Chile: Minor Changes in Policy

BHP Billiton CEO Andrew Mackenzie with Chilean President Michelle Bachelet on June 23, 2014. (Photo: Chilean Presidency)

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Perspectives

President Bachelet's policy changes will not impact Chile’s overall sound outlook, experts say.

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Chilean President Michelle Bachelet, who in June marked 100 days in office, has faced criticism from investors who fear that her ambitious reform agenda, which includes overhauls of the tax and education systems, will undermine the country's economic model. Will Chile maintain its strong business climate during Bachelet's presidency? Can investors in Chile rely on its current rules, or will they be dramatically altered? How vulnerable is Chile's economy to a slowing Chinese demand for copper?

Jorge Heine, Chile's ambassador-designate to the People's Republic of China and CIGI professor of Global Governance at the Balsillie School of International Affairs at Wilfrid Laurier University: Past performance is the best predictor of future performance. During her first presidency (2006-2010), Bachelet's management of the Chilean economy won many plaudits, and there is no reason it should be any different this time. That said, one reason she was elected with 62 percent of the vote is because the so-called Chilean model needs some adjustment if it is to continue to provide what the citizenry expects. A number of features of it, including the tax code and the educational system, not only perpetuate the country's huge income inequalities (1 percent of the population gets 30 percent of the income), but actively foster them. That is what triggered the 2011 student demonstrations that caused so much trouble to her predecessor, Sebastián Piñera. Although Chile has one of the highest per capita incomes in the region, the tax intake is a mere 19 percent of GDP, just about the regional average, and well below the OECD mean, of which Chile is such a proud member. The notion that a mere 3 percent rise in this tax intake, to 22 percent, would wreak havoc in the investment rate is quite ludicrous. Investors have always been able to rely on Chile treating them fairly, but that cannot mean an open promise that taxes will never be raised. Yes, Chile is vulnerable to a slowing Chinese demand for copper, but most predictions are that the price (at 3 dollars a pound) will hold steady in the near future.

Guillermo Holzmann, CEO of Analytyka Consulting and professor at the University of Valparaíso, Chile: The structural reforms pushed by the Bachelet government have created a climate of uncertainty in the business sector and the conservative elite regarding the impact on Chile's macroeconomic model. This is in the context of a perception of global slowdown that is affecting the United States, Europe and Asia, a scenario that has created difficulties in the rate of passing a tax reform that modifies the rules of the game and impacts the perception of stability of the middle class and investors. The central problem is the lack of prior agreement within the governing coalition, which has delayed its approval in Congress. The criticisms come from the opposition, which distrusts the benefits heralded by the government, and from the middle class, which fears an increase in individual and small business taxes. For foreign investors, this means waiting for the final version to be approved (foreseen for August) and only then assessing their reaction. The position stated by President Bachelet is to carry out changes within the institutional order and with none of these changes being dramatic or a significant substantive change in the rules of the economic or political game. However, themes referred to as 'values issues' have been included on the discussion agenda, such as therapeutic abortion, energy options, pension reform and the issues of citizen health and security, among others, achieving a climate of confusion and doubt. In this context, the government tries to align its parties in promoting the agenda, and the opposition tries to generate spaces for negotiation by taking extreme positions. Meanwhile, the business owners activate an intense lobby. The process of passing the reforms is advancing slowly, affecting economic confidence, the credibility of the political system and generating frustration in citizens' expectations.

Peter M. Siavelis, professor of politics and international affairs and director of the Latin American and Latino Studies Program at Wake Forest University: Criticisms that Michelle Bachelet's ambitious tax and education reform agendas will somehow undermine Chile's successful economic model are overblown and are based more on party politics than on serious economic analysis. Bachelet understands precisely what her challenge is. She must act to stem the levels of inequality that could, over the long term, potentially squelch Chile's entry into the club of developed nations. She must do so, however, without killing the very goose that is laying the golden eggs that will provide the economic growth necessary for Chile to achieve this status. The proposed increases in corporate taxes are moderate, yet shocking to a business community accustomed to a privileged position since the end of the dictatorship. The average corporate tax burden will be similar to those in other countries with comparable levels of economic development. While the education reforms appear extreme to Bachelet's critics, the government's current proposal to put an end to for-profit education over a period of 10 to 12 years will stem immediate and expensive upticks in educational spending. Educational reform can (and probably should) also change substantially in form and substance as it is implemented. Slowing demand for copper poses a more serious challenge to the economy than any of Bachelet's proposed reforms. However, Bachelet's tax and educational reforms (if properly implemented) may ironically better position Chile to weather the storm of falling copper prices by providing a more diversified economy, a better educated populace and a more equal society.

Gabriel Torres, vice president and sovereign analyst at Moody's Investors Service: President Bachelet's proposed fiscal reform program targets Chile's income inequality and demands for improved access to education. While increased taxes may impact economic activity in the short term, we expect a continuation of the sound macroeconomic approach, including conservative debt metrics and disciplined domestic spending, that has characterized Chile's policy mix for several decades. The reforms highlight Chile's policy commitment to avoid increasing permanent expenditures without fiscally offsetting revenues, a key reason behind the country's very low debt burden. Chile's economic growth fell to 4.1 percent in 2013 compared to a 5.7 percent average the prior three years. Slower growth reflected a more challenging international economic scenario as well as a fall in domestic investment as the business community weighed potential changes in the tax code. The proposed fiscal reform aims to increase the government's revenues by up to 3 percent of GDP, once fully implemented, through a mix of higher taxes and reduced loopholes. Most of the increased revenues will be geared toward education reforms and the rest to close the fiscal deficit. At the same time, a higher corporate tax rate, expected to increase to 25 percent from 20 percent over four years, together with a hike in the stamp tax on loan and bond issuance, would likely raise corporations' cost of capital and limit their ability to invest. This has implications for growth in the short term as corporations account for the lion's share of fixed investment in Chile. Over the long haul, we expect successful implementation of both tax and education reforms to support the economy via productivity gains and increased social stability.

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