

ECONOMIC GROWTH DOES MATTER

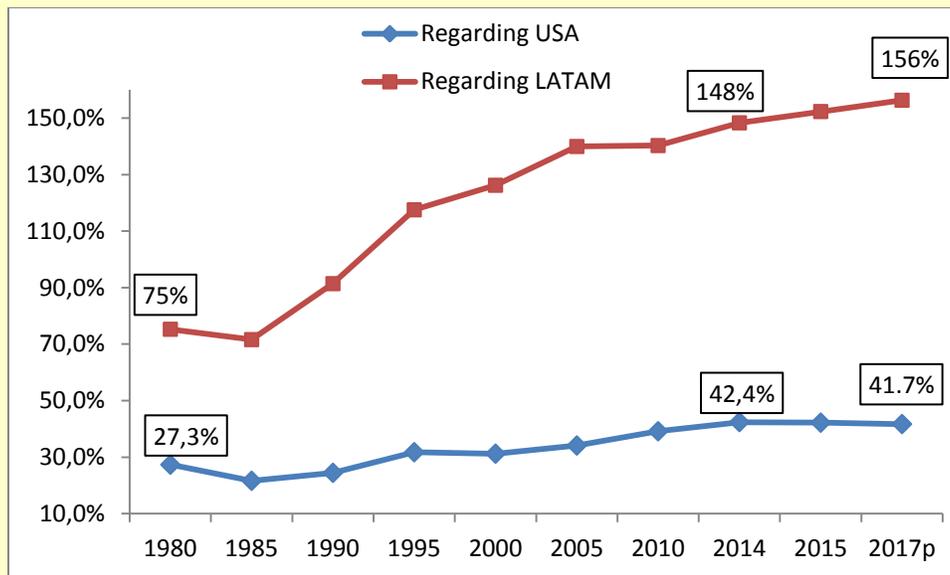
- Chile's record economic growth in the last decades has clearly entailed an unprecedented improvement in the quality of life and opportunities for the entire population. Thus, between 1990 and 2013, it accounts for 67% of the poverty reduction.
- After two years of poor economic growth and a government that has demonstrated with facts to have forgotten the importance and benefits of growth, the message given by the Ministries of Finance and Economy, which includes "22 Measures to Boost Productivity and Increase the Economy's Growth Capacity", is optimistic.
- These 22 measures proposed by the government, which for the most part aim at the right direction, emphasize once again the relevance of economic growth. However, they are second-line features compared with the deep anti-growth reforms that the government has carried out.

During the last three decades, Chile has increased its real Gross Domestic Product (GDP) systematically faster than developed countries, thereby narrowing its per capita income gap in relation to them. Moreover, our country has also grown faster than Latin America, which makes it the most prosperous nation in the region. In fact, the GDP has expanded more rapidly than the rest of the world in general, being now qualified as an "example" for other developing countries.

This exemplary growth has been observed during high- and low-price cycles of raw materials, as well as under governments with different political orientations, but which had always –until now– put economic growth as a necessary condition to pursue other goals.ⁱ A sort of consensus that has been put off by reforms with very adverse impact, but is now included in the agenda again.

CHILE IS GETTING CLOSER TO DEVELOPED COUNTRIES AND EXCEEDING LATIN AMERICA

Chart 1: Chile's GDP per capita (PPP) as a percentage of the USA's and Latin American's GDP



Source: L&D based on data of the 2015 IMF WEO.

CHILE: GROWTH AND WELLBEING

Chile's record economic growth in the last decades has clearly entailed an unprecedented improvement in the quality of life and opportunities for the entire population. Next, a handful of indicators show just a small part of the country's economic transformation and the benefits of an accelerated growth.

Poverty Reduction

The poverty rate reduction in the country has been simply extraordinary. In 1990, according to the traditional methodology, 38.6% of the people were under the poverty line, and in 2013, only 11.7%. A look at the speed of poverty reduction shows that poverty tends to decrease faster in higher-growth periods: between the years 1990 and 2000, annual growth was 6.6% and the variation in the poverty rate was 6.3% each year (dropping from 38.6% to 20.2%), while between 2000 and 2013, the annualized growth rate was 4.4% and the variation of the poverty rate was 4.1% annual (from 20.2% to 11.7%).

More rigorous methodologies such as the Datt and Ravallion (1992) analysisⁱⁱ allow decomposing poverty rate changes, under certain assumptions, into three components -the effect of economic growth, redistribution and a residual term-, thereby obtaining an estimate of the “pure” effect of economic growth, reflected on the average salary, *vis-à-vis* social and redistributive policies. Following this methodology, and using data from the CASEN surveys, Henoch and Larraín (2015)ⁱⁱⁱ find that between 1990 and 2013, economic growth accounts for 67% of the poverty reduction, while only 25% is explained by the distributive effect. They discover that “*with an economic growth of 1% annual, [Chile] could go from a poverty rate of 14.4% (according to the new official methodology) to a rate between 11.8% and 13% by 2020. Instead, if the average annual growth were 5%, the poverty rate would reach a figure between 3.7% and 8.6%. In other words, four additional percentage points of annual growth would mean having between 1,421,031 and 835,233 persons less in poverty conditions by 2020*”.

In the same line, ECLAC, in its *Social Panorama of Latin America 2015*^{iv}, uses a similar methodology and finds that between 55% and 65% of the poverty reduction in the country, in the period of 2010-2014, is explained by economic growth, through increases in salaries and employment.

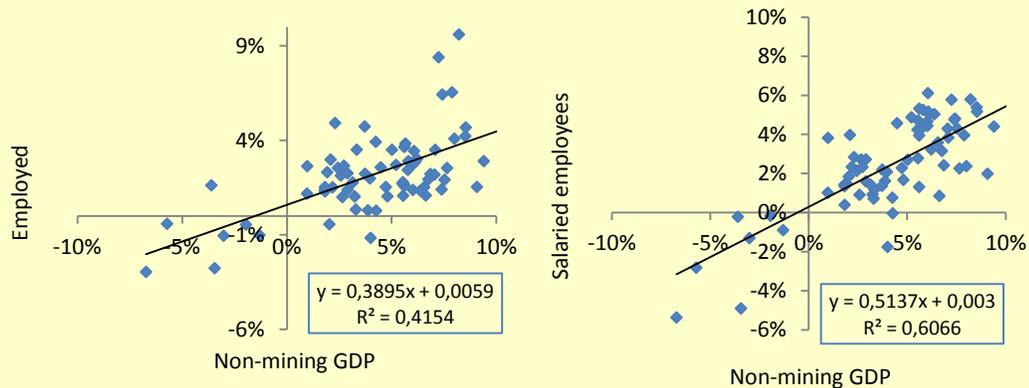
Employment and Salaries

As ECLAC recognizes, the recently analyzed -inverse- relationship between poverty and growth is greatly related to employment and salaries, which are the main income sources for most families.

Between 1996 and 2015^v, the salaried job creation rate, which is generally associated to greater stability and quality, and the real growth of the non-mining GDP (to avoid the effect of marked mining cycles), show a strong positive correlation: a 1-point increase in the non-mining GDP growth rate is related to an additional 0.5 point in the salaried job creation rate, which at the end of 2015 is equal to an additional creation of slightly more than 28 thousand salaried jobs each year. From the perspective of the Okun’s Law, and according to a document of the Central Bank of Chile (BCCh)^{vi}, for every growth point, the unemployment rate decreases by one-third of a point, which would be equal to more than 25 thousand people being no longer unemployed today.

It should be noted that the relationship between total employment and economic growth is positive, but lower than for salaried employees; during periods of limited dynamism, own-account employment tends to compensate for a slower creation of salaried jobs. This can be clearly appreciated in the Chilean labor market today.

GROWTH AND EMPLOYMENT CREATION ARE TWO SIDES OF THE SAME COIN
Chart 2: Non-mining GDP, Employed and Salaried Employees (var. % 12 months)



Source: L&D based on data from the National Statistics Institute (INE) and BCCh.

Access to Goods, Education and Health

Currently, the historical poverty reduction, the employment growth and the salaries' increase have allowed families of all income quintiles to have better access to goods and services, which were exclusively for the richer a few decades ago. This goes from the most basic factors like access to sewage systems and urban drinkable water, which in 1990 did not exceed 30% and 60% respectively; nevertheless, today, according to the Superintendence of Sanitary Services, it is practically 100%. But this reality is also reflected on the access to other goods that improve the quality of life and save time for remunerated work or leisure, such as washing machines, refrigerators or computers.

CHILEAN HOUSEHOLDS HAVE ACCESS TO GOODS LIKE NEVER BEFORE

Table 1: Access to goods (% of households that have)

	Washing Machine	Refrigerator	Cable TV	Computer	Mobile Phone
2013	87%	95%	57%	57%	89%
2011	82%	92%	47%	50%	79%
2009	74%	91%	40%	42%	65%
2006	67%	89%	27%	33%	54%
2003	59%	85%	23%	25%	36%
2000	50%	82%	-	18%	18%
1998	47%	78%	-	-	-
1990	42%	52%	-	-	-

Source: L&D based on data from CASEN surveys.

The access to education has taken a huge leap with the country's economic transformation. While in 1990 only 3% of the young between 18 and 24 years of the poorest 20% attended higher education, in 2013, 27% did it, which is similar to the percentage of young belonging to the richest 20% who attended higher education in 1990.

ACCESS TO HIGHER EDUCATION HAS TRANSVERSALLY INCREASED

Table 2: Access to higher education (% of young between 18 and 24 who attend)

	1990	1992	1994	1996	1998	2000	2003	2006	2009	2011	2013
I	3%	5%	7%	7%	6%	7%	10%	14%	17%	22%	27%
II	6%	7%	8%	12%	9%	12%	15%	17%	21%	27%	31%
III	9%	9%	14%	16%	17%	22%	23%	24%	26%	26%	36%
IV	16%	18%	25%	26%	28%	31%	35%	35%	34%	39%	41%
V	32%	31%	44%	50%	52%	52%	58%	53%	55%	59%	58%
Total	12%	13%	18%	21%	21%	22%	26%	27%	29%	33%	37%

Source: L&D based on data from CASEN surveys.

The health sector results also show explicit data. As of the CASEN Survey of 2013, it is possible to observe that the incidence of health problems is relatively even throughout all income quintiles (around 14% of the members of each quintile reports health problems); the same is observed in medical care (between 81% and 82% received health care regardless of the quintile). Furthermore, Candia (2015)^{vii} finds that the years of life lost due to premature deaths are increasingly lower in the neighborhoods where the lowest-income 10% lives, and they are more similar to the neighborhoods where the richest 10% lives.

Fiscal Revenue and Social Expenditure

Economic growth allows the existence and sustainability of public expenditure through income tax, consumption and accumulated wealth. The best tax reform to increase fiscal revenues –or allow a reduction of the tax burden- is growth. The higher the wealth creation, the higher is the income base for all rate levels and the tax collection or, alternatively, for any expected collection level, a higher growth rate allows lower tax rates. Moreover, tax collection has a non-linear growth in relation to the GDP; for every additional point of product growth, tax collection tends to grow more than one percentage point^{viii}. There are different estimates regarding this GDP elasticity-tax collection, both at the aggregate level and for each individual tax. The Final Report of the so-called

Corbo Commission (2011)^x, aimed at improving the fiscal rule of Chile, presents a summary of different works that calculate this relationship, and find values from a practically linear growth between taxes and GDP to figures where the collection of individual direct taxes grow three times faster than the GDP. Currently, for the purpose of the mentioned fiscal rule, there is an elasticity of annual income taxes in relation to the GDP of 1.63, and 1.04 for indirect taxes such as the VAT, which acknowledges the non-linear relationship described above.

COUNTERACTING THE DEEP ANTI-GROWTH REFORMS?

After more than two years of poor economic growth and a government that has forgotten the importance and benefits of growth, by fostering reforms that have affected substantive aspects of growth such as a tax structure that encourages savings (beyond all improvements that could have been made) or a labor reform that ignores the existence of a global world and that must adapt to technological changes, the message given by the Ministries of Finance and Economy through their “22 Measures to Boost Productivity and Increase the Economy’s Growth Capacity”^x is optimistic, and seeks to restore the wrong direction that policies had taken. We cannot expect that this pack of measures nor those announced by the National Productivity Commission will reverse the trend nor the adverse impact already caused, but we appreciate that the debate emphasizes long-term growth, which is essential to face the political and social challenges in the long and midterm.

Regardless of valuing the fact that the subject is being explicitly put on the table, it is important to assess the real potential of the proposed measures and their capacity to help the country resume its historical growth path. The following paragraphs analyze the measures proposed by the Executive, which can be grouped in three large groups: Financial, Exports of Services and Simplification of Bureaucracy.

Financial or Financing

Among the 9 measures that could fall into this category, the following can be highlighted: “*To allow insurance companies to directly invest on infrastructure projects*” and “*To update the pension funds regulation with the aim of diversifying their portfolio, thereby allowing, among other things, to directly invest on infrastructure projects*”. In a few words, these two measures seek to reduce brokerage fees, since insurance companies and private pension funds (AFP) are obliged to invest on these assets indirectly through Investment Funds and, in this manner, contribute to the productivity of the financial area, precisely in a sector that mobilizes resources whose impact on development is and has been high; Corbo and Schmidt-Hebbel, (2003)^{xi} found that, through different channels, the social security reform explained between 0.2 and 0.9 points of annual growth during the period of 1981-2001.

Regarding the AFP, it seems that the measures address not only the elimination of intermediation in the investment on infrastructure, but also add a third category for the AFP to invest, embracing direct investment on infrastructure, private debt and private equity, which means a step forward in deregulating the industry, but again, it does not alter much the current situation considering the indirect investment on these assets through funds. However, it is not a good practice to create different types of assets for specific sectors; a better solution would be to increase the capacity of the AFP to finance projects in general.

Concerning the provision of infrastructure, in a world of high liquidity and historically low interest rates, and with an economy whose capital account is open to the world, our real stumbling block is the lack of projects and not how they are financed. The fact is that, without much consideration, the government worsened the tax situation of all those affiliated to the AFP system, while increasing the first category tax, but now it is trying to facilitate their investments, which is worthy of mention.

Exports of Services

The 10 measures of this category aim at the right direction in order to continue with Chile's open trade practices, by eliminating some arbitrary aspects and obstacles concerning exports of services. Thus, they include mechanisms to simplify and facilitate this type of deliveries: international coding, special form, easy acknowledgement of degrees in the Pacific Alliance and adaptability of CORFO's financing and promotion mechanisms to the reality of service exporters. They also seek to prevent the exporting of service taxes, by leveling their tax treatment to that of the exports of goods. And the most significant aspect is to broaden the definition of exports to include services delivered by Chileans abroad, thereby assimilating them to those delivered in the country, so that may benefit from the exports' VAT exemption.

Simplification of Bureaucracy

Finally, three measures are included that seek to simplify some paperwork by means of two bills, one that already exists (Advanced Electronic Signature) and another to be introduced soon (integrated Electronic Platform for Notary and Registrar Formalities). Additionally, they aim at encouraging the use of the tool that the Internal Revenue Service (SII) provides to the banking system regarding the electronic access to the companies' tax information, thereby facilitating credit risk assessments. Some of these measures have been discussed since the creation of the Agenda of Competitive Stimulus five years ago, and they were incorporated in bills to which the

government has given no priority. This is the case for the advanced electronic signature that allows speeding up the paperwork in notaries and public offices.

CONCLUSION

The relevance of these 22 measures, which for the most part aim at the right direction of eliminating distortions that hinder exports of services, speed up paperwork, increase CORFO funds and reduce the cost of investments for the AFP system and insurance companies, is that they restore the discussion about economic growth. However, they are second-line features compared with the deep anti-growth reforms that this government has carried out –or pretended to do so-, making capital cost more expensive, complicating the incorporation of more people to the labor market and putting an uncertainty blanket on investments and new projects while proposing a Constitutional Reform.

ⁱ <http://www.elmercurio.com/blogs/2016/04/04/40673/La-muerte-de-los-mitos.aspx>

ⁱⁱ Datt, G. and M. Ravallion (1992). "Growth and Redistribution Components of Changes in Poverty Measures: A Decomposition with Applications to Brazil and India in the 1980s." *Journal of Development Economics*.

ⁱⁱⁱ Henoch, P. and J.R. Larraín (2015). "El rol del crecimiento económico en la reducción de la pobreza." Serie Informe 154, December 2015, LyD.

^{iv} <http://ceal.co/cepal-panorama-social-de-america-latina/>

^v Period for which the BCCh offers chained series disaggregated by economic activity.

^{vi} Unemployment Rate and Demographic Changes in Chile, Draft for Monetary Policy Report (IPoM), March, 2015, BCCh.

^{vii} Candia A. (2015). "Salud y las mejoras en bienestar y equidad: El caso de los años de vida potencialmente perdidos (AVPP)". Serie Informe 152, September 2015, LyD.

^{viii} It is a short and mid-term relationship, it is not reasonable to think that growth will be always more than proportional, otherwise at some point 100% of the GDP will correspond to taxes..

^{ix} "Propuestas para perfeccionar la regla fiscal". Consulting Committee Fiscal Policy of Structural Balance.

^x <http://www.hacienda.cl/documentos/documentos-de-trabajo/22-medidas-para-impulsar-la.html>

^{xi} Corbo, and K. Schmidt-Hebbel (2003). "Efectos macroeconómicos de la reforma de pensiones en Chile". Results and Challenges of Pension Fund Reforms.