

## Updating of Fiscal Figures: End of the so-called “Supercycle”

**Figures indicate that the large financial slack derived from copper between 2004 and 2012 has come to an end. The public finance situation estimated for this year is restrictive, a scenario that should be maintained henceforward. The political discussion faces this point erroneously, since it establishes the idea that we are a rich country and the time has come to share this wealth in a better way. However, it neglects the fact that the proposed distribution process negatively affects what is already considered assured.**

Recently, the Budget Office (DIPRES, in Spanish) presented the updated fiscal balance and estimates for 2012 and 2013. It should be highlighted that these figures reveal very clearly that the large financial slack derived from copper between 2004 and 2012 has come to an end. In the recent Chilean history there is no such sharp and especially extended increase of terms of trade. The positive effects of this situation are evident, but a shock of such long duration creates the problem that it is perceived as a permanent shock, and thus it is incorporated as a revenue source in that condition.

The Chilean fiscal policy, based on the criterion of eliminating the cycle effects in the expenditure determination, in theory should correct this situation. But, when the copper price increase is incorporated in the trend price, this does not occur. In fact, between 2004 and 2013

the copper trend price grew from US\$0.88/pound to US\$3.06/pound, with an obvious counterpart of a strong increase in the structural revenue of the Public Treasury and, therefore, can be allocated to permanent spending. Nevertheless, this situation has started to change back, since the copper trend price could actually fall from now on, and there is also a very significant increase of the copper production costs, which are difficult to revert in the short run. The structural balance methodology does not incorporate the production cost among the trend variables, but it obviously has an impact on the long term incomes, being this the main phenomenon behind the estimated structural balance shortfall for this year.

The analysis of the fiscal figures presented by the DIPRES shows better results than those estimated for 2012, partly explained by a greater dynamism of the economy, together with a sub-execution of expenditures with respect to the budget approved for that year. In 2012, the economy revealed a stronger dynamism than expected, which generated effective tax revenues above the budget, following a trend that began in 2010. However, the copper price was lower than the budget and, additionally, the costs' upward trend was maintained. Consequently, the revenues derived from private and public mining activities dropped by 14.2% and 31.1% real respectively, in relation to what was collected in 2011. We will later see that this trend has continued throughout the present year. The non-mining tax collection was US\$3.5 billions higher than the budget, while mining revenues registered a decrease regarding the US\$2.9 billion budget. These trends were also maintained in the cyclically-adjusted revenues. The non-mining tax component was US\$2.754 billions above the expected, while the mining industry contributed with US\$1.99 billions less than the estimations contained in the Budget Law. Anyhow, in both measurements, the revenues' situation was more comfortable than the estimates; therefore, the downturn of copper as a revenue source was more than compensated by the activity's dynamism and the collection's efficiency.

On the other hand, spending was below the budgeted level, with a sub-execution of less than 1% -somewhat lower than that of previous years- and a real growth of 4.7%, which means that it is feasible to comply with social commitments without increasing the size of the State in the economy. In terms of the GDP, total spending was equivalent to 21.5%, lower than 2009's 23.4%, but still above 2008's 20.3%. The sub-execution was due to lesser subsidies and transfers and less capital expenditure, partly explained by the legislative delay in the bills' approval. All the same, the item of subsidies and grants increased by 10.1% real, which shows that the emphasis of fiscal policy has been put on social spending. However, it is a matter of concern that both the expenditure on staff and consumer goods and services was above the budget, with real growth rates of 6.2% and 6.4% respectively.

The final 2012 balance indicated an effective surplus of 0.6% of the GDP, and a structural deficit of 0.4% of the trend GDP. This result lies within the downward trend of the structural deficit, from 3.1% of the GDP in 2009, and actually shows a significant fiscal consolidation effort in this period.

However, part of this achievement will probably be reverted during the current year, not only because spending will grow at a relatively high rate, but also, and mainly, because the figures of the first months and estimated for this year reveal the end of the so-called "super cycle" of copper in the fiscal accounts, which envisages an uncertain scenario henceforward. Thus, we could say, as opposite coalition technicians argue, that this is one more reason in favor of a tax reform. Nevertheless, supporting this thesis is equivalent to saying that economic growth does not matter, when figures of

these years eloquently indicate that dynamism of the economic activity is not only the best labor policy but also the best social policy, also allowing significant fiscal revenue increases. It would be frankly absurd to face a period of minor mining revenues and, thus, lower national income, with significant increases in corporate tax rates, since the impact on growth would be quite important. In this point, the tax base is being affected. In fact, we are already beginning to see this phenomenon in the tax receipts, as we will see below.

The fiscal figures of the January-May period were concerning, and the issue goes beyond the strong cutback of mining revenues. The non-mining taxation increased by 3.1% real, in spite of the retroactive effect of the tax increases approved last year. The reason lies probably in the fact that not only the mining companies, but the business sectors in general are facing margin reductions as a result of cost pressures. We should not forget that, in the end, the State is partnered with the companies through the taxes, so their results are not indifferent to it.

Obviously, the more complex aspect is the behavior of revenues coming from the mining sector. The private mining taxation dropped 36% real in relation to the same period of last year, and the contribution of CODELCO decreased 64% real. By way of comparison, the price drop in that period accounts for 7% with respect to the same period of the previous year; therefore, this smaller contribution is mainly explained by higher costs. We can certainly affirm that –among others- the energy issue is taking its toll on public finance.

In the first five months, spending registered a real growth of 7.1%, which according to the DIPRES is partly explained by a more even execution during the year, which should entail a moderation of the expansion rate in the current semester. In the first five months of 2012, 35.5% of the budget was executed, a figure which rises to 36% in the same time span of this year. The item with the highest increase was subsidies and grants, with 14% real. The expenditure on staff was also quite high, with 8.3% real, which seems concerning; and capital expenditure showed a growth of 5.8% real.

The situation of the first five months led to a shortfall of fiscal estimates for this year, mainly as a result of the lesser contribution from the mining sector. As we stated earlier, this is probably the most relevant aspect of the fiscal analysis. Since this shortfall is not explained by lower prices, but by higher costs, it has a more permanent character. As we indicated in Public Issues N° 1,112, the “goose that lays copper eggs” is becoming exhausted; therefore, a responsible attitude of political leaders should be to moderate the spending promises, because they might lack the necessary funds. Additionally, the actual condition makes it evident that the best way to procure resources to the State is not by increasing taxes in an economy facing a national income decrease, but to solve the energy issue.

According to the DIPRES' estimates, the non-copper tax revenues will probably register an increase of barely 0.9% real this year, and will be close to US\$800 millions below the budget. Mining tax revenues will probably drop 32.5% real, with US\$ 240 millions below estimates.<sup>i</sup> In a somewhat optimistic way, the DIPRES estimates that the contribution of CODELCO will drop 14.4% and will be US\$1.8 billions below the budget. In total, lower revenues amounting to US\$ 2.8 billions, a drop that is mitigated by other revenues slightly above the budget like, among others, the social security contributions.

As we said, since these drops are not explained by cyclical factors, the structural incomes also show a decrease with respect to the budgeted US\$ 1.6 billions. On the other hand, expenditures are also adjusted downward by US\$1.11 billions in relation to the calculations. The lower estimated spending is partly explained by the delay in the proceeding of some of the bills. The *Transantiago* bill (public transportation system), the school subsidy bill for the middle class and the bills concerning pension incentives for public employees are among the most significant initiatives. Regarding the effective 2012 expenditure, fiscal spending will probably register a real growth of 5.9% this year; thus, during these four years, the expenditure should register an average real growth of 5.1%, compared with an average GDP increase of 5.5%. In the former government, these figures accounted for 10.5% real for spending and 3.3% for the GDP. It strongly calls our attention that the own candidate of the opposite coalition and members of her team are now criticizing the present government for an alleged lack of fiscal responsibility when, in a mid-term analysis, fiscal sustainability depends on how much spending grows in relation to the revenues, which are crucially determined by the evolution of the economic activity. Chart 1 shows a summary of the figures indicated above.

The lesser revenues and expenditures estimated for the current year result in an effective revenue deficit of 1.2% of the GDP, equivalent to the structural balance estimates. The Budget Law for 2014 should be adjusted to a structural balance of -1% of the GDP, corresponding to the goal set by the government. This means that the expenditure growth rate should be moderated with respect to the estimates for this year.

In short, the public finance situation estimated for this year is restrictive, a scenario that should be maintained henceforward. The political discussion faces this point erroneously, since it establishes the idea that we are a rich country and the time has come to share this wealth in a better way. However, it neglects the fact that the proposed distribution process negatively affects what is already considered assured.

Chart 1

FISCAL SITUATION JANUARY-MAY 2013 AND ESTIMATED FOR  
CURRENT YEAR

|   | Jan-May<br>2013<br>(real<br>growth<br>rate) | Budget<br>2013  | Current<br>Estimate<br>2013 | Difference<br>(%) | Real<br>Growth<br>%<br>r/a<br>2012 |
|---|---|-----------------|-----------------------------|-------------------|------------------------------------|
|   |   | (CLP\$billions) |                             |                   |                                    |
| <b>CURRENT REVENUES</b>                         | -4.6  | 29,601          | 28,406                      | -4.0              | -2.6                               |
| Net revenues from taxation                      | -1.1  | 23,252          | 22,733                      | -2.2              | -2.0                               |
| - Private mining taxation (GMP10) <sup>ii</sup> | -35.8                                       | 1,512           | 1,393                       | -7.9              | -32.5                              |
| - Remainder of tax-payers                       | 3.1   | 21,740          | 21,340                      | -1.8              | 0.9                                |
| Copper, gross                                   | -63.7                                       | 2,615           | 1,714                       | -34.5             | -14.4                              |
|   |   |                 |                             |                   |                                    |
| <b>CURRENT EXPENDITURES</b>                     | 7.3   |                 |                             |                   |                                    |
| Staff   | 8.3   |                 |                             |                   |                                    |
| Goods and services                              | 0.4   |                 |                             |                   |                                    |
| Subsidies and grants                            | 14.0  |                 |                             |                   |                                    |
|   |   |                 |                             |                   |                                    |
| <b>TOTAL REVENUES</b>                           | <b>-4.5</b>                                 | <b>29,632</b>   | <b>28,443</b>               | <b>-4.0</b>       | <b>-2.5</b>                        |
| <b>TOTAL EXPENDITURES</b>                       | <b>7.1</b>                                  | <b>30,665</b>   | <b>30,119</b>               | <b>-1.8</b>       | <b>5.9</b>                         |
|   |   |                 |                             |                   |                                    |
| <b>RESULT (% of the GDP)</b>                    | <b>0.8</b>                                  | <b>-0.8</b>     | <b>-1.2</b>                 |                   |                                    |
| <b>Cyclically-adjusted balance</b>              |   | <b>-1.1</b>     | <b>-1.2</b>                 |                   |                                    |

Source: DIPRES.

### In brief...

- Figures clearly show that the large financial slack derived from copper between 2004 and 2012 has come to an end.
- The 2014 Budget Law should be adjusted to a structural balance of -1% of the GDP, a goal set by the current government.

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<sup>i</sup> The drop is due to the fact that the payment of the single First Category Income Tax was not repeated by one corporate taxpayer.

<sup>ii</sup> GMP10 refers to a group of ten large private mining companies including the following: Escondida, Collahuasi, Pelambres, Anglo American Sur, El Abra, Candelaria, Anglo American Norte, Zaldívar, Cerro Colorado and Quebrada Blanca. DIPRES has adopted this denomination for classifying tax revenues. (T.N.)