



# Fiscal Policy 2012: Social Emphasis within a Cautious Climate in Total Expenditure

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Last year's fiscal balance was quite surprising, since global figures were clearly better than those estimated by the government during the budget discussion, only four months before definitive results were published. This estimation error was given both in the revenues and the expenditures, but in a higher proportion in the latter. Finally, the public treasury registered a surplus of US\$1,520 millions (0.6% of the GDP), instead of the estimated deficit of US\$470 millions (0.2% of the GDP). This significant improvement was explained by higher revenues for US\$976 millions and lower expenditures for US\$1,021 millions; these figures are higher than what would have been collected through the tax reform, which was discussed for several months.

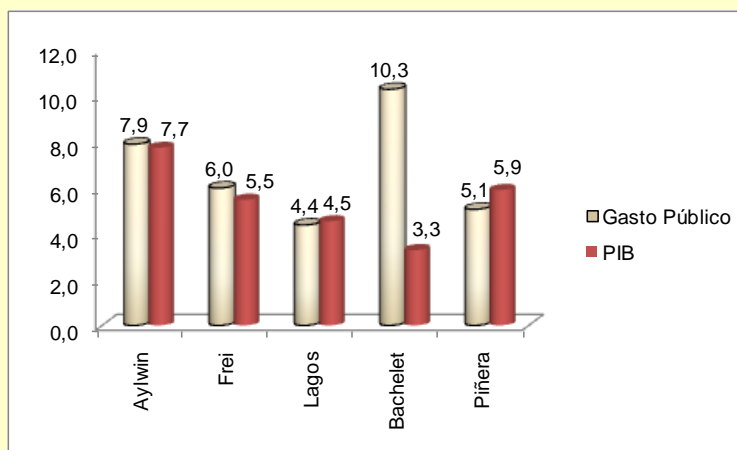
This is a very important aspect of the discussion. First, because it has become a usual phenomenon to obtain higher revenues than the expected ones, which brings us to question the real need for last years' tax increases. Later on, we will go back to the factors underlying these higher revenues. Second, although we do not see clearly unobserved spending commitments, in the end it was possible to spend US\$1 billion less than the estimated figure, a clear indicator that efficiency improvements are possible. With a public spending level of US\$60,050 millions, which doubles that of five years ago, it has to be possible to find space to improve the use of financial resources, without deteriorating the quality of services. The 2012 outcome is a sign that the current government is making progress along this line, since 2011 saw a similar situation.

On the other hand, total expenditure registered a real growth rate of 4.7%, compared with 6.3% estimated in September. Considering that the GDP

grew somewhat over 5.5%, the fiscal policy in 2012 was not only expansive, but it also significantly contributed to mitigate the spending pressures of the last quarter of the year, with an expansion rate of 1.5% real in the last quarter. Thus, the current government is keeping its promise in terms of achieving, on average, a public spending growth rate below the GDP expansion. This commitment is not, as certain people are arguing, a caprice for reducing the size of the State, but a contribution to improve the economy's competitiveness, by not pressuring the economy's non-tradable goods sector and favor the course of the real exchange rate. Chart 1 shows the GDP and public spending growth rates during the last governments.

Chart 1

### REAL PUBLIC SPENDING AND GDP GROWTH RATES (%)



Source: DIPRES (Budget Office), BCCH (Central Bank of Chile)

It is quite clear that the current government has managed to reverse the downward trend in the GDP growth, and obtain a significant moderation of the fiscal spending expansion rate, which is much below economic growth. This is not a minor point in today's political discussion, where many of the economic development proposals are inevitably linked to greater public spending. Reality shows that it is feasible to have a high economy growth based on the private sector and not the public one.

The good fiscal situation of 2012 was given within a much moderated growth context of the current revenues, of only 1.2%. The government expected a low revenue increase, but explained by the First Category Tax reduction. Finally, as in 2011, revenues coming from the mining sector, both private and public, were below the budget estimates. Table 1 shows the year's fiscal situation in millions of Chilean pesos, the different items' real growth rates, and the percentages of the GDP represented by each one of them.

Table 1

STATE OF GOVERNMENT OPERATIONS 2012  
TOTAL CENTRAL GOVERNMENT  
LOCAL CURRENCY + FOREIGN CURRENCY

	CLP\$ millions	Real growth (%)	% of GDP
<b>CURRENT REVENUES</b>	<b>28,608,289</b>	<b>1.2</b>	<b>22.3</b>
Net revenues from taxation	22,770,030	4.8	17.8
Private mining taxation	2,024,806	(14.2)	1.6
Remainder of tax-payers	20,745,224	7.1	16.2
Copper, gross	1,963,870	(31.1)	1.5
Social security contributions	1,802,468	7.8	1.4
Grants	78,898	(17.9)	0.1
Property income	604,476	7.4	0.5
Operational incomes	663,239	6.8	0.5
Other incomes	725,309	0.3	0.6
<b>CURRENT EXPENDITURES</b>	<b>22,755,287</b>	<b>5.5</b>	<b>17.8</b>
Staff	5,409,874	6.2	4.2
Consumer and producer goods and services	2,647,390	(2.1)	2.1
Interests	764,243	9.8	0.6
Subsidies and grants	8,620,330	10.1	6.7
Social security benefits 1/	5,255,186	1.1	4.1
Others	58,264	39.4	0.0
<b>FISCAL SAVING</b>	<b>5,853,002</b>	<b>(12.6)</b>	<b>4.6</b>
<b>NET ACQUISITION OF NON FINANCIAL ASSETS</b>	<b>5,126,122</b>	<b>0.8</b>	<b>4.0</b>
Sale of tangible assets	34,142	54.8	0.0
Investment	2,675,273	(0.3)	2.1
Capital transfer	2,484,990	2.4	1.9
<b>TOTAL REVENUES 2/</b>	<b>28,642,431</b>	<b>1.3</b>	<b>22.3</b>
<b>TOTAL EXPENDITURES 3/</b>	<b>27,915,551</b>	<b>4.7</b>	<b>21.8</b>
<b>NET LOAN / NET INDEBTEDNESS</b>	<b>726,880</b>		<b>0.6</b>

Source: DIPRES.

We observe that non-mining taxation revenues registered a real growth rate of 7.1%, despite the corporate tax reduction, being higher than what was estimated in September. The lesser mining revenues are partly explained by the copper price, which dropped an average of 10% in 2012. However, mainly for CODELCO, the fall is also due to higher production costs.

Table 2 shows the revenues budgeted by Law 2012, those estimated by the Budget Office (DIPRES) in September and the profits effectively obtained.

Table 2

**BUDGETED AND EFFECTIVE FISCAL REVENUES  
(CLP\$ MILLIONS 2012)**

	Law 2012 (1)	Sept. 2012 (2)	Effective (3)	Diff (3) & (1)	Diff (3) & (2)
				In US\$ millions	
<b>TOTAL REVENUES</b>	<b>27,877,510</b>	<b>28,178,760</b>	<b>28,642,431</b>	<b>1,610</b>	<b>976</b>
<b>CURRENT REVENUES</b>	<b>27,851,948</b>	<b>28,153,503</b>	<b>28,608,289</b>	<b>1,592</b>	<b>957</b>
Net revenues from taxation	21,841,843	22,382,388	22,770,030	1,954	816
Private mining taxation	2,802,455	1,993,712	2,024,806	-1,637	65
Remainder of tax-payers	19,039,389	20,388,676	20,745,224	3,591	751
Copper, gross	2,608,366	2,161,365	1,963,870	-1,357	-416
Social security contributions	1,699,986	1,785,198	1,802,468	216	36
Grants	90,433	75,813	78,898	-24	6
Property income	557,348	592,212	604,476	99	26
Operational incomes	569,030	588,415	663,239	198	158
Other incomes	484,942	567,841	725,309	506	332

Source: DIPRES.

It is interesting to note that non-mining taxation revenues were US\$3,600 million higher than what was estimated for the year, even though the GDP growth was only half a point higher than the estimated one (5.5% vs. 5%), and the inflation was nearly half of the estimated one (1.5 vs. 2.9%). Even in September, when most of the profits and losses for the year were already known, these revenues were underestimated by US\$750 millions. These figures show evidence of the legitimacy of the questionings we made several times regarding the real need to make the tax reform that was approved at the end of last year.

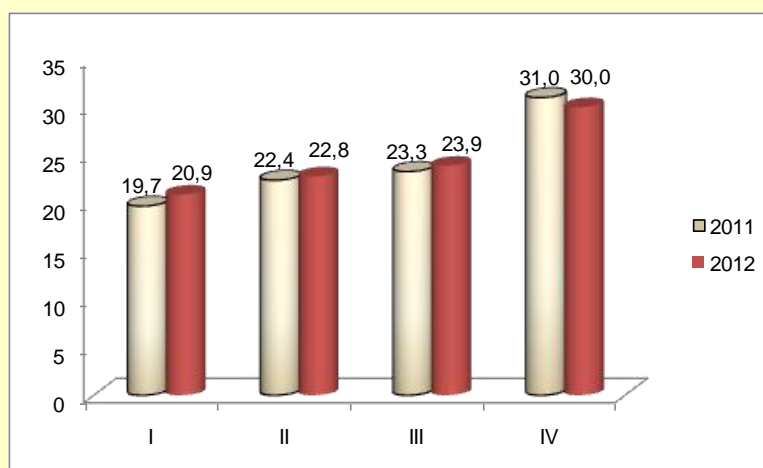
Instead, copper is contributing with less than what was budgeted, and it would be interesting to analyze with more detail the high fiscal impairment derived from the higher energy cost for the mining sector. The figures in this table show that instead of increasing the taxes, it is much more

profitable for the public treasury to search for policies that reduce the mining production costs, and among these, the energy policies should be a priority. Finally, the mining revenues were 26% lower than what was budgeted, even though the copper price was only 3% lower than estimated.

Concerning the expenditures' behavior, the under-execution of 2012 was somewhat lower than that of 2011, when 96.3% of the budget was executed, compared with 97.6% last year. Behind this budgetary under-execution lies a relatively slow execution of the capital budget of the Ministry of Education, which reached 75.5% of the passed law. Anyhow, it improved in relation to 2011, when 67.5% of the respective law was executed. Another relevant factor is that execution was more even throughout the year, thereby mitigating the strong spending concentration which is usually given in the last three months of the year. Chart 2 shows this process.

Chart 2

### BUDGET EXPENDITURES' EXECUTION BY SEMESTER: 2011-2012



Source: DIPRES.

Among the different expenditure items in Table 1, we observe that subsidies and grants (10.1% real) increased the most, more than two times the total expenditure growth, which clearly demonstrates the priority given to this type of expenditure. Despite legitimate apprehensions concerning a growing handout approach, something that is worth mentioning is that the current government has managed to perform its social agenda within a context of fiscal discipline and austerity, contrary to what we saw, for example, in the previous government. The expenditure on subsidies and grants actually grew in this government at a yearly average rate of 14.6%, but within a context where total expenditure increased at a rate of 10.1% real.

A not so positive factor is that expenditure on staff grew 6.2% real in 2012, compared with a 2.7% rate in 2011. This forces to be more careful about the work benefits for public employees, although if the explanation lies in greater incentives for retirement, the situation would be less concerning, since to a certain extent it would be a capital expenditure.

Since the improved effective fiscal balance was mainly due to the expenditures being less than what was budgeted, a quite significant reduction of the structural deficit was also registered, 0.6% of the GDP last year, compared with 1.1% in 2011 and 1% estimated in September. Throughout this government, the structural deficit has been reduced 2.4 percentage points (from 3% to 0.6%), which gives no support whatsoever to the accusations of lack of fiscal responsibility made by the opposing parties.

Finally, we should review the budgetary situation of the current year. The passed law assumes an expenditure growth of 5% real, above the figure estimated as total expenditure in 2012. However, since in the end the expenditure was less than estimated, the execution of the total approved budget would lead to an expenditure growth around 7% real, which considering a 5% GDP growth for this year, would result in a quite expansive fiscal policy. This is not a desirable situation in the current macroeconomic context, where there is justified concern about excessive domestic spending, high current account deficit and a downward trend of the real exchange rate. This context advises a contractionary fiscal policy for this year. Since spending adjustments are difficult to implement in an election year, having again an under-execution of the budget, which has been the keynote of the last two years, should at least be regarded as something positive.

### **Conclusions**

In the end, and contrary to what was expected four months ago, the 2012 fiscal policy was rather contractive, with a spending growth around one percentage point below economy growth. This is a very positive factor in the current context of spending pressure and deterioration of the real exchange rate. The fiscal policy is definitely contributing to the stability of the economy.

Not only were expenditures US\$1 billion below the budget, but the revenues were also greater by a similar number. This was due to a very high non-mining tax collection, even though the First Category Tax rate was lower than in 2011, which leads us to ask ourselves if the tax reform was actually necessary. What should be revised is the taxation contribution from the mining sector, both private and public. The higher production costs (partly explained by the energy) are being detrimental for the Treasury. Therefore, it seems much more profitable for the government to deal with CODELCO's efficiency, rather than to increase taxes.

The emphasis on social spending is evident while noting that the item of subsidies and grants grew at a real rate that more than duplicates the total expenditure growth. Contrary to what we observed in the previous government, this government has been able to comply with its social agenda in a fiscal austerity context.

Finally, and since in 2012 there was actually an under-execution of the budgetary spending of 3.7%, if this year the entire budget is executed, the total expenditure would end up growing close to 7% real, which does not seem desirable at all, considering the current macroeconomic context. Thus, the recommendation would be to keep some degree of under-execution this year as well. In short, that the government applies its demonstrated knowledge on fiscal policy.

### In brief...

- The 2012 fiscal policy ended up contributing to the macroeconomic stability and competitiveness, through a spending growth quite lower than the GDP expansion.
- In 2012, the structural deficit continued to reduce, at an estimated 0.6% of the GDP, 0.5 points below the outcome of 2011.
- As for revenues, a very positive trend of the non-mining tax collection is maintained, while the mining sector's contribution was less than expected. CODELCO's production costs are being detrimental for the Treasury, and it is urgent to search for efficiency improvements. The energy matter is a key factor herein.
- Considering that the Chilean economy maintains a situation with excessive expenditure, the best contribution of the fiscal policy 2013 to a stable and sustainable growth would be to persist with the spending discipline of the last two years. In practice, this means to keep that period's under-execution of the budget.