

2012 Economic Evaluation: Positive, Negative and Pending Issues

Low unemployment, higher wages, and low risk classification acknowledged by risk rating agencies, are highlighted among the positive aspects. The tax reform and the almost null progress in investment projects are among the negative ones. Within this classification, questionings to the 2011 CASEN Survey and the labor market official data are among the most reprehensible issues. Finally, the energy subject and some measures in labor matters are still pending.

Having ended 2012 and looking into the last year of President Sebastián Piñera's government, it seems useful to analyze past year's milestones in economic matters, highlighting the positive, showing the negative, and ending with the period's pending issues.

Likewise, it is also helpful to review the bills introduced last year in this area, in order to add information on which were the priorities at the Congress and how these initiatives' proceedings have progressed.

Positive Aspects

The year 2012 was highly positive in relation to macroeconomic figures (GDP, employment, real wages, and inflation, among others), especially if we consider that early that year expectations were, to say the least, cautious.

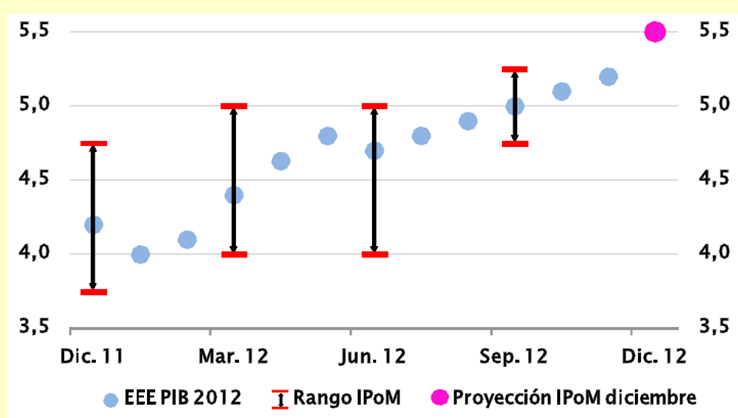
In growth matters, a look at the estimates of the Gross Domestic Product (GDP) included in last year's Monetary Policy Reports (IPoM, in Spanish) and the Economic Expectations Surveys that are periodically published by the Central Bank of Chile (Banco Central), gives a clear idea of how figures exceeded the expectations as months went by. 2012 will probably close with a GDP real growth of 5.5%, which widely exceeds global growth and specially that of the OECD countries.

Regarding the labor sector, and considering employment as the most powerful indicator of the families' quality of life in the short-run, unemployment levels have remained below 7%, a figure we had not

observed for over a decade. This has a counterpart which is the sustained growth over 6% in the General Wage Index, that is, an enhancement of average salaries that, in 2012, doubled the increase of the average prices measured by the CPI. In other words, the families' real incomes grew within an inflation context that should be maintained below 3%.

Chart 1

GDP (ANNUAL VARIATION, PERCENTAGE)



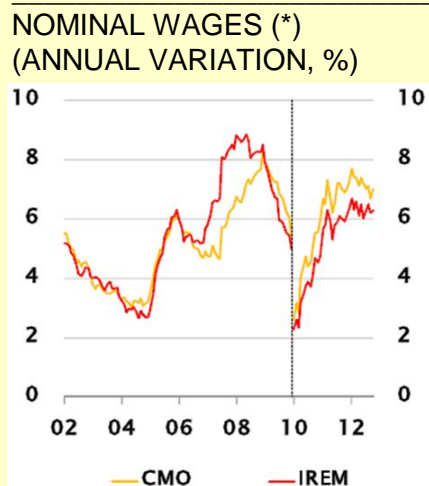
Source: Banco Central de Chile

Chart 2

UNEMPLOYMENT RATE (PERCENTAGE)



Chart 3



Source: Banco Central de Chile and National Statistics Institute (INE).

(*) As of January 2010 (indicated by dashed line) the new index with yearly base 2009 = 100 is used, therefore, figures are not strictly comparable with former ones.

**CMO= Costo de la Mano de Obra (Labor Force Cost), IREM = Índice de Remuneraciones (Wage Index).

From a more global perspective, the emission in September of a 10-year bond with an historically low rate of 2.379%, the best in Latin America and the emerging world, reaffirms the trust that the world puts in Chile as a serious country, with a General Treasury (“Fisco”) that holds low borrowing levels and a credible tax liability allowing counter-cyclical policies. These conditions and the current administration’s effort to communicate these strengths to the market, have meant in practice that the three biggest risk rating agencies improved the score of Chile during this period, culminating with the AA-minus rating recently given to Chile by S&P and that places it at the level of countries like Japan, Taiwan and Saudi Arabia.

All these economic figures, in addition to illustrate the dynamism of today’s Chilean economy, and which will probably continue this year, are a reliable reflection of the real improvement in the households’ quality of life, and which is the final result of having a stable and constantly growing economy.

In the legislative sector, the economic agenda has been strongly focused on competitiveness and stimulus for entrepreneurship, which had not occurred for many years and is highly valuable. Within this item, it is important to mention the bill that modifies the Bankruptcy Law, thus helping those who fail in business to rapidly stand on their feet again and without the current stigma of business bankruptcy. The enactment of the Research & Development (R&D) Stimulus Law is also worth mentioning.

Another highly relevant subject for the government in 2012, and it is expected to continue this year, was dealings with the consumers and the protection of personal data, where the bill updating the regulation applied to the treatment of this kind of data is appreciated, although certain matters could be refined. Furthermore, the bill which reforms the notary, registrar and archivist system is also important, since it means an important step aiming at giving users a better service, without endangering the legal security of the respective legal documents. We should single out the bill concerning the direct sale of medicines in supermarkets; although it is a great initiative that benefits consumers, it did not succeed to obtain the Congress' support in 2012, so we expect that it will be introduced again as soon as possible, because it is important to give more competition and coverage to the sale of drugs that do not need medical prescription.

A great triumph that should be acknowledged was the approval by the Congress of the Fishing Law – currently at the Constitutional Court -, whose aim is the sustainability of hydrobiological resources and greater competition in the sector through the strengthening of the secondary market.

Negative Aspects

However, during 2012 there were not only good bills, positive economic figures and an exceptional capacity of enduring the European recession and anemic growth in the United States. We also committed mistakes and clumsiness.

Particularly serious was the showy launching of the “Tax Reform” bill, which should have entailed the enactment of the Law 20,630, with the following misleading description: “Refines the tax legislation and finances the educational reform”. From its very start, this initiative was doomed to being labeled as insufficient and it did not only rarefy the political environment and consume the Executive, but it probably opened the door to more aggressive and potentially harmful tax reforms in the future, with all its implicit uncertainty for investment and growth.

This amendment, which was finally approved after a long proceeding that included withdrawing the bill in August, then simplifying it and reintroducing it, will collect approximately US\$1 billion per year. Its structure embraces a corporate tax rise – from 17% to 20% -, once again turning a temporary tax raise – for the reconstruction after the 2010 earthquake – into a permanent one, along with a timid reduction of the income tax and taxes on loans and a very well focused credit for education expenses, which finally recognizes the human capital investment character of these expenses made by families.

No matter how laudable the purpose or destiny of the resources it could collect, and we should not forget the non-earmarked taxes in Chile, that is, that – fortunately - taxes in general cannot have a defined purpose, the truth is that it was motivated by political rather than strictly fiscal reasons.

On the other hand, but equally negative, there are necessary investment bills for the country's development, which were delayed or were not concluded, thereby enhancing the uncertainty of investors in relation to the safety and ease that Chile grants for large investment projects. We are not talking about approving all projects having potential environmental impacts, but about respecting the institutional framework which has the specific role of assessing them. In 2012, it became evident that the judicialization of large projects seems insurmountable for now, especially in the Chilean context of judicial activism.

There are many examples thereof, but maybe the most emblematic one was HidroAysén. Despite the fact that the environmental approval of the power plants was ratified by the Supreme Court, and that the Board of Directors made it clear that the project would continue, it is not certain yet if it is going to be carried out. January shall be a key month, when the Ministers' Committee takes a stand on the claims against the project.

Other cases such as Bocamina II, where a Supreme Court decision forced ENDESA to make an environmental impact study, even though it is an optimization of the already approved project, or the hydroelectric plant Cuervo, where the Supreme Court accepted a remedy of protection against the SEA (Environmental Assessment Service) from ecological organizations and communities due to the approval of the environmental impact study, are examples of the complex and negative scenario that might be putting at stake the continuance of the positive figures we have observed until now.

In this context, there are two episodes which seem especially deplorable, which eclipsed the public discussion during 2012.

The dissemination of the results of the 2011 National Socio-Economic Survey (CASEN) was especially controversial last year. It seems that the intention was to diminish the positive results concerning poverty uprooting and inequality reduction. It was regrettable to “technically” question the comparison of this survey with the previous ones in order to discredit these achievements.

The CASEN Survey has been taken for more than 26 years. With reliability, transparency and the possibility of replying the official results, it has been set up in the center of the Chilean public policy. It does not only allow

assessing the poverty rate and inequality indicators, but also the expenditure coverage, focalization and distribution, among other things.

It was deplorable to reach the point of questioning the validity of the 2011 CASEN Survey; regardless of the political sidewalk we are on, losing the credibility of this survey has a high cost for our country's social policy. Although every methodology is improvable, it is not justifiable to start doubting a tool that has been and still is very useful for the implementation of public policies.

The second controversy concerned the labor market's official data, stating that the employment's dynamism was partly due to a change of the criterion used to classify a person as occupied. This accusation, it seems, sought to undermine the positive results, in the same way as with the 2011 CASEN Survey.

However, these statements were quite groundless; you only had to take a look at the documents published by the National Statistics Institute (INE) in its web page in order to prove that they were mistaken. For many years, the definition of occupied has followed ILO's recommendation, which puts in that condition a person who worked at least an hour during the week prior to the survey or who did not work, but because he/she was on holidays or on leave. Maybe this is not the strictest criterion, but it has always been the same.

Additionally, the Survey of the Microdata Center of the Universidad de Chile, whose methodology has not varied in the least, showed very similar results to those of the INE.

It is hard to say to what degree the exceptional dynamism of the labor market in 2012 was a consequence of the current government policies, but it is undeniable that the situation has significantly improved; so much so, that the goal of one million new jobs in five years, greatly questioned during the campaign, seems highly feasible if we consider that 750,000 new jobs have already been recorded.

Pending Aspects

When closing the year 2012, and after analyzing its positive and negative aspects, it only remains to consider what is still pending with a view to the present year.

In this category, there is probably nothing more imperative than the energy issue, since the electricity costs in Chile are substantially higher than in other OECD countries and those of the region, mainly because the energy production has been prevented, which sends us back to the worst of 2012.

Likewise, if Chile wants to maintain its 5% potential growth, and hopefully have another golden decade with growth around 7%, there is much work to do in relation to competitiveness and investment. We do not only have to reduce energy costs, but also improve human capital and make the labor market more flexible.

Concerning the labor market particularly, many measures could be taken to relax the Indemnities per Service Year (IAS, in Spanish) and other measures that would allow incorporating women and young people more in accordance with their characteristics.

In relation to savings and investment, the investment rate as a percentage of the GDP has increased from 21% of the GDP at the end of 2009 to more than 25% in the third quarter of last year (China invests 50%). This is partially due to the financing with direct foreign investment, since local savings are clearly insufficient, which is reflected on the increasing current account deficit. Thus, it is evident that Chile requires enhancing savings, especially considering that many people raise their voices to call for advancing in the opposite direction, which means to raise taxes and take us to a taxation system that punishes savings and blindly focuses on income tax.

In brief...

POSITIVE ECONOMIC ASPECTS IN 2012:

- **Surprisingly good macro figures**, especially concerning growth, where it is expected to close 2012 with a 5.5% real growth of the GDP, which widely exceeds global growth and that of the OECD countries. As for employment, unemployment levels have been kept under 7% and wages have increased.
- **Good rate of return of the AFP**, which benefits people who save for their retirement.
- **Chile obtained the best risk classification ever**: the three biggest risk rating agencies improved Chile's score, placing it at the level of countries like Japan, Taiwan and Saudi Arabia.
- Nevertheless, among the aspects qualified as negative we should mention the tax reform and the weakening of the energy and environmental institutional framework.

See "Ten Answers to the Debate on CASEN Survey 2011". Libertad & Desarrollo. Public Issues 1,076, August 24th, 2012.