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# Savings, Investment and Growth: Factors at Stake

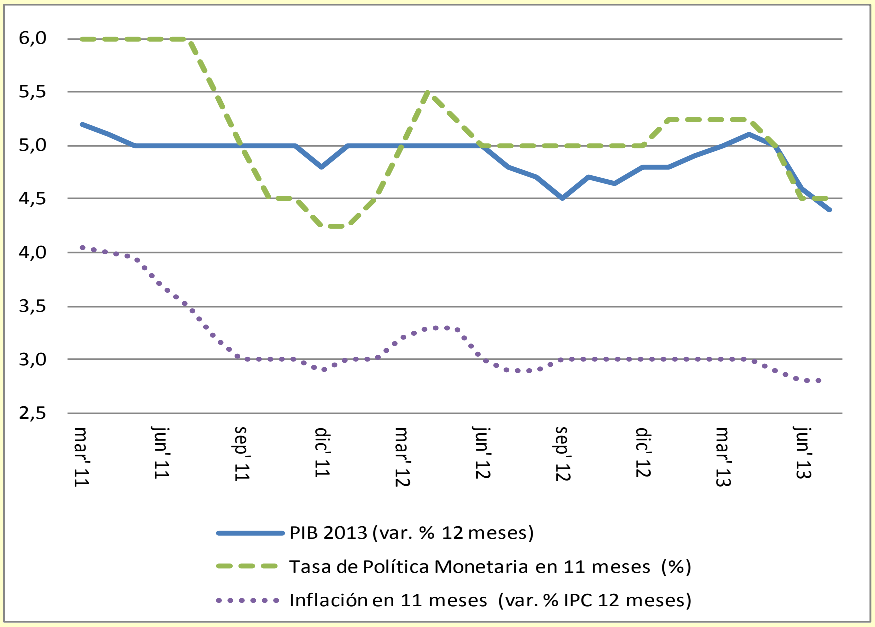
**Creating a propitious climate for investments is crucial to grow, create employments and increase productivity, all of them key factors of the successful path that has led Chile to a regional leadership position. The counterpart of this investment is always savings, either domestic or external. Currently, the latter is at fairly high levels, thus the sole additional and realistic financial source is domestic savings, particularly those coming from the private sector.**

The last figures published by the Central Bank of Chile (BC) for the Gross Domestic Product (GDP) and the Domestic Demand for the first quarter of this year, were 4.1% and 6.8% respectively. These figures, together with other slender sectoral indicators[i] and the systematic diminution of the expectations of private agents and the BC, which in its last Monetary Policy Report (IPOM) even reduced by half a percentage point its growth projection for 2013 from 4.5-5.5% to 4.0-5.0%, tend to confirm that the anticipated deceleration of the local economy is already on the way. Furthermore, in the years to come we will probably not see such positive numbers as those of the last three years following the crisis of 2009. (See Chart 1)

This phenomenon was expected and in fact in the beginning it was considered a healthy process that would get the country closer to a growth level more aligned with that which is sustainable in the long run,[ii] keeping at a distance the phantom of inflationary pressures. Today, on the contrary, it is understood that this lower activity can intensify if it is a reflect of the manifest deterioration of the business climate, which can accelerate the investment drop, that has already been reduced by 5.1% in real terms and seasonally adjusted between the fourth quarter of 2012 and the first one of 2013, and threaten the economy's potential growth for the next periods if this trend continues.

Chart 1

ECONOMIC EXPECTATIONS SURVEY




Source: Banco Central de Chile

There are several factors, both internal and external, that converge in this diagnosis, among which we can highlight the following:

- **A possible unfavorable turn of the global economy**: paradoxically, the incipient better results concerning employment in the North American economy have allowed having expectations that the strong monetary stimulus of the Federal Reserve will soon start to be withdrawn. This belief has been reaffirmed by the same issuing institute through its statements, and it could entail a smaller dynamism of the USA demand, at least in the short-run. On the other hand, the uncertainty in relation to the dimension of the Chinese lesser dynamism, its strategy of changing its growth focus from investment to consumption, and the impact on its demand for copper, make the option of postponing investment projects in the country relatively more attractive.

- **Disincentives for project approvals**: the small certainty granted today by the compliance of the requirements of the Environmental Impact Assessment System (SEIA, in Spanish) and the associated Environmental Qualification Resolution (RCA, in Spanish), leads to an increasing judicialization of large investment projects, increasing the process' discretionary actions, which has no doubt entailed investment delay and disincentive. In the same line, the lack of clarity regarding the pertinence of applying the Agreement 169 of the International Labor Organization (ILO), particularly in relation to the indigenous consultation – Article 6- is another uncertainty factor to be considered in the evaluation of potentially beneficial projects.

- **Political scenario**: the current administration was especially determined in this matter with the pack of reforms called "Competitive Impulse Agenda", with 51 of its 60 measures already implemented and the "Pro- Investment and Competitiveness Agenda", where 8 of 20 have been carried out. Both agendas are coordinated by the Competitiveness Office of the Ministry of Economy, which was especially created for this purpose. Unfortunately, it seems that the government's initial impulse on this matter has diluted, neglecting new micro-reforms which could result in greater competitiveness, for example, energy and work.

- **Electoral scenario**: in the middle of the political battle, there are voices calling for a change of direction. They question the free market model and have established redistribution as a priority, for example, through a heavier tax burden and the establishment of "universal rights", instead of growth, investment and productivity.

**Investment, Growth and Savings**

Internal factors of the diagnosis suggest that – for different reasons – it has been forgotten that the road started by Chile in the last 40 years has been especially successful. The country has a dynamic economy and no anti-competitive barriers, which is what boosts social mobility and poverty uprooting most.
Figures are known. It is enough to recall that in the last 25 years, while the world and Latin America grew at a rate of 3.5% and 3.1% respectively, Chile managed to grow at a 5.5% rate. Still more important, according to the World Bank,[iii] Chile is the country with most upward social mobility in Latin America, and ECLAC statistics confirm that our country has reduced poverty from 45% to 10% in just 22 years.

It is thus evident that we have to put economic growth in the first priority again, which of course demands big efforts in investment, source of employment and productivity matters. It should not be forgotten that other countries, with a development level similar to Chile today, grew rapidly and invested around 30% of their GDP. Some of them are Singapore, Korea, Hong Kong, Spain, Portugal and Ireland (see Table 1).

However, although investments in Chile have grown, they only account for 24% of the GDP, above the average of 1996-2012 (see Chart 2). Nevertheless, this investment is insufficient and far from the goal of 28% of the product, that is consistent with maintaining a potential growth rate close to 5%,[iv] which allow us to reach a product per capita similar to Portugal in 2018, one the poorest countries of the developed world.

Table 1

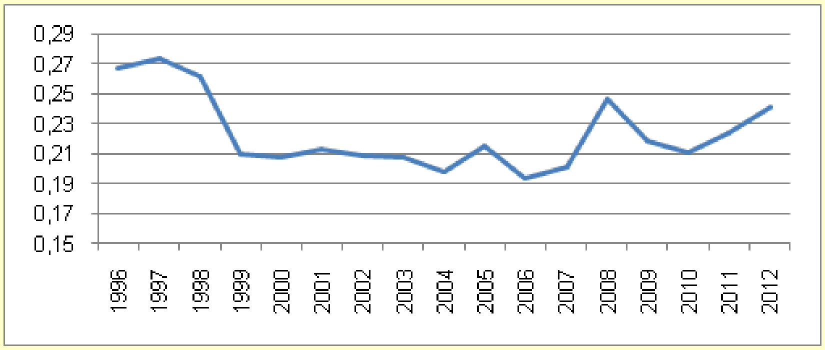
GROSS SAVINGS, AVERAGE 1990-2013 (% OF THE GDP)

| | | | | | |
|---|---|---|---|---|---|
| China | 41.4 | Ukraine | 23.1 | Germany | 20.1 |
| Korea | 31.7 | Saudi Arabia | 23.1 | Finland | 20.1 |
| Thailand | 30.6 | United Arab Emirates | 22.8 | Israel | 19.9 |
| Morocco | 30.1 | Hungary | 22.7 | Argentine | 19.63 |
| Indonesia | 29.4 | Switzerland | 22.7 | Ireland | 19.62 |
| Estonia | 29.1 | Venezuela | 22.7 | Denmark | 19.53 |
| India | 29.1 | Panama | 22.7 | France | 19.30 |
| Malaysia | 28.8 | Croatia | 22.4 | USA | 18.39 |
| Vietnam | 28.5 | Bangladesh | 22.4 | Dominican Republic | 18.36 |
| Singapore | 28.1 | Norway | 22.2 | Sweden | 18.16 |
| Czechs Republic | 27.8 | Bulgaria | 21.7 | Paraguay | 18.00 |
| Slovakia | 26.5 | Peru | 21.5 | Brazil | 17.99 |
| Australia | 26.1 | Belgium | 21.5 | Pakistan | 17.86 |
| Hong Kong | 26.0 | Canada | 21.4 | Uruguay | 17.41 |
| Mexico | 25.3 | New Zealand | 21.1 | Cameroon | 17.28 |
| Spain | 24.6 | Colombia | 21.1 | Cambodia | 17.17 |
| **Chile** | **24.2** | Poland | 21.0 | South Africa | 17.10 |
| Portugal | 23.9 | Greece | 20.9 | United Kingdom | 16.75 |
| Russia | 23.8 | Ecuador | 20.9 | Bolivia | 16.47 |
| Slovenia | 23.8 | Costa Rica | 20.9 | El Salvador | 16.18 |
| Austria | 23.7 | Turkey | 20.8 | Togo | 14.78 |
| Nigeria | 23.5 | Netherlands | 20.4 | Central African Republic | 11.40 |
| Zimbabwe | 23.4 | Italy | 20.4 | Sierra Leona | 10.76 |
| **Average** | **23.4** | Iceland | 20.2 | Ivory Coast | 10.42 |

Source: IMF

Chart 2

INVESTMENT 1990-2012 CURRENT TERMS (% OF THE GDP)




Source: Banco Central de Chile

When considering the investment that the country requires, we cannot forget its saving counterpart. One of the basic macroeconomic identities is absolutely clear: investment is financed with savings, either domestic or foreign, private or governmental. From the composition of the expenditure of the Gross Domestic Product we get:

GDP = CONSUMPTION + INVESTMENT + SPENDING + (EXPORTS – IMPORTS)

GDP – CONSUMPTION – SPENDING – (EXPORTS – IMPORTS) = INVESTMENT

Domestic Savings + External Savings = INVESTMENT

Private Savings + Government Savings + External Savings = INVESTMENT

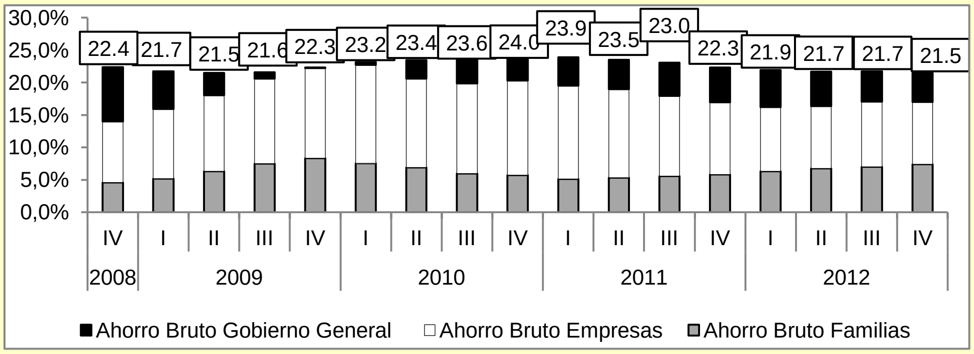
For example, for 2012 in current terms:

16.5% + 5% + 3.5% = 25%

Then, as this identity has to be complied with at all moments, it is evident that the current domestic saving level is insufficient if the aim is to keep and even increase the investment rate. Particularly when the external saving level (5% of the GDP) and fiscal saving (5% real and 3.3% structural) have probably reached their ceiling.

Chart 3

GROSS SAVINGS AS PERCENTAGE OF THE GDP




Source: Banco Central de Chile

If we consider that a third of private savings come from households, including social security, while two thirds derive from the companies' retained earnings, the campaign announcements in tax matters are concerning. The New Majority seeks to continue with the tax increase for the purpose of greater public spending – which has already grown between 2006 and 2013 from 17% to 22% of the GDP-, and now aims at increasing this percentage to 25%.

Moreover, it is not a tax burden increase focused on efficient taxes, but rather on corporate savings. They consider the profits collected in the Global Complementary base, eliminating the current system which precisely stimulates the reinvestment of the profits in the company, or in others, through the capital market, in order to finance a strongly redistributive State, which in turn damages the incentives to effort and savings at the level of the families.

**Conclusions**

Creating a propitious climate for investments is crucial to grow, create employments and increase productivity, all of them key factors of the successful path that has led Chile to a regional leadership position. The counterpart of this investment is always savings, either domestic or external. Currently, the latter is at fairly high levels, thus the sole additional and realistic financial source is domestic savings, particularly those coming from the private sector.

Unfortunately, we observe a deteriorated scenario caused by the lack of political will to remove the red tape, regulatory and legal obstacles, in addition to a potential corporate tax burden increase, which conspires against such necessary savings.

**In brief…**

- When considering the investment that Chile requires, we cannot forget its saving counterpart. One of the basic macroeconomic identities is absolutely clear: investment is financed with savings (domestic or foreign, private or governmental).
- The New Majority seeks to continue with the tax increase for the purpose of greater public spending – which has already grown between 2006 and 2013 from 17% to 22% of the GDP-, and which now the opposition seeks to raise to 25%.
- We observe a deteriorated intention of removing red tape, regulatory and legal obstacles, in addition to a potential corporate tax burden increase, which conspires against savings.

[i] Although the Manufacturing Index of the National Statistical Institute (INE) dropped in May by 4.2% and the Industrial Production Index scarcely increased in 12 months, trade is still dynamic and growing at two-digit numbers.

[ii] In its minute of August 22nd, 2012, the committee estimates a potential product of 5.0% for 2013, 2014 and 2015.

[iii] Economic Mobility and the Rise of the Latin American Middle Class, World Bank.

[iv] Public Issues 1,060. Tax Reform Bill: Main Issues. May, 2012.