

Index of Economic Freedom: Chile Improves the Score and Leads the Region

Our country holds an outstanding seventh place, doing better than the United States, and leading the ranking in South and Central America and the Caribbean. However, at global level, progress towards economic freedom has tended to remain unchanged. The next report could show variations due to the Tax Reform approved in 2012.

Since 1995, The Heritage Foundation, The Wall Street Journal and a think tank network have elaborated the Index of Economic Freedom, which ranks and tracks the evolution of economic freedom in a group of countries around the world.

Version number 19 of the Index, corresponding to 2013, was published this week; in it, Chile holds an outstanding seventh place at global level and leads the ranking in South and Central America and the Caribbean. This position means that it has kept its place in relation to 2012 results, but with a better score (79.0 in 2013 and 78.3 in 2012), as a consequence of our country's pro-freedom reforms.

However, at global level, headway towards economic freedom has tended to remain unchanged since it reached its maximum value in 2008. 91 out of 177 countries improved their scores in relation to 2012 and 78 show lower scores, reaching an average world score of 59.6 points (0.1 percentage points over last year's score), explained mainly by improvements in Government Spending and a drop in Regulatory Efficiency due to the minimum wage increase and labor rigidity in many of the evaluated countries.

Economies were classified into four broad categories of economic freedom, Rule of Law, Regulatory Efficiency, Limited Government and Open Markets, which in turn are divided into 10 specific categories: Business Freedom, International Trade Freedom, Fiscal Freedom, Government Spending Freedom, Monetary Freedom, Investment Freedom, Financial Freedom, Property Rights, Freedom from Corruption and Labor Freedom, which are averaged in order to obtain the global score for each country.

The measurement scale of the Index goes from 0 to 100, where countries that rank between 80-100 belong to the free category; 70-79.9 are mostly free, 60-69.9 are moderately free, 50-59.9 are mostly unfree and 0-49.9 are repressed. This means that the highest the score in a specific factor, the lesser the interference level in the economy.

In general terms, it should be highlighted that only two regions improved their scores: Europe and North America, both reducing their gaps, and as we observe in Table 1, Hong Kong leads the list again as the freest economy in the world, followed by Singapore and, in the third place, Australia.

Table 1

RANKING OF THE INDEX OF ECONOMIC FREEDOM

	2012	2013
1	Hong Kong	Hong Kong
2	Singapore	Singapore
3	Australia	Australia
4	New Zealand	New Zealand
5	Switzerland	Switzerland
6	Canada	Canada
7	Chile	Chile
8	Mauritius	Mauritius
9	Denmark	Ireland
10	United States	United States

Source: Index of Economic freedom 2013.

Mexico is the only economy that improves its score in relation to 2012 in North America, the freest region in the world. It leads in Rule of Law, Regulatory Efficiency and Open Markets, but not in Government Spending, since State intervention is increasingly greater in that region.

On the other hand, South and Central America and the Caribbean showed the biggest decline; all countries less nine are qualified as “moderately unfree” or “moderately free”.

Different Indicators in Chile

Among the 10 indicators, the country improves in four, is worse in two and remains stable in four of them. As shown in Table 2, Chile’s improved scores are mainly due to better results in Investment and Business Freedoms.

Table 2

VARIATIONS IN THE SCORES OF THE RANKING INDICATORS

Rule of Law		Limited Government		Regulatory Efficiency		Open Markets	
Property Rights	0	Fiscal Freedom	0.2	Business Freedom	1.9	Trade Freedom	0
Freedom from Corruption	0	Government Spending	1.6	Labor Freedom	-0.9	Investment Freedom	5
				Monetary Freedom	-1	Financial Freedom	0

Source: Index of Economic freedom 2013.

In brief, the report stresses the way the Chilean economy is being managed and its capacity to adjust to external shocks, which together with its commitment to trade liberalization, facilitates the entrepreneurial activity, making Chile a more competitive country.

There are also weak points to be improved, such as the still existing bureaucracy to start and terminate a business, labor rigidity, income and corporate tax burden increase, minimum wage increase above the productivity growth average, and greater intervention of groups that hinder projects already approved by the corresponding regulatory agency.

In a detailed form, we can point out the following for each category:

- 1) Rule of Law: contractual agreements in Chile are the most secure in Latin America. Courts are transparent and efficient. Property Rights are strongly respected, and expropriation is rare. There is a persistent concern over intellectual property rights and copyrights. Therefore, both in the categories of Property Rights and Freedom from Corruption, our scores remain at a very high level.

There is a high probability of having a lower score in next year's report in the Property Rights category, due to the larger number of attacks in the region of *La Araucanía*.

- 2) Limited Government: we obtained better scores in both categories included in this area: Fiscal Freedom and Government Spending, reflected upon the management of public finances, keeping public debt and the budget deficit under control, in spite of the fact that the income tax burden, with a top marginal rate of 40%, is quite high in comparison to the

rest of the countries, thus inhibiting the freedom of people to freely dispose of what they have obtained through their efforts.

The next report could show some variations in the area due to the 2012 Tax Reform, where the top payment of taxes in stamps and duties, which makes bank mobility more expensive and prevents competition, went from 0.6% to 0.4%, which will be compensated by the corporate tax increase from 17% to 20%.

- 3) **Regulatory Efficiency:** there has been an important progress in the elimination of regulatory bottlenecks. The time needed to start a business was reduced from 22 to 7 days, requiring only 7 procedures, thus improving the Business Freedom indicator, and it could improve even further with the approval of the bill which would allow forming, modifying or dissolving partnerships in less than 24 hours and costless. This law, together with the amendment bill of the Bankruptcy Law, the *Estatuto Pyme 2.0* (articles of incorporation for small and medium business), the *Ley Única de Fondos* (consolidated law on funds) and the *Sistema de Obligaciones Económicas* (system of financial obligations) can contribute to improve the productive sectors; therefore it is necessary to rely on its short-time approval to eliminate the excessive red tape and regulations that affect them.

Furthermore, minimum wage increases have exceeded overall productivity growth, which has an effect on Economic Freedom, in the same way as labor rigidity reduces Labor Freedom.

In 2011, inflation rose slightly above the target band of the *Banco Central* (Central Bank) due to the dynamism of the domestic demand. Since the report includes outdated data, we got a lower score in Monetary Freedom; this could be reverted in the next report, because we ended 2012 with an inflation of 1.5% in twelve months.

- 4) **Open Markets:** The trade-weighted average tariff is 4%, non-tariff barriers are relatively low, and the search for free-trade deals continues. Foreign and domestic investments generally receive equal treatment and they are transparent and efficient. The well-capitalized and stable banking sector offers a wide range of services in the same way as the financial system. These features, which distinguish us above many Latin American countries, allowed improving the score in Investment Freedom and keeping the score in International Trade Freedom and Financial Freedom.

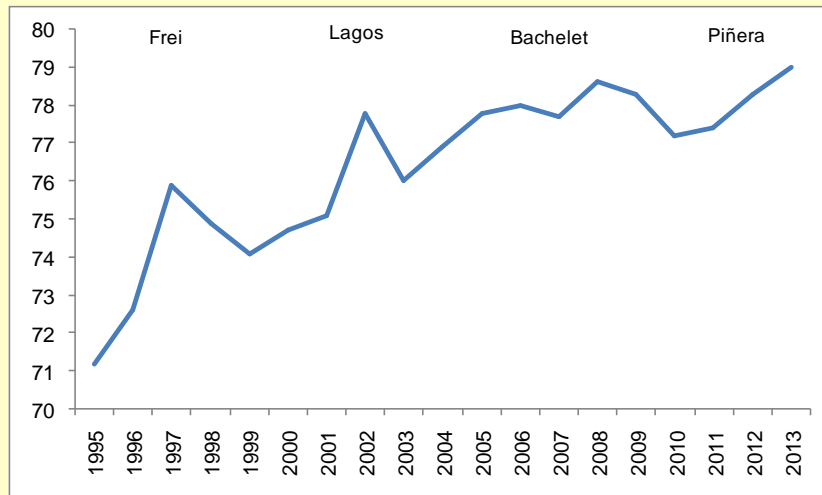
The Evolution of Economic Freedom in the Last Governments

The Heritage Foundation Index was first published in 1995; therefore, we can make a follow-up of the evolution of economic freedom in the last administrations. As we can observe in Chart 1, at the beginning of President Eduardo Frei's administration, Chile had a score of 71.2, and at the end of his period it had increased to 74.1, with significant increases in the areas of trade liberalization as

a result of the Free Trade Agreements, less inflation pressure and opening private investment to basic services.

Chart 1

SCORE IN THE ECONOMIC FREEDOM INDEX IN DIFFERENT GOVERNMENTS



Source: Index of Economic freedom 1995-2013.

At the end of the administration of President Ricardo Lagos, the indicator had grown to 77.8 as a result of the Free Trade Agreements, reforms to capital markets and wider opportunities to the private sector in the concessions' sector. This ascending curve stopped growing and started to fall in the next government.

In the last year of President Michelle Bachelet's term, the index scored 77.2 points because of greater bureaucracy, corruption and property rights fragility, which outweighed the improvements in foreign trade.

However, in 2012 (Index 2013), during the administration of President Sebastián Piñera, Chile obtained 79.0 points, the highest score since the ranking's creation. This is due to important progresses in bureaucratic matters, specifically, the reduction of the time and procedures needed to start a business and different measures within the Competitive Impulse Agenda that have allowed improving the Business Freedom index.

Conclusion

From 1990 to 2009, not many reforms were undertaken in terms of economic freedom, but nevertheless, we stood out above the other countries of the region because of our institutions based on the market and the economic policies set forth. This has allowed keeping a good score, although it showed a clear

reduction in Michelle Bachelet's administration, thus demonstrating that it was not a priority in her government.

Instead, the current government has given important steps towards improving this area by way of the measures promoted within the Competitive Impulse Agenda, and reducing the time and procedures required to start a business, among others. The bills concerning the formation of partnerships and the amendment of the Bankruptcy Law, among others, will improve the domestic economic freedom still further; therefore it is clear that the government is going in the right direction. However, this task will be hindered if the Congress does not allow the bill to advance and if the government's unsolved weak points, such as labor rigidity, high income tax burden and corporate tax increase, minimum wage increase above productivity, and greater intervention of groups who obstruct projects that have been already approved by the corresponding regulatory agency, are not reversed as soon as possible.

In brief...

CHILE IN THE INDEX OF ECONOMIC FREEDOM 2013:

- Chile (7th) does better than the United States for the second consecutive year and it is the leading country in South and Central America and the Caribbean.
- The country gets its highest score since the ranking's creation, so we can say that the current government has made the greatest progress in economic freedom matters.
- Our major headways were in Business Freedom and Investment Freedom.
- Our weak points are labor rigidity, the still existing red tape to create and dissolve a business, the high income tax burden and the corporate tax increase.
- We are going in the right direction, but it is necessary to make progress in bills aimed at forming a partnership in a single day and costless and the amendment of the Bankruptcy Law to support entrepreneurship in the country, and thus achieve the desired development and economic growth.