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Fiscal Accounts 2010: End-of-the-Year Celebration

The fiscal figures for 2010 closed with a more positive balance than the one estimated by the government in September, but a substantive spending expansion in December (real 30% increase in twelve months), opens certain questionings regarding the execution quality for this month. Despite the attenuating fact of the earthquake, in 2010 the fiscal policy was procyclical, which is questionable in the current context of a significant drop in the real exchange rate.

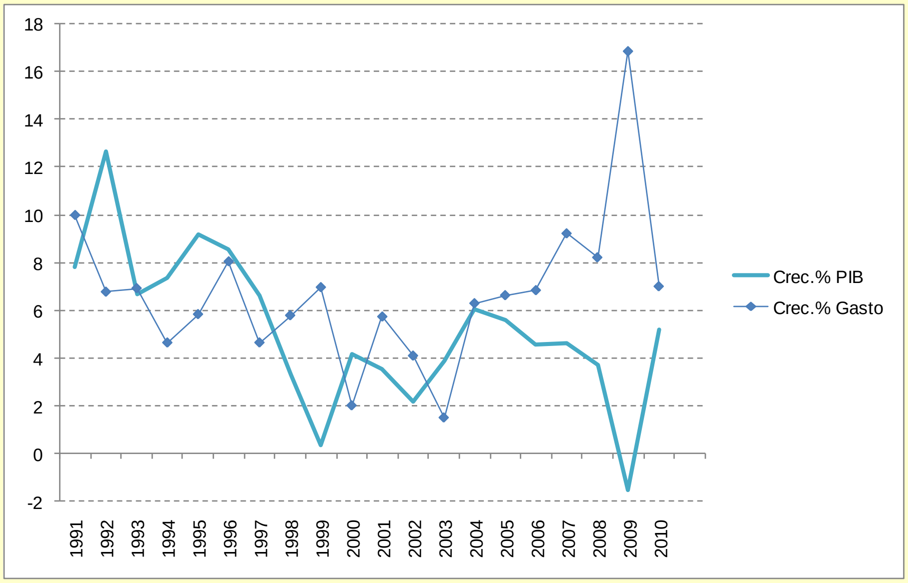
In the information available for the last quarter, we observe that the fiscal figures for 2010 closed with a more positive balance than the one anticipated in September, since incomes behaved better and spending was somewhat lower than expected. The government had estimated a deficit of 1% of the GDP, a figure which gave a negative result of 0.4%. The expenses were equivalent to 99% of what was budgeted in September (there was practically no sub-execution) and the incomes, to 101.3%.

The income growth reached an elevated real 28.4%, explained by the copper price increase and the dynamism of the private demand. The private mining taxation increased a real 130%, thereby contributing with 7.8% of the fiscal revenues and the transfers of CODELCO increased 88%, with a contribution equivalent to 12.9% of the revenues. The relevance achieved by the private mining taxation contribution shows that the transfer from CODELCO to private entities may be an excellent business for the public treasury, because it does not only receive the selling price, but also a permanent flow of tax receipts.

Public spending registered a 7% real increase, and although it was lower than the 7.8% previously estimated, it exceeded the economy growth, estimated in approximately 5.2%. Thus, the keynote of the period 2004-2009 is maintained, when public spending always grew above the GDP which, as we know, negatively affects the real exchange rate and, therefore, reduces the growing spaces for the private sector.

Chart 1

GDP AND PUBLIC SPENDING, REAL GROWTH RATES



Source: DIPRES (Budget Direction) and Banco Central

This expansive fiscal policy, even though it may be partially justified due to the F27 earthquake, presents the following difficulty: in terms of macroeconomic stability, a less procyclical policy would have been desirable, considering the strong private dynamism, with almost a real 20% growth estimation of private spending in 2010.

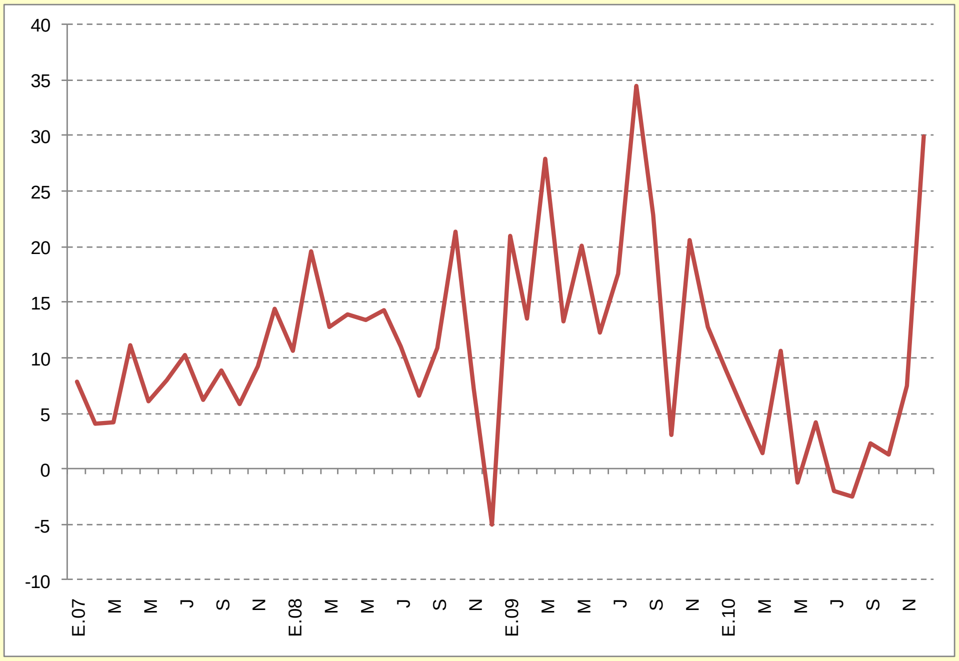
Along these lines, with a drop scenario in the real exchange rate, a more neutral fiscal policy would have been desirable. As a matter of fact, this occurred in the first three quarters, where the budget public spending grew in a very moderate way (the extra-budget spending was expansive all year long), around a real 3%. This aspect had been positively highlighted in our previous analysis, which recognized the considerable effort of fiscal austerity in a context where reconstruction expenses were already being executed. Nevertheless, during the last quarter, the direction of the fiscal policy changed radically, especially in the last month of the year, and we believe that this is not a reasonable budget execution.

In fact, it was during this time that the exchange rate dropped considerably, partly due to a fiscal deficit in pesos in that quarter of almost US$4,000 millions. In December, the budget spending registered a real 30% increase in twelve months, over a base which was already high. It calls our attention that almost 15% of the whole year's amount was spent in only one month. In that month, the deficit in pesos was above US$3,000 millions.

Chart 2 shows the real growing rates in twelve months regarding the budget spending, which reflects the abrupt balance of the month of December.

Chart 2

REAL GROWTH IN 12 MONTHS OF BUDGET SPENDING



Source: DIPRES.

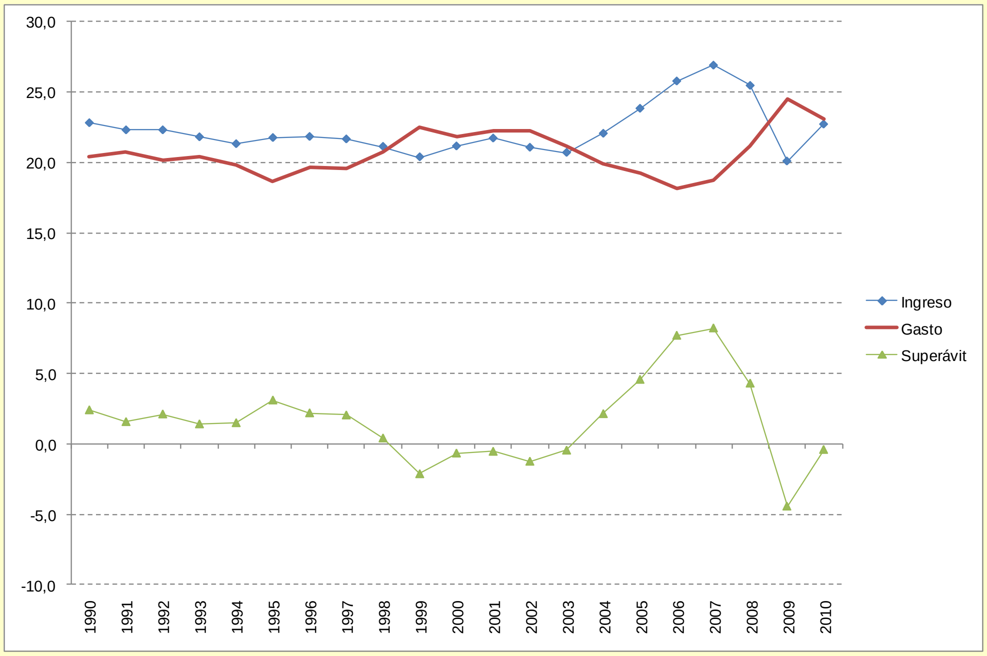
What is the reason for this significant spending expansion in December? When we look at the figures, we observe that there was a strong rebound in the investment spending (real 39% increase), which could be explained by the lag shown by this item during the rest of the year. However, we ask ourselves if this corresponds to a mere delay or to the eagerness to comply with the budget, which could lead to inefficiencies and/or unnecessary spending. The recurrent expenses excluding interests also show a strong rebound in December, a real 23.4%, especially visible in subsidies and donations. The leading subject is that there is the risk that the policy of spending concentration in only one month affects the efficient use of resources, and there is also an interpretation problem of the fiscal figures, because we thought that the fiscal policy had been actually counter-cyclical in 2010, when at the end it turned out to be procyclical.

Another relevant issue is the analysis of the extra-budget spending, which corresponds mainly to the incomes generated by the Copper Reserve Law and the payment of the recognition bonds. Nevertheless, in 2010 the extra-budget spending in consumer goods and services amounted to US$831 millions, compared with US$380 millions in 2009. A considerable part of this spending (almost US$200 millions) was made in the fourth quarter. Even if these figures probably include reconstruction expenses, such as in the case of the meccano bridge in the Bío-Bío region, it seems important to clarify this information in order to avoid transparency problems with regard to such relevant spending amounts. From the data given by the DIPRES, it might be inferred that part of the resources generated by the Reserve Law, which amount to US$1,000, were used in the reconstruction process.

The spending and revenue figures of the central government in terms of the GDP show a reversion in relation to the situation of 2009: the revenue ratio increases strongly and the spending ratio drops slightly. The latter is mainly due to a deflator problem, since, as we mentioned above, the public spending grew, in real terms, more than the GDP. Chart 3 shows these percentages.

Chart 3

REVENUE AND SPENDING OF THE CONSOLIDATED CENTRAL GOVERNMENT (% OF THE GDP)

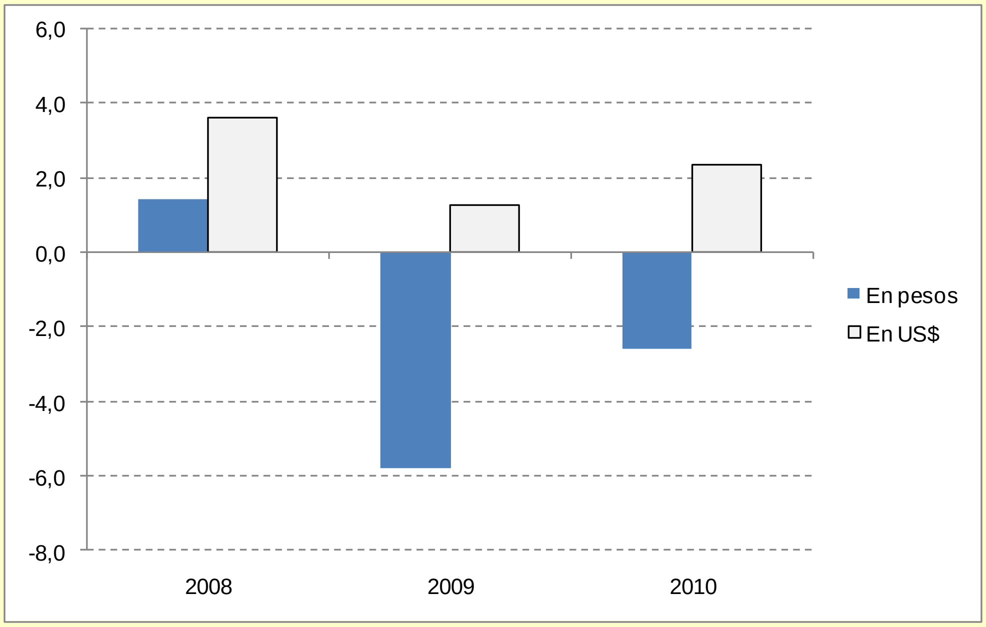


Source: DIPRES.

The drop of the Spending-GDP ratio is explained by the significant increase registered by the nominal GDP in 2010, due to the copper price increase. For 2010, a nominal GDP increase of 14.6% is estimated. Therefore, even though this lower participation somewhat reverses the expansive trend of the last four years, it is not due to an austerity effort, but to the increase of the national revenue.

Chart 4

BUDGET CENTRAL GOVERNMENT:
RESULT IN PESOS AND DOLLARS (% OF THE GDP)



Source: DIPRES.

A last interesting aspect is the problem of currency mismatch which affects the public treasury since 2009, and which is a permanent pressure on the real exchange rate. Since 2009, the local currency expenditures exceeded the revenues, due to the strong revenue drop and the high spending expansion in that year. The outcome was that, at the budget level, the public treasury registered a local currency deficit of 5.8% of the GDP, compared with a foreign currency surplus of 1.3%. Last year, despite the strong increase of the tax receipts, the currency mismatch problem persisted, with a deficit in pesos of 2.6% of the GDP, and a foreign currency surplus of 2.3%. This means that this problem, originated in 2009, should continue in the future, unless a considerable moderation is achieved in the spending growth in pesos. The announced growth of a real 5.5% public spending constitutes an insufficient moderation to reverse the situation. If spending grows at the rate estimated by the government, the deficit in pesos could be maintained above 2% of the GDP, with a significant increase of the dollar surplus. Why is it a negative condition? Basically, because the government does not have enough revenues available in pesos to finance its spending. This local currency deficit must be financed with the sale of dollars or debt issuing in pesos. Both alternatives affect the exchange rate, either by the direct effect of the sale of dollars, or the upward pressure on the local currency interest rates. Thus, if the government wishes to contribute to a stable real exchange rate, it must make efforts to moderate its spending. This effort is important during the present year, because we will probably maintain a significant dynamism of the private demand.

Conclusions

The fiscal figures for 2010 closed with a more positive balance than the one estimated by the government in September, but a substantive spending expansion in December (real 30% increase in twelve months), opens certain questionings regarding the execution quality for this month. Finally, despite the attenuating fact of the earthquake, in 2010 the fiscal policy was procyclical, which is questionable in the current context of a significant drop in the real exchange rate.

A relevant currency mismatch condition was maintained, which entails a constant pressure on the exchange rate and the interest rates. The only way to reverse this situation is to moderate the spending growth in pesos, a desirable policy for this year, since the high dynamism of the private demand should continue.

The strong expansion of the extra-budget spending shows the need to review the Copper Reserve Law in order to avoid transparency problems in the use of those resources.