

# Budget 2014: Main Points of the Discussion

**For the first time in the last decade, the budget discussion will face lower long-term copper prices, which imply a more restrictive income scenario and redoubles the need for cautious spending decisions. Criticism from the opposing coalition regarding an alleged lack of fiscal discipline from the present government cannot be sustained, mainly because they come from the same ones who generated a significant fiscal impairment during their administration, which cannot be explained by the 2009 fiscal stimulus package, since it was created between 2007 and 2008.**

At the end of this month, the government has to introduce the 2014 Budget bill, the last of the current administration; furthermore, and for the first time, it is going to be discussed in the middle of the presidential and parliamentary elections, which adds a further complexity.

This year, the starting point of the budget formulation is situated in a scenario that differs from the last nine years. Currently, the panel of experts estimates a lower long-term copper price, following a long period of constant and pronounced increases. Although the reduction was very moderate, from US\$3.06/pound to US\$3.04/pound, it clearly evidences an issue that we have reaffirmed in previous reports: the end of the so-called “super cycle” of copper, which means a definite change of approach in the public spending policy. The permanent increases of social benefits do no longer seem easy to achieve. A more prudent approach is necessary on what is more sustainable over time, so as not to incur in the serious situations faced by Southern European countries.

Moreover, if we add a decrease, also moderate, of the trend GDP growth for 2014, from 5% to 4.8%, and the need to reduce the structural deficit of 1.2% of the GDP estimated for this year at 1% for 2014 (a target imposed by the current government), we have a more restrictive spending situation than in previous years. With the available data it is possible to estimate that total spending in 2014 will not grow above 4% real. Is this a dramatic issue? Certainly not, since during the period 2011-2012 average spending grew at 3.9% real, and the Treasury was able to fulfil all commitments and could easily implement the postnatal extension program, the elimination of

the health deduction, the subsidies to the public transport system (*Transantiago*) and its entire social agenda.

Anyhow, the opposing coalition will probably adduce that it has been given a restrictive budgetary situation, with the utmost purpose of establishing the need for a tax reform. In this regard, the important thing is to reaffirm that in this matter we are still putting “the cart before the horse”, since the need for substantial additional financial resources is introduced without a clear knowledge of how they are going to be spent, or still more, without having any idea of the social profitability of future projects. In any case, it is quite evident that fee-free higher education on its own is a project that hardly has a positive social profitability.

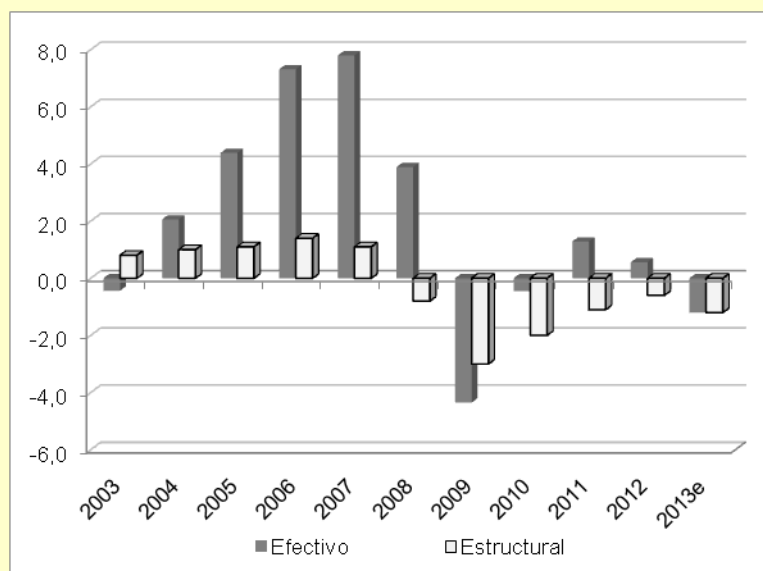
In the same line, we can mention the strong pressure being exerted by the opposing coalition to the current government in the sense of establishing a large amount of unrestrictive resources in the budget. Figures around US\$700 millions have been mentioned, which practically double the unrestrictive resources left by the former government to the present one.<sup>1</sup> Are these resources really necessary for the government to implement its program? The truth is that they are not, for various reasons; first, it is not easy to have approved projects with that extent of financial resources, and start their execution, during the first months of the new government, unless the idea is to begin the term with a March bonus three times more generous than the previous ones. As an example, during this government the extension of the postnatal allowance –one of its emblematic projects– took almost a year to be approved and meant additional resources for nearly US\$350 millions yearly.

Moreover, the budgetary execution has sufficient flexibility so as to make spending reallocations if necessary. For example, during the present government spending adjustments have been made twice for amounts close to US\$800 millions, so if it is really necessary to reallocate a significant amount of resources, it can be done. Furthermore, every year, almost every fiscal program is subject of budget modification decrees<sup>2</sup>, so we can hardly say that a new coming government would be constrained from acting by the former government’s Budget Law.

Another issue that will probably be included in the budget discussion is the criticism made by the opposing coalition concerning an alleged lack of fiscal discipline by this government, which will inherit the next one a structural deficit of 1% of the GDP. Without denying that a structural balance situation would be preferable, it calls our attention that this criticism comes from the same persons who left the government with a structural deficit of 3% of the GDP. Chart 1 shows the structural and effective balance during the last decade (with estimated figures for 2013).

Chart 1

## STRUCTURAL AND EFFECTIVE FISCAL BALANCE (% OF THE GDP)



Source: Dirección de Presupuestos (DIPRES - Budget Office)

When analyzing the structural balance, we observe that during the previous government there was a quite significant deterioration, going from a structural surplus of 1.1% of the GDP in 2005 to a deficit of 3% in 2009, that is, a decline of 4.1 points. These results correspond to those agreed by the Corbo Commission, which include the transitional tax rebates in the 2009 structural deficit, equivalent to 1.2% of the GDP. This point has been questioned by the Finance authorities of the time, who declare that since these rebates were going to be reverted, they should not be considered, thus the deficit would be 1.8% of the GDP. We believe that the Corbo Commission is right to include these rebates for two reasons: 1) There is always the pressure to make these rebates permanent ones, and in fact pressure was put to keep the fuel tax rebate in 2010; and 2) if the transitional rebates are not considered in the calculation, perverse incentives are created among the authorities to implement this type of rebates in an electoral period, without having to impair the structural balance. Nevertheless, if we accept the argument that they should not be considered, then the result would be that in the previous government the structural balance was deteriorated by 2.9% of the GDP (4.1-1.2). It has been argued that this impairment is explained by the international crisis and the fiscal stimulus made in 2009. If we look at the numbers it is not correct, because a great deal of this impairment was produced between 2005 and 2008 (1.9 points of the GDP in that term), in a very comfortable copper context and economic dynamism, due to a very high spending increase,

much higher than the structural incomes' growth. In that period, public spending registered an average growth rate of 8.5% real.

Consequently, excluding the transitional tax rebates, the fiscal impairment of the previous government was mostly produced between 2007 and 2008, that is, it cannot be explained by the crisis. Thus, it strongly calls our attention that this government is being criticized for an alleged lack of fiscal discipline, when it actually reduced, instead of increased, the structural deficit. Without considering the transitional tax rebates, in the last four years the structural deficit has been reduced from 1.8% to 1.2% of the GDP. It is certainly not a very significant reduction, but it is surprising that the criticism comes from authorities of the former government who were responsible for a structural deficit of 1.9 points of the GDP, between 2005 and 2008.

Has this been a fiscally responsible government? In general terms, the answer is yes. The goal of reducing the structural deficit of 3% of the GDP to 1% of the GDP in 2014 is on the verge of being accomplished. The average growth of public spending estimated for the period 2010-2013 will be around 5.1% real, less than half than last government's figure of 10.5%, and somewhat below the average expansion of the GDP, estimated in 5.4%. Could we have done a greater effort? Probably yes, in a context of greater parliamentary support, it could have been possible to make an additional improvement in the structural balance, but we should recall that in all budget discussions faced by this government, the opposing coalition has put a strong pressure to increase spending; the government has always been considered "stingy". In every social project where the subsidiarity concept came into play, the limits to the beneficiaries were considered the "small print" of the bills, which entailed that the fiscal cost of the bill ended up being quite higher than the initial estimates. Therefore, given the restrictions, some moderation degree has been achieved, at least in terms of prioritizing the spending increases. Table 1 shows the average increases per spending items in both governments, using estimated figures for 2013.

Table 1

	2006-2009	2010-2013
<b>TOTAL SPENDING</b>	<b>10.5</b>	<b>5.1</b>
Staff	9.0	6.4
Consumption and production goods and services	11.2	3.1
Interests	-7.4	12.1
Subsidies and grants	14.6	7.3
Social security allowances	5.9	2.5
Others	13.3	11.5
Investment	14.8	6.9
Capital transfers	16.1	6.2

Source: DIPRES and self estimates for 2013.

It can be observed that this government has managed to significantly moderate spending in goods and services, while the subsidy item grows beyond total spending. Spending on staff is moderated in relation to the previous government, but it grows above the average. It would be very interesting to undertake a study to show the productivity figures of public officers that could justify the relevant increase in resources allocated to this item in the last eight years.

### Conclusions

For the first time in the last decade, the budget discussion will face lower long-term copper prices, which imply a more restrictive income scenario and redoubles the need for cautious spending decisions.

The opposing coalition will use this more restrictive scenario and the request for a very high amount of unrestrictive resources to justify the need for a tax reform. However, the trend of putting “the cart before the horse” is maintained, since the need for substantial additional resources is put forth without a clear knowledge of their destination or, still less, the social profitability of future projects.

Criticism from the opposing coalition regarding an alleged lack of fiscal discipline from the present government cannot be sustained, mainly because they come from the same ones who generated a significant fiscal impairment during their administration, which cannot be explained by the 2009 fiscal stimulus package, since it was created between 2007 and 2008.

This government has achieved a moderate fiscal improvement regarding the structural deficit. A major reduction of the deficit would have been

desirable, however, the pressures for higher spending have come mainly from those who currently question that alleged lack of discipline, and who also rely upon a parliamentary majority.

### In brief...

- With the available information it can be estimated that the total spending in 2014 will not grow above 4% real.
- The opposing coalition will very probably consider that they are being given a restrictive budgetary situation, with the utmost purpose of establishing the need for a tax reform.
- In the same line, there is the strong pressure being exerted by the opposing coalition to the current government in the sense of establishing a large amount of unrestrictive resources in the budget.
- Another issue that will probably be included in the budget discussion is the criticism made by the opposing coalition of an alleged lack of fiscal discipline from this government, which will inherit the next one a structural deficit of 1% of the GDP.
- However, we observe that during the previous government there was a quite significant deterioration, from a structural surplus of 1.1% of the GDP in 2005 to a deficit of 3% in 2009.

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<sup>1</sup> The amount of unrestrictive resources established by the Budget Law in 2010 was US\$300 millions, together with the flexibility of reallocating additional US\$150 millions.

<sup>2</sup> See <http://www.dipres.gob.cl/595/w3-propertyvalue-20816.html>