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OVERVIEW

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This Overview is extracted from the 2021 Economic Survey of Chile. The Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

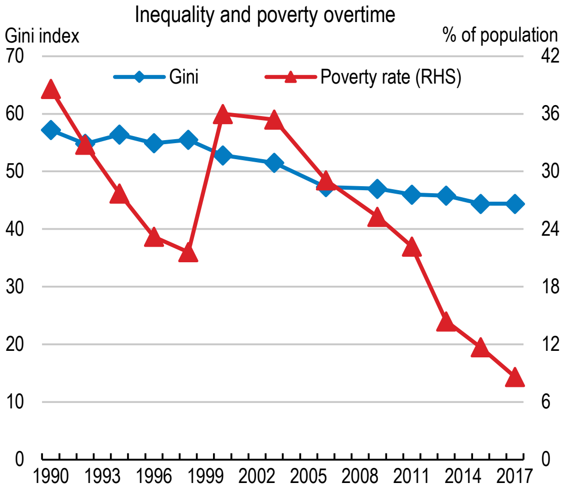
Executive summary

The social protests and the COVID-19 outbreak put the economy to a halt

Chile has experienced tremendous economic progress and sustained poverty reduction over the past decades (Figure 1**)**. During 2020, Chile faced an unprecedented recession after two large shocks, the social protests at the end of 2019 and the COVID-19 outbreak. A strong institutional and macroeconomic framework is allowing Chile to navigate well the crisis.

In the short term, the policy priority should continue to be preventing contagion, continuing the vaccination programme and avoid future waves, supporting the health system, the most vulnerable families, workers and firms. In the medium term and with the recovery underway, Chile should continue an ambitious structural reform agenda to foster inclusive growth and reduce a persistently high level of inequality. As the economy recovers, a window of opportunity may be open to create consensus among citizens around major pending reforms and continue to reduce inequality.

Figure 1. Progress in poverty reduction has been impressive but inequality remains high



Source: World Bank, World Development Indicators database.

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COVID-19 could continue to strike in future waves, delaying the recovery and leaving deeper scars. Chile is set for a gradual recovery over the next two years, with activity returning to its pre-pandemic levels in late 2022. Private consumption will be a main driver of the recovery, temporarily sustained by extraordinary withdrawals from pension funds, public support to households, and a gradual improvement of the labour market sustained by hiring subsidies. Investment will regain momentum at a slow pace, conditional on the evolution of the pandemic and the effectiveness of the vaccination process in an uncertain environment, and will be driven by public infrastructure plans, supportive financing conditions and tax incentives.

Table 1. Chile is set for a gradual recovery

	2019	2020	2021	2022
Gross domestic product	1.0	-6.0	4.2	3.0
Private consumption	1.1	-7.7	7.5	3.4
Government consumption	0.0	-2.1	5.5	1.5
Gross fixed capital formation	4.2	-13.9	1.8	4.1
Exports	-2.2	-0.7	7.2	4.1
Imports	-2.3	-13.4	8.4	5.6
Consumer price index	2.6	2.9	2.6	3.0
Central government financial balance (% of GDP)	-2.8	-8.7	-4.7	-3.8
Current account balance (% of GDP)	-3.9	0.3	-0.2	-0.7

Source: OECD, Economic Outlook 108 database.

The policy reactions to the pandemic have been swift and bold. Chile entered the crisis with the most fiscal space in the region, solid fundamentals and credible institutions. Containment measures were taken early, and the coordination between fiscal authorities, the Central Bank and the financial market regulator has been smooth and swift. The authorities have introduced unprecedented fiscal and monetary stimulus packages, among the largest in Latin America, to mitigate the impact of COVID-19 and preserve jobs and liquidity needs. An agreement between political parties led to a temporary emergency plan in mid-2020 for the next two years to support support a swift and inclusive recovery and a commitment to fiscal consolidation thereafter. Monetary policy has also significantly eased and should continue to support the recovery.

The outlook is bleak and subject to sizeable risks in a higher than usual uncertain environment. Limits to international travel, bans on large public events, and some restrictions on bars and restaurants could persist. The economic impact of the pandemic could be long-lasting, driven by an increase in economically vulnerable households and more indedbted firms. The evolution of the pandemic and its effects on households and firms, the ongoing constitutional review and a series of elections during 2021 could further increase uncertainty and dampen investment. The resurgence or the deepening of social conflicts could also delay the economic recovery. Exports and job creation would benefit from a potentially stronger global recovery than anticipated. The recovery could be stronger if herd immunity through vaccination is reached faster.

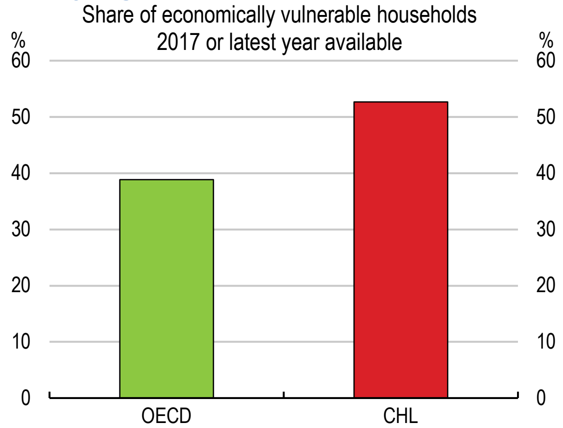
The economic recovery should be accompanied by action to limit the threats from climate change. Chile has a solid track record in this area, but the recovery will give a chance to integrate environmental improvements further in the economic landscape. The unintended negative environmental impacts of new short-term fiscal and tax provisions should be evaluated. The use of financial support measures could be directed towards supporting stronger environmental commitments.

Avoiding hysteresis effects on inequality after the outbreak

More than half of Chileans are economically vulnerable (Figure 2). They are not counted as poor but remain at risk of poverty. They have low productivity, many work in informal jobs associated with little protection and unstable incomes. The outbreak is likely to reinforce these vulnerabilities. Many households will have to deal with plunging incomes, with few financial buffers to cushion themselves and a substantial risk of falling into poverty. Therefore, continuing targeted, temporary income support is crucial in the near term, as done recently with the Emergency Family Income.

Improving educational outcomes would be the most powerful tool to achieve lasting improvements in inequality over time. Access to quality education remains strongly linked to the socio-economic status of the family. Public spending on primary and secondary education is one of the lowest in the OECD. While the effects of these policies will be felt only in the long run, education constitutes a pivotal lever to fight now the consequences that COVID-19 could imprint on inclusiveness. Spending on education should be stepped-up and prioritised on high-quality early childhood, primary and secondary education, as a prerequisite for raising skill levels and expanding tertiary education. Access to affordable childcare would also encourage greater female labour force participation.

Figure 2. The outbreak may reinforce the already high share of vulnerable households



Source: OECD, Wealth Distribution database.

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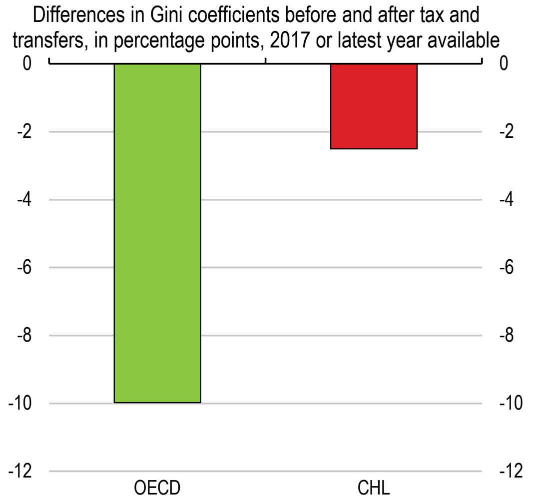
The tax and transfer system could become a key means to reducing economic vulnerability. Taxes and transfers do not provide enough protection against adverse economic shocks (Figure 3). The base of the personal income tax is narrow and broadening it once the recovery is well on its way would raise needed revenue. In return, the extra resources can be devoted to the creation of a negative income tax, which would assure each household and individual a basic benefit.

In response to the outbreak, the government took rapid actions to ensure access to health services for all. There is substantial space to improve the efficiency, quality and equity of the health system. The reform proposal announced at the beginning of 2020 to cover at least 80% of health care costs and the reduction in the price of medications by more than half is a welcome step.

Figure 3. The tax and transfer system could do more to reduce inequality



Source: OECD, Income Distribution and Poverty database.

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Closing productivity gaps to support the recovery, notably through digitalisation

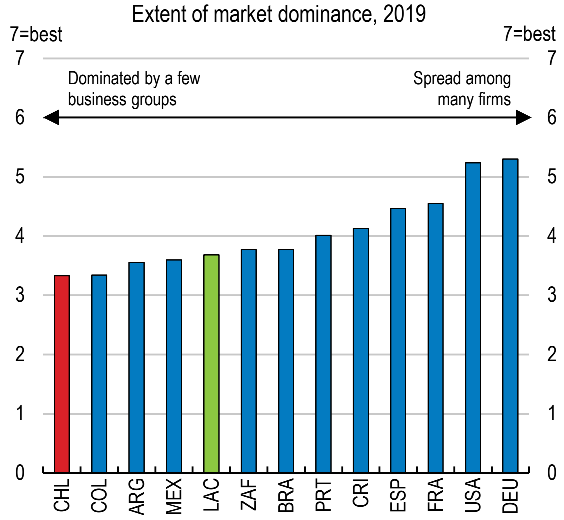
Productivity is low, driven by business polarisation. Chile has a persistent division between a small number of large and productive firms, and a long tail of micro, small and midsize companies with considerably weaker productivity performance. These small firms are likely to suffer more from the lockdown measures adopted to fight COVID-19.

The regulatory environment inhibits competition and the scaling up of firms (Figure 4). Generalising "zero licensing" by involving municipalities in the design of the initiative could ease firm entry and formalisation. This could contribute to reducing inequalities over time by creating better paying jobs.

A further digitalisation of the economy entails great potential to boost productivity in an inclusive way. The COVID-19 outbreak is accelerating the digital transformation, which has seen a surge in e-learning, online shopping and teleworking**.** However, inequality in the adoption of digital tools and digital skills could deepen the already high inequality of opportunities.

The deployment of fixed and mobile broadband infrastructure is essential to fully reap the benefits of the digital era. Replacing the existing burdensome regulation on concessions will be key to fostering deployment of communication infrastructure.

Figure 4. Competitive pressures remain low



Source: World Economic Forum.

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Education and training can be a powerful tool to make sure all Chileans can reap the opportunities of digitalisation. Raising the quality of education from early age is a precondition, and boosting digital proficiencies early will be key. Digital skills should be taught early in school, while ensuring that teachers are adequately prepared for this. A profound reform to the lifelong learning system could ensure that no one is left behind.

To boost productivity, businesses need to raise the adoption and use of productivity-enhancing digital technologies. This is especially true for SMEs, which lag behind in terms of digital tools. Strengthening public support in partnership with the private sector would lower barriers for digital adoption, for example through specific programmes to help SMEs to adopt digital technologies like e-commerce or cloud services. Fostering business collaboration for innovation and open-innovation practices would help SMEs and start-ups to thrive in the digital era.

MAIN FINDINGS	KEY RECOMMENDATIONS
Containing the pandemic and its consequences	
COVID-19 could continue to strike in future waves, costing human lives and amplifying further the economic consequences.	Increase capacity for extensive testing and tracing provide further support to health-care workers, and enhance the provision of masks, ICUs and respirators. Continue transitory support to SMES and the most vulnerable families, including non-conditional cash transfers, tax deferrals and reductions, food baskets or suspension of payments of basic utilities for the poorest households, as long as needed. Going forward the fiscal effort should be focused on making efficient reallocations of public spending, including the elimination of exemptions in the tax system, to support the recovery.
Headline inflation will remain contained.	With well-anchored inflation expectations, keep monetary policy accommodative until the economic recovery is well underway.
Fostering inclusiveness	
Educational achievements are low and access to good education is strongly linked to socio-economic status, posing the risk of a long-lasting effect of the pandemic on poverty and social mobility.	Step-up investment in high-quality early childhood, primary and secondary education. Enhance the provision of childcare and early childhood public structures.
The tax and transfer system is ineffective in providing protection for vulnerable households and the base and redistributive power of the personal income tax are low.	Strengthen the redistributive impact of the personal income tax by lowering the thresholds at which the bottom and top bracket apply.
Individuals and workers often lack the foundation and digital skills necessary to flourish in a digital world.	Increase digital literacy in schools giving digital skills more prominence in the national curriculum, and enhancing the digital skills of teachers and school-directors.
Access of vulnerable workers to training courses is insufficient and many of their job profiles might change in the future or even disappear with further automation.	Embark on a full revision of firm-provided training programmes to increase relevance and quality of training and better target participation to vulnerable workers.
Closing productivity gaps	
The complexity of some regulatory procedures remains high, penalising mostly start-ups and SMEs.	Streamline permits and their process by implementing a zero-licensing procedure to encourage investment and simplify regulations for SMEs.
Adoption of digital tools lags behind other OECD countries, particularly for SMEs.	Boost public support to SMEs, in cooperation with the private sector, trough targeted programmes to facilitate the adoption digital tools.
R&D and innovation expenditure is low, especially in SMEs, and comes mainly from public resources.	Foster a collaborative digital innovation ecosystem by strengthening business collaboration and fostering open-innovation practices.
High-speed fixed broadband penetration is low compared to OECD average and rural/urban disparities are large. Entry barriers in the communication sector are high.	Ensure low barriers to entry to the communication sector by replacing the existing regulation for concessions.
Strengthening green growth	
CO_2 emissions and energy consumption have risen in line with strong GDP growth. Chile has committed to achieving carbon neutrality by 2050 but the recovery after COVID-19 could jeopardise these commitments.	Carefully screen the environmental impacts of stimulus measures in the wake of the outbreak to avoid unintended environmental consequences. Condition direct financial support measures for pollution-intensive sectors that may be particularly affected by the crisis to cost-efficient and verifiable environmental improvements.

1 Key policy insights

The successes of Chile over the last decades are being challenged by an unprecedented recession after facing two large shocks, the social protests at the end of 2019 and the COVID-19 outbreak. In the short term, the priority continues to be a focus on preventing contagion, supporting most vulnerable families, workers and firms. In the aftermath of the crisis and once the recovery is underway, Chile should continue its reform agenda, to allow all Chileans to share better the fruits of economic growth. This chapter identifies policy priorities to support the large cohort of economically vulnerable individuals that is likely to increase after the pandemic, and increase the number of dynamic midsize firms, helping to sustain the recovery and create jobs.

In the last decades, Chile has made tremendous progress towards greater economic prosperity and lower poverty. Per capita income more than doubled over the past 20 years and is now the highest in Latin America. Chile enjoys solid institutions and a strong macroeconomic framework, with well-recognised features that sustain resilience and encourage investment. These include a prudent fiscal policy supported by a fiscal rule and a well-working inflation-targeting framework with an independent central bank. The financial sector is healthy, and successive governments have sought to broaden the productive base of the economy and to boost entrepreneurship and innovation through investments in education and the reduction of product-market entry barriers.

Growth has come to a halt during 2020. Since October 2019, Chile has faced two unprecedented shocks, the social protests and the COVID-19 outbreak. Income convergence was already slowing before these shocks (Figure 1.1, Panel A) amid modest productivity growth. While the past growth performance has lifted many Chileans out of poverty over the last three decades, income inequality remains high by OECD standards (Figure 1.1, Panel B). Well-being outcomes are also mixed, as Chile ranks relatively low on a large number of dimensions tracked by the OECD's Better Life Index, such as security, education, environmental quality and health status (Figure 1.1, Panel C). A rise in the Santiago Metro's subway fare in October 2019 ignited social protests, revealing mounting social discontent with unequally distributed income and well-being outcomes, as many Chileans struggle to make ends meet and reach better living conditions. The protests and the violence that ensued took a first toll on growth prospects and was further compounded by the COVID-19 outbreak, which will have strong economic and social consequences, accentuating the already complex scenario faced by Chile.

Due to the pandemic, the economy experienced a sharp contraction, unprecedented since the 1982 monetary crisis, in 2020. Chile is set for a gradual and uneven recovery over 2021-2022 in a higher than usual uncertain environment, with activity returning to its pre-pandemic levels only in late 2022. Beyond the direct effect of COVID-19 on human health, the economic impact of the pandemic could be long-lasting, driven by an increase in economically vulnerable households and more indedbted firms. Containment measures are still affecting mobility and activity, especially in tourism, retail, wholesale trade, construction and transport, impacting the recovery in employment in these sectors. The evolution of the pandemic and its effects on households and firms,, the ongoing constitutional review and a series of elections during 2021 could further increase uncertainty and dampen investment. Renewed social protests could also delay the economic recovery. Exports and job creation would benefit from a potentially stronger global recovery than anticipated. The recovery could be stronger if herd immunity through vaccination is reached faster.

The policy reactions of Chile to the pandemic, on the back solid institutional coordination, have been swift and bold to preserve the economy and cushion an unprecedented shock for the households and firms (Box 1.1). In the short term, the priority should continue to focus on preventing contagion and avoiding further resurgences of COVID-19, supporting most vulnerable families, workers and firms. In the aftermath of the crisis and once the recovery is underway, Chile should continue its social agenda initiated before the pandemic (Box 1.2), to allow all Chileans to share better the fruits of economic growth. The digital transformation of the economy, which has been accelerated by the COVID-19 outbreak, can catalyse reforms and help in meeting these challenges by expanding the productive assets of the economy, investing in skills of the people, and by providing an environment where all firms and workers in Chile have the same opportunities to succeed.

Figure 1.1. Growth, inclusiveness and well-being outcomes in Chile

Note: In Panel A, LAC refers to the unweighted average of Brazil, Colombia and Mexico. OECD refers to an unweighted average. In Panel B, the Gini index refers to the Gini index defined by the World Bank. Data show 3-year moving averages. OECD refers to an unweighted average. In Panel C, data for the categories Income and wealth, Jobs and earnings and Work-life balance are based on a sample of 35 OECD member countries, excluding Colombia and Lithuania.
Source: OECD, Productivity database; OECD Better Life Index, www.oecdbetterlifeindex.org; World Bank, World Development Indicators database.

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While the COVID-19 crisis may further deepen social discontent, it gives the opportunity to create consensus among citizens around major pending reforms, strengthen common values around the importance of having strong public services and the relevance of belonging to the formal sector. Achieving such economic and social improvements will require further progress toward reducing inequalities and building a stronger middle-class, modernising the State and public services, and raising productivity, competition and the dynamism of SMEs that will be especially impacted by the outbreak.

This survey charts the road ahead for Chile in the aftermath of the pandemic, with the following key messages:

- COVID-19 could continue to strike in future waves, either directly or indirectly through other economies emphasising readiness to react. The scars left by the pandemic will be also a challenge in the medium term. However, solid macroeconomic foundations, credible institutions and sustainable fiscal policy will help recover a robust growth path.
- To make growth sustainable and benefiting to all, Chile needs to reduce the large cohort of economically vulnerable individuals that is likely to increase after the pandemic and increase the number of dynamic midsize firms helping to support the recovery and create jobs.
- During the pandemic, digital technologies are being critical to sustain continuity in business, jobs or learning from home. Digitalisation will play an ever important role in the recovery, while addressing the persistent low productivity.

Box 1.1. Policy responses to the COVID-19 pandemic

Chile has reacted swiftly by adopting social distancing and targeted lockdown measures, as well as fiscal and monetary measures to protect the most vulnerable and to preserve human, productive and financial capacities to enable a return to normality and avoid hysteresis once the measures are lifted. Among the main measures are:

- **State of emergency**: The 18th of March, Chile entered a state of emergency, as authorised by the Constitution. It has been extended several times until 13th March 2021. This is the second time in the past five months, the first having occurred following the social protests of October 2019. This allows controlling supply and dispatch of basic goods and services, monitoring by the army of the streets and using its medical capacity, and restricting the circulation of individuals.
- **Containment measures**: All schools and universities have been closed while winter holidays were brought forward. Local quarantines, mobility restrictions and night time curfews have been applied across the country. The city of Santiago and other large cities were put under a strict lockdown in May, with most containment measures lifted progressively in mid July, when infections started declining. Since then, sanitary measures indicate if stricter or more flexible local containment measures can be applied, with some parts of the Metropolitan area subject to strictier containment measures from December 10th.
- **A national campaign** was launched to inform the public of prevention measures and detection. Testing for people covered by the National Health Fund is free (subject to a prescription), and the price for people covered by private insurers is capped. 2% of the government general budget has also been allocated to raise health spending. Telemedicine regulation has also been eased to promote its use for several health care services.
- **Monetary policy**: In mid-March, the Central Bank cut the interest rate by 0.75 points to 1%, then to 0.5% at end of March. A new funding facility for banks has been introduced while a programme for purchasing bank bonds has been initiated (up to USD 8 billion). A programme for providing liquidity in pesos and dollars through repo operations and swaps has been

extended, as well the window for possible resumption of FX sales and non-deliverable forward operations, that was opened in November 2019 after the social events. In early August, congress passed a law to allow the Central Bank to buy treasury bonds, enriching the Bank's toolkit.

- **Support to individuals and households**: A subsidy (COVID bonus) for vulnerable households, most of them without formal income, was introduced for 1.5 million households. The “Alimentos para Chile” (Food for Chile) programme is providing food baskets and hygiene products to vulnerable and middle-class families across all Chile. A new fund to protect the income of the 80% most vulnerable was also created. Part of that fund is used to finance cash transfers to vulnerable households during 6 months (Emergency Family Income). This also covers independent and informal workers. In January 2021, a new payment of cash transfers has been announced for regions or local communities in quarantine. An emergency package of USD 5.5 billion to save jobs and help small businesses has also been put in place. In addition, the government has introduced the Act on Distance Work and Teleworking to broaden the use of teleworking, and the Act for the Protection of Work (Ley de Protección de Empleo), to protect labour income and reducing working hours or allowing for the temporary suspension of the contractual relationship when teleworking is not possible. Salary is financed from the unemployment insurance under more flexible criteria and social security and health contributions and the corresponding employment rights should be maintained. This mechanism can be used until January 2021.
- **Support to firms**: Payment to state suppliers has been accelerated. The deferral of various taxes benefits numerous SMEs. An accelerated income tax refund for SMEs (in April 2020 instead of May 2020) is expected to benefit also 500.000 SMEs. The capital of the guarantee fund for SMEs (Fogape) has been increased by USD 3 000 million, and by December 2020 250 000 loans have already been granted to finance labour capital. In January 2021, a law modified benefits and uses from the fund (extending it to investment and repayment of credits) to allow more SMEs acess state-guaranteed credits and extended the repayment period for already issued fogape credits. The capitalization of Banco Estado has been also increased by USD 500 million. The resources will be used to provide financing to individuals and SMEs, and will increase Banco Estado's credit capacity by USD 4.4 billion.
- **Recovery plan for the forthcoming two years**: A national agreement achieved between the government and political parties lead to a new emergency plan in June 2020 to support the economy for the forthcoming two years. Its main pillars are: i) protecting households’ income and well-being, with a new emergency family plan, a new solidarity fund at the municipal level, a new health fund, and some improvements to the employment protection law and unemployment insurance scheme ii) a reactivation plan for the economy and the labour market, which includes a public investment plan, hiring subsidies, easing the financing of SMEs, promoting private investment, new teleworking measures, facilitating access to credit and supporting public companies iii) the creation of a new USD 12 000 million fund to finance the recovery plan, to be financed partly by sovereign wealth funds; iv) the creation of a new COVID health fund for the next 24 months; this fund can expire sooner if sufficient economic and sanitary conditions are met.
- **The vaccination plan**: on December 17th, the President announced Chile would start a gradual and progressive vaccination programme on 25^{h} December. About 5 million people will receive the vaccine in the first quarter of 2021, and 80% of the population (about 15 million people) by the end of the first half of 2021.

Box 1.2. Keys features of the social agenda in response to October 2019 protests

In response to the October protests, the government has put forward a number of reforms to bring concrete and effective replies. Among its main proposals are:

- **Temporary measures to support activity and jobs (*Plan de Recuperación Económica*)**, including improving access to and levels of the unemployment benefits, the possibility of negotiating reduced hours for displaced workers after the social events and measures to support micro and SMEs.
- **A major pension reform,** by revamping the pension solidarity pillar to broaden coverage and increasing the pensions of current and future retirees.
- **The creation of a health plan** to benefit 14.5 million Chileans by reducing health care costs and instituting a guaranteed maximum waiting time for treatment.
- **A minimum guaranteed income of CLP 384 000 per month**, subsidised by the government and focused primarily on formal workers whose wages range between the current minimum salary (CLP 320 500) and CLP 384 500. This benefit will be maintained in the case of the suspension of the employment relationship or a reduction of working hours during the pandemic.
- **The creation of a new tax bracket** in the personal income tax for high income taxpayers at 40%.
- **The strengthening of the Municipal Common Fund (*Fondo Común Municipal*)** to establish greater contributions from higher income regions.
- **Cancellation of the rise in subway fare and the freeze of the rise in electricity price.**

In addition, the national referendum held on 25 October 2020 resulted in the decision to adopt a new constitution, to be drafted by a "constitutional convention", made up by members elected solely and especially for the purpose. The election of the delegates will be held on 11 April 2021, together with municipal and regional governor elections. It will be based on universal suffrage, using the electoral system governing the election of the Chamber of Deputies, with additional safeguards for gender parity, a quota for indigenous peoples and promotes the participation of people with disabilities. The process of rewriting the constitution will last two years, before there is a final public referendum in end-2022.

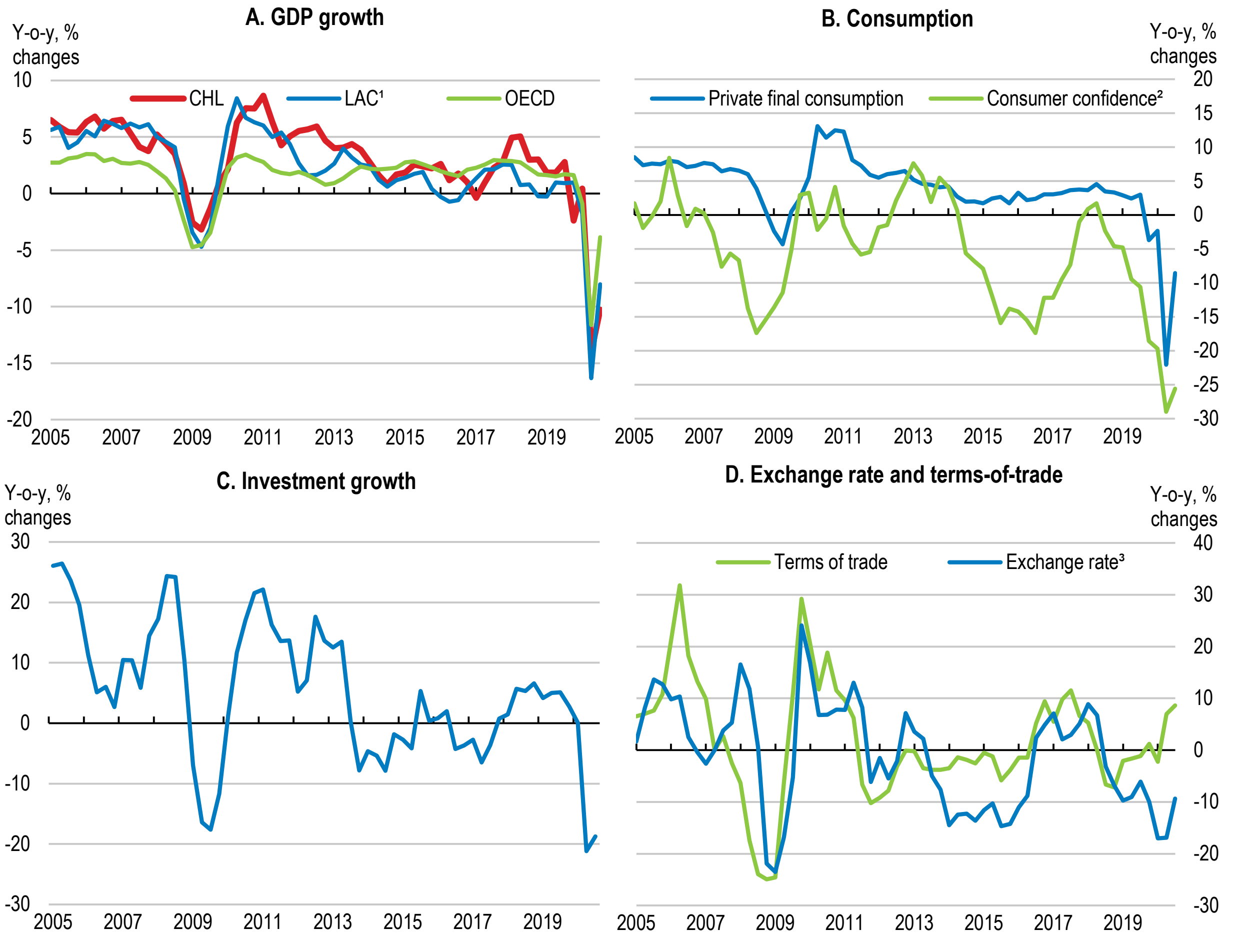
Recent macroeconomic developments and short-term prospects

The Chilean economy entered into recession driven by the COVID-19 outbreak

The pandemic has amplified the growth decline following the social protests in the last quarter of 2019. Growth was robust until the third quarter of 2019 led by domestic demand, but has slowed significantly since the start of the social protests towards end 2019 (Figure 1.2, Panel A). Private consumption plunged by 3% in the last quarter of 2019 as consumer confidence dropped (Figure 1.2, Panel B), a trend that the pandemic has aggravated significantly. While investment recovered slightly before the outbreak it has plunged significantly since (Figure 1.2, Panel C and D). Net exports are contributing positively to growth as imports have experienced a much larger slump than exports driven mainly by resilient mining exports.

Economic activity has started to recover in the third quarter of 2020. With containment measures being relaxed gradually since July, short-term and mobility indicators suggested that economic activity started to recover, particularly retail sales and manufacturing output, while tourism and hospitality continue to be weak. The announcements in December of stricter containment measures, mainly in the Metropolitan area, are reflecting a very gradual recovery. Business sentiment has improved considerably and consumer confidence has picked-up, even if both fell during December 2020 with the resurgence of mobility restrictions.

Figure 1.2. Growth started to decelerate before the outbreak



Note: 1. LAC refers to the unweighted average of Argentina, Brazil, Colombia and Mexico. 2. Consumer confidence is equivalent to 50 minus the value of the index. A value under (over) 50 indicates pessimism (optimism). 3. Nominal exchange rate in US dollars.
Source: OECD, National Accounts database; OECD, Analytical database; Central Bank of Chile.

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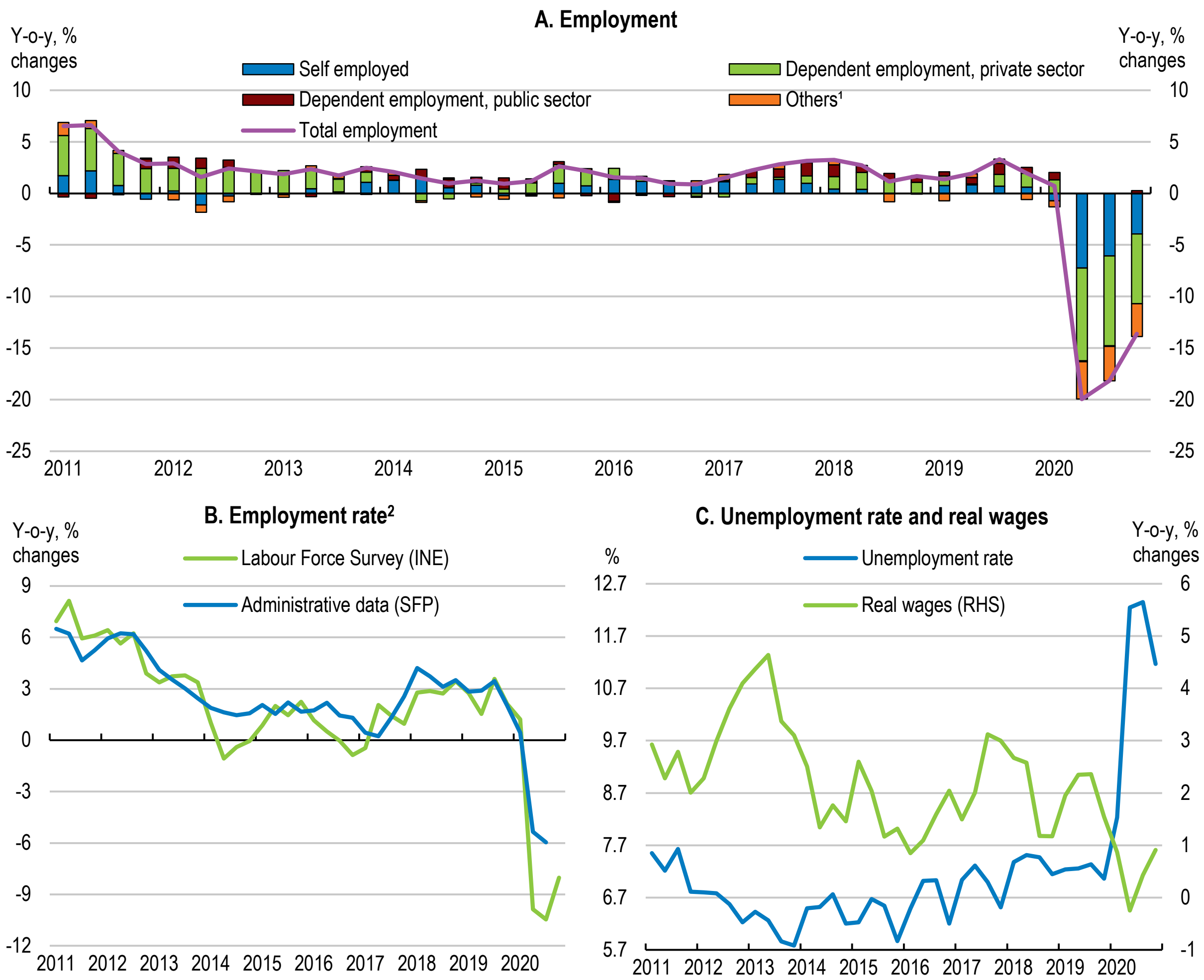
The labour market has been largely impacted by the COVID-19 outbreak. During 2019, the labour market remained subdued (Figure 1.3, Panel A), as the immigration wave of the last five years, with 1.2 million foreign people residing in Chile in 2018 (6.7% of the total population) added to labour supply. The impact on the labour force is potentially significant, considering that immigrants have a greater participation rate than the native population.

Because of the pandemic, 1.6 million jobs have been lost since the beginning of 2020 to September, accounting for around 20% of the workforce. Half of such decline is explained by the destruction of formal employment, deepening the trend started as a result of the social unrests. Informal employment, which regularly acts as a buffer during economic contractions, has also slowed down significantly. The unemployment rate increased to 12.3% during the third quarter of 2020, the worst performance in recent decades. Furthermore, more than 120 thousand firms requested the temporary suspension of contracts and 9 thousand have reduced working hours, for around 900 thousand workers until October 2020, around 10% of all workers. Moreover, the weakness of the labour market has been reflected in a 13.5% decline of the workforce in September 2020 with respect to the same period the year before. The labour market has started to improve slightly in the third quarter of 2020 (Figure 1.3, Panel B) as the unemployment rate reached 10.8% in November 2020, with informal employment showing better performance. Wages picked up by 0.4% in third quarter of 2020 (Figure 1.3, Panel C).

Figure 1.3. The labour market has been significantly hit

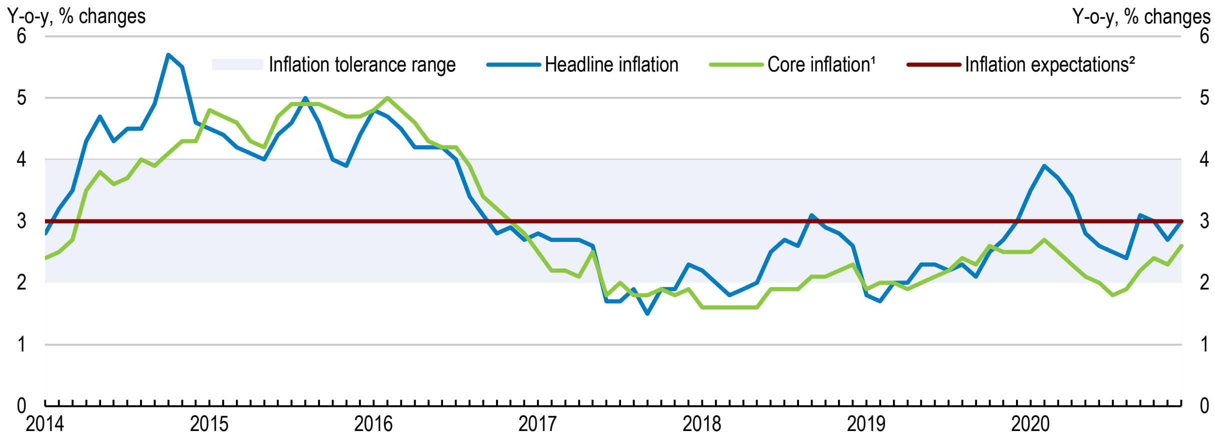


Note: For all panels, data for 2020Q4 refers to the average of October and November 2020. 1. Employers, domestic service and unpaid family members. 2. Considers only employees who contribute to the pension system. Data for all charts refer to quarterly data.
Source: National Statistics Institute (INE).

StatLink https://doi.org/10.1787/888934193231

Inflation expectations remain well anchored at 3% in the long-run. While inflation has been around 2% during most of 2019, the lower bound of the tolerance band of the Central Bank target rate, it is now near the target level (Figure 1.4). The drop in the prices of services and a relatively weak pass-through from currency depreciation account for the weakness of inflation before the social protests started. Since then, the pandemic sent the Chilean peso to historical lows in March 2020 with the worsening financial conditions of international markets, accelerating inflation and prompting the Central Bank to extend its intervention programme aimed at ensuring liquidity and stabilising the peso, which was put in place in a welcome move following the social events. As the peso is starting to recover gradually, this programme will be gradually wound down. Additionally, the extraordinary withdrawals from pension funds have push demand for durable goods, pushing prices and inflation up.

Figure 1.4. Inflation is on target and expectations remain anchored



Note: 1. Core inflation includes all items without energy and fuels. 2. Inflation expectations at 23 months.
Source: Central Bank of Chile; National Statistical Institute (INE).

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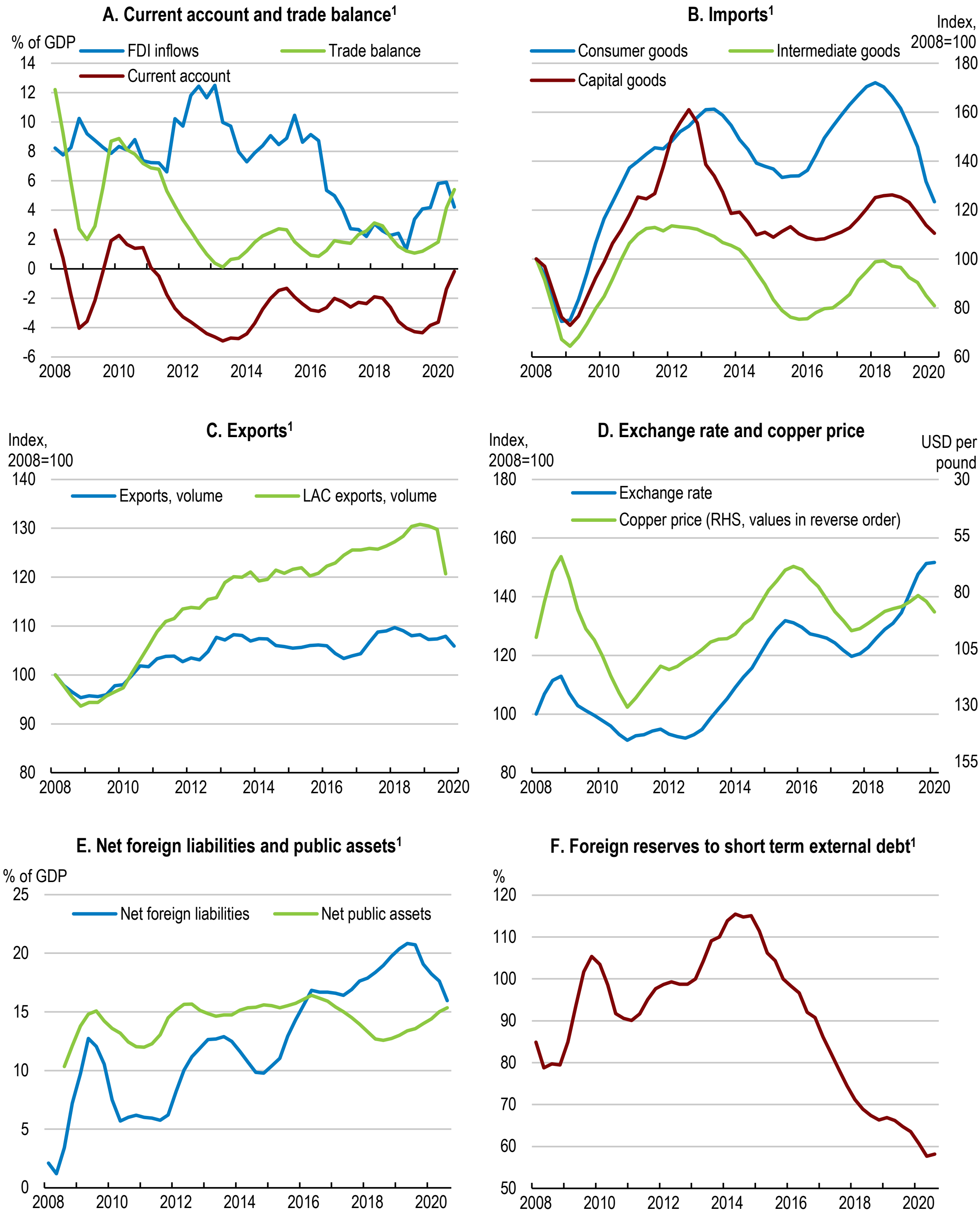
Until the end of 2019, strong domestic demand and moderate exports increased the current account deficit, which has been in negative territory since 2011 (Figure 1.5, Panel A). Imports responded to the higher level of economic activity until the social unrest and the dynamism of investment (Figure 1.5, Panel B). Export performance has been weak even before the pandemic (Figure 1.5, Panel C), affected by weather conditions, lower copper ore grade and an already decreasing international price of copper (Figure 1.5, Panel D). The pandemic has reversed the current account and put it in surplus in the second quarter of 2020 and balance the rest of the year, driven by the surplus in the trade account and a narrow primary income deficit. Driven by a large drop in investment, imports have experienced a much more pronounced decline than exports. Mining exports have been resilient, given the fast rebound of the Chinese economy. In March 2020, copper was the least performing among metals, but its price is now back to pre-pandemic levels. Low oil prices benefit the current account given that Chile is a net oil importer.

The current account deficit has been, and will remain, largely financed by FDI inflows, mainly to the mining sector, while net foreign liabilities remain limited. Net external public assets remained stable at 15% of GDP before the outbreak and reserves have decreased to around 60% of short-term external debt (Figure 1.5, Panels E and F). However, since the beginning of the outbreak the whole region is experiencing substantial capital outflows, surpassing the levels reached in the aftermath of the 2008 financial crisis. On a global scale, FDI is expected to fall between 30% to 40%, decreasing the most in economies that are most severely hit by the pandemic (UNCTAD, 2020[1]). Those outflows have also resulted in strong stock market falls since the beginning of 2020. While the COVID-19 crisis has not originated in the financial sector, it has affected markets and created high volatility. In March 2020, Chile's main stock index IPSA fell by 5.9%, to a four-year low. The arrangement passed with the IMF in May 2020 for a flexible credit-line, combined with the comfortable level of international reserves, should boost confidence among foreign investors.

Figure 1.5. The current account has moved into surplus during the pandemic



Note: 1. Four-quarter moving averages.
Source: OECD, Analytical database; Central Bank of Chile.

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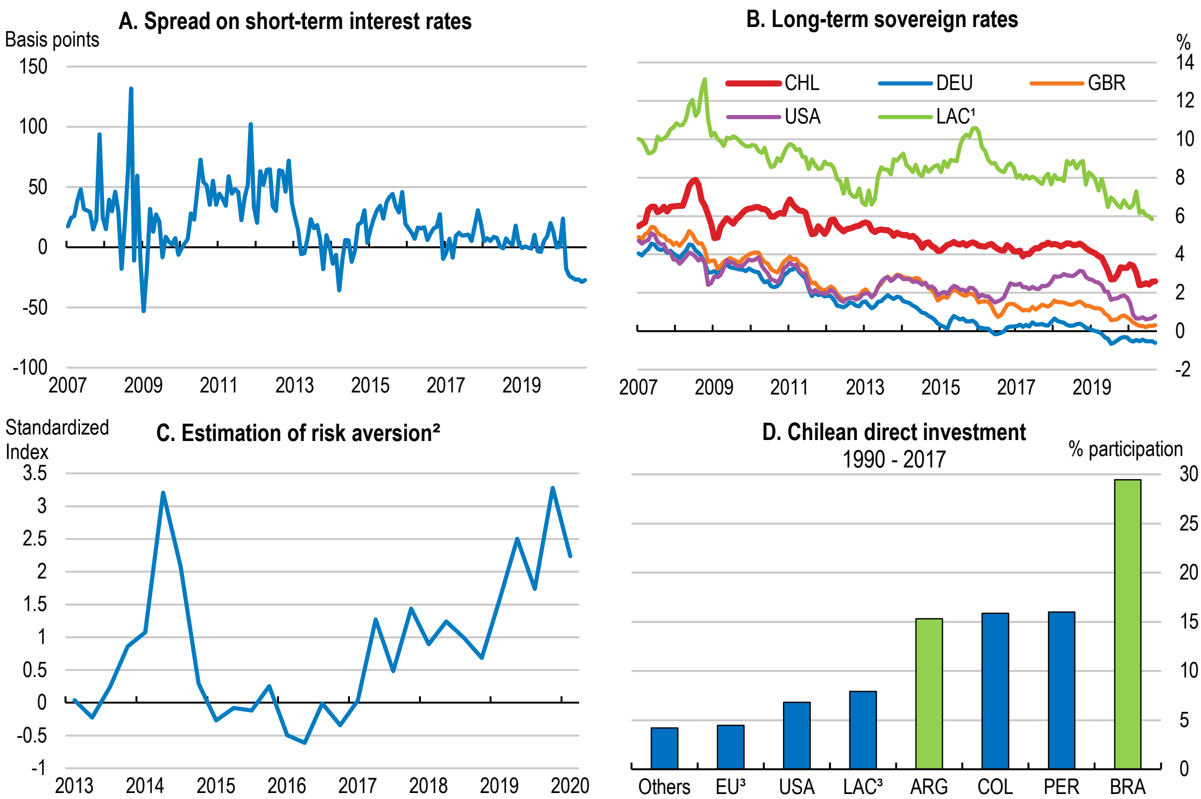
Financial stability remains well preserved but the outbreak poses unprecedented risks

Despite the uncertainties triggered by the social protests and the COVID-19 outbreak, financial conditions remain favourable and the banking sector is solid. The spreads of short-term interest rates are low (Figure 1.6, Panel A). Long-term sovereign rates spiked after the first social protests and at the arrival of coronavirus in Chile, but prompt policy responses contained both these surges and put sovereign-rates on a downward trajectory (Figure 1.6, Panel B). Moreover, stress tests indicate that banks still have sufficient capital to withstand a severe adverse scenario. However, the steady decline in long-term sovereign rates before the events, as elsewhere in the region, has induced greater risk appetite by investors, which could be further reinforced by the outbreak, as investors will search for yields while interest rates are cut on a global scale. This could trigger a potential impact on risk and term spreads (Figure 1.6, Panel C). The drop in international trade following the outbreak could also increase financing costs by raising uncertainty, particularly in emerging countries. The macro-financial vulnerabilities of some Latin-American economies remain also high and will likely be magnified by the pandemic, in particular in highly-indebted Brazil, whose economic cycles are important for Chilean firms with investments there (Figure 1.6, Panel D).

Figure 1.6. Financial conditions stay favourable



Note: 1. LAC refers to the unweighted average of Brazil, Colombia and Mexico. 2. Differential between real and implied volatility of DXY Index. Positive (negative) values indicate higher (lower) risk appetite relative to the historical average. 3. EU and LAC refer to unweighted averages.
Source: Central Bank of Chile database; Central Bank of Chile, Financial Stability Report First Half 2019; OECD, Analytical database; DIRECON, Presencia de Inversiones Directas de Capitales Chilenos en el Mundo 1990- 2017, 2018.

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Resurgence of the pandemic and social tensions are the main risks to the outlook

Similar to most countries in the world, the fight against coronavirus is pushed Chile into recession during 2020, with economic growth expected to decline to -6% (Table 1.1). The economy suffered a sharp contraction in the second quarter of 2020, driven by the hit to global growth, copper prices below their long-term level and the impact of containment measures on consumption and investment, with some sectors such as tourism completely paralysed. However, economic activity began to recover during the third quarter of the year as containment measures started to be lifted gradually in July.

Table 1.1. Macroeconomic indicators and projections

	2019	2020	2021	2022
	Percentage changes, volume (2013 prices)			
GDP at market prices	1.0	-6.0	4.2	3.0
Private consumption	1.1	-7.7	7.5	3.4
Government consumption	0.0	-2.1	5.5	1.5
Gross fixed capital formation	4.2	-13.9	1.8	4.1
Final domestic demand	1.6	-8.3	5.9	3.3
Stockbuilding[1]	-0.6	-1.3	-1.4	0.0
Total domestic demand	1.0	-9.6	4.5	3.3
Exports of goods and services	-2.2	-0.7	7.2	4.1
Imports of goods and services	-2.3	-13.4	8.4	5.6
Net exports[1]	0.0	3.6	0.0	-0.2
Memorandum items				
GDP deflator	2.6	6.7	3.6	2.5
Consumer price index	2.6	2.9	2.6	3.0
Private consumption deflator	1.9	3.1	2.7	3.0
Unemployment rate (% of labour force)	7.2	10.8	9.8	8.7
Central government financial balance (% of GDP)	-2.8	-8.7	-4.7	-3.8
Current account balance (% of GDP)	-3.9	0.3	-0.2	-0.7

Note: Seasonal adjusted data. 1. Contributions to changes in real GDP, actual amount in the first column.
Source: OECD, Economic Outlook 108 database.

Solid fiscal and monetary policy frameworks allowed the authorities to pursue bold measures, which prevented an even stronger contraction and are avoiding deeper scars from the pandemic. The USD 12.1 billion package (4.9% of GDP) passed in March and subsequently completed by a further 2% of GDP in April, among the largest packages in the region, are supporting workers and households and providing liquidities and working capital to companies, particularly SMEs, to prevent the destruction of jobs and capital when a large part of the economy is at halt. Additionally, after an agreement among political parties, an emergency package for the next two years has been agreed to support the economic recovery through enhanced income support for vulnerable households and the middle-class, hiring subsidies, a strong public investment programme, and liquidity measures for firms in need.

Economic recovery will be gradual and uneven in the next two years in a higher than usual uncertain environment. The economy will rebound to 4.2% during 2021 and 3% in 2022. Private consumption will be a main driver of the recovery, driven by measures implemented by the government to support households, the transitory impact of extraordinary withdrawals from pension funds, and a gradual improvement of the labour market supported by hiring subsidies. However, precautionary savings will remain high. Private investment will start to recover only slowly conditional on the evolution of the pandemic in a higher than usual uncertain environment and a worsen financial situation of firms do to the pandemic. The countercyclical fiscal policy response also includes a significant increase in public investment of infrastructure, while the private investment pipeline over the next five years has increased, amid supportive financing conditions and tax and government incentives. Mining exports have been resilient and Chile will further benefit from recovering global demand, especially from China and the United States.

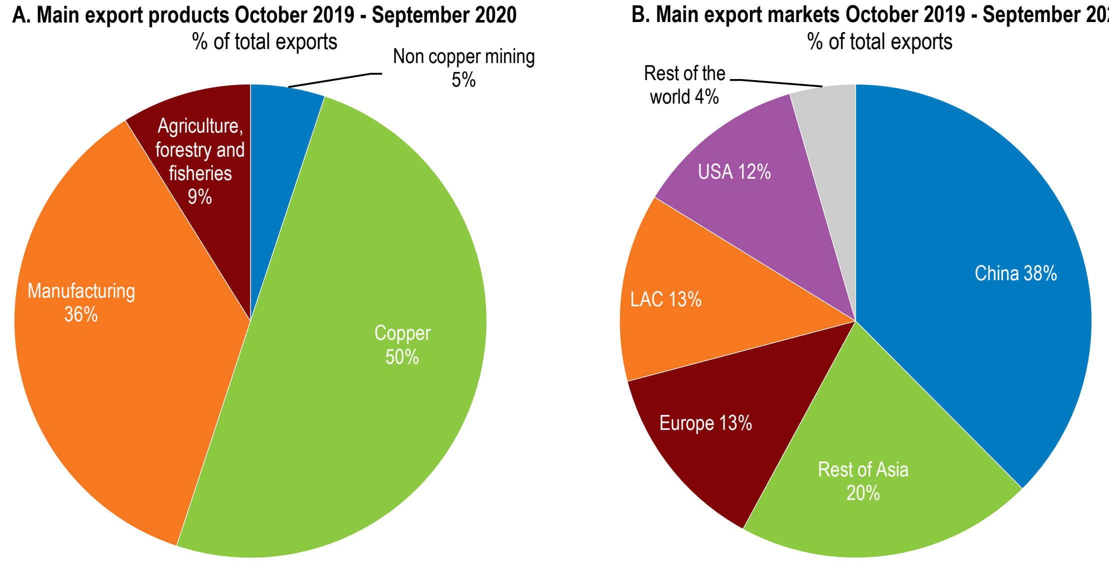
The evolution of the pandemic, which require distancing and local containment measures during 2021, could delay economic recovery. Limits to international travel, bans on large public events, and some restrictions on bars and restaurants could persist, notably if the tracking and isolating system is not strengthened. In that scenario, the prolonged period of depressed output will trigger some hysteresis effects with higher long-term unemployment due to permanently lost jobs, already highly indebted firms facing a weak financial situation could face bankrucies with capital scrapping and a hit to productivity, with the destruction of knowledge and human capital attached to the gone production factors.

The main domestic risks to growth relate to the persistence of the outbreak, with the permanent scars that it could leave on households and firms, and the resurgence of social conflicts after the outbreak. With a programme of vaccination being gradually developed and cumulative infection rates not sufficiently high to generate adequate herd immunity, immediate priorities should be to continue with the vaccination programme and increase capacity for extensive testing and tracking programmes, provision of treatment for all patients, regardless of whether they are insured or not, to provide support to health-care workers, enhancing the provision of masks, ICUs and respirators, and ensuring a timely and effective enforcement of mitigation measures, while sustaining an adequate risk communication strategy. For the economy, monetary measures should be maintained as necessary to provide liquidity to uphold domestic demand and facilitate business. Fiscal measures to support firms, in particular SMEs, and additional cash transfers in support to the most vulnerable families including non-conditional cash transfers, tax deferrals and reductions, suspension of payments of basic utilities, or extending the deliveries of food baskets initiated in May 2020, could be further needed until the recovery is well underway.

Once the outbreak is contained, a failure or a delay to deliver on the social agenda and renewed social instability represent an additional risk to the outlook. The implementation of the announced social reforms will maintain stability. On the contrary, the resurgence and even the deepening of social conflicts may amplify and protract the deep recession due to the outbreak. The uncertainty induced by the process of rewriting the constitution could act as a drag on domestic and foreign investment decisions.

External risks are related to the concentration of exports in copper and the performance of key trading partners (Figure 1.7, Panel A). The effects on the Chilean economy of further waves of COVID-19, globally or particularly in the United States and China could be significant since both countries account for almost half of total exports (38% for China and 12% for the United States) (Figure 1.7, Panel B). This could lead to copper prices below their long-term levels, could deteriorate the fiscal accounts and the terms of trade, create pressures on the Chilean peso and delay the rebound of economic growth, with a potential marked downward adjustment in investment. Overall, it is estimated that for a fall in a percentage point of growth in both China and the United States, Chile grows by one point less (IMF, 2019[2]). On the contrary, an earlier and sustained recovery in China would significantly brighten the outlook for Chile. Finally, the economy could also confront additional unforeseen shocks, which are difficult to include in the projections (Table 1.2).

Figure 1.7. The concentration of specialised exports to China and the United States is a risk to growth



Source: Central Bank of Chile.

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Table 1.2. Events that could lead to major changes in the outlook

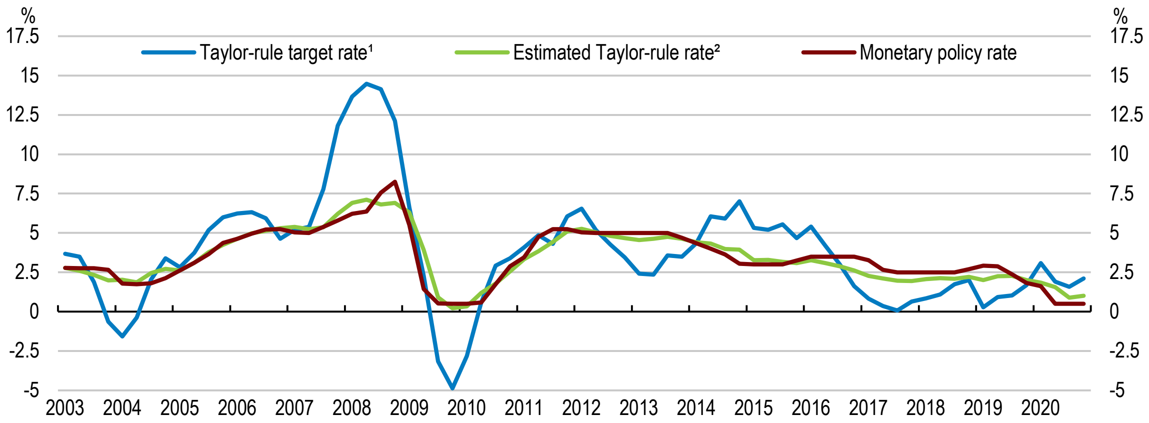
Shock	Potential impact
Prolonged global trade disruptions.	Export prospects would decrease.
Increased domestic one-off events such as weather variability and natural disasters.	Depending on the nature and scale of the natural disaster, the fall in output from agriculture and other sectors could be regional or national.
Strong deterioration of the outlook in other LAC countries	Financial linkages could trigger instability, FDI outflows and expose vulnerabilities
Permanent low plateau for copper prices	Deterioration of the fiscal accounts and postponement of recovery

The macroeconomic policy framework is solid

Monetary policy is appropriately accommodative

The Central Bank conducts monetary policy under an inflation-targeting framework and a flexible exchange rate regime. Skilful monetary management and an independent Central Bank have led to strong confidence in the framework, which helped anchor inflation expectations. Inflation expectations remain anchored at 3%, allowing the Central Bank to maintain its sound conduct of monetary policy (Figure 1.8). The Taylor rule shows that monetary policy started to become more accommodative in 2019, supporting activity in an economy operating below potential and in the context of global economic softening and financial market volatility. The social protests and the COVID-19 outbreak have put inflation on a downward trajectory during the first half of 2020. In response to decreasing inflation expectations and to support activity, the Central Bank slashed its interest rate to its lowest level since 2009: after a first cut from 3% to 1.75% in October 2019, the interest rate has now been at 0.5%, the technical minimum, since April 2020 in response to the pandemic. Liquidity lines have also been put in place, alongside the purchase of bank bonds worth USD 5.5 billion. The financial market regulator has also delayed the full implementation of Basel III. These measures allowed credit flows to increase instead of decreasing during such unusual times. Going forward, with inflation expectations firmly anchored, monetary policy should remain accommodative and support the recovery, although the programme of bank bonds purchasing is coming to a limit as there are now few left on the market. In this context, and in order to enhance the Central Bank's ability to weather further shocks to the financial system, the government passed a Constitutional reform to provide the Central Bank the ability to purchase Treasury bonds on the secondary market under exceptional circumstances. Such purchases had been forbidden by the Constitution before. In January 2021, the Central Bank initiated a programme to to buy USD 12 000 million to restore and expand the country's international reserves.

Figure 1.8. Monetary policy is accommodative



Note: 1.The displayed Taylor rule is computed as: nominal interest rate = real natural interest rate + inflation rate + 0.5 (inflation gap) + 0.5 (output gap); the inflation target is set at 3%; the natural real interest rate is taken to be 1%, as suggested by the Central Bank of Chile (2019).
2.The estimated Taylor rule rate is based on a simple quarterly regression of nominal interest rate on lagged nominal interest rate, current inflation and output gap estimated over 2002-2013.
Source: OECD Calculations and Central Bank of Chile, Monetary Policy Report June 2019, Santiago.

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Chile's fiscal position remains strong

Chile has years of prudent fiscal management driven by a strong fiscal framework, and the structural budget deficit has been broadly stable until 2017 (Table 1.3). The structural rule adopted in 2001 works under the principle of adjusting revenues both by the cycle of economic activity and the fluctuations in the price of copper around its long-term level. This fiscal framework has recently been improved in line with OECD best practices: the periodicity of fiscal reports has increased, while a new Financial Management Evaluation Report and a Public Sector Human Resources Report have been incorporated. Moreover, a welcome newly created Autonomous Fiscal Council, constituted in 2019 and which replaces the previous Fiscal Advisory Council, aims at enhancing the transparency and accountability of the fiscal framework.

The combination of a credible fiscal rule with financial and monetary policies managed by an autonomous Central Bank will allow Chile to maintain its macroeconomic strength and support counter-cyclical policy. However, repeated shocks in recent years (global financial crisis and the 2010 earthquake) have exposed gaps in the framework. Since 2008, the rule has been subject to repeated revisions in the face of these shocks, mainly because of the difficulty of disentangling structural and cyclical factors. The structural balance target set out by decree has been modified several times, given the lack of a well-defined escape clause: in 2010, after the social protests of 2019 and again after the domestic appearance of the COVID-19 outbreak. Defining clear escape clauses would add transparency to the fiscal rule. Additionally, specifying a long-term debt target clearly linked to the medium-term structural balance target, would provide a direct link with sustainability objectives proving more transparency and credibility to the management of public finances.

Table 1.3. The structural budget deficit was stable until recently

Percentage of GDP

	2011	2013	2015	2017	2018	2019	2020[4]	2021[4]
Total revenues	**22.6**	**20.9**	**21.1**	**21.0**	**22.0**	**21.4**	**19.8**	**22.3**
Copper revenues	2.3	1.0	0.4	0.5	0.6	0.4	0.6	0.6
Non-copper revenues	20.3	19.9	20.7	20.5	21.4	21.0	19.2	19.7
Total expenditures	**21.3**	**21.5**	**23.2**	**23.7**	**23.6**	**24.3**	**28.0**	**32.6**
Social spending[1]	14.3	14.7	15.8	16.5	16.4	17.1		
Other public spending	2.1	2.0	2.6	2.4	2.6	2.6		
Public investment	4.3	4.3	3.9	4.3	3.8	3.7		
Interests	0.6	0.6	0.7	0.8	0.8	0.9		
Fiscal balance	**2.3**	**-0.1**	**-2.6**	**-0.7**	**-0.2**	**-1.3**	**-8.2**	**-4.3**
Structural balance	**-1.0**	**-0.5**	**0.5**	**-2.0**	**-1.5**	**-1.5**	**-3.2**	**-4.7**
Structural primary balance[2]	**-0.8**	**-0.2**	**0.9**	**-1.5**	**-0.9**	**-0.9**	**-2.3**	**-3,9**
Fiscal impulse[3]	**-1.0**	**0.1**	**-1.0**	**0.9**	**-0.6**	**0.0**	**1.4**	**1.6**
Gross debt	**11.1**	**12.7**	**17.3**	**23.6**	**25.6**	**27.9**	**33.7**	**36.4**
Net debt	**1.0**	**-1.3**	**-5.0**	**-13.0**	**-15.6**	**-18.4**	**-26.3**	**-30.8**

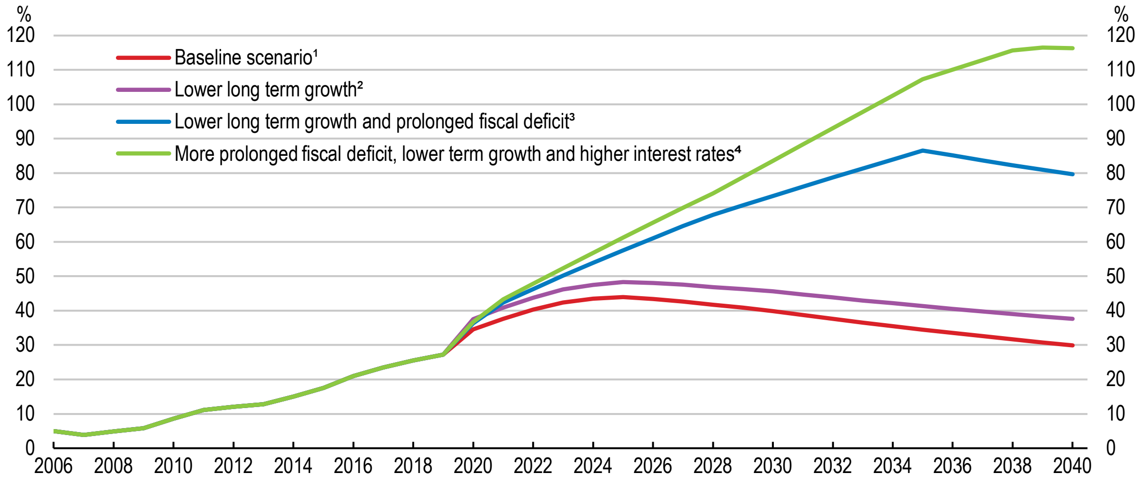
1. Education, health and social protection.
2. Structural deficit (national definition) plus net interest payments. Copper revenues are cyclically adjusted using an estimate of long-term copper prices .
3. Change in structural primary balance.
4. Forecasted by Dipres in the Public Finances Report from the third quarter of 2020.
Source: Dipres.

Authorities remain committed to the fiscal rule and a medium-term fiscal path balancing consolidation and social spending. The social events and COVID-19 entail greater spending in a context of considerably weaker economic activity, leading to plunging revenues. After the social protests, the structural deficit was foreseen to rise to 3.2% of GDP in 2020 from 1.2% foreseen in Budget Law for 2020, as social reforms raised spending permanently as a response to the large-scale social crisis. Most of the increase in spending due to the pandemic is foreseen to revert in the short-term, not affecting the structural deficit. The historically large government response to the pandemic, and low copper prices during the first months of the outbreak will increase the fiscal deficit to 8.2% of GDP in 2020. A strong sovereign balance sheet enables Chile to partly finance deficits through asset drawdowns from its stabilisation fund. The government used USD 2.6 billion in 2019 for the social crisis and will draw USD 3 billion in 2020 for the coronavirus crisis, leaving USD 9 billion available, 3% of GDP, some of which could be used to finance the recovery plan.

Under a baseline scenario where growth recovers in 2021 and then stabilises at around 3% in volume terms, inflation remains close to the central-bank target, and the government implements a gradual fiscal consolidation plan of 0.2% of GDP (until reaching a 0% structural balance), which is below the official path of 0.7% set before the pandemic, gross central-government debt will remain on a sustainable path, after having achieved a peak of 44% in 2022 (Figure 1.9). With lower long-term growth after 2022, at 2% per year, the gross debt-to-GDP ratio would only be slightly above the baseline in 2040. However, if the authorities were only able to shrink the primary deficit by 0.05% of GDP each year, government debt could reach 80% of GDP in 2040, or 120% if the consolidation was further delayed and interest rates on government debt were to rise significantly.

Figure 1.9. Illustrative public debt paths

Public debt to GDP projections under different scenarios



1. Baseline scenario where long-term growth remains close to 3% in volume terms, inflation is close to the central-bank target and ageing costs are included. The nominal interest rate on government assets is set at 2%.
2. Same assumptions as in 1, but nominal long-term growth of 5%.
3. Same assumptions as in 2, except primary deficit achieves balance in 2035.
4. Same assumptions as in 2, except primary deficit achieves balance in 2040 and the real long-term interest rates are higher by 1.5 percentage point over 2020-2040.
Source: DIPRES, OECD Economic Outlook 108, Central Bank of Chile and OECD calculations.

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With the start of the relaxation of lockdown measures, fiscal policy should continue to support public health, providing resources to the health system for monitoring and tracing cases of contagion, and ensuring the availability of diagnostic tests and achieving herd immunization through vaccinations. Similarly, support measures for families and firms should be reviewed and adapted with the gradual return of economic activity, efficiently refocusing transfers to displaced vulnerable workers in the most affected sectors and dropping those who can or could be reintegrated.

Once the pandemic is under control, given the strong impact of the COVID-19 crisis on economic activity, public finances, poverty and inequality, reform could further support both the reconstruction of economic activity and to improve the fiscal situation. The newly agreed economic emergency plan, to run over the course of two years, goes in the right direction to support a swift and inclusive recovery, balancing the need for income and employment support with measures to foster a fast economic recovery. Moreover, prior to the two shocks, the government passed or approved some structural reforms, such as the tax modernisation act, that will notably support consolidation by allowing to raise more revenues (Table 1.4). Going forward the fiscal effort should be focused on making efficient reallocations of public spending, including the elimination of exemptions in the tax systems, which would also support the recovery. Authorities, and particularly a recently formed expert commission, are working to review tax expenditures and aim to set long-term path for fiscal reform reviewing the tax system with particular attention to progressivity and tax evasion.

Altogether public debt remains sustainable and Chile will continue to have the most fiscal space in the region. The new temporary economic emergency plan will protect household incomes and raise spending, particularly for the most vulnerable, while the emergency spending for the outbreak, which also targets the most vulnerable, will help containing the permanent destruction of jobs and capital, allowing to re-start the economy on a growth path close to the one before the events. In fact, in the current low-interest rate environment it is possible for Chile to support the economy if further outbreaks materialise, and be more ambitious on structural reforms after. The large financial surplus of the private sector will reinforce the downward pressure on interest rates globally, which will remain below Chile's growth potential, keeping the debt sustainable, as long as the temporary fiscal measures are phased out once the recovery is fully underway. The main downside risk to the fiscal situation of Chile remains essentially the political uncertainties and social tensions that could sustain a prolonged recession, affecting public finances. As a result, continuing with the social reforms after the recovery remains essential to stabilise the country further.

Table 1.4. Past OECD recommendations on macroeconomic policies

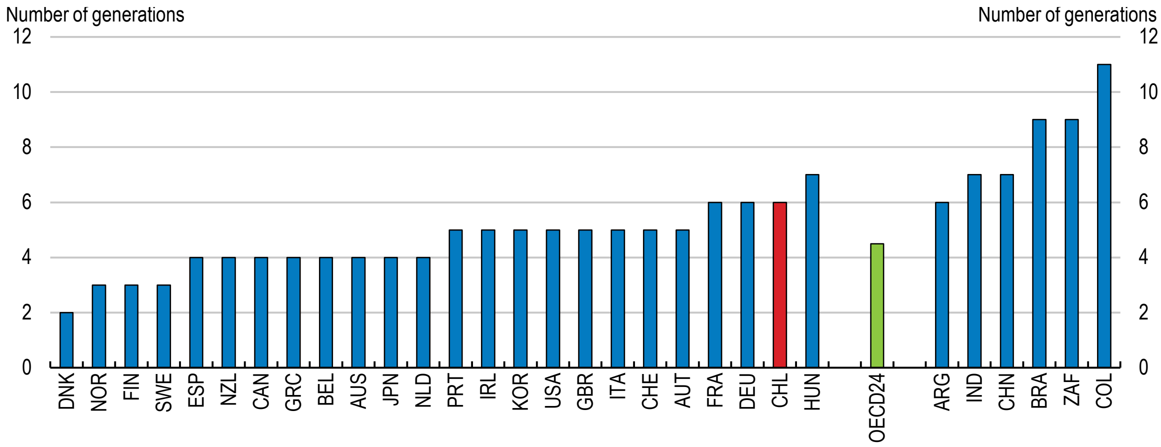
Recommendations	Actions taken since the 2018 survey
Implement the banking law, which incorporates Basel III capital adequacy requirements and strengthens supervision.	In 2019, the National Congress approved the new General Banking Law (GBL), a step toward the convergence process of national regulation with international standards under Basel III. In addition, a new General Banking Law updates the corporate governance and powers of the banking regulator. The implementation of the Basel III requirements has been postponed by one year, but the schedule for the issuance of all regulations for December 1 2020 is maintained.
Secure the mandate, resources and independence of the Fiscal Advisory Council in Law and strengthen its role in medium-term budgetary planning.	The Autonomous Fiscal Council (CFA), created in February 2019, replace the Fiscal Advisory Council. It is constituted as an autonomous body of a technical and consultative nature endowed with legal personality and its own assets.
Increase further public revenues from environmental, property and personal income taxes to increase equity and stimulate growth over time.	The Tax Modernisation Law was approved in early 2020. The main measures are (1) increase in the top PIT rate, from 35% to 40% for individuals that earn more than 15 million Chilean pesos per month (2) return to one single Corporate Income Tax (CIT) regime for businesses. The regime will differ for large firms and SMEs. SMEs that have earned average profits in the last 3 years of less than 75000 UF (approximately EUR 2.45 million) will benefit from a reduced CIT rate of 25% and a full dividend integration regime.; (3) accelerated depreciation to stimulate investment; (4) introduction of a progressive surtax for property with fiscal value exceeding 400 million pesos; (5) changes to Green Tax will tax pollutant emissions rather than capacity to generate these emissions; (6) mandatory e-invoicing; (7) VAT is levied on business to consumer supplies of digital services from non-resident vendors (8) old-age tax relief for low-income property owners.

Avoiding hysteresis effects on inequality after the outbreak and building a stronger middle class

Chile has managed to sharply reduce poverty in the past three decades, as the benefits of the commodity boom and sound government policies lifted 30% of Chileans out of economic deprivation (ECLAC, 2018[3]). However, this momentum has now slowed and the pandemic could reverse this trend, as a large number of households have to deal with the prospect of falling into poverty due to a drop in their income and few financial buffers to cushion the shock. Moreover, limited social mobility perpetuates a high level of inequality in Chile, hampering notably the building of a strong middle class. Currently, it would take 6 generations for the offspring of a poor family to reach the average income standards (Figure 1.10). As a result, COVID-19 could have long-lasting effects on inequality.

Figure 1.10. Social mobility is low in Chile

Expected number of generations it would take the offspring from a family at the bottom 10% to reach the mean income in society



Note: These estimates are based on earnings persistence (elasticities) between fathers and sons and the current level of household incomes of the bottom decile and the mean income, assuming constant elasticities.
Source: OECD publication, "A Broken Social Elevator? How to Promote Social Mobility" (2018); OECD, Income Distribution database.

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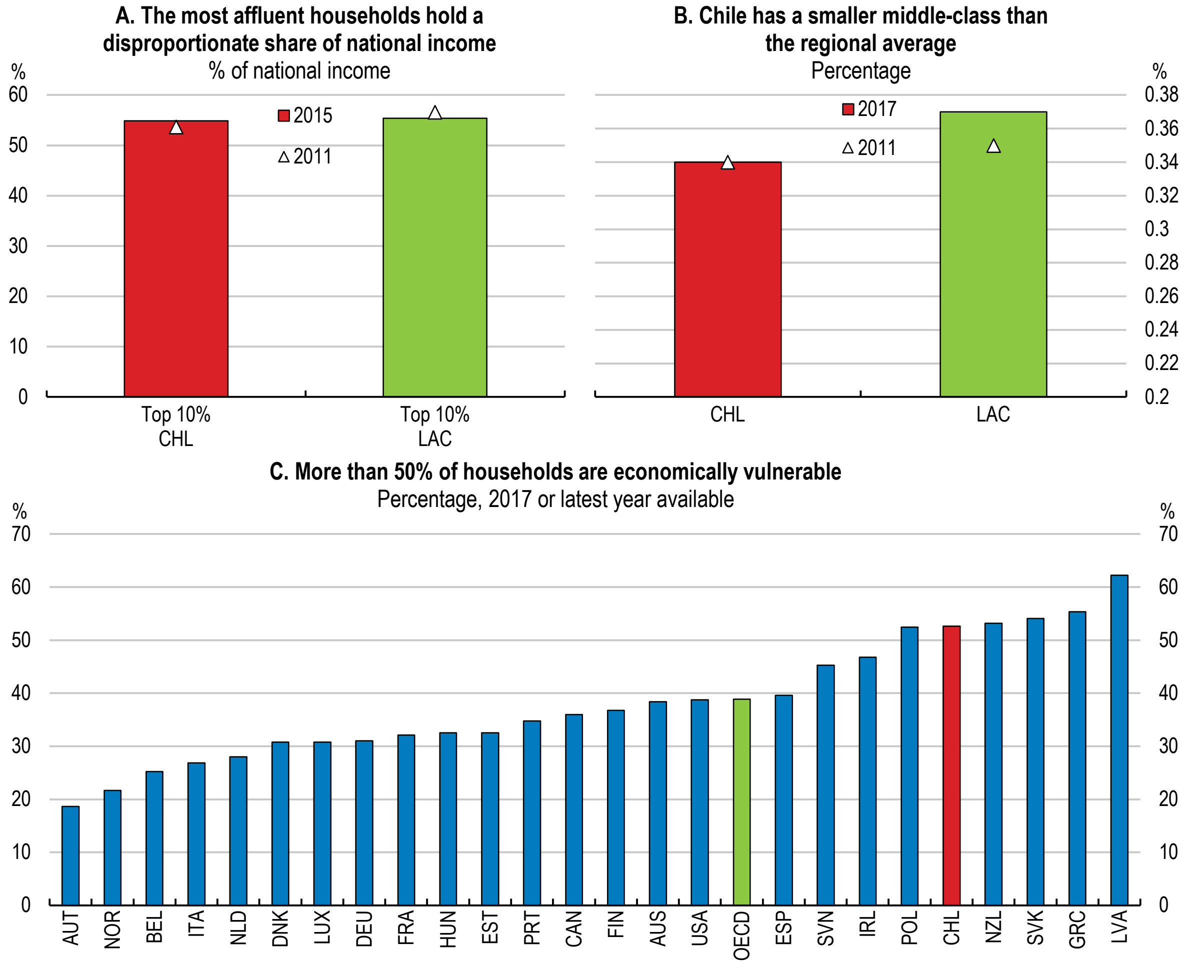
Economic vulnerability is a brake to inclusive and sustainable growth

The structure of inequality in Chile is characterised by income polarization and a relatively thin middle. At the top, the share of income owned by the richest 10% is high, albeit on par with the region (Figure 1.11, Panel A). In the middle, the share of income accruing to the middle class is comparatively low (Figure 1.11, Panel B). Finally, in the bottom poverty is compounded by a further half of the population not counted as poor but economically vulnerable, due to a lack of sufficient minimum liquid financial assets to cope with an adverse income shock. This is one of the highest prevalence in the OECD (Figure 1.11, Panel C), with the majority of vulnerable households generally concentrated above the poverty line but below the median income and at risk of falling back into poverty (Balestra and Tonkin, 2018[4]). The aftermath of the coronavirus outbreak is likely to reinforce these vulnerabilities, putting more Chileans under serious financial strain.

To cope with the adverse income shock due to the outbreak, vulnerable households will have to cut on core, essential spending. Core spending is defined as the spending on consumption categories that are unavoidable to cover necessities and basic needs, such as housing, clothing, food and transportation, on which households have no real possibility of choice, as they cannot live without (Sen, 1981[5]). In Chile, it is already unequally distributed, with households at the bottom of the income distribution allocating 70% of their total spending on core items (at least 50% for 80% of Chileans), while for the richest households it is 45% (Figure 1.12). Stated otherwise, the 20% poorest households can only manage to allocate freely 30% of their budget to non-basic but essential spending such as education and health, but also to other areas such as recreation and culture, which remain important for well-being. Spending on transportation services, which triggered social unrest at the end of 2019, is a case in point: the 20% poorest households allocate twice as much of their budget on them than the 20% richest households. The increase in food prices during the pandemic will also exacerbate the regressive profile of core spending, and the programme “Alimentos para Chile” puts in place recently is a welcome step to cushion such effect.

Figure 1.11. Economic vulnerability is high while income is concentrated at the top



Note: In Panel A, LAC refers to the definition of Latin America in the World Inequality Database. In Panel B, the middle class is defined as the households situated between the 40th and 80th percentiles of the distribution. LAC refers to an unweighted average from the OECD Income Distribution and Poverty database. In Panel C, the "economically vulnerable" are those who are not "income poor" but have equivalised liquid financial assets below 25% of the income poverty line. The OECD average is the simple country average.
Source: World Inequality Database, https://wid.world/; OECD, Income Distribution and Poverty database; OECD, Wealth Distribution database.

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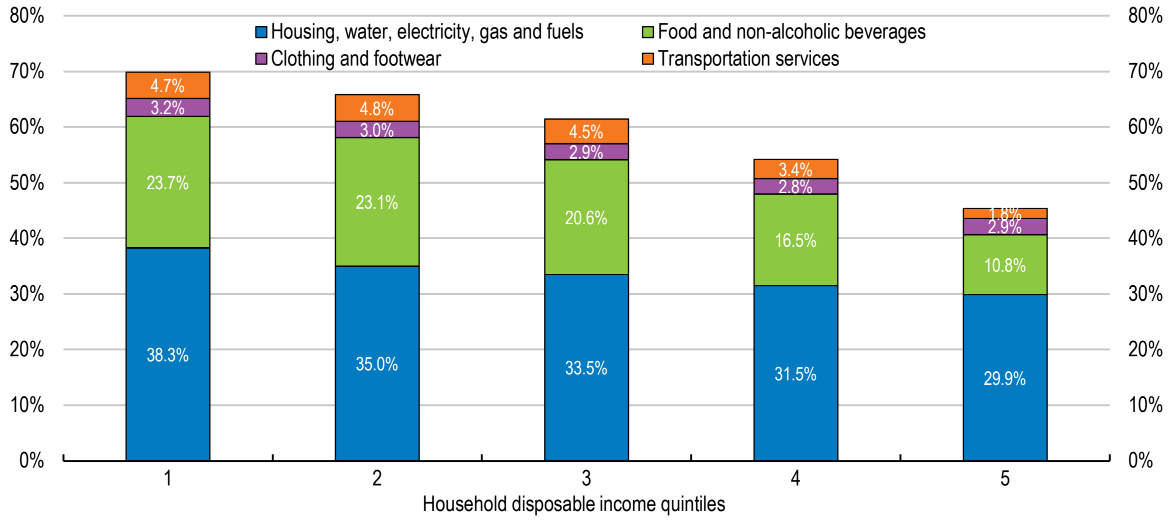
Figure 1.12. Core spending falls disproportionately on the poorest sections of the population

Share of core spending (as a % of total budget) along the income distribution, 2017



Source: OECD computations based on Casen Survey (2017).

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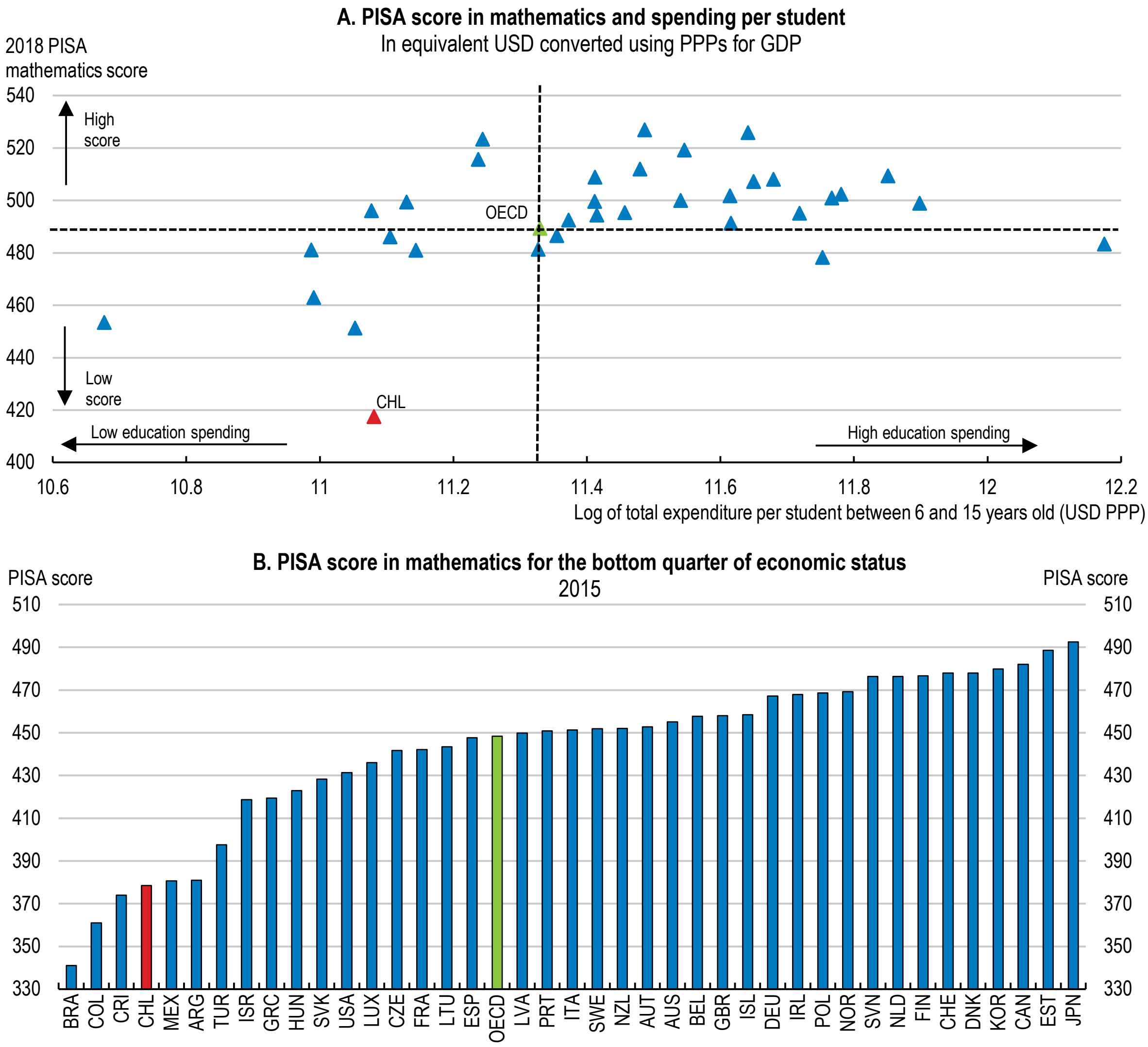
Spending on education should focus more on early levels

To reduce economic vulnerability and foster inclusiveness and long-term growth, Chile must build a strong and prosperous middle-class. Improving the educational outcomes of Chileans would be a powerful tool to achieve this. While the effects of these policies will be felt only in the long run, they constitute a pivotal lever to fight now the consequences that COVID-19 could imprint on inclusiveness in Chile. Indeed, school closures across the countries will have a long-lasting negative impact on the accumulation of human capital, mainly for the children from the most vulnerable households. The actions taken by the government to enhance digital means and online resources for education in the first three months of the pandemic are thus a welcome step to cushion such adverse impact. Nonetheless, despite important improvements during the last decade, public educational spending efficiency and academic achievement are amongst the lowest in OECD countries (Figure 1.13, Panel A). Furthermore, access to good education in Chile is strongly linked to the socio-economic status of the family (Figure 1.13, Panel B).

To address these challenges, several recent reforms have been introduced. The inclusion and equity law of 2015 ends student selection in public schools, which was an important driver of inequality as students from disadvantaged backgrounds tended to be penalised by the selection. In 2018, two laws related to higher education were approved, creating a National System for Quality Assurance of Higher Education (*SINACES*), and strengthening the power of the National Council to develop a National Training Strategy of vocational technical education. The laws also addressed the institutional funding for public universities and established free higher education for students that belong to the bottom 60% of the income distribution. These reforms go in the right direction, but could be complemented by transformations of the educational system at lower levels.

Figure 1.13. Quality and inclusiveness of education are low



Note: In Panel A, data on total expenditure per student between 6 and 15 years old refer to 2017 for Chile and 2016 or latest available year for all remaining countries. The OECD refers to an unweighted average of latest available data for its member countries. In Panel B, Argentina refers to region of Ciudad Autónoma de Buenos Aires. Socio-economic status according to ESCS which refers to the PISA index of economic, social and cultural status.
Source: PISA 2018 Results (Volume I) - © OECD 2019; PISA 2015 Results (Volume I): Excellence and Equity in Education - © OECD 2016; OECD, Education at a Glance database.

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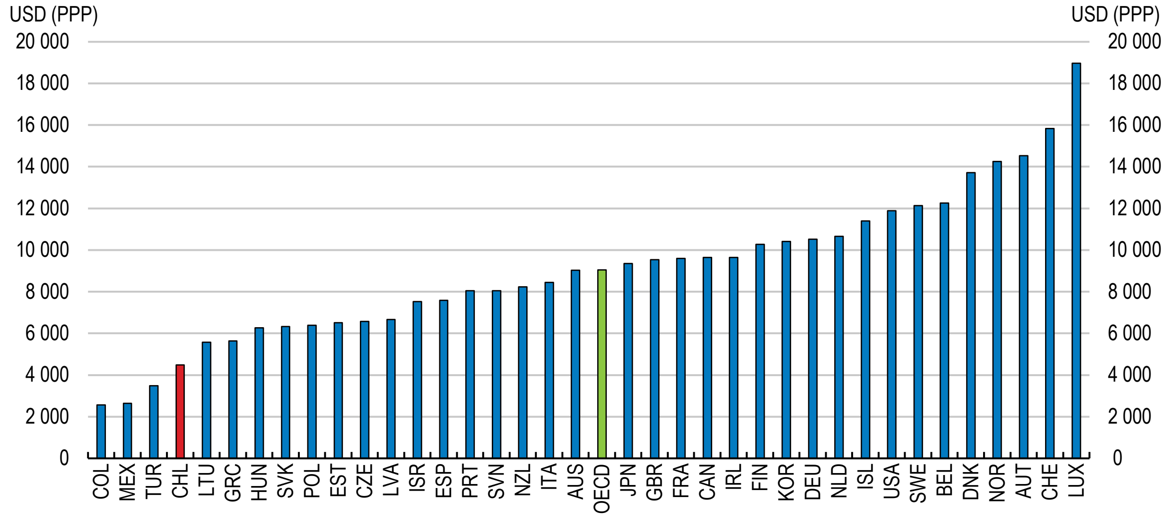
Chile spends half of the OECD average on pre-primary, primary and secondary education (Figure 1.14). Increasing the quality of lower-level schooling across all segments of the population is key for improving productivity, but also for raising participation in higher education (OECD, 2017[6]). Public spending on education should thus be increased and focus on high-quality early childhood, primary and secondary education, as a prerequisite for raising skill levels, expanding tertiary education and raising equality of opportunities. A new programme, currently under discussion and aiming at stepping-up spending on education for child above two years old, would be a welcome step in this regard.

Figure 1.14. Spending in pre-primary, primary and secondary education is lagging behind

In equivalent USD converted using PPPs for GDP, general government expenditure, based on full-time equivalents



Note: Data for Chile refer to 2017. Data for the OECD refer to an unweighted average from 2016.
Source: Education at a Glance 2019: OECD Indicators - © OECD 2019.

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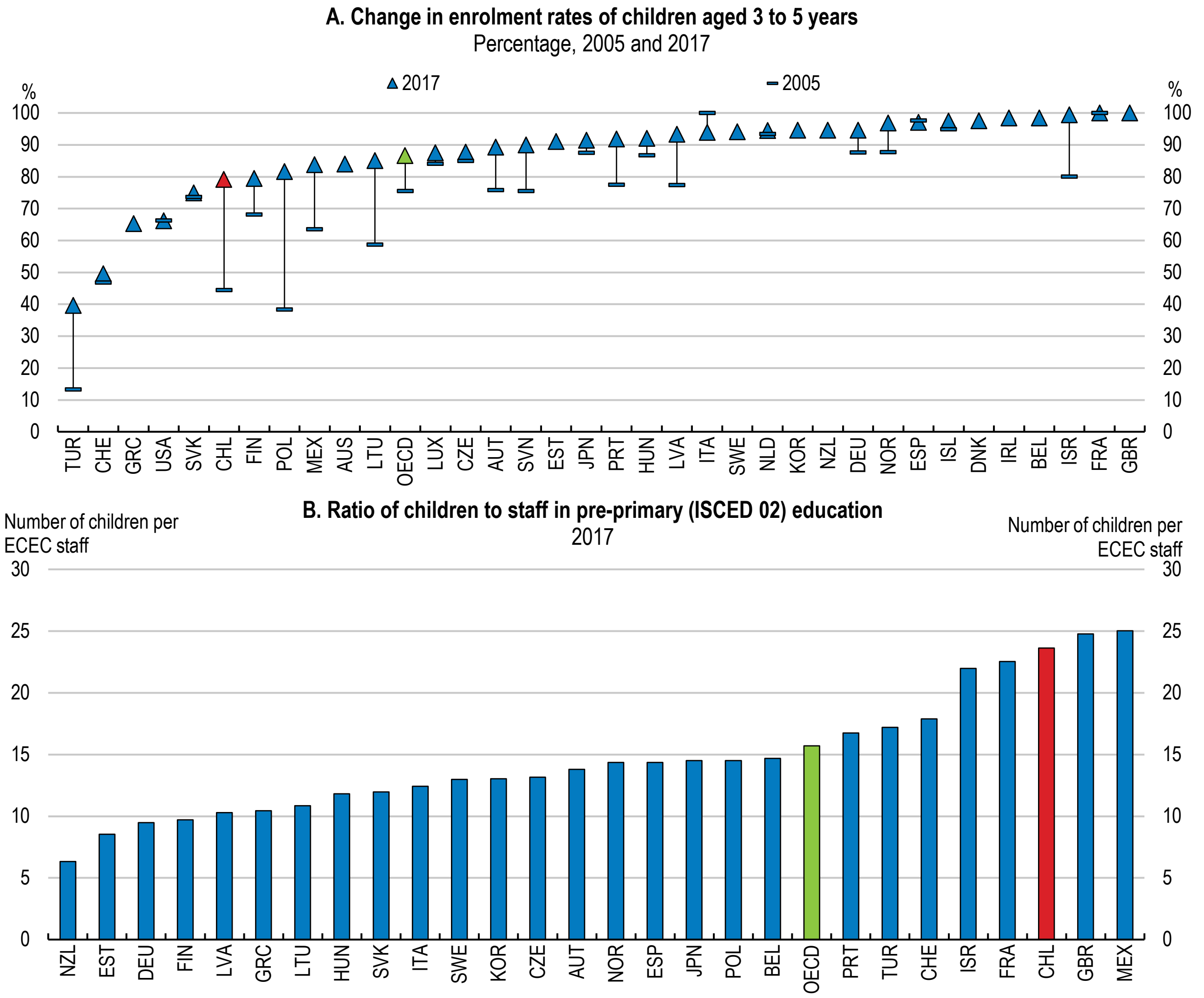
In particular, early childhood education and care has been shown to yield large returns because a person can build on the acquired learning as input in later education stages, resulting in a process of dynamic synergies (Heckman and Mosso, 2014[7]). Returns from early intervention are particularly high for children from disadvantaged backgrounds. Access to affordable childcare and pre-schools are thus strong instruments to ensure equity in compulsory education. Moreover, it entails the double dividend of encouraging greater female labour force participation.

The enrolment rate has almost doubled in Chile over the past 15 years for children aged 3 to 5 years (Figure 1.15, Panel A). Yet, the ratio of children to teaching staff, an important indicator of the resources devoted to, and the quality of, education, remains one of the highest in the OECD (Figure 1.15, Panel B). This ratio should be lowered, which would be conducive to improve the quality of education in the earliest stages. Smaller ratios can be particularly beneficial for children from disadvantaged backgrounds, because they allow staff to focus more on the needs of each child.

Figure 1.15. Enrolment in early childhood education has increased but quality remains low



Note: In Panel A, countries are ranked in ascending order of the enrolment rates of 3-5 year-olds in 2017. In Panel B, data for France exclude independent private institutions. Data for Japan on staff do not cover all ECEC services. Data for Sweden cover ISCED 0 instead of pre-primary education (ISCED 02).
Source: Education at a Glance 2019: OECD Indicators - © OECD 2019.

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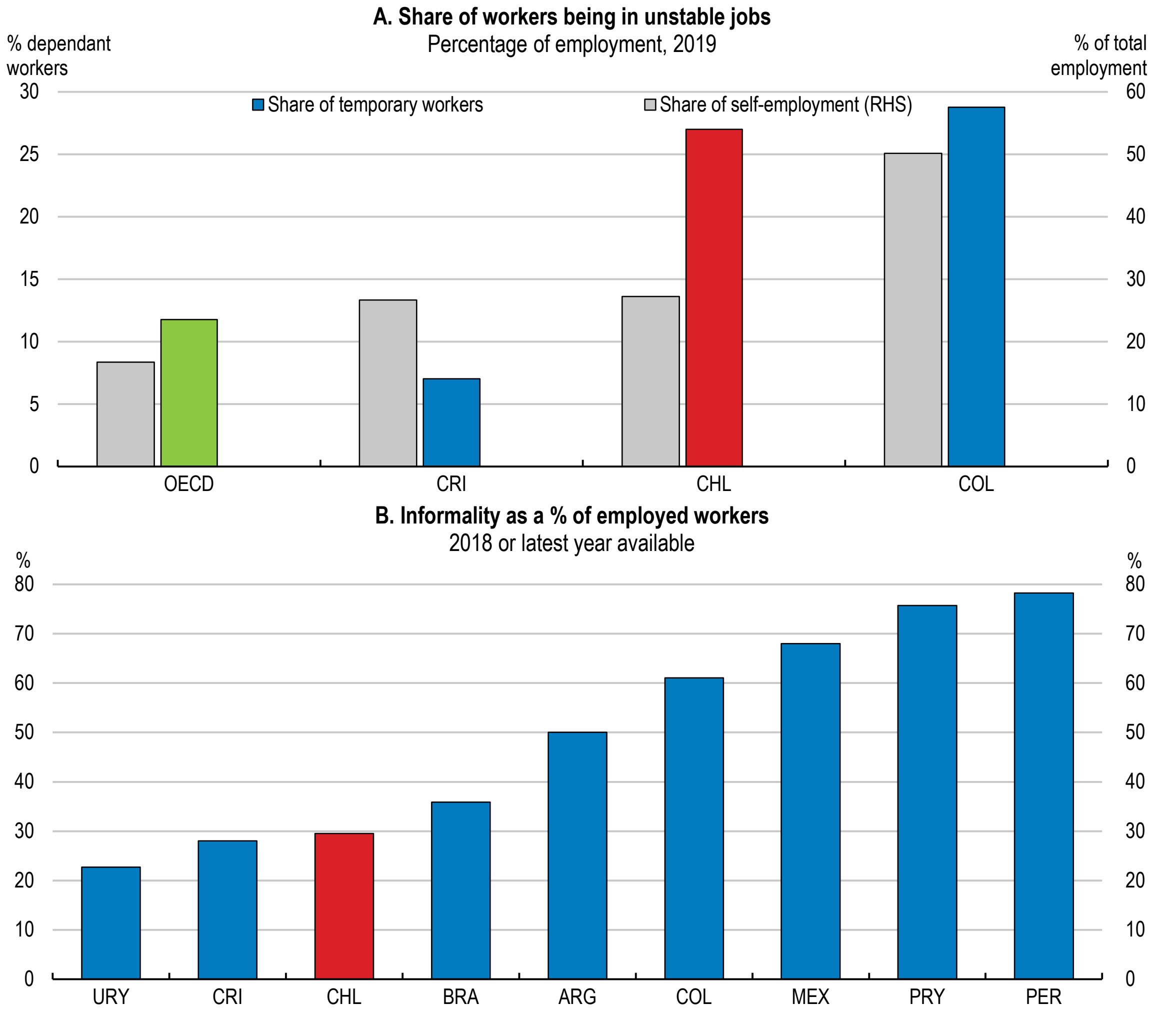
Raising equality of opportunities through labour market inclusion

The quality of employment opportunities is crucial for equal chances of succeeding in life, by enhancing career prospects over the lifecycle and reducing inequality from a dynamic perspective. The Chilean labour market shows an entrenched duality, with almost 40% workers being in formal but unstable jobs (Figure 1.16, Panel A). Informality, notably through self-employment, is also important, with almost one third of the total workforce being in the informal sector, although this is among the lowest shares in Latin America (Figure 1.16, Panel B). Both are preventing many workers from accessing unemployment insurance, severance pay, childcare, training and pensions. As such, the recent reform that incorporates independent workers to social security goes in the right direction. Moreover, moving out of informality and precarious jobs is difficult, and starting a career with such jobs may have negative consequences for future labour market prospects, hampering workers to move up along the income distribution (Petreski, 2018[8]).

The coronavirus outbreak will also deteriorate the precarious conditions of informal workers, despite the financial support provided by the government for this population (e.g. *Ingreso Familiar de Emergencia* and *Bono Covid*). The outbreak may also increase informal employment as laid-off workers struggle to survive. Migrants, youth and the low-skilled are particularly affected by precarious work (OECD, 2015[9]), and the outbreak is likely to amplify this prevalence. Access to quality jobs is difficult for young and low-skilled workers who are often trapped in informal or temporary jobs, or joblessness. The same applies to students who have the additional burden of combining education with a job, albeit the recently passed reform on alternative part-time aims at easing such balance.

Figure 1.16. Duality and informality remain high



Note: In Panel B, informal workers are defined as those workers not contributing to the pension system.
Source: OECD, Labour Force Statistics database; IADB, SIMs database.

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More opportunities for women need to be created, as overcoming gender inequalities in the labour market is fundamental to achieve inclusive growth. The COVID-19 pandemic has also amplified the gender gap in the labour market, with a decrease of 9 percentage points in a year of the women participation rate to 44%. Women are less likely to have paid work than men, are more frequently unemployed and, when employed, they are more likely to hold non-standard jobs, work in the informal sector, be self-employed or have low-paid jobs. The provision of quality childcare and early childhood education is key in this respect and will also promote equality of educational opportunities for children from disadvantaged backgrounds (see above). Similarly, the bill for elderly care would alleviate a responsibility that tends to impact disproportionally women, while the Act on Distance Work and Teleworking passed during the pandemic aims at setting the right balance for women to manage family responsibilities.

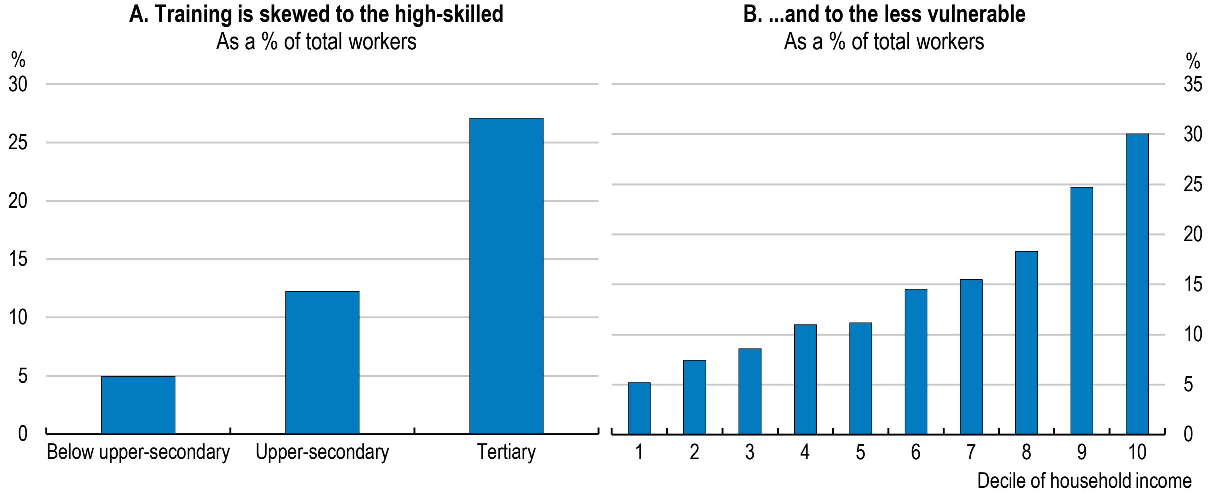
Progress along these lines is fundamental to allow women to better combine family and work responsibilities. The bills currently in discussions, to put men and women at the same level in the civil code and create more efficient and simpler legal tools to fight violence, are also important steps to empower women in the Chilean society and ensure equality of opportunities, notably on the labour market. Moreover, the reduction of the standard work-week from 45 to 40 hours could be a way to improve work and life balance, and more generally well-being (Lepinteur, 2016[10]). However, its overall potential effects on labour market performance and productivity are uncertain (Raposo and Van Ours, 2010[11]; CNP, 2020[12]) and need to be carefully evaluated, particularly to set the economy on a right path of recovery after the outbreak.

Adequate protection and strong job search and training policies should be put in place to tackle economic vulnerability and keep workers attached to the formal sector, as part of an inclusive recovery. Currently, the minimum contribution period required to get access to the unemployment benefits is too high compared to the average duration of employment contracts (Central Bank of Chile, 2016[13]). The temporary reduction in required minimum contribution periods implemented to support workers after the social protests and COVID-19 should be made permanent or at least become available when economic activity is reduced below certain thresholds. Additionally, to avoid misreporting, there needs to be a greater effort to ensure that contributions are paid in full for the correct amount of earnings. For example, ensuring that the Ministry of Labour has access to both tax and social contribution records could minimise evasion on the part of employers.

Underperforming job search and training policies, which poorly match workers with employers, also complicate the access to formal, good quality jobs. Such policies should allow vulnerable workers to acquire and maintain relevant skills. By doing so, these policies can improve the quality of workers as well as achieve higher productivity growth. This is especially important given the low skill levels of Chileans. The lifelong learning system should help adults to regularly update, upgrade, and sometimes even acquire entirely new skills and competences while in and out of work. This is even more critical in the context of population ageing, where the majority of the future workforce has already left initial education. The skills of the older workers will become obsolete more quickly as a result of rapid technological change and they will be required to stay in the labour force for longer to sustain pension systems.

Although Chile’s expenditure in training as a proportion of GDP is low (0.08% in 2015) compared with the OECD average (0.13%), it is higher than in other Latin American countries, including Mexico and Brazil. However, it is poorly distributed, and vulnerable, low-skilled workers and those facing labour market difficulties receive less training (Figure 1.17).

Figure 1.17. Training programmes do not reach the most vulnerable



Note: Data refer to 2015. Training is defined as participating in training of at least 8 hours in the last 12 months. Panel B is people aged 25-64.
Source: OECD calculations based on CASEN (2015).

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Chile lacks a lifelong learning system with a clear national regulatory framework and a clear national plan. Most expenditure on active labour market programmes (ALMPs) are channelled into job training or regular training and executed by SENCE (the National Agency on Training and Employment). Public spending in training is channelled through tax credits for on-the-job training (*Franquicia Tributaria*), training programs targeted primarily at vulnerable groups (e.g. *Fórmate para el Trabajo*), programs for training and hiring older adults (e.g. *Experiencia Mayor*), programs for reconversion in digital skills (e.g. *Talento Digital*) and employment subsidies, among others. One-third of public spending in training goes to the tax credit but this programme benefits mostly large firms, which tend to already have less vulnerable, highly educated workers, and does not reach those most in need. This programme should be thoroughly reviewed by limiting the universe of eligible workers to those with medium and low salaries, to allocate public resources to those who are less able to pay and have greater deficiencies in labour competencies (see Chapter 2). Quality and relevance of training courses will also be key to have an impact on the labour market.

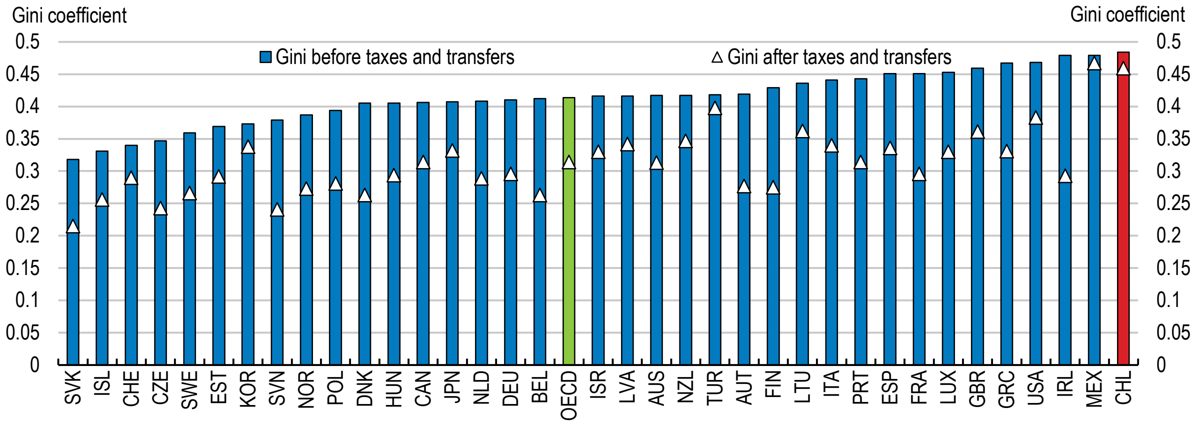
The tax and transfer system can be a strong catalyst for reducing inequality

Currently the tax and transfer system lacks traction in reducing income inequality: the Gini coefficients before and after taxes and transfers are almost identical (Figure 1.18, Panel A). With half of Chilean households being economically vulnerable, the tax and transfer system does not provide any protection from adverse economic shocks. Hence the incomes of the most deprived households and the lower middle-class follow overall macroeconomic trends, increasing in good times and decreasing in bad ones (Figure 1.18, Panel B).

Figure 1.18. The tax and transfer system could provide more protection for vulnerable households

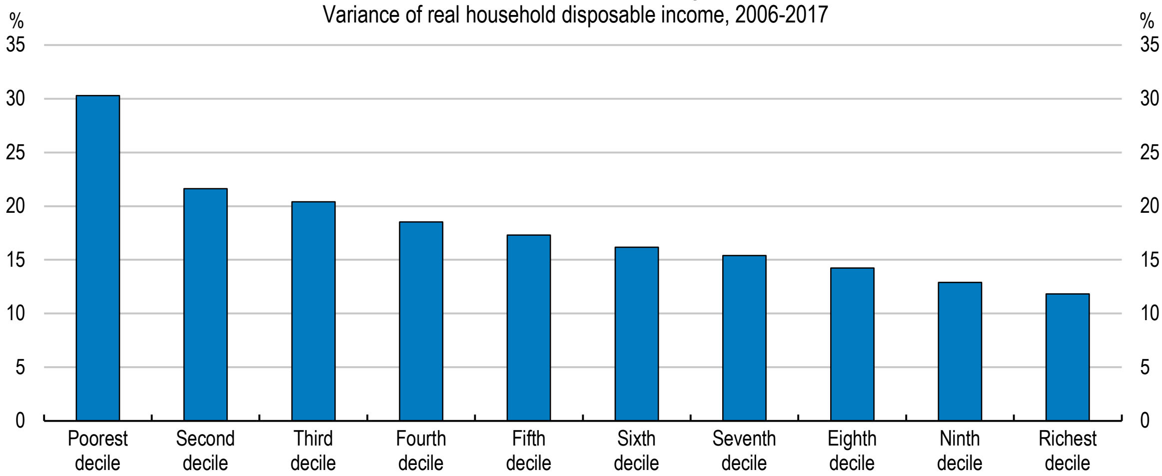
A. Differences in income inequality pre and post-tax and government transfers

Working age population, 2018 or latest year available



B. The poor and the middle class have very volatile income

Variance of real household disposable income, 2006-2017



Note: In Panel A, data for Chile refers to 2017. Data for Chile are not directly comparable to other countries due to pension's contributions that are not taken into account, but which reduce pre-transfers and taxes income dispersion. OECD refers to the unweighted average of latest available data of 36 member countries, excluding Colombia. In Panel B, household disposable income in current prices deflated by CPI.
Source: OECD, Income Distribution and Poverty database; OECD, Consumer and Producer Price Indices database.

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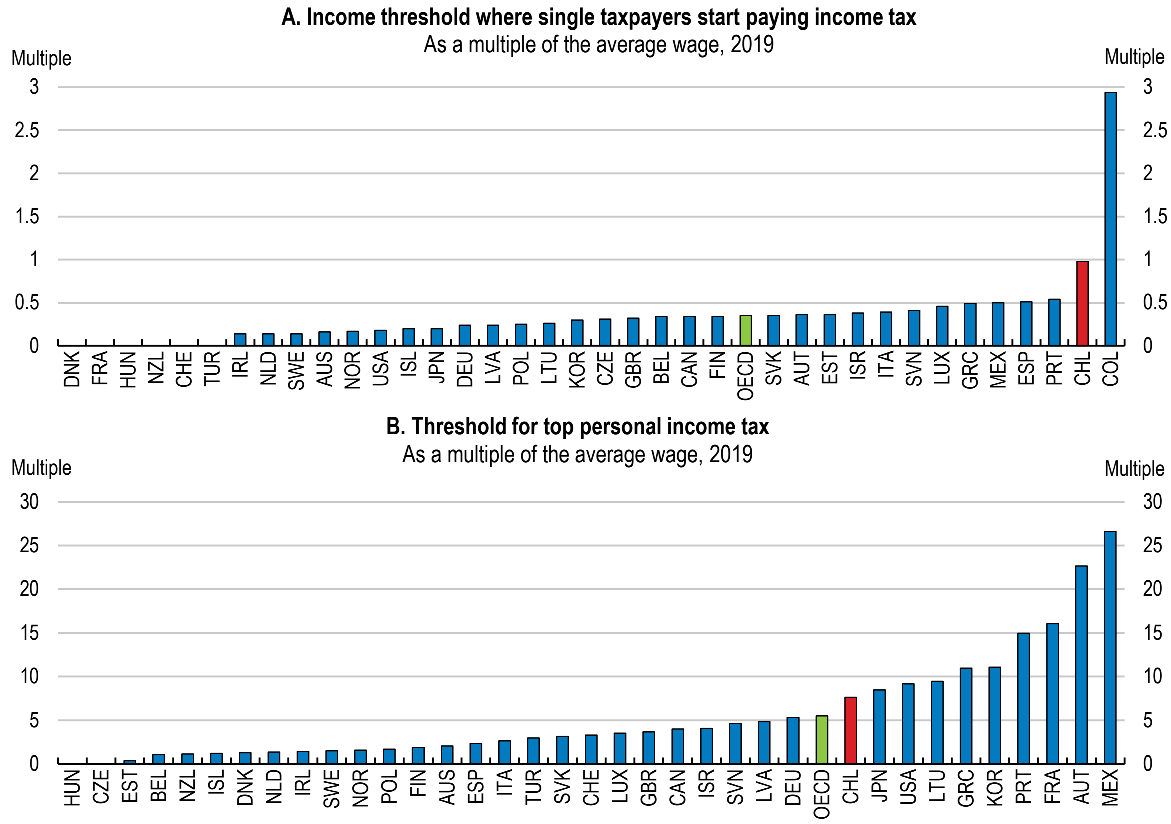
A solution to increase income protection would be to strengthen the redistributive impact of the personal income tax. Currently, only the 25% richest pay income taxes, and the top marginal tax rate applies at around 10 times the average wage (Figure 1.19). Such a structure leads to untapped redistributive potential. Given that the ratio between the average wage of the 10% highest earners and the national average wage is around four in Chile, the top marginal tax rate only applies to very few affluent households. In the wake of the social events, the government enacted, as part of the tax modernisation act, a new top marginal tax bracket of 40%, while aiming at broadening the tax base and the efficiency of the overall tax system. This is a welcome but limited step as it applies at 21 times the average wage. Lowering the thresholds at which the bottom and top bracket apply would lead both to a significant increase in revenue and also an increase in the redistributive profile of the personal income tax, thus lowering disposable income inequality in Chile.

Other tax instruments could also be considered, such as the creation of a negative income tax as part of the personal income tax schedule, replacing other local subsidies and government allowances. Such an instrument would assure each household and individual a basic benefit related to the size of the tax unit to which it pertains and would define an income level beyond which the tax unit would become a net taxpayer (Box 1.3). It does not entail alteration to the existing tax structure and would be a way to consolidate all income support programmes targeted at the poor into a single programme. Moreover, beyond poverty this would be a way to support working but vulnerable households, for example by setting the breakeven income level above the median wage. This would reduce economic vulnerability, strengthen the income of the middle class and increase employment, in particular for single women with children (Agostini, Perticara and J., 2014[14]; Center on Budget and Policy Priorities, 2018[15]). Beyond income taxes, a strengthening of property taxes could also be considered. More generally, a more progressive tax and transfer system would reduce significantly income gaps across Chileans (Box 1.4).

Figure 1.19. The personal income tax structure has little redistributive power



Note: For Panel A, in Denmark, France, Hungary, New Zealand, Switzerland and Turkey, personal income tax is levied on the first earned currency unit. In both panels, OECD refers to the unweighted average of data shown.
Source: OECD calculations based on the Taxing Wages models; OECD, Tax database.

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Box 1.3. How does a negative income tax work? The example of the Earned Income Tax Credit in the United States

A negative income tax is a way to provide individuals below a certain income level with financial resources. In contrast to a standard income tax, where individuals pay money to the government, people with low incomes would receive money back from the government. In principle, a negative income tax operates by giving to individuals a percentage of the difference between their income and an income cut-off, or the level at which they start paying income tax. For instance, if the income cut-off is set at USD 40 000, and the negative income tax percentage was 50%, a tax unit with an income of USD 20 000 would receive USD 10 000 from the government. If the income is USD 35 000, USD 2 500 is received. It must be noted that a negative income tax is different from a universal basic income in which everyone, regardless of income level, receives the same amount. However, the goal of the two mechanisms is identical such as no one is allowed to fall below a certain income threshold. Moreover, a negative income tax has generally a weak impact on labour supply, as it is designed so that individuals who work will always end up with more income than individuals who do not, which would ideally not impinge on working incentives.

Currently, the mechanism closest to a negative income tax in OECD countries is the Earned Income Tax Credit (EITC) in the United States, albeit by design it provides support only to working families (97 percent of benefits from the credit go to families with children). With the EITC, workers receive a credit equal to a percentage of their earnings up to a maximum credit. Both the credit rate and the maximum credit vary by family size, with larger credits available to families with more children. After the credit reaches its maximum, it remains flat until earnings reach the phase-out point. Thereafter, it declines with each additional dollar of income until no credit is available. The EITC is concentrated among the lowest earners, with almost all of the credit going to households in the bottom three quintiles of the income distribution (Center on Budget and Policy Priorities, 2018[15]).

Research shows that the EITC encourages single people (in particular women) and primary earners in married couples to work (Dickert, Houser and Scholz, 1995[16]). However, it appears to have little effect on the number of hours they work once employed (Meyer and Rosenbaum, 2000[17]). In 2018, the EITC lifted about 5.6 million of individuals out of poverty, including about 3 million children. The number of poor children would have been more than one-quarter higher without the EITC (Center on Budget and Policy Priorities, 2018[15]). The EITC also reduced the severity of poverty for another 16.5 million people, including 6.1 million children.

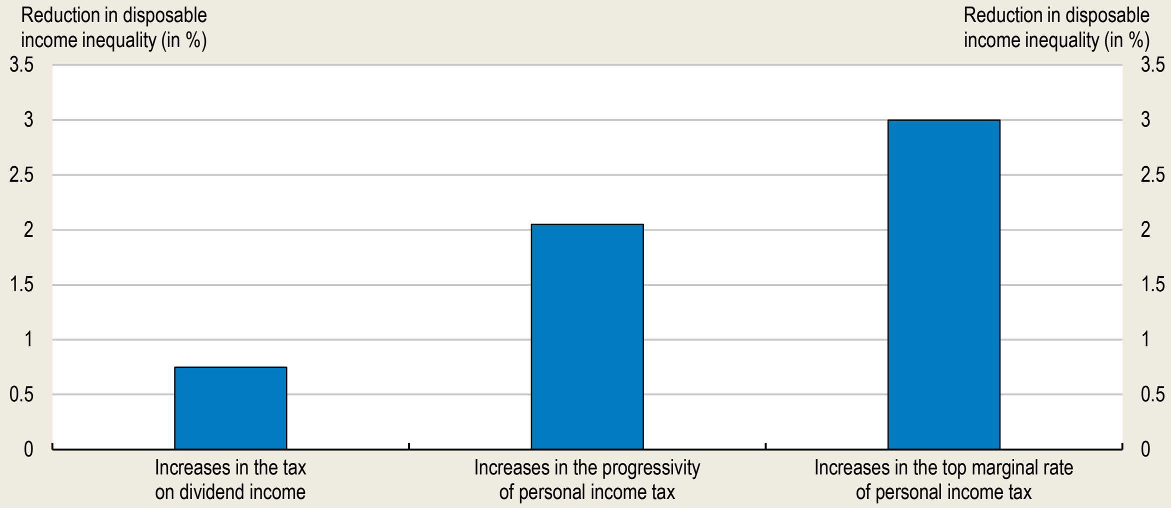
Box 1.4. Illustrative impacts of a more inclusive tax system on income inequality

Recent empirical investigations conducted by the OECD on the drivers of income redistribution through taxes and transfers can be used to quantify the effects on income inequality of increased redistribution in Chile. Redistribution is measured as the relative reduction in market income inequality achieved by personal income taxes. As income inequality is quantified by the Gini coefficient, the redistributive effect of taxes is defined as the difference between the Gini coefficient of household market incomes and the Gini coefficient of household disposable incomes (see Causa, Vindics and Akgun (2018[18])).

Tax reforms scenarios suggest substantive potential policy-driven redistribution gains in Chile (Figure 1.20). For example, closing the gap between Chile and the OECD median in term of overall progressivity of the personal income tax would reduce disposable income inequality by 2%. Similarly, increasing the top marginal tax rate on personal income to the OECD median level would reduce disposable income inequality by 3%. While purely illustrative, these scenarios provide an indicative view of the considerable policy space in Chile to improve redistribution.

Figure 1.20. Illustrative income redistribution effects of selected tax reforms

Closing the gap with the OECD median



Source: Based on (Causa, Vindics and Akgun, 2018[18]).

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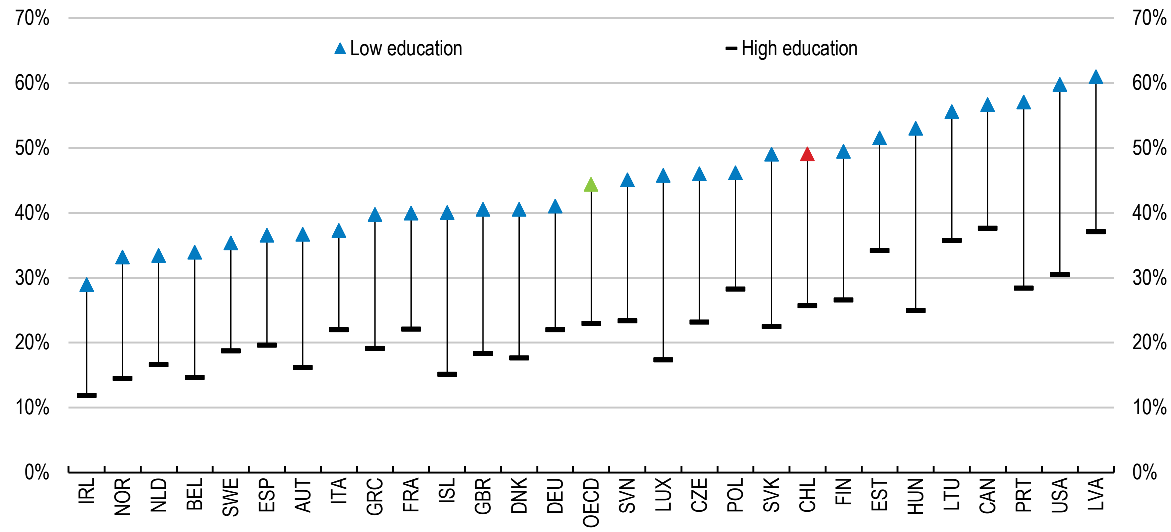
More inclusive health care services

In response to the COVID-19 outbreak, the government took rapid actions to ensure to ensure the access to health services for all, though structural inequalities remain. The cost of tests taken for public health purposes and for all the beneficiaries of the public insurer (Fondo Nacional de Salud, FONASA) that comply with the clinical criteria defined by the Ministry of Health will be covered. Matched with an ambitious national campaign to inform the public of prevention measures and detection, this will ensure the affordability of diagnostics for all in the immediate term. However, it should be noted that while universal affordability is a prerequisite to access to diagnostics and treatment, organisational barriers and the health system capacity issues play a crucial role. For example, access to testing depends on a test being both physically available, as well as laboratory capacity. Moreover, surge demand has put particular pressure on access to diagnostics, hospitalisations, and critical care treatment of the most complex cases. The increase in health spending up to 2% of the general government budget passed at the very beginning of the outbreak in Chile aims at easing such constraints.

These short-term measures are welcome, but more is needed in the medium-term to tackle deeply entrenched healthcare inequality in Chile (Figure 1.21). Healthcare is predominantly public, with around 78% of the population covered by FONASA. 22% are enrolled in private insurers (ISAPRE). The financing is underpinned by a mandatory requirement to be insured. However, stark inequalities characterise the range and quality of health care services that Chileans can access. ISAPREs compete in a weakly regulated market, selecting good risks and differentiating the premiums paid by the insured. Women, people with pre-existing conditions and the elderly pay more, resulting in a segregated system where FONASA provides coverage for the most in need and to lower and middle-income groups. However, the coverage provided is insufficient: individuals' out-of-pocket spending for health care are amongst the highest in the OECD (Figure 1.22).

Figure 1.21. Chile has the one of the highest gap in health status between education groups

Probability of reporting a poor self-assessed health status by education level



Note: Results correspond to age-sex standardised predicted probabilities. OECD refers to the unweighted average of data shown.
Source: OECD estimates based on national survey data; OECD publication, "Health for Everyone? Social Inequalities in Health and Health Systems", 2019.

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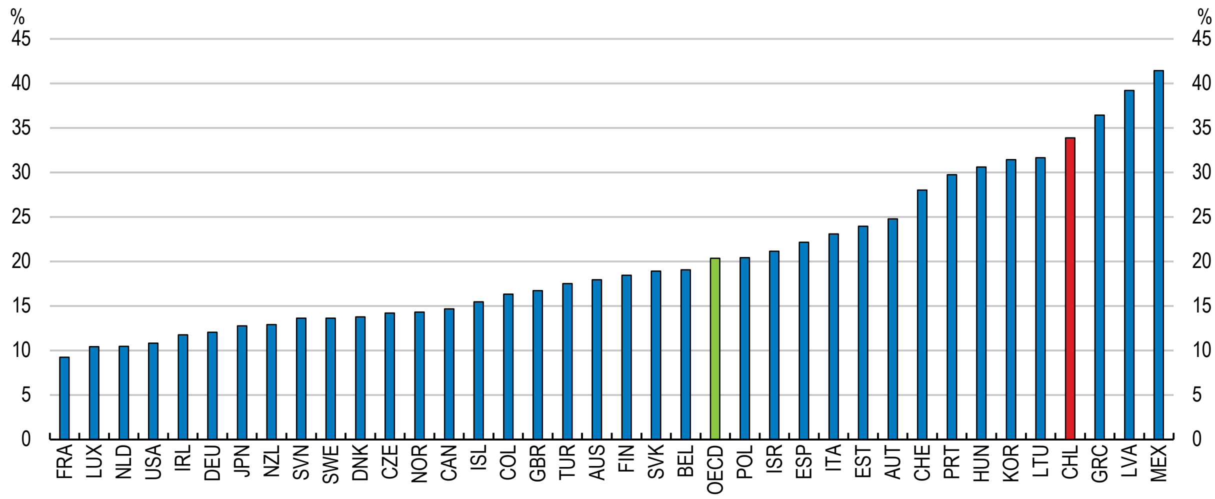
Figure 1.22. Out-of-pocket spending for health care are amongst the highest in the OECD

Out-of-pocket spending as a % of health spending, 2019 or latest year available



Note: OECD refers to an unweighted average of latest available data for all its member countries.
Source: OECD, Health Expenditure and Financing database.

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There is substantial space to improve the equity of the health system but also its quality and efficiency (CNP, 2020[19]). The reform proposal announced at the beginning of 2020 is a welcome step, with the speeding up of treatment by setting new maximum wait times for surgeries, the coverage of at least 80% of health care costs, a lowering of healthcare costs for women with a new and unique factor table, and the reduction in the price of medications by more than half. The temporary increase in health spending, by 2% of the overall public budget, to face the outbreak is also welcome insofar as Chile lacks notably of ICU beds and ventilators to cope with the most severe cases of the disease.

Nonetheless, the fragmented (different sub-systems) and segregated (different population groups in each sub-system) model of the Chilean health system remains different from most OECD countries. For instance, public and/or private insurers and providers co-exist in a regulated market in countries like Germany, the Netherlands, Switzerland, Belgium and Israel. National health insurance models exist in countries such as Australia and Canada, where a public entity covers the whole population and people can hire complementary private insurance, with the presence of public and private providers. In all these countries, several mechanisms are in place to avoid the problems of selection described above. As a result, establishing a single national pool of healthcare funding to cover a common package of services for the whole population, revising the collection of resources for the health system to rely more on general taxation than on social contributions, defining a better integration between a strong primary care and public-private services and devising schemes in addition to subsidies to control out-of-pocket expenditures should be implemented. More generally, undertaking an OECD Health Systems Reviews to benchmark Chile's performances regarding other OECD countries in terms of access, financial protection, quality of care, and equity would provide the backbone to support a major health reform.

Table 1.5. Past OECD recommendations on inclusive growth

Recommendations	Actions taken since the 2018 survey
Further increase social spending to reduce inequalities.	The coverage and focus of the Ethical Family Income (for extremely poor households) will be increased by 40% to improve the income of the most vulnerable families in 2021. The social spending is the main emphasis of the 2019 Budget, mainly in education, which represents 24% (with a growth of 2.9% compared to 2018); health 19% (increases of 6%); labour and social security 16% (increases of 2%) and housing represents 5% (increases of 5%).
Raise contributions to increase savings for retirement.	A bill, which has been modified several times and is still in Congress, establishes a 6 percentage point increase in the mandatory contribution (to be paid by the employer).
Continue to increase the solidarity pillar funded with general taxation.	In response to the social events at the end of 2019, the solidarity pillar and the basic solidarity pension were increased, both by 20%, benefiting almost 1.5 million pensioners which were at high risk of poverty.
Progressively increase and align the retirement age of women and men.	The pension reform also incorporates incentives for workers to voluntarily postpone their retirement age.
Strengthen cash benefits, notably employment subsidies and unemployment- and health-insurance support.	In response to the social protests of end-2019, a Minimum Guaranteed Income (subsidy for those earning the minimum wage) was created. The Budget for 2021 increases coverage for the main employment subsidies (Subsidio al Empleo Joven and Bono al Trabajo Mujer). In response to the pandemic and in face of the recovery, the Government created hiring subsidies aimed at creating new jobs or recovering those under the Employment Protection Law (with contracts suspended because of COVID-19). In May 2019, the government sent the Protected Middle Class System bill to Congress. This bill will provide security to middle class households at the risk of being affected by an adverse event. The main events to be covered are (1) improve catastrophic disease insurance, as well as facilitate the use of these insurance; (2) creation of dependency insurance for the elderly; (3) improve the network of labour intermediation and conversion programs; (4) improve credit mechanisms for scholarship.
Further increase affordable, good-quality childcare for the poorest children and in rural areas, and expand opening hours for childcare institutions.	In March 2019, the government announced the implementation of the time extension programme in kindergartens and nurseries part of the Integra Foundation (one of the main pillars of public early childhood education). The objetive is to add, over the next two years, 142 nurseries to the programme. In 2019, the Senate approved the Universal Nursery bill, which is currently under constitutional review. This project will allow all children under 2 years of all working parents

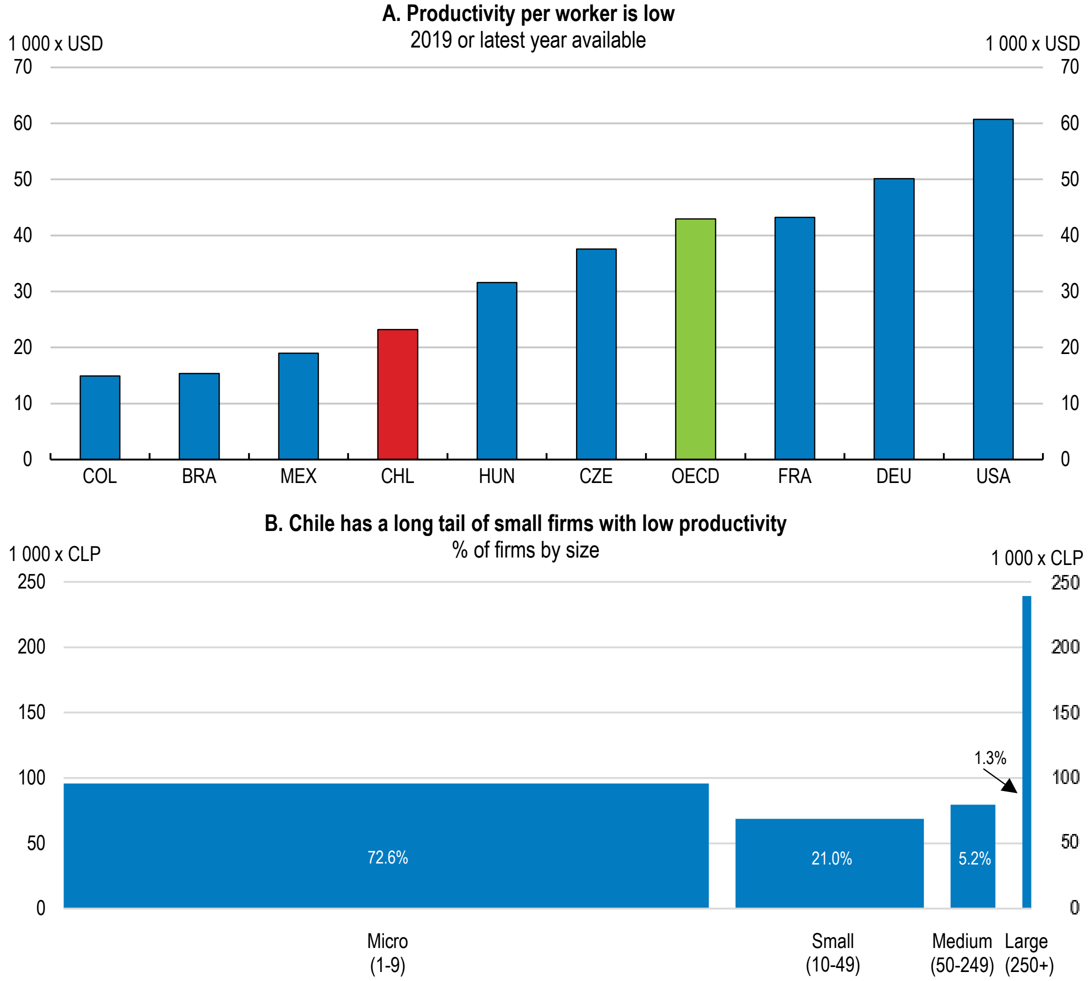
	affiliated to the social welfare system to have this benefit, regardless of the number of women hired by the company. In addition, the government sent to the Congress the Equity in Early Childhood bill, which creates a subsidy for the middle levels of the first educational level and new quotas for the most vulnerable families.
Continue ongoing efforts to improve quality at all levels of education. Develop apprenticeships, integrating work and school-based learning, across all levels of education	The government implemented and agenda to modernise professional technical education. The main items of this agenda are the introduction of new schools of excellence, the expansion of gratuity for young people belonging to the 70 % poorest families, the assignment of "Technical Scholarships for Chile" to improve higher level technicians, unlicensed professionals and teachers of secondary and higher professional technical education, and the implementation of state technical training centres in five regions.
Reduce dismissal costs for permanent contracts. Increase coverage of unemployment benefits by reducing the minimum contribution periods.	No action taken
Better target firm-provided training programmes to the most vulnerable workers. Continuously evaluate active labour market policies, public and firm-provided training, to focus funding on those that are performing well.	In March 2019, the government sent to the Congress a bill that modernises the training and public employment system. The bill modifies the way that the current training system responds to the needs of the productive sector and allows the acquisition of new technological skills. It modernises the National Training and Employment Service (SENCE) in order to improve the results of training programmes.

Closing productivity gaps to make mid-size firms thriving and support the recovery

In international perspective, productivity per worker continues to lag behind (Figure 1.23, Panel A), entailing a lack of high-productivity and high-wage jobs. This has led to the emergence of a sizable cohort of "vulnerable" households at risk of poverty. They have low productivity, usually informal jobs associated with low social protection and low, unstable income. As a result, they remain at high risk of falling back into poverty in a recession or in the event of an employment or health crisis like the one that is currently unfolding.

This shortfall can partly traced back to business polarisation. Chile has a persistent division between a small number of large and productive firms and a long tail of small and midsize companies with considerably weaker productivity performance (Figure 1.23, Panel B). The lack of a cohort of vibrant midsize companies is a brake to business dynamism and competitive pressure. It prevents the expansion of productive and well-paying jobs, and keeps the middle income class small. Moreover, these small firms are likely to suffer more from the lockdown and distancing measures that have been adopted to fight COVID-19. They are likely to have less resilience and flexibility in dealing with the costs these shocks entail, due to the costs of under-utilised labour and capital weighing greater on SMEs than larger firms, the extent of informality, and, in many cases, lower levels of digitalisation precluding e.g. teleworking when that would have otherwise been possible or selling on-line. Thus, the period over which SMEs can survive the shock may be shorter than for larger firms. To avoid further polarisation in the aftermath of the outbreak, there is room in several policy areas to raise productivity and support the recovery of small and midsize firms and set in motion a virtuous cycle of improved productivity growth, strengthened middle class and greater inclusiveness.

Figure 1.23. Productivity is low and polarised



Note: In Panel A, units are measured in thousand USD per person employed (PPPs).

Source: OECD calculations based on Quinta Encuesta Longitudinal de Empresas (ELE-5), 2017; OECD, Productivity database.

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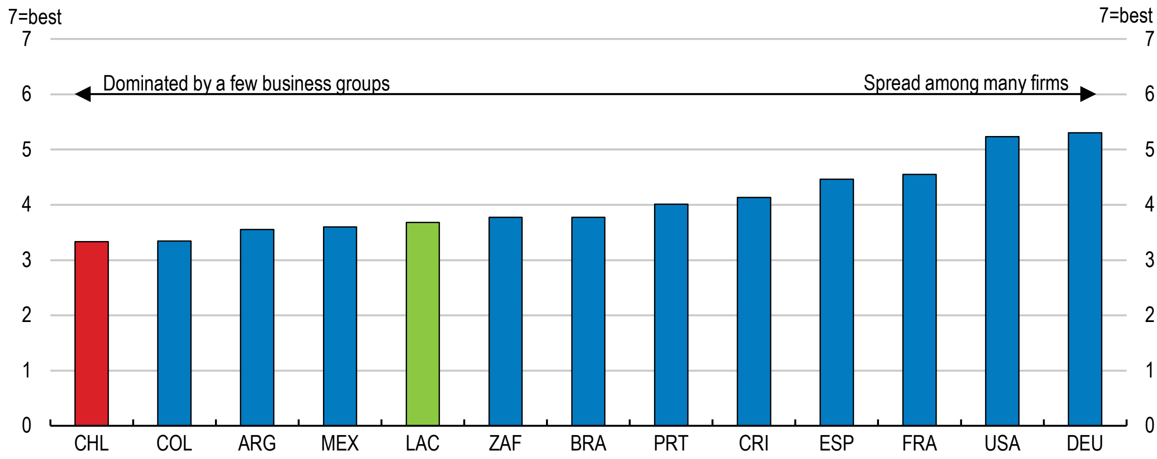
The regulatory environment inhibits competition

The lack of strength in SME productivity can be partly traced back to weaknesses in the competitive environment in product markets. Over the recent years, Chile has made important improvements to its competition policy framework. The 2016 reform introduced criminal sanctions for cartels, introduced merger controls, a leniency programme and private enforcement, and increased fines against anti-competitive behaviour. The reform also boosted the competition agency (*Fiscalía Nacional Económica*) powers and resources to undertake market studies, in line with OECD recommendations. Along the same lines, a bill currently in discussion aims at establishing stronger penalties for cartels on markets for necessity products, a welcome move given that these products represent a large share of the spending for the most vulnerable households (see above). Other measures under development would give the competition agency higher monitoring powers, such as bank transactions and access information from the telecommunications. However, further actions could still raise competitive pressures.

An overly strict regulatory environment accounts for still weak competitive pressure in Chile and is an important barrier to SME growth (Figure 1.24). It could also represent an important obstacle to a swift recovery from the COVID-19 recession. The amount of time and/or money needed to comply with regulations is proportionately greater for SMEs than for larger firms, discouraging entry and scaling-up. According to a recent study from the National Productivity Commission, the regulatory system is characterised by low efficiency in the permitting process and a low degree of legal certainty (CNP, 2019[20]). The low efficiency is reflected in long processing times, and is the result of a lack of coordination between agencies and the low use of technologies for traceability. There are also inconsistent rules and areas of contradiction and confusion around the jurisdictions of different agencies. The limited legal certainty gives rise to a lack of predictability with respect to the criteria for the admissibility and granting of the permit, and clarity with respect to the ways in which it may be revoked.

Figure 1.24. Competitive pressures remain low

Extent of market dominance, 2019



Note: This indicator shows the extent of market dominance, 1-7 (best). In the World Economic Forum, Executive Opinion Survey, it is the answer to the following question: In your country, how do you characterise corporate activity? [1 = dominated by a few business groups; 7 = spread among many firms]. LAC refers to the unweighted average of Argentina, Brazil, Colombia, Costa Rica and Mexico.
Source: World Economic Forum, The Global Competitiveness Index 4.0 2019 dataset (version 04 October 2019).

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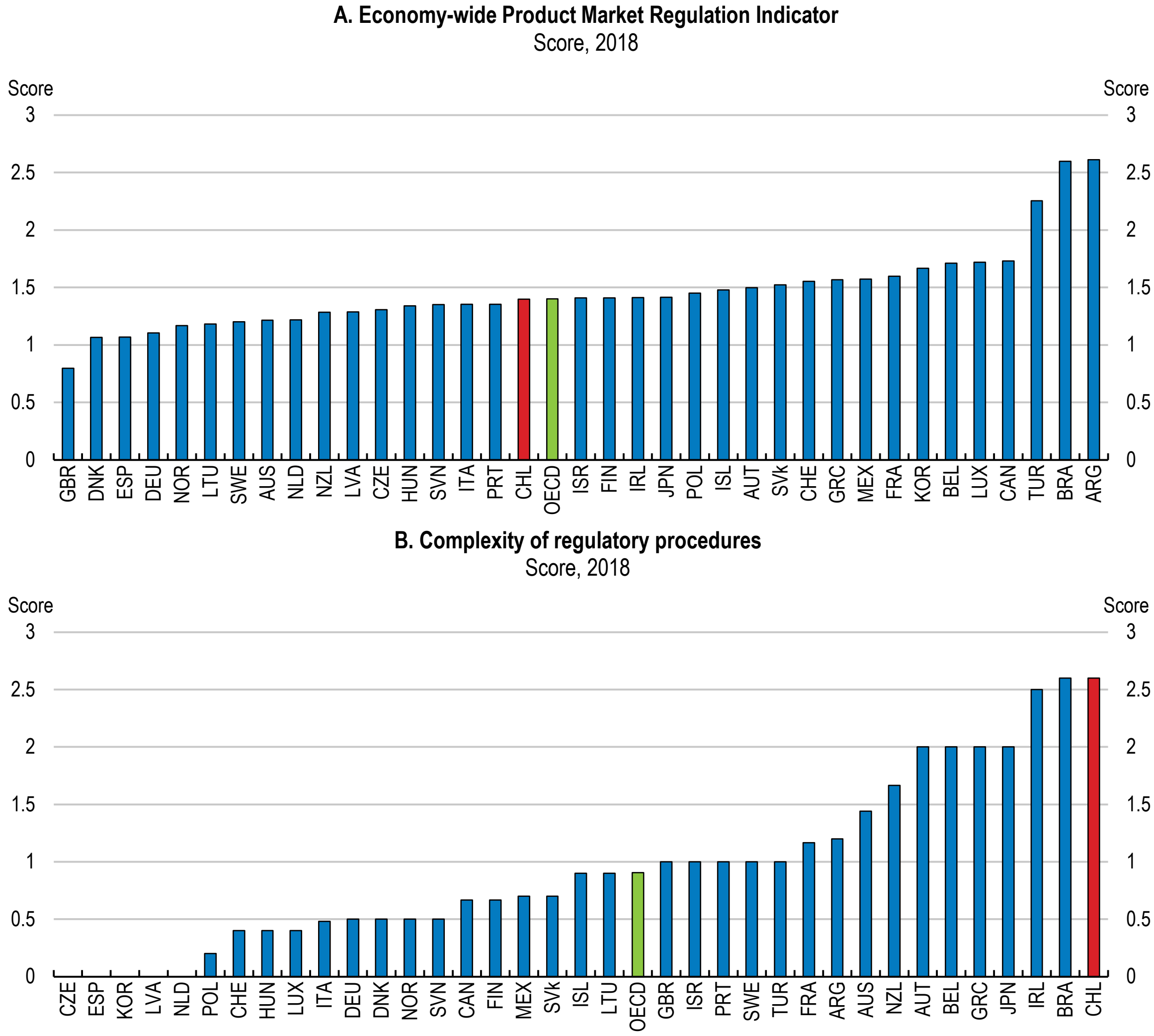
Significant steps have been taken over the last decade to ease regulations. In 2018, a reform aimed at simplifying procedures and licenses now reduces the time and number of procedures related to water permits. It also created a one-stop shop for licensing from different sectors. The "Open" office for reducing bureaucracy has also been created in 2018. The new vintage of the OECD Product Market Regulation indicators shows that economy-wide, Chile is below the OECD average (Figure 1.25, Panel A). However, the complexity of some regulatory procedures remains the highest in the OECD (Figure 1.25, Panel B). In particular, municipal licences and authorisations are entangled with national ones, imposing an excessive burden on SMEs (CNP, 2019[20]).

Figure 1.25. The complexity of some regulations remains the highest in the OECD



Source: OECD, 2018 PMR database.

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Generalising “zero licensing procedures” by involving municipalities in the design of the initiative, as was done for instance in Portugal (Box 1.5), could ease firm entry and formalisation, by reducing administrative burden and focusing instead on ex-post control. As part of the COVID-19 recovery plan, in a welcome steps, authorities are implementing measures to reduce burocracy, particularly for SMEs, such as providing provisional patents for SMEs to start operations and have one year to obtain the necessary permits for their final commercial patent.

Reforms of the notary profession and reducing the use of notary procedures could also ease significantly the administrative burden for firms and households. The competition authority has recently concluded a market study on Chilean notaries highlighting that notaries are involved in more than 200 procedures, such as certifying bank guarantees or concluding real estate sales. They are also unequally spread across municipalities, lengthening procedures, and appear to frequently overcharge for their services (FNE, 2019[21]). The study highlights the need to open the market of notaries and allow introducing technological innovations and data sharing with the administration in a systematic way to reduce the time of procedures and increase efficiency. There has been good progress in the use of electronic signatures, and the bill under discussion to broaden it and establishing equal legal validity with physical ones goes in the right direction. Further expanding it on all notarial activities and notaries would further ease administrative burdens.

Box 1.5. The Zero Licensing Initiative in Portugal

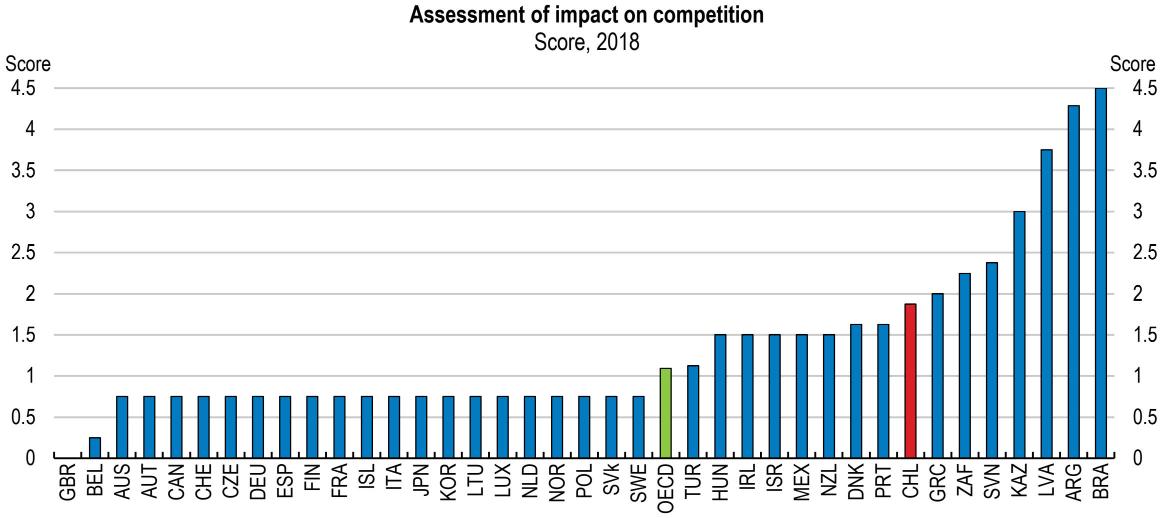
The Zero Licensing Initiative, implemented in 2013, aimed to make the exercise of commercial economic activities more simple, faster, transparent and cheaper, helping to increase the competitiveness of the municipalities and the country. It involves several central administration entities, with a direct impact on the operation of local authorities, in the capacity of authorities competent for matters of licensing and collecting taxes. Under this initiative:

- A new and very simplified regime for setting up and modifying the establishment of commercial activities was passed.
- Licenses were eliminated and substituted by a simple prior notification to the authorities.
- The notification to the authorities is now done electronically in a Point of Single Contact (PSC), dematerialising the licensing process, therefore reducing the administrative burden and the economic costs.
- The State reduced the pre-control mechanisms, increasing the responsibility and accountability of the economic agents, and reinforced the post-control mechanisms, through inspections and sanctions for noncompliance.

This initiative was a complete shift of paradigm, modifying significantly the licensing process in Portugal. For example, it created a single form to be used in all of the municipalities, while before every municipality had their own form. As such, a key feature in the success of this initiative was the involvement of the municipalities in the design of the innovation, which were an integral part the process and of the culture change entailed

Some size-dependent thresholds in regulations can also be especially harmful for SMEs in Chile. Employment thresholds for safety, staff-representativeness, and quotas for foreign workers or mandatory childcare provision can unduly complicate the scaling-up of firms and should be made progressive. Some have been recently lifted, but the impact of all new regulations should also be thoroughly assessed by the competition agency, by conducting market studies and ex ante regulatory impact assessment (Figure 1.26). The competition agency opinions and recommendations, including those on market studies, should be carefully considered by the government, and if they are not followed the reasons should be explained publicly.

Figure 1.26. The impact of new regulations should be systematically assessed



Source: OECD, 2018 PMR database.

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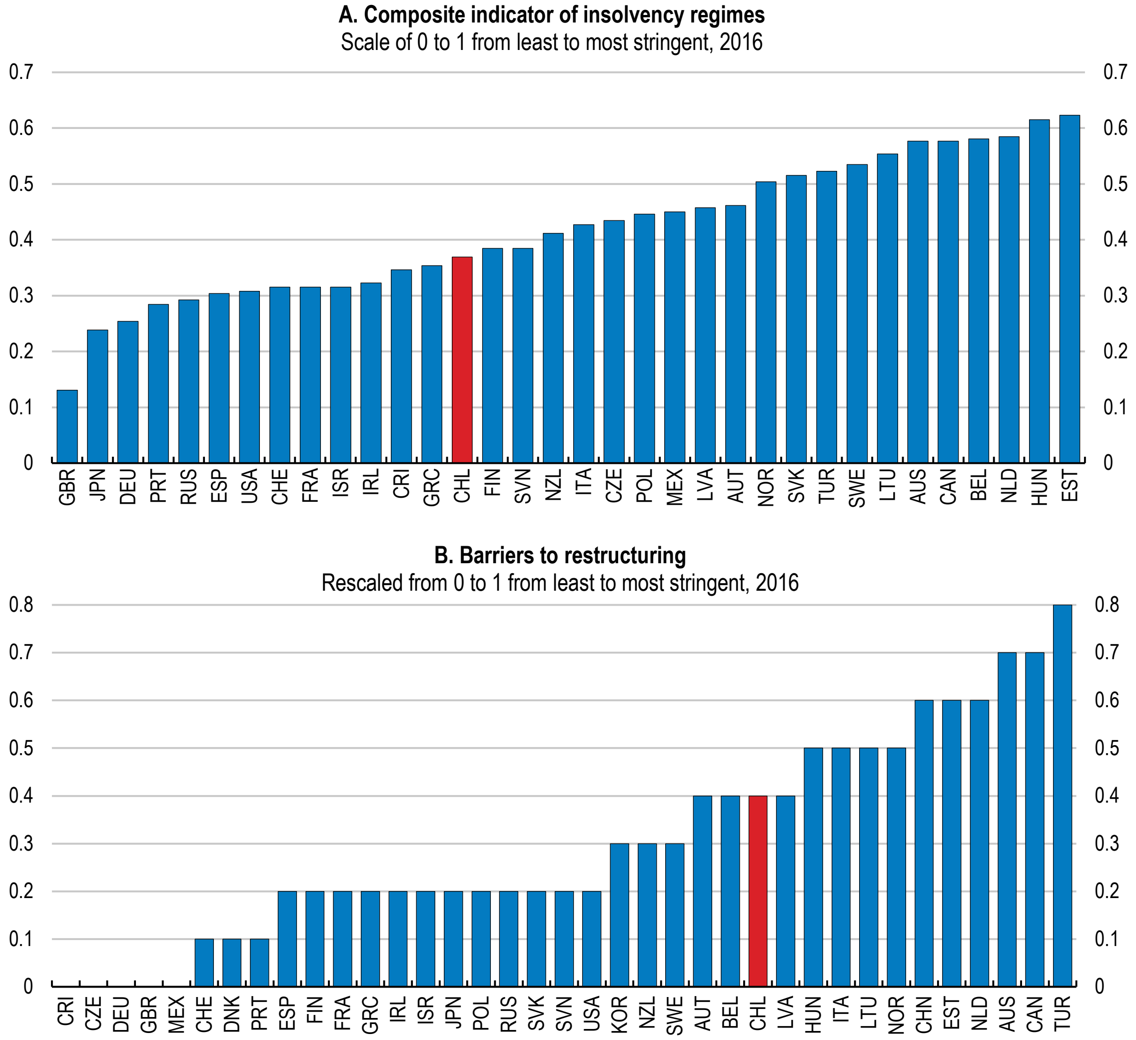
Improving exit policies

While the policy environment should incentivise firms to grow, at the same time it should also encourage unsuccessful firms to close down. In the aftermath of the outbreak, this will turn out to be of particular importance for a successful recovery. Despite the large stimulus provided to preserve firms and capital during lockdown and social distancing measures, business closures will be unavoidable and the resulting strained assets should be freed up quickly to promote an efficient reallocation of capital. An enterprise failure needs to be recognised as an opportunity for the entrepreneur to learn and rebound, finding new opportunities which lead to quicker recovery, and thus to new employment opportunities. In practice, this calls for a number of measures on bankruptcy legislation that does not excessively penalise business failure and proceed quickly to liquidation.

The 2014 revised liquidation law was much needed and welcome. Before its introduction, only 6 firms were declared bankrupt in 2014, while the number rose to 295 in 2016. Nonetheless, the overall design of the insolvency regime could be improved (Figure 1.27 Panel A). Barriers to restructuring are currently high and should be eased to support the rehabilitation of viable firms (Figure 1.27, Panel B). In particular, creditors should be able to initiate restructuring and not only liquidation. This would allow non-viable firms to exit the market quicker and viable firms, which encounter temporary financial distress, to be less likely to become impaired due to a lack of impetus to restructure. The bill currently under discussion to improve the Law on Reorganization and Liquidation of Companies and People aims at closing some of those gaps, by streamlining and simplifying the bureaucratic aspects of current bankruptcy procedures, creating simplified procedures for quick processing with low administration costs, and increasing credit recovery rates by promoting liability restructuring rather than settlement.

Figure 1.27. The insolvency regime can be eased further



Source: (Adalet-McGowan and Andrews, 2018[22]).

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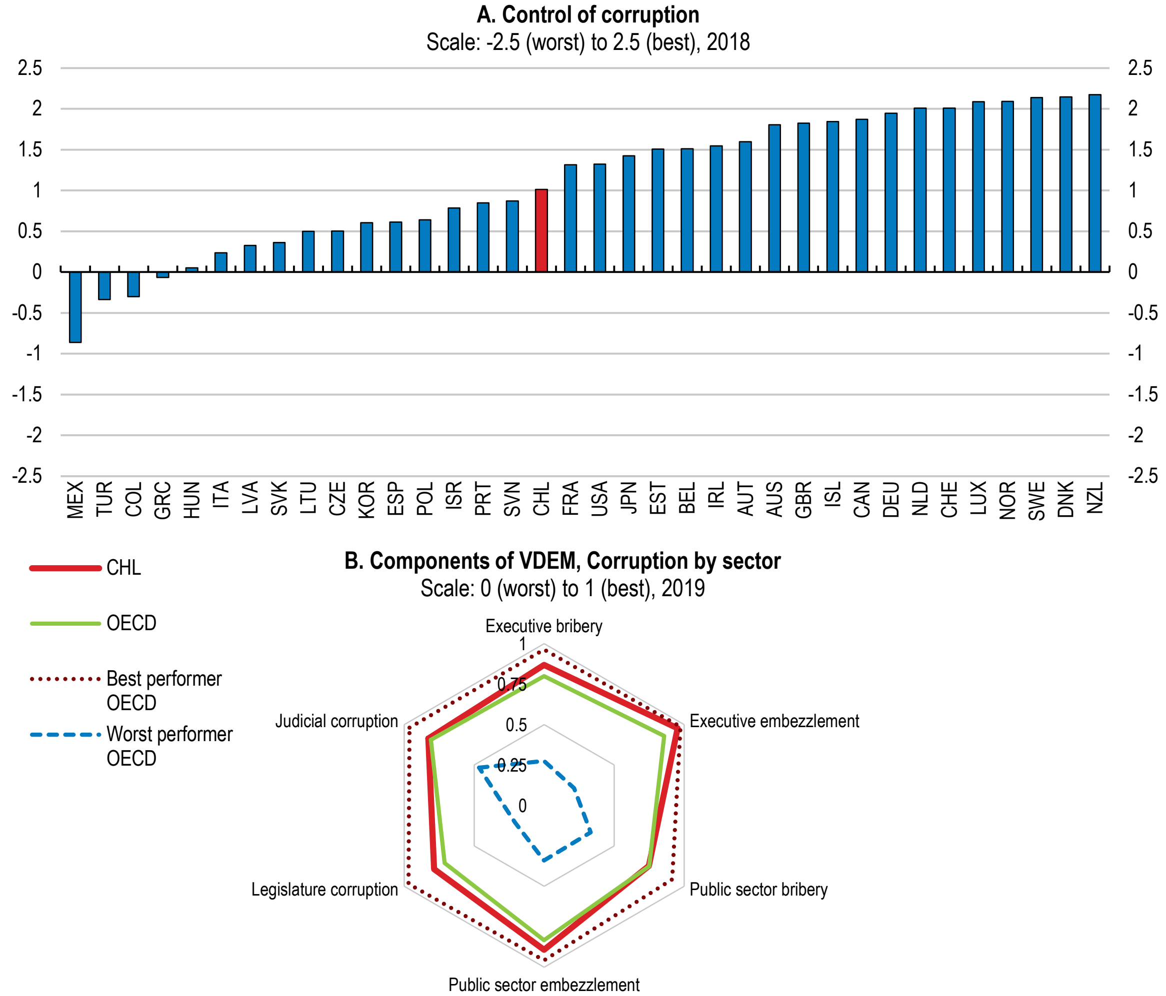
Public procurement must ensure a level playing field for SMEs

The fact that corruption is low in Chile makes its economic fabric a favourable environment for entrepreneurial talent to be directed towards productive activities (Figure 1.28, Panel A). The 2018 various modifications to Chilean criminal law on corruption crimes have further increased the punishment of certain existing crimes and incorporating new criminal offenses to the legislation, strengthening the position of Chile as a regional leader on transparency and anticorruption matters. In particular, public procurement is exempt from corruption (Figure 1.28, Panel B), although it still represents a potential source as there tends to be a strong connection between politicians and the economy, with ex-ministers or high public officials often taking jobs in firms operating in sectors they had previously overseen (Bertelsmann Stiftung, 2018[23]). Moreover, given the rapid expansion of liquidity facilities in the economy as a reply to the pandemic, Chile should continue its efforts to carefully monitor corruption.

Moreover, the relative lack of competition in public procurement procedures represents a hindrance to the involvement of SMEs in public purchasing. Stepping-up this involvement would result in a double dividend: i) higher competition for public contracts, leading to better value for money for contracting authorities; ii) a more competitive and transparent public procurement practices that would allow SMEs to unlock their growth and innovation potential, given the fact that public procurement is increasingly used as a mainstreaming strategy to accelerate the diffusion of innovation.

Figure 1.28. Corruption remains low



Note: The "Control of corruption" indicator compiles individual indicators. Panel A shows both the point estimate and the margin of error. Panel B shows sector-based subcomponents of the "Control of Corruption" indicator by the Varieties of Democracy Project. OECD refers to an unweighted average of all its member countries.

Source: World Bank, Worldwide Governance Indicators; Varieties of Democracy Institute; University of Gothenburg; and University of Notre Dame.

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While SMEs account for 90% of suppliers under the current procurement system (Chilecompra), they represent only 48% in terms of value, and 46% in terms of the number of purchase orders (OECD, 2017[24]). Moreover, on average around 60% of suppliers have no transactions. ChileCompra should further engage with suppliers and contracting authorities to enhance competition. Its committee for SMEs (Propyme) to promote the engagement of SMEs and the new expedited purchase programme (*Compra Ágil*), created as part of the reply to the pandemic, are good initiatives, but further progress can be made. For instance, and given Chile unique geography, procurement needs should be disaggregated into regional lots. This would foster the participation of SMEs in the corresponding competitive procurement process, in which they may otherwise not have been able or interested to participate. It would also introduce environmental considerations.

Finally, in many countries, such as those under the European Union directive, contracting authorities are obliged by law to accept a group of suppliers submitting a bid. In this case, the group or consortium may rely on the capacities of all participants. ChileCompra does not currently allow for this kind of co-operation among suppliers, even for the second stage competition. While rationalising the number of suppliers, ChileCompra could consider allowing the grouping of suppliers in order to further remove barriers to participation for SMEs.

Table 1.6. Past OECD recommendations on productivity

Recommendations	Actions taken since the 2018 survey
Systematically review competitive pressures in key sectors, such as telecommunications and maritime services, by conducting market studies and applying the guidelines of the OECD's Competition Assessment Toolkit.	In September 2019, the National Productivity Commission presented a study on regulatory quality in Chile in order to stimulate productivity through the implementation of administrative and regulatory simplification for large investment projects in five sectors: mining, infrastructure, energy, industry and real estate. In addition, the "Agenda de Reimpulso Económico" contains proposals to facilitate the installation of telecommunications infrastructure in public spaces and deploy 5G technology, and to increase competition in the cabotage freight transport.
Ensure that public entities have to comply with the Competition Agency recommendations or to publicly explain their decisions.	During 2018, The National Economic Prosecutor's Office (FNE) increased the number of strategic actions that led to changes in behaviour of agents and published the complaints guide. In the area of ??collusive agreements, the FNE presented during 2018 a total of 3 requirements in front of the Free Competition Court, which represented 60% of the total cases during the year and an increase with respect to the previous years. The 3 Requirements presented requested fines.
Streamline permits and their process to encourage investment and simplify regulations that depend on firm size, such as childcare provision, to limit their impact on firm growth.	The government sent three bills that allow simplifying regulations for companies: (1) a bill that promotes legislative simplification; (2) a bill that establishes measures to boost productivity and entrepreneurship. Among the proposals is to increase the maximum hiring limit for foreigners from 15% to 30% for companies that have more than 25 workers; (3) Universal nursery, whose main objective is to allow all children under 2 years of all working mothers and fathers to have this benefit, regardless of the number of women hired by the company.
Strengthen policy evaluation by beefing-up data collection, systematic reviews and independent studies.	In August 2018, the Ministry of Science, Technology and Innovation was created to promote research and development, contribute to the formation of scientific culture, promote inter-ministerial coordination and collaborate and develop joint initiatives in the private-public sector. It has a special coordination mandates with the Ministry of Education defined for improving the link between science-development-innovation and universities.
Expand R&D support programmes that are proven to work, and close down or adjust inefficient ones.	The latest evaluation of government programs developed by DIPRES concluded that the majority of them had sufficient performance. However, the Agency Corporation for the Promotion of Production (CORFO) was evaluated with low performance regarding early financing for entrepreneurship.
Continue efforts to fully integrate the single window mechanism with the domestic logistic infrastructure and with regional partners.	In March 2019 started the interoperability between SICEX, the port systems of Coronel and San Vicente, Directemar and the National Customs Service. This digital connection is materialised with the DUS (Single Departure Document). The Unified System of Logistics Networks (SURLOG) was also implemented, which consists of a single electronic and integrated portal in which users (exporters, importers, dispatchers, etc.) can carry out international trade operations. This system will be integrated to the single windows of commerce of the countries of the Pacific Alliance in a first stage and then of the Region.
Reduce further non-tariff barriers on intra-regional trade by simplifying regulations of preferential trade agreements.	Since 2018, Chile has worked on 7 international trade negotiations. 4 agreements are now signed (United Kingdom, Brazil, Indonesia and CPTPP) and 3 are still under negotiations (Pacific Alliance and Associated States, Chile and European Union Association Agreement, Free Trade Agreement with South Korea). Among the objectives of these negotiations is to update the current norms in matters such as rules of origin, sanitary and phytosanitary measures, technical obstacles to trade, labour, environment and intellectual property, in order to favour and strengthen the exchange of goods and services.
Develop national, regional and metropolitan long-term infrastructure strategies.	In line with the 2018-2022 government program, the National Infrastructure Plan was prepared by the Ministry of Public Works, which proposes an integrated network of roads, ports and airports and a portfolio of strategic projects. This infrastructure programme includes investments of USD 4 billion for 2019, totalling USD 20 billion for the four-year period.

Integrate the regulation of public and private ports.	In March 2019, it was formalised a Special Investigative Commission to evaluate the impact of the law that modernises the state port sector. The Commission recommended to overcome the current asymmetry in the use and conditions of maritime concessions and of the operational regulations between public and private ports.
Fully integrate the environmental and health damages of transport modes in taxes and road pricing to ensure fair competition.	In 2019, the Ministry of the Environment submitted to public consultation the draft framework law on climate change in order to comply with the international commitments assumed by the State of Chile. This draft establishes the obligation to develop a national long-term and multisector climate strategy that, among others, defines a path to carbon neutrality emissions and assigns sectoral reduction targets, which should be fulfilled through mitigation and adaptation plans developed by the respective sector authorities. Among the climate management instruments, the preliminary draft considers the development of a climate financing strategy by the Ministry of Finance, and a law that defines greenhouse gas emission limits and creates a surplus transfer system.
Reduce barriers to entry in maritime services and railways.	In February 2019, the Congress approved a law that authorises cabotage of passengers for foreign flag tourist cruises of more than 400 passengers.
Strengthen existing national e-procedures for firm registration and authorisation, and focus on ex-post controls for businesses that have low associated sanitary and environmental risks.	In October 2019, the Senate approved the Public Sector Digital Transformation Law that seeks to materialise a series of principles associated with technological change, simplifying several procedures for company creation and administration, investments, digital authentication, and public bidding. In addition, the “Agenda de Reimpulso Económico” creates an institutional framework to tackle the problems that affect productivity and competitiveness of the country. Under this Agenda, measures to facilitate the operation of “Tu Empresa en Un Día 2.0” were established and created a special agency in the Ministry of Economy called "GPS", responsible for unlocking the coordination between companies and the State, was created.
Improve further technical assistance and mentoring to small firms, building on the new local business centres.	The Ministry of Economy created a programme called “Digitaliza tu PYME”,along with Corfo and Sercotec, which seeks for smaller companies to increase sales, lower costs and improve their relationship with customers and suppliers using digital technologies.
Involve stakeholders further in the design of regulations through early consultation procedures. Conduct systematic ex-ante and ex-post evaluations of regulations, notably through the existing productivity assessments.	In 2018, the government inaugurated the Office of National Productivity and Entrepreneurship (OPEN). It has directly based on citizens' recommendations with a virtual participatory process called “Enciende tu Ampolleta”. There has been a survey of regulatory improvement opportunities, based on the recommendations of the National Productivity Commission, other institutions, unions and the virtual participatory process. In August 2018, the government sent a bill that establishes measures to boost productivity and entrepreneurship in order to, among other things, formalise productivity and regulatory coherence by strengthening the ex-ante control mechanism.

Box 1.6. Potential impact of structural reforms on per capita GDP

Selected reforms proposed in the Survey are quantified in the table below, based on the framework from (Égert and Gal, 2017[25]). The estimates are based on cross-country empirical relationships between past structural policy settings and productivity, employment and investment. The estimates assume direct and full implementation. Being based on cross-country estimates, they do not incorporate Chile's specific economic and institutional settings. As such, these estimates are meant to be illustrative.

Table 1.7. Illustrative GDP-per-capita impact of recommended reforms

Reform	Percentage increase in GDP per capita	
	2 years effect	10 years effect
Streamline business licensing and regulations	0.6%	1.4%
Increase family benefits in kind	0.4%	1.0%
Increase spending on activation	0.3%	1.1%
Increase business R&D expenditures	0.5%	2.2%

Notes: The permanent policy changes assumed for the scenarios in the table are:
1. Reducing the complexity of regulatory procedures (reducing the 2013 PMR indicator from 1.5 to 1.2);
2. Increasing spending on early childhood education and care from 0.7 to 1% of GDP;
3. Increasing spending per unemployed as a % of GDP per capita, from 3.3 to 7;
4. Increasing spending on total R&D from 0.1 to 0.3% of GDP.
Source: OECD calculations based on (Égert and Gal, 2017[25]).

Box 1.7. Quantifying the fiscal impact of structural reforms

The following estimates roughly quantify the fiscal impact of selected recommendations. The estimated fiscal effects are static, abstracting from behavioural responses and consequent second-round GDP effects that could be induced by the given policy change. Limitations in available estimates and data mean the reform examples differ from those shown in the companion box illustrating GDP impacts.

Table 1.8. Illustrative fiscal impact of recommended reforms

Policy	Measure	Annual fiscal balance effect % of GDP
Increase family benefits in kind	Increasing spending on early childhood education and care from 0.7 to 1% of GDP	-0.3
Increase spending on activation	Increasing spending per unemployed from 3.3 to 7% per unemployed as a % of GDP per capita	-0.4
Increase business R&D expenditures	Increasing spending on total R&D from 0.1 to 0.3% of GDP	-0.2
Balance		-0.9

Notes: 1. Impact of efficiency gains in human services and in early childhood education calculation based on the OECD's Social Expenditure Database;
2 Activation spending calculation based on OECD public spending on labour markets indicators;
3. R&D expenditure based on (Westmore, 2013[26]).
Source: OECD calculations.

Continuing to decouple economic growth from environmental impacts

CO2 emissions and energy consumption have risen in line with strong GDP growth (Figure 1.29, Panel A and B). Greenhouse gas emissions have risen by 22% since 2010, although they are still only half the per-capita emissions of the OECD area. A large share of primary energy supply is renewable (Figure 1.29, Panel C), mostly the firing of biomass, which meets a large part of industrial and residential energy demand. Hydro, wind and solar sources account for about 45% of electricity generation and this share is expected to reach 60% by 2023 (IEA, 2019[27]), but only for 7% of primary energy use. This share has barely increased in recent years, reflecting the strong growth of energy demand and modest electrification of energy. Coal contributes to 40% of electricity generation.

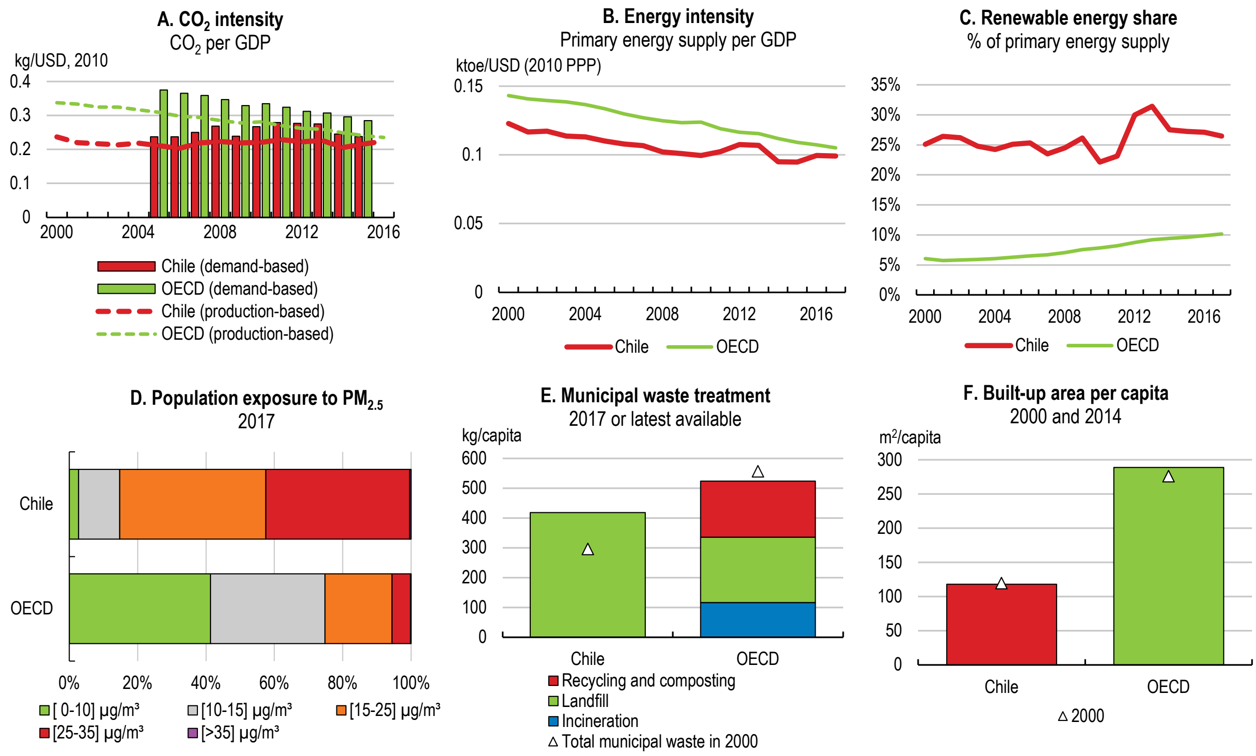
Recently Chile has made a series of commitments, which, if implemented, may reverse these trends. In particular, it has committed to achieving carbon neutrality of its economy by 2050. This is in line with the need to reach net zero CO2 emissions worldwide by 2050 to limit global warming to 1.5 degrees (Intergovernmental Panel on Climate Change, 2018). By 2024, Chile will close 20% of its coal electricity capacity and phase out coal completely by 2040. The electro mobility strategy sets out an action plan to achieve a 40% share of the private vehicle fleet—and 100% of public urban transport—being electric by 2050 (Climate Analytics, 2018[28]). Chile was also the first country in Latin America to have issued green bonds in 2019, as a tool to channel investments towards green assets. Chile will also hold the COP until December 2021, and in that context reaffirmed during the pandemic its commitments concerning carbon emissions.

The immediate effect of widespread virus containment measures in Chile has resulted in some short-term environmental improvements, including significant reductions in local air pollution and greenhouse gas emissions, particularly in the Santiago Metropolitan region. However, these effects are likely to be temporary when economic growth will reinvigorate, and with oil prices slated to stay low for a long time, there is a risk to jeopardise the commitments taken. For example, the reluctance of users to continue using public transports could have negative effects on the environmental sustainability of Santiago. The recent steps taken for managing the density of public transport, ensuring the deep cleaning of stations and the creation of new cycling lanes are thus welcome.

Beyond the immediate health crisis, supporting economic recovery will be essential but should not undermine action to limit the threats from climate change and environmental degradation, which could be as destabilising as COVID-19 but are on a different time scale. Recovery will give Chile a chance to make further environmental improvements an integral part of an inclusive economic recovery, rather than such measures being perceived as an additional burden at a time of crisis. In particular, stimulus measures can be an opportunity to invest in the economic transformations and technological innovations that are deemed necessary to deliver sustainable improvements in people’s lives that depend, amongst other things, on a healthy environment, in particular for the most vulnerable, which are disproportionately affected by environmental changes.

As a result, to build back better, the unintended negative environmental impacts of new short-term fiscal and tax provisions should be evaluated (OECD, 2020[29]). While the priority will rightly be on providing urgent relief to impacted businesses and individuals, a careful screening of the environmental impacts of stimulus measures would significantly add coherence to policies and avoid creating unintended environmental consequences. Moreover, the concession of financial support measures such as preferential loans, loan guarantees and tax abatements should be conditional on achieving, in a cost-effective way, stronger environmental commitments and performance in pollution-intensive sectors that may be particularly affected by the crisis.

Figure 1.29. Green growth indicators



Note: In Panel A, data include CO2 emissions from combustion of coal, oil, natural gas and other fuels. Gross Domestic Product (GDP) is expressed at constant 2010 USD using PPP. Data in Panel E concern waste collected by or for municipalities and includes household, bulky and commercial waste, and similar waste handled at the same facilities.

Source: OECD (2019), Green Growth Indicators, OECD Environment Statistics database, OECD National Accounts database; IEA (2019), IEA World Energy Statistics and Balances database; OECD (2019), Exposure to air pollution; OECD (2019), Municipal waste; OECD (2019), Land cover.

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MAIN FINDINGS	RECOMMENDATIONS
Containing the pandemic and its consequences	
COVID-19 could continue to strike in future waves, costing human lives and amplifying further the economic consequences.	**Increase capacity for extensive testing and tracing, provide further support to health-care workers, and enhance the provision of masks, ICUs and respirators.** **Continue transitory support to SMES and the most vulnerable families, including non-conditional cash transfers, tax deferrals and reductions, food baskets or suspension of payments of basic utilities for the poorest households, as long as needed.** **Going forward the fiscal effort should be focused on making efficient reallocations of public spending, including the elimination of exemptions in the tax system, to support the recovery**.
Repeated shocks in recent years have exposed gaps in the fiscal framework.	Define clear escape clauses to the fiscal rule and specify a long-term debt target clearly linked to the medium-term structural balance target.
Headline inflation will remain below-target during and after the COVID-19 outbreak.	**With well-anchored inflation expectations, keep monetary policy accommodative until the economic recovery is well underway.**
Fostering inclusiveness	
Educational achievements are low and access to good education is strongly linked to socio-economic status, posing the risk of a long-lasting effect of the pandemic on poverty and social mobility.	**Step-up investment in high-quality early childhood, primary and secondary education.** **Enhance the provision of childcare and early childhood public structures.** Lower ratio of children to teaching staff.
The tax and transfer system is ineffective in providing protection for vulnerable households and the base and redistributive power of the personal income tax are too low.	**Strengthen the redistributive impact of the personal income tax by lowering the thresholds at which the bottom and top bracket apply.** Consider other tax instruments, such as the creation of a negative income tax or strengthening property taxes.
Individuals and workers often lack the foundation and digital skills necessary to flourish in a digital world.	**Increase digital literacy in schools giving digital skills more prominence in the national curriculum, and enhancing the digital skills of teachers and school-directors.**
The coverage and levels of unemployment benefits are low.	Make the temporary measures to increase protection for unemployed workers permanent or automatically triggered when unemployment reaches certain thresholds.
Access of vulnerable workers to training courses is insufficient and many of their job profiles might change in the future or even disappear with further automation.	**Embark in a full revision of firm-provided training programmes to increase relevance and quality of training and better target participation to vulnerable workers.**
Closing productivity gaps	
The complexity of some regulatory procedures remains high, penalising mostly start-ups and SMEs.	**Streamline permits and their process by implementing a zero-licensing procedure to encourage investment and simplify regulations for SMEs.**
Notary procedures are burdensome for firms and households.	Open the market of notaries and allow introducing technological innovations and data sharing with the administration in a systematic way.
Barriers to restructuring are currently high	Allow creditors to be able to initiate restructuring and not only liquidation.
A relative lack of competition in public procurement procedures represents a brake to the involvement of SMEs in public purchasing.	Disaggregate procurement needs into regional lots and consider allowing the grouping of suppliers.
Adoption of digital tools lags behind other OECD countries, particularly for SMEs.	**Boost public support to SMEs, in cooperation with the private sector, trough targeted programmes to facilitate the adoption digital tools.**
R&D and innovation expenditure is low, especially in SMEs, and comes mainly from public resources.	**Foster a collaborative digital innovation ecosystem by strengthening business collaboration and fostering open-innovation practices.**
High-speed fixed broadband penetration is low compared to OECD average and rural/urban disparities are large. Entry barriers in the communication sector are high.	**Ensure low barriers to entry to the communication sector by replacing the existing regulation for concessions.**
Strengthening green growth	
CO2 emissions and energy consumption have risen in line with strong GDP growth. Chile has committed to achieving carbon neutrality by 2050 but the recovery after COVID-19 could jeopardise these commitments.	**Carefully screen the environmental impacts of stimulus measures in the wake of the outbreak to avoid unintended environmental consequences.** **Condition direct financial support measures for pollution-intensive sectors that may be particularly affected by the crisis to cost-efficient and verifiable environmental improvements.**

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