From the different strategies, the rivalry between the wine companies also arises. There are a lot of different companies and with the globalization the competition increases and intensifies. Chile is positioned as a country that sells good quality wine to a low price; a strategy that has worked well when entering the international markets but that also has led to lower revenues. Thus, a new strategy has been on the rise for a while with the promotion of more expensive premium wines (Morel-Astorga, 2001).

The local competition has become harder since numerous smaller exporting firms have emerged, called ‘viñas boutique’ or ‘viña emergente’. Even though there has been a rise of such domestic firms, the large wine companies in Chile are the dominating ones (Björk, 2005). There are mainly four big producers, which have gained a lot of power and that continues to grow. This has led to an oligopolistic structure in the Chilean wine industry.

These four producers are accounting for about 80 percent of the wine production in Chile (Morel-Astorga, 2002). Porter argues that the domestic rivalry is one of the most powerful attribute, simply because the presence of local rivals contributes to the creation of competitive advantages. (Porter, 2009)

4.6.5 Government

As the government shapes the institutional structure and the trade policy it plays a partial role in the diamond framework. For instance, a government can facilitate an industry's or a company's possibility to grow and become more competitive through providing an appropriate national environment (Porter, 1990).

The Chilean wine industry is dependent on cluster governance and this is also considered to play a great part for the future development of the industry. In the past, the role of the government did not seem as important, but after 2000 the quality of governance was found to play a key role for the development of the Chilean wine industry and its position in the world market (Visser & de Langen, 2006). Chile's government has a positive attitude and work for the promotion and marketing of Chilean wine in the world (Visser, 2004). In 2007, the organization 'Vinos de Chile' was founded by the joining of the already existing organizations 'Viñas de Chile' and 'ChileVid'. Vinos de Chile works closely with the export organ ProChile. This organization is responsible for the promotion and marketing of Chilean wine, the expansion and strengthening of the wine industry and the training and improvement of the work force etc. (Vinos de Chile, 2012 e). Another group that works for the facilitating of international trade for wine and the removal of trade barriers is the 'World Wine Trade Group' that consists of representatives from the government. Some member countries are Australia, Canada, Chile, Argentina, USA, Georgia, New Zealand and South Africa (Vinos de Chile, 2012 f).

4.6.6 Chance

The chance factor includes unplanned events, such as recessions, price shocks, wars or other intervening actions that can have an effect on the national environment (Ankli, 1992). Chance factors can have both positive and negative effects. When it comes to the Chilean wine industry, however, one can see that most of the unplanned events have led to positive effects. The internationalization of the Chilean wine for instance, started with the economic crisis in Europe in the 1980's, which led to a search for alternative suppliers to the companies in

Europe (Morel-Astorga, 2001). As mentioned before, since 1990 the Chilean wine industry has experienced a sustained growth of export and quality, much thanks to the liberalization of Chile. This is a good example of a chance factor that has affected the national environment in a positive way. With this, the economic climate improved, leading to investments in the Chilean wine industry, and hence the development and improvement of technology and production processes (Guliani, 2003). Furthermore, with the shift from supply driven production to market-oriented wine production, Chile gained even more competitive advantages since the producers were prepared and could adapt to this change. These factors have helped Chile to reach its position in the world market and to become a world supplier of wine (Heijbroek, 2007). Other factors that can affect the wine industry are the weather condition and diseases. Grape growing is sensitive and a disease, organism or a shifting weather can affect the whole production or at least the quality of the wine (Morel-Astorga, 2002). A disease that affected many wine growers in Europe was 'Phylloxera'. It led to an increased demand and export of Chilean quality wines, since Chilean vineyards were not affected by the disease (Visser, 2004). What happens in the world can be hard to predict, thus it is vital to stay alert and be prepared for the changing environment in order to keep up with the competitors and to gain valuable competitive advantages.

5. Analysis

In the analysis, the theoretical framework is used to analyze our empirical findings. It evaluates to what extent trade policies have affected the Chilean wine industry, the wine export and FDI. Thus, it seeks to find the correlation between trade policy and the growth of wine industry. Additionally, the value of FDI in the wine sector and the importance of wine export are discussed.

5.1 The Value Chain of Wine

Porter's theory suggests that, in the value chain, one can choose to spread activities downstream or upstream to create competitive advantages. Seemingly the trend in the Chilean wine cluster, consisting of many exporting wineries, is to keep the core activities within the company and within the Chilean wine cluster. By doing this, they gain more control over the value chain and as the quality of the wine and the taste, today are determinate factors when it comes to demand, this is strategically smart. Additionally, it goes hand in hand with the overall strategy to increase exports of high-quality wines. Hence, when a winery buys fresh grapes from an external supplier, reliability is of great importance in order to insure quality. Nevertheless, the relationship is also sensitive as for example weather conditions can lead to poor harvest and bad quality of the grapes. Only if it concerns production of cheap bulk wine, the quality of grapes is less important. Further, the strategic choice to keep winemaking processes, marketing and some sales functions in-house, follows the same reasoning. Quality has become more important and by adding the personal value through marketing and sales, to the wine, companies gain competitive advantages. Moreover, it facilitates coordination of and communication through the first parts of the value chain, which naturally implies a competitive advantage. Supporting products and activities, such as corks and bottles and labeling etc. do not directly affect the quality of wine, thus it is less risky to rely on imports of these products. Nevertheless, the Chilean wine cluster would become more competitive as a whole if a larger extent of production of support products and support activities were available in the country. Then, the cluster would become more complete and the infrastructure, the communication and coordination with support product and activity producers improved. Thus, companies would be able to increase efficiency and reduce several transport and import costs.

The initial steps of the value chain seems to be under control, however, the question about

how much control and influence a Chilean exporting winery has over the last steps of the value chain, remains. If the wine is bottled and labeled in Chile, the problem is not very big. The wine is then transported, distributed and sold of retailers and drug stores but the final consumer will for sure know that he/she is drinking a wine produced in Chile. Then, not only financial value, but also indirect value of marketing and brandbuilding is gained by the Chilean winery. When it comes to export of bulk wine however, it is often bottled and labeled in the importing country. Hence, there is a risk, and it happens that the country uses the bulk wine for own purposes, for instance blend it with domestic wine and put another name and country of origin on the label. When this happens, the Chilean exporting winery has lost all control over the wine and one can wonder how much value that is brought back to the winery. This phenomenon indicates the importance of the Denomination of Origin system. Thus, in order to control, also the last parts of the value chain, it should be used more. To further control the last parts of the value chain, some Chilean wineries have self-owned subsidiaries for marketing and sales in the key export markets. Naturally, this gives the companies valuable insights in demand and trends in the market. Furthermore it facilitates communication and coordination also after the product has been exported. Thus, this is a good strategy that should be used more in order to gain more control over the GVC.

When it comes to the government's role in shaping the value chain of wine and contributing to the growth, it has had an important role primarily as import tariffs gradually have been reduced, which enabled Chilean wineries to import support products, technology and equipment. Nevertheless, this development seems to have had both positive and negative effects. It has on the one hand contributed to the development and the growth of the Chilean wine industry, but on the other hand it has led to a strong dependence on foreign technology and support products. The government also has influence over the availability of human resources, education, and R&D, which is of high importance throughout the value chain. Efforts have been made in this respect, and the level of educated oenologists has increased and modern practices and technology is used by most of the Chilean wineries. The public institutions responsible for promoting exports and the associations that enhance the development of the wine industry are political initiatives, and have contributed to the spreading of new technologies and know-how within the sector. Especially, efforts to enhance education, training of human resources, and R&D are of great importance as the Chilean wine sector still is dependent on foreign knowledge. Hence, by increasing this kind of efforts, the

Chilean wine cluster will become stronger throughout many activities in the value chain and, thus become more competitive in the world arena. The sharing of knowledge within a cluster implies quality and quality in turn, increases sales and thus, exports.

5.2 Shifting Trade Policies and the effects on Export and FDI

In general, the shifts of governments and trade policy measures during the period, has led to an increased openness of the Chilean economy. Protectionist behavior has not been practiced to a great extent, even though the central-left alliance governed the majority of the period; instead promotion of export and FDI, by policymakers has been in focus during the period. Chile is today characterized by extreme openness. Following this, is there a limit for when liberalization is beneficial or not? Is Chile is prepared for further liberalization? Theoretically, strategies and methods to promote trade are necessities to reach a high level of export and FDI. While some argue that liberalization is the best way for a country to develop, that increased competition is favourable to domestic industries and that economic development in turn, improves the standard of living and overall welfare of a nation. Other argues that the capitalism is directly destructive for the domestic industries and companies, and that foreign capital and MNC's, in reality is what governs Chile today. Hence, that protectionist measures enhances economic performance. It is also argued that in this development of liberalization and privatization, people with fewer resources are left behind. Nevertheless, the statistics shows that the general level of welfare in Chile has increased in recent years and that Chile is one of the regional leaders when it comes to economic development. Moreover, liberalization and trade promotion has certainly affected the growth of Chilean wine industry positively in many ways, stimulating technological and organizational development and improved the knowledge based production processes and innovation. However, Chile is still a developing country where political divergences reflect the reluctance of too much dependence on trade and foreign capital. The wine industry is evidence on this dependence. While innovation has taken place in the developed nations Chile has been a follower and imitated rather than innovated. Even though the costs to imitate might be lower than the costs to innovate, higher innovation rates would bring more value to a nation striving to become fully developed.

When it comes to the theme of increased competition in the Chilean wine industry, it has forced Chilean wineries to constantly improve and seemingly that is a great reason for the growth of the industry and the augmenting export rates. However, Chile is still a follower,

and the growth rate would increase even more if innovation and knowledge originated from a stronger Chilean wine cluster. Chile has historically been underdeveloped and dependent on foreign firms, hence the question is if Chile has been able to break out of this?

When it comes to the Chilean wine industry it is on the way to reduce this dependency, but it is still far to go. In the wine industry the sharing of knowledge is good, but it could still be improved. Chile's government should not be afraid to demand even more knowledge transfer from foreign investors because it is an attractive country to invest in, especially when it comes to the wine industry. Hence, the investment will continue. Thus, this demand for investing in Chile should be used to become less dependent in order to develop the wine industry more independently.

Export diversification, increased openness and promoting trade policies have contributed to the growth of the wine industry and the increased trade flows. Import tariff reductions meant that foreign technology and knowledge could be acquired. The macroeconomic stability and improved investment climate attracted foreign investors that applied an export-oriented strategy, which was adopted by many Chilean wineries. Furthermore, the strategy of bilateral, regional and multilateral trade agreements and the membership in different trade blocks such as WTO and APEC, has given Chile access to many markets. Wine export has increased steadily during the period and seemingly the development of trade policy has contributed a lot to this development. For instance, wine export increased markedly from 1995 and onwards. During this time, several trade agreements were signed and Chile became a full member of WTO. This may well have been a reason for the sharp increase. Moreover, it is evident that new foreign technology and knowledge improved the quality of Chilean wine and that foreign consumers then demanded more. Nevertheless, the export may have grown a lot thanks to a general increase in global demand of wine. In addition, it is not excludable that the growing presence of foreign wine companies during 1990-2012, stood for a great share of the increase in total wine export.

The value of Chilean wine increased in the world market during the period. This may partly be a result of the strategy to produce higher-quality wines. Further, the increased trade value can be traced to the decreased export share of bulk wine in comparison to bottled wine, but overall both of the categories have increased during the period. Bulk wine is becoming a more

rentable segment. Thus, with the right protection and regulations, the risks of bulk wine export can be reduced and the winery can instead enjoy the advantages of such export, for instance, potential cost reductions and reduced environmental damage.

When looking at the trade value development of Chilean wine export in USD and Chilean Peso the difference is not very significant. However, during the time of the financial crisis in 2007-2009 the trade value in USD decreased in development pace but the trade value measured in Chilean Peso did not seem to be that affected. It rather increased significantly during the period. Why it was not so affected might be explained by the fact that Chile during this time had developed its export and reached new markets. Hence, the wine export was not only dependent on the countries that worst suffered from the crisis, for instance EU and the US. The only time there was a considerable decrease in the trade value in Chilean Peso was in 2005. During this time the Chilean peso appreciated, which might be a reason for the decreased trade quantity and thus, the value of export. However, it could also just have been a bad year for wine production in Chile.

Another important factor to analyze is the development of destination markets for Chilean wine exports. According to the statistics of the development of Chilean wine exports to key buyers, the export has increased to all. In recent years, regulations and requirements concerning oenological practices, use of chemical substances, and technical requirements have been more restricted. In this respect, Chile needs to be attentive and updated when it comes to developments in the key markets. The more restrictive regulations require a greater degree of transparency of the winemaking process. If Chile succeeds in following the practices and regulations, together with the developments of for instance, fair trade and organic wine, export is likely to increase further to the mature key markets. One clear trend in export orientation during the time period has been the focus on Asian-Pacific countries. It is strategically smart to turn to these emerging markets. However, when trading with some Asian countries, a good relationship with the governments is very important. For instance, China has historically been highly protected by trade barriers and non-tariff barriers. It is not a transparent country and the applied tax rate is often different than the final tax that is assessed on the goods. Further, the use of non-tariff barriers is still common. In this sense, Chile should act with precaution when making business with some Asian countries.

FDI in the wine industry has also increased during the period. There is a clear connection between macroeconomic stability, improved investment climate and the positive attitude towards FDI by the governments and the general increase of FDI. As the economic climate improved and the exchange rate was maintained more stable, investors found it less risky to move their capital and invest in Chile. It seems like the Foreign Direct Investment Committee of Chile has contributed to the increased presence through its investment services and valuable knowledge about the Chilean market. Nevertheless, there are other aspects that investors in the wine sector consider when making an investment, for instance, the beneficial climate, the lands, the soil, the availability of cheap labor and resources. These factors may be reasons for the development of FDI in the Chilean wine sector as well. Hence, the promoting investment efforts and the trade policy shifts may not be the only reasons.

5.3 The Competitiveness of the Chilean wine Industry

Chile is positioned well when it comes to wine and the competitive advantages Chile has gained only the last decade are many. The wine producers are adaptive to changes and the attractive climate has led to an increase of FDI and thus spillover effects to the Chilean wine cluster. According to Porter, the advanced factors are more important than the basic factors and through increased FDI in the wine industry, these advanced factors have developed and given competitive advantages to the Chilean wine producers. Further, the number of educated oenologists has increased which has given Chile's wine cluster further knowledge and decreased the dependence on foreign knowledge and spillover effects. In the long term, higher educated and skilled human resources, is vital for the Chilean wine industry in order to become a stronger international competitor. Chile is still a developing country and in the future it is important to become more independent to avoid the risk of exploitation. The basic factors, terrain and lands etc. are good and imply many advantages for the Chilean wine cluster. The strategy of Chile today is to produce more high quality wines, thus by further development of the advanced factors, Chile will gain valuable advantages and succeed with its strategy. Moreover, by improving advanced factors Chile would gain a greater share on the world market. However, as Chile aims to become a world leader in wine production it is important that emphasis is put also on protection of the basic factors such as the environment. This is also considerable as the requirements on wine production and export might become more restricted.

In terms of the demand factor, the domestic demand is weak and not very sophisticated. According to Porter, strong and sophisticated domestic demand is important. He argues that, companies in the industry then have to respond to these consumers' needs, which in turn implies competitive advantages, both when it comes to the preparation to meet different needs but also for the prediction of trends in global demand. Hence, the weak home market demand is negative and the Chilean wineries should maybe consider the domestic demand and try to find ways to enhance it. In comparison to this, Chile has been very successful in reaching out to many international customers. Chile has been adaptive and followed the shifting demands, which have contributed a lot to the success of Chilean wine. The broadening of the product portfolio has made it possible for Chile to reach out to even more customers, and improved its position in the international competition. The new challenge for Chilean wine producers today, is to meet the new demands of the growing markets in Asia. If they successfully meet these trends and demands they will reach a big new market, which would improve the position in the world market even more.

Development of related and supporting industries is important for the wine cluster since this would improve the cluster as a whole, make the value chain more efficient and lead to lower costs. Chile's wine industry still lacks most of the supporting industries and the major part of related and necessary products is imported from foreign firms. Once again, this shows a dependency on foreign firms, a dependency that indicates weaker competitiveness of the Chilean wine industry. Thus, if Chile wants to become more competitive, the availability of supporting industries within the cluster is crucial. First then, it will be easier to meet the increasing international competition. Thus, the presence of these industries is something that the Foreign Direct Investment Committee should consider and make efforts to attract.

The industry structure in the Chilean wine sector is developed and good. It is less fragmented and this structure can be both positive and negative. The positive aspect is that the presence of strong exporting companies can lead to a greater position of the Chilean wineries in the world arena. Following this, Chilean wine as a brand gets well known on the international market. In other words, with a few companies that enjoy big market shares, it is possible to produce and export more. Thus, the Chilean wine industry may be more recognized by the international customers. However, the oligopolistic structure may also lead to less domestic competition and hence, reduced development pace. The presence of local rivals contributes to

the creation of competitive advantages. Thus the oligopolistic structure in the Chilean wine industry may be a hindrance. Chile should be a bit careful in this aspect and protect and help SME's in the wine industry in order to create a good structure and more competitive advantages to compete with other wine producing nations. They should also protect SME's in the respect of the importance they have for the wine tourism that is getting bigger and more important for Chile.

The positive attitude of the government and the trade policies has contributed to the development of the wine industry. Without this, Chile's share of the world wine market certainly would be smaller. Thus, the liberalization and good economic climate has led to an increase of FDI and hence, more competitive advantages.

The last factor in Porter's diamond is the chance factor. The chance factor has played a part in the development of the Chilean wine sector the last two decades. The economic crisis in Europe led to the search for alternative suppliers, thus Chile's export of wine increased. The liberalization led to a better economic climate and more FDI, hence, technology and skills improved and the competitive advantages grew. A 'chance factor' will always be present and something a country or industry will not be able to control. For the Chilean wine industry, one concern today is the dependence on foreign demand. Thus, when key markets suffer from a recession or a crisis, this can have unwanted effects and as the domestic demand is weak, the industry cannot lean on it. Hence, in Chile's case it is important to be prepared to changes and to be adaptive. It is also important to be able to use and see the opportunities that the chance factor may give. This ability may imply strong competitive advantages.

Judging from the parts of Porter's diamond framework, Chile has many and good competitive advantages against other countries. Wine producers are adaptive and enjoy good basic conditions for the production of wine. The Chilean wine producers are becoming more recognized in the world and have good strategies that fit the demands. Chile is today ranked as the fifth largest wine exporter and tenth biggest wine producer. With further development of the different factors, especially the advanced, Chile will become even more competitive. It has all the factors and possibilities to make further development possible and it is just a time question until Chilean wine is sold in most of the world's countries.

6. Conclusions

In this chapter we answer our sub-questions and research question presented in the introduction chapter.

How has the export of Chilean wine developed from 1990-2012 and how important is it today?

Chile has historically been very dependent on its mineral exports, especially the copper. Wine, was always a traditional product, but until recently it was not of great significance to Chile. Since the 1990's, however, wine export has increased steadily. The increased openness of Chile, as well as the diversification efforts of exports made by the governments were stimulating factors. The export-oriented strategy adopted by new foreign investors also stimulated export rates, as Chilean wineries imitated the strategy and reached out for the international markets. The improved quality, through the use of new practices and technology, led Chilean wineries to better meet the international demands. An important factor was also the strategy of trade agreements that the governments after 1990 adopted and developed. New markets and costumers could be reached and wine export consequently rose. Hence, several factors can be recognized as reasons for the marked export increase. During the period, wine export has gone from a trade value of slightly more than 50 million USD, to reach a value of 1710.9 million USD in 2011. Price and trade quantity of both bulk- and bottled wine has increased during the period, some years more than others. However, the export of bulk wine has decreased in relation to bottled wine with Denomination of Origin. This development confirms the new strategy of Chilean wineries to increase sales of high quality wines. Moreover, the Chilean wine export to all key destinations has augmented. New markets such as Japan, China and Brazil are now in focus and wine export has in result increased also to these markets. Today, wine export from Chile flows relatively freely as the many trade agreements gives free access to trade partners markets. In 2010, the share of wine export of total exports was 2.2 percent. When comparing this to 1993, when the wine export represented only 1.3 percent of total exports, we can conclude that the wine industry as an export sector has grown in importance. Thus, diversification efforts have had an effect and even though copper and other minerals stands for a large share of the total export, other sectors, such as the wine industry, have grown. Another factor that make the wine sector important is the increasing wine tourism, as tourism in general contributes to economic development.

How have foreign direct investments in the Chilean wine industry developed during 1990-2012?

The liberalization of the Chilean economy and the efforts to attract investments, made under the Pinochet regime, naturally played a key role in the increase of FDI the following years. After the restoration of democracy in 1990, the macroeconomic environment in Chile was stabilized and the continued government support of FDI stimulated the investment climate. Foreign investors found it less risky to move their capital to Chile, a country that provided many opportunities and possibilities for investments. These developments, seems to have been direct reasons for the increase of foreign investments. Thus, in the 1990's FDI commenced to increase and started to rise markedly from 1995. The increase of general FDI inflows continued during the 2000's. Investments were made through joint ventures, green-field investments and investments in existing Chilean companies etc. Foreign investments in the wine industry came mostly from the US, Spain, France and Italy. In 2005, there were about 15 multinational firms operating in the Chilean wine industry, among those for example Miguel Torres (Spain) and Chateau Larose Trintaudon and Viña de Larose (France). FDI has contributed a lot to the growth of the Chilean wine industry as important technology and knowledge was transferred and contributed to organizational and technological development, and thus better quality wines. Of course one reason for increasing FDI in the wine industry might have been the availability good terrains, soil, and labor pool etc. However, the opening and integration of Chile made these basic favorable factors visible in the world market.

How have the trade policies regarding export and foreign direct investment changed with the shifting governments in Chile in the time period post-Pinochet until today?

Our study has shown that throughout the period, all democratic governments have stimulated further opening and integration of Chile in the world economy. Thus, they have followed the same path when it comes to trade policy. The uniform tariff has stepwise been reduced and the use of non-tariff barriers have been restricted and decreased as Chile signed the agreements under GATT and the Uruguay Round, and later became a member of the WTO in 1995. As a member of WTO, the Chilean trade policy had to be adjusted to the agreed WTO guidelines. Thus, Chile agreed on eliminating export subsidies and take measures to adjust regulations concerning anti-dumping and countervailing duties. The adjustment to the WTO agreements has continued throughout the period. Another important development in the late 1990's was the transition from a policy of an exchange rate band to a floating exchange rate.

In parallel with these developments, the governments made efforts to create a good perception of the Chilean environment as beneficial for entrepreneurs and private enterprises. During the 2000's the privatization process was stimulated further.

The essence in the new strategy, of striking trade agreements adopted in the 1990's, was to enhance trade by bilateral, regional and multilateral agreements. Hence, Chile negotiated agreements with several nations and trade blocs. This strategy was followed through the whole period and is still today an important attribute of Chilean trade policy. During the time period the focus on trade with Asian-Pacific countries increased and today those countries are priority markets. Nevertheless, the strategy of trade agreements created concerns that Chile's elaborated system of different tariffs would cause unequal treatment of trade partners, and that it would be problematic for Chile as a WTO member. Today, Chile is more open than ever. The unilateral and multilateral liberalization and the strategy of FTA's, has positioned Chile in the world economy. The government of Piñera, will put further focus in combining export promotion with an extensive promotion of investments, using trade policy measures.

Have shifting trade policies affected the growth of the Chilean wine industry, the international trade, and FDI in the Chilean wine industry from 1990 until present time (2012) and in that case, how?

Trade policy measures during the period 1990-2012 certainly have affected the growth and development of the Chilean wine industry. It has contributed to an increased inflow of FDI, which in turn has stimulated the development of the industry and led to a steady increase of wine export.

7. Suggestions for Further Research

A suggestion for further research is to study the advantages and disadvantages of further liberalization of the Chilean economy. Hence, if there is a critical point, when openness and liberalization no longer is beneficial to a country and the domestic industries. In this respect it would be interesting to look at the Chilean wine cluster and the dependence on foreign investors. Another suggestion would be to evaluate the demand for wine in Asia and the prospects for Chilean wineries in terms of export and FDI. It would be interesting to look at suitable strategies for these markets and the possibility for investment in the wine sectors in Asian-Pacific countries.

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9. Appendix

Figure. 1 The wine regions of Chile

Region: Coquimbo

- Sub-Region: Elqui
- Sub-Region: Limarí
- Sub-Region: Choapa

Region: Aconcagua

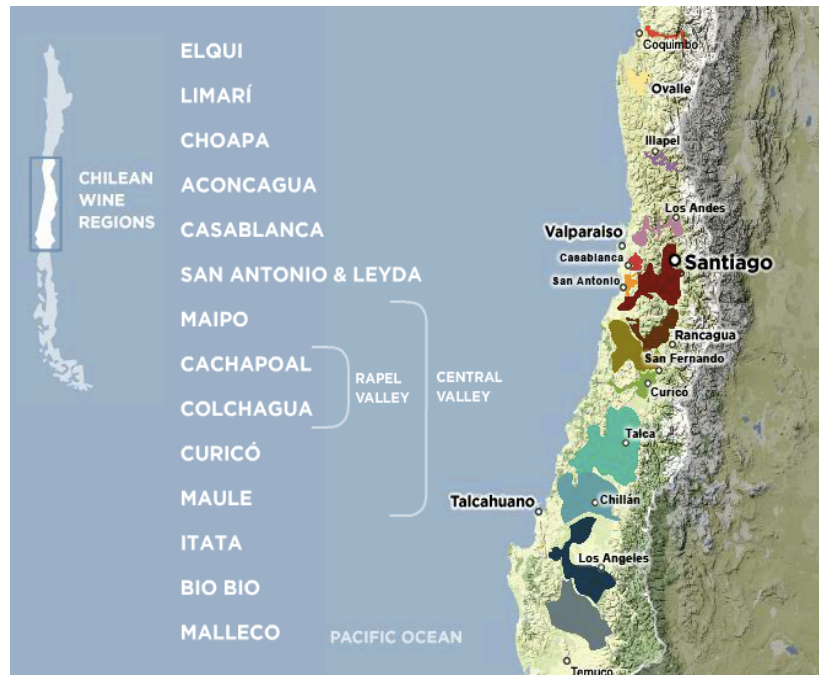
- Sub-Region: Aconcagua
- Sub-Region: Casablanca
- Sub-Region: San Antonio
- Zones: Leyda, Lo Abarca

Region: Central Valley

- Sub-Region: Maipo
- Sub-Region: Rapel
- Zone: Cachapoal
- Zone: Colchagua
- Sub-Region: Curicó
- Sub-Region: Maule

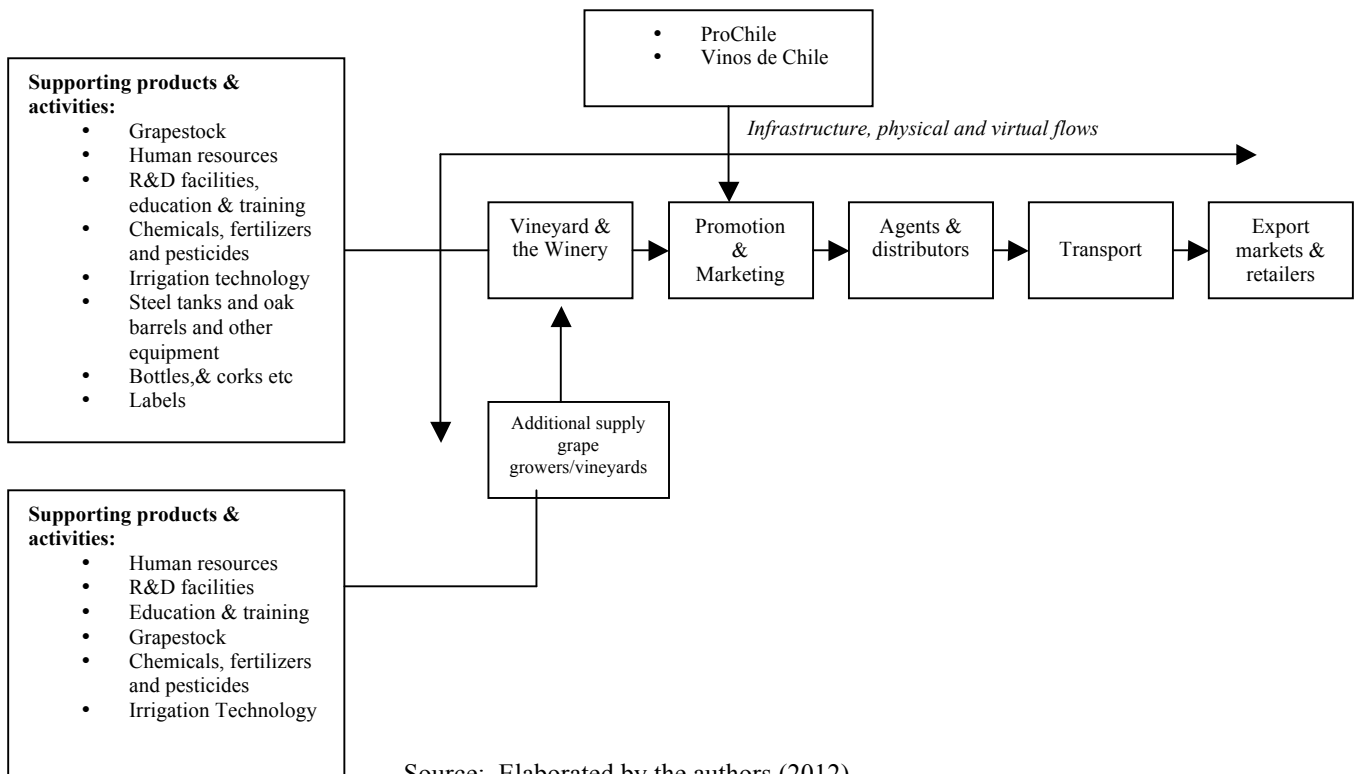
Region: Southern Regions

- Sub-Region: Itata
- Sub-Region: Bío Bío
- Sub-Region: Malleco



Source: Vinos de Chile (2009)

Figure. 2 The Value Chain of Wine – Exporting Actors



Source: Elaborated by the authors (2012)

Chart. 3 Resume of Agreements signed by Chile from 1993-2012

Country/region	Kind of agreement	Signed (year)
Venezuela	Economic Complementation Agreement No.23	1993
Bolivia	Economic Complementation Agreement No.22	1993
Mercosur (1)	Economic Complementation Agreement No.35	1996
Canada	Free Trade Agreement	1996
Mexico	Free Trade Agreement	1998
Costa Rica (FTA Chile-Central America)	Bilateral Protocol Free Trade Agreement	1999
Cuba	Partial Scope Agreement	1999
El Salvador (FTA Chile-Central America)	Bilateral Protocol Free Trade Agreement	2000
European Union	Economic Partnership Agreement	2002
United States	Free Trade Agreement	2003
Corea	Free Trade Agreement	2003
EFTA (2)	Free Trade Agreement	2003
China	Free Trade Agreement	2005
P-4 (3)	Economic Partnership Agreement	2005
Honduras (FTA Chile-Central America)	Bilateral Protocol Free Trade Agreement	2005
India	Partial Scope Agreement	2006
Panama	Free Trade Agreement	2006
Peru	Free Trade Agreement	2006
Colombia	Free Trade Agreement	2006
Japan	Economic Partnership Agreement	2007
Guatemala (FTA Chile-Central America)	Bilateral Protocol Free Trade Agreement	2007
Australia	Free Trade Agreement	2008
Ecuador	Economic Complementation Agreement No.65	2008
Turkey	Free Trade Agreement	2009
Malaysia	Free Trade Agreement	2010
Nicaragua (FTA Chile-Central America)	Bilateral Protocol Free Trade Agreement	2011
Vietnam	Free Trade Agreement	2011

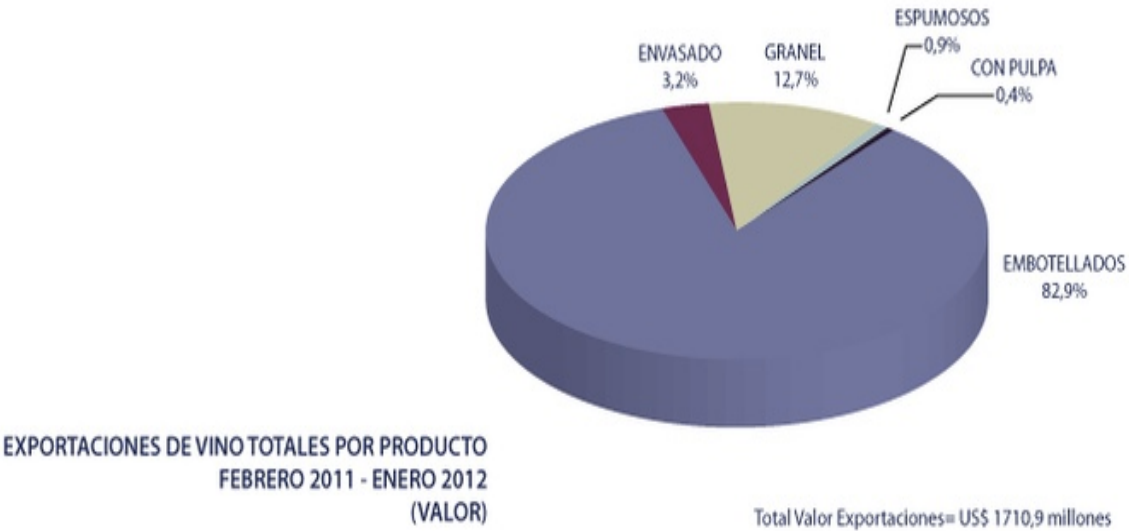
Agreements in negotiation

Country/region	Kind of agreement
Thailand	Free Trade Agreement
Trans Pacific Partnership (TPP) (4)	Free Trade Agreement
China Investments	Chapter of investments of the FTA
Deepening process India	Partial Scope Agreement

- (1) El Mercado Común del Sur (Argentina, Brazil, Uruguay, Paraguay and Chile (associate member))
(2) European Free trade Association (Iceland, Liechtenstein, Norway and Switzerland)
(3) P-4 (Brunei, Chile, New Zealand, and Singapore)
(4) Trans Pacific Partnership (Australia, Brunei, Chile, United States, Malaysia, New Zealand, Peru, Singapore and Vietnam)

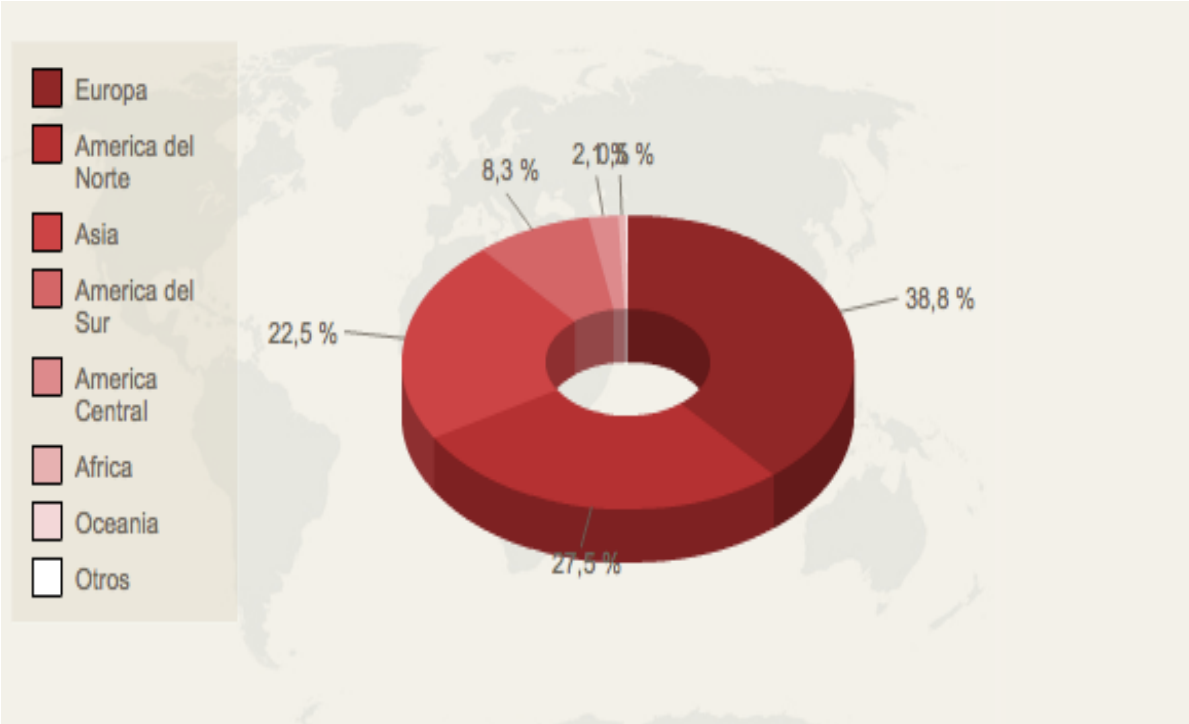
Source: Direcon, (2012). b, Elaborated by the authors (2012)

Figure. 4 Total wine export by product, February 2011- January 2012 (value)



Source: Vinos de Chile (2012). d

Figure. 5 Distribution of the Total Wine Export by continent (2012)



Source: Intelvid Ltda (2012)

Figure. 6 Trade Value and Trade quantity of Chilean Wine export from 1990-2010*Trade Value (USD) and Trade Quantity (Netweight, kg)*

Year	Trade Value	Trade Quantity
1990	\$50,481,756	No estimation
1991	\$81,485,984	92,992,656
1992	\$116,260,624	85,663,728
1993	\$124,712,720	93,298,016
1994	\$138,170,256	114,592,504
1995	\$175,547,840	137,568,752
1996	\$285,014,208	197,266,288
1997	\$416,215,264	315,009,984
1998	\$505,987,200	266,048,544
1999	\$517,970,540	No estimation
2000	\$573,170,890	296,371,835
2001	\$641,244,624	329,234,161
2002	\$604,788,331	281,747,712
2003	\$668,333,678	396,233,224
2004	\$831,312,064	467,056,607
2005	\$866,702,358	413,789,907
2006	\$956,372,342	469,813,462
2007	\$1,247,426,395	604,600,119
2008	\$1,360,945,079	584,118,249
2009	\$1,364,523,254	689,325,315
2010	\$1,528,143,627	726,597,732

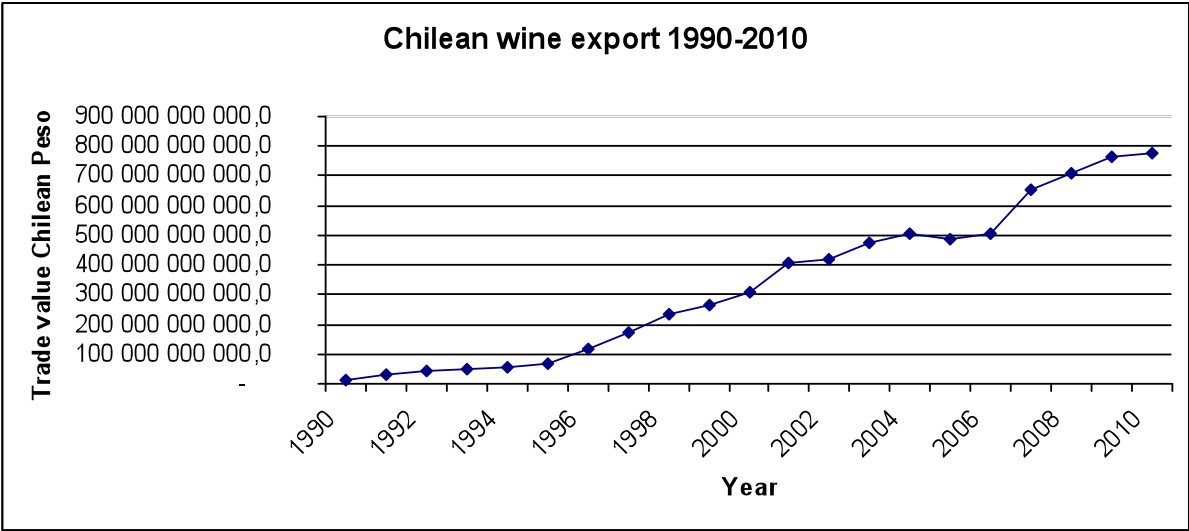
Source: UN Comtrade (2012)

Chart. 7 Trade Value of Chilean wine export from 1990-2010 *(In Chilean Peso)*

Year	Trade value in Chilean Peso
1990	15 400 065 448,9
1991	28 469 002 688,0
1992	42 154 707 134,9
1993	50 405 140 042,4
1994	58 056 378 166,1
1995	69 652 116 476,8
1996	117 502 807 532,2
1997	174 519 060 195,2
1998	232 900 848 288,0
1999	263 533 051 341,2
2000	309 277 280 535,1
2001	407 151 861 562,6
2002	416 662 872 759,1
2003	475 913 904 969,2
2004	506 709 642 369,9
2005	485 153 978 937,7
2006	507 145 125 515,8
2007	651 730 394 331,7
2008	711 039 365 974,3
2009	765 306 512 238,4
2010	779 735 285 676,8

Source: UN comtrade (2012) & IMF International financial statistics (1990-2011)

Figure. 8 Trade Value of Chilean wine export from 1990-2010 (Measured in Chilean Peso)



Source: UN comtrade (2012) & IMF International financial statistics (1990-2011)